Revenue Recognition: Application of IFRS 15 Revenue from Contracts with Customers.

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"International Financial Reporting Standard 15 (IFRS 15) Revenue from Contracts with Customers has significantly changed the philosophy of revenue recognition, not only to provide a fairer representation of corporate revenues but also to inhibit the use of revenues for 'earnings management' purposes".

Christopher J. Napier & Christian Stadler (2020)

This quote demonstrates how IFRS 15 has revolutionised the way that corporate financial reporting approaches revenue recognition. This article examines the background that led to the adoption of IFRS 15, presents its primary principles, and uses case studies from the media and publishing industries to show how it has affected these industries.

Historical Context:

Before the introduction of IFRS 15, revenue recognition varied widely across industries and geographical regions. Conflicting practices led to inconsistencies, making it challenging for stakeholders to compare financial statements. Recognising this, the IASB collaborated with the Financial Accounting Standards Board (FASB) to develop a single, robust standard that could be applied globally. The result was IFRS 15, aiming to enhance comparability, eliminate industry-specific guidance, and provide a principles-based approach to revenue recognition.

IFRS 15 Principles: The 5-Step Model

To assist in the implementation of the principles-based approach IFRS 15 has developed a 5-step approach to revenue recognition.

Step 1. Identifying the Contract with the Customer:

With the introduction of IFRS 15, the conventional rules-based approach to revenue recognition has been abandoned in favour of a more principles-based process. The emphasis on recognising revenue when control of goods or services is passed to customers, which more closely aligns with economic reality, marks the philosophical shift. IFRS 15 has been in effect since January 1, 2018, and it mandates that organisations explicitly identify contracts. This was a pivotal change, emphasising the importance of explicit approval and commitment between parties.

Step 2. Identifying Separate Performance Obligations:

A more rigorous framework for determining performance obligations is introduced in IFRS 15. Following from Step 1 with contracts in place, under Step 2 businesses must now clearly define their responsibilities. It helps decide when and how revenue should be recognised for each performance obligation by assisting organisations in carefully identifying and separating different performance obligations within a contract.

Step 3. Determining Transaction Price:

The difficulty of calculating transaction pricing was highlighted by Step 3, especially in situations where there are variable considerations, discounts, or non-cash components. Regular evaluation of these approximations should become the standard.

The 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. It includes fixed and variable components, discounts, and any consideration payable to the customer.

For example, a company offers a one-year print subscription for €200. Additionally, the company provides a promotional discount of 10% for customers who sign up during a specific period. The transaction price, in this case, would be €180 (€200 - 10%).

Step 4. Allocating Transaction Price:

The ongoing challenge of allocating prices to various performance obligations has become a standard practice since implementation. Entities must consider standalone selling prices and employ estimation techniques for accurate allocation.

Allocation involves assigning the transaction price to each performance obligation based on the standalone selling price of the promised goods or services. This ensures that revenue is recognised in a manner that reflects the amount of consideration to which the entity expects to be entitled.

Consider a company that offers a bundled package including a print subscription of €200 and a digital subscription of €150 for a total transaction price of €300, the company needs to allocate the transaction price to each element. If the standalone selling prices are €200 for print and €150 for digital, the allocation might be done proportionally. This example shows that for the bundle package, the company is getting 86% (€300/€350) of the price if packages were not sold in a bundle. Hence, the allocation of revenue for the bundle would be €200 * 86% = €172 to the print subscription and €150 * 86% = €128 to the digital subscription.

Step 5. Recognising Revenue:

The core principle of recognising revenue when control transfers to the customer remains fundamental. The adoption of IFRS 15 in 2018 set a uniform standard for revenue recognition across industries, promoting transparency and consistency.

> ‘Control of an asset refers to the ability to direct the use of, and obtain substantially all of the remaining benefits from, the asset. Control includes the ability to prevent other entities from directing the use of, and obtaining the benefits from, an asset.’

Revenue is recognised when the entity satisfies a performance obligation by transferring control of a promised good or service to the customer. This could be at a point in time or over a period, depending on when control is deemed to transfer.

Identifying when control transfers under this step involves examining key indicators. The nature of the goods or services, contractual terms, payment structure, risk and rewards, and the extent of customer involvement all play crucial roles.

For example, a company sells a software license to a customer with an upfront payment, allowing them to download and use the software for one year. The performance obligation is satisfied over time, as the customer has continuous access to the software throughout the license period. Revenue is recognised monthly, spreading the transaction price evenly over one year.