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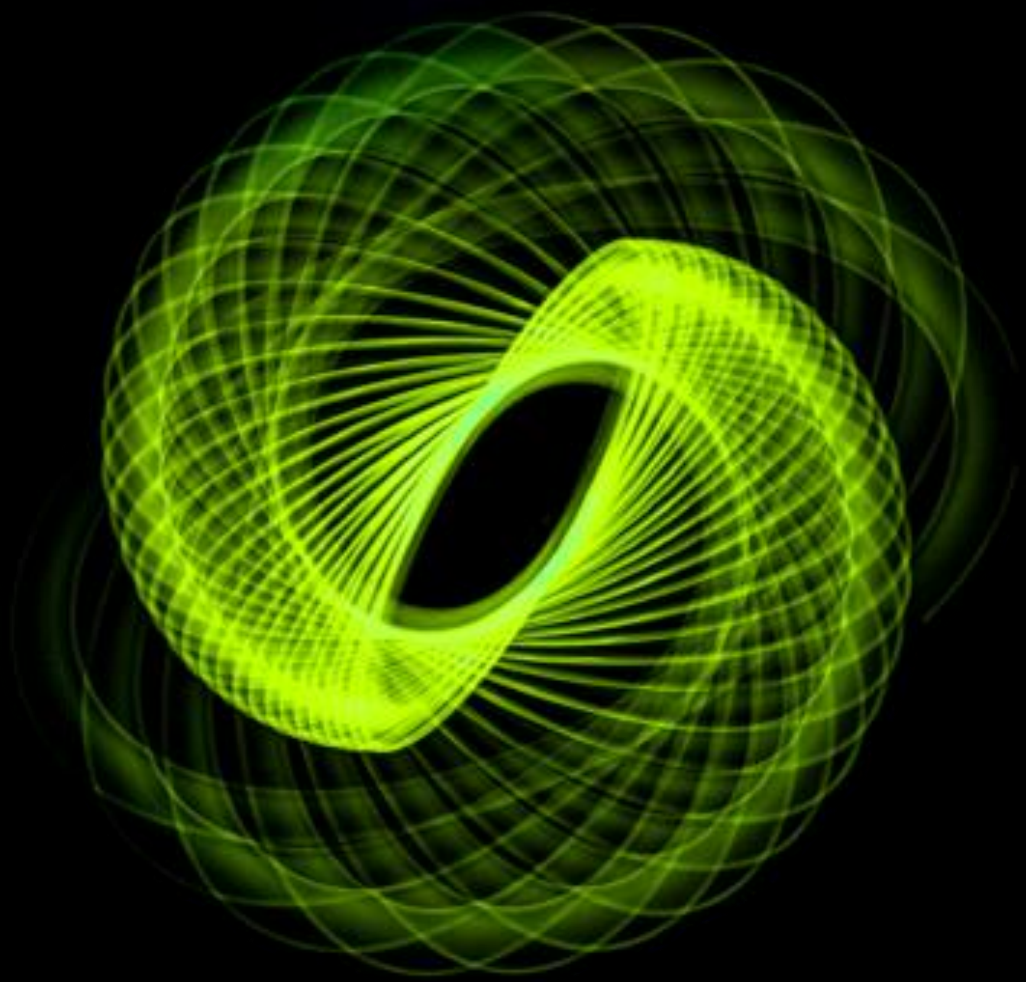


IFRS 15 Revenue from Contract with Customers

19 January 2019

In the Middle East
since 1926

Contents

Caveat

These seminars are meant to provide high level presentations on various IFRS Standards.

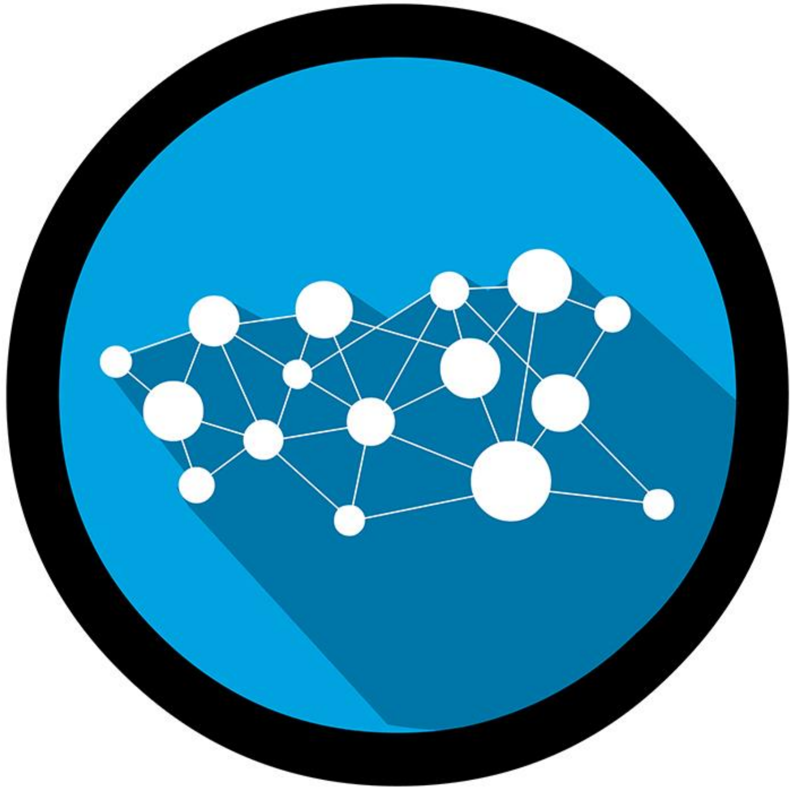
The training material does not provide official Deloitte Touché Tohmatsu Limited interpretive accounting guidance.

Financial Statements prepares and users are advised to seek professional advise in applying and interpreting the IFRS Standards covered by these presentations.

Introduction

Introduction
Scope
Q&As and cases
Other specific considerations

The Core Principle –
5 Step Revenue Recognition Model



The Core Principle –5 Step Revenue Recognition Model

Overview—the core principle

Recognize revenue to depict the transfer of 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 or services.

Five-step model to apply the core principle:

1. **Identify the contract with a customer (Step 1)**
2. **Identify the performance obligations in the contract (Step 2)**
3. **Determine the transaction price (Step 3)**
4. **Allocate the transaction price to the performance obligations (Step 4)**
5. **Recognise revenue when each performance obligation is satisfied (Step 5)**

Control approach
(differs from the risks and rewards approach under IAS 18)

The Core Principle –5 Step Revenue Recognition Model
Step 1: Identifying the contract

Step 1 | Step 2 | Step 3 | Step 4 | Step 5

A legally enforceable contract (incl. oral or implied) must meet all of the following requirements:

Contracts are approved and the parties are committed to perform.

Each party's rights can be identified.

Payment terms can be identified.

Commercial substance.

It is probable that the entity will collect the consideration to which it will be entitled.

Collectibility threshold

A contract is outside the scope if:

The contract is wholly unperformed

AND

Each party can unilaterally terminate the contract without compensation

Step 2: Identifying performance obligations

Identify all (incl. implicit) promised goods/services in the contract

Is the good/service distinct?

CAPABLE OF BEING DISTINCT

Can the customer benefit from the good or service on its own or together with other readily available resources?

AND

DISTINCT IN CONTEXT OF CONTRACT

New

Is the good or service separately identifiable from other promises in the contract?

YES

Account for as a separate performance obligation

NO

Combine two or more promised goods or services

Distinct within the context of the contract

In April 2016, the IASB amended IFRS 15 to clarify when a promised good or service is "separately identifiable" from other promises.

Factors that indicate that two or more promises to transfer goods or services to a customer are not separately identifiable include but not limited to the following:

a) *The entity provides a significant service of integrating the goods or services;*

b) *One or more of the goods or services do significantly modifies or customizes or are significantly modified or customized by one or more of the other goods or services promised in the contract;*

c) *The goods or services are highly dependent or highly interrelated.*

Unbundling of contacts

Fact pattern

ManufactCo enters into a contract to sell a customer a pool filter system and a filter cartridge that is delivered two weeks later.

- The pool filter system cannot filter without the filter cartridge.
- Both the pool filter system manufacturer and sellers of generic filter cartridges sell the pool filter system and filter cartridges separately.

How many distinct performance obligation(s) can be identified?

Unbundling of contacts (continued)

Suggested solution

- ManufactCo identifies **two** distinct performance obligations: the pool filter system and the filter cartridge:
  - The customer can benefit from the goods either on their own or together with other resources that are readily available to the customer (IFRS 15.27(a)); and
  - ManufactCo's promise to transfer the goods or service to the customer is separately identifiable from other promises in the contract (IFRS 15.27(b)). In particular, ManufactCo does not provide a significant service of integrating the cartridges with the filter system (IFRS 15.29(a)) into a combined output. The cartridges are not significantly modified or customized by the filter system (IFRS 15.29(b)). The cartridges are not highly dependent on, or highly interrelated with, the filter system (IFRS 15.29(c)).

Step 3: Determining the transaction price

What is the transaction price? What does it include?

Definition

Consideration amount to which an entity expects to be entitled in exchange for transferring promised goods or services to a customer.

Variable consideration

- Estimated and potentially constrained
- e.g., discounts, rebates, refunds, etc.

Exception for sales/usage based royalties of IP

Fixed consideration

The amount is fixed and not contingent on the outcome of future events.

Consideration payable to customers

Reduces transaction price unless payment is made for a distinct good/service.

Excluding credit risk

The transaction price would not be reduced for the effects of customer credit risk.

Exception

Significant benefit of financing

- If identified, leads to adjustment in transaction price.
- Practical expedient available.

Non-cash consideration

- Consideration in a form other than cash
- Shall be measured at FV

Step 3: Determining the transaction price (continued)

The following should be considered while determining the transaction price

1. **Variable consideration**
   - Performance Bonuses, Incentives, Rights of return, Discounts
2. **Consideration payable to customer**
   - Coupons, Vouchers, Volume Rebates, Shelf space payments
3. **Non cash consideration**
   - Share considerations, Material equipment, labour
4. **Time Value of Money**
   - Expected length of time between delivery and payment
   - Difference between consideration promised and cash selling price
   - Prevailing market interest rate

Variable consideration can only be recognised <u>if it is highly probable that a significant reversal</u> in the amount of the cumulative revenue recognized will not occur.

Determine the transaction price (continued)
Selection of method for variable consideration

1. Expected Value Method

- This method may be appropriate when the entity has a large number of contracts with similar characters and it is calculated as the sum of probability weighted amounts in a range of possible consideration amounts.
- Outcome of each contract is independent of others.

2. Most Likely Method

- When the contact has only two possible outcomes. It is the single most likely amount in a range of possible consideration amounts (single most likely outcome of the contact)
- Additional consideration receivable is based on performance bonus by meeting the criteria set.
- Although Entity X has a large number of contracts, the outcomes are not independent because they all depend on the same criterion.

1. **Slotting fees**

- Entity X contracts to sell products to Entity Y, a retailer. Entity Y promises to display the products in a prime location within the store to encourage the sales. Any payments made or discounts provided to Entity Y in exchange for such services should be accounted for as a reduction of the transaction price recognised by Entity X as the services provided by Entity Y are not sufficiently separable from Entity Y's purchases of products from Entity X.

2. **Inclusion in retailer's advertising circular or Website**

- As part of the contract the retailer agrees to include the seller's product in its weekly circular. It should be accounted for as a reduction of the transaction price recognised by the seller.

Step 4: Allocating the transaction price

Determine standalone selling price

- Estimate the price if unobservable
- Acceptable methods :
  > Adjusted market assessment approach
  > Expected cost plus a margin approach
  > Residual approach

Only allowed in limited circumstances

Maximize the use of observable inputs and apply consistently

Allocate the transaction price

- Allocate the transaction price to each performance obligation on a relative stand-alone selling price basis.
- Allocate discounts proportionally to **all** performance obligations unless certain criteria are met.
- Allocate variable consideration and changes in transaction price to **all** performance obligations.
- Do not reallocate changes in standalone selling price after inception.

Step 1 Step 2 Step 3 Step 4 Step 5

Step 5: Recognizing revenue

Performance satisfied over time = Revenue recognised over time

The seller's performance creates or enhances an asset controlled by the customer.

OR

The customer simultaneously receives and consumes the benefit of the seller's performance as the seller performs.

OR

The seller **does not** create an asset that has an alternative use to the seller **and** the seller **has the right to be paid** for performance to date.

IF NOT

Revenue recognized at a point in time

Key impact on revenue recognition

Actual impact will depend on specific customer contracts

Step 1
Identify the contract with a customer

Step 2
Identify the performance obligations in the contract

Step 3
Determine the transaction price

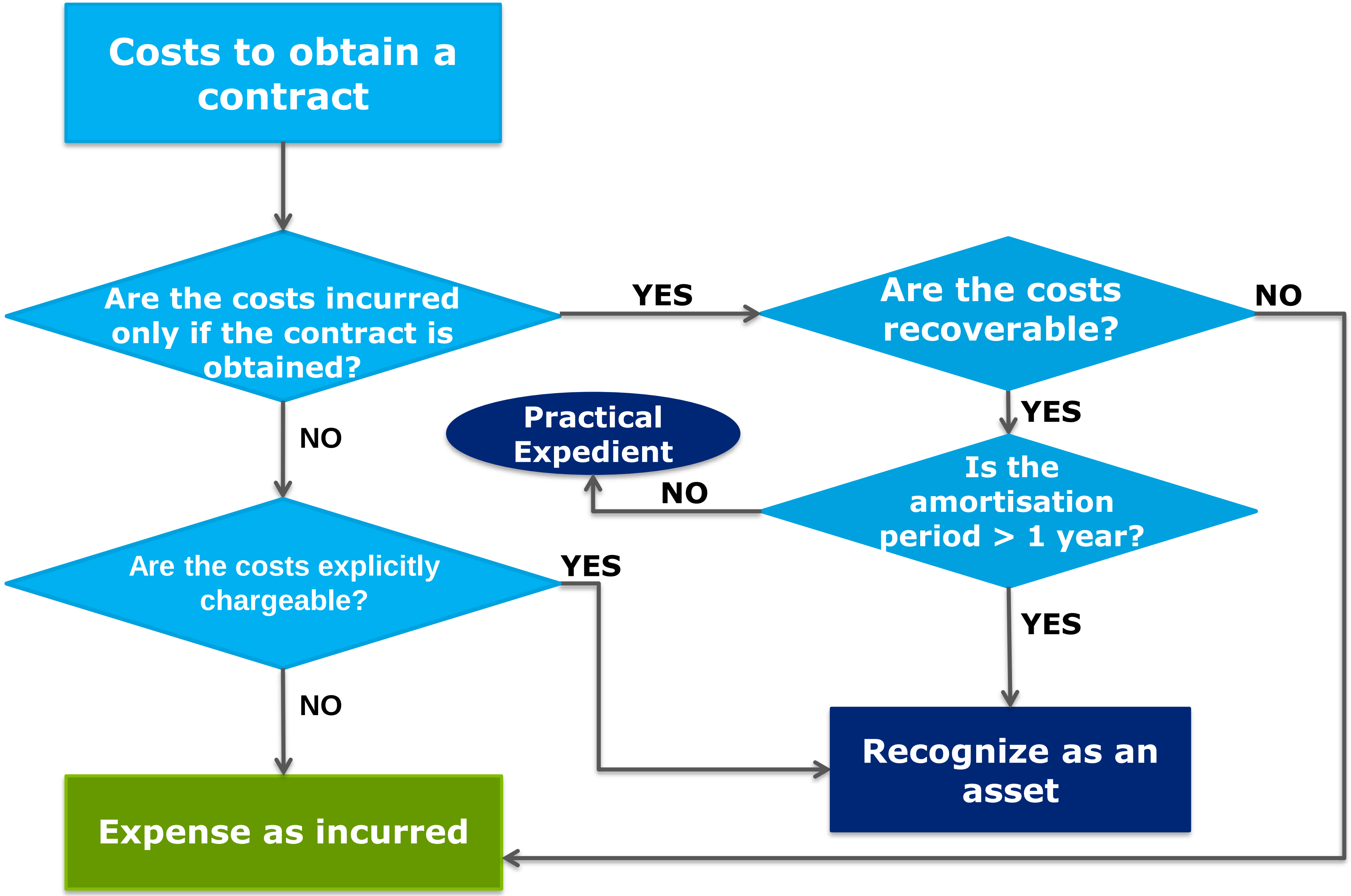
Step 4
Allocate the transaction price to performance obligations

Step 5
Recognise revenue when each performance obligation is satisfied

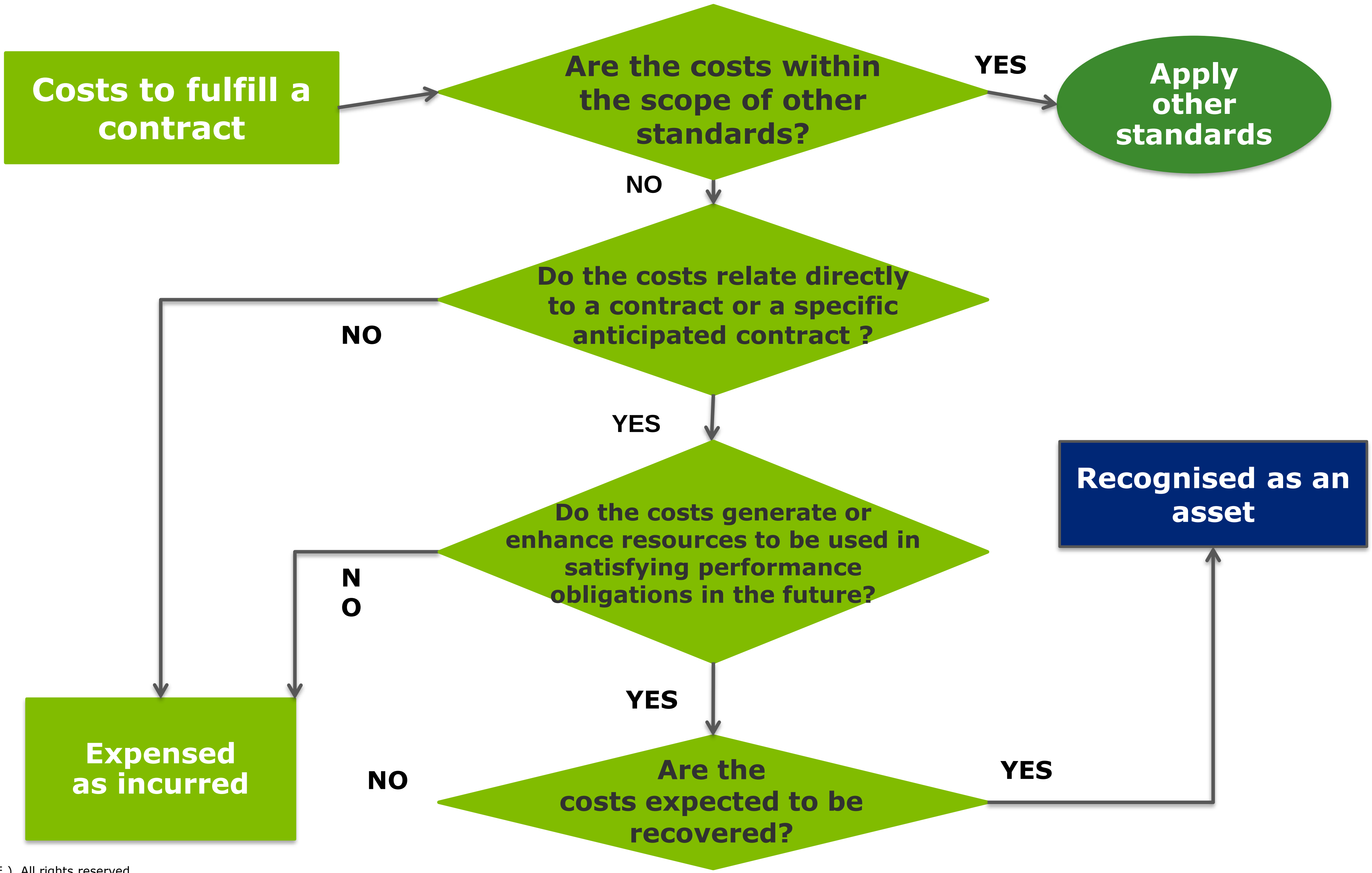
Collectability	Unbundling of contracts	Uncertain revenue or contingent revenue	Allocation of total revenue to the unbundled parts	Recognition of revenue at a point in time or over time
Healthcare Technology	Telecom Software Automotive	Life Science Consumer & Industrial Products	Telecom	Contract Manufacturer Real estate

Contract costs

Contract to Obtain a contract



Costs to fulfil a contract



Other specific considerations

Other Provisions

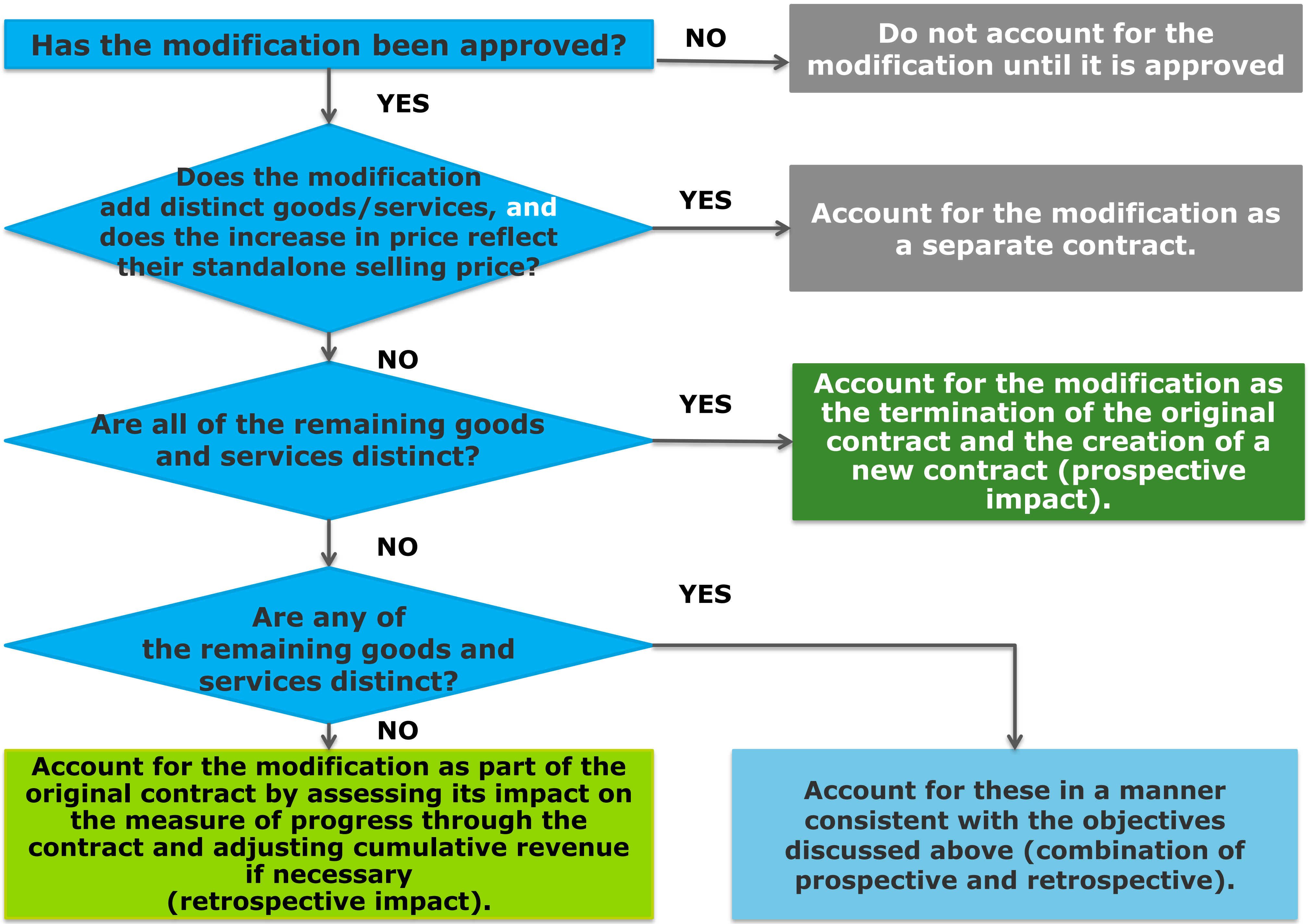
Contract modifications

Licensing

Warranties

Principal versus Agent

Contract Modifications



Principal Versus Agent

The Standard provides three indicators of when an entity controls the specified good or service and is, therefore, a principal.

Indicators that an entity controls the good or service before it is transferred to the customer include the following:

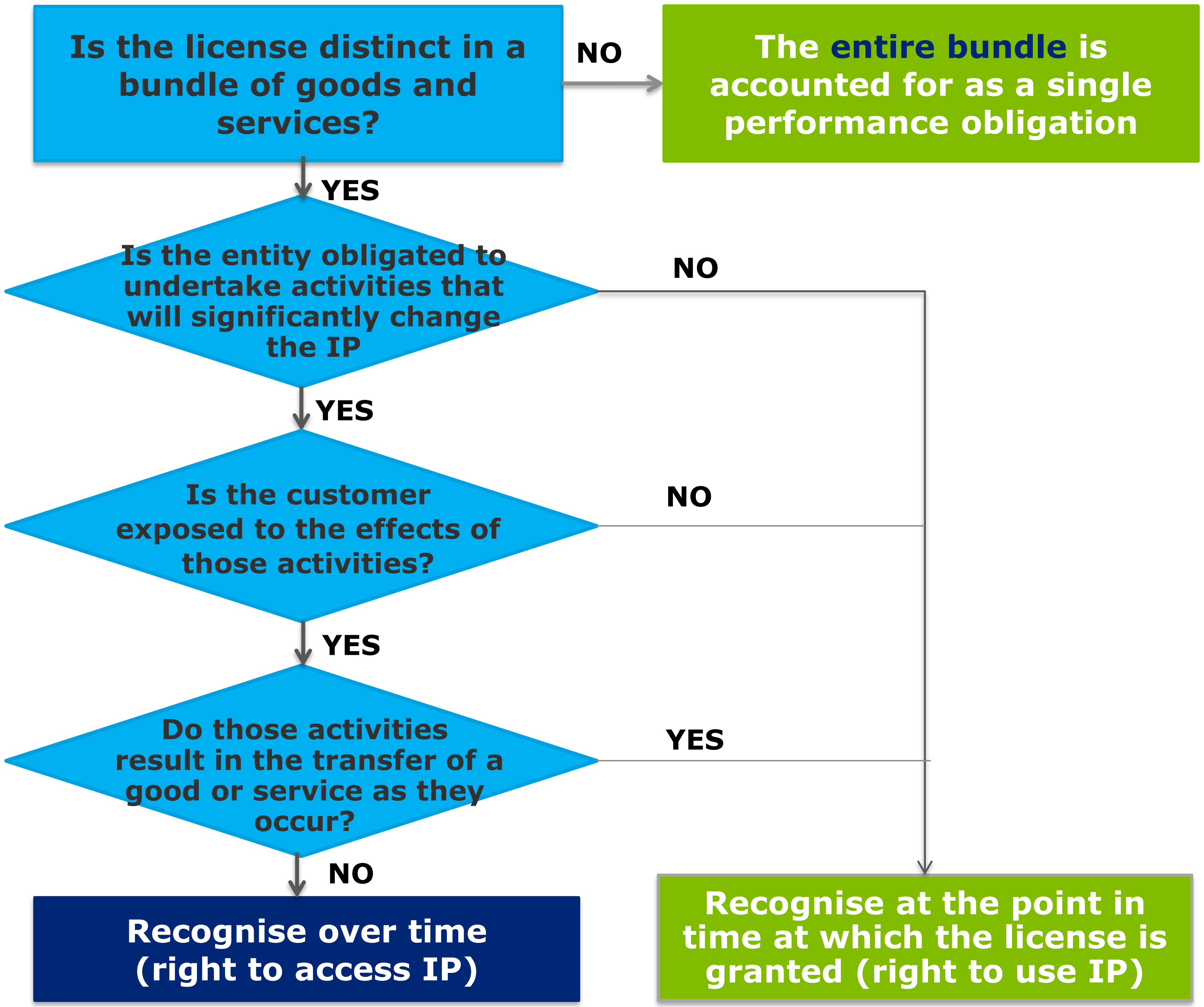
1) the entity is primarily responsible for fulfilling the promise to provide the specified goods or service;

2) The entity has inventory risk before the specified good or service has been transferred to a customer or after transfer of control to the customer (right of return);

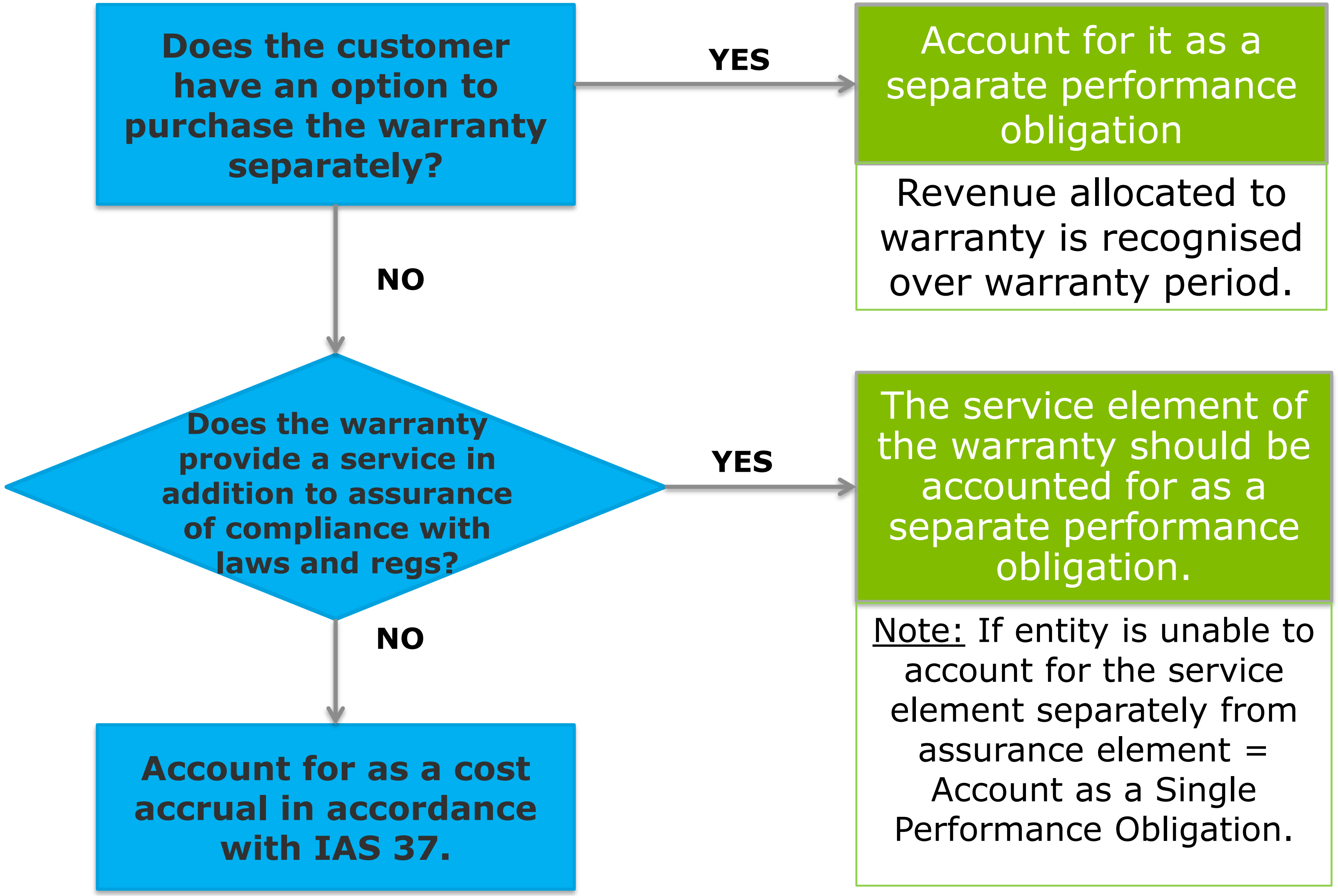
3) The entity has discretion in establishing the price for the specified good or service.

The new standard does not carry forward some other indicators from IAS 18 (e.g. those relating to exposure ro credit risk and the form of consideration as commission)

Application Guidance: Licensing



Warranties


Does the customer have an option to purchase the warranty separately?
YES
Account for it as a separate performance obligation
Revenue allocated to warranty is recognised over warranty period.
NO
Does the warranty provide a service in addition to assurance of compliance with laws and regs?
YES
The service element of the warranty should be accounted for as a separate performance obligation.
Note: If entity is unable to account for the service element separately from assurance element = Account as a Single Performance Obligation.
NO
Account for as a cost accrual in accordance with IAS 37.

Transition and Disclosure

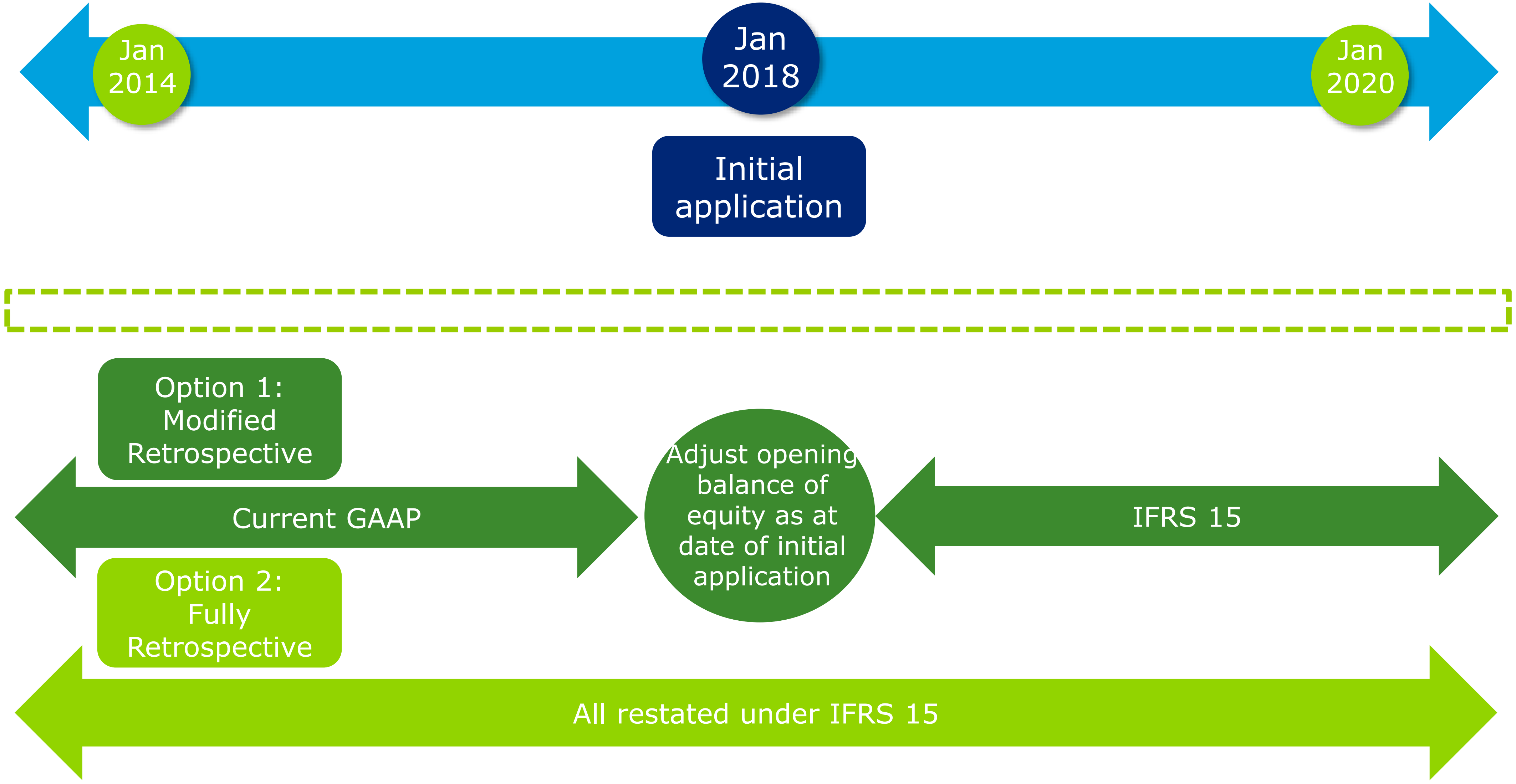
Transition Approaches

Two approaches are permitted on transition

- No restatement of comparatives; or
  - Adjustment to equity at the start of the current year (2018)
- Full retrospective restatement (subject to limited practical expedients).

Whichever approach is adopted, the current year (2018) will be prepared as if the new Standard had always been in force.

Transition Approaches (continues)



Disclosures

Disclosures

Enable users to understand the amount, timing, and uncertainty of revenue and cash flows.

Significant judgments

- Description of significant judgments applied/transaction price, allocation methods and assumptions.

Contracts with customers

- Disaggregation of revenue;
- Contract balances (including reconciliation);
- Information about performance obligations;
- Remaining performance obligations; and
- Practical expedients.

Others

- Policy decisions – time value of money and cost to obtain a contract; and
- Contract costs.

Questions and insights?