

Financial Reporting Workshop

IFRS 15: Revenue from Contract with Customers

Eastern Branch – November 2019

Introduction

- IFRS 15 **Revenue from Contracts with Customers** was issued on 28 May 2014.
- It replaced the previous revenue standards:
 - IAS 18 Revenue;
 - IAS 11 Construction contracts; and
 - The related Interpretations on revenue recognition:
 - *IFRIC 13 Customer Loyalty Programmes;*
 - *IFRIC 15 Agreements for the Construction of Real Estate;*
 - *IFRIC 18 Transfers of Assets from Customers; and*
 - *SIC-31 Revenue – Barter Transactions Involving Advertising Services.*
- Was effective from 1 January 2018; and earlier application was permitted.

Recap

Revenue recognition	
IAS 11	Construction contracts
IAS 18	Sales of goods
IAS 18	Sales of services
IFRIC 15	Real estate sales
IAS 18	Royalties
IFRIC 13	Customer loyalty programmes
IFRIC 18	Transfers of assets from customers
	Advertising barter transactions
SIC 31	Previously little guidance on costs of obtaining and fulfilling a contract
Other revenue	
IAS 18	Interest
IAS 18	Dividends

Revenue from contracts with customers	
IFRS 15	Point in time or over time
	New guidance on royalty revenue
	New guidance on options for additional goods and services and breakage
	Guidance on non-cash consideration
	New guidance on costs of obtaining and fulfilling a contract
Other revenue	
IAS 39 or IFRS 9	Interest
	Dividends

Objective

One Model

A single, joint revenue standard to be applied across all industries and capital markets

Clear principles

Robust framework

Comparability across industries

Enhanced disclosures

Simplified guidance

Key definitions

- Contract
 - Contract asset/liability
- Revenue
- Income
- Performance obligation
- Transaction price
 - Stand alone selling price



A **customer** is a party that has **contracted** with an entity to obtain goods or services that are an output of the entity's **ordinary activities** in exchange for **consideration**.

Scope exclusion

- Leases, insurance, financial instruments, investments in associates and joint ventures, **certain guarantee contracts and certain non-monetary exchanges**
- Contracts with elements in multiple standards
 - Evaluate under **other standards** first – *e.g. if a contract contains a lease, you first apply IAS 17 or IFRS 16*

What changed?

IAS 18 /11

Separate models for:

- Construction contracts
- Goods
- Services

Focus on risk and rewards

Limited guidance on:

- Multiple element arrangements
- Variable consideration
- Licences

IFRS 15

Single model for performance obligations:

- Satisfied over time
- Satisfied at a point in time

Focus on control

More guidance:

Separating elements, allocating the transaction price, variable consideration, licences, options, repurchase arrangements
and so on....

Control vs Risk & Rewards

INDICATORS THAT THE CUSTOMER HAS OBTAINED CONTROL OF THE GOOD OR SERVICE INCLUDE:

- The entity has a **present right** to payment for the asset.
- The **customer has legal title** to the asset.
- The entity **transferred physical possession** of the asset.
- The customer has the **significant risk and rewards** of ownership.
- The **customer has accepted** the asset.
- = ABILITY TO DIRECT THE USE & RECEIVE BENEFITS

CONDITIONS FOR RISK & REWARDS TO BE SATISFIED:

- The risks and rewards of ownership have transferred.
- The seller does not retain managerial involvement to the extent normally associated with ownership nor retain effective control.
- The amount of revenue can be reliably measured.
- It is probable that the economic benefit will flow to the customer.
- The costs incurred can be measured reliably.

Why the change

- significant diversity in revenue recognition practices
- limited guidance on many important topics, such as accounting for arrangements with multiple elements.
- difficult for investors and analysts ('investors') to understand and compare a company's revenue.
- difficult to apply to complex transactions due to lack of **basis for conclusions**.
- new types of transactions emerges.

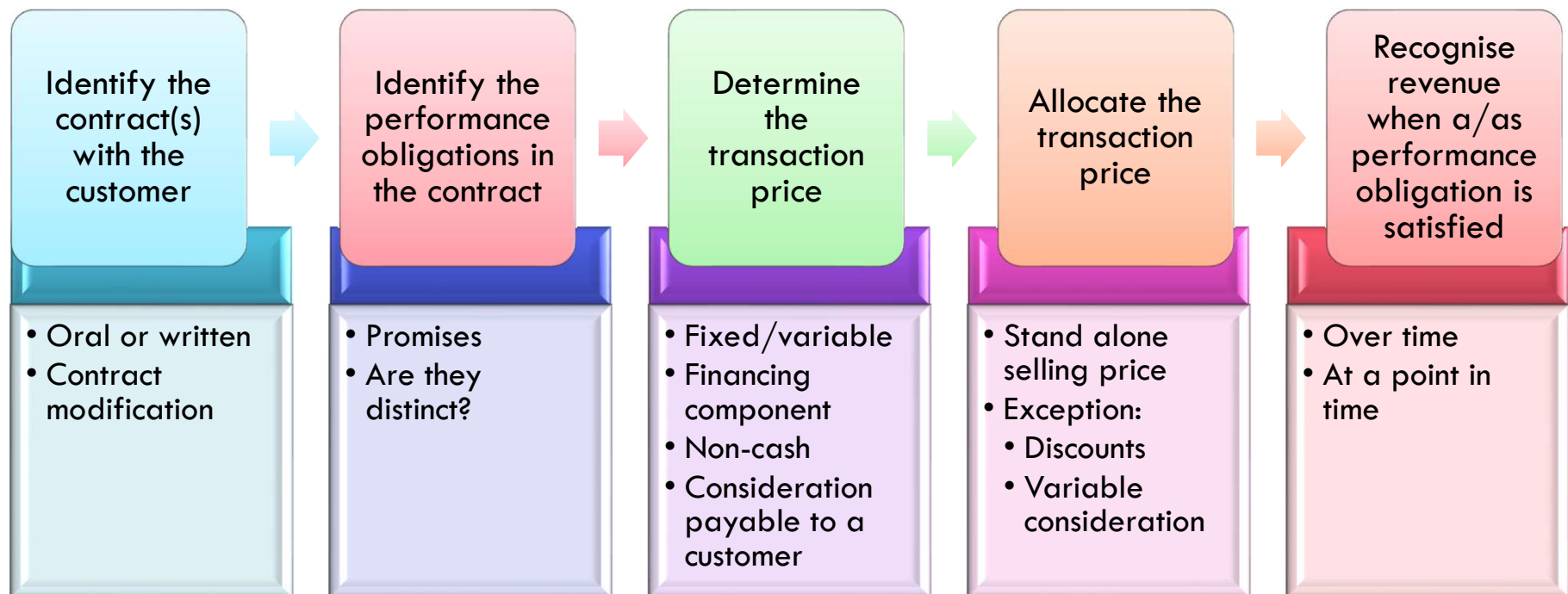
Impact

- For straightforward contract such as retail transactions, IFRS 15 has little, if any, effect on the amount and timing of revenue recognition.
- For other contracts, such as long-term service contracts and multiple-element arrangements, IFRS 15 results in some changes either to the amount or timing of the revenue recognised by an entity.
- **The most impacted industries:**
 - **Telecom industry:** Unbundle contracts, discounts, subscriber acquisition costs, handset costs
 - **Contract manufacturing industry:** Unbundle contracts, progress payments, performance obligations satisfied over time or at a point in time
 - **Software industry:** Unbundle contracts and allocate the transaction price, recognize revenue over time or at a point in time
 - **Construction industry:** Recognition of revenue over time or at a point in time; contract modification

Core principle

- “a company should recognise revenue to depict the **transfer of promised goods or services** to the customer in an **amount that reflects the consideration** to which the company **expects to be entitled in exchange** for those goods or services”

5 step model



Step I – Identify the Contract

A contract exists if...

collection of **consideration is probable**

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

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

iii. has **commercial substance**

- *An agreement between two or more parties that creates enforceable rights and obligations*
- Combine two or more contracts with the same customer when:-
 - *negotiated as a package with a single commercial objective;*
 - amount of consideration to be paid in one contract *depends on the price or performance of the other contract;* or
- goods or services promised in the contracts are a single performance obligation (see step 2)

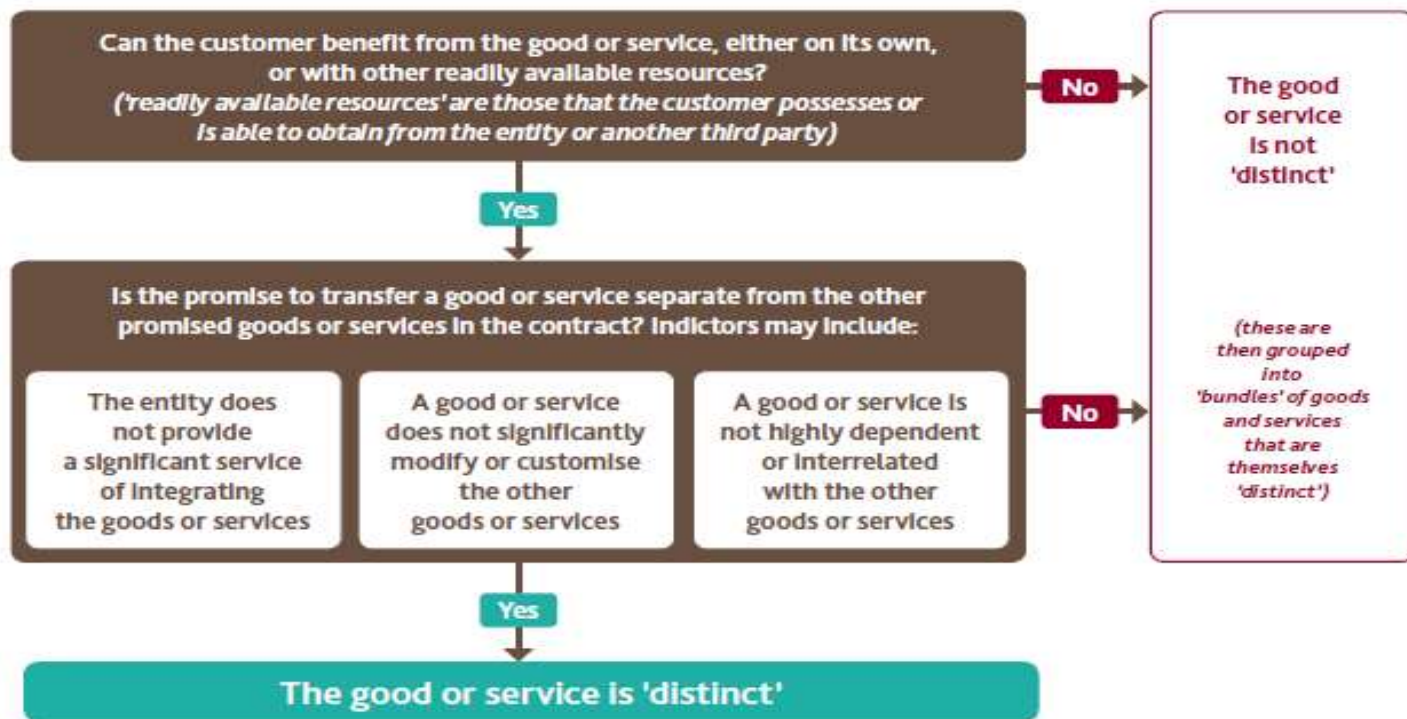
Step II – Identify performance obligation(s)

- **A performance obligation is a promise to a customer to transfer:**
 - a good or service (or a bundle of goods or services) that is distinct; or
 - a series of distinct goods or services that are substantially the same and that have the same pattern of transfer to the customer.

- A promise within a contract is a performance obligation if the contract contains either a good or a service that is **distinct**, or a **series of distinct goods or services that are substantially the same**, have the **same pattern of transfer** to the customer and meet two criteria:
 - i. Each distinct good or service in the series is a performance obligation satisfied over time, and
 - ii. The same method would be used to measure the vendor's progress towards complete satisfaction of the performance obligation to transfer each distinct good or service in the series to the customer.

- Identifying performance obligations is critical to **measurement** and **timing of recognition**

Step II – Identify performance obligation(s)



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 1.6 billion.
- Are the software and consulting services one performance obligation or two?

Performance obligation

- The entity is providing a significant **service of integrating the goods and services** (the license and the consulting services) into the **combined item** for which the customer has contracted.
- The software is significantly customized by the entity in accordance with the specifications negotiated with the customer. Thus, the goods and services are **not distinct** as the criterion that the customer can benefit from the CRM on a stand-alone basis has not been met.
- Therefore, the entity would account for the license and consulting services together as **one performance obligation**.

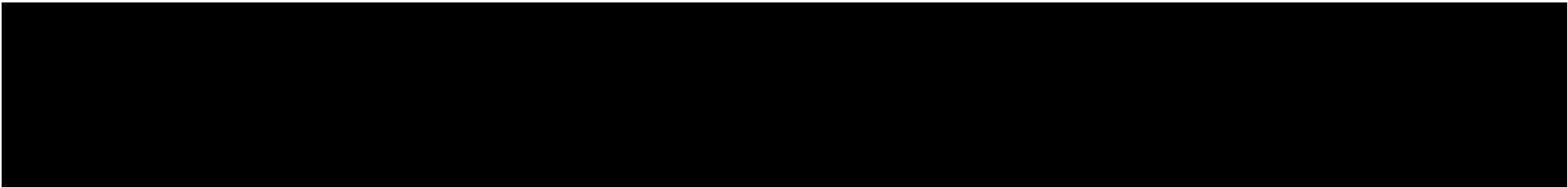
Step III – Determine the transaction price

- Probability weighted or best estimate
- More specific guidance covering:
 - time value of money
 - variable consideration
 - non-cash consideration
- consideration payable to customers: **reduction to transaction price unless for a distinct good or service.**

Example

Slotting fees

- A Kimberly Clark (KC) sells diapers to Tuskys for KES. 28 million. They also makes a KES. 1 million non-refundable upfront payment to Tuskys for favourable product placement.
 - How does the KC account for the upfront payment?
 - How does the Tuskys account for the upfront payment?

- 
- *The product placement services cannot be sold separately. The service is not distinct because the manufacturer would not obtain any rights or receive any benefit without selling products to the retailer.*
 - *The KC recognises a reduction in the transaction price of KES. 1 million and recognises KES. 27 million in revenue when control of the products transfers to the retailer.*
 - *From the Tuskys' perspective, the KES. 1 million upfront payment for product placement services is not a payment for satisfying a distinct performance obligation and should be recognised as a reduction of cost of goods sold.*

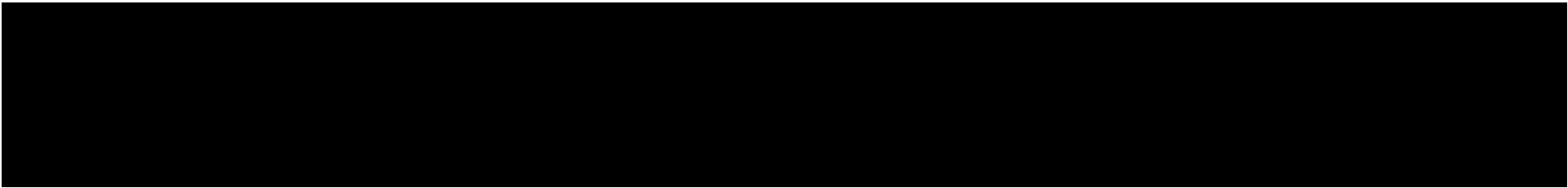
Step IV – Allocate the transaction price to the performance obligation

- Allocate transaction price to separate performance obligations based on **relative standalone** selling price:
 - Actual or estimated
 - Residual ‘approach’ if selling price is highly variable or uncertain (**change from current practice**)
- Initial allocation and changes to **variable consideration** might be allocated to a single performance obligation if:
 - Contingent payment relates only to satisfaction of that performance obligation, and
 - Allocation is consistent with the amount the entity expects to be entitled to for that performance obligation

Example

Loyalty points

- MRP 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. MRP 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?

- 
- Deacons would allocate the transaction price of KES.100,000 between the product and points based on the relative stand-alone selling prices of KES.100,000 for the product and KES.9,500 for the loyalty reward as follows:-
 - Product KES.91,324 ($100,000 \times 100,000/109,500$)
 - Points KES.8,676 ($100,000 \times 9,500/109,500$)
 - The revenue allocated to the product is recognised upon transfer of control of the product and the revenue allocated to the points is recognised upon the **earlier of the redemption or expiration of the points**. The estimate of the number of awards that will expire unredeemed is updated at each period end.

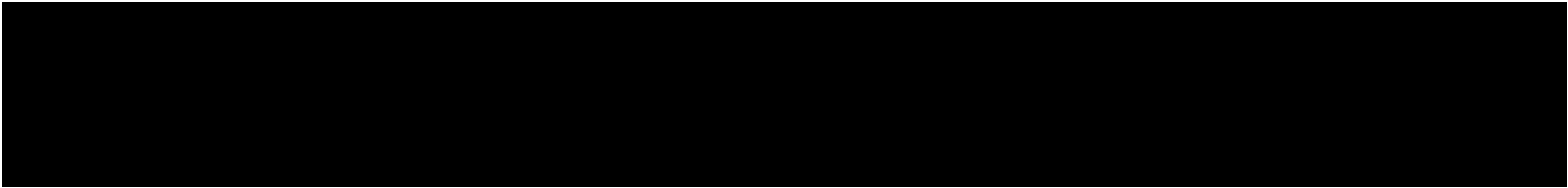
Step V – recognise revenue

- Guidance applies to each separate performance obligation
 - First, evaluate if performance obligation satisfied ‘over time’ = recognise revenue based on the pattern of transfer to the customer; or
 - If not point in time = recognise revenue when control transfers

Example

Sale using a sell-through (distributor) approach

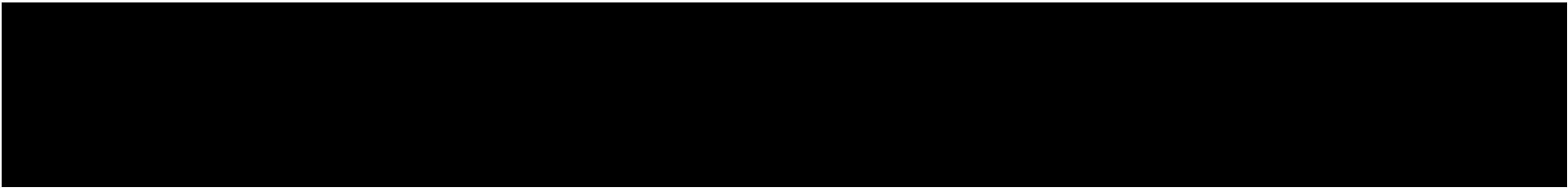
- A manufacturer uses a distributor network to supply its product to the end customer. The distributor **receives legal title** and is required to **pay for the products upon receipt**, but **may return unsold product** at the end of the contract term. Once the products are sold to the end customer, the manufacturer has **no further obligations** for the product and the distributor has **no further return rights**.
- When does the manufacturer recognise revenue?

- 
- *The distributor has physical possession, legal title, a present obligation to pay for the asset, and the right to determine whether the goods are returned, which are all indicators that control transferred when the goods were delivered to the distributor.*
 - *If control has transferred to the distributor and revenue is recognised, the manufacturer would recognise a liability for expected returns.*

Example

Sale of products on consignment

- A manufacturer provides household goods to a retailer on a **consignment basis** (i.e., scan-based trading). The manufacturer **retains title** to the products until they are scanned at the register. The retailer does not have **an obligation to pay** the manufacturer until a **sale occurs** and any **unsold products may be returned** to the manufacturer. The manufacturer also retains the **right to call back or transfer unsold products** to another retailer until the sale to the consumer. Once the retailer sells the products to the consumer, the manufacturer has no further obligations for the products, and the retailer has no further return rights.
- When does the manufacturer recognise revenue?

- 
- *Although the retailer has physical possession of the products, it does not take title or have an unconditional obligation to pay the manufacturer, and the manufacturer maintains a right to call the products.*
 - *Therefore, control does not transfer and revenue is not recognised until the product is sold to the consumer.*

Example

Warranty, cost accrual

- A manufacturer sells stereo equipment. The manufacturer also provides a 60-day warranty that covers certain components of the stereo equipment. The warranty is not sold separately by the entity.
- How should the manufacturer account for the warranty?

The manufacturer should accrue the cost it expects to incur to satisfy the warranty, similar to existing provisions

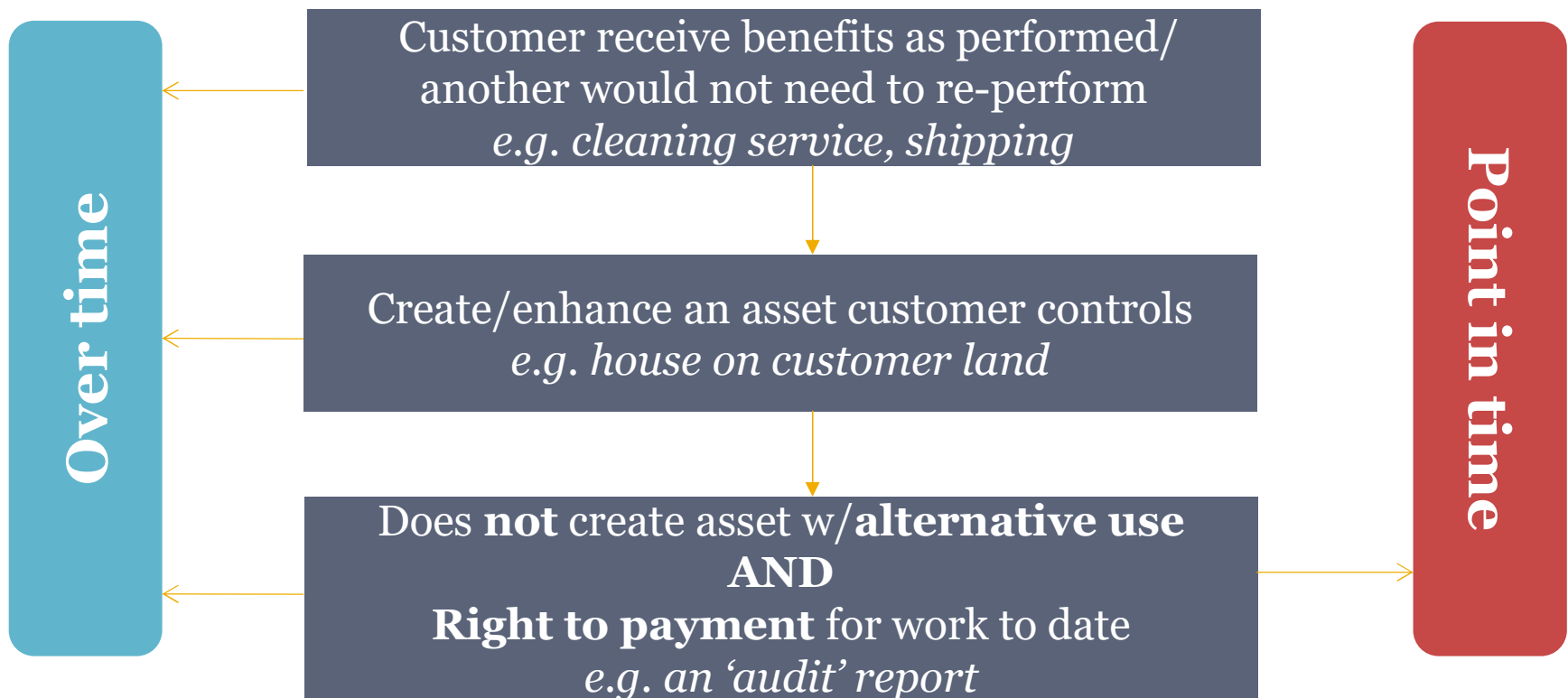
Example

Warranty, separate performance obligation

- A manufacturer sells stereo equipment. A customer has elected to also **purchase** the optional 12-month extended warranty.
- How should the manufacturer account for the warranty?

*The manufacturer should treat the 12-month warranty as a separate performance obligation. A portion of the transaction price is allocated to the warranty based on its relative **stand-alone** selling price and is recognised as revenue when the warranty obligation is satisfied. The manufacturer will need to assess the pattern of warranty satisfaction to determine when revenue is recognised.*

When does control transfer over time?

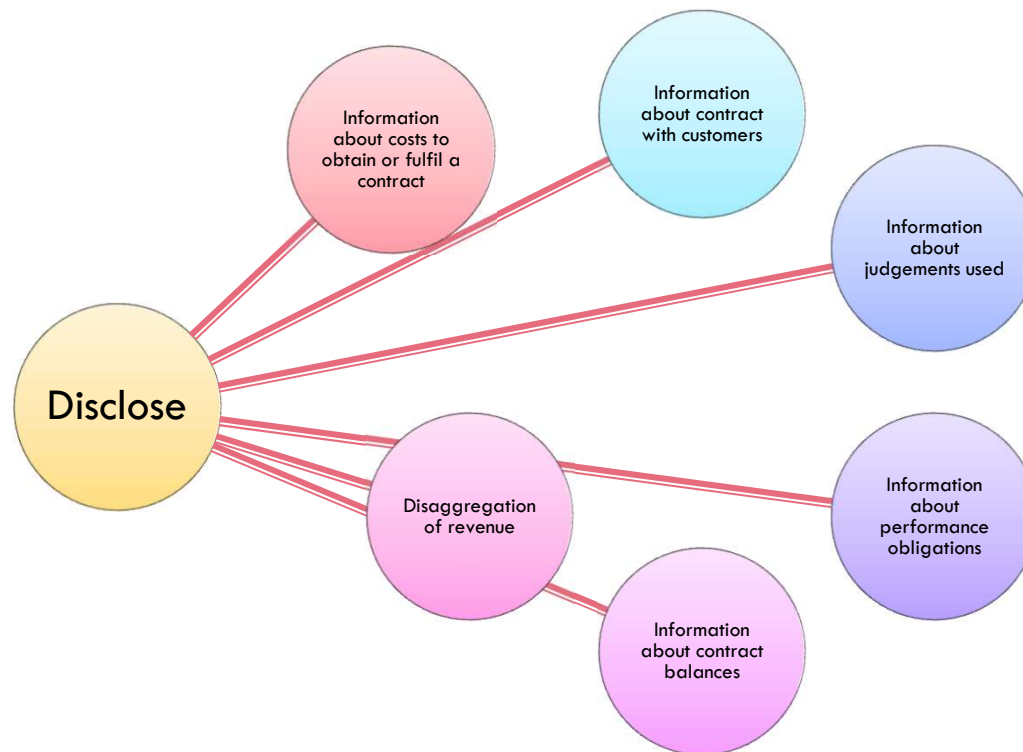


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Uphold Public Interest

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Disclosure



Refer to Safaricom Annual Reports and Audited Financial statements for the year ended 31 March 2019

Disclosure

- Both qualitative and quantitative information including;
 - Disaggregated information
 - 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 recognised
 - Significant judgments and changes in judgments
- **More extensive disclosures in the following areas: -**
 - **Disaggregation of revenue** to “depict how the nature, amount, timing and uncertainty of revenue and cash flows are affected by economic factors”
 - **Changes in contract balances** e.g. opening and closing balances of contract assets and liabilities.
 - **Contracts extending beyond one year** – aggregate amount of transaction price allocated to the remaining performance obligation and explanation of expected timing of revenue recognition.
 - **Contract costs** – information about asset recognised for costs to obtain or fulfil a contract
 - **Information about contracts** - types of goods or services, significant payment terms, typical timing of satisfying obligations
 - **Significant judgments** about the amount and timing of revenue recognition
 - **Policy decisions** made by entity related to practical expedients
 - **Information about methods, inputs and assumptions** used to determine transaction price and price allocation

Implementation Guidelines

- Customer options
- Warranties
- Breakage
- Non-cash consideration
- Consideration payable to the customer
- Returns
- Repurchase options
- Principal or agent

