



*cutting through complexity™*

# IFRS 15: Revenue from Contracts with Customers

## General interpretations and application



# Standards replaced



Single standard (IFRS 15) replaces:

- IAS 11 *Construction Contracts*
- IAS 18 *Revenue*
- IFRIC 13 *Customer Loyalty Programmes*
- IFRIC 15 *Agreements for the Construction of Real Estate*
- IFRIC 18 *Transfers of Assets from Customers*
- SIC-31 *Revenue – Barter Transactions Involving Advertising Services*

1. A five-step model is applied to determine when to recognise revenue, and at what amount.
2. Revenue is recognised when (or as) a company transfers control of goods or services to a customer at the amount to which the company expects to be entitled.
3. Depending on whether certain criteria are met, revenue is recognised either over time, in a manner that best reflects the company's performance, or at a point in time, when control of the goods or services is transferred to the customer.

# The Five Step Model – Overview



1

Identify the contract with a customer

2

Identify the performance obligations

3

Determine the transaction price

4

Allocate the transaction price to performance obligations

5

Recognise revenue



# Identify the Contract



**... collection of consideration is considered probable.**

**... rights to goods or services and payment terms can be identified.**

**A contract exists if...**

**... it has commercial substance.**

**... it is approved and the parties are committed to their obligations.**



# Identify the Contract



## Combining Contracts

Contracts shall be combined and accounted for as a single contract if entered into at or near the same time with the same customer and one or more of the following is met:

- 1) Negotiated as a package with a single commercial objective
- 2) Consideration in one contract depends on the other contract
- 3) Goods and services are a single performance obligation



# Identify Performance Obligations in the Contract



A performance obligation (PO) is a promise to deliver a good or service that meets **both** the following criteria

**Criterion 1: Can the customer benefit from the good or service either on its own or together with other resources that are readily available to the customer?**

+

**Criterion 2: Is the promise to transfer the good or service separately identifiable from other promises in the contract?**

Yes

No

**Distinct performance obligation**

**Not distinct – combine with other goods and services**

**Exception: A series of distinct goods or services that are substantially the same and have the same pattern of transfer to the customer may be a single performance obligation.**



# Indicators that a Performance Obligations is separately identifiable



- 1) The entity does not provide a significant service of integrating the good or service with other goods or services promised in the contract.
- 2) The good or service does not significantly modify or customise another good or service promised in the contract
- 3) The good or service is not highly dependent on or highly interrelated with other goods or services promised in the contract





# Performance Obligations



An entity enters into a contract to build a house for a customer

## Potential Performance Obligations

**Bricks**

**Windows**

**Fittings**

**Construction  
service**

# Performance Obligations

Identify the performance obligations

- A. Bricks
- B. Windows
- C. Fittings
- D. Construction services
- E. Single performance obligation  
(i.e. all combined)
- F. Bricks, Windows & Fittings  
combined

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# Performance Obligations



An entity enters into a contract to build a house for a customer

## Potential Performance Obligations

Bricks

Windows

Fittings

Construction  
service

**Q: Do the goods and services individually meet the criteria?**

**Criterion 1 – Benefit on its own**



**Each material could be used with another readily available item.**

**Criterion 2 – Good or service separately identifiable**



**Entity is providing a significant integration service.**

**k1**

Presenter only

kbromfield; 2014-07-24



# Performance Obligations



- Customer contract for a sale of a machine and standard installation.
- Installation services are also offered by third party providers.

## Potential Performance Obligations

**Machine**

**Installation**

**Q: Does the sale of the machine meet the performance obligation criteria?**

# Performance Obligations

Does the sale of the machine meet the performance obligation criteria?

A. Yes

B. No

# Performance Obligations

Does the sale of the machine meet the performance obligation criteria?

A. Yes

B. No





# Performance Obligations



- Customer contract for a sale of a machine and standard installation.
- Installation services are also offered by third party providers.

## Potential Performance Obligations

**Machine**

**Installation**

**Q: Does the machine meet the performance obligation criteria?**

### **Criterion 1 – Benefit on its own**



**Machine can be used with other available inputs.**

**I.e. third party installation.**

### **Criterion 2 – Good or service separately identifiable**



**No significant integration service, because installation is a standard service.**

k2

presenter only  
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# Determine the Transaction Price



**Variable consideration and the constraint**

**Consideration payable to a customer**

...reduction to the transaction price unless it's a payment for a distinct good or service.

**Non-cash consideration**

...measured at fair value unless it cannot be reliably measured.

**Transaction Price  
(excludes credit risk)- include amount that is highly probable**

**Significant financing component**

**Exception: Variable consideration is not estimated for sales- or usage-based royalties on licenses of intellectual property (recognized as the variable occurs).**

# Transaction price

ABC supplies goods for CU 1000. At date of sale it expects bad debts of 1%.

What is the entry at date of sale?

- A. Revenue 1 000, expense (impairment loss) 10, receivable 990
- B. Revenue 990, receivable 990
- C. Revenue 1 000, receivable 1 000

# Transaction price

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What is the entry at date of sale?

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990
- B. Revenue 990, receivable 990
- C. Revenue 1 000, receivable 1 000



# Variable Consideration



## Variable consideration can be

Discounts

Returns

Incentives

Performance  
bonuses

Many  
more...

**Variable consideration is estimated using most appropriate method of either:**

Expected Value

Most Likely Amount



# Significant Financing Component



## Significant financing component

- Transaction price compared to cash selling price.
- Period between payment and delivery.
- Other reasons for payment terms.

## Discount rate

- Rate that would be used in separate financing transaction between the entity and customer.
  - *Credit to customer- use client discount rate*
  - *Advance payment – use own borrowing rate not WACC*

## Practical Expedient

- No adjustment required if the period between performance and payment is 12 months or less.



# Allocate the Transaction Price to Performance Obligations



Allocate based on **relative stand-alone selling prices**

Performance obligation 1

Performance obligation 2

Performance obligation 3

Determine stand-alone selling prices

Best evidence

Observable price

If not available

Estimate price

Adjusted market  
assessment  
approach

Expected cost plus  
a margin approach

Fair value measurement  
(Price is entity specific hence  
not a fair value. **X**)

**Residual approach** only if  
selling price is highly variable or  
uncertain





## Question: Allocate the Transaction Price to Performance Obligations



- A Cellphone company sells a smartphone with a once-off bundle of 50 minutes anytime talk time and 300mb of data at a price of CU 80.
- The standalone prices of the smartphone, talk time and data is CU50, CU30 and CU20 respectively
- Assume that all of these have been identified as separate performance obligations



# Recognise Revenue as Performance Obligations Satisfied



## ‘Transfer of Control’ principle

- Recognise revenue as and when **control** of the good or service is transferred to a customer
- **Control** may be transferred **over time** or at **a point in time**
- Assessed from customer’s perspective and at the PO level



# Recognise Revenue as Performance Obligations Satisfied



A performance obligation is satisfied over time if either:

1

Customer simultaneously receives and consumes the benefits as the entity performs.

Routine or  
recurring  
services.

2

The customer controls the asset as the entity creates or enhances it.

Asset built on  
customer's site.

3

The entity's performance does not create an asset for which the entity has an alternate use and there is a right to payment for performance to date.

Asset built to  
order.



# Measuring Performance Over Time



For each performance obligation an entity chooses the method that depicts performance.

## Output method

- Surveys
- Milestones reached
- Units delivered

## Input method

- Costs incurred
- Labour hours
- Machine hours

- Units delivered and similar methods not appropriate if work in progress is material.
- Adjustments required for wastage and uninstalled materials when cost method used.



# Transfer of Control Indicators



Transfer of control at a point in time when customer has...

A present  
obligation to  
pay

Legal title

Physical  
possession

Risks and  
rewards of  
ownership

Accepted the  
asset

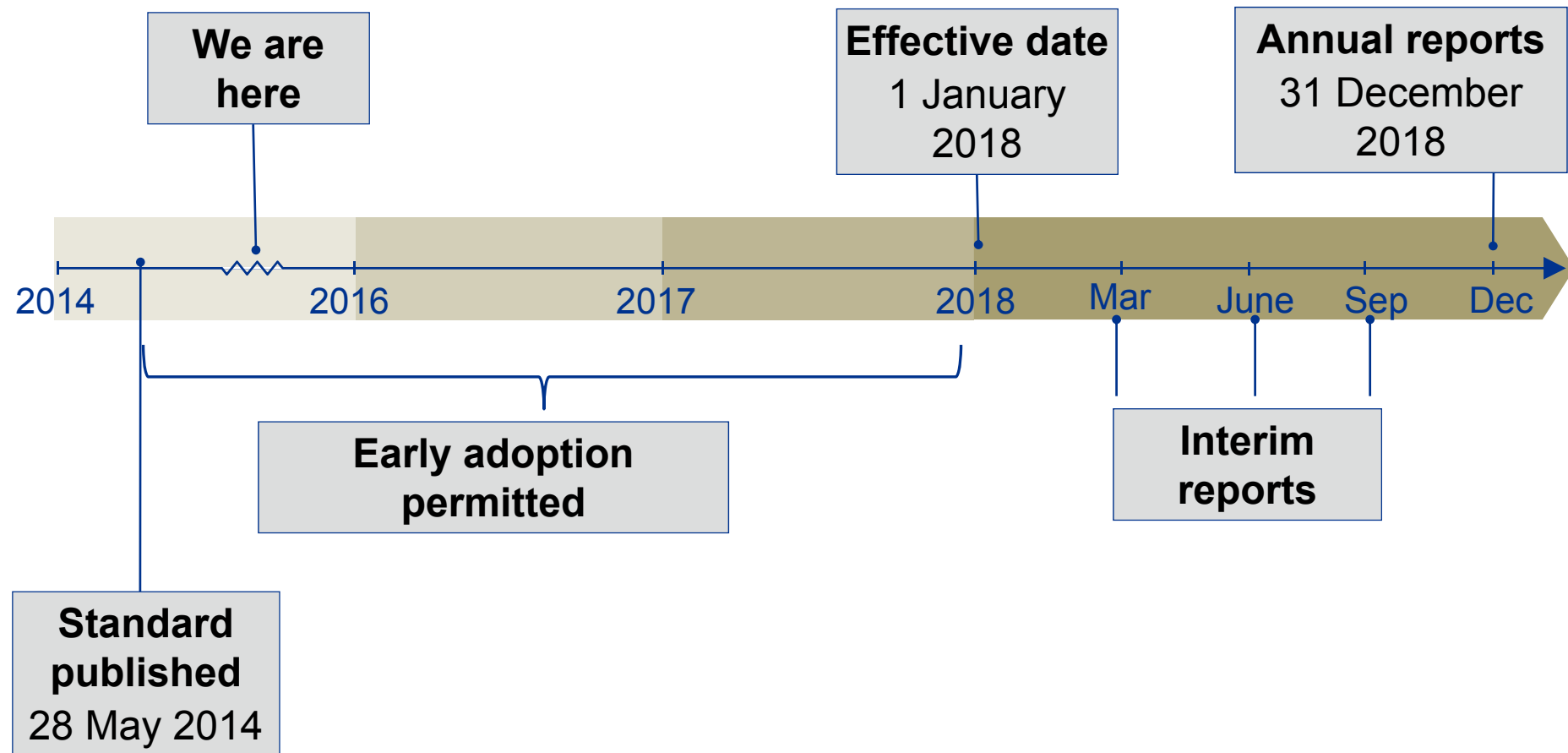
# Principal vs Agent



- An entity is an agent if the entity's performance obligation is to arrange for the provision of the specified good or service by another party. Revenue is recognised **net**
- An entity is **a principal** if it controls the specified good or service before that good or service is transferred to a customer. Revenue is recognised **gross**
- **Indicators that an entity is principal:**
  - ✓ Has primary responsibility for fulfilling the promise to provide the good or service
  - ✓ Has inventory risk before that good or service is transferred to a customer
  - ✓ Has discretion in establishing the price

*Please note that credit risk no longer assessed in the new standard*

# Effective date



# Expected or possible impact

## Internal impacts for entities

- Revenue recognition may be accelerated or deferred
- Revenue may be recognised at a point in time or continuously over time
  - Long-term contracts: contract completion or as contract fulfilled
- New estimates and judgements required
- Cost guidance is limited
- Extensive new disclosure requirements
- New systems and processes may be required
- Transition options need to be considered

## External impacts for entities

- Contract terms and business practices may need to change to achieve or maintain a particular revenue profile
- Changes in timing of revenue recognition may impact the timing of dividends, taxation and sales incentives
- Communications with stakeholder will require careful consideration
- Get it right the first time! Capital markets highly intolerant of revising revenue accounting



- Sufficient information to enable users understand the nature, amount, timing and uncertainty of revenue and cash flows from contracts with customers.
- Revenue from contracts with customers (different from other revenue sources)
- Any impairment losses recognised on receivables or contract assets
- If an entity does not adjust for significant financing component, then it discloses this fact
- Any significant judgements used in price allocations

# Effective date and transition



- The standard is effective for annual periods beginning on or after 1 January 2018.
- An entity can apply the standard to all contracts using either:
  - The retrospective method
  - The cumulative effect method
- The retrospective method requires recognition of the cumulative effect of applying the standard at the start of the earliest comparative period.
- The cumulative effect method recognises the cumulative effect of applying the standard as of the date of initial application, with no restatement of comparative information. In this case the entity applies it to only open contracts under existing standard at date of initial application.

# Transition Approaches – various options

Approach	2016	2017	2018	Date of equity adjustment
<b>Full retrospective – no practical expedients</b>	<b>Legacy GAAP</b>	<b>IFRS 15</b>	<b>IFRS 15</b>	<b>1 January 2017</b>
<b>Partial retrospective – practical expedients</b>	<b>Legacy GAAP</b>	<b>Mixed</b>	<b>IFRS 15</b>	<b>1 January 2017</b>
<b>Cumulative effect</b>	<b>Legacy GAAP</b>	<b>Legacy GAAP</b>	<b>IFRS 15</b> <b>Legacy GAAP</b>	<b>1 January 2018</b>

**Cumulative effect approach: entity also needs to disclose revenue amounts that would have been presented under legacy GAAP.**

Ask  
Answer  
Who  
Why  
Where  
What  
When  
How  
Apply  
Question  
Answers  
Understand  
Query  
Questions



*cutting through complexity™*

Stephen Obock

+254 20 2806000

sobock@kpmg.co.ke

[www.kpmg.com](http://www.kpmg.com)

**Thank You**



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