IFRS 15 – Revenue from Contracts with Customers

- Anand Banka

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Revenue – What? How much? When?

- Readymade Garments Shop
  - Returnable
  - Only Exchange
- Flight Tickets
- Sales on CIF basis

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WHAT IS REVENUE (OLD)

- GROSS inflow of ECONOMIC BENEFITS
  - 1. Discounts?? 2. Taxes??
- Arising in the course of ORDINARY activities
- Resulting in INCREASE in EQUITY (other than contribution from equity participants)
  - Sales tax/ Service tax collected
  - VAT collected
  - Agent's collections on behalf of its principal

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CASE STUDY

- An undertaking sells canned food and has 100 customers
- The delivery of the goods is made on the last day of each month. Standard payment terms require settlement within 45 days of delivery
- The undertaking's policy is to grant a settlement discount of 2% to customers that pay within 15 days of delivery
- Past experience shows that 45% of the customers normally pay within 15 days, while the remaining 55% pay after the early settlement period

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SOLUTION

Trade receivables	1,000	
To Revenue		991
To Provision for discounts (1000*45%*2%)		9

SUMMARY

- Multiple element arrangement
- Deferred settlement terms
- Barter Transactions
- Customer Loyalty Programmes
- Service concession arrangements
- Transfer of assets from customers

Case Study

- Company XYZ takes Rs. 10 lakh loan from Bank ABC
- The loan is repayable in 10 equal annual installments
- Interest Rate @ 7% p.a.
- Processing Fees paid - Rs. 12,500

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Case Study Answer

		Repayment Schedule			Amortisation Schedule		
Date	Cash Ouflows	Interest Expense @7%	Principal Amount	Outstanding Balance	Interest Expense @7.28%	Principal Amount	Carrying Amount
1/1/2009				1,000,000			987,500
31/12/2009	142,378	70,000	72,378	927,622	71,822	70,556	916,944
31/12/2010	142,378	64,934	77,444	850,178	66,690	75,688	841,256
31/12/2011	142,378	59,512	82,866	767,312	61,186	81,192	760,064
31/12/2012	142,378	53,712	88,666	678,646	55,280	87,098	672,966
31/12/2013	142,378	47,505	94,873	583,773	48,946	93,432	579,534
31/12/2014	142,378	40,864	101,514	482,259	42,150	100,228	479,306
31/12/2015	142,378	33,758	108,620	373,639	34,860	107,518	371,788
31/12/2016	142,378	26,155	116,223	257,416	27,041	115,337	256,451
31/12/2017	142,378	18,019	124,359	133,057	18,652	123,726	132,725
31/12/2018	142,378	9,321	133,057	0	9,653	132,725	0
Total		423,780	1,000,000		436,280	987,500	

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Intro to IFRS 15

- Supersedes:
  - IAS 11 *Construction Contracts*;
  - IAS 18 *Revenue*;
  - 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*
- Robust framework

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Definitions under IFRS 15

- Revenue
  - **Income** arising in the course of an entity's ordinary activities.
- Income
  - **Increases in economic benefits** during the accounting period in the form of inflows or enhancements of assets or decreases of liabilities that result in an **increase in equity**, other than those relating to contributions from equity participants
- Customer
  - 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.

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Steps to IFRS 15

- Identifying a Contract
- Identifying Performance Obligations (PO)
- Determine Transaction Price (TP)
- Allocate TP to PO
- Recognise revenue as you satisfy a PO

I. Identifying a contract

- the parties to the contract have approved the contract and are committed to perform their respective obligations;
- the entity can identify each party's rights regarding the goods or services to be transferred;
- the entity can identify the payment terms for the goods or services to be transferred;
- the contract has commercial substance; and
- it is probable that the entity will collect the consideration to which it will be entitled. An entity shall consider only the customer's ability and intention to pay that amount of consideration when it is due

COMBINING A CONTRACT

- the contracts are negotiated as a package with a single commercial objective;
- the amount of consideration to be paid in one contract depends on the price or performance of the other contract; or
- the goods or services promised in the contracts are a single performance obligation

CASE STUDY

- PQR invited tenders for construction of
  - factory and
  - township that includes residential complex, school and hospital
- Tender requires cost estimates for each of these components to be separately provided
- However, the whole tender will be given to a single contractor only
- XYZ wins the tender and enters into separate contracts for each component with PQR
- Whether XYZ should account each component as a separate contract or all components as a single contract?

Steps to IFRS 15

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II. Identifying Performance Obligations (PO)

- At contract inception, identify PO :
  - a good or service (or a bundle of goods or services) that is distinct; or
  - a series of distinct goods or services

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What is distinct?

- the customer can benefit from the good or service either on its own or together with other resources that are readily available to the customer; and
  - good or service could be used, consumed, sold for an amount that is greater than scrap value or otherwise held in a way that generates economic benefits
- the entity's promise to transfer the good or service to the customer is separately identifiable from other promises in the contract
  - the entity does not provide a significant service of integrating the good or service
  - the good or service does not significantly modify or customise another good or service
  - the good or service is not highly dependent on, or highly interrelated with, other goods or services

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Bundle or Series?

- the customer simultaneously receives and consumes the benefits as the entity performs?
- 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?
- 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**?

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MEASURING PROGRESS…

- Apply a single method for each PO satisfied over time and apply that method consistently to similar POs and in similar circumstances.
- Input Methods
  - Costs incurred
  - Hours spent
- Output Methods
  - Survey
  - Milestones reached
  - Units produced/ delivered
- Outcome not reasonably measurable?
  - Costs will be recovered?
    - the entity shall recognise revenue only to the extent of the costs incurred

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STEPS TO IFRS 15

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III. Determine Transaction Price (TP)

- TP is the amount of consideration 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).
- Consider
  - variable consideration
  - constraining estimates of variable consideration
  - the existence of a significant financing component in the contract
  - non-cash consideration
  - consideration payable to a customer

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Variable Consideration

- discounts, rebates, refunds, credits, price concessions, incentives, performance bonuses, penalties, etc
- Estimate the amount of variable consideration –
  - The expected value
  - The most likely amount
- Constraining Estimate
  - include variable consideration only to the extent that it is highly probable that a significant reversal in the amount of cumulative revenue recognised will not occur when the uncertainty associated with the variable consideration is subsequently resolved

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FINANCING COMPONENT

- the customer or the entity
- receives a significant benefit of financing the transfer of goods or services
- Recognise at Cash Selling Price

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NON CASH CONSIDERATION

- Fair Value of Consideration
- If FV cannot be estimated - Stand-alone selling price of the goods or services
- **Transfer of Assets from Customers**
  - 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.

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CONSIDERATION PAYABLE TO A CUSTOMER

- Credits/ vouchers/ Coupons
  - Reduction of transaction price
  - At later of
    - the entity recognises revenue for the transfer of the related goods or services to the customer; and
    - the entity pays or promises to pay the consideration (even if the payment is conditional on a future event).
- If for distinct goods or services (transfer of assets from customer)
  - Account as expense/ purchase

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CASE STUDY

- You travel today in our Cabs for Rs. 500
- Get discount on your next trip of Rs. 250

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STEPS TO IFRS 15

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- Determine Transaction Price (TP)
- Allocate TP to PO
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ALLOCATE TP TO PO

- The objective is to allocate the TP to each PO in an amount that depicts the amount of consideration to which the entity expects to be entitled in exchange for transferring the promised goods or services to the customer
- Use relative stand-alone selling price basis
  - If not directly observable, estimate the stand-alone selling price at an amount that would result in the allocation of the transaction price meeting the allocation objective
  - Adjusted market assessment approach
  - Expected cost plus a margin approach
  - Residual approach

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Allocating Discount

- When bundle of goods and services sold
  - Allocate to all unless relates to a single item
- Proportionate allocation
  - basis relative stand-alone selling prices of the underlying distinct goods or services

Steps to IFRS 15

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V. Recognise revenue as you satisfy a PO

- Recognise revenue when the entity satisfies a PO by transferring a promised good or service (i.e. an asset) to a customer.
  - Goods and services are assets, even if only momentarily, when they are received and used
- An asset is transferred when the customer obtains control of that asset.

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Indicators

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

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Contract Costs

- Incremental costs of obtaining a contract
  - Costs incurred to obtain a contract that would not have incurred if the contract had not been obtained
- Costs to fulfill a contract
  - direct labour
  - direct materials
  - allocations of costs that relate directly to the contract or to contract activities (costs of contract management and supervision, insurance and depreciation of tools and equipment used in fulfilling the contract)
  - costs that are explicitly chargeable to the customer under the contract;
  - other costs that are incurred only because an entity entered into the contract (payments to subcontractors)

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Incremental costs of obtaining a contract

- Cost expected to be recovered from customer
  - Recognise as an Asset
- Costs that would have been incurred regardless of whether the contract was obtained
  - Expense
  - Unless explicitly chargeable to the customer

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Costs to fulfill a contract

- Within scope of another standard?
  - IAS 2, IAS 16, IAS 38
  - Go to that standard
- If not – recognise an asset if
  - the costs relate directly to a contract or to an anticipated contract that the entity can specifically identify
  - the costs generate or enhance resources of the entity that will be used in satisfying PO in the future
  - the costs are expected to be recovered

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Cost to be expensed

- general and administrative costs
- costs of wasted materials, labour or other resources to fulfil the contract that were not reflected in the price of the contract
- costs that relate to satisfied PO (or partially satisfied PO) in the contract
- costs for which an entity cannot distinguish whether the costs relate to unsatisfied PO or to satisfied PO

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Amortisation and impairment

- Amortise
  - on a systematic basis consistent with the transfer to the customer of the goods or services to which the asset relates
- Impair if carrying amount of the asset recognised exceeds:
  - the remaining amount of consideration that the entity expects to receive; less
  - the costs that relate directly to providing those goods or services and that have not been recognised as expenses

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Disclosures (Illustrative)

- revenue recognised from contracts with customers, including the disaggregation of revenue into appropriate categories;
- contract balances, including the opening and closing balances of receivables, contract assets and contract liabilities;
- performance obligations, including when the entity typically satisfies its performance obligations and the transaction price that is allocated to the remaining performance obligations in a contract;
- significant judgements, and changes in judgements, made in applying the requirements to those contracts; and
- assets recognised from the costs to obtain or fulfil a contract with a customer.

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CASE STUDIES

CASE 1: SALE WITH A RIGHT TO RETURN

- Readymade Garments Shop
  - Returnable
  - Only Exchange

Answer 1 (if Returnable/ Exchange for anything)

Cash A/c Dr (not expected to be returned)

To Sales

Provision for refund A/c Dr. (at sale value)

To Refund Liability

Right to recover products A/c Dr. (at cost)

To Cost of Sales

Cannot setoff asset and liability

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Answer 1 (if exchange only)

- Exchanges by customers of one product for another of the same type, quality, condition and price (for example, one colour or size for another) are not considered returns for the purposes of applying this Standard.

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Case 2: Warranties

- If a customer has the option to purchase a warranty separately
  - Separate PO
  - Allocate TP
- If compulsory but only against defective goods
  - Provision required
- If compulsory involving service
  - Separate PO

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Case 3: Additional goods/ services

- Pay Rs. 299 today in the online wallet, get Rs. 498

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Answer 3

- Allocate the credit to the PO on a relative stand-alone selling price basis

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Case 4: Unexpired Rights

- 498 credited to the online wallet expires on 31 Dec 2014
- If entity expects breakage
  - recognise the expected breakage amount as revenue in proportion to the pattern of rights exercised by the customer
- If breakage not expected
  - recognise the expected breakage amount as revenue when the likelihood of the customer exercising its remaining rights becomes remote

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Case 5: Initiation, entrance, and membership fees

- Fee permits only membership, and all other services or products are paid for separately
- Fee entitles the member to services or publications to be provided during the membership period, or to purchase goods or services at prices lower than those charged to non members

Case 6: Franchise fees

- Franchise fees may cover the supply of initial and subsequent services, equipment and other tangible assets, and know-how
  - Example: Franchise agreement of a vada-pav has the following offerings for Rs. 1 crore
    - Tangible assets worth Rs. 50 lakhs
    - Charges for use of brand/ logo - Rs. 10 lakhs in the first year + 30% of revenue for subsequent years
    - Know-how charges – Rs. 30 lakhs
    - One-time fee – Rs. 10 lakhs
    - Consultation at nominal rates
    - Supply of materials at cost

Case 7: Repurchase Agreements

- an entity's obligation to repurchase the asset and the customers obligation to sell the asset (a forward);
  - Control with the entity
  - Lease – if repurchase amount < original
  - Financing arrangement - if repurchase amount = > original
- an entity's right to repurchase the asset (a call option);
  - Same as above

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Repurchase Agreements

- an entity's obligation to repurchase the asset at the customer's request (a put option)
  - If repurchase amount < original
    - Customer has economic incentive to sell (i.e. repurchase amount > market value on the date of exercise)
      - Account as lease
    - Customer does not have economic incentive to sell (i.e. repurchase amount < market value on the date of exercise)
      - Account as sale with a right to return
  - If repurchase amount > = original
    - Financing arrangement

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Case 8: Consignment Arrangements

- Entity A sells goods to Dealer B
- Dealer B sells those goods to customers
- All the decision making vests with Entity A
  - Selling price
  - Target market
  - Advertising
  - Number of salesman

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Case 9: Bill-and-hold arrangements

- Mr. X went to a mobile shop to buy latest technology mobile
- The mobile was not available in the shop but the shopkeeper promised to order one and deliver it to Mr. X in 15 days time
- The mobile shop orders the mobile and receives it after 15 days
- Shopkeeper calls Mr. X and requests him to accept the delivery
- Mr. X was not in town and hence requested the shopkeeper to hold the delivery for a month, on his behalf.

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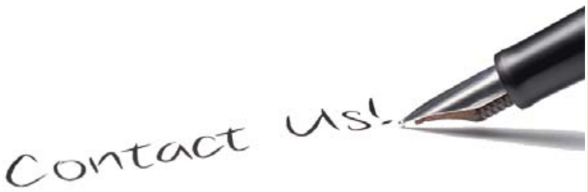
ThanQ?



Anand Banka
Partner,
Talati & Talati
Chartered Accountants

Email: anand.banka@talatiandtalati.com
Mob: 98673 53743

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