



**IFRS AT A GLANCE**  
**IFRS 15 *Revenue from Contracts with Customers***



# IFRS 15 Revenue from Contracts with Customers

SCOPE	DEFINITIONS			
<p>Applies to all contracts with customers, except:</p> <ul style="list-style-type: none"> <li>▶ Lease contracts (refer to IFRS 16)</li> <li>▶ Insurance contracts (refer to IFRS 4 / IFRS 17)</li> <li>▶ Financial instruments and other contractual rights or obligations (refer to IFRS 9/IAS 39, IFRS 10, IFRS 11, IAS 27, and IAS 28)</li> <li>▶ Certain non-monetary exchanges.</li> </ul>	<p><b>Contract:</b> An agreement between two or more parties that creates enforceable rights and obligations.</p>	<p><b>Revenue:</b> Income arising in the course of an entity's ordinary activities.</p>	<p><b>Distinct:</b> Refer to Step 2 below.</p>	<p><b>Performance obligation:</b> A promise to transfer to the customer either:</p> <p>(i) A <b>distinct</b> (bundle of) good(s) or service(s)</p>
	<p><b>Customer:</b> 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.</p>	<p><b>Income:</b> Increases in economic benefits in the form of inflows or enhancements of assets or decreases of liabilities that result in an increase in equity (other than those from equity participants).</p>	<p><b>Stand-alone selling price:</b> The price at which a promised good or service would be sold separately to a customer.</p>	<p>(ii) A series of substantially the same <b>distinct</b> goods or services that have the same pattern of transfer to the customer, and the pattern of transfer is both over time and represents the progress towards complete satisfaction of the performance obligation.</p>

## THE 'FIVE STEP' MODEL

Revenue from contracts with customers is recognised based on the application of a principle-based 'five step' model:





# IFRS 15 Revenue from Contracts with Customers

## STEP 1 - IDENTIFY THE CONTRACT

### Features of a 'contract' under IFRS 15

Contracts, and approval of contracts, can be written, oral or implied by an entity's customary business practices.

IFRS 15 requires contracts to have **all** of the following attributes:

- ▶ The contract has been approved
- ▶ The rights and payment terms regarding goods and services to be transferred can be identified
- ▶ The contract has commercial substance
- ▶ It is probable that the consideration will be received (considering only the customer's ability and intention to pay).

If each party to the contract has a unilateral enforceable right to terminate a wholly unperformed contract without compensating the other party (or parties), no contract exists under IFRS 15.

### Combining multiple contracts

Contracts are combined if they are entered into at (or near) the same time, with the same customer, if either:

- ▶ The contracts are negotiated as a package with a single commercial objective
- ▶ The consideration for each contract is interdependent on the other, or
- ▶ The overall goods or services of the contracts represent a single performance obligation.

### Contract modifications

A change in enforceable rights and obligations (i.e. scope and/or price) is only accounted for as a contract modification if it has been approved, and creates new or changes existing enforceable rights and obligations.

Contract modifications are accounted for as a separate contract if, and only if:

- ▶ The contract scope changes due to the addition of **distinct** goods or services, and
- ▶ The change in contract price reflects the standalone selling price of the **distinct** good or service.

Contract modifications that are not accounted for as a separate contract are accounted for as either:

- (i) *Replacement of the original contract with a new contract* (if the remaining goods or services under the original contract are **distinct** from those already transferred to the customer)
- (ii) *Continuation of the original contract* (if the remaining goods or services under the original contract are **not distinct** from those already transferred to the customer, and the performance obligation is partially satisfied at modification date).
- (iii) *Mixture of (i) and (ii)* (if elements of both exist).



# IFRS 15 Revenue from Contracts with Customers

## STEP 2 - IDENTIFY THE PERFORMANCE OBLIGATIONS

### DEFINITION OF 'DISTINCT' (TWO CRITERIA TO BE MET)

Performance obligations are the contractual promise by an entity, to transfer to a customer, **distinct** goods or services, either individually, in a bundle, or as a series over time (Refer to the 'Definitions' section above).

Activities of the entity that do not result in a transfer of goods or services to the customer (e.g. certain internal administrative 'set-up activities') are **not** performance obligations of the contract with the customer and do not give rise to revenue.

#### (i) The customer can 'benefit' from the good or service

Benefit from the good or service can be through either:

- ▶ Use, consumption, or sale (but not as scrap)
- ▶ Held in a way to generate economic benefits.

Benefit from the good or service can be either:

- ▶ On its own
- ▶ Together with other readily available resources (i.e. those which can be acquired by the customer from the entity or other parties).

#### (ii) The promise to transfer a good or service is separable from other promises in the contract

The assessment requires judgement, and consideration of all relevant facts and circumstances.

A good or service may **not be separable** from other promised goods or services in the contract, if:

- ▶ There are significant integration services with other promised goods or services
- ▶ It modifies/customises other promised goods or services
- ▶ It is highly dependent/interrelated with other promised goods or services.





# IFRS 15 Revenue from Contracts with Customers

## STEP 3 - DETERMINE THE TRANSACTION PRICE

The transaction price is the amount of consideration an entity expects to be entitled to in exchange for transferring the promised goods or services (not amounts collected on behalf of third parties, e.g. sales taxes or value added taxes).

The transaction price may be affected by the nature, timing, and amount of consideration, and includes consideration of significant financing components, variable components, amounts payable to the customer (e.g. refunds and rebates), and non-cash amounts.

### Accounting for a significant financing component

If the timing of payments specified in the contract provides either the customer or the entity with a significant benefit of financing the transfer of goods or services.

The transaction price is adjusted to reflect the cash selling price at the point in time control of the goods or services is transferred.

A significant financing component can either be explicit or implicit.

Factors to consider include:

- ▶ Difference between the consideration and cash selling price
- ▶ Combined effect of interest rates in the relevant market and length of time between transfer of control of the goods or services and payment.

A significant financing component does not exist when

- ▶ The customer paid in advance and timing of the transfer of control of the goods or services is at the customer's discretion
- ▶ The consideration is variable with the amount or timing based on factors outside of the control of the parties
- ▶ The difference between the consideration and cash selling price arises for other non-financing reasons (i.e. performance protection).

### Discount rate to be used

- ▶ Must reflect credit characteristics of the party receiving the financing and any collateral/security provided.

### Practical expedient - period between transfer and payment is 12 months or less

- ▶ Do not account for any significant financing component.

### Accounting for variable consideration

E.g. Discounts, rebates, refunds, credits, concessions, incentives, performance bonuses, penalties, and contingent payments.

Variable consideration must be estimated using either:

- (i) **Expected value method:** based on probability weighted amounts within a range (i.e. for large number of similar contracts)
- (ii) **Single most likely amount:** the amount within a range that is most likely to arise.

### Constraining (limiting) the estimates of variable consideration

- ▶ Variable consideration is only recognised if it is highly probable that a subsequent change in its estimate would not result in a significant revenue reversal (i.e. a significant reduction in cumulative revenue recognised).

### Accounting for consideration payable to the customer

Includes cash paid (or expected to be paid) to the customer (or the customer's customers) as well as credits or other items such as coupons and vouchers.

Accounted for as a reduction in the transaction price, unless payment is in exchange for a good or service received from the customer in which case no adjustment is made - except where:

- ▶ The consideration paid exceeds the fair value of the goods or services received (the difference is set against the transaction price)
- ▶ The fair value of the goods or services cannot be reliably determined (full amount taken against the transaction price).

### Accounting for non-cash consideration

Is accounted for at fair value (if not reliably determinable, it is measured indirectly by reference to stand-alone selling price of the goods or services).



# IFRS 15 Revenue from Contracts with Customers

## STEP 4 - ALLOCATE THE TRANSACTION PRICE TO EACH PERFORMANCE OBLIGATION

The transaction price (determined in **Step 3**) is allocated to each performance obligation (determined in **Step 2**) based on the *stand-alone selling price* of each performance obligation.

If the *stand-alone selling price(s)* are not observable, they are estimated. Approaches to estimate may include:

- (i) **Adjusted market assessment approach**
- (ii) **Expected cost plus a margin approach**
- (iii) **Residual approach** (i.e. residual after observable stand-alone selling prices of other performance obligations have been deducted).

Note that restrictive criteria must be met for approach (iii) to be applied.

### Allocating a 'discount'

A discount exists where the sum of the stand-alone selling price of each performance obligation exceeds the consideration payable.

Discounts are allocated on a proportionate basis, unless there is observable evidence that the discount relates to one or more specific performance obligation(s) after meeting all of the following criteria:

- ▶ The goods or services (or bundle thereof) in the performance obligation are regularly sold on a stand-alone basis, and at a discount
- ▶ The discount is substantially the same in amount to the discount that would be given on a stand-alone basis.

### Allocating variable consideration

Variable consideration is allocated entirely to a performance obligation (or a **distinct** good or service within a performance obligation), if both:

- ▶ The terms of the variable consideration relate specifically to satisfying the performance obligation (or transferring the **distinct** good or service within the performance obligation)
- ▶ The allocation of the variable consideration is consistent with the principle that the transaction price is allocated based on what the entity expects to receive for satisfying the performance obligation (or transferring the **distinct** good or service within the performance obligation).





# IFRS 15 Revenue from Contracts with Customers

## STEP 5 - RECOGNISE REVENUE AS EACH PERFORMANCE OBLIGATION IS SATISFIED

The transaction price allocated to each performance obligation (determined in Step 4) is recognised as/when the performance obligation is satisfied, either

(i) **Over time**, or

(ii) At a **point in time**.

Satisfaction occurs when **control** of the promised good or service is transferred to the customer:

- ▶ Ability to direct the use of the asset
- ▶ Ability to obtain substantially all the remaining benefits from the asset.

Factors to consider when assessing transfer of **control**:

- ▶ Entity has present right to payment for the asset
- ▶ Entity has physically transferred the asset
- ▶ Legal title of the asset
- ▶ Risks and rewards of ownership
- ▶ Acceptance of the asset by the customer.

### (i) RECOGNISING REVENUE OVER TIME (APPLIES IF ANY OF THE FOLLOWING THREE CRITERIA ARE MET)

**(a) Customer simultaneously receives and consumes all of the benefits**

e.g. many recurring service contracts (such as cleaning services).

If another entity would not need to substantially re-perform the work already performed by the entity in order to satisfy the performance obligation, the customer is considered to be simultaneously receiving and consuming benefits.

**(b) The entity's work creates or enhances an asset controlled by the customer**

The asset being created or enhanced (e.g. a work in progress asset) could be tangible or intangible.

**(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.**

*(i) Alternate use*

Assessment requires judgment and consideration of all facts and circumstances.

An asset does not have an alternate use if the entity cannot *practically or contractually* redirect the asset to another customer, such as:

- ▶ Significant economic loss, i.e. through rework, or reduced sale price (*practical*)
- ▶ Enforceable rights held by the customer to prohibit redirection of the asset (*contractual*).

Whether or not the asset is largely interchangeable with other assets produced by the entity should also be considered in determining whether practical or contractual limitations occur.

*(ii) Enforceable right to payment*

Consider both the specific contractual terms and any applicable laws or regulations. Ultimately, other than due to its own failure to perform as promised, an entity must be entitled to compensation that approximates the selling price of the goods or services transferred to date.

The profit margin does not need to equal the profit margin expected if the contract was fulfilled as promised. For example, it could be a proportion of the expected profit margin that reflects performance to date.

Revenue that is recognised **over time** is recognised in a way that depicts the entity's performance in transferring control of goods or services to customers. Methods include:

- ▶ Output methods: (e.g. Surveys of performance completed to date, appraisals of results achieved, milestones reached, units produced/delivered etc.)
- ▶ Input methods: (e.g. Resources consumed, labour hours, costs incurred, time lapsed, machine hours etc.), excluding costs that do not represent the seller's performance.

### (ii) RECOGNISING REVENUE AT A POINT IN TIME

Revenue is recognised at a **point in time** if the criteria for recognising revenue **over time** are not met.

Revenue is recognised at the point in time at which the entity transfers control of the asset to the customer (see adjacent box).



# IFRS 15 Revenue from Contracts with Customers

## APPLICATION GUIDANCE WITHIN IFRS 15

IFRS 15 contains application guidance for:

- ▶ **Contract costs**
- ▶ Sale with a right of return
- ▶ **Warranties**
- ▶ Principal versus agent considerations
- ▶ Customer options for additional goods or services
- ▶ Customers' unexercised rights
- ▶ **Non-refundable upfront fees (and some related costs)**
- ▶ **Licensing**
- ▶ Repurchase agreements
- ▶ Consignment arrangements
- ▶ Bill-and-hold arrangements
- ▶ Customer acceptance.

A summary is set out on this page for those items in bold type above.

### Contract costs

Only incremental costs of obtaining a contract that are incremental and expected to be recovered can be recognised as an asset.

If costs to fulfil a contract are within the scope of other IFRSs (e.g. IAS 2, IAS 16, IAS 38 etc.) apply those IFRSs.

If not, a contract asset is recognised under IFRS 15 if, and only if, the costs:

- ▶ Are specifically identifiable and directly relate to the contract (e.g. direct labour, materials, overhead allocations, explicitly on-charged costs, other unavoidable costs (e.g. sub-contractors))
- ▶ Create (or enhance) resources of the entity that will be used to satisfy performance obligation(s) in the future, and
- ▶ Are expected to be recovered.

*Costs that are recognised as an expense as incurred*

- ▶ General and administrative expenses
- ▶ Wastage, scrap, and other (unanticipated) costs not incorporated into pricing the contract
- ▶ Costs related to (or can't be distinguished from) past performance obligations.

*Amortisation and impairment of contract assets*

- ▶ **Amortisation** is based on a systematic basis consistent with the pattern of transfer of the goods or services to which the asset relates
- ▶ **Impairment** exists where the contract carrying amount is greater than the remaining consideration receivable, less directly related costs to be incurred.

### Licensing (of an entity's intellectual property (IP))

(i) If the licence is **not distinct** from other goods or services

- ▶ It is accounted for together with other promised goods or services as a single performance obligation
- ▶ A licence is not distinct if either:
  - It is an integral component to the functionality of a tangible good, or
  - The customer can only benefit from the licence in conjunction with a related service.

(ii) If the licence is **distinct** from other goods or services

- ▶ It is accounted for as a single performance obligation.
- ▶ Revenue from a distinct licence is recognised **over time** (refer **Step 5**) if, and only if:
  - (a) The entity (is reasonably expected to) undertakes activities that will significantly affect the IP to which the customer has rights
  - (b) The customer's rights to the IP expose it to the positive/negative effects of the activities that the entity undertakes in (a).
  - (c) No goods or services are transferred to customer as the entity undertakes the activities in (a).
- ▶ Revenue from a distinct licence is recognised at a **point in time** (refer to **Step 5**) if the criteria for recognition over time (above) are not met. The right is over the IP in its form and functionality at the point at which the licence is granted to the customer.
  - Revenue is recognised at the point in time at which control of the licence is transferred to the customer.

**Warranties (fall into either one of the two categories):**

#### (i) Assurance type (apply IAS 37):

- ▶ An assurance to the customer that the good or service will function as specified
- ▶ The customer cannot purchase this warranty separately from the entity.

In determining the classification (or part thereof) of a warranty, an entity considers:

- ▶ **Legal requirements:** (warranties required by law are usually assurance type)
- ▶ **Length:** (longer the length of coverage, more likely additional services are being provided)

#### (ii) Service type (accounted for separately in accordance with IFRS 15):

- ▶ A service is provided in addition to an assurance to the customer that the good or service will function as specified
- ▶ This applies regardless of whether the customer is able to purchase this warranty separately from the entity.

### Non-refundable upfront fees

Includes additional fees charged at (or near) the inception of the contract (e.g. joining fees, activation fees, set-up fees etc.).

Treatment depends on whether the fee relates to the transfer of goods or services to the customer (i.e. a performance obligation under the contract):

- ▶ **Yes:** Recognise revenue in accordance with IFRS 15 (as or when goods or services transferred)
- ▶ **No:** Treated as an **advance payment** for the performance obligations to be fulfilled. (Note: Revenue recognition period may in some cases be longer than the contractual period if the customer





# IFRS 15 Revenue from Contracts with Customers

## PRESENTATION

### Statement of financial position

- ▶ Contract assets and contract liabilities from customers are presented separately
- ▶ Unconditional rights to consideration are presented separately as a receivable.

### Statement of profit or loss and other comprehensive income

- ▶ Line items (revenue and impairment) are presented separately in accordance with the requirements of IAS 1 *Presentation of Financial Statements*.

## TRANSITION (APPENDIX C)

### Retrospective application (either)

- ▶ For each prior period presented in accordance with IAS 8 *Accounting Policies, Changes in Accounting Estimates and Errors*; or
- ▶ Cumulative effect taken to the opening balance of retained earnings in the period of initial application.

### For full retrospective application, practical expedients (for)

- ▶ Restatement of completed contracts
- ▶ Determining variable consideration of completed contracts
- ▶ Disclosures regarding the transaction price allocation to performance obligations still to be satisfied.

For both approaches there is a practical expedient for contracts modified in earlier periods.

## DISCLOSURE

Overall objective to disclose sufficient information to enable users to understand the nature, amount, timing, and uncertainty of revenue and cash flows arising from an entity's contracts with customers.

### Contracts with customers (information regarding):

- ▶ Disaggregation of revenue
- ▶ Contract assets and contract liabilities
- ▶ Performance obligations (incl. remaining).

### Use of practical expedients (related to):

- ▶ Significant financing component (12 month)
- ▶ Contract costs (12 month amortisation).

### Significant judgements:

- ▶ Performance obligation satisfaction
- ▶ Transaction price (incl. allocation)
- ▶ Determining contract costs capitalised.

### Contract costs capitalised:









- ▶ Method of amortisation
- ▶ Closing balances by asset type
- ▶ Amortisation and impairment.

# Contact

For further information about how BDO can assist you and your organisation, please get in touch with one of our key contacts listed below.

Alternatively, please visit [www.bdo.global](http://www.bdo.global) where you can find full lists of regional and country contacts.



## EUROPE

Anne Catherine Farlay		France	<a href="mailto:annecatherine.farlay@bdo.fr">annecatherine.farlay@bdo.fr</a>
Jens Freiberg		Germany	<a href="mailto:jens.freiberg@bdo.de">jens.freiberg@bdo.de</a>
Ehud Greenberg		Israel	<a href="mailto:ehudg@bdo.co.il">ehudg@bdo.co.il</a>
Stefano Bianchi		Italy	<a href="mailto:stefano.bianchi@bdo.it">stefano.bianchi@bdo.it</a>
Roald Beumer		Netherlands	<a href="mailto:roald.beumer@bdo.nl">roald.beumer@bdo.nl</a>
Reidar Jensen		Norway	<a href="mailto:reidar.jensen@bdo.no">reidar.jensen@bdo.no</a>
David Cabaleiro		Spain	<a href="mailto:david.cabaleiro@bdo.es">david.cabaleiro@bdo.es</a>
René Füglistner		Switzerland	<a href="mailto:rene.fueglistner@bdo.ch">rene.fueglistner@bdo.ch</a>
Moses Serfaty		United Kingdom	<a href="mailto:moses.serfaty@bdo.co.uk">moses.serfaty@bdo.co.uk</a>




## SUB SAHARAN AFRICA



Theunis Schoeman		South Africa	<a href="mailto:tschoeman@bdo.co.za">tschoeman@bdo.co.za</a>
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## NORTH AMERICA &






Jonathan Chasle		Canada	<a href="mailto:jchasle@bdo.ca">jchasle@bdo.ca</a>
Wendy Hambleton		USA	<a href="mailto:whambleton@bdo.com">whambleton@bdo.com</a>


## LATIN AMERICA

Marcello Canetti		Argentina	<a href="mailto:mcanetti@bdoargentina.com">mcanetti@bdoargentina.com</a>
Victor Ramirez		Colombia	<a href="mailto:vramirez@bdo.com.co">vramirez@bdo.com.co</a>
Ernesto Bartesaghi		Uruguay	<a href="mailto:ebartesaghi@bdo.com.uy">ebartesaghi@bdo.com.uy</a>

Ayez Qureshi		Bahrain	<a href="mailto:Ayez.qureshi@bdo.bh">Ayez.qureshi@bdo.bh</a>
Antoine Gholam		Lebanon	<a href="mailto:agholam@bdo-lb.com">agholam@bdo-lb.com</a>

## ASIA PACIFIC

Aletta Boshoff		Australia	<a href="mailto:aletta.boshoff@bdo.com.au">aletta.boshoff@bdo.com.au</a>
Hu Jian Fei		China	<a href="mailto:hu.jianfei@bdo.com.cn">hu.jianfei@bdo.com.cn</a>
Fanny Hsiang		Hong Kong	<a href="mailto:fannyhsiang@bdo.com.hk">fannyhsiang@bdo.com.hk</a>
Pradeep Suresh		India	<a href="mailto:pradeepsuresh@bdo.in">pradeepsuresh@bdo.in</a>
Khoon Yeow Tan		Malaysia	<a href="mailto:tanky@bdo.my">tanky@bdo.my</a>
Ng Kian Hui		Singapore	<a href="mailto:kianhui@bdo.com.sg">kianhui@bdo.com.sg</a>



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