

# FINANCIAL REPORTING WORKSHOP

## IFRS 15 – Revenue from contracts with customers Interpreting the requirements

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# Agenda



1. Overview of IFRS 15- Revenue from Contracts with Customers
2. Key sector considerations
3. Discussions

# 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*

*IFRS 15 applies to annual periods beginning on or after 1 January 2018*

# IFRS 15 – objectives of the new standard



Remove inconsistencies and weaknesses in existing requirements

Provide a more robust framework for addressing revenue issues

IASB / FASB  
Converged  
Standard

Provide more useful information through improved disclosure requirements

Simplify preparation of financial statements by reducing the number of requirements by having one revenue framework

# 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

## Step 1 Identify the Contract



A *contract* is an agreement between two or more parties that creates enforceable rights and obligations in exchange for consideration. Contracts can be written, oral or implied by an entity's customary business practices.



# Identify the Contract



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

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

**A contract exists if...**

... it has commercial substance.

... collection of consideration is considered probable.



# 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**



# Performance Obligations



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

**The contractor supplies the following as 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



# 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



# 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.**



## 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

# Contracts in the scope of multiple standards



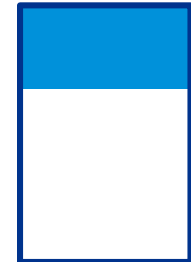
**Total contract  
amount**

-



**IFRS 4/IFRS 9  
amount**

=



**IFRS 15 amount,  
which may be nil**

# Performance obligations - Insurance

Do any services promised in the contract meet the new **'distinct' test** to be accounted for separately?

A good or service is distinct if it is...

Capable of being distinct



Distinct in the context  
of the contract

Think about...

Administrative services | Custody services | Renewal options incentives



# 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.

**Transaction Price  
(excludes credit risk)**

**Non-cash consideration**

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

**Significant financing component**



# 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



# Constraint on Variable Consideration



## Application

Transaction price – include the amount that is ‘highly probable’ and will not result in a significant revenue reversal.

## Qualitative Assessment

- The risk of a reversal arising from an uncertain future event.
- The magnitude of the reversal if the uncertain event occurs.



# 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.

## 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 price

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



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



# 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.

## Over Time or Point in Time?



- Entity agrees to build specialised equipment to integrate with the customer's existing plant
- Customer can cancel contract on 30 days notice
- If the contract is cancelled the entity has a right to payment that covers costs incurred
- Customer has agreed to make quarterly payments

**Q: Is the PO satisfied over time or point in time?**

# Over Time or Point in Time?



Is the PO satisfied over time or point in time?

- A. Over time
- B. Point in time

# Over Time or Point in Time?



Is the PO satisfied over time or point in time?

A. Over time

B. Point in time

## Over Time or Point in Time?



- Entity agrees to build a specialised equipment to integrate with existing plant
- Customer can cancel contract on 30 days notice
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**Point in time – ‘no alternate use and right to payment’ criteria’ is not met**

No alternate use



Right to payment



- Payment needs to approximate selling price of goods and services transferred to date – i.e. payment amount should include a profit margin.

# 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.

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