

# Financial Reporting -Nyanza Branch

New Developments on Revenue Recognition, IFRS 15, IPSAS 9 and  
IPSAS 23

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# Topics



1. IFRS 15-Revenue from Contracts with Customers
2. IPSAS 9 -Revenue from Exchange Transactions
3. IPSAS 23 -Revenue from Non-Exchange Transactions
4. Transitioning from IFRS 4 to IFRS 17-Insurance Contracts

# Standards Replaced by IFRS 15



IFRS 15 applies to annual periods beginning on or after 1 January 2018 and was issued by IASB on the 28<sup>th</sup> April 2014.

## 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

# Objectives of IFRS 15



The objective of IFRS 15 is to establish the principles that an entity shall apply to report useful information to users of financial statements about the **nature, amount, timing, and uncertainty** of revenue and cash flows arising from a contract with a customer. **This it achieves by:-**

- a. Removing inconsistencies and weaknesses in existing requirements
- b. Simplifying preparation of financial statements by reducing the number of requirements through a single revenue framework.
- c. Providing more useful information through improved disclosure requirements.
- d. By creating a more robust framework for addressing revenue issues.

# Objectives of IFRS 15



I want to stress “**a customer**” here. If you have a contract with party other than a **customer**, then IFRS 15 does not apply.

Sometimes, it’s quite difficult to determine whether you deal with a **customer** or simply with a **collaborating party** (e.g. some mutual development projects with other entities), therefore take care!

## Exclusion

Be aware that there are some exclusions from IFRS 15, namely:

**Leases (IAS 17)**

**Financial instruments and other rights and obligations within the scope of IFRS 9 (IAS 39), IFRS 10, IFRS 11, IAS 27, IAS 28;**

**Insurance contracts (IFRS 4 now being replaced by IFRS 17) and**

**Non-monetary exchanges between entities within the same business to facilitate sales.**

We need to apply IFRS 15 for periods starting from 1 January 2018 or later..

# Summary of 5 step revenue recognition model



## ***The 5 Step Model for Revenue Recognition***

***Step 1*** - Identify the contract with the customer

***Step 2*** - Identify the performance obligations in the contract

***Step 3*** - Determine the transaction price

***Step 4*** - Allocate the transaction price

***Step 5*** - Recognise revenue when (or as) a performance obligation is satisfied

# Five Step Revenue recognition model- Overview



The five-step model applies to revenue earned from a contract with a customer with limited exceptions, regardless of the type of revenue transaction or the industry. Developed by Graham Holt.

## Step 1: Identification of contract

Step one in the five-step model requires the identification of the contract with the customer. Contracts may be in different forms (written, verbal or implied), but must be **enforceable**, have **commercial substance** and be **approved** by the parties to the contract.

# Five Step Revenue recognition model- Overview



## Identification attributes

These are:

- a. Parties to the contract have **approved** it and are **committed** to **perform**;
- b. Each party's **rights** to the goods/services transferred are identified;
- c. The payment terms are **identified**;
- d. The contract has a **commercial substance**; and
- e. It is probable that an entity will collect the **consideration** – here, you need to evaluate the **customer's ability and intention to pay**.

So, if the contract does not meet all 5 criteria, then you don't apply IFRS 15, but some other standard



# Five Step Revenue recognition model- Overview



## Step 2: Performance obligations

Step two requires the identification of the separate **performance obligations** in the contract. This is often referred to as ‘unbundling’, and is done at the beginning of a contract. The key factor in identifying a separate performance obligation is the **distinctiveness** of the good/service, or a bundle of goods or services.

A good or service is distinct if the **customer can benefit** from the good or service on its own or together with other readily available resources and is **separately identifiable** from other elements of the contract.

# Five Step model-Overview



## Step 3: Transaction price

This step requires the entity to determine the transaction price, which is the amount of consideration that an entity expects to be entitled to in exchange for the promised goods or services. This amount excludes amounts collected on behalf of a third party –e.g government taxes. An entity must determine the amount of consideration to which it expects to be entitled in order to recognize revenue.

The transaction price might include variable or contingent consideration.

# Five Step model-Overview



## Step 3: Transaction price—Contd....

Variable consideration should be estimated as either the expected value or the most likely amount. The expected value approach represents the sum of probability-weighted amounts for various possible outcomes. The most likely amount represents the most likely amount in a range of possible amounts.

Variable consideration is wider than simply contingent consideration as it includes any amount that is variable under a contract, such as performance bonuses or penalties.

# Five Step model-Overview



## Step 4: Allocation of price to performance obligations

This requires allocation of the transaction price to the separate performance obligations. The allocation is based on the relative standalone selling prices of the goods or services promised and is made at inception of the contract. It is not adjusted to reflect subsequent changes in the **standalone** selling prices of those goods or services.

The best evidence of standalone selling price is the observable price of a good/service when the entity sells that good/service separately. If that is not available, an estimate is made using an approach that maximizes the use of **observable inputs**.

# Five Step model-Overview



## Step 4: Allocation of price to performance obligations--Contd...

This will be a major practical issue as it may require a separate calculation and allocation exercise to be performed for each contract.

### Example:

A mobile telephone contract typically bundles together the handset and network connection. IFRS 15 will require their separation.

# Five Step model-Overview



## Step 5: Recognition of revenue

This requires revenue to be recognized as each **performance obligation** is satisfied. Under repealed IAS 18 revenue in respect of goods is recognized when the significant risks and rewards of ownership of the goods are transferred to the customer.

An entity satisfies a **performance obligation** by **transferring control** of a promised good/service to the customer, which could be over time or at a point in time. Control includes the ability to prevent others from directing the use of and obtaining the benefits from the asset.

# Five Step model-Overview



## Step 5: Recognition of revenue... contd....

A performance obligation is satisfied at a **point in time** unless it meets one of the following criteria, in which case, it is deemed to be satisfied **over time**:

- a.) The customer simultaneously receives and consumes the benefits provided by the entity's performance as the entity performs.
- b.) The entity's performance creates or enhances an asset that the customer controls as the asset is created or enhanced.
- c.) The entity's performance does not create an asset with an alternative use to the entity and the entity has an enforceable right to payment for performance completed to date.

# Contract Costs



IFRS 15 gives a guidance about two types of costs related to the contract:

## **Costs to obtain a contract**

Those are the incremental costs to obtain a contract. In other words, these costs would not have been incurred without an effort to obtain a contract – for example, legal fees, sales commissions and similar.

These costs are not expensed in profit or loss, but instead, they are recognized as an asset if they are expected to be recovered (the exception is the contract costs related to the contracts for less than 12 months).



# Contract Costs



## Costs to fulfill a contract

If these costs are within the scope of IAS 2(inventory), IAS 16(PPE), IAS 38(Intangible assets), then you should treat them in line with the appropriate standard.

If not, then you should capitalize them only if certain criteria are met.

(The costs relate directly to an existing contract or a specific anticipated contract, the cost generates or enhances resources to be used in fulfilling the performance obligation, the vendor expects to recover the costs-if explicitly reimbursable)

# Implementation of IFRS 15



The requirements of IFRS 15 are very extensive and demanding, IFRS 15 permits 2 methods of adoption:

## Full retrospective adoption

Under this approach, you need to apply IFRS 15 fully to **all prior reporting periods**, with some exceptions.

## Modified retrospective adoption

Under this approach, **comparative figures** remain as they were reported under the previous standards and you recognize the **cumulative effect** of IFRS 15 adoption as a one-off adjustment to the **opening equity** at the initial application date.  
met.

# Disclosure requirements of IFRS 15



Both **qualitative** and **quantitative** information including;

Disaggregated information (refers to numerical or non-numerical information collected from multiple sources or variables)

Contract balances and a description of significant changes

Amount of revenue related to remaining performance obligations and an explanation of when revenue is expected to be recognized  
Significant judgments and changes in judgments.

# IPSAS 9 Revenue from Exchange Transactions



## Key definition:

Exchange transactions are transactions in which one entity receives assets or services, or has liabilities extinguished, and directly gives approximately equal value (primarily in the form of cash, goods, services, or use of assets) to another entity in exchange.

Revenue should be measured at the fair value of the consideration received or receivable.

# IPSAS 9 Revenue from Exchange Transactions



Revenue from rendering of Services should be recognized when all the following conditions are satisfied:

- a) The amount of revenue can be measured reliably;
- b) It is probable that the economic benefits or service potential associated with the transaction will flow to the entity;
- c) The stage of completion of the transaction at the reporting date can be measured reliably; and
- d) The costs incurred for the transaction and the costs to complete the transaction can be measured reliably.at the fair value of the consideration received or receivable.

# IPSAS 9 Revenue from Exchange Transactions



Revenue from the sale of goods should be recognized when all the following conditions have been satisfied:

- a) The entity has transferred to the purchaser the significant risks and rewards of ownership of the goods;
- b) The entity retains neither continuing managerial involvement to the degree usually associated with ownership nor effective control over the goods sold;
- c) The amount of revenue can be measured reliably;
- d) It is probable that the economic benefits or service potential associated with the transaction will flow to the entity; and
- e) The costs incurred or to be incurred in respect of the transaction can be measured reliably.

# IPSAS 9 Disclosures



An entity shall disclose:

The accounting policies adopted for the recognition of revenue including the methods adopted to determine the stage of completion of the transaction involving the rendering of services.

The amount of each significant category of revenue recognized during the period including revenue arising from.

- a. Rendering of services
- b. The sale of goods
- c. Royalties
- d. Dividends or similar distributions
- e. The amount of revenue arising from exchanges of goods and services included in each category of revenue.

# IPSAS 23 Revenue from Non-Exchange Transactions (Taxes&Transfers)



## Objective

To prescribe requirements for the financial reporting for revenue that emanates from non-exchange transactions other than non-exchange transactions giving rise to an entity combination.

An entity combination is a transaction or other event in which an acquirer obtains control of one or more operations.

On the flip side, exchange transactions are those in which one entity receives assets/services or has liabilities extinguished, and **gives directly an approximate equal value**(mainly in form of cash, goods, services or use of an asset) to another entity in exchange.

In a non-exchange transaction, an entity either receives value from another entity without directly giving approximately equal value in exchange, or gives value to another entity without directly receiving approximately equal value in exchange.



# IPSAS 23 Revenue from Non-Exchange Transactions



## **Contributions from owners**

These transactions are disclosed separately and are not part of revenue. These occur when a 'contributing' entity provides and designates funding or other assets as being a permanent contribution, establishing a financial interest in the net assets/equity of the receiving entity. (IPSAS 23 paragraph 37-38).

## **Advance receipts**

An entity may receive an asset in advance of the period for which it was intended.

Such advance receipts relate generally to taxes or annual contributions received in the preceding year.

These advance receipts are treated as a liability until the taxable or other event triggering recognition occurs for revenue to be recognized.

# IPSAS 23 When Assets received are not reported as Non-Exchange Revenue(contd--)



## Assets that have linked obligations

The receipt of assets may give rise to a present obligation, in the form of a duty to act or perform in a certain way. In some cases this will indicate that the asset has been exchanged for acceptance of an obligation, and normal accounting for exchange transactions should be followed.

In other cases it is more helpful to treat the asset as being received as a non-exchange transaction, and to recognize a balancing liability in respect of the obligation.

For example, a grant may have been provided by an agency to improve and maintain a medical clinic. If there is a condition, the recipient has an obligation to spend the money in a specified manner, therefore a liability to incur such expenditure, or to return the money

Revenue from a non-exchange transaction is measured at the amount of the increase in net assets recognized by the entity.

An asset acquired through a non-exchange transaction is measured at its fair value at the date of acquisition, together with a corresponding amount of revenue unless a liability is required to be recognized.

The liability is measured as the best estimate of the amount required to settle the present obligation at the reporting date. It is the increase in net assets, if any, that is accounted for as revenue.

# IPSAS 23 Application of recognition and measurement principles



1. **Grants** -Grants are recognized at the receipt of grant or enforceable claim.
2. **Fines**-Fines are recognized in the period in which the fine is imposed.
3. **Bequests**-Bequests are recognized when the nature of the bequest is known and it has been established that the estate is sufficient to meet all claims. Bequests may contain stipulations as to how the money or assets are to be spent or utilized.
4. **Donations** -Receipt of gift of donation and transfer of legal title. For goods in-kind, receipt of the goods or binding agreement to receive them.
5. **Debt forgiveness** -Lenders may waive their right to collect a debt owed by a public sector entity, thus effectively cancelling the debt. In such a case the entity has an increase in net assets/equity and treats the amount forgiven as revenue from a non-exchange transaction

# IPSAS 23 Application of recognition and measurement principles(Contd..)



## Services in-kind

Services in-kind are voluntary services provided to an entity by an individual or individuals. Such services may include free technical assistance from other governments or international organizations, voluntary work in schools and hospitals or community services performed by convicted offenders.

The standard provides that entities may, but are not required to, recognize services in-kind as revenue and expenditure where the amount can be measured, is material and its inclusion enhances the presentation of the financial statements.

Disclosure of the nature of significant in-kind services in all cases is encouraged

# IPSAS 23 Non Exchange Revenue that is not classified as Tax-Grants



Grants represent a noteworthy type of revenue from non-exchange transactions. Grants are often provided with limitations on how money should be spent or assets utilized. The standard separates such 'stipulations' into **conditions** and **restrictions**.

The distinction between **conditions** and **restrictions** may not always be clear cut and it is necessary to consider the **substance** of the stipulation and not merely its **form**. This might take into account the likelihood of enforcement, prior experience with the donor/grant-giver, and the extent of specification of detailed requirements.

For transactions where the recipient entity considers that the donor/grant-giver has imposed conditions, they will set up a liability for the obligation generally to the value of the money received, which will be reduced as the conditions are satisfied.

There is no such requirement for grants with restrictions and revenue is recognized immediately.

# Transitioning from IFRS 4 to IFRS 17 Insurance Contracts.....



## Background

IFRS 17 was issued in May 2017 and is applicable for periods beginning 1<sup>st</sup> January 2021. Early adoption is permitted especially for entities using IFRS 9(Financial Instruments) & 15 (Revenue from contracts with customers).

The existing IFRS 4 (which is now transitioning to IFRS 17) allows insurance companies to account differently for insurance contracts even if the contracts are similar.

IFRS 17 addresses many inadequacies in the existing wide range of insurance accounting practices. It requires all insurers to reflect the effect of **economic changes** in their financial statements in a timely and transparent way. It also provides improved information about the current and future profitability

# Transitioning from IFRS 4 to IFRS 17 Insurance Contracts.....



## Requirements of IFRS 17

IFRS 17 requires a company that issues insurance contracts to report them on the balance sheet as the total of:

(a) **the fulfillment cash flows**—the current estimates of amounts that the company expects to collect from premiums and pay out for claims, benefits and expenses, including an adjustment for the timing and risk of those amounts; and

(b) **the contractual service margin**—the expected profit for providing insurance coverage. The expected profit for providing insurance coverage is recognized in profit or loss over time as the insurance coverage is provided



# Transitioning from IFRS 4 to IFRS 17 Insurance Contracts.....



## Requirements of IFRS 17

IFRS 17 requires an entity to distinguish between groups of contracts expected to be profit making and groups of contracts expected to be loss making.

Any expected losses arising from loss-making, or onerous, contracts are accounted for in profit or loss as soon as the company determines that losses are expected.

# Transitioning from IFRS 4 to IFRS 17 Insurance Contracts.....



## Application of IFRS 17

IFRS 17 applies to:

- a. Insurance contracts that an entity issues
- b. Reinsurance contracts that an entity issues and holds.
- c. Investment contracts with **discretionary participation features**.ie contracts under which the investor receives an additional payment, the amount or timing of which is contractually at the discretion of the issue

END.....



Questions and Feedback!

# Conclusion

