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Chapter 9 IFRS 15 Revenue

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IFRS 15 *Revenue from contracts with customers*

IFRS 15 *Revenue from contracts with customers*

IFRS 15 *Revenue from contracts with customers* was issued in May 2014. It is the result of a joint IASB and FASB project on revenue recognition. It seeks to strike a balance between the IASB rules in IAS 18,which were felt to be too general, leading to a lot of diversity in practice, and the FASB regulations, which were too numerous.

IFRS 15 *Revenue from contracts with customers*

Under IFRS 15 the transfer of goods and services is based upon the transfer of **control,** rather than the transfer of risks and rewards as in IAS 18. **Control of an asset** is described in the standard as the ability to direct the use of, and obtain substantially all of the remaining benefits from the asset.

IFRS 15 *Revenue from contracts with customers*

IFRS 15 applies to all contracts with customers except:

- Leases within the scope of IAS 17；
- Insurance contracts within the scope of IAS 4；
- Financial instruments and other contractual rights and obligations within the scope of IFRS 9, IFRS 10, IFRS 11, IAS 27 or IAS 28；
- Non-monetary exchanges between entities in the same line of business.

Recognition and measurement

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Generally revenue is recognised when the entity has transferred promised goods or services to the customer. IFRS 15 sets out five steps for the recognition process.

The five-step model

The five-step model

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

Step 2 Identify the separate performance obligations

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The key point is distinct goods or services. A contract includes promises to provide goods or services to a customer. Those promises are **called performance obligations**. A company would account for a performance obligation separately only if the promised good or service is distinct. A good or service is distinct if it is sold separately or if it could be sold separately because it has a distinct function and a distinct profit margin.

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Factors for consideration as to whether an entity's promise to transfer the good or service to the customer is separately identifiable include, but are not limited to:

(a)The entity does not provide a significant service of integrating the good or service with other goods or services promised in the contract.

(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.

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Example: identifying the separate performance obligation

Office Solutions, a limited company, has developed a communications software package called CommSoft.

Office Solutions has entered into a contract with Logisticity to supply the following:

(a) Licence to use Commsoft

(b) Installation service. This may require an upgrade to the computer operating system, but the software package does not need to be customised.

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(c) Technical support for three years

(d) Three years of updates for Commsoft

Office Solutions is not the only company able to install CommSoft, and the technical support can also be provided by other companies. The software can function without the updates and technical support.

Required

Explain whether the goods or services provided to Logisticity are distinct in accordance with IFRS 15 Revenue from contracts with customers.

Solution

CommSoft was delivered before the other goods or services and remains functional without the updates and the technical support. It may be concluded that Logisticity can benefit from each of the goods and services either on their own or together with the other goods and services that are readily available.

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The promises to transfer each good and service to the customer are separately identifiable. In particular, the installation service does not significantly modify the software itself and, as such, the software and the installation service are separate outputs promised by Office Solutions rather than inputs used to produce a combined output.

In conclusion, the goods and services are distinct and amount to four performance obligations in the contract under IFRS 15.

Step 3 **Determine the transaction price.**

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Determine the transaction price.

The transaction price is the amount of consideration a company expects to be entitled to from the customer in exchange for transferring goods or services. The transaction price would reflect the company's probability-weighted estimate of variable consideration (including reasonable estimates of contingent amounts) in addition to the effects of the customer's credit risk and the time value of money (if material).

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Variable contingent amounts are only included where it is highly probable that there will not

be a reversal of revenue when any uncertainty associated with the variable consideration is

resolved. Examples of where a variable consideration can arise include: discounts, rebates,

refunds, price concessions, credits and penalties.

Example: determining the transaction price

Taplop supplies laptop computers to large businesses. On 1 July 20X5, Taplop entered into a contract with

TrillCo, under which TrillCo was to purchase laptops at $500 per unit. The contract states that if TrillCo purchases more than 500 laptops in a year, the price per unit is reduced retrospectively to $450 per unit.Taplop's year end is 30 June.

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(a) As at 30 September 20X5, TrillCo had bought 70 laptops from Taplop. Taplop therefore estimated

that TrillCo's purchases would not exceed 500 in the year to 30 June 20X6, and TrillCo would

therefore not be entitled to the volume discount.

(b) During the quarter ended 31 December 20X5, TrillCo expanded rapidly as a result of a substantial acquisition, and purchased an additional 250 laptops from Taplop. Taplop then estimated that TrillCo's purchases would exceed the threshold for the volume discount in the year to 30 June 20X6.

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Required

Calculate the revenue Taplop would recognise in:

(a) Quarter ended 30 September 20X5

(b) Quarter ended 31 December 20X5

We need to apply the principles of IFRS 15 Revenue from contracts with customers.

IFS 15 *Revenue from contracts with customers*

(a) Applying the requirements of IFRS 15 to TrillCo's purchasing pattern at 30 September 20X5,

Taplop should conclude that it was highly probable that a significant reversal in the cumulative

amount of revenue recognised ($500 per laptop) would not occur when the uncertainty was resolved, that is when the total amount of purchases was known.

Consequently, Taplop should recognise revenue of 70 × $500 = $35,000 for the first quarter ended

30 September 20X5.

IFRS 15 *Revenue from contracts with customers*

(b) In the quarter ended 31 December 20X5, TrillCo's purchasing pattern changed such that it would

be legitimate for Taplop to conclude that TrillCo's purchases would exceed the threshold for the

volume discount in the year to 30 June 20X6, and therefore that it was appropriate to reduce the

price to $450 per laptop.

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Taplop should therefore recognise revenue of $109,000 for the quarter ended 31 December 20X5.

The amount is calculated as from $112,500 (250 laptops × $450) less the change in transaction price of $3,500 (70 laptops × $50 price reduction) for the reduction of the price of the laptops sold in the quarter ended 30 September 20X5.

IFRS 15 *Revenue from contracts with customers*

Step 4 Allocate the transaction price to the performance obligations.

IFRS 15 *Revenue from contracts with customers*

Where a contract contains more than one distinct performance obligation a company allocates the transaction price to all separate performance obligations in proportion to the stand-alone selling price of the good or service underlying each performance obligation. If the good or service is not sold separately, the company would have to estimate its standalone selling price.

IFRS 15 *Revenue from contracts with customers*

So, if any entity sells a bundle of goods and/or services which it also supplies unbundled,the separate performance obligations in the contract should be priced in the same proportion as the unbundled prices. This would apply to mobile phone contracts where the handset is supplied 'free'. The entity must look at the stand-alone price of such a handset and some of the consideration for the contract should be allocated to the handset.

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Allocating the transaction price to the performance obligations

A mobile phone company gives customers a free handset when they sign a two-year contract for provision of network services. The handset has a stand-alone price of $100 and the contract is for $20 per month.

Prior to IFRS 15, the company would recognise no revenue in relation to the handset and a total of $240 per annum in relation to the contract.

IFRS 15 *Revenue from contracts with customers*

Under IFRS 15, revenue must be allocated to the handset because delivery of the handset constitutes a performance obligation. This will be calculated as follows:

	$	%
Handset	100	17%
Contract – two years	480	83%
Total value	580	100%

As the total receipts are $480, this is the amount which must be allocated to the separate performance obligations. Revenue will be recognised as follows (rounded to nearest $).

	$
Year 1	
Handset (480 × 17%)	82
Contract (480 – 82)/2	199
	281
Year 2	
Contract as above	199

So application of IFRS 15 has moved revenue of $41 from Year 2 to Year 1.

Contract cost

IFRS 15 *Revenue from contracts with customers*

Recognition

If the costs incurred in order to obtain a contract such as sales commissions, legal fees, and bonus to employees then entity should **capitalize** it if it is more than 1 year and amortize it based on the revenue proportion.

If the contract is less than 1 year, then we simply charge the contract costs to statement of profit or loss.

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Costs incurred in **fulfilling** a contract, unless within the scope of another standard (such as IAS 2 *Inventories*, IAS 16 *Property, plant and equipment* or IAS 38 *Intangible assets*) are recognised as an asset if they meet the following criteria:

(a)The costs relate directly to an identifiable contract (costs such as labour, materials, management costs)

(b) The costs generate or enhance resources of the entity that will be used in satisfying (or continuing to satisfy) performance obligations in the future

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Costs recognised as assets are amortised on a systematic basis consistent with the transfer to the customer of the goods or services to which the asset relates.

Example

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Cloud A plc provides cloud service to client A on a 2 year contract.

Before providing the services, following expenses are incurred:

1. Commission to a sales representative for arranging the contract: $5,000;
2. Fee to a lawyer for drafting the sales contract: $3,500;
3. Make the investment of 20 IPADs for client A for $4,000;

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4. Customization of existing system of client and perform testing: $13,000

5. Payroll expenses of 5 employees dedicated to the contract: $50,000

Revenue from the client over 2 years are: $60,000 in year 1; $40,000 in year 2. Total revenue is $100,000.

Required:

How to recognize the expenses in the financial statements?

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Direct Costs to obtain the client:

1. Commission to a sales representative for arranging the contract: $5,000;

2. Fee to a lawyer for drafting the sales contract: $3,500;

Total =$8,500

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Customization of existing system of client and perform testing: $13,000:

Costs incurred to enhance resources/expected to recovered/directly relate to contract.

DR Contract costs (Asset) $21,500

CR Cash $21,500

IFRS 15 *Revenue from contracts with customers*

Amortization: (Based on proportion of revenue):

Year 1: $60,000/$100,000 X $21,500= $12,900: DR amortization expense

CR Contract Cost Asset

Year 2: $40,000/$100,000 X $21,500= $8,600: DR amortization expense

CR Contract Cost Asset

Make the investment of 20 IPADs for client A for $4,000:

This should be accounted for using IAS 16 Property, Plant & Equipment and depreciated on a straight line/reducing balance basis.

Payroll Expense:

These costs do not enhance the resources.

DR Payroll Expense $50,000

CR Cash $50,000

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