LET'S GET TECHNICAL

Top tutor Cat Hill explains how the rules for the new IFRS 15 affect the way that revenue must be recorded

Accounting for a sale is one of the first things a student learns in the ACCA F3 Financial Accounting paper, and it is relevant for ACCA F7 studiers, too.

Most people studying accountancy have heard some of the history of double entry bookkeeping, the theory of which is thought to date back to the 12th century, or even before. But, of course, a new IFRS means a new set of rules, and although double entry will still apply, the new IFRS 15, *Revenue from Contracts with Customers*, gives detailed guidance via five steps for revenue recognition, thereby clarifying the rules for a lot of businesses. The five steps are:

1. Identify the contracts with the customer.
2. Identify the separate performance obligations.
3. Determine the transaction price.
4. Allocate the transaction price to the performance obligations.
5. Recognise revenue when (or as) a performance obligation is satisfied.

Fundamentally, this covers the questions: What? When? and Where?

What?

The first four of the steps all cover the same question. What contract are we talking about? What is the price? What are the performance obligations? What is allocated to the obligations?

Let's imagine I run a shop selling computers. Most of these questions are easily answered:

1. A customer comes in to the shop and we agree that she will buy a computer for $1,000– that is the contract with the customer.
2. I give her the computer – that's the performance obligation in the contract.
3. We have determined the transaction price as $1,000.
4. The $1,000 (transaction price) is in return for the computer (performance obligation).

Easy enough? But what if it's more complicated?

1. A customer comes in to the shop and we agree that she will buy a computer and 2 years of support for $1,200 – that is the contract with the customer.
2. There are TWO performance obligations – the computer which she gets now, and the support she will receive for the next 2 years.
3. The transaction price is $1,200.
4. But that price needs to be split between the computer and the support, to allocate the transaction price across the performance obligations.

So I need more information.

Let's assume, if the customer had bought the computer and the support separately from each other, I would have sold the computer for $1,000 and the support for $500. But as a package, I only charged her $1,200.

I need to allocate $1,200 to the performance obligations in the same proportion as I would have done if the computer and support were bought separately.

Exam tip: in the exam, they would have to give you some clue on how to do this apportionment.

As two separate items, the computer and support would look like this:

Obligation	Individual selling price		% of total price
Computer	$1,000	$1,000/$1,500	66.7
Support	$500	$500/$1,500	33.3
Total	$1,500		100

This means, in the package contract, the revenue of $1,200 is allocated across the computer and support, in the same proportion as above:

Obligation	Package price x appropriate %	Revenue allocated to obligation
Computer	$1,200 x 66.7%	$800
Support	$1,200 x 33.3%	$400
Total		$1,200

When?

Now we know that the revenue for the computer is $800 and the revenue for the support is $400, the next question is: when do we recognise those two items of revenue? This the fifth step in IFRS 15 – recognise the revenue when the performance obligation is satisfied.

For the computer: If the customer takes the computer away with her today, that has satisfied the first of my performance obligations, so I can recognise $800 of revenue at that point. If I will be delivering it to her in a couple of weeks, I can't recognise the revenue until I have delivered the computer, because I haven't satisfied my obligation until that point – the customer doesn't have control of the asset.

For the support: This $400 revenue must be recognised over the next two years, as I am satisfying the performance obligation over that time by providing the support.

Exam tip: check the dates of the contract carefully.

If the sale was made on 1 December 20X7, and my year end is 31 December 20X7, I would only be entitled to recognise 1 month of the 24 months of revenue in 20X7:

$400 x 1/24 = $17

I could recognise 12 months of revenue in 20X8:

$400 x 12/24 = $200

And the remaining 11 months of revenue would fall in 20X9:

$400 x 11/24 = $183

Where?

The final question is: where should the double entry sit in the financial statements? As this was a sale in a shop, let's assume it was a cash sale, we would increase the bank figure.

When the sale is made, the revenue for the computer must be recognised, as must the one month of support in 20X7.

The missing figure must be held as a credit on the Statement of Financial Position and released over the next two years; which means everything to be released in 20X8 is a current liability, and the revenue to release in 20X9 is non-current.

	$	$
Dr Bank	1,200	
Cr Revenue – Computer		800
Cr Revenue – Support		17
Cr Deferred income – CL		200
Cr Deferred income – NCL		183

In 20X8, a year of support revenue would be released to the profit or loss and the Deferred Income for 20X9 would become a Current Liability:

	$	$
Dr Deferred income – CL	200	
Cr Revenue – Support		200
Dr Deferred income – NCL	183	
Cr Deferred income – CL		183

And, finally, in 20X9, the last of the revenue would be released to the profit or loss:

	$	$
Dr Deferred income – CL	183	
Cr Revenue – Support		183

Now the computer and all the support has been recognised as revenue, albeit at different times.

Conclusion

To some businesses, the new IFRS 15 will have little impact on their revenue recognition, to others it will have a significant impact, but it will undoubtedly be important for the F3 and F7 exams. PQ

• Cat Hill is the F7 tutor at AVADO