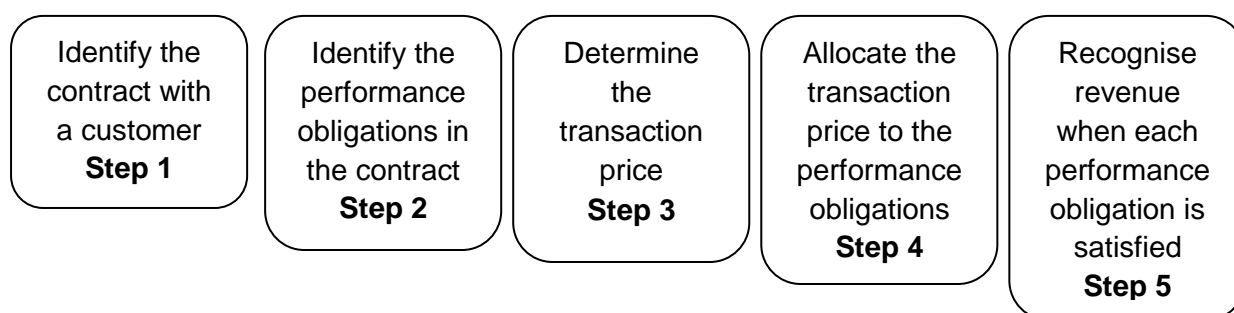


## **IFRS 15 – Revenue from Contracts with Customers**

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**Examiner: Formation 2 Financial Accounting**

The objective of this Standard is to establish the principles that an entity shall apply to report useful information to users of financial statements about the nature, amount, timing and uncertainty of *revenue* and *cash flows* arising from a *contract* with a *customer*.

The core principle of IFRS 15 is that an entity recognises revenue to depict the transfer of promised goods or services to customers in an amount that reflects the consideration to which the entity expects to be entitled to in exchange for those goods or services. An entity recognises revenue in accordance with that core principle by applying the following five steps.



### **Step 1: Identify the contract(s) with a customer**

A contract is an agreement between two or more parties that creates enforceable rights and obligations. A legally enforceable contract (be it in writing, oral or implied) must meet all of the following requirements:

- a) The parties to the contract have approved the contract and are committed to perform their respective obligations;
- b) The entity can identify each party's rights regarding the goods or services to be transferred;
- c) The entity can identify the payment terms for the goods or services;
- d) The contract has commercial substance i.e. the risk, timing or amount of the entity's future cash flows is expected to change as a result of the contract; and
- e) It is probable that the entity will collect the consideration to which it will be entitled in exchange for the goods or services that will be transferred to the customer.

A contract does not exist if each party to the contract has the unilateral enforceable right to terminate a wholly unperformed contract without compensating the other party. A contract is wholly unperformed if both of the following criteria are met:

- i) The entity has not yet transferred any promised goods or services to the customer; and
- ii) The entity has not yet received and is not yet entitled to receive any consideration in exchange for promised goods or services.

An entity shall recognise the consideration received as a liability unless points a) to e) are fulfilled or the contract has been terminated and the consideration received from the customer is non-refundable. Depending on the facts and circumstances relating to the contract, the liability recognised represents the entity's obligation to either transfer goods or services in the future or refund the consideration received. In either case, the liability shall be measured at the amount of consideration received from the customer.

A key part of considering whether a contract is valid is reviewing the extent to which the customer has the intention and ability to pay the agreed consideration. It is possible that the consideration amount will be less than the agreed amount because the seller expects to offer a price discount. In these cases, the assessment of the customer's ability and intention to pay is made against the lower amount.

**Example:**

*T Limited sells 2,000 units of its new product to a customer at €100 per unit. The customer is in a country that is enduring significant economic difficulty and as a result of that T Limited expects to receive only 60% of the agreed price. T Limited expects to meet the other four criteria re revenue as per IFRS 15.*

**Solution**

*T Limited should recognise revenue of €120,000 i.e. 2,000 units x €100 x 60% as it is probable that this amount will be collected taking into account the factors presented in the example.*

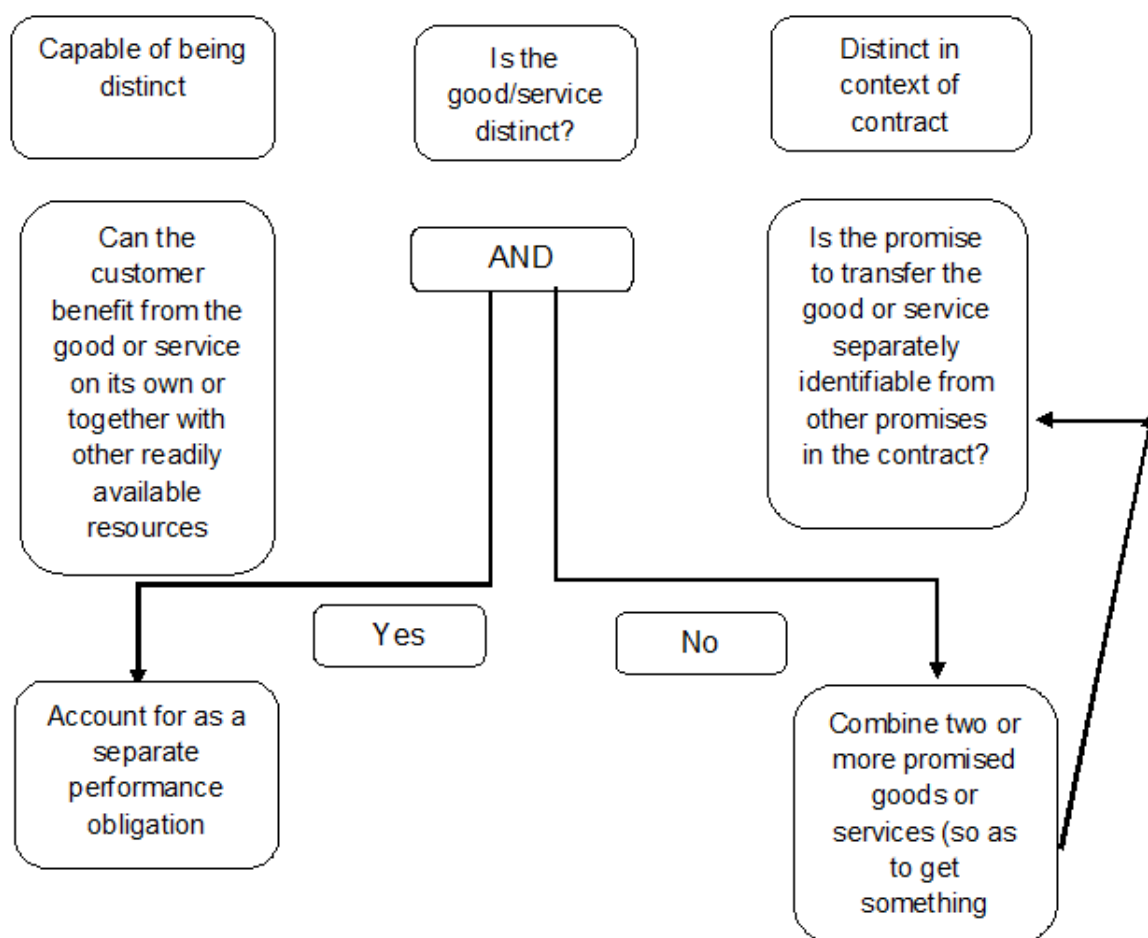
**Step 2: Identify the performance obligations in the contract**

A contract includes promises to transfer goods or services to a customer. If these goods or services are distinct, the promises are performance obligations and are accounted for separately.

A good or service is distinct if:

- a) The customer can benefit from the good or service on its own or together with other resources that are readily available to the customer; and
- b) The entity's promise to transfer the good or service to the customer is separately identifiable from other promises in the contract. Factors that indicate that an entity's promise to transfer a good or service to a customer is separately identifiable include, but are not limited to, the following:
  - a) The entity does not provide a significant service of integrating the good or service with other goods or services promised in the contract into a bundle of goods or services that represent the combined output for which the customer has contracted. In other words, the entity is not using the good or service as an input to produce or deliver the combined output specified by the customer.

- b) The good or service does not significantly modify or customise another good or service promised in the contract



- c) The good or service is not highly dependent on, or highly interrelated with, other goods or services promised in the contract. For example, the fact that a customer could decide to not purchase the good or service without significantly affecting the other promised goods or services in the contract might indicate that the good or service is not highly dependent on, or highly interrelated with, those other promised goods or services.

If a promised good or service is not distinct, an entity shall combine that good or service with other promised goods or services until it identifies a bundle of goods or services that is distinct. In some cases, that would result in the entity accounting for all the goods or services promised in a contract as a single performance obligation.

Paragraph 31 of IFRS 15 states that an entity shall recognise revenue when (or as) the entity satisfies a performance obligation by transferring a promised good or service (i.e. an asset) to a customer. An asset is transferred when (or as) the customer obtains control of that asset. When evaluating whether a customer obtains control of an asset, an entity shall consider any agreement to repurchase the asset.

An entity transfers control of a good or service over time and, therefore, satisfies a performance obligation and recognises revenue over time, if one of the following criteria is met.

- a) The customer simultaneously receives and consumes the benefits provided by the entity's performance as the entity performs
- b) The entity's performance creates or enhances an asset (for example, work in progress) that the customer controls as the asset is created or enhanced; or
- c) 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.

The assessment of whether an asset has an alternative use to the entity is made at contract inception. After contract inception, an entity shall not update the assessment of the alternative use of an asset unless the parties to the contract approve a contract modification that substantively changes the performance obligation.

An entity shall consider the terms of the contract, as well as any laws that apply to the contract, when evaluating whether it has an enforceable right to payment for performance completed to date in accordance with c) above. The right to payment for performance completed to date does not need to be for a fixed amount. However, at all times throughout the duration of the contract, the entity must be entitled to an amount that at least compensates the entity for performance completed to date if the contract is terminated by the customer or another party for reasons other than the entity's failure to perform as promised. If a performance obligation is not satisfied over time in accordance with the above paragraphs, an entity satisfies the performance obligation at a point in time.

In addition, an entity shall consider indicators of the transfer of control, which include, but are not limited to, the following;

- a) The entity has a present right to payment for the asset—if a customer is presently obliged to pay for an asset, then that may indicate that the customer has obtained the ability to direct the use of, and obtain substantially all of the remaining benefits from, the asset in exchange
- b) The customer has legal title to the asset—legal title may indicate which party to a contract has the ability to direct the use of, and obtain substantially all of the remaining benefits from, an asset or to restrict the access of other entities to those benefits. Therefore, the transfer of legal title of an asset may indicate that the customer has obtained control of the asset. If an entity retains legal title solely as protection against the customer's failure to pay, those rights of the entity would not preclude the customer from obtaining control of an asset.
- c) The entity has transferred physical possession of the asset—the customer's physical possession of an asset may indicate that the customer has the ability to direct the use of, and obtain substantially all of the remaining benefits from, the asset or to restrict the access of other entities to those benefits. However, physical possession may not coincide with control of an asset.
- d) The customer has the significant risks and rewards of ownership of the asset—the transfer of the significant risks and rewards of ownership of an asset to the customer may indicate that the customer has obtained the ability to direct the use of, and obtain substantially all of the remaining benefits from, the asset.
- e) The customer has accepted the asset—the customer's acceptance of an asset may indicate that it has obtained the ability to direct the use of, and obtain substantially all of the remaining benefits from, the asset.

For each performance obligation satisfied over time an entity shall recognise revenue over time by measuring the progress towards complete satisfaction of that performance obligation. The objective when measuring progress is to depict an entity's performance in transferring control of goods or services promised to a customer (i.e. the satisfaction of an entity's performance obligation).

An entity shall recognise revenue for a performance obligation satisfied over time only if the entity can reasonably measure its progress towards complete satisfaction of the performance obligation.

**Example – Determining whether goods or services are distinct**

*R Limited enters a contract with a customer to supply a licence for a standard software product. R Limited will also install the software, provide updates to the software and technical support for a number of years. R Limited sees the licence and technical support separately, the software will continue to operate without the software updates and R Limited subcontract the installation of the software to a number of approved installers throughout the country.*

**Solution**

*Given the above information, the customer can benefit from each of the goods or services either on their own or altogether. The promises to transfer goods or services are separately identifiable. Consequently there are a number of distinct good or services identified i.e. software licence, installation service, software updates and technical support.*

**Example**

*A similar scenario to the previous example except that as part of the installation service, the software can be substantially customised to suit the customers' requirements. The customised installation service can be provided by a number of unconnected sellers.*

**Solution**

*IFRS 15 indicates that within the context of its contract with the customer, the promise to transfer the license is not separately identifiable from the customised installation service and therefore, the following distinct goods or services are identified i.e. software licence and customised installation service, software updates and technical support.*

**Step 3: Determine the transaction price**

When (or as) a performance obligation is satisfied, an entity shall recognise as revenue the amount of the transaction price that is allocated to that performance obligation.

The transaction price is the amount of consideration in a contract 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 (for example, some sales taxes). The consideration promised in a contract with a customer may include *fixed amounts, variable amounts, or both or consideration in a form other than cash.*

The nature, timing and amount of consideration promised by a customer affect the estimate of the transaction price. For the purpose of determining the transaction price, an entity shall assume that the goods or services will be transferred to the customer as promised in accordance with the existing contract and that the contract will not be cancelled, renewed or modified.

If the consideration promised in a contract includes a variable amount, an entity shall estimate the amount of consideration to which the entity will be entitled in exchange for transferring the promised goods or services to a customer. An amount of consideration can vary because of discounts, rebates, refunds, credits, price concessions, incentives, performance bonuses, penalties or other similar items. The promised consideration can also vary if an entity's entitlement to the consideration is contingent on the occurrence or non-occurrence of a future event. For example, an amount of consideration would be variable if either a product was sold with a right of return or a fixed amount is promised as a performance bonus on achievement of a specified milestone

**Example: Volume Discount**

*S Limited enters into a contract with a customer to see its product for €200 per unit for the year 01.01.17 – 31.12.17. If the customer purchases more than 1,200 units in the year, the price will decrease to €150 per unit. S Limited does not believe at the date of the contract be initiated that the customer will purchase more than 1,200 from it due to past trading patterns with this customer. On 01.10.17, S Limited believes that the customer will meet the target based on its sales of 1,100 units by that date to the customer as the customer purchased 500 units on that date and informed management of S Limited that it would be placing a further order of 200 units on 1 December 2017. 600 units were sold to the customer by the 30.06.17.*

*How should S Limited account for its sales to the customer in the period from 01.01.17 – 30.06.17 and in the period 01.07.17 – 31.12.17?*

**Solution**

*Period 01.01.17 – 30.06.17*

*As S Limited does not believe that the customer will hit the target, it should account for the sales using a sales price per unit of €200 i.e. sales of 600 units x €200 per unit = €120,000 as follows:*

Dr.	Trade Receivables	€120,000	
Cr.	Revenue		€120,000.

*Period 01.07.17 – 30.12.17*

*On the basis that S Limited believes that the customer will reach its target its accounts for its transactions with the customer as follows:*

*Order of 500 units x €150 = €75,000*

Dr.	Trade Receivables	€75,000	
Cr.	Revenue		€75,000.

*Order of 200 units x €150 = €30,000*

Dr.	Trade Receivables	€30,000	
Cr.	Revenue		€30,000.

*Recalculating the sales value of the original 600 units sold in the first six months at €150 per unit instead of €200 per unit i.e. €50 selling price per unit of a difference i.e. 600 units x €50 per unit difference = €12,000 as follows:*

Dr.	Revenue	€12,000	
Cr.	Trade Receivables		€12,000.

An entity shall estimate an amount of variable consideration by using either of the following methods, depending on which method the entity expects to better predict the amount of consideration to which it will be entitled:

- a) The expected value — the expected value is the sum of probability-weighted amounts in a range of possible consideration amounts. An expected value may be an appropriate estimate of the amount of variable consideration if an entity has a large number of contracts with similar characteristics.
- b) The most likely amount — the most likely amount is the single most likely amount in a range of possible consideration amounts (i.e. the single most likely outcome of the contract). The most likely amount may be an appropriate estimate of the amount of

variable consideration if the contract has only two possible outcomes (for example, an entity either achieves a performance bonus or does not).

**Example: Variable Consideration – Expected Value and Most Likely Amount Method**

*U Limited enters into a contract to manufacture some equipment at a selling price of €500,000 and to sell it to the customer by 1 June. If the delivery of the equipment is late, U Limited will reduce the selling price by €2,000 per day.*

*U Limited enters into a contract to manufacture some equipment at a selling price of €800,000 and to sell it to the customer by 1 June. If the delivery of the equipment is late, U Limited will incur a penalty of €50,000.*

**Solution**

*In determining the selling price, U Limited considers the approach that will better predict the amount of consideration that it will ultimately be entitled to and determines that the expected value method is the most appropriate approach because there is a range of possible outcomes.*

In determining the selling price, U Limited considers the approach that will better predict the amount of consideration that it will ultimately be entitled to and determines that the most likely amount is the most appropriate approach because there are only two possible outcomes – either the penalty will be applied or not.

The transaction price is also adjusted for the effects of the time value of money if the contract includes a significant financing component and for any consideration payable to the customer. The objective when adjusting the promised amount of consideration for a significant financing component 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 (i.e. the cash selling price).

As a practical expedient, an entity need not adjust the promised amount of consideration for the effects of a significant financing component if the entity expects, at contract inception, that the period between when the entity transfers a promised good or service to a customer and when the customer pays for that good or service will be one year or less.

An entity shall present the effects of financing (interest revenue or interest expense) separately from revenue from contracts with customers in the statement of comprehensive income. Interest revenue or interest expense is recognised only to the extent that a *contract asset* (or receivable) or a contract liability is recognised in accounting for a contract with a customer.

To determine the transaction price for contracts in which a customer promises consideration in a form other than cash, an entity shall measure the non-cash consideration (or promise of non-cash consideration) at fair value.

If an entity cannot reasonably estimate the fair value of the non-cash consideration, the entity shall measure the consideration indirectly by reference to the stand-alone selling price of the goods or services promised to the customer (or class of customer) in exchange for the consideration.

If a customer contributes goods or services (for example, materials, equipment or labour) to facilitate an entity's fulfilment of the contract, the entity shall assess whether it obtains control of those contributed goods or services. If so, the entity shall account for the contributed goods or services as non-cash consideration received from the customer.

Consideration payable to a customer may also include credit or other items (for example, a coupon or voucher) that can be applied against amounts owed to the entity (or to other parties that purchase the entity's goods or services from the customer). An entity shall account for consideration payable to a customer as a reduction of the transaction price and, therefore, of revenue unless the payment to the customer is in exchange for a distinct good or service that the customer transfers to the entity. If the consideration is variable, an entity estimates the amount of consideration to which it will be entitled in exchange for the promised goods or services.

**Step 4:        Allocate the transaction price to the performance obligations in the contract.**

An entity typically allocates the transaction price to each performance obligation on the basis of the relative stand-alone selling prices of each distinct good or service promised in the contract in exchange for transferring the promised goods or services to the customer.

To meet the allocation objective, an entity shall allocate the transaction price to each performance obligation identified in the contract on a relative stand-alone selling price basis. This is achieved by an entity determining the stand-alone selling price at contract inception of the distinct good or service underlying each performance obligation in the contract and allocate the transaction price in proportion to those stand-alone selling prices.

The stand-alone selling price is the price at which an entity would sell a promised good or service separately to a customer. A contractually stated price or a list price for a good or service may be (but shall not be presumed to be) the stand-alone selling price of that good or service.

If a stand-alone selling price is not directly observable, an entity shall estimate the stand-alone selling price at an amount that would result in the allocation of the transaction price meeting the allocation objective above.

Suitable methods for estimating the stand-alone selling price of a good or service include, but are not limited to, the following:

- a) Adjusted market assessment approach — an entity could evaluate the market in which it sells goods or services and estimate the price that a customer in that market would be willing to pay for those goods or services. That approach might also include referring to prices from the entity's competitors for similar goods or services and adjusting those prices as necessary to reflect the entity's costs and margins.
- b) Expected cost plus a margin approach — an entity could forecast its expected costs of satisfying a performance obligation and then add an appropriate margin for that good or service.
- c) Residual approach — an entity may estimate the stand-alone selling price by reference to the total transaction price less the sum of the observable stand-alone selling prices of other goods or services promised in the contract. However, an entity may use a residual approach to estimate, the stand-alone selling price of a good or service only if one of the following criteria is met:



- i) The entity sells the same good or service to different customers (at or near the same time) for a broad range of amounts (i.e. the selling price is highly variable because a representative stand-alone selling price is not discernible from past transactions or other observable evidence); or
- ii) The entity has not yet established a price for that good or service and the good or service has not previously been sold on a stand-alone basis (i.e. the selling price is uncertain).

A combination of methods may need to be used to estimate the stand-alone selling prices of the goods or services promised in the contract, the entity shall evaluate whether allocating the transaction price at those estimated stand-alone selling prices would be consistent with the allocation objective and the requirements for estimating stand-alone selling prices.

**Example: Allocating the Transaction Price**

*A retailer sells a customer a package consisting of a computer and a printer for €700. The retailer realises that there are two separate performance obligations involved. It regularly sells the computer for €500 and the printer for €300.*

*Determine how the retailer will allocate the total transaction price across the computer and printer?*

**Solution**

*The transaction price of €700 will be allocated across the computer and printer as follows:*

*Computer:  $€700 \times €500/€800 = €437.50$*

*Printer:  $€700 \times €300/€800 = €262.50$*

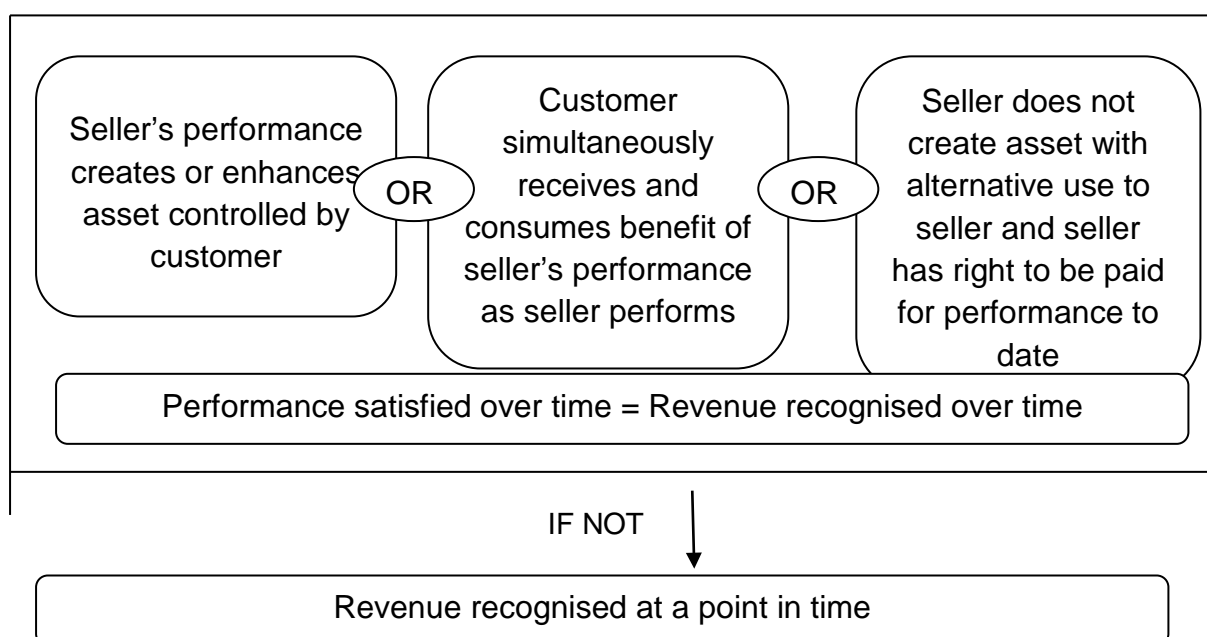
*In this transaction, there is an inherent discount of €100 which does not relate to a specific performance obligation and is therefore, allocated to all performance obligations on a stand-alone selling price basis.*

A customer receives a discount for purchasing a bundle of goods or services if the sum of the stand-alone selling prices of those promised goods or services in the contract exceeds the promised consideration in a contract. Except when an entity has observable evidence that the entire discount relates to only one or more, but not all, performance obligations in a contract, the entity shall allocate a discount proportionately to all performance obligations in the contract.

Variable consideration and changes in transaction prices are allocated to all performance obligations unless two criteria are both met.

**Step 5: Recognise revenue when (or as) the entity satisfies a performance obligation.**

An entity recognises revenue when (or as) it satisfies a performance obligation by transferring a promised good or service to a customer (which is when the customer obtains control of that good or service). The amount of revenue recognised is the amount allocated to the satisfied performance obligation. A performance obligation may be satisfied at a point in time (typically for promises to transfer goods to a customer) or over time (typically for promises to transfer services to a customer). For performance obligations satisfied over time, an entity recognises revenue over time by selecting an appropriate method for measuring the entity's progress towards complete satisfaction of that performance obligation.



Revenue recognised at a point in time

Indicators that control transfers include:

- a) Present right to payment
- b) Legal title of goods and services
- c) Transferred physical possession
- d) Significant risks and rewards of ownership; and
- e) The customer has accepted the asset.

**Contract Costs**

An entity shall recognise as an asset the incremental costs of obtaining a contract with a customer if the entity expects to recover those costs.

The incremental costs of obtaining a contract are those costs that an entity incurs to obtain a contract with a customer that it would not have incurred if the contract had not been obtained

(for example, a sales commission). Costs to obtain a contract that would have been incurred regardless of whether the contract was obtained shall be recognised as an expense when incurred, unless those costs are explicitly chargeable to the customer regardless of whether the contract is obtained. As a practical expedient, an entity may recognise the incremental costs of obtaining a contract as an expense when incurred if the amortisation period of the asset that the entity otherwise would have recognised is one year or less.

If the costs incurred in fulfilling a contract with a customer are not within the scope of another standard (for example, IAS 2 *Inventories*, IAS 16 *Property, Plant and Equipment* or IAS 38 *Intangible Assets*), an entity shall recognise an asset from the costs incurred to fulfil a contract only if those costs meet all of the following criteria:

- a) The costs relate directly to a contract or to an anticipated contract that the entity can specifically identify (for example, costs relating to services to be provided under renewal of an existing contract or costs of designing an asset to be transferred under a specific contract that has not yet been approved);
- b) The costs generate or enhance resources of the entity that will be used in satisfying (or in continuing to satisfy) performance obligations in the future; and
- c) The costs are expected to be recovered.

Costs that relate directly to a contract (or a specific anticipated contract) include any of the following:

- a) Direct labour (for example, salaries and wages of employees who provide the promised services directly to the customer);
- b) Direct materials (for example, supplies used in providing the promised services to a customer);
- c) Allocations of costs that relate directly to the contract or to contract activities (for example, costs of contract management and supervision, insurance and depreciation of tools and equipment used in fulfilling the contract);
- d) Costs that are explicitly chargeable to the customer under the contract; and
- e) Other costs that are incurred only because an entity entered into the contract (for example, payments to subcontractors).

An entity shall recognise the following costs as expenses when incurred:

- a) General and administrative costs (unless those costs are explicitly chargeable to the customer under the contract, in which case an entity shall evaluate those costs in accordance with the previous point.
- b) Costs of wasted materials, labour or other resources to fulfil the contract that were not reflected in the price of the contract;
- c) Costs that relate to satisfied performance obligations (or partially satisfied performance obligations) in the contract (i.e. costs that relate to past performance); and
- d) Costs for which an entity cannot distinguish whether the costs relate to unsatisfied performance obligations or to satisfied performance obligations (or partially satisfied performance obligations).

An asset recognised in accordance with the above shall be amortised on a systematic basis that is consistent with the transfer to the customer of the goods or services to which the asset relates.

When either party to a contract has performed, an entity shall present the contract in the statement of financial position as a contract asset or a contract liability, depending on the relationship between the entity's performance and the customer's payment. An entity shall present any unconditional rights to consideration separately as a receivable.

If a customer pays consideration, or an entity has a right to an amount of consideration that is unconditional (i.e. a receivable), before the entity transfers a good or service to the customer, the entity shall present the contract as a contract liability when the payment is made or the payment is due (whichever is earlier). A contract liability is an entity's obligation to transfer goods or services to a customer for which the entity has received consideration (or an amount of consideration is due) from the customer.

If an entity performs by transferring goods or services to a customer before the customer pays consideration or before payment is due, the entity shall present the contract as a contract asset, excluding any amounts presented as a receivable. A contract asset is an entity's right to consideration in exchange for goods or services that the entity has transferred to a customer. An entity shall assess a contract asset for impairment in accordance with IFRS 9.

A receivable is an entity's right to consideration that is unconditional. A right to consideration is unconditional if only the passage of time is required before payment of that consideration is due. For example, an entity would recognise a receivable if it has a present right to payment even though that amount may be subject to refund in the future. An entity shall account for a receivable in accordance with IFRS 9.

## **Disclosure**

The objective of the disclosure requirements is for an entity to disclose sufficient information to enable users of financial statements to understand the nature, amount, timing and uncertainty of revenue and cash flows arising from contracts with customers. To achieve that objective, an entity shall disclose qualitative and quantitative information about all of the following:

- a) Its contracts with customers
- b) The significant judgements, and changes in the judgements, made in applying this Standard to those contracts; and
- c) Any assets recognised from the costs to obtain or fulfil a contract with a customer in accordance with

An entity shall consider the level of detail necessary to satisfy the disclosure objective and how much emphasis to place on each of the various requirements. An entity shall aggregate or disaggregate disclosures so that useful information is not obscured by either the inclusion of a large amount of insignificant detail or the aggregation of items that have substantially different characteristics. An entity need not disclose information in accordance with this standard if it has provided the information in accordance with another standard.

Items that need to be disclosed include under the following headings;

- a) Contracts with customers;
- b) Disaggregation of revenue;
- c) Contract balances;
- d) Performance obligations;
- e) Transaction price allocated to the remaining performance obligations;
- f) Significant judgements in the application of this standard;
- g) Determining the timing of satisfaction of performance obligations;
- h) Determining the transaction price and the amounts allocated to performance obligations'
- i) Assets recognised from the costs to obtain or fulfil a contract with a customer; and
- j) Practical expedients.