

IFRS 15 – A Snapshot

February 2016



Executive Summary

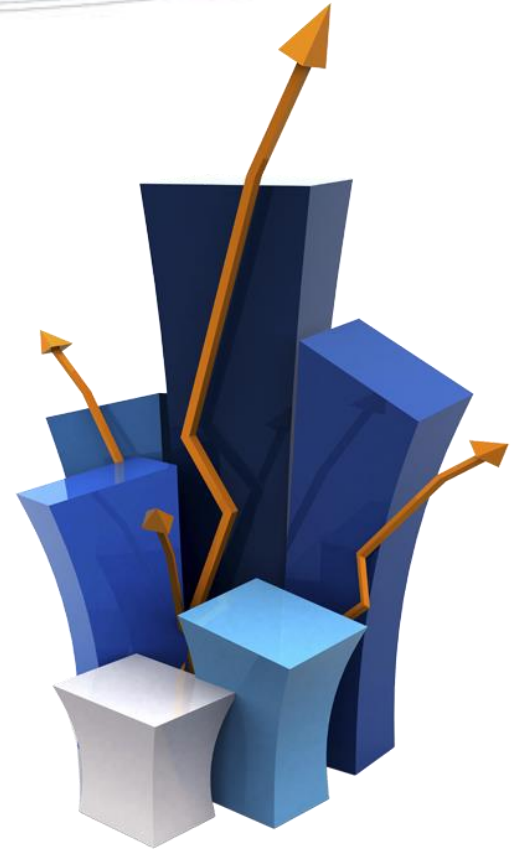
IFRS 15 *Revenue from Contracts with Customers* was issued by the IASB on 28 May 2014 and replaces several previous standards in the revenue space.

Most people have heard something about this standard but know very little about the details as the effective date is some time away.

Many others have attended some presentations on the new standard and seem to have left these sessions even more confused.

This publication hopes to simplify the basics of IFRS 15 and provide a broad overview of the transition to the new standard.

Our firm specialises in IFRS advisory and the preparation of financial statements and would be happy to engage with you further.

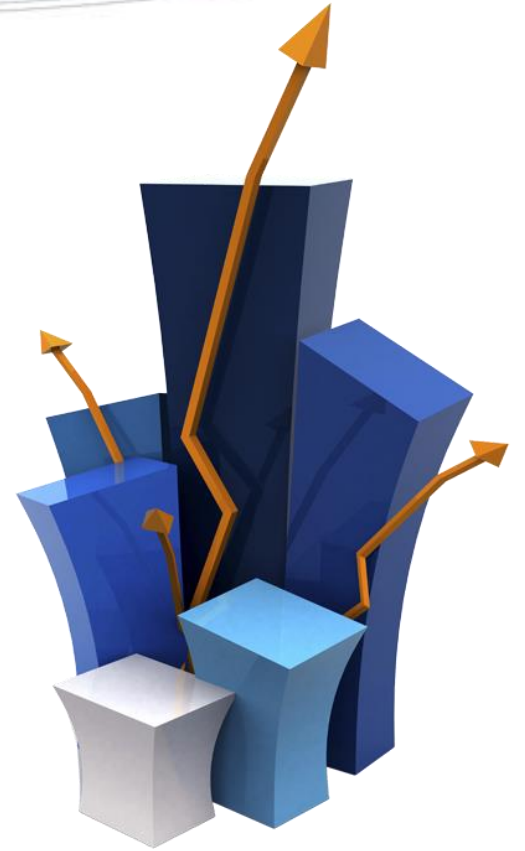


Executive Summary (continued...)

This publication firstly outlines the key changes from the previous standards covering revenue to the new IFRS 15. IFRS 15 is based on a 5 step revenue recognition process and we unpack each of these steps throughout the publication.

This publication is not intended to provide in depth knowledge into the

subject matter of IFRS 15 but to rather highlight some of its key principles. Please refer to the end of the publication for details on what has been excluded.



Summary of changes

The development of the new standard was a joint project between IASB & FASB to remove inconsistencies, improve comparability, simplify the requirements & provide more useful disclosure related to revenue.

The new standard supersedes the following previous standards:

- IAS 11 Construction Contracts
- IAS 18 Revenue
- IFRIC 13 Customer Loyalty Programmes
- IFRIC 15 Agreements for Construction of Real Estate
- IFRIC 18 Transfers of Assets from Customers
- SIC-31 Revenue-Barter Transactions Involving Advertising Services

IFRS 15 provides a 5 part criteria approach to all transactions:

Identify contracts with customers

Identify performance obligations in the contract

Determine transaction price

Allocate transaction price to performance obligations

Recognise revenue when performance obligation met



Defined terms

An entity shall recognise revenue to depict the **transfer of promised goods or services** to **customers** in an amount that reflects the **consideration** to which the entity expects to be entitled in **exchange for those goods and services**

Contract Agreement between 2 or more parties that creates enforceable rights and obligations	Performance obligation A promise in a contract with a customer to transfer: - Distinct Good or service - Series of distinct goods or services
Customer Party contracted to entity to obtain goods and services that are an output of the entity's ordinary activities for a consideration	Transaction price Amount of consideration to which an entity expects to be entitled in exchange for transferring promised goods or services to a customer

Defined terms

In order to recognize revenue and calculate the amount of revenue to be recognized during a particular financial period, it is necessary to work through the 5 step process.

Contract liability
Entity's **obligation** to transfer goods and services to a customer for which the entity has **received consideration**

Contract asset
Entity's **right** to a consideration in exchange for goods and services that have been transferred to a customer when the right is **conditioned** on something other than passage of time

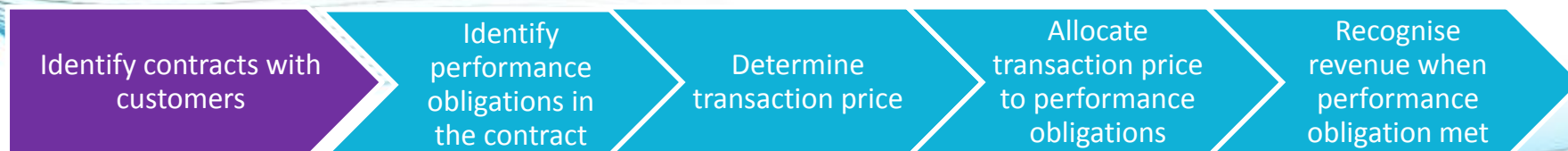
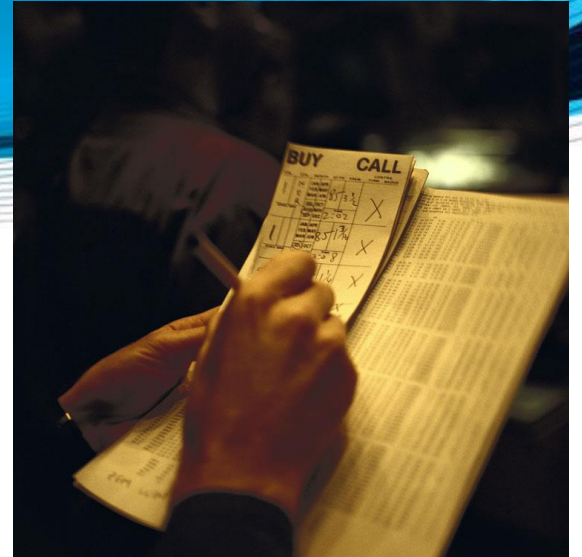


Identify contracts with customers

The first criteria allows one to determine whether the transaction is within the scope of IFRS 15. In order to be within the scope of IFRS 15, a contract has to be established.

Once the criteria have been met, there is no further reassessment of the contract at a later date. If the criteria have not been met at a particular reporting date,

management should continue to reassess the criteria on a continual basis at subsequent reporting dates.



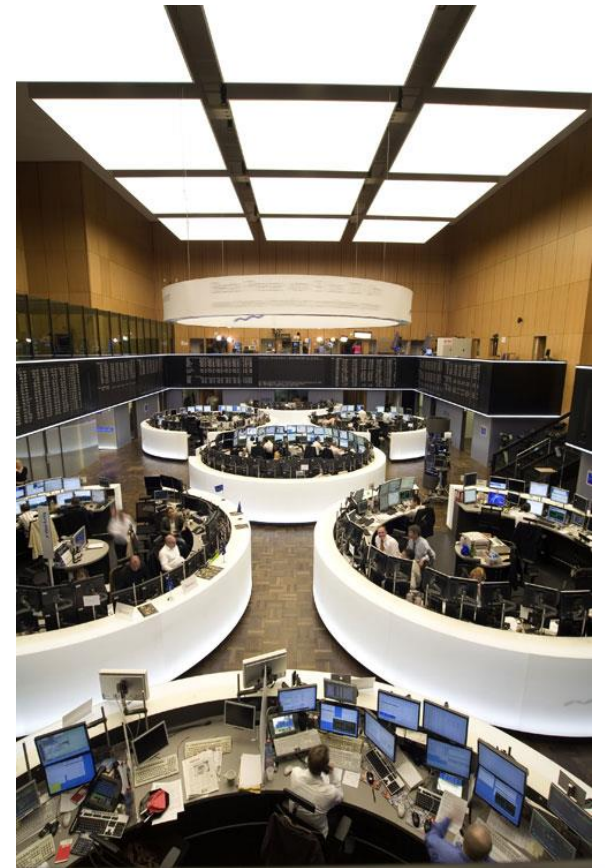
Illustrative example – Collectability of consideration

Scenario

A real estate developer enters into a contract with a customer to sell a building for R1m. The customer intends opening a restaurant in the building. The competition for restaurants in the areas is very high and the customer has little experience about managing restaurants. The customer pays a R50k deposit and takes a loan from the entity for the balance which will be repaid, including interest, using proceeds from the restaurant.

Solution

This contract fails on the probability of collectability of the amount. The customer intends repaying the loan which is significant using proceeds from the restaurant. There are significant risks around these proceeds given the high competition. The customer lacks other income to repay the loan. The R50k deposit will be recorded as a deposit liability.



Identifying performance obligations

In order to identify a performance obligation, the entity has to identify goods and services that are distinct, or a series of goods and services that are substantially the same and have the same pattern of transfer.

A G+S is distinct if both of the following are met:

- Customer can benefit on its own or with other, readily available resources
- Promise is separately identifiable

Same pattern of transfer if:

- Is satisfied over time (p35)
- Progress towards completion measured in terms of p39 - 40

If G+S not distinct then an entity shall combine it with other promised G+S until it identifies a bundle of G+S that is distinct.

A promise is not separately identifiable if:

- The customer is not using the G+S as an input
- The G+S does not modify another G+S

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Illustrative example – Distinct goods and services

Scenario

A contractor enters into a contract to build a hospital for a customer. The contractor is responsible for overall project management as well as the provision of various goods and services e.g. engineering, site clearance, foundations, equipment etc.

Are each set of goods and services separate performance obligations that are separately identifiable?

Solution

The promised goods and services are capable, individually of being distinct as the customer can benefit from each one individually.

However, in terms of p27b, they are not distinct as the entity's promise to transfer individual G+S are integrated and therefore both criteria under p27 are not met.

Therefore all G+S (building of the entire hospital) is a single performance obligation.



Determining the transaction price

The transaction price 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.

The consideration promised may include **fixed amounts, variable amounts or both**.

If an entity receives an amount which it expects to refund to the customer, it will recognise a refund liability.

A variable amount arises when the consideration may vary due to items such as discounts, rebates, refunds, credits, price concessions etc. An entity should estimate the variable consideration at the outset using either an expected value (probability weighted amounts in a range of possibilities) or the most likely amount (single most likely amount in a range of possibilities).

A variable amount is only recognised to the extent that it is highly probable that a significant reversal in the amount of cumulative revenue recognised will not occur.

An entity should recognise a financing component if the consideration receivable exceeds the cash selling price and the period of payment is in excess of 1 year.

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Illustrative example – Right of return

Scenario

An entity enters into a contract with 100 customers to sell 1 product at a value of R100 per product (Total = R10 000). Cash is received when control transfers. The customary practice to allow a return within 30 days (unused product) for a full refund. The cost of the product is R60. The entity expects that 97 products won't be returned.

Solution

Return of products means that consideration receivable is variable.

Using expected value, transaction price = $97 \times R100 = R9\,700$

In considering constraining estimates of variable consideration, the entity notes that, although the return is outside its control, it has experience around returns and it will be resolved in a short space of time. Therefore it is highly probable that a reversal of the R9700 would not occur.

The entity will recognise:

- R9 700 revenue

- R300 refund liability ($R100 \times 3$)

- R10 000 of cash received

Allocating the transaction price

Key principle

The objective when allocating a transaction price is for an entity to allocate it to each performance obligation (or distinct good or service) in an amount that depicts the amount of consideration to which an entity expects to be entitled in exchange for the good or service transferred.

The allocation of the transaction price consists of 3 specific categories viz. the allocation based on standalone selling prices of each performance obligation, the treatment of discounts and the allocation of variable considerations.

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**Allocation based on
stand alone selling
prices**

↓

Allocation of discounts

↓

**Allocation of variable
consideration**

Identify contracts with
customers

Identify
performance
obligations in
the contract

Determine
transaction price

Allocate
transaction price
to performance
obligations

Recognise
revenue when
performance
obligation met

Allocating the transaction price

The standalone selling price represents the price that the entity would sell the goods and services separately to a customer. This is generally observable in practice. In cases where it is not observable, the standalone selling price would have to be estimated. IFRS 15 outlines some suggested estimation techniques.

Once the standalone selling price for each performance obligation has been determined, the selling price for the contract will be allocated to each performance obligation in the respective proportions.

If the sum of the standalone selling prices of each performance

obligation exceeds the contract price, there is a discount. The discount is allocated in the same way as the allocation of the transaction price unless there is evidence that it relates specifically to one or more specific performance obligations.

Illustrative example – Allocating transaction price

Scenario

An entity sells 3 products, A, B & C in a single contract for R100. The performance obligations are settled at different points in time for each. Selling price for A is directly observable only. The entity estimates the selling prices of B & C. The selling prices are as follows:

A – R50

B – R25

C - R75

Solution

The total selling price of R150 is less than the consideration, therefore there is a discount.

As there is no evidence to suggest allocating discount to a particular product, it will be allocated across all.

Transaction price allocated as follows:

A = R33 ($50/150 \times 100$); B = R17 ($25/150 \times 100$); C = R50 ($75/150 \times 100$)

Allocating the variable consideration

Variable considerations may be attributed to the entire contract or to part of the contract if they relate to one or some of the performance obligations.

This will only be the case if the terms of the payment relate specifically to the fulfilment of the respective performance obligation.

Scenario

An entity sells 2 licences, X and Y with stand alone prices of R800 and R1 000. The price in the contract is fixed for X at R800 and for Y is 3 percent of sales revenue for products sold using licence Y. The entity estimates the sales based royalty (consideration) to be R1 000.

Solution

The variable consideration should be allocated entirely to Y as:

- Variable payment relates specifically to outcome from performance obligation linked to product Y

- Fixed payment approximates stand alone selling price of X and variable payment stand alone selling price of Y

- Consideration for X recognised on transfer of licence

- Consideration for Y recognised when sales occur

Satisfying performance obligations

An entity shall recognise revenue when it **satisfies a performance obligation** by **transferring** the promised G+S. Transfer occurs when the customer obtains **control** of the G+S. An entity shall determine at inception of the contract whether the performance obligation is satisfied **at a point in time or over time**.

A performance obligation is satisfied over time when either of the following occur:

- The customer receives and consumes the benefits simultaneously
- An asset is created or enhanced due to the performance
- Performance does not create an asset with alternative use & the entity has the right to payment

A performance obligation is satisfied at a point in time when either of the following occur:

- It is not satisfied over time
- There is a present right to payment
- The customer has legal title of the asset or physical possession
- The customer has significant risks and rewards

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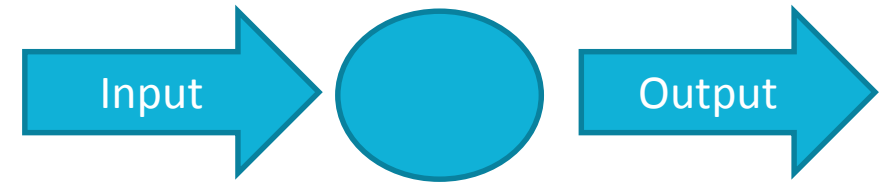
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Measuring progress towards complete satisfaction of a performance obligation

An entity has two alternatives to measure revenue recognized over time viz. an input or output method.

The input method is based on a measure of inputs into the satisfaction of a performance obligation e.g. parts used in a manufacturing process

The output method, on the other hand, is based on direct measurements of value to the customer of goods and services transferred to date e.g. surveys of work performed, milestones reached



Out of scope

The following key areas have not been included in the scope of this publication:

- Combination of contracts (p17) & Contract modifications (p18 – 21)
- Constraining estimates of variable consideration (p56 – 58)
- Consideration payable to a customer (p70 – 72)
- Changes in the transaction price (p87 – 90)
- Contract costs (p91 – 104)
- Disclosure & Presentation

Reference: IFRS 15 Revenue from contracts with customers, IASB, July 2014

About ZKC & Associates

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AFS Preparation & IFRS Advisory

Advising clients on appropriate IFRS treatment and end to end preparation of financial statements including complex entities and consolidations

SMME Management Consulting

Providing cutting edge financial and operational expertise to SMME clients in order to maximise efficiencies, develop sound controls and enhance profitability.

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Training clients on IFRS and accounting related issues and developing easy to use material for learning and development within the IFRS space.



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