IFS 15: Revenue from Contracts with Customers

Last updated: December 2016

Note: IFRS 15 is effective for annual periods beginning on/after Jan 1/18; earlier adoption is permitted.

SCOPE

Apply to all contracts with ***customers*** except the following:

- Lease contracts within the scope of IAS 17 *Leases* or IFRS 16 *Leases*;
- Insurance contracts 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*; and
- Non-monetary exchanges between entities in the same line of business to facilitate sales to ***customers*** or potential ***customers***,

DEFINITIONS

Contract: an agreement between two or more parties that creates enforceable rights and obligations. Contracts can be written, oral or implied by an entity's customary business practices.

Customer: a party that has contracted with an entity to obtain goods/services that are an output of the entity's ordinary activities in exchange for consideration.

Transaction price: the amount of consideration (excluding amounts collected on behalf of third parties such as sales taxes) to which an entity expects to be entitled in exchange for transferring promised goods/services to a ***customer***.

Stand-alone selling price: the price at which an entity would sell a promised good/service separately to a ***customer***.

RECOGNITION AND MEASUREMENT

Step 1: Identify the Contract(s) with a Customer

Identifying the contract

A contract with a ***customer*** is required to meet all of the following criteria at contract inception:

- The parties to the contract have approved the contract (in writing, orally or as implied by their customary business practices) and are committed to perform their respective obligations.
- Each party's rights regarding the goods/services to be transferred can be identified.
- Payment terms for the goods/services to be transferred can be identified.
- The contract has commercial substance.
- It is probable that the consideration to which the entity is entitled will be collected, considering only the ***customer's*** ability and intention to pay the consideration when due.

If the contract does not meet the above criteria at contract inception, the entity is required to reassess the contract going forward to determine if it meets the criteria subsequently.

Contracts that do not meet the criteria but consideration received

When a contract with a ***customer*** does not meet the criteria above and consideration is received from the ***customer***, revenue shall be recognized only when either:

- No remaining obligations to transfer goods/services to the ***customer*** and all, or substantially all, of the consideration promised by the ***customer*** has been received and is non-refundable; or
- The contract has been terminated and the consideration received from the ***customer*** is non-refundable.

The consideration received from a ***customer*** shall be recognized as a liability until one of the events above occur or until the five criteria noted above are subsequently met.

Combination of contracts

Multiple contracts entered into at, or near, the same time with the same ***customer*** (or related parties of the ***customer***) are accounted for as a single contract if at least one of the following criteria are met:

- Contracts are negotiated as a package with a single commercial objective;
- Amount of consideration to be paid in one contract depends on the price or performance of the other contract(s); or
- All (or some) of the goods/services promised in each of the contracts are a single ***performance obligation***.

- **Contract modification:** a change in the scope or price (or both) of a contract that is approved by the parties to the contract.
- **Contract modification represents a separate contract**

  If both of the following conditions are met, a modification must be accounted for as a separate contract:

  (a) The scope of the contract increases because of the addition of promised goods/services that are ***distinct***; and

  (b) The price of the contract increases by an amount of consideration that reflects the entity's ***stand-alone selling prices*** of the additional goods/services.

  No impact to the existing contract from modification(s); revenue recognized to date is not adjusted and any ***performance obligations*** remaining continue to be accounted for under the existing contract.
- **Contract modification is not a separate contract**

  (a) Remaining goods/services are ***distinct*** from those transferred on or before the contract modification – modification accounted for as a termination of the existing contract and creation of a new contract.

  - Revenue recognized to date is not adjusted but the remaining consideration under the existing contract (i.e. not yet recognized as revenue) and the consideration promised as part of the modification are proportionately allocated to the remaining ***performance obligations*** on a prospective basis.

  (b) Remaining goods/services are not ***distinct*** from those previously transferred – modification accounted for as if it were a part of the existing contract.

  - Revenue previously recognized needs to be adjusted on a cumulative catch-up basis.

  (c) Remaining goods/services are the mixture of (a) and (b).

  - Modification accounted for using a combination of the principles outlined in (a) and (b).

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Step 2: Identify the Performance Obligations

An entity shall, at contract inception, assess goods/services promised in a contract and identify ***performance obligations.***

Performance obligation: is a promise in a contract with a ***customer*** to transfer to the ***customer*** either:

- A good/service (or a bundle of goods/services) that is ***distinct***; or
- A series of ***distinct*** goods/services that are substantially the same and have the same pattern of transfer to the ***customer***.

A good/service is ***distinct*** if both of the following criteria are met:

- The ***customer*** can benefit from the good/service (through use, consumption, sale at an amount greater than scrap value or held in a way to generate economic benefits) either on its own or together with other resources that are readily available to the ***customer***; and
- The entity's promise to transfer the good/service to the ***customer*** is separately identifiable from other promises within the contract.

Factors that indicate two or more promises to transfer goods/services are not separately identifiable include, but are not limited to:

- The entity is using the goods/services as inputs in the production or delivery of a combined output to the ***customer*** (i.e. the entity provides significant integration services).
- One or more of the goods/services significantly modifies/customizes, or is significantly modified/customized by, other goods/services promised in the contract.
- The goods/services are highly interdependent or highly interrelated.

If a promised good/service is not ***distinct***, an entity shall combine that good/service with other promised goods/services until it identifies a bundle of goods/services that is ***distinct***.

Step 3: Determine the Transaction Price

The ***transaction price*** may be fixed, variable, or both. The estimate of the ***transaction price*** may be affected by the nature, timing and amount of consideration promised. When determining the ***transaction price***, the existence of ***significant financing components***, variable consideration, amounts payable to the ***customer*** (e.g. refunds, rebates, etc.) and non-cash amounts need to be considered.

- Contract contains a ***significant financing component*** if agreed (explicitly or implicitly) timing of payments provides the ***customer*** or entity with a significant benefit of financing for the transfer of goods/services. ***Transaction price*** is adjusted for the effects of the time value of money; objective is to recognize revenue at cash selling price.
- **Practical expedient:** if the expected period between transfer of goods/services and payment will be one year or less, an entity need not adjust the promised amount of consideration.

An entity shall consider both of the following in assessing whether a ***significant financing component*** exists:

- The difference, if any, between the amount of promised consideration and the cash selling price of the promised goods/services; and
- The expected length of time between the transfer of, and payment for, the promised goods/services and the prevailing market interest rates.

No ***significant financing component*** if any of the following factors exist:

- The ***customer*** paid for the goods/services in advance and the timing of the transfer of those goods/services is at the discretion of the ***customer***.
- A substantial amount of the consideration is variable based on the occurrence or non-occurrence of a future event that is not substantially within the ***control*** of the ***customer*** or the entity.
- Difference between promised consideration and cash selling price arises for reasons other than financing (e.g. performance protection).

Variable consideration (e.g. discounts, rebates, refunds, credits, price concessions, incentives, performance bonuses, penalties, and other payments contingent on a future event)

- If the consideration in a contract includes a variable amount, an entity shall include the estimated variable amount in the ***transaction price*** to the extent that it is highly probable that a significant reversal of cumulative revenue recognized will not occur.
- An entity shall estimate an amount of variable consideration using either of the following methods:
  - (a) Expected value – sum of probability-weighted amounts within a range.
  - (b) Most likely amount – the single most likely amount within a range.

The method which best predicts the ultimate amount of consideration shall be used and applied consistently throughout the life of the contract. At the end of each reporting period, the estimated ***transaction price*** shall be updated.

Consideration payable to a *customer* (e.g. cash that an entity pays, or expects to pay, to the ***customer*** or credit, coupon, voucher, etc. that can be applied against amounts owed) shall be accounted for as a reduction of the ***transaction price*** and, therefore, of revenue when (or as) the later of either of the following events occurs:

- Revenue for the transfer of the related goods/services to the ***customer*** is recognized; and
- The consideration payable to a ***customer*** is paid or promised (even if payment is conditional on a future event).

Exception: If payment is for a ***distinct*** good/service from the ***customer***, it shall be accounted for as the purchase of the goods/services.

- If consideration payable > the fair value of ***distinct*** goods/services, excess is a reduction of the ***transaction price***.
- If the fair value of the goods/services received from the ***customer*** cannot be reasonably estimated, all of the consideration payable should be accounted for as a reduction of the ***transaction price***.

Non-cash consideration shall be measured at fair value. If fair value cannot be reasonably estimated, the consideration shall be measured indirectly by reference to the ***stand-alone selling price*** of the goods/services.

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Step 4: Allocate the Transaction Price to Each Performance Obligation

Allocation objective - allocate the ***transaction price*** to each ***performance obligation*** (or ***distinct*** good/service) in an amount depicting the consideration to which the entity expects to be entitled. This objective is met by allocating the ***transaction price*** based on the relative ***stand-alone selling price***, except for discounts and variable consideration. If a contract has only one ***performance obligation***, there is no need to make this allocation.

If a ***stand-alone selling price*** is not directly observable, estimate using the following methods, or a combination of the following methods:

(a) Adjusted market assessment approach.

(b) Expected cost plus a margin approach.

(c) Residual approach, only if selling price for the same good/service sold to different ***customers*** (at or near the same time) is highly variable or a price has not yet been established and good/service has not previously been sold on a stand-alone basis.

Allocation of a discount - allocate proportionately to all ***performance obligations*** in the contract unless observable evidence (refer to IFRS 15.82) indicates that the entire discount relates to only one or more, but not all, ***performance obligations***.

Allocation of variable consideration - allocate entirely to a ***performance obligation*** or ***distinct*** good/service that forms part of a single ***performance obligation*** if both of the following criteria are met:

- The terms of a variable payment relate specifically to the entity's efforts to satisfy the ***performance obligation*** or transfer the ***distinct*** good/service; and
- Allocating the variable consideration entirely to the ***performance obligation*** or the ***distinct*** good/service is consistent with the allocation objective.

Step 5: Recognize the Revenue

Revenue is recognized when, or as, the entity satisfies a ***performance obligation*** by transferring a promised good/service (i.e. an asset) to a ***customer***. An asset is transferred when (or as) the ***customer*** obtains ***control*** of that asset.

Control: the ability to direct the use of, and obtain substantially all of the remaining benefits from, the asset and prevent others from doing so. Indicators of the transfer of ***control*** include:

- 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.

Performance obligations satisfied over time:

Revenue is recognized over time if one of the following criteria are met:

- The ***customer*** simultaneously receives and consumes the benefits provided by the entity's performance as the entity performs;
- The entity's performance creates or enhances an asset that the ***customer controls*** as the asset is created or enhanced; or
- 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.

Methods to measure performance obligations satisfied over time:

- Output methods (e.g. surveys of performance completed to date, appraisals of results achieved, milestones reached, time elapsed, units produced/delivered) – recognize revenue on the basis of direct measurements of the value to the ***customer*** of the goods/services transferred to date relative to the remaining goods/services in the contract.
- Input methods (e.g. resources consumed, labour hours expended, costs incurred, time elapsed, machine hours used) – recognize revenue on the basis of the entity's inputs to the satisfaction of a ***performance obligation*** relative to the total expected inputs.

If an entity does not satisfy a ***performance obligation*** over time, the ***performance obligation*** is satisfied at a point in time. In determining the point in time at which a ***customer*** obtains ***control***, the entity considers the requirements for ***control***, in addition to the indicators of the transfer of ***control***.

PRESENTATION AND DISCLOSURE

- An entity shall present the contract in the statement of financial position as a contract asset or a contract liability, depending on the relationship between the entity's performance and the customer's payment. An entity shall present any unconditional rights to consideration separately as a receivable.
- The entity shall disclose sufficient information to enable financial statements users to understand the nature, amount, timing and uncertainty of revenue and cash flows arising from contracts with ***customers***. An entity shall disclose qualitative and quantitative information about all of the following:
  (a) Its contracts with ***customers*** (see paragraphs IFRS 15.113 – 122);
  (b) The significant judgments, and changes in the judgments, made in applying IFRS 15 to those contracts (see paragraphs IFRS 15.123-126).
  (c) Any assets recognized from the costs to obtain or fulfill a contract with a ***customer*** (see paragraphs IFRS 15.127 – 128).
- If an entity elects to use the practical expedient related to ***significant financing components*** or incremental costs of obtaining a contract, the entity shall disclose that fact (IFRS 15.129).