



FINANCIAL REPORTING WORKSHOP

****REVENUE FROM CUSTOMER CONTRACTS****

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Agenda



- ❑ Objectives of IFRS 15
- ❑ Approach to recognizing revenue
- ❑ Disclosures

IFRS 15: Revenue from Contracts with Customers



IFRS 15 supersedes:

- ✓ 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

Scope



An entity shall apply the standard to **all contracts with customers, except:**

- Lease contracts within the scope of IFRS 16
- Insurance contracts within the scope of IFRS 4
- Financial instruments and other contractual obligations within the scope of IFRS 9 (*Financial Instruments*), IFRS 10 (*Consolidated Financial Statements*), IFRS 11 (*Joint Arrangements*), IAS 27 (*Separate Financial Statements*) and IAS 28 (*Investments in Associates and Joint Ventures*)
- Non-monetary exchanges between entities in the same line of business to facilitate sales

Objectives of the IFRS 15



The 5-step approach



Identify the contract(s) with a customer

Identify the performance obligations (POs) in the contract

Determine the transaction price

Allocate transaction price to the POs

Recognize revenue when/or as entity satisfies a PO

Step 1

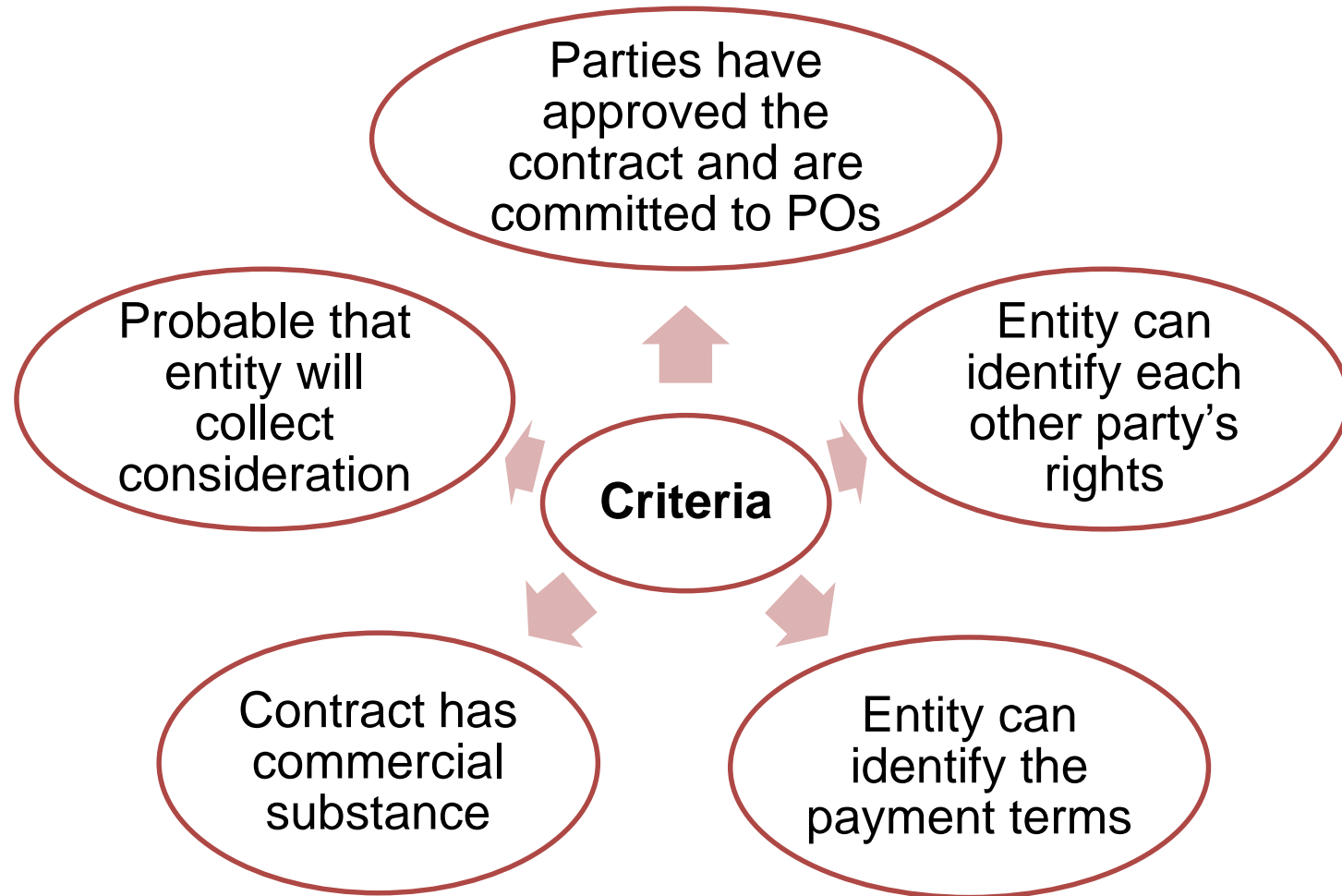
Identify the contract



- 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.
- Practices and processes for establishing contracts vary.

Step 1

Identify the contract



Combination of contracts



An entity shall combine two or more contracts entered into at or near the same time with the same customer and account for the contracts as a single contract if one or more of the following criteria are met:

- The contracts are negotiated as a package with a single commercial objective
- The amount of consideration to be paid in one contract depends on the price or performance of the other contract; or
- The goods or services promised in the contracts are a single performance obligation.

Example



An entity licenses CRM software to a customer. In addition, the entity promises to provide consulting services to significantly customize the software to the customer's information technology environment for total consideration of CU1.6 billion.

Does this qualify to be a combined contract?

Step 2

Identify the POs



A PO is a promise to transfer goods or services to a customer. The goods and services in the PO must be **distinct** (or a series of goods and services that are substantially the same and have the same pattern of transfer to the customer).

Distinct goods should meet the following criteria;

1. The customer can benefit from the good or service either on its own or together with other resources readily available to the customer.
2. The entity's promise to transfer the good or service to the customer is separately identifiable from other promises in the contract.

Step 2

Identify the POs



Examples

- a) A Ltd enters into an agreement to **build a warehouse** for a customer. It delivers windows and sand to the customers site.

Do the items meet the performance obligation criteria?

- b) M Ltd enters into a contract to **sell and install a machine** to a customer. Installation services are also offered by other third parties.

What are the potential POs?

Does the sale of the machine meet the PO criteria?

Example



FOB destination

A cosmetics manufacturer enters into a contract to sell hair extensions to a retailer. The delivery terms are *free on board* (FOB) shipping point (legal title passes to the retailer when the extensions are handed over to the carrier). A third-party carrier is used to deliver the extensions. The manufacturer has a past business practice of providing replacements to the retailer at no additional cost if the items are damaged during transit. The retailer does not have physical possession of the items during transit, but has legal title at shipment and therefore can redirect the items to another party. The manufacturer is also precluded from selling the extensions to another customer while in transit.

Does the manufacturer have a separate performance obligation with respect to the risk of loss during transit?

Step 3

Determine the transaction price



- Transaction Price is the amount of consideration to which an entity expects to be entitled in exchange for transferring promised goods or services to a customer, excluding amounts collected on behalf of third parties.
- In determining the transaction price the effect of the following factors must be considered;
 - Variable consideration – discounts, rebates, refunds, credits etc
 - Constraining estimates of variable consideration
 - Existence of a significant financing component in the contract
 - Non-cash consideration (to be measured at fair value)
 - Consideration payable to a customer.

Variable consideration is estimated using most appropriate method of either the most likely amount or the expected value.

Step 3

Determine the transaction price



Example

On 1st February 201, Anga Ltd enters into a contract to build a jet for one of its customers. The transaction price agreed includes:

- **Fixed amount:** KES 100 million.
- **Completion bonus:** KES 100 million if completed two months prior to 30th September 2017.
- **Performance bonus:** Up to KES 100 million depending on the number of flights in its first 12 months of service.

Is there any variable consideration in the above contract?

How should Anga account for the variable consideration?

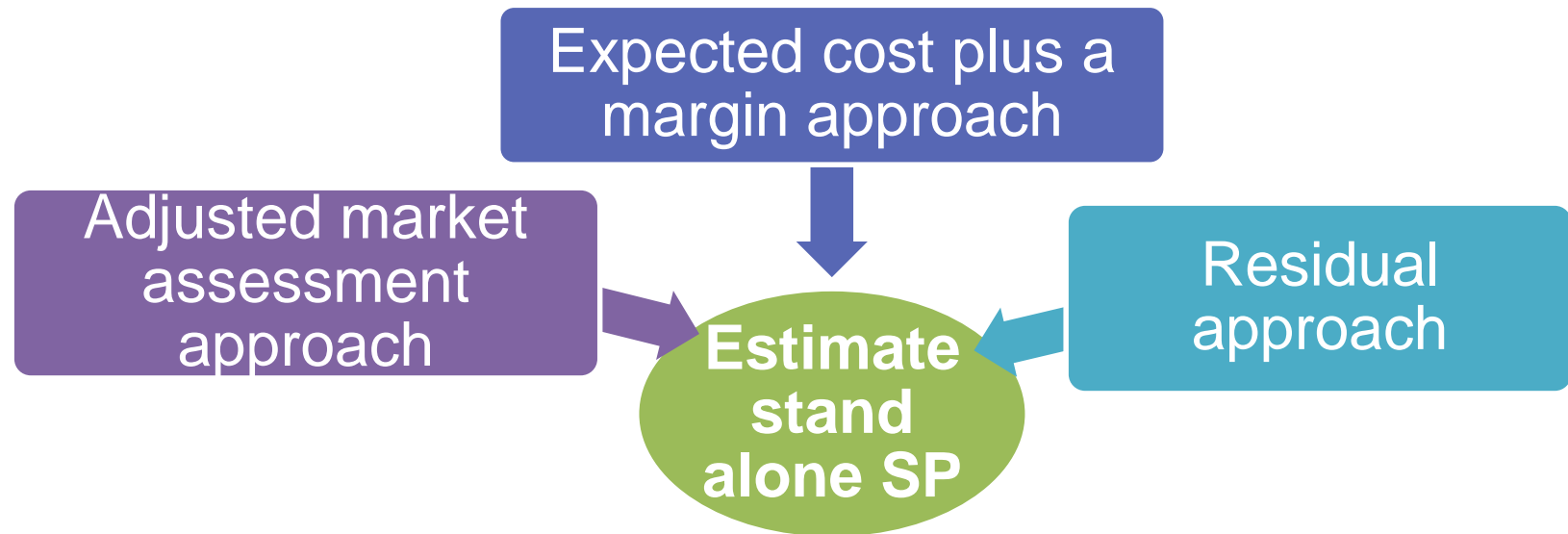
Step 4

Allocating the TP to POs



Logic - Transaction price to be allocated to each PO in an amount that depicts the amount of consideration the entity is entitled to, using the **relative stand alone selling price** basis.

The stand alone selling price could be **directly observable**, or **estimated**.



Step 5

Revenue recognition



- ☐ 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

Step 5

Revenue recognition



A performance obligation is satisfied over time if it meets any of the below criteria;

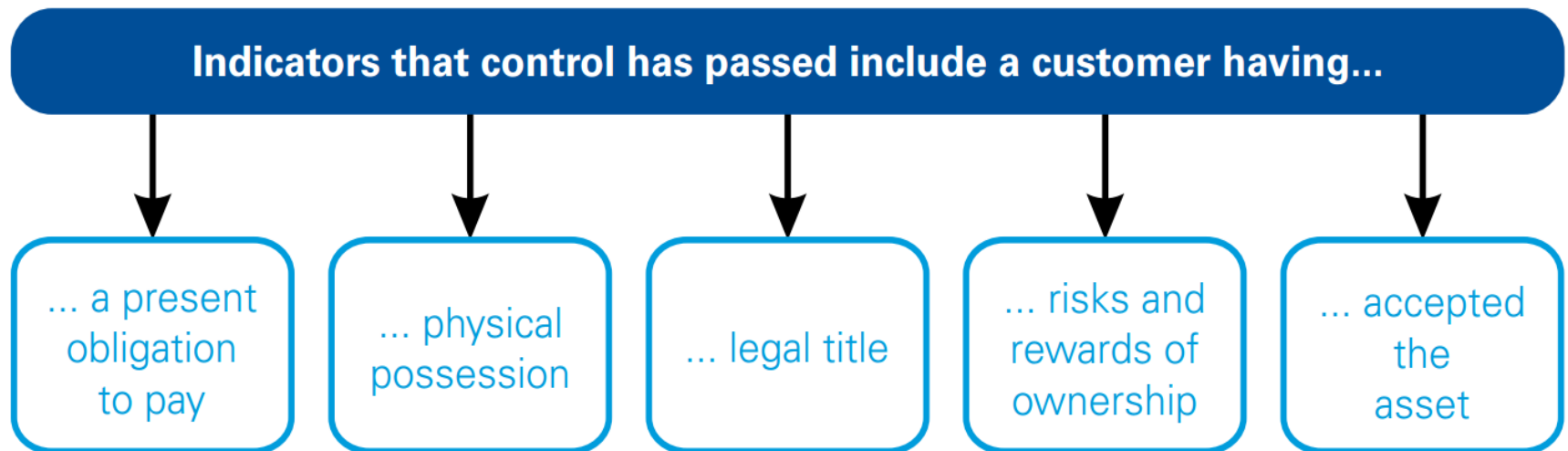
	Criterion	Example
1	The customer simultaneously receives and consumes the benefits provided by the entity's performance as the entity performs.	Routine or recurring services.
2	The entity's performance creates or enhances an asset that the customer controls as the asset is created or enhanced.	Building an asset on a customer's site.
3	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.	Building a specialised asset that only the customer can use, or building an asset to a customer order.

Step 5

Revenue recognition



If **none** of the three criteria is met, then the entity recognizes revenue at the point when it transfers the **control** of the goods and services to the customer.



Step 5

Revenue recognition



Example

M Contractors agrees to build a cancer diagnostic centre for County X under the following terms

- The county can **cancel** the contract on 45 days notice
- If the contract is cancelled the M Ltd has a **right to payment that covers costs incurred**
- The county government has agreed to make **quarterly payments**

Is the PO satisfied over time or point in time?

Licenses



Revenue from a distinct license to intellectual property is guided by

What is provided by the licence	When revenue is recognised
A right to use the intellectual property as it exists at the time the licence is granted.	Point in time
A right to access the intellectual property as it exists throughout the licence period.	Over time

Disclosures



Qualitative and quantitative information about:

- i) Revenue recognised from contracts with customers, including the disaggregation of revenue into appropriate categories.
- ii) Contract balances, including the opening and closing balances of receivables, contract assets and liabilities.
- iii) POs, including when the entity typically satisfies its POs and the transaction price allocated to the remaining POs.
- iv) Significant judgements, and changes in the judgements, made in applying the standard.
- v) Any assets recognized from the costs to obtain or fulfil a contract with a customer.

Discussion - Loyalty points



Naivas has a loyalty programme that rewards customers one point per KES.100 spent. Points are redeemable for KES.10 off future purchases (but not redeemable for cash). A customer purchases KES.100,000 of product at the normal selling price and earns 1,000 points redeemable for KES.10,000 off future purchases of goods or services. The store expects redemption of 950 points (that is, 5% of points will expire unredeemed). The retailer therefore estimates a stand-alone selling price for the incentive of KES.9.50 per point based on the likelihood of redemption (KES.10 less 5%).

How is the consideration allocated between the points and the product?

Interactive Session

