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IFRS Hot Topic: A Summary of IFRS 15 *Revenue from Contracts with Customers*

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Background

In 2008, the International Accounting Standards Board (IASB) and Financial Accounting Standards Board (FASB) initiated a joint project to clarify the principles for recognizing revenue and to develop a common revenue standard for International Financial Reporting Standards (IFRS) and United States Generally Accepted Accounting Principles (US GAAP) that would:

- Remove inconsistencies and weaknesses in existing revenue requirements.
- Provide a more robust framework for addressing revenue issues.
- Improve comparability of revenue recognition practices across entities, industries, jurisdictions and capital markets.
- Provide more useful information to users of financial statements through improved disclosure requirements.
- Simplify the preparation of financial statements by reducing the number of requirements to which an entity must refer.

Previous revenue recognition requirements under IFRS provided limited guidance, and as a result, the two main revenue recognition standards, IAS 18 *Revenue* and IAS 11 *Construction Contracts*, could be difficult to apply to complex transactions and multiple-element arrangements. Accordingly, IFRS 15 *Revenue from Contracts with Customers* replaces all existing revenue standards.

Scope

IFRS 15 provides an inclusive framework for the recognition, measurement and disclosure of revenue. Guidance is provided on the timing and amount of revenue that should be recognized on a contract basis. The standard improves the comparability of revenue from contracts with customers and reduces the need for the development of case-by-case guidance for emerging revenue recognition issues.

Under this standard, the recognition of revenue depicts the transfer of goods or services to customers in amounts that reflect the consideration (i.e., payment) that the entity expects to acquire in exchange for those goods or services.

IFRS 15 should be applied to all contracts with customers except the following:

- Lease contracts within the scope of IAS 17 *Leases*.
- Insurance contacts within the scope of IFRS 4 *Insurance Contracts*.
- Financial instruments and other contractual rights or obligations within the scope of IFRS 9 *Financial Instruments*, IFRS 10 *Consolidated Financial Statements*, IFRS 11 *Joint Arrangements*, IAS 27 *Separate Financial Statements* and IAS 28 *Investments in Associates and Joint Ventures*.
- Non-monetary exchanges between entities in the same line of business to facilitate sales to customers or potential customers.

Key Definitions

Performance obligation: A promise in a contract to transfer a good or service (or a bundle of goods or services) that is distinct or a series of distinct goods or services that are substantially the same and that have the same pattern of transfer to the customer.

Transaction price: The amount of consideration that an entity expects to receive in exchange for transferring promised goods or services to a customer.

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Summary

Under the new standard, an entity applies the following five steps when recognizing revenue:

Step 1: Identify the contract(s) with the customer

- An entity applies IFRS 15 to each contract with a customer that has commercial substance and meets other specific criteria (such as the probability of the entity collecting its entitled consideration in exchange for promised goods or services).
- The standard has specific conditions that need to be met in order for a contract to be within the scope of IFRS 15.

Step 2: Identify the performance obligation(s) in the contract

- To identify the performance obligation(s), an entity must consider if the customer can benefit from the good or service on its own or together with other readily available resources. The entity must also consider whether its promise to deliver the good or service is separately identifiable from other promises in the contract.

Step 3: Determine the transaction price

- The transaction price is typically a fixed amount of customer consideration. However, the price could include estimates of consideration that are variable, or consideration that is in a form other than cash. Factors such as collection uncertainty and the effects of financing are also considered in the determination of the transaction price.

Step 4: Allocate the transaction price

- An entity allocates the transaction price to each performance obligation on the basis of the stand-alone selling prices of each distinct good or service. The standard specifies when an entity should allocate the consideration to a specific part of the contract vs. all of the performance obligations in the contract.
- If it is determined that a contract contains a significant financing arrangement, an entity needs to adjust for the time value of money.

Step 5: Recognize revenue when a performance obligation is satisfied

- Revenue is recognized when the entity satisfies a performance obligation by transferring a promised good or service to a customer (i.e., the customer obtains control of that good or service).
- Therefore, revenue is recognized as control is passed, either over time or at a point in time. Control of an asset is defined as the ability to direct the use of, and obtain substantially all of the remaining benefits from, the asset. This includes the ability to prevent others from directing the use of, and obtaining the benefits from, the asset. The benefits related to the asset are the potential cash flows that may be obtained directly or indirectly.

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New Disclosure Requirements

IFRS 15 results in enhanced disclosures about revenue, provides guidance for transactions that were not previously addressed comprehensively (e.g. service revenue and contract modifications), and improves guidance for multiple-element arrangements.

An entity discloses qualitative and quantitative information about its contracts with customers, any significant judgments, and any assets recognized from the costs to obtain or fulfil a contract with a customer.

Effective Date and Transitional Requirements

IFRS 15 is effective for annual reporting periods beginning on or after January 1, 2017. Earlier application, with appropriate disclosure, is permitted.

An entity can apply this standard either:

- Retrospectively to each prior reporting period presented in accordance with IAS 8 *Accounting Policies, Changes in Accounting Estimates and Errors*.
  - An entity does not need to restate completed contracts that begin and end within the same annual reporting period.
  - For completed contracts with variable consideration, an entity may use the transaction price at the date the contract was completed.
  - For all reporting periods presented before the date of initial application, the entity does not need to disclose the amount of the transaction price allocated to the remaining performance obligations.
- Retrospectively, with the cumulative effect of initially applying this standard at the date of initial application.
  - An adjustment is made to the opening balance of retained earnings (or other component of equity, as appropriate).
  - The standard is only retrospectively applied to contracts that are not completed contracts at the date of initial application.

- IFRS 15 replaces the following standards and interpretations:
  - 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*
  - SIC 31 *Revenue - Barter Transactions Involving Advertising Services*

Resources

To see a detailed overview of the standard please click here.

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