UNCTAD-Intergovernmental Working Group of Experts on International Standards of Accounting and Reporting

Workshop on Accounting and Financial Reporting Standards

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Morning Session

IFRS 15 – Revenue from Contracts with Customers

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IFRS 15
REVENUE FROM CONTRACTS WITH CUSTOMERS

The Accounting Standards Board

The Institute of Chartered Accountants of India

Agenda

1. About ICAI	:	2 slides
2. IFRS in India	:	1 slide
3. Revenue - Intro	:	1 slide
4. Watch out	:	4 slides
5. Issues in Revenue	:	6 slides

6. Revenue (back up)

Chartered Accountancy Profession in India

1. ICAI is a Regulatory body set up under an Act of Parliament (1949)
2. Governing Body- 32 elected members and 8 Govt. Nominees
3. Members in India : 227 K
4. Members outside India : 30 K
5. Students : 850 K

6. Regulating the Profession of Chartered Accountancy
   - Laying down Ethical Standards
   - Continuing Professional Education
   - Monitoring Quality through Peer Review & Financial Report Review
   - Disciplinary action
7. Education & Examination of Chartered Accountancy

8. Formulation of Accounting Standards (Ind AS which are converged with IFRS) and Auditing Standards

International Presence

- **ICAI is founder member of IFAC, CAPA SAFA.**
- **ICAI is represented in:**
  - IFAC - As Board Member, Membership in Small and Medium Practices Committee, IAESB
  - CAPA – As Deputy President
  - SAFA – As Board Member and member of various Committees & Working Groups (ICAI holds Permanent Secretariat, SAFA)
  - Asian Oceanic Standard Setters Group (AOSSG)-As member
  - XBRL International- As member of various Committees
  - CAW – as a member

IFRS in India

- Indian Accountancy Standards converged with IFRS – Ind AS
- Negligible carve outs
- Adoption from FY15-16 in phased manner
- IFRS 9   implemented
- IFRS 15 announce for implementation FY15-16; withdrawn as IASB postponed for a year

Revenue

- Imperative / Transformational : overdue

- User of FS
  - Past : historIcal
  - Present : fair value
  - Future : forecasting

- Information not capable of forecasting is irrelevant as users use FS more for predicting the future to take economic decisions

- Disclosures in the standard are in this direction

Watch out ! (1/4)

1. Sought to be applied across different (quite wide):
   - Geo
   - Industries
   - Regulatory environment
   - State of economy

2. Significant IT changes
   - Full retrospective or modified retrospective (only few months away)

3. For an MNC : Different audit firms in different geography – alternate views quite possible.

Watch out !! (2/4)

4. A contract should create enforceable rights & obligations as per laws of the local land. Hence this may bring out variation across globe based on each country's law.

5. The performance obligation shall include the services which are implied by the customer's customary practices and policies. This may vary from company to company and also based on the country and products offered by the company.

4. Goods/services to be distinct should be evaluated from customer perspective on whether it can benefit the customer with the existing resources which are readily available with it. This will require additional skill sets as it requires understanding the customer environment.

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Watch out !!! (3/4)

5. Lot of estimate and judgment – requires disclosure of the inputs and assumptions it has used in arriving at those.

6. Para 120 - Disclosure of unsatisfied performance obligations and the time band when that would be realized.
   - ❖ This is a critical market information
   - ❖ In case an entity early adopts, it may be required to disclose this information before other companies.
   - ❖ NA for contracts which expire in less than 1 year and contracts which earn per unit revenue capturing this data can be challenging.

7. Taxation during transition – whether retrospective or modified retrospective; importantly Minimum alternate tax/ book profit tax

Watch out iiii (4/4)

7. Alignment of other laws to support the revenue model of IFRS 15. Direct & Indirect taxation, Revenue share in case of telecom industry, etc.

8. Bank covenants compliance, impact on revenue & profit; impact on sales based incentives, dividends etc

9. ICoFR to meet Assurance requirements/ Management Certification

10. Change in AOP and other long term plans/ investment valuations

11. Some long term contracts- to be reviewed and renegotiated

12. Transition period IR is key- explanation of impact, ratios, etc

Issue 1

- Paragraph 5(d) provides scope exclusion for contracts related to non-monetary exchanges between entities in the same line of business to facilitate sales to customers.
- For example, a contract between 2 oil companies to exchange of oil to fulfil demand from their customers in different specified locations on a timely basis.
- BC58 explains application of para 5(d) that such exchange is commonly done by entities in industries with homogeneous products & revenue to be recognised only on sale to end customer.
- This explanation can be included either in para 5(d) or in the application guidance for better understanding.
- Also, Whether the term 'timely basis' in example given in 5(d) indicates that the exchange has to be at the same time?

Issue 2

- Paragraph 9 (e) provides that contract shall be accounted for, only when it is probable that the entity will collect the consideration to which it will be entitled.
- If there will be uncertainty of collectability of consideration at the inception only, an entity will not enter into the contract as it will not be a rational behaviour.
- Practically difficult to make assessment of the customer's credit risk at the contract inception.

Issue 3

- Where conditions under para 9 not met, an entity cannot recognise revenue
- Para 15-If entity receives consideration, the entity shall recognise revenue only when :

  (a) no remaining obligations & substantially all consideration has been received & is non-refundable; or

  (b) the contract has been terminated & the consideration is non-refundable.
- Clarification required if consideration received is not substantial.

Issue 3 (Contd…)

- Eg, an entity completed all obligations but consideration received is only 50% of the total consideration. Whether revenue can be recognised in this case according to paragraph 15(a). If not, what would be the appropriate accounting.

- Whether such consideration received can be treated as a contract liability? If yes, at what point would revenue be recognised, as in the given case there is delay in balance payment & parties do not terminate their contract as the seller will demand the balance consideration.

Issue 4

- Paragraph 62(c) provides that a contract would not have significant financing component if difference between promised consideration & cash selling price arises for reasons other than provision of finance, and the difference between those amounts is proportional to the reason for the difference.

- The word ‘proportional’ in paragraph 62(c) is not giving a clear meaning. For better understanding, word ‘commensurate’ can be used in place of word ‘proportional’.

Issue 5

- Paragraph 35(a) provides that an entity transfers control of a good or service over time &, therefore, satisfies a PO & recognises revenue over time, if the customer simultaneously receives & consumes the benefits as the entity performs

- Example given in BC 126 -relating to paragraph 35(a) provides that where in case of a freight logistics contract, entity has agreed to transport goods from Vancouver to New York City, the customer does benefit if the goods were delivered only part way (for example, to Chicago) as another entity would not need to substantially re-perform the entity's performance to date

- In this case, though the condition of substantial re-performance of entity's performance to date is fulfilled (para 35(a)) but the PO cannot be said to be satisfied over time

Issue 5 (Contd…)

- Control is transferred only when the goods are received by customer
- Without transfer of control, revenue can't be recognized over a period of time.
- Whether revenue can be recognised at a point in time when the customer receives goods & obtains control of the same?
- Will the recognition of revenue on over a period of time basis result in inflating revenues without obligations being performed?

THANK YOU

IFRS 15
REVENUE FROM CONTRACTS WITH CUSTOMERS

Background

- Issued by IASB in May 2014 under a convergence project with FASB

- Effective date for IFRS 15 was January 01, 2017. Early application permitted

- In June 2014, IASB, along with the US Financial Accounting Standards Board (FASB), announced the formation of a joint **Transition Resource Group (the TRG)** to support implementation by considering potential implementation issues submitted by stakeholders.

Background

- In April 2015, FASB, decided to defer the effective date of the new Revenue standard by one year (from 15 December 2016 to 15 December 2017)

- IASB issued amendments to IFRS 15 to defer the effective date by one year (from 1 January, 2017 to 1 January, 2018). Option to early adopt IFRS 15 to continue

- In April 2016, IASB issued **Clarifications to IFRS 15** & announced that it does not plan to schedule further meetings of TRG.

Introduction

- **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 (SIC 31)*

Benefits of IFRS 15

- Uses transaction price approach instead of fair value while determining amount of consideration.

- Provides guidance on revenue recognition for multiple-element arrangements which ensures consistent application of the Standard.

Objective

To establish the principles that an entity shall apply to report useful information

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to users of financial statements

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about the nature, amount, timing and uncertainty of

↓

revenue and cash flows arising from a contract with a customer

Portfolio Application

- Can be applied to portfolio of contracts or performance obligations
  - Contracts / Performance obligations should have similar characteristics
  - Effect on FS of applying this standard to portfolio would not differ materially from applying this standard to individual contracts or performance obligations within that portfolio
  - Estimates & assumptions used to reflect the size & composition of portfolio

Scope

- Applies to all contracts with customers except
  - Lease contracts
  - Insurance contracts
  - Financial instruments and other contractual rights and obligations within the scope of IFRS 9, IFRS 10, IFRS 11, IAS 27 and IAS 28
  - Non-monetary exchanges between entities in same line of business to facilitate sales to customers or potential customers

Multiple Scope

Contract that is partially within IFRS 15 and partially within scope of another standard, then:

Whether the other standard specifies separation and/or initial measurement for a part(s) of the contract

Yes

Apply that other standard for separation and initial measurement

No

Apply IFRS 15 to the entire contract/remaining part

Core Principle

Recognise Revenue to depict transfer of promised goods or services to customers	at an amount that reflects consideration	to which entity expects to be entitled in exchange for those goods or services

Steps to achieve Core Principle

1 Identify contract with a customer

2 Identify performance obligations in contract

3 Determine transaction price

4 Allocate transaction price to performance obligations in contract

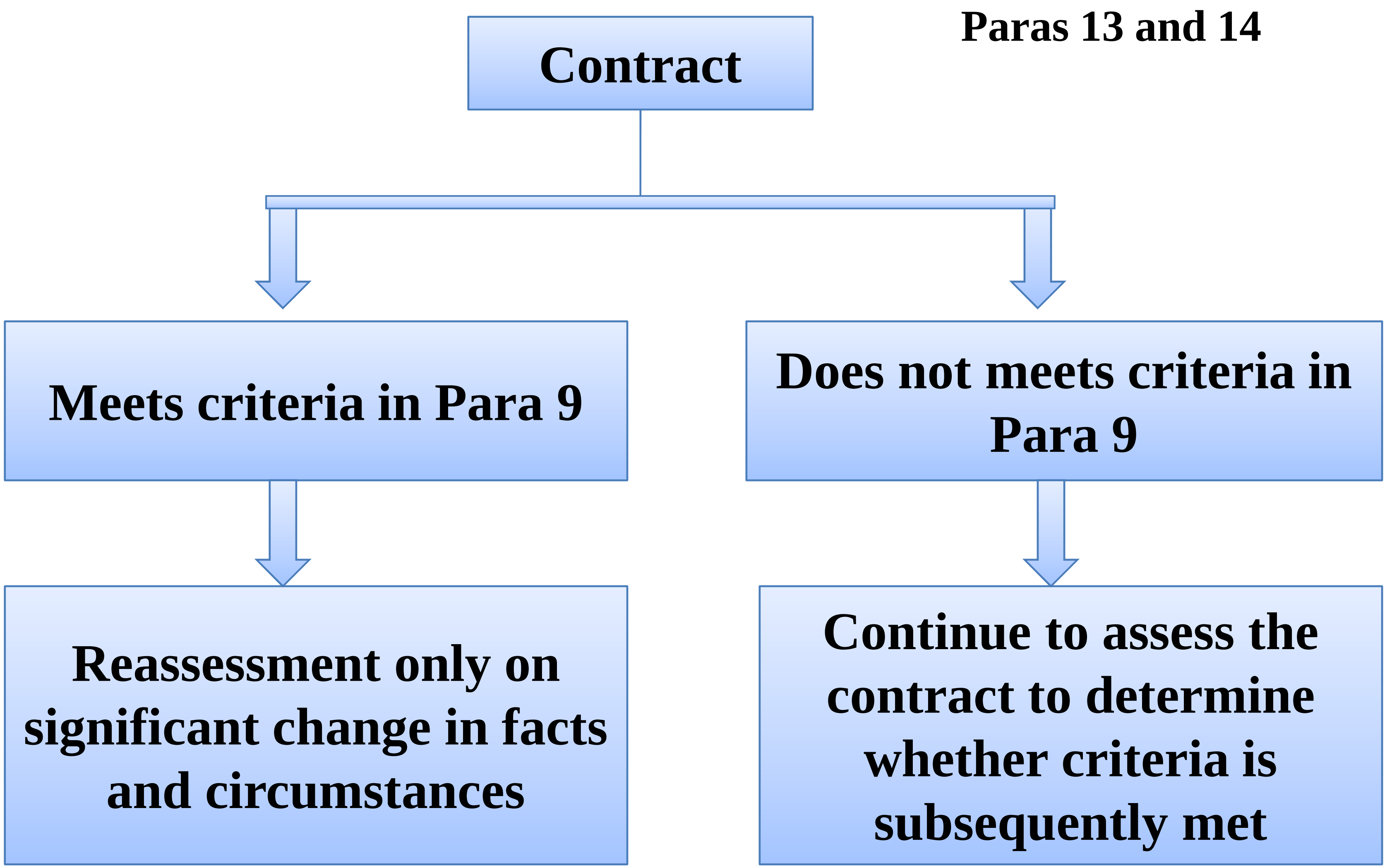
5 Recognise revenue when entity satisfies a performance obligation

Step 1: Identify Contract

Criteria for identifying a Contract (Para 9):

1. has been approved by the parties (Written, Oral or in accordance with other customary business practices) & commitment to perform respective obligations
2. each party's right regarding goods/services can be identified by the entity
3. payment terms can be identified by the entity
4. has commercial substance and
5. it is probable that entity will collect the consideration to which it will be entitled in exchange for goods/services that will be transferred to the customer

Step 1: Identify Contract – Contd.



Step 1: Identify Contract – Contd.

Para 15

Criteria not met and consideration received

Recognise consideration received as Revenue

When

No remaining obligations

AND

All or substantially all consideration received

AND

Consideration received is non-refundable

OR

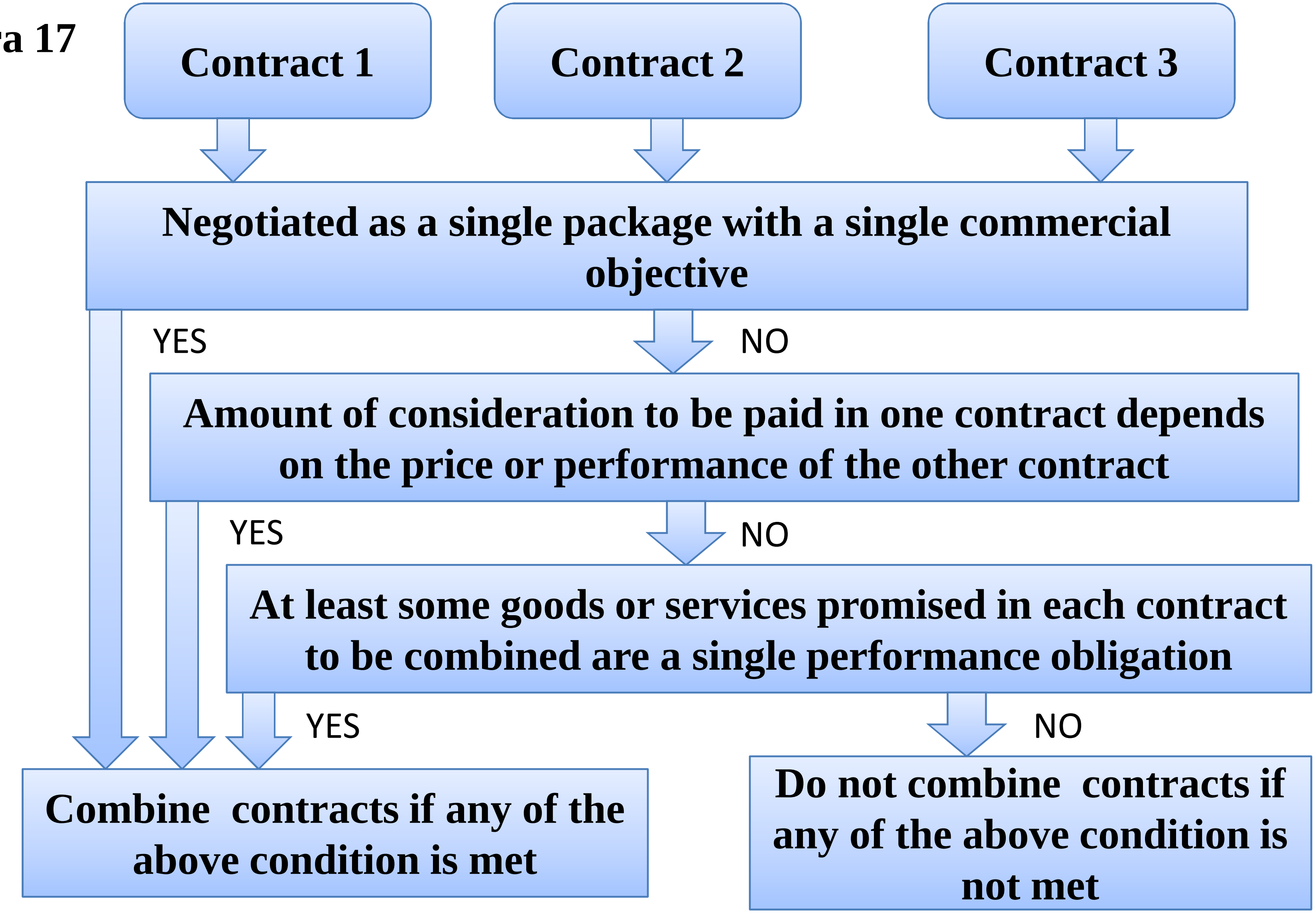
Contract has been terminated

AND

Consideration received is non-refundable

Step 1: Identify Contract – Contd.

Para 17



Step 1: Identify Contract – Contd.

Paras 18 - 21

Contract modifications approved by the parties

- **Yes**
  - Scope increases due to addition of goods and services
    - Price increase reflects Stand-Alone Selling Price (SASP) of additional promised goods or services
      - Account for as a separate contract
  - Remaining goods or services are distinct from those transferred
    - Replaces the existing contract
      - Derecognise existing and recognise new
  - Remaining goods or services are not distinct
    - Part of existing contract
- **NO**
  - Apply to existing contracts until modifications are approved

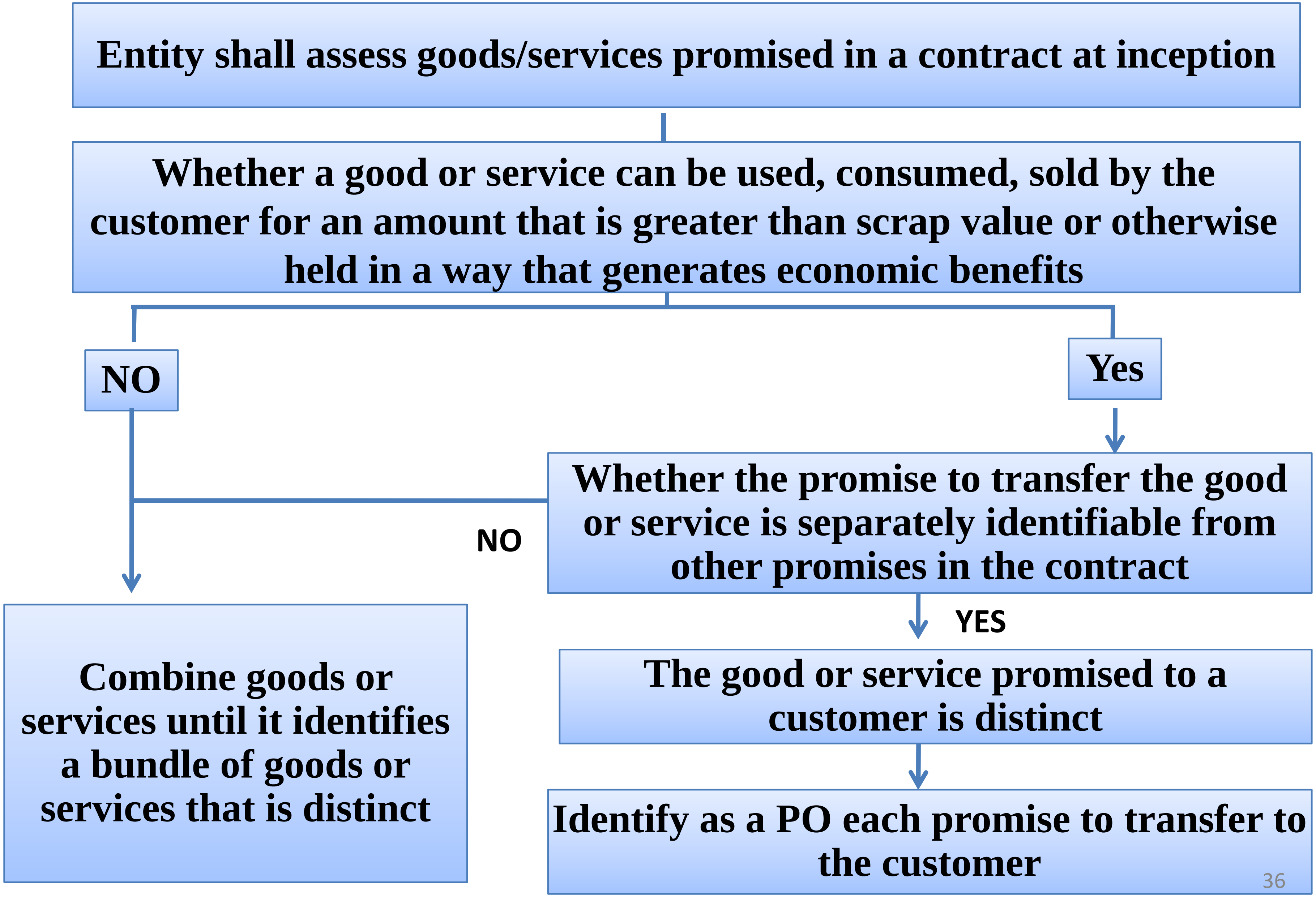
Step 2: Identify performance obligations

Performance Obligation (PO): Promise in a contract with a customer to transfer distinct goods/services to customer

Customer: Party that has contracted with entity to obtain goods/services that are output of entity's ordinary activities in exchange for consideration

- IFRS 15 to apply only to contract when the counterparty is a Customer

Step 2: Identify POs (contd.) (Paras 22 to 30)



Step 2: Factors for Separate Identifiability of POs

- Entity is not using the good or service as an input to produce or deliver the combined output specified by the customer
- The good or service does not significantly modify or customise another good or service promised in the contract
- The good or service is not highly dependent on, or highly interrelated with, other goods or services promised in the contract

Step 3: Determine Transaction Price (TP)

- **TP**: Amount of consideration to which an entity expects to be entitled in exchange for transferring promised goods or services to a customer, excluding amount collected on behalf of third parties
- Effect of all of the following to be considered when determining TP:
  - Variable consideration
  - Constraining estimate of variable consideration
  - Existence of a significant financing component
  - Non-cash consideration
  - Consideration payable to customer

Step 3: Determine Transaction Price

- **Variable consideration**: Estimate amount of consideration to which entity will be entitled in exchange for transferring the promised goods or services to a customer (ex: sales tax)
  - ❖ **Methods** of estimating variable consideration:
    - ➢ Expected Value
    - ➢ Most Likely Amount
  - ➢ Only to the extent that it is highly probable that a significant reversal in the amount of cumulative revenue recognised will not occur when the uncertainty associated with the variable consideration is subsequently resolved

Step 3: Determine Transaction Price

- **Refund Liability**
  - Recognised if the entity receives consideration and expects to refund it to the customer
  - Measured at the amount of consideration received or receivable for which the entity does not expect to be entitled
  - To be updated at the end of each reporting period

- **Non-cash consideration**: At Fair Value

  If FV can’t be estimated reasonably, measure by reference to stand-alone selling price of goods/services.

Step 3: Determine Transaction Price

- Significant Financing Component
  - The objective is for an entity to recognise revenue at an amount that reflects the price that a customer would have paid for the promised goods or services if the customer had paid cash for those goods or services when (or as) they transfer to the customer
  - No significant financing component if payment within one year of the transfer of control

Step 3: Determine Transaction Price

- Consideration payable to Customer
  - Account as a reduction of TP unless the payment is in exchange for a distinct good or service that the customer transfers to the entity
  - Reduction of revenue to be recognised when (or as) the later of either of the following occurs:
    - The entity recognises revenue for the transfer of the related goods or services
    - The entity pays or promises to pay the consideration (even if the payment is conditional on future event)

Step 4: Allocate Transaction Price

- Objective is to allocate the TP to each PO in an amount that depicts the amount of consideration to which the entity expects to be entitled in exchange for transferring the promised goods or services to the customer

- Allocation on relative stand-alone selling price (SASP) basis

Step 4: Allocate Transaction Price

Methods of allocating :

(a) Adjusted market assessment approach

(b) Expected cost + margin approach

(c) Residual approach

- Total TP – Sum of observable SASP of other goods or services promised in the contract

- Discount to be allocated before using residual approach

Step 4: Allocate Transaction Price

- Allocation of Discount
  - Discount = Sum of SASP of all POs in a contracts – Consideration promised in a contract
  - Allocate proportionately to each PO unless there is an observable evidence that the entire discount relates to one or more, but not all, POs in a contract

Step 4: Allocate Transaction Price

Subsequent changes in TP:

- Allocate any subsequent changes in TP on the same basis as at contract inception

- Allocate the change in TP entirely to one or more but not all POs or distinct goods or services only if the criteria for allocating variable consideration is met as indicated in immediately preceding slide

Step 5: Recognise Revenue

Satisfy Performance Obligation by transferring a promised good or service

Customer obtains control of good or service

Recognise Revenue

Step 5: Recognise Revenue (Contd.)

Customer Obtains Control of Good or Service:

- Goods and services are assets, even if only momentarily, when they are received & used (as in case of many services)
- Control of an asset:
  - ability to direct the use of and obtain substantially all of the remaining benefits from asset
  - ability to prevent other entities from directing use of and obtaining benefits from an asset

  Benefits are potential cash flows that can be obtained directly or indirectly in many ways

Step 5: Recognise Revenue (contd.)

Determine at contract inception whether PO is satisfied:

Over Time

If one of the following conditions is met:

(a) customer simultaneously receives and consumes benefits provided by the entity's performance as it performs

(b) entity's performance creates or enhances an asset (e.g. work in progress) that the customer controls as the asset is created or enhanced or

(c) entity's performance does not create an asset with an alternative use to entity and it has an enforceable right to payment for performance completed to date.

Point in time

Entity to consider following indicators of transfer of control (in addition to requirements for control) to determine point in time:

- entity has a present right to payment for asset
- customer has legal title to asset
- entity has transferred physical possession of asset
- customer has significant risks and rewards of ownership of asset
- customer has accepted asset

Step 5: Recognise Revenue (contd.)

PO satisfied over time:

- Recognise revenue over time by measuring progress towards complete satisfaction of performance obligation (PO)
- Apply a single method of measuring progress for each PO and apply that method consistently to similar POs and in similar circumstances
- Appropriate methods include Output or Input Methods
- Remeasure progress at end of each reporting period

PO satisfied at a point in time:

Recognise revenue when entity satisfies a performance obligation and customer obtains control of promised good/service

Contract Costs

Costs to obtain a Contract

- Incremental costs of obtaining a contract with a customer to be recognised as asset if the entity expects to recover those costs
- Incremental costs of obtaining a contract are avoidable costs (i.e., would not have incurred if contract had not been obtained eg, sales commission)
- Incremental costs of obtaining a contract to be recognised as expenses if the amortisation period of that asset is one year or less

Contract Costs

Costs to fulfill a Contract

- Recognise asset from the costs incurred to fulfill a contract only if those costs meet all of the following criteria:
  - Those costs are not within the scope of another standard
  - The costs relate directly to a contract or an anticipated contract that the entity can specifically identify
  - The costs generate or enhance resources of the entity that will be used in satisfying (or in continuing to satisfy) POs in the future
  - The costs are expected to be recovered

Contract Costs

Amortisation and Impairment

- Amortised on a systematic basis that is consistent with the transfer to the customer of the goods or service to which the asset relates
- Impairment to be recognised if the carrying amount of the assets exceeds
  - Remaining amount of consideration that the entity expects to receive in exchange for the goods or services to which the asset relates; less
  - The costs that relate directly to providing those goods or services and that have not been recognised as expenses
- Reversal to the extent of the Amortised CA

Presentation

- When either party to a contract has performed, the contract shall be presented in Balance Sheet as a contract asset or contract liability

- Any unconditional rights to consideration to be presented separately as receivable

    - Right to consideration is unconditional if only the passage of time is required before payment of that consideration is due

- Impairment of contract asset to be measured, presented and disclosed on the same basis as a financial asset that is within the scope of IFRS 9