Latest Developments around Revenue Recognition (IFRS 15)

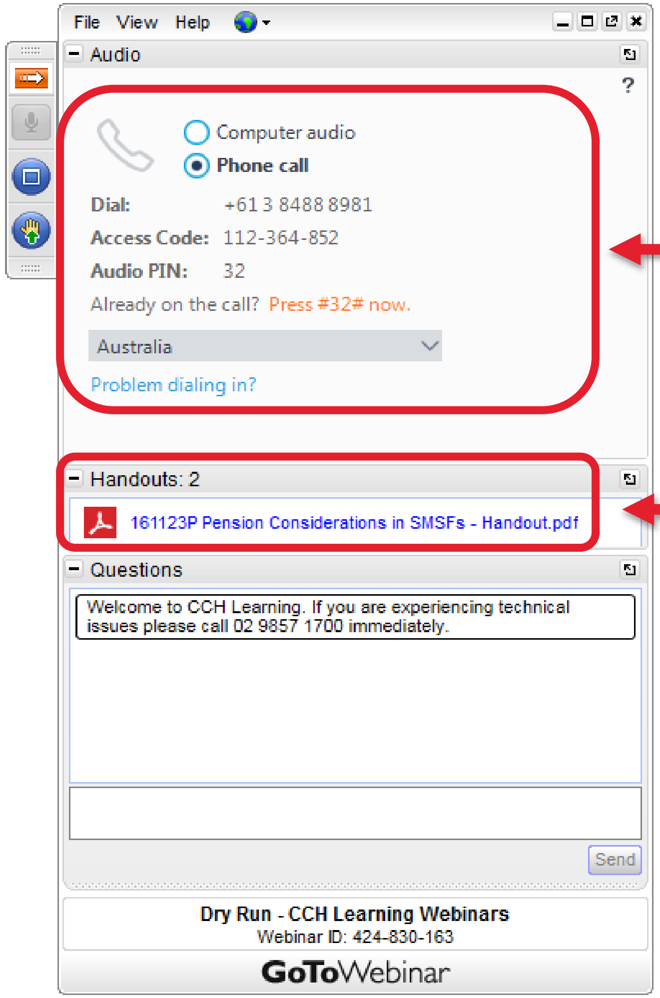
Aletta Boshoff

Thursday 02 May 2024

Wolters Kluwer

BDO

How to Participate Today



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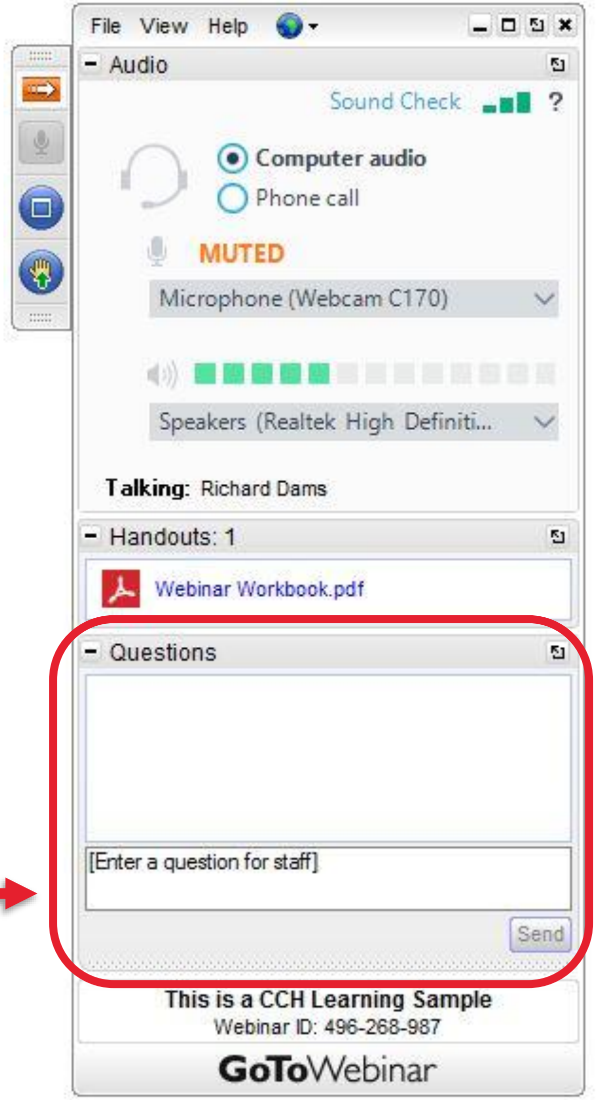

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Your Presenter

- Aletta Boshoff
- Partner, BDO
- National Leader IFRS & Corporate Reporting
- National Leader ESG & Sustainability

Acknowledgement of Country

We begin by acknowledging the Traditional Owners of the land on which we meet today and pay our respects to Elders past and present

We extend that respect to Aboriginal and Torres Strait Islander peoples here today

Today’s agenda

Today's agenda

- The importance of revenue
- Scope of IFRS 15
- IFRS 15's 5-step revenue recognition model
- Step 1: Identify the contract
- Step 2: Identify separate performance obligations
- Step 3: Determine the transaction price
- Step 4: Allocate the transaction price to performance obligations
- Step 5: Recognise revenue as or when each performance obligation is satisfied
- Contract modifications
- Other practical issues

BDO resources

https://www.bdo.com.au/en-au/content/ifrstopics/revenue

Articles | BDO Global IFRS | Webinars | IFRIC agenda decisions | Online training

Corporate Reporting Insights

BDO's monthly newsletter, Corporate Reporting Insights, keeps you up to date with the latest Australian and global developments in corporate financial and sustainability reporting.

Steps 1 to 5

General

Industry impacts

Not-for-profit entities

BDO resources

https://global-www.bdo.global/getmedia/5909496a-8002-4de5-b770-0dcb810af3f4/IFRS-15-In-Practice.pdf.aspx

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The importance of revenue

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The importance of revenue

- One of the most important financial reporting metrics
- Largest item in the statement of comprehensive income
- Revenue (for example, sales) have a direct impact on profit
- Indication of the activity level and the capacity of the entity
- First row of the statement of profit or loss and other comprehensive income
- Investors often focus on revenue growth and acceleration
- An assumed significant risk for auditors
- Compliance (lodgement) obligations with ASIC
  - Financial statements
  - Mandatory sustainability reporting

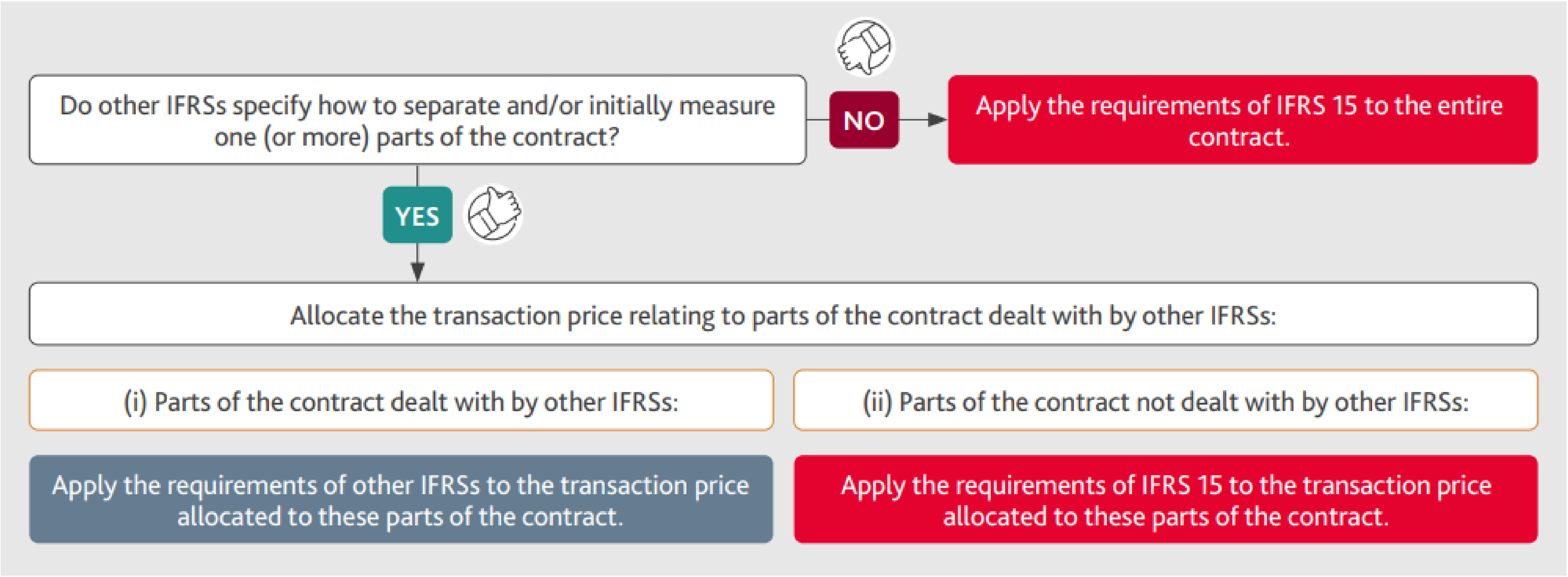
Scope of IFRS 15

Scope of IFRS 15

IFRS 15 applies to all contracts with customers, except for:

- Lease contracts within the scope of IAS IFRS 16 *Leases*;
- Insurance contracts within the scope of IFRS 17 *Insurance Contracts*. However, an entity may choose to apply IFRS 15 to insurance contracts that have as their primary purpose the provision of services for a fixed fee in accordance with paragraph 8 of IFRS 17.
- Financial instruments and other contractual rights and 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 (such as a contract between two oil customers to exchange oil to fulfil demand from their customers in different specified locations).

Scope of IFRS 15



Scope of IFRS 15

Example 1

A car manufacturer leases a fleet of cars to a customer for 3 years. As part of the contract it also deals with various administrative matters for the customer such as arranging insurance, providing breakdown cover and annual servicing.

IFRS 16 Leases require contracts to be separated into their lease and non-lease components. A vendor applies IFRS 15 to the amounts received from the customer that relate to the non-lease components of the contract.

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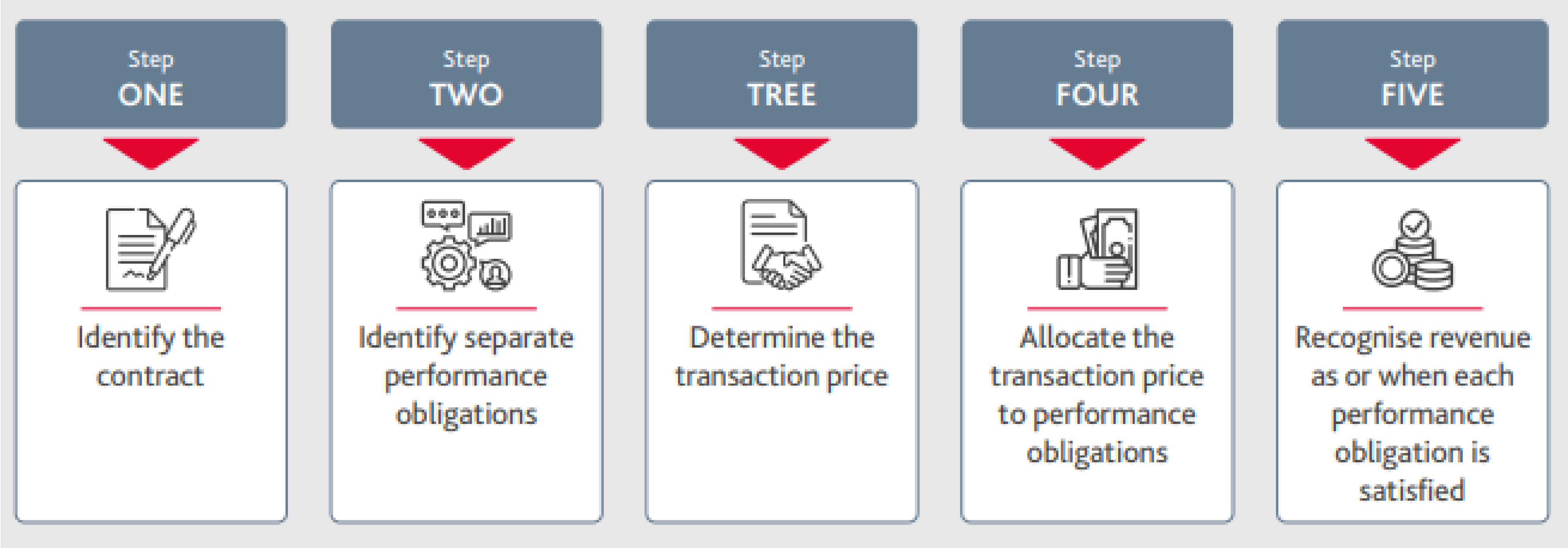
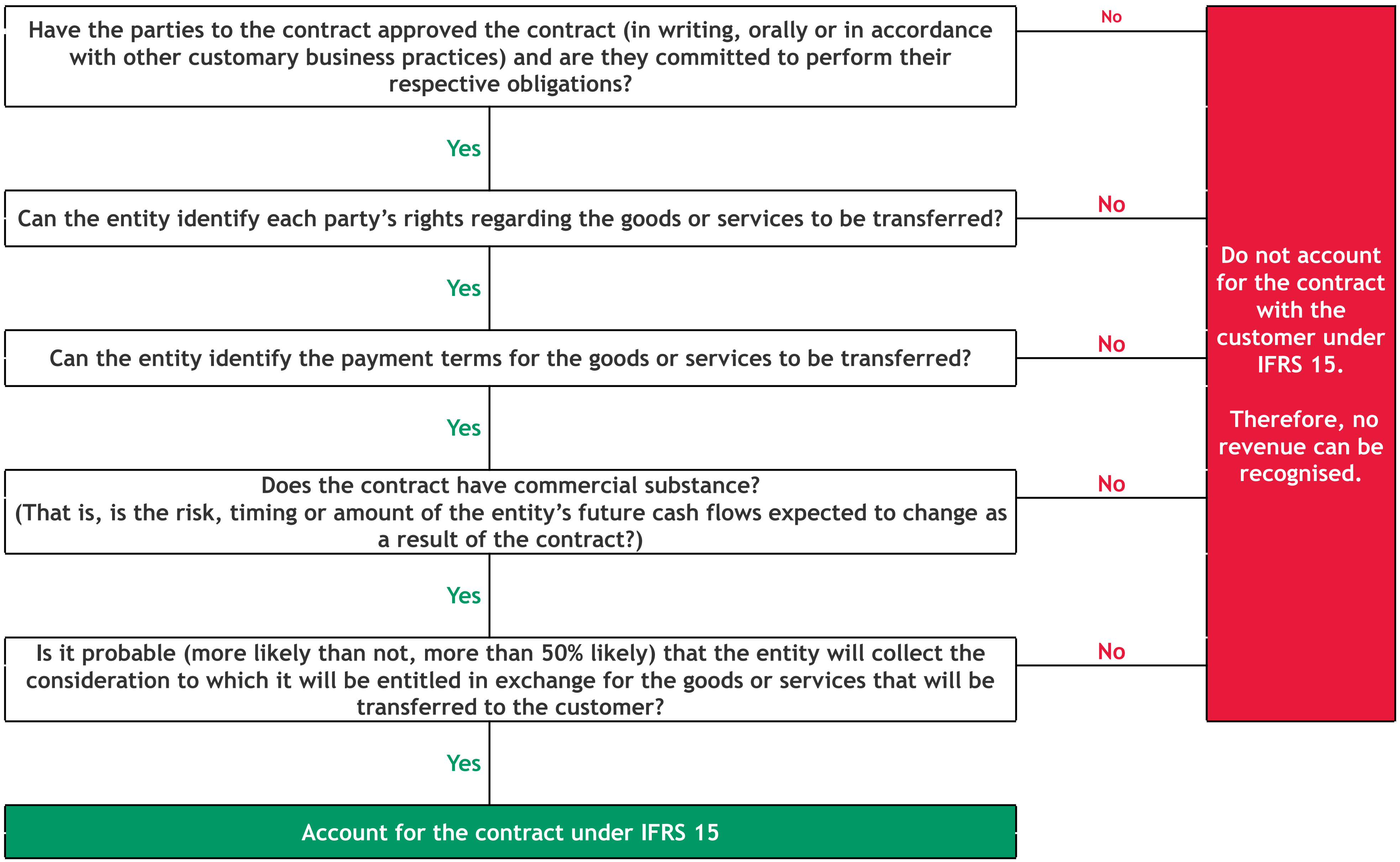
IFRS 15's 5-step revenue recognition model

Five-step revenue recognition model

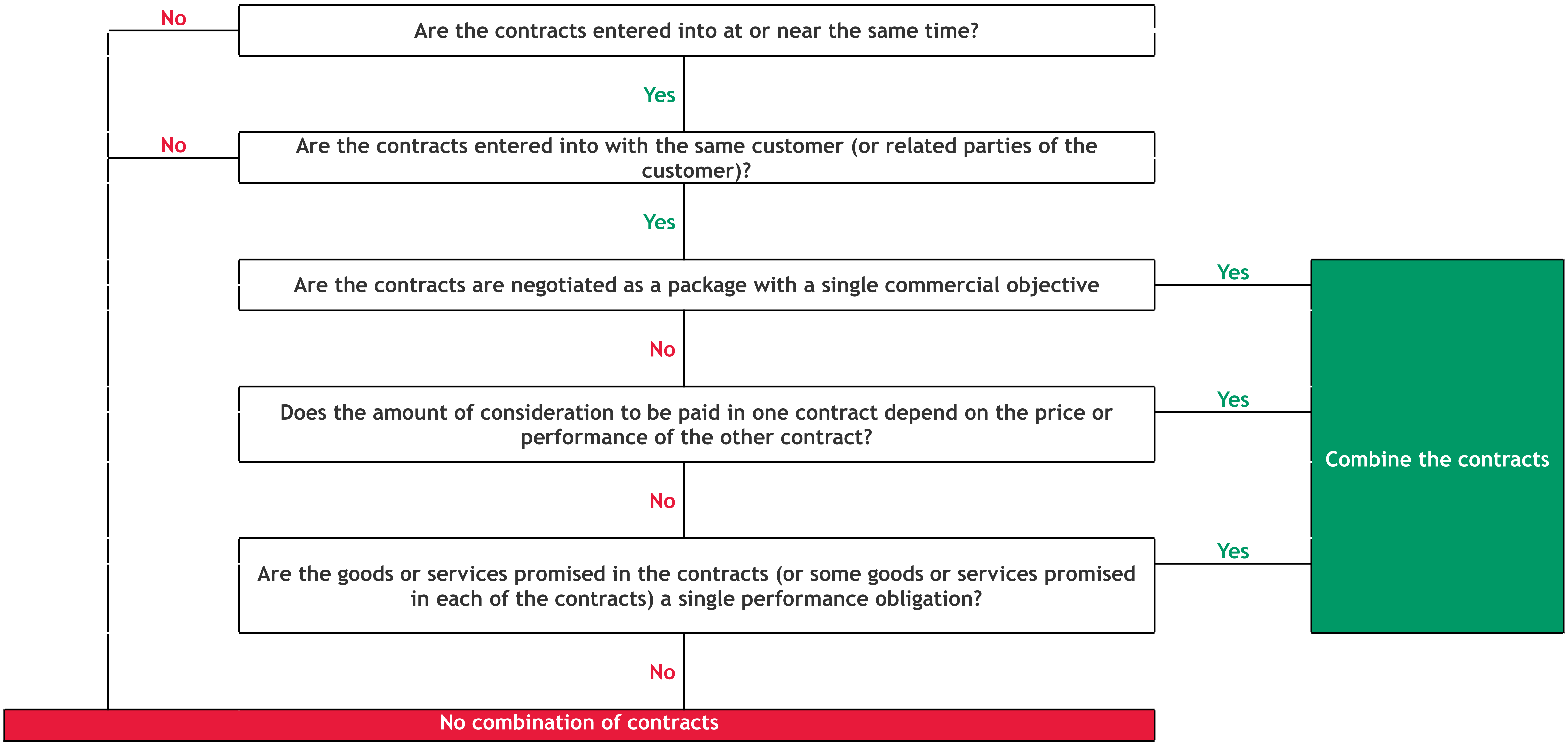


Step 1: Identify the contract

Step 1(a) - Identify the contract(s) with the customer



Step 1(b) – Consider the potential combination of contracts



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Step 2: Identify separate performance obligations

Step 2 – Identify the separate performance obligations

Is the good or service distinct?

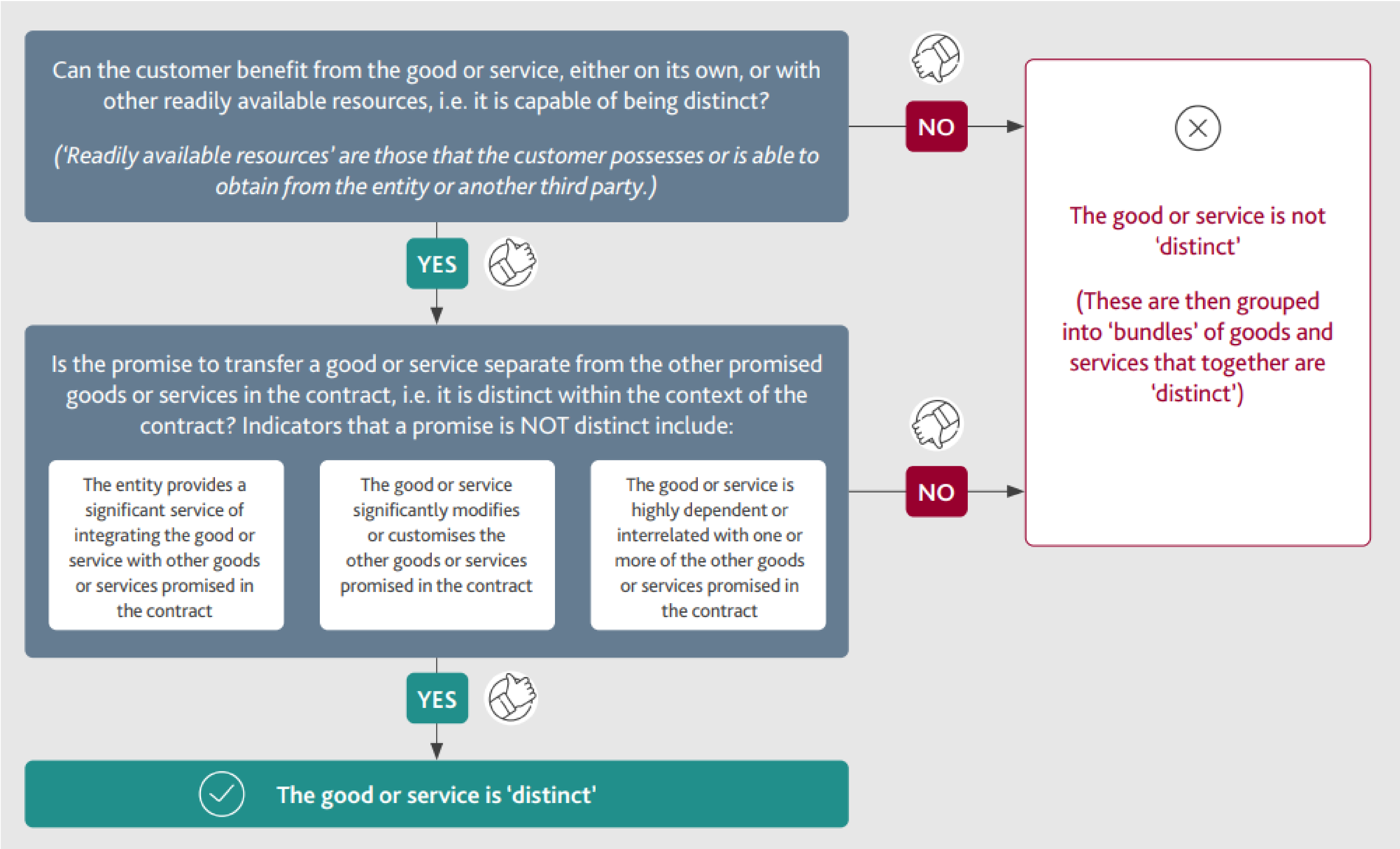
Yes

Separate performance obligation

No

Combine the good or service with other promised goods or services until a bundle of goods and services that is distinct can be identified

Step 2 – Identify the separate performance obligations



Example 7 – Construction of a wall

A building company contracts with a customer to build a wall. It identifies two activities that are necessary to complete the wall:

- Arrange for raw materials (such as bricks) for the purposes of building a wall to be available at the customer's premises; and
- Provide construction services to build a wall with the raw materials.

The sale of raw materials and the provision of services for the construction of a wall are capable of being distinct. Although the failure to purchase construction services would not significantly affect the delivery of bricks (which, by itself, might result in a vendor identifying two distinct performance obligations), the nature of the overall promise is to build the customer a wall. Consequently, the risks associated with each activity are not separable, and hence they are not distinct within the context of the overall contract. This is for the following reasons:

- the raw materials and construction services are both inputs that combined and result in the creation of a single identifiable output (the wall);
- the provision of construction services significantly modifies the nature of the raw materials (i.e. it transforms the raw materials into something that performs a very different function to the raw materials on their own).

The analysis would be the same even if the arrangement was structured as two contracts negotiated at or around the same time (i.e. a legal contract for the sale of bricks and a separate legal contract for construction services) because for accounting purposes there would be a single contract. Although there are two activities that are capable of being distinct, in the context of the single accounting contract, the assessment of whether they would be distinct within the context of that accounting contract remains the same.

Step 3: Determine the transaction price

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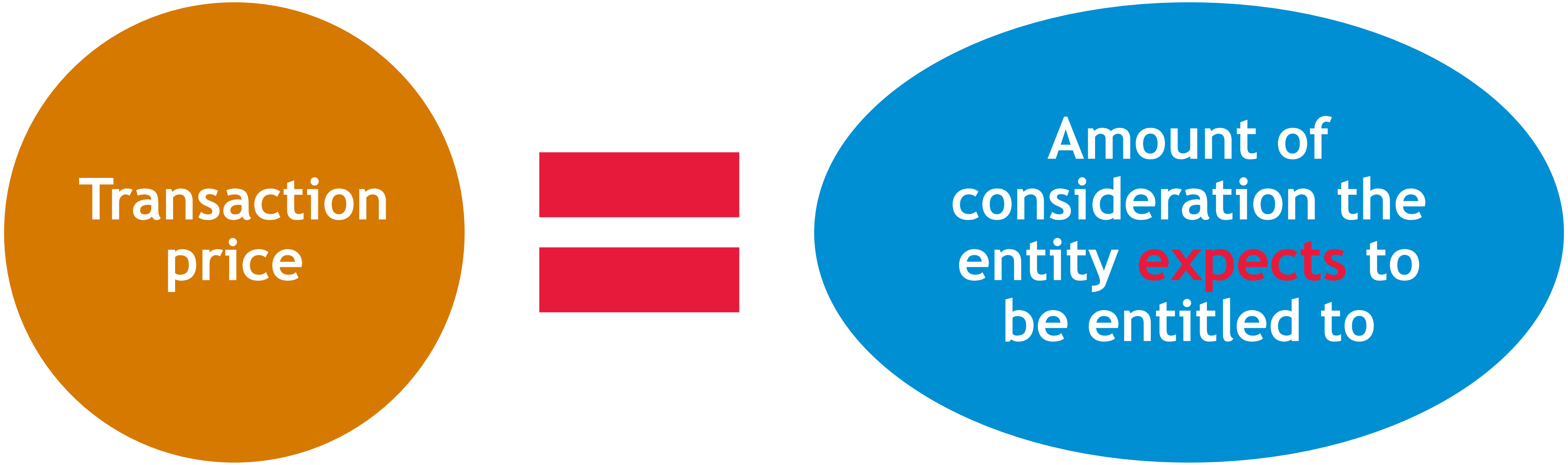
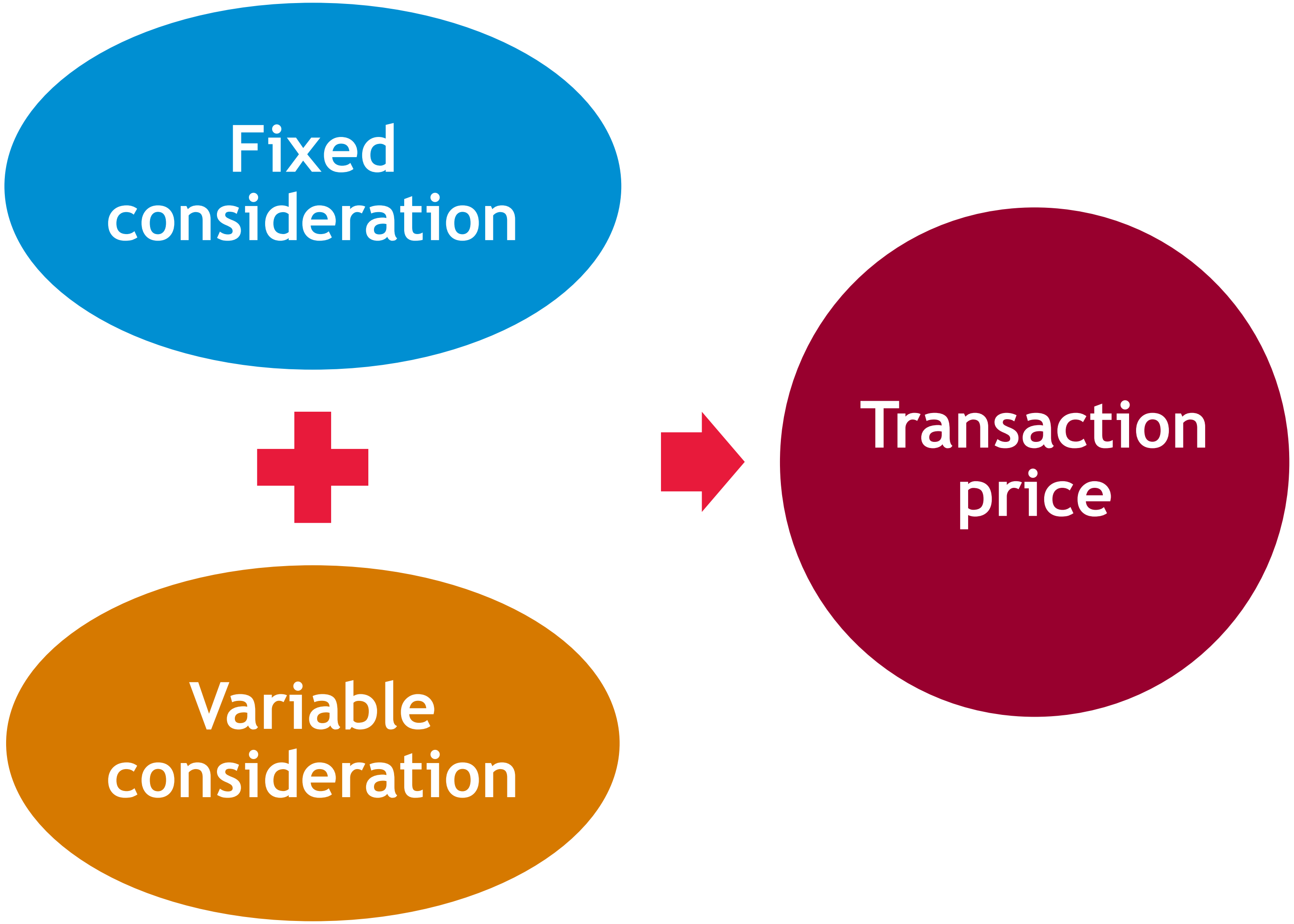
Step 3 – Determine the transaction price

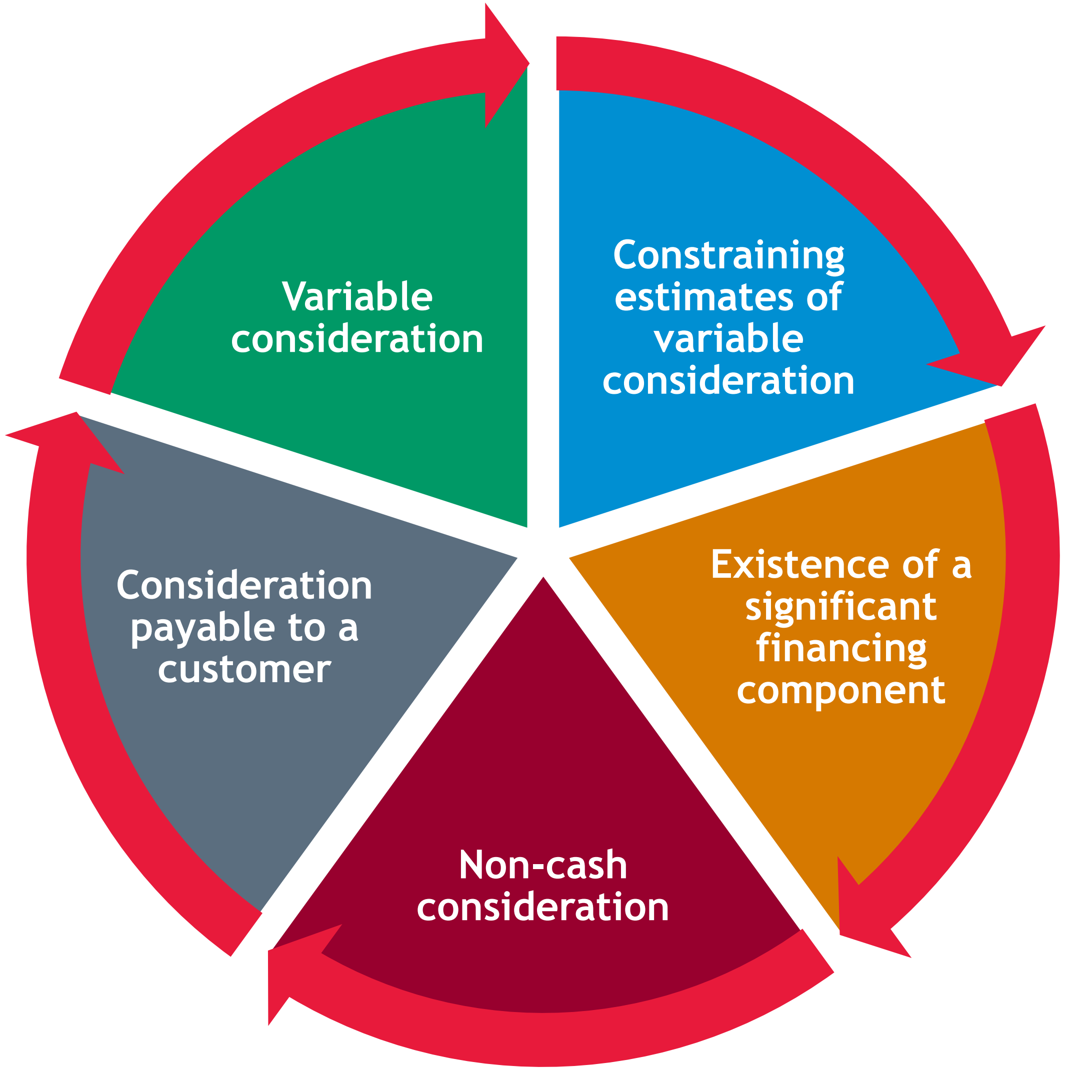


- Entities have to consider the following in order to determine the transaction price:
  - The terms of a contract (for example, a sales invoice); and
  - The entities customary business practices (for example, the entity usually provides a settlement discount of 10% if the customers pays within 30 days)

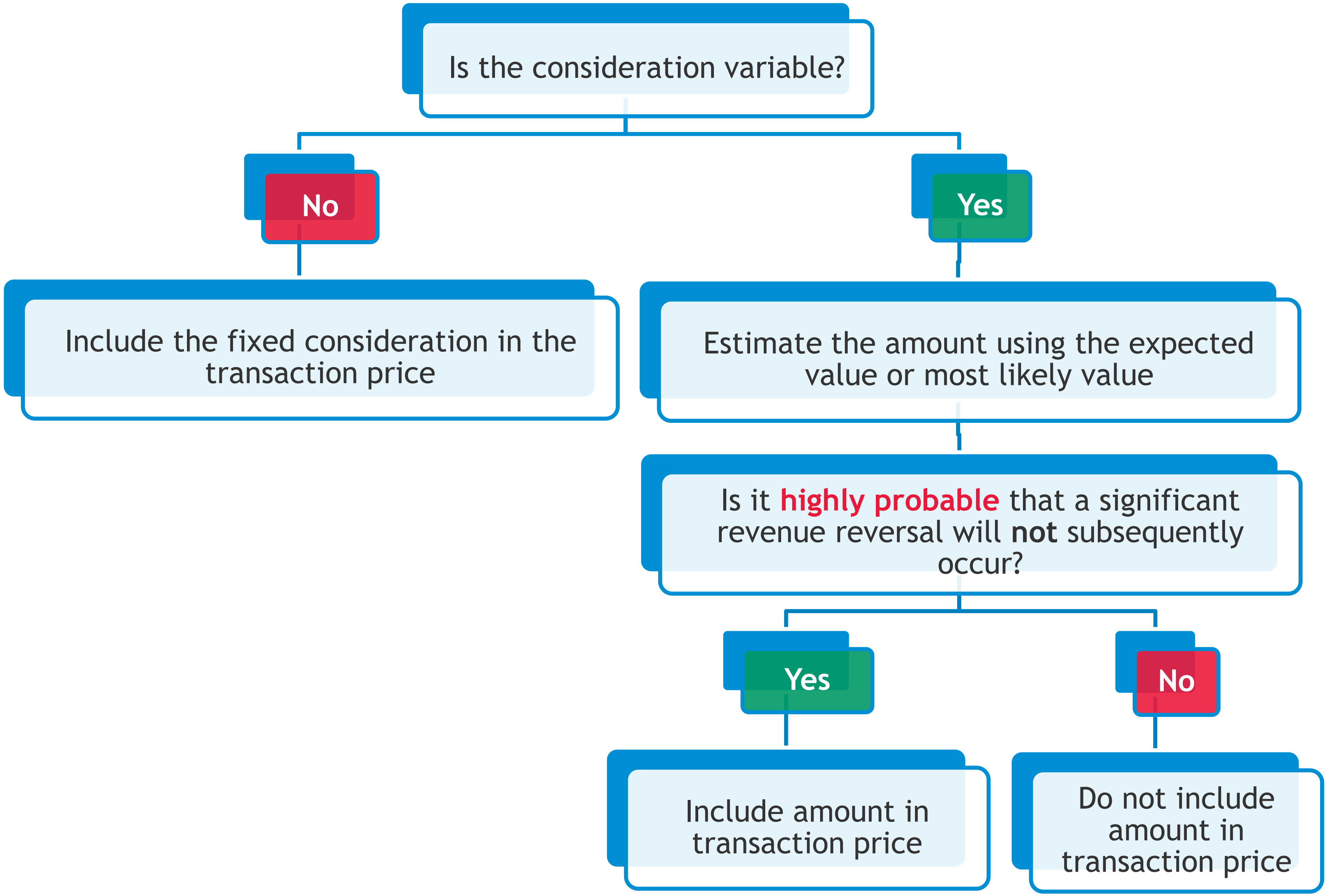
Step 3 – Determine the transaction price



Step 3 – Determine the transaction price



Step 3 – Determine the transaction price



Step 4: Allocate the transaction price to performance obligations

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Step 4 – Allocate the transaction price

Is the stand-alone selling price of the performance obligation observable?

Yes

Determine the stand-alone selling price at contract inception of the distinct good or service underlying the performance obligation in the contract

No

Estimate the stand-alone selling price using one of the following

- Adjusted market assessment approach;
- Expected cost plus a margin approach; or
- Residual approach (only use as a last resort)

Allocate the transaction price in proportion to the stand-alone selling prices

Step 4 - Allocate the transaction price

Three methods to estimate standalone selling prices		
Adjusted market assessment approach	**Expected cost plus margin approach**	**Residual approach**
Estimate price customers would be willing to pay	Forecast expected costs of satisfying performance obligation PLUS margin	Transaction price LESS other observable standalone selling prices

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Step 5: Recognise revenue as or when each performance obligation is satisfied

Step 5 – Recognise revenue

Does the customer simultaneously receive and consume the benefits provided by the entity's performance as the entity performs?

Yes

No

Does the entity's performance create or enhance an asset that the customer controls as the asset is created or enhanced?

Yes

No

Does the entity's performance create an asset with NO alternative use to the entity

AND

Does the entity have an enforceable right to payment for performance completed to date?

Yes

No

The entity transfers control at a point in time

=

The entity should recognise revenue at a point in time at which it transfers control of the good or service to the customer

The entity transfers control over time

=

The entity should recognise revenue over time, using a method that depicts its performance

Step 5 – Recognise revenue

What do we mean by ‘control’?

Ability to direct the use, and obtain substantially all of the remaining **benefits** from the asset

+

Ability to prevent others from directing use & obtaining **benefits** from the asset

Benefits

- Using asset to produce goods/services
- Using asset to enhance value of other assets
- Using asset to settle liabilities or reduce expenses
- Selling or exchanging the asset
- Pledging the asset to secure a loan
- Holding the asset

Step 5 – Recognise revenue

Measuring progress for 'over time' recognition

Measure progress to depict entity's performance in transferring control of goods/services promised

Output method

Input method

Step five: recognise revenue

Methods for recognising revenue over time

Output methods

- Based on results achieved and value transferred to the customer
- Performance completed to date
- Milestones reached
- Results achieved

Input methods

- Based on inputs used to satisfy the performance obligation
- Costs incurred
- Labour hours
- Machine hours used
- Materials used

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Contract modifications

What about contract modifications?

A contract modification is a change in the scope and/or price of a contract that is approved by the parties to that contract. This might be referred to as change order, variation, and/or an amendment. Consistent with the provisions of IFRS 15, adjustments are only made for a contract modification when either new enforceable rights and obligations are created, or existing ones are changed.

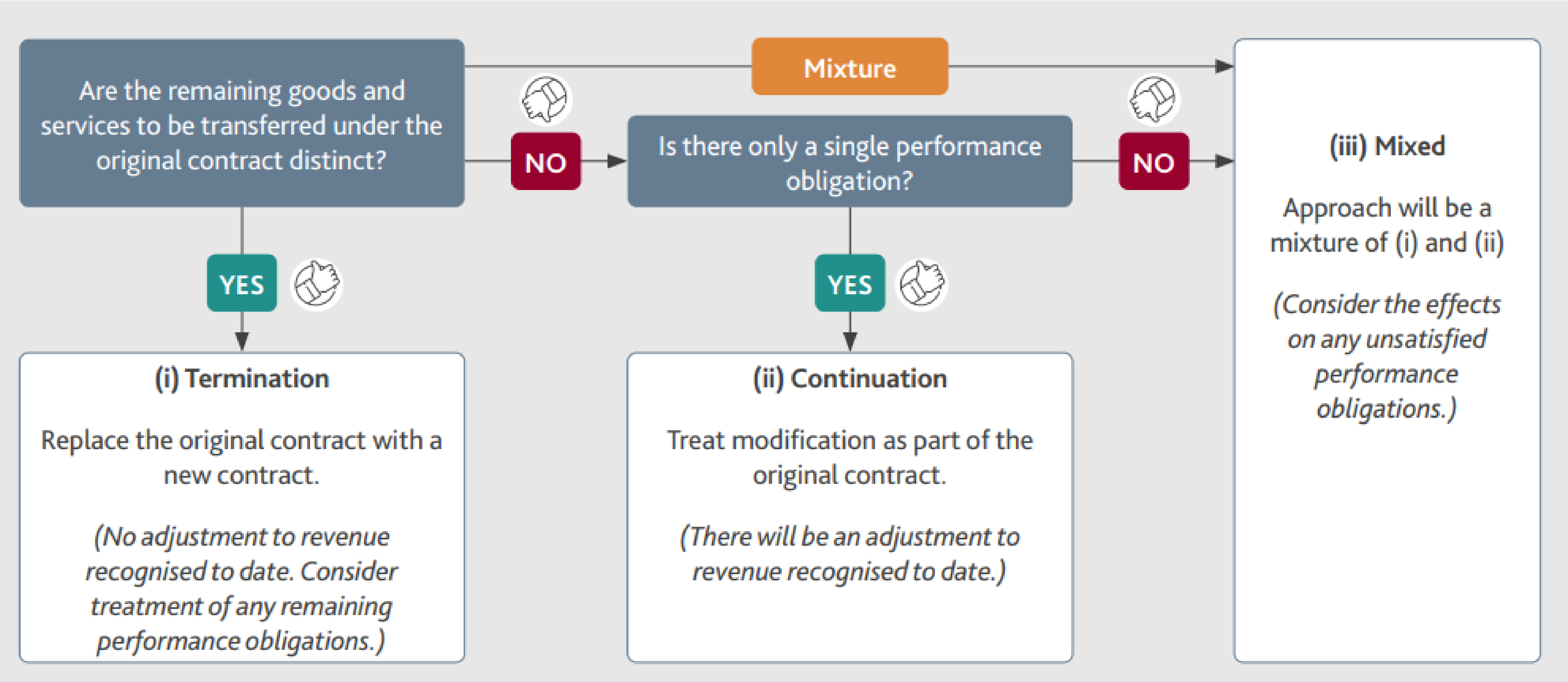
A vendor accounts for a contract modification as a separate contract to the original one, such that the accounting for the original contract remains unchanged, only if:

- the scope of the contract changes due to the addition of promised goods or services that are distinct for the purposes of step 2 of the five-step model (see section 4.2 below); and
- the price of the contract increases by an amount of consideration that reflects the vendor's stand-alone selling price of the additional promised goods or services and any appropriate adjustments to that price to reflect the circumstances of the particular contract (e.g. a discount to reflect that the vendor did not incur the same costs as it would do for a new customer).

If both of these criteria are met, then the contract modification is, for accounting purposes, a separate contract which is subject to the same five-step model as any other contract.

What about contract modifications?

When a contract modification is not accounted for as a separate contract (i.e. one or both of the above two criteria are not met), the vendor identifies the total goods or services that have not yet been transferred. This will be comprised of the remaining goods or services from the original contract, and any new goods or services arising from the contract modification. The approach which is then followed is illustrated by the following diagram:



Other practical issues

Other practical issues

- Contract costs
- Changes in transaction price after contract inception
- Sale with a right of return
- Warranties
- Principal vs. agent
- Customer options for additional goods or services
- Renewal options
- Breakage (unexercised rights)
- Non-refundable upfront fees
- Licensing
- Sales-based or usage-based royalties
- Repurchase agreements
- Consignment arrangements
- Bill-and-hold arrangements
- Customer acceptance
- Treatment of onerous contracts
- Success-based fees

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Do you need assistance?

IFRS & Corporate Reporting Assistance

BDO's IFRS & Corporate Reporting Leaders

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Senior Consultant

TERTIA GERMISHUYS
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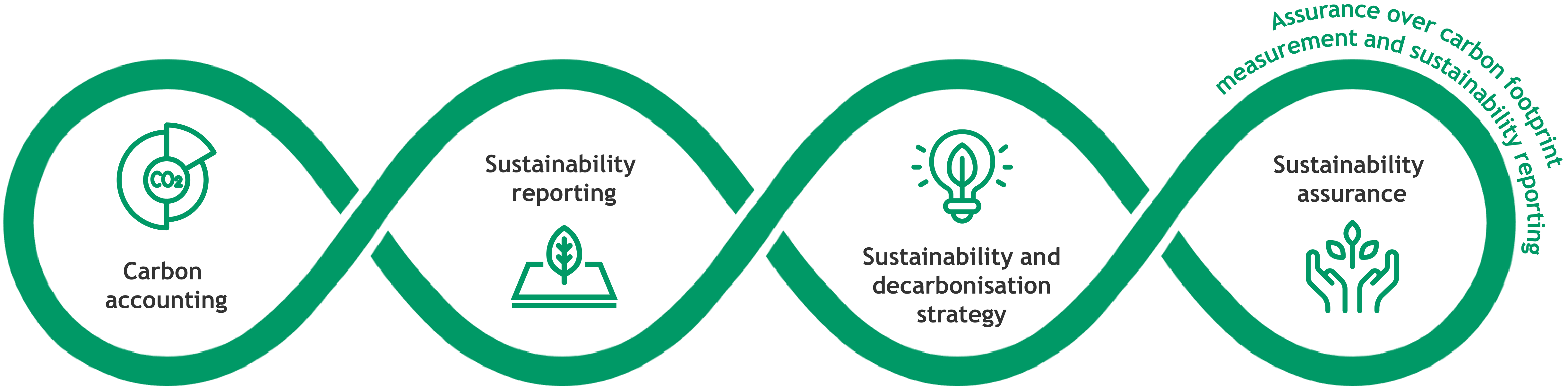
Sustainability Assistance

Core sustainability services

A continuous improvement journey



Core sustainability services

A detailed look at our core sustainability services

Carbon footprint measurement

- Carbon accounting (GHG Protocol)
- Baseline measurements and benchmarking
- Target development (e.g. Science Based Target initiative (SBTi))

Sustainability reporting

1. Mandatory reporting in the annual report:
   - TCFD and IFRS S2 readiness
   - IFRS S1 readiness.
2. Voluntary reporting in separate sustainability reports (e.g. GRI, WEF IBC)

Sustainability and decarbonisation strategy

- Current state assessment (ESG health check)
- Materiality assessment
- ESG risk and opportunity assessment
- Sustainability or decarbonisation strategy development
- ESG priorities and targets identification and communication
- Sustainability roadmap development
- Organisational transformation

Assurance

Third-party assurance over mandatory and voluntary sustainability reporting.

This also includes:

- NGER audits
- Due diligence
- Carbon credit audits and certification assurance
- Second-party opinion on sustainable finance products.

Key contacts

Our national team of sustainability experts to support you in our core service areas

National leaders

Aletta Boshoff
National Leader, ESG & Sustainability
National Leader, IFRS & Corporate Reporting
Partner, Advisory

Sherif Andrawes
National Leader, ESG & Sustainability
Global Head of Natural Resources
Partner, Corporate Finance

Carbon accounting

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Sustainability reporting

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Brett Spicer
Partner, Sustainability

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Sustainability strategy

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Justin Harness
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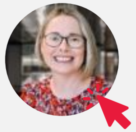

Kristy Porter
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Sustainability assurance

Ian Hooper
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Phillip Murdoch
Partner, Audit

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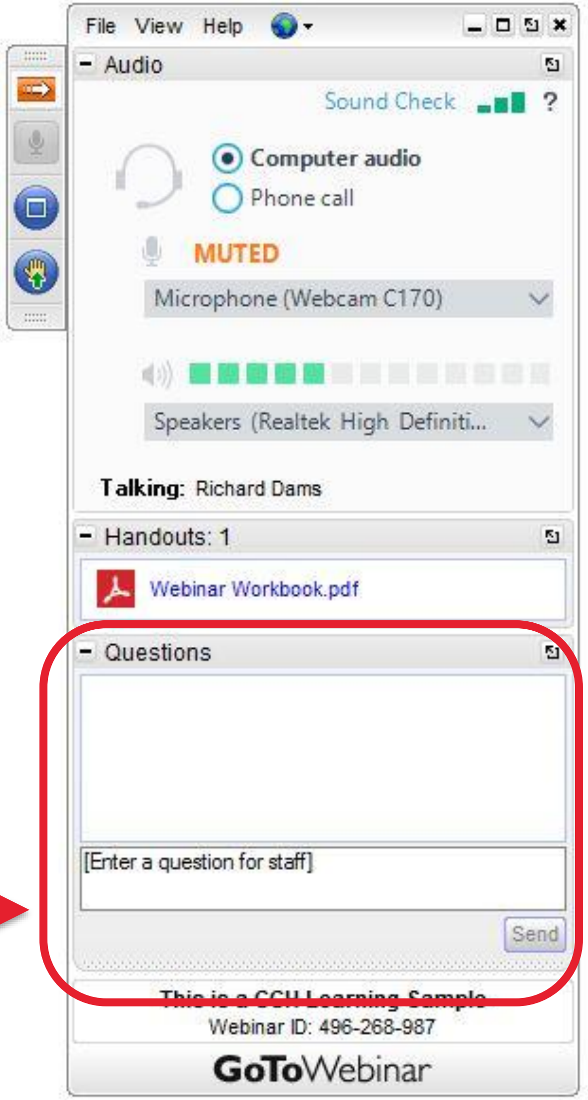
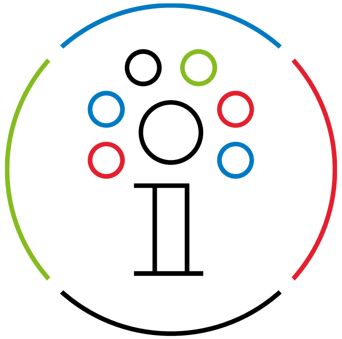
Questions?

Alison Wood
CCH Learning Moderator

Type your question and hit Send



Upcoming Webinars



View all Webinars

- 7 May – Incident Response and Data Management Plans
- 7 May – Tax Consolidations for SME’s
- 8 May – Boosting your Retirement Nest Egg – Legally! Superannuation Contributions
- 8 May – Combining Strategic and Operational Leadership – Grow your business as you work
- 9 May – Sell More to Existing Clients

Questions?

- **Aletta Boshoff**
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- National Leader ESG & Sustainability
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