IFRS 15 Revenue from Contracts with Customers

Emerging Economies Group meeting
Agenda Paper 1
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Overview of IFRS 15
IFRS 15 at a glance

- IFRS 15 *Revenue from Contracts with Customers*
  - Replaces IAS 18, IAS 11 and related Interpretations
  - Joint Standard with FASB

- Framework for revenue recognition

- Effective date 1/1/2018, early application permitted
IFRS 15 implementation timeline

Joint IASB/FASB TRG discussions until Nov 2015

FASB continues US-only TRG discussions

IFRS 15 issued
May 2014

Clarifications to IFRS 15
1 Jan 2016

Full retrospective transition
April 2016
1 Jan 2017
(if one year comparative)

Modified retrospective transition
1 Jan 2018
(no restatement)

IAS 8 disclosures on possible impact of application of IFRS 15
Significant improvements

- Robust framework for addressing revenue issues
- Increases comparability
- Provides guidance in areas on which previous IFRS Standards had none
- Enhances disclosures

The thought process changes even if the accounting doesn’t
The 5-step model
The 5-step revenue recognition model

1. Identify the contract(s) with a customer
2. Identify the performance obligations in the contract
3. Determine the transaction price
4. Allocate the transaction price to the performance obligations
5. Recognise revenue when (or as) the entity satisfies a performance obligation

Recognise revenue to depict transfer of goods or services in an amount of consideration to which the entity expects to be entitled.
Existence of a contract (¶9–16)

• Must meet specified criteria to apply the model, including
  • Collection of consideration probable

Combine contracts (¶17)

• Negotiated as a package
• Linked consideration
• Goods or services form single performance obligation

Contract modifications (¶18–21)

• Separate contract if the modification adds distinct goods/services at standalone selling price
• Prospective if remaining goods/services distinct from goods or services already transferred
• Otherwise, cumulative catch-up

Identify the contract
Identify the contract—Collectability (¶ 9(e))

It is probable the entity will collect the consideration it will be entitled to in exchange for goods or services that will be transferred (BC46)

Assessing whether contract is a genuine transaction (only a minority of contracts expected to fail this criterion)

Revenue recognition when a contract fails the collectability criteria:

No remaining performance obligations

- Recognise revenue only if: all consideration received; and consideration is non-refundable

Some remaining performance obligations under the contract:

- Recognise revenue only if: contract terminated; and consideration received; and consideration is non-refundable
Objective: To identify the promised goods or services that are distinct and should be accounted for separately (¶22)

Promise to transfer a distinct good or service, or series of substantially similar distinct goods or services

**Good or service is capable of being distinct (¶27(a))**
- Customer can benefit from good or service:
  - on its own; or
  - together with other readily available resources

**Distinct within the context of the contract (¶27(b))**
- Is the entity’s promise to transfer:
  - each of the goods or services separately; or
  - a combined item to which the goods or services are *inputs*
Distinct within the context of the contract (¶29)

1. Significant integration
2. Modification or customisation
3. Highly interdependent or highly interrelated
4. Transfer individually

Step 2

1+1
Significant integration service

• An entity, a contractor, enters into a contract to build a hospital for a customer

• Facts
  – Contractor is responsible for the overall management of the project and identifies various goods and services to be provided, including
    • engineering, site clearance, foundation, procurement, construction of the structure, piping and wiring, installation of equipment and finishing.
  – Contractor or competitors regularly sell many of these goods and services separately to other customers.
  – Customer could generate economic benefit from the individual goods and services by using, consuming, selling or holding those goods or services.
Distinct within the context of the contract (Example 10 Case A)

- Capable of being distinct
- Distinct within the context of the contract
- Separate performance obligations

- Engineering, procurement
- Foundation, construction
- Piping, wiring, installation and finishing

**BUT**

Significant service of integrating goods or services (inputs) into the hospital (combined output)
Other examples

- Example 11 Case C—*customisation or modification*
  - Contract to provide equipment & installation service. Equipment functional without customisation & modification. Installation could be performed by others.

- Example 11 Case E—*highly interdependent or interrelated*
  - Contract to provide equipment and related specialised consumables. Consumables sold separately by entity.
A framework for measuring revenue

- Transaction price is the amount to which the entity expects to be entitled in exchange for transferring goods or services.
- Specific guidance on the following:

  **Variable consideration**
  - Estimate using:
    - Expected value
    - Most likely amount but ‘constrained’ (next slide)

  **Significant financing**
  - Adjust promised consideration if timing provides customer or entity with significant benefit of financing

  **Non-cash consideration**
  - Measure at fair value unless FV cannot be reasonably estimated

  **Consideration payable to customer**
  - Reduction of the TP unless in exchange for a distinct good or service
When to recognise variable consideration

Include estimate of some/all of variable consideration in the transaction price only to extent it is *highly probable* a significant reversal of revenue will not occur when uncertainty is resolved (¶56)

- Variable consideration is a broad term
  - includes rebates, refunds, price concessions
- Estimate of transaction price updated each period
- Expectations of revenue reversal assessed using 5 indicators
Volume discount incentive

- An entity enters into a contract on 1/1/16 to sell Product A for ₹100/unit. If customer purchases more than 1,000 units in a calendar year, price retrospectively reduced to ₹90/unit

How much revenue should the entity recognise?

- The entity has significant experience with this product and purchasing pattern of customer
- For Q1 ended 31/3/16:
  - Company sells 75 units
  - Company estimates that the customer’s purchases will not exceed 1,000-unit threshold
For Q1 ended 31/3/16

Is the consideration variable? 
- Yes, consideration varies if the customer’s purchases exceed the threshold ₹100 - ₹90

If so, how much? 
- ₹10

Is it highly probable that cumulative revenue will not reverse? 
- Yes, based on the entity’s experience, the customer’s purchases are not expected to exceed the threshold

Q1 revenue 
- ₹7,500 (75 units x ₹100)
Variable consideration (Example 24)

Volume discount incentive

• An entity enters into a contract on 1/1/16 to sell Product A for ₹100/unit. If customer purchases more than 1,000 units in a calendar year, price retrospectively reduced to ₹90/unit

How much revenue should the entity recognise?

– The entity has significant experience with this product and purchasing pattern of customer
– For Q2 ended 30/6/16:
  • In May 2016, the customer acquires another company and the entity sells an additional 500 units to the customer
  • In the light of new facts, the entity estimates that the customer’s purchases will exceed the threshold
For Q2 ended 30/6/16

Is it highly probably that cumulative revenue will not reverse?

- The customer’s purchases now are expected to exceed the threshold, so it is NOT highly probable that revenue will not reverse if recognised at ₹100/unit

Is this correction of error?

- No; this is a change in the estimate of variable consideration

Q2 revenue

- 500 units x ₹90 = 45,000
- 75 units x (₹10) = (750)
- TOTAL = ₹44,250

Variable consideration (Example 24)
Allocate to each performance obligation the amount to which entity expects to be entitled in exchange for satisfying that performance obligation (¶73)

- Relative standalone selling price basis
  - estimate selling prices if not observable
  - residual estimation techniques may be appropriate

- Discounts and variable amounts allocated entirely to specific performance obligation if specified criteria met
## Recognise revenue when (or as) a performance obligation is satisfied

Performance obligation is satisfied by transferring good or service (because the customer obtains control of the good or service)

<table>
<thead>
<tr>
<th>Performance obligations satisfied over time if specified criteria met (¶35)</th>
<th>All other performance obligations satisfied at a point in time (¶38)</th>
</tr>
</thead>
</table>
| • Select single measure of progress to depict performance in transferring goods/services  
  - Input methods may need to be adjusted [eg uninstalled materials (Example 19)]  
  - Units produced or delivered may be a reasonable proxy in some cases | • Revenue recognised at the point the customer obtains control of the promised asset. Indicators of control include:  
  - Present right to payment  
  - Legal title  
  - Physical possession  
  - Risks and rewards of ownership  
  - Customer acceptance |
When is PO satisfied over time? (ie revenue over time)

Customer receives and consumes benefits of entity’s performance as entity performs (¶35(a)) or

- Cleaning services, shipping service

Entity’s performance creates or enhances an asset that customer controls as asset is created or enhanced (¶35(b)) or

- Building an asset on a customer’s site

Entity’s performance does not create an asset with an alternative use to entity and entity has an enforceable right to payment for performance completed to date (¶35(c))

- Building a specialised asset that only the customer can use
When is PO satisfied over time? (¶35(c))

Multi-unit real estate development

Asset has no alternative use (¶36)

- (1) Contractually cannot redirect the asset
- (2) Practically cannot redirect the asset in completed state
  - This condition is generally met

Right to payment for performance to date (¶37)

- Throughout contract, right to approximate selling price of goods/services transferred
  - Depends upon the legal requirements in the jurisdiction

- Pattern of transfer may be different for different real estate contracts because of differing facts and circumstances
- Revenue recognised only if both conditions are met
Application guidance
• Performance obligations satisfied over time
• Methods for measuring progress
• 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
• Licensing
• Repurchase agreements
• Consignment arrangements
• Bill-and-hold arrangements
• Customer acceptance
• Disclosure of disaggregated revenue
Who are you?
I am a ‘principal’. I **control** the good or service before the customer gets it. My performance obligation is *to provide* the good or service…

Who are you?
I am an ‘agent’. I **don’t control** the good or service before the customer gets it. My performance obligation is *to arrange* for the good or service to be provided…

*It is all about control*
Principal or agent? (Example 47)

• Facts
  – An entity, a travel agency, purchases tickets from airlines at reduced rates compared with the tickets sold directly to the public
  – The entity agrees to buy a specific number of tickets at a fixed price regardless of whether it is able to resell them
  – The entity determines the prices at which the tickets will be sold to its customers

Is the entity a principal or an agent?
Principal or agent? (Example 47)

Identify the specified good or service
- Ticket
- Flight

Does the entity control the good or service?
- Yes
  - Ability to direct the use
  - Obtains benefit by use/sale

The entity is...
- A principal
What if a ticket is bought by the entity from an airline only when requested by a customer?

- **Identify the specified good or service**
  - **Ticket**: ✓
  - **Flight**: ✗

- **Does the entity control the good or service?**
  - **No**
    - ✗ Ability to direct the use
    - ✗ Does not obtain benefit by use/sale

- **The entity is...**
  - An agent
Principal or agent? (Example 46)

• Facts
  – An entity promises to develop specifications and manufacture a machine for a customer
  – The entity sub-contracts the manufacturing of the machine and arranges for the sub-contractor to deliver the machine
  – The entity and customer negotiate the selling price
  – The entity is responsible for any corrections to the machine resulting from error in specifications

Is the entity a principal or an agent?
Principal or agent? (Example 46)

Identify the specified good or service

- Machine
- Design

Does the entity control the good or service?

Yes

- Significant integration service by the entity
- Sub-contractor services are inputs to the output

The entity is...

A principal
Licensing intellectual property

Does the licenced IP change?

- **Right to use IP**
  - IP has significant standalone functionality
  - Revenue at point in time

- **Right to access IP**
  - Change in form or functionality of IP
  - Benefits substantially derived/dependent on licensor’s activities
  - Revenue over time

**Right to access IP** is correct.
Licensing—what is the promise? (Example 61)

• Facts
  – An entity, a well-known sports team, licenses the use of its name and logo to a customer. The customer, an apparel designer, has the right to use the sports team’s name and logo on items including t-shirts, caps, mugs and towels for one year
  – The entity will receive fixed consideration of ₹2 million and a royalty of 5% of sales price of any items using the team name or logo
  – The customer expects that the entity will continue to play games and provide a competitive team
  – The entity concludes that its only performance obligation is to transfer the licence.

Is the performance obligation a right to access IP satisfied over time or a right to use IP satisfied at a point in time?
Licensing—what is the promise? (Example 61)

Entity will undertake activities that significantly affect IP

Licence exposes the customer to +/- effects of entity’s activities

Activities don’t result in transfer of good or service to customer

Licence provides a right to access IP

- The customer reasonably expects, and it is entity’s customary business practice, to continue to play and provide a competitive team to support and maintain the value of the name and logo
- Ability of the customer to obtain benefit from the name and logo is substantially derived from, or dependent upon, the expected activities of the entity
- Continuing to play and providing a competitive team do not directly transfer a good or service to the customer
Licensing intellectual property

Other examples

• An entity licences software and provides updates, which it concludes as two performance obligations. Software has significant standalone functionality that is unaffected by the updates or the entity’s ongoing activities.
Sales-based or usage-based royalties for licence of IP

Exception applies if:

• Royalty relates only to a licence or
• Licence is the predominant item (e.g., licence to show a movie and additional promotional goods or services)
Other requirements, transition and disclosures
## Contract costs

<table>
<thead>
<tr>
<th>Category</th>
<th>Description</th>
</tr>
</thead>
<tbody>
<tr>
<td>Acquire a contract</td>
<td>• Capitalise if incremental (except if contract &lt;= 12 months)</td>
</tr>
<tr>
<td>Set-up costs</td>
<td>• No revenue recognition&lt;br&gt;• Capitalise if create resource for future use</td>
</tr>
<tr>
<td>Fulfilment costs</td>
<td>• No WIP if PO satisfied over time</td>
</tr>
</tbody>
</table>
## Transition

<table>
<thead>
<tr>
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</thead>
<tbody>
<tr>
<td><strong>Full retrospective</strong></td>
<td>Cumulative catch-up</td>
<td>Contracts under new standard</td>
<td></td>
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<tr>
<td></td>
<td></td>
<td>Contracts restated</td>
<td></td>
</tr>
<tr>
<td><strong>Modified retrospective</strong></td>
<td>Contracts not restated</td>
<td>Cumulative catch-up</td>
<td>Contracts under new standard</td>
</tr>
</tbody>
</table>

Optional reliefs that permit
- use of hindsight in restating modified contracts
- not to apply IFRS 15 to contracts that are completed contracts at the date of transition to IFRS 15

Completed contract is a contract for which the entity has transferred all of the goods or services identified in accordance with previous revenue Standard.
Disclosure requirements

To enable users to understand the nature, amount, timing and uncertainty of revenue and cash flows arising from contracts with customers

<table>
<thead>
<tr>
<th>Revenue</th>
<th>Contracts</th>
<th>Significant judgments</th>
</tr>
</thead>
<tbody>
<tr>
<td>Disaggregation of revenue</td>
<td>Information about contract balances and changes</td>
<td>Timing of and methods for recognising revenue</td>
</tr>
<tr>
<td>Amounts recognised relating to performance in previous periods</td>
<td>Information about performance obligations</td>
<td>Determining the transaction price and amounts allocated to performance obligations</td>
</tr>
<tr>
<td>Amounts allocated to remaining performance obligations</td>
<td></td>
<td></td>
</tr>
</tbody>
</table>
IFRS 15 Implementation page

go.ifrs.org/IFRS15-implementation

IFRS 15 Revenue from Contracts with Customers: Implementation

This page provides an overview of all the activities undertaken by the International Accounting Standards Board (the Board) to support implementation of IFRS 15. It will be updated throughout the implementation phase of this Standard.

Educational and implementation materials

In addition to the materials provided within IFRS 15 itself, including the Illustrative Examples, various materials that support implementation of IFRS 15 are available. These are summarized below. Throughout the implementation phase, the Board will monitor implementation and will consider whether additional materials might be helpful.

Materials published alongside IFRS 15 and Clarifications to IFRS 15

Project Summary and Feedback Statement

IASB member article—Patricia McConnell

Innovator Perspective: ‘Revenue recognition: finally, a Standard approach’

Debent: IA SB Vice-Chairman Ian MacKintosh discussing Clarifications to IFRS 15

Webcasts

Joint IASB and FASB Webcast—Implementation Update on IFRS 15

[Register now]

Summaries of issues discussed at TRG Meetings

July 2014

October 2014

January 2015

March 2015

July 2016

November 2016

The complete log of submissions received by the TRG as at 2 November 2016 (with hyperlinks to staff papers, meeting summaries, etc) is available here.
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