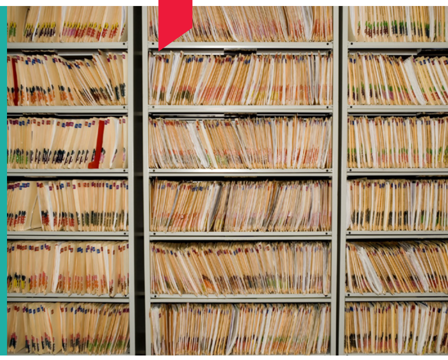
REVENUE FROM CONTRACTS WITH CUSTOMERS
INTERNATIONAL FINANCIAL REPORTING BULLETIN 2014/08



STATUS
Final

EFFECTIVE DATE
Periods beginning on or after 1 January 2017. Early application permitted

ACCOUNTING IMPACT
Significant changes for the accounting and disclosure of revenue.

Summary

On 28 May 2014, the International Accounting Standards Board (IASB) and the US Financial Accounting Standards Board (FASB) jointly issued IFRS 15 *Revenue from Contracts with Customers* and Topic 606 *Revenue from Contracts with Customers* respectively.

IFRS 15 supersedes IAS 18 *Revenue*, IAS 11 *Construction Contracts* and related Interpretations (IFRIC 13 *Customer Loyalty Programmes*, IFRIC 15 *Agreements for the Construction of Real Estate*, IFRIC 18 *Transfers of Assets from Customers* and SIC 31 *Revenue – Barter Transactions Involving Advertising Services*).

The objective of IFRS 15 is to clarify the principles of revenue recognition. This includes removing inconsistencies and perceived weaknesses and improving the comparability of revenue recognition practices across companies, industries and capital markets. In doing so IFRS 15 establishes a single revenue recognition framework. The core principle of the framework is, that an entity should recognise 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 in exchange for those goods or services.

In its *Feedback Statement*, the IASB identified some broad areas where the application of IFRS 15 may affect existing practice, including:

- Incidental obligations and sales incentives (must be separated under IFRS 15, example given is where automotive companies offer sales incentives in the form of future maintenance)
- Contingent revenue cap (example given in the telecom sector where a mobile phone is provided as part of a bundle on a fixed period subscription plan)
- Licences (much more defined requirements within IFRS 15 than under current IFRS)
- Timing of revenue recognition for some entities (e.g. companies selling residential real estate in multi-unit developments – service provided over time vs. transfer of an asset at a point in time)
- Recognition of variable consideration (IFRS 15 requires the estimation of either the expected value or the most likely amount, introduces the concept of not recognising contingent revenue unless it is highly probable that a significant reversal in recognised revenue will not occur)
- Significant financing components within contracts with customers (specific requirements within IFRS 15, includes looking at the impact of prepayments for goods and services)
- Disclosures (IFRS 15 includes a comprehensive set of disclosure requirements).

Scope, Effective Date and Transition

The Standard is applicable to all entities that enter into contracts with customers, unless those contracts are within the scope of other standards such as:

- Lease contracts (IAS 17)
- Insurance contracts (IFRS 4)
- Financial instruments and other rights or obligations (IFRS 9, IFRS 10, IFRS 11, IAS 27, IAS 28)
- Non-monetary exchanges between entities in the same line of business to facilitate sales to (potential) customers.

The effective date is for annual periods beginning on or after 1 January 2017. Early application is permitted. Retrospective application is required by using one of two methods:

(i) Retrospective application to each prior reporting period presented in accordance with IAS 8 *Accounting Policies, Changes in Accounting Estimates and Errors* (i.e. effect presented on a line-by-line basis); or

(ii) Retrospective application with the cumulative effect of initial application as an adjustment to the opening balance of retained earnings (i.e. effect presented on a single line basis). Note that additional disclosures will apply if an entity chooses to apply this method.

In addition, IFRS 15 includes various transition reliefs.

Revenue recognition framework

The core principle of the revenue framework is that an entity should recognise revenue to depict the transfer of promised goods or services to the customer in an amount that reflects the consideration to which the entity expects to be entitled in exchange for those goods or services.

To accomplish this, IFRS 15 requires the application of the following five steps:

1. Identify the contract(s)

The standard applies to all oral, written or implied contracts with the following characteristics:

- The contract has commercial substance
- The entity and customer have approved the contract and are committed to performing under the contract
- The entity can identify each party's rights with respect to the goods or services to be transferred
- The entity can identify the payment terms with respect to the goods or services to be transferred; and
- It is probable that the entity will collect the consideration to which it will be entitled in exchange for the goods or services transferred.

These provisions are generally applied to each individual contract with a customer. However, if certain criteria are met, separate contracts with the same party entered into at or near the same time must be combined. Contracts are to be combined and accounted for as a single contract if:

- They are negotiated with a single commercial objective
- The consideration paid in one contract is dependent on another contract; or
- The goods or services to be provided under the contracts represent a single performance obligation (i.e. they are not 'distinct' as described below).

IFRS 15 also addresses contract modifications. A contract modification would be accounted for as a separate contract if both:

- The scope of the contract increases due to the modification; and
- The additional consideration paid reflects the entity's stand-alone selling price for that performance obligation.

If these criteria are not met, the modification is accounted for as an adjustment to the original contract. Depending on the circumstances, the modified contract (i.e. the adjustment) would be allocated to the remaining performance obligations on a prospective basis or reflected as a cumulative catch-up adjustment to revenue, whether positive or negative.

The application of step 1, requires there to be a customer, it will in some circumstances involve significant complexity in terms of which contracts should be grouped together, particularly when accounting for contract modifications.

2. Identify the performance obligation

IFRS 15 defines a performance obligation as a contractual promise to deliver a good or service to the customer. Each promised good or service is treated as a separate performance obligation if it is 'distinct'. A good or service is distinct if the customer can benefit from the good or service separately (on its own or with other resources) and the good or service is separately identifiable from other promises in the contract. The fact that the entity regularly sells the good or service separately indicates that a customer can benefit from the good or service on its own. Indicators for separately identifiable goods or services include (but are not limited to):

- No significant service of integrating the good or service with other goods or services promised in the contract is provided
- The good or service does not significantly modify or customise other goods or services
- The good or service is not highly dependent/interrelated with other goods or services promised in the contract.

Nevertheless, IFRS 15 requires an entity to account for goods or services as a single performance obligation (i.e. a 'bundle') if the goods or services are not distinct.

IFRS 15 does not define 'highly dependent' and 'highly interrelated' and therefore judgment is required in determining when performance obligations are considered highly interrelated or highly dependent.

The concept of what the vendor 'promises' in the contract is key to determining whether a good or service should be treated as a separate performance obligation or not.

3. Determine the transaction price

A contract's transaction price is the amount of consideration to which an entity expects to be entitled in exchange for the promised goods or services. The transaction price can be a fixed or variable amount. IFRS 15 contains guidance for variable consideration, significant financing components, non-cash consideration, and consideration payable to a customer when determining the appropriate transaction price.

The amount of consideration can vary for a variety of reasons, including discounts, rebates, refunds, performance bonuses, etc. If the consideration is variable, an entity is required to estimate the transaction price using one of two methods:

(i) ***The expected value method*** – consideration is equal to the sum of probability weighted amounts in the range of total possible consideration

(ii) ***The most likely amount method*** – consideration is the single most likely amount in the range of possible amounts.

The method selected depends on the approach that the entity expects to better predict the amount of consideration to which it will be entitled. For example, it would be appropriate to estimate the most likely amount when the contract has only two possible outcomes (e.g. the customer either will, or will not, pay a performance bonus).

IFRS 15 constrains the amount of variable consideration that can be recognised by an entity, to an amount where it is highly probable that a significant reversal in the amount of cumulative revenue recognised will not occur. In assessing a significant reversal an entity considers both the likelihood of the revenue reversal occurring as well as the magnitude of the likely revenue reversal.

4. Allocate the transaction price

For contracts with more than one performance obligation, an entity must allocate the transaction price on the basis of the relative stand-alone selling prices of the goods or services. The best evidence of a stand-alone selling price is based on the observable price at which the good or service can be sold separately. If an observable price is not available, IFRS 15 requires that the stand-alone price is estimated. Therefore under IFRS 15 distinct performance obligations are not able to be combined simply because difficulty may exist in estimating stand-alone sales prices.

IFRS 15 provides several methods of estimating the stand-alone selling price, including:

(i) Market-based approach

(ii) Expected cost plus margin approach, and

(iii) Residual approach.

The residual approach is only permitted to be used if either:

- The good or service is sold to different customers by the entity for a broad range of amounts (i.e. highly variable selling price); or
- The entity has not yet established a price for that good or service and it has not previously been sold on a stand-alone basis (uncertain selling price).

If a discount is allocated to a performance obligation, it must be allocated before using the residual approach to estimate the stand-alone selling price of a good or service.

Any changes to the transaction price subsequent to contract inception are generally allocated to all performance obligations on the same basis as at inception. However, in limited circumstances, the change is allocated to one or more specific performance obligations, where there is observable evidence that the change is specific to one (or more) performance obligations.

5. Recognise revenue when each performance obligation is satisfied

Revenue is recognised when the entity satisfies each performance obligation. Obligations are satisfied when (or as) the entity transfers control of a promised good or service to a customer. This occurs when (or as) the customer can direct the use of and can obtain substantially all the remaining benefits from the promised good or service. IFRS 15 provides indicators for assessing when control of the good or service has transferred from the entity to the customer. Entities will need to exercise judgment to determine if the performance obligations are transferred over a period of time, or at a single point.

One of the following criteria must be met for control to transfer over time:

(i) The customer simultaneously receives and consumes the benefits of the entity's performance as the entity performs

(ii) The entity's performance creates or enhances an asset controlled by the customer as it is created or enhanced (e.g. work in progress); or

(iii) 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.

If the entity determines that control is transferred continuously, the corresponding revenue would be recognised over time by using an input or output method for measuring progress towards completion. Input methods include resources consumed, labour hours expended, costs incurred, etc. Output methods are generally more visible to the customer and include milestones reached or units produced, etc.

When control is not transferred over time, it is deemed to transfer at a point in time as and when control of the good or service is transferred from the entity to the customer.

Key indicators of when revenue should be recognised (i.e. control of the good or service has transferred) include:

- The entity has a present right to payment for the asset
- The customer has legal title to the asset
- Physical possession of the asset has been transferred to the customer
- The customer has the significant risks and rewards of ownership of the asset
- The customer has accepted the asset.

Note: no individual factor above is determinative on its own.

In addition to the general principle of recognising revenue when control is transferred, variable consideration associated with a performance obligation that has been satisfied is only recognised to the extent that it is highly probable that a significant reversal in the amount of revenue recognised will not occur when the uncertainty is subsequently resolved (i.e. it is constrained). Entities will be required to exercise judgment to make that determination based on their experience with similar contracts, where that experience is still considered predictive.

Other key areas

IFRS 15 also includes specific guidance related to several additional topics, some of which are discussed below:

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

Guidance on the above topics may change the current approach taken under IFRS.

Contract costs

IFRS 15 requires incremental costs associated with obtaining a contract be capitalised if those costs are expected to be recovered. Costs associated with fulfilling a contract that are within the scope of other standards are dealt with in accordance with those standards (e.g. IAS 2 *Inventories*, IAS 16 *Property, Plant and Equipment*, IAS 38 *Intangible Assets*). Otherwise, the costs associated with contract fulfilment are capitalised if, and only if:

- The costs are directly related to the contract
- will generate or enhance resources of the entity that will be used in satisfying performance obligations in the future; and
- are expected to be recovered.

Capitalised contract costs are amortised over the period commensurate with the transfer of the corresponding good or service. As a practical expedient, contract costs can be expensed as incurred if the expected amortisation period is less than one year.

Warranties

IFRS 15 identifies two types of warranties, and requires different accounting treatments for each:

(i) ***Assurance warranties*** (e.g. assurances that a product will function as specified, warranties that the customer cannot purchase separately)

- These do not represent separate performance obligations under IFRS 15
- Therefore, they are accounted for in accordance with IAS 37 *Provisions, Contingent Liabilities and Contingent Assets*.

(ii) ***Service warranties*** (e.g. a warranty that provides the customer with an additional service, warranties that the customer can purchase separately)

- These represent separate performance obligations under IFRS 15
- Therefore, they are accounted for in accordance with IFRS 15.

For example, a separate performance obligation is likely to exist were an entity:

- Gives free servicing and extended maintenance packages as a sales incentive (e.g. automotive sector)
- Provides free upgrades and support (e.g. software entities).

Sale with a Right of Return

Many products are sold with a right of return (e.g. sale of clothes from a department store). Under IFRS 15, an entity recognises the following:

- Revenue: based on the amount the entity expects to be entitled (considering the products expected to be returned)
- A refund liability: for the portion expected to be repaid to the customer
- An asset (and adjustment to cost of sales): for the products expected to be recovered.

The refund liability is subsequently assessed at each reporting period for changes in expectations about the amount of refunds. Likewise, the asset is subsequently subject to an impairment assessment at each reporting period.

Non-refundable upfront fees

It is recognised that in some contracts customers are charged non-refundable upfront fees. Examples include joining fees for health clubs, activation fees in the telecommunications industry, mobilisation fees, and set up fees.

In all circumstances an assessment needs to be made whether these fees relate to the transfer of a promised good or service or whether they represent a prepayment for the supply of promised goods and services in the future.

If it is identified that the upfront fee is compensation for costs incurred rather than the provision of a good or service, the fee is offset against the costs rather than recognised as revenue.

Licences

Current IFRS contains little guidance on accounting for sales of 'licences', IFRS 15 introduces much more defined principles to determine when revenue should be recognised on the issues of a licence.

This principle requires the determination as to whether the promise to provide a licence is separate from other promises made by the vendor 'licensor'.

If the promise to grant a licence is not distinct from other promised goods or services then the entity shall account for the promise to grant a licence and those other promised goods or services as a single performance obligation. Examples where a licence is not distinct from other promises include:

- Where the licence forms a component of a tangible good and is integral to the functionality of that good
- The customer can only benefit from the licence in conjunction with a related service provided by the vendor (such as online service provided by the entity that enables to access content).

If it is determined that the licence represents a distinct promise and is not part of an obligation to provide other goods or services, the entity must determine whether the performance obligation arising from this promise is satisfied at a point in time or over a period of time.

Specifically:

- Does the promise give the licensee the right to access intellectual property as it existed at the time the licence was granted (i.e. the licence gives no rights to updates of the intellectual property); or
- Does the promise give the licensee the right to access intellectual property over a period of time (the licence period i.e. the intellectual property is maintained and enhanced over the period of the licence).

If it is determined that the licence gives the customer rights to intellectual property that will change after the licence is granted then the performance obligation should be accounted as an obligation that is satisfied over time.

Customer Acceptance

Revenue can be recognised when there is objective evidence that goods or services provided to the customer are in accordance with the agreed-upon specifications in the contract. If there is insufficient evidence to show that specifications have been met, revenue cannot be recognised.

Disclosures

The guidance significantly enhances the required qualitative and quantitative disclosures related to revenue. The main objective of the requirements is the disclosure of sufficient information in terms of the nature, amount, timing and uncertainty of revenue and cash flows arising from contracts with customers. In order to meet this objective, IFRS 15 requires specific disclosures in the following areas:

Contracts with customers

- Revenue and any impairment losses recognised
- Disaggregation of revenue in to categories that depict the nature, amount, timing, and uncertainty
- Presentation of (disaggregated) revenue separately from other sources of income
- Information to compare the disaggregated revenue and the revenue amounts presented in the segment reporting according to IFRS 8 *Operating Segments*
- Contract balances (e.g. relationship between the timing and payment of the performance obligation; and significant changes in the contract assets/liabilities)
- Performance obligations (e.g. terms for satisfaction, significant payment terms, refunds, returns, warranties)
- Transaction price allocated to remaining performance obligations.

Significant judgements

- Judgements that significantly affect the determination of the amount and timing of revenue (e.g. timing of satisfaction of performance obligations)
- Judgements used in determining the timing of satisfaction of a performance obligation (e.g. methods used incl. an explanation why they faithful depict the transfer of the goods or services)
- Judgements used in determining the transaction price (e.g. methods, inputs and assumptions used for determining and allocating the transaction price).

Assets recognised

- Judgements made to determine the amount of the costs incurred to obtain or fulfil a contract
- Methods used to determine the amortisation for each period
- Balances of assets recognised from the costs incurred to obtain or fulfil a contract including the amounts for amortisation and impairment recognised during the period.

Use of practical expedients

- Disclose if practical expedients permitted by IFRS 15 have been used:
  - The existence of a significant financing component
  - The incremental costs of obtaining a contract.

Comparison of the 2011 Exposure Draft and IFRS 15

IFRS 15 reflects the IASB's and FASB's consideration of the principles proposed in the first (2010) and second (2011) Exposure Drafts. Comments received by respondents to the most recent 2011 Exposure Draft focused mainly on clarification of and refining the boards' proposals. The changes between the 2011 Exposure Draft and IFRS 15 are summarised in Appendix A. A comparison to FASB Topic 606 is provided in Appendix B.

Effective Date and Transition

IFRS 15 is required to be applied retrospectively for periods beginning on or after 1 January 2017. Early application is permitted. The retrospective application can be made using one of the following methods:

(i) Retrospective application to each reporting period presented in accordance with IAS 8 *Accounting Policies, Changes in Accounting Estimates and Errors*

(ii) Retrospective application with the cumulative effect of initially applying IFRS 15 recognised directly in equity (retained earnings).

If an entity chooses the latter method, additional disclosures must be provided stating the amount by which each financial statement line item is affected as compared to IAS 11 and IAS 18 and their related Interpretations. Additionally, the entity is required to explain the reasons for significant changes identified.

IFRS 15 *Revenue from Contracts with Customers*, its *Basis for Conclusions* as well as the *Implementation Guidance* can be accessed here (eIFRS subscription required).

Appendix A

Summary of changes from the 2011 Exposure Draft (reproduced from the Basis for Conclusions to IFRS 15)

2011 Exposure Draft	IFRS 15
Performance obligations satisfied over time	
The criteria for determining when control of a good or service transfers to a customer over time required an entity to consider whether the company's performance would create an asset with an alternative use to the company, and also whether: – The customer simultaneously receives and consumes benefits of the company's performance – Another company taking over the performance obligation would need to re-perform the work completed; and – The company has a right to payment for the work completed.	**(i) Limits the duplication between the criteria** IFRS 15 clarifies the application of each criterion for determining whether a performance obligation is satisfied over time. **(ii) Includes additional application guidance** Explains the meaning and application including: – Determining whether an asset has an alternative use – Factors that determine whether the entity has a right to receive payments.
Identifying performance obligations	
An entity accounts for the promise to transfer a good or service as a separate performance obligation if it is distinct. However certain goods or services promised in a bundle are not distinct if: – The goods or services of the bundle are highly interrelated and the entity provides a service of integrating them into a combined item – The bundle is significantly modified or customised to fulfil the contract.	**(i) Distinct good or service** At a minimum the good or service must be capable of being distinct. Which means that the customer could benefit from the good or service on its own or together with other resources available. **(ii) Distinct within context of other promises** IFRS 15 includes indicators to consider whether the promised good or service is distinct within the context of other promises in the contracts. **(iii) Transfer of series of distinct goods or services as one performance obligation** IFRS 15 specifies circumstances in which the repeat transfer of distinct goods or services is accounted for as a single performance obligation. Illustrative examples are also provided.
Collectability (customer credit risk)	
Revenue would be recognised at the amount of consideration to which a company is entitled to receive in exchange for transferring promised goods or services (i.e. gross amount). Impairment losses would be presented adjacent to revenue unless they include a significant financing component.	In order to avoid confusion about the presentation of revenue net or gross of any recognised impairment losses, IFRS 15 includes the following requirements: – Disclose impairment losses related to contracts with customers – Include a collectability threshold which requires that it must be probable that a company will collect the consideration from the customer.
Constraining estimates of variable consideration	
If an entity is entitled to a variable consideration the cumulative amount of revenue recognised would not exceed the amount to which the company is reasonably assured to be entitled.	**(i) Consider likelihood and magnitude** IFRS 15 clarifies that the constraint should consider the likelihood and magnitude of any subsequent reversal. **(ii) Replacement of 'reasonably assured'** To avoid confusion, the estimate of variable consideration must pass the 'highly probable' confidence level instead of 'reasonably assured'.

2011 Exposure Draft	IFRS 15
Significant financing components	
Adjusting the amount of promised consideration for the effects of the time value of money when determining the transaction price. Additionally factors a company should consider when assessing whether a financing component is significant or not were included.	**(i) Consider financing components** IFRS 15 clarified that a company should adjust for the effects of financing when one party is receiving a significant benefit of financing. **(ii) Indicators for financing component** Includes indicators to clarify when some payment terms do not give rise to a significant financing component.
Disclosure requirements	
The requirements ask to disclose quantitative and qualitative information, to enable investors to understand the nature, amount, timing and uncertainty of revenue. The qualitative information require to disclose information about performance obligations and significant judgements. Whereas the quantitative information require to disaggregate and reconcile revenue and provide the balances of contract assets and liabilities recognised.	The requirements of IFRS 5 clarify that the requirement to disclose information about the opening and closing balances of contract assets and liabilities do not outweigh the benefits.
Transition: retrospective application	
An entity applies the requirements of IFRS 15 retrospectively. Additional practical expedients are provided, releasing the burden of retrospective application.	IFRS 15 offers the opportunity to use on of the following methods to apply the requirements retrospectively: (i) Retrospective application to each reporting period presented in accordance with IAS 8 *Accounting Policies, Changes in Accounting Estimates and Errors*. (ii) Retrospective application with the cumulative effect of initially applying IFRS 15 recognised in equity (retained earnings). If the latter method is applied additional disclosures must be provided.
Licensing intellectual property	
Revenue for a license is recognised at the point in time it transfers to the customer. However the pattern of revenue recognition is driven by the fact whether the license is distinct or combined with other goods or services in the contract. A company only recognises revenue when the uncertainty related to those royalties is resolved.	**(i) License not distinct (point of time)** Recognise revenue when the bundle transfers to the customer. **(ii) License distinct** Revenue recognition depends on whether the license provides the customer with a right to: – Access the company's intellectual property as it exists throughout the license period (over time); or – Use the company's intellectual property as it exists at the point in time the license is granted (point in time). **(iii) Sales- and usage-based royalties** IFRS 15 requires the recognition of revenue at the later of when sale or usage occurs or when the company has transferred the license.
Onerous performance obligations	
A performance obligation is onerous if the lowest cost of settling that performance obligations exceeds the transaction price allocated to it. A performance obligation is only recognised if the performance obligation is satisfied over a period of time greater than one year.	The requirements for onerous performance obligations were deleted, as the Boards decided that the exisiting requirements are sufficient.

Appendix B

Summary of changes to FASB Topic 606 (reproduced from the Basis for Conclusions to IFRS 15)

FASB Topic 606	IFRS 15
Collectability threshold	
For an entity to recognise revenue, it must conclude that it is probable that it will collect the consideration to which it will be entitled in exchange for the goods or services that will be transferred to the customer. The meaning of probable under US GAAP is: 'likely to occur'	For an entity to recognise revenue, it must conclude that it is probable that it will collect the consideration to which it will be entitled in exchange for the goods or services that will be transferred to the customer. The meaning of probable under IFRS is: 'more likely than not'
The boards decided that there would be no significant practical effect of the different meaning. And therefore decided to set the threshold at a level that is consistent with previous revenue recognition practices and requirements under IFRS und US GAAP.	
Interim disclosure requirements	
The FASB amended Topic 270 *Interim Reporting* to require disclosure of disaggregated information of revenue in interim financial statements. However, under US GAAP entities are also required to provide in interim financial statements information about: – Contract balances; and – Remaining performance obligations.	The IASB amended IAS 34 *Interim Financial Reporting* to require disclosure of disaggregated information of revenue in interim financial statements.
Early application and effective date	
– Early application is not permitted – Effective date is for annual periods beginning after 15 December 2016.	– Early application permitted – Effective date is for annual periods beginning on or after 1 January 2017.
Impairment loss reversal	
No reversal of impairment losses that is recognised in accordance with the guidance on costs to obtain or fulfil a contract.	Reversal of impairment losses, consistent with the requirements of IAS 36 *Impairment of Assets*.
Non-public entity requirements	
The requirements of FASB Topic 606 are also applicable to non-public entities with some specific disclosure reliefs.	There are no specific requirements included in IFRS 15 for non-public entities. Entities without public accountability might apply *IFRS for SMEs*.

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