# IFRS 15 REVENUE FROM CONTRACTS WITH CUSTOMERS

IFRS 15 Revenue from Contracts with Customers replaced both IAS 18 Revenue and IAS 11 Construction Contracts and was effective for application for the period commencing 1st January 2018. IFRS 15 sets out the rules for recognition of revenue based on transfer of control to the customer from the entity supplying the goods and services.

**Definitions**

**Control:** This is defined as the ability to direct the use of and obtain substantially all of the remaining benefits from the asset.

**Contract asset:** This refers an entity's right to consideration in exchange for goods and services that the entity has transferred to a customer when the right is conditioned on something other than passage of time, for example an entity's future performance.

**Contract liability:** This is an entity's obligation to transfer goods or services to a customer for which the entity has received consideration.

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

**RECOGNITION OF REVENUE**

Under IFRS 15 Revenue is recognized and measured using the five step model as indicated below:

1) **Identify the contract with the customer**
A contract with a customer is within the scope of IFRS 15 only when;
   - The parties have approved the contract and are committed to carrying it out.
   - Each party's rights regarding the goods and services to be transferred can be identified.
   - The payment terms for the goods and services can be identified.
   - The contract has commercial substance.
   - It is probable that the entity will collect the consideration to which it will be entitled.
   - The contract can be written, verbal or implied. ***May 2019 Qn. 3a(i)***

2) **Identify the separate performance obligations**

A performance obligation is a promise in a contract with a customer to transfer to the customer either;

- 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.

A good or service is distinct if it is sold separately or if it could be sold separately because it has a distinct function and a distinct profit margin.

3) **Determine the transaction price**

The transaction price is the amount of consideration a company expects to be entitled to from the customer in exchange for transferring goods or services.

4) **Allocate the transaction price to the performance obligations**

Where a contract contains more than one distinct performance obligation a company allocates the transaction price to all separate performance obligations in proportion to the stand-alone selling price of the good or service underlying each performance obligation.

This would apply to mobile phone contracts where the handset is supplied 'free'. The entity must look at the stand-alone price of such a handset and some of the consideration for the contract should be allocated to the handset.

5) **Recognise revenue when (or as) a performance obligation is satisfied**.

The entity satisfies a performance obligation by transferring control of a promised good or service to the customer. A performance obligation can be satisfied at a point in time, such as when goods are delivered to the customer, or over time.

**Example 1: Application of IFRS 15 Five Step Model**

Katumba entered into a 12-month telecom plan with the local mobile operator MTN. The terms of plan are as follows:

- Katumba's monthly fixed fee for data is Shs 100,000
- Katumba receives a free handset at the inception of the plan

MTN sells the same handsets for Shs 300,000 and the same monthly prepayment plans without handset for Shs 80,000 per month.

**Required:**

Applying IFRS 15 five step model, determine how MTN should recognize the revenue from this transaction according to IFRS 15 Revenue from contracts with customers.

**Solution:**

**Step 1: Identify the contract with the customer**

There is a contract between MTN and Katumba for a twelve month plan for provision of data.

**Step 2: Identify the separate performance obligations**

Provision of a free handset

Provision of data for 12 months

**Step 3: Determine the transaction price**

= 100,000 X 12 = 1,200,000

**Step 4: Allocate the transaction price over the different performance obligations in relation to their stand-alone selling prices**

| Performance obligation | Stand-alone selling price | Percentage of the total | Revenue to be recognised (%age X Transaction price 1.2m) |
|---|---|---|---|
| Handset | 300,000 | 23.8% | 285,600 |
| Data | 960,000 | 76.2% | 914,400 |
| | 1,260,000 | 100% | 1,200,000 |

Stand-alone selling price of data= 80,000 x 12 = 960,000

**Determining percentage of total**

= 300,000/1,260,000 x 100 = 23.8%

= 960,000/1,260,000 x 100% = 76.2%

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

The revenue from the handset Shs 285,600 will recognised at the point when the handset is provided to the customer.

MTN will recognise monthly revenue from provision of data of (914,400/12) = Shs 76,200.

## Performance obligations satisfied at a point in time

A performance obligation is satisfied at a point in time at the point at which the customer obtains control of the promised asset and the entity satisfies a performance obligation.

## Indicators of the transfer of control are:

(a) The entity has a present right to payment for the asset.
(b) The customer has legal title to the asset.
(c) The entity has transferred physical possession of the asset.
(d) The significant risks and rewards of ownership have been transferred to the customer.
(e) The customer has accepted the asset.

## Example 2: August 2019 Qn. 2(b)

**Sales contract:**

On 1 June 2018, IML entered into a sales contract with a customer to supply energy saving stoves for Shs 60 million. The customer paid an initial deposit of Shs 15 million immediately as per the conditions stipulated in the contract. The deposit is to be refundable only if IML does not deliver the stoves by 30 September, 2019. The remainder is payable when full delivery is made. If the customer defaults on the contract prior to completion of full delivery, IML has the right to retain the deposit. The managing director of IML is not sure of how revenue from such a contract would be recognised. However, he has suggested to the accountant to include the deposit and a percentage of the remaining balance in revenue for the year ended 31 March, 2019.

**Required:**

With regard to IFRS 15: Revenue from Contracts with Customers, comment on the managing director's suggestion of recognising revenue from the sales contract, explaining how the transaction should be treated.

**(8 marks)**

**Performance obligations satisfied over time**

A performance obligation is satisfied over time if it entered into more than one accounting period.

In this type of contract an entity often has an enforceable right to payment for performance completed to date i.e. the **stage of completion** of the contract.

**Determining stage of completion**

**Revenue approach**

$$\text{Stage of completion} = \frac{\text{Work certified to date}}{\text{Total Contract Revenue}} \times 100\%$$

**Physical units approach**

$$\text{Stage of completion} = \frac{\text{Units completed to date}}{\text{Total Contract Units}} \times 100\%$$

**Cost approach**

$$\text{Stage of completion} = \frac{\text{Cost incurred to date} - \text{Closing stock}}{\text{Total Estimated Costs}} \times 100\%$$

**Contract asset/liability**

As contracts that span more than one accounting period progress, the company is creating an asset for the customer that needs to be recognized in the statement of financial position or has a contract obligation. The amount recognized is as follows;

| | |
|---|---|
| Actual Costs incurred to date | xxx |
| Recognized profit | xxx |
| Recognized losses | (xxx) |
| Receivables (amount invoiced) | (xxx) |
| Contract asset/Contract liability | xx/(xx) |

## Example 3: Long-term contracts

PM Limited is a company engaged in building work. At the end of December 2019 the company had the following information relating to one of its contracts;

Date commenced January 1st 2019
Expected completion date April 30th 2020

| Details | Amount Shs |
|---|---|
| Total contract revenue | 1,160,000,000 |
| Costs incurred to 31st December 2019 | 841,800,000 |
| Work certified to 31/12/2019 | 920,000,000 |
| Amounts invoiced for work certified to 31st December 2019 | 840,000,000 |
| Estimated costs to completion at 31st December 2019 | 82,400,000 |
| Cash received to 31st December 2019 | 776,000,000 |

PM Limited calculates satisfaction of performance obligations based on work certified as a percentage of contract price.

**Required:**

Prepare extracts of the statement of profit or loss and the statement of financial position at 31st December 2019 in respect of the above contract.

**Solution:**

**Step 1: Determine whether the contract results into a profit or a loss.**

| | |
|---|---|
| Total Contract Revenue | 1,160,000,000 |
| Less: Total Contract Costs (841,800,000 + 82,400,000) | (924,200,000) |
| Total Profit | 235,800,000 |

**Step 2: Determine the stage of completion of the contract**

$$\text{Stage of completion} = \frac{\text{Work certified to date}}{\text{Total Contract Revenue}} \times 100\%$$

$$= \frac{920{,}000{,}000}{1{,}160{,}000{,}000} \times 100\%$$

= 79.3% (used to determine revenue and costs to date)

**Step 3: Determine the revenue and costs at the stage of completion of 79.3%**

| | |
|---|---|
| Revenue (79.3% x 1,160,000,000) | 919,880,000 |
| Less: Contract costs (79.3% x 924,200,000) | (732,890,600) |
| Profit | 186,989,400 |

**Extract of Statement of Profit/Loss for the year ended 31st December 2019**

| | |
|---|---|
| Contract Revenue | 919,880,000 |
| Contract Costs | (732,890,600) |
| Profit | 186,989,400 |

**Extract statement of financial position as at 31st December 2019**

**Assets**

**Current Assets**

| | |
|---|---|
| Contract Receivable (840,000,000 – 776,000,000) | 64,000,000 |
| Contract asset (w1) | 188,789,400 |

**Equity**

| | |
|---|---|
| Profit on contract | 186,989,200 |

**Workings**

**W1: Amount due from client/Contract Asset**

| | |
|---|---|
| Actual Costs incurred to date | 841,800,000 |
| Add: Profit recognised to date | 186,989,400 |
| Less: Recognised loss to date | - |
| | 1,028,789,400 |
| But amount invoiced was | (840,000,000) |
| Amount due from client | 188,789,400 |

**ONEROUS CONTRACTS**

This is a contract which results into losses. Once a loss is ascertained it must be recognised in the Statement of profit or loss as an expense but the contract revenue must be limited to the stage of completion.

**Example 4: Onerous Contracts**

PQ Limited a contracts in progress with the following details;

| Details | Amount Shs |
|---|---|
| Total contract revenue | 128,000,000 |
| Work certified to date | 51,200,000 |
| Costs incurred to date | 60,000,000 |
| Estimated costs to complete | 90,000,000 |
| Payments invoiced and received | 46,000,000 |

PQ Limited measures satisfaction of performance obligations based on the percentage of work certified as complete.

**Required:**

Show extracts from the statement of profit or loss and other and the statement of financial position for the above contract.

**Step 1: Determine whether the contract results into a Profit or a loss.**

| | |
|---|---|
| Total Contract Revenue | 128,000,000 |
| Total Contract Costs (60,000,000 + 90,000,000) | (150,000,000) |
| Loss | (22,000,000) |

Since the contract results into a loss, the revenue will be limited to the stage of completion but the entire loss will be recognised in the statement of profit or loss as an expense.

**Step 2: Determine the stage of completion of the contract**

$$\text{Stage of completion} = \frac{\text{Work certified to date}}{\text{Total Contract Revenue}} \times 100\%$$

$$= \frac{51{,}200{,}000}{128{,}000{,}000} \times 100\%$$

$$= 40\%$$

**Step 2: Determine the revenue and costs with a stage of completion of 40%**

| | |
|---|---|
| Contract Revenue (40% x 128,000,000) | 51,200,000 |
| Less: Contract costs (Balancing figure 51.2m + 22m) | (73,200,000) |
| Contract loss | (22,000,000) |

**Extract of Statement of Profit/Loss**

| | |
|---|---|
| Contract Revenue | 51,200,000 |
| Contract Costs | (73,200,000) |
| Contract loss | (22,000,000) |

**Extract statement of financial position as at 30th September 2019**

**Liabilities**

**Current liability**

| | |
|---|---|
| Contract liability | 8,000,000 |

**Equity**

| | |
|---|---|
| Loss on contract | (22,000,000) |

**Workings**

**W1: Amount due to client/Contract liability**

| | |
|---|---|
| Costs incurred to date | 60,000,000 |
| Add: Profit recognised to date | - |
| Less: Loss recognised to date | (22,000,000) |
| | 38,000,000 |
| But amount invoiced was | (46,000,000) |
| Amount due to client/Contract liability | (8,000,000) |

## CONTRACT MODIFICATIONS

A contract modification is a change in the scope or price (or both) of a contract that is approved by the parties to the contract. A contract modification exists when the parties to a contract approve a modification that either creates new or changes existing enforceable rights and obligations of the parties to the contract. A contract modification is either accounted for as a **separate contract or not as a separate contract.**

### Contract modification represents a separate contract

Certain contract modifications are treated as separate new contracts. For these modifications, the accounting for the original contract is not affected by the modification and the revenue recognized to date on the original contract is not adjusted. Furthermore, any performance obligations remaining under the original contract continue to be accounted for under the original contract.

An entity shall account for a contract modification as a separate contract if both of the following conditions are present:

a) The scope of the contract increases because of the addition of promised goods or services that are distinct.

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

### Contract modification is not a separate contract

If a contract modification is not accounted for as a separate contract, an entity shall account for the promised goods or services not yet transferred at the date of the contract modification in whichever of the following ways is applicable;

i. An entity shall account for the contract modification as if it were termination of an existing contract and the creation of a new contract, if the remaining goods or services are distinct from the goods or services transferred on or before the date of the contract modification.

ii. An entity shall account for the contract modification as if it were part of the existing contract if the remaining goods or services are not distinct, and therefore form part of a single performance obligation that is partially satisfied at the date of the contract modification. The entity would just update the transaction price and measure progress for the single performance obligation.

**Example May 2019 Qn. 3**

(a) Beama Produce Ltd (BPL) is a company that deals in buying and selling of agricultural produce especially beans and maize from various parts of Uganda. At the beginning of term 1, 2018 BPL entered into a contract to sell 4.5 tonnes of beans at Shs 2 million per tonne to Basome Secondary School (BSS) located in western Uganda. The beans were to be delivered to the school over a 3 months period in equal installments.

BPL chose to deliver installments at the beginning of every month starting February 2018. After transferring 3 tonnes to BSS, the contract was modified and required BPL to deliver an additional 2 tonnes to BSS at a price of 1.9 million per tonne. The additional 2 tonnes were not included in the original contract.

Management of BPL has decided to use IFRS 15: Revenue from Contracts with Customers while accounting for revenue from this contract, effective January 2018 and the chief finance officer (CFO) has approached you for advice.

**Required:**

(i) State the conditions that must be met for contracts with customers to be recognised as per the requirements of IFRS 15

**(5 marks)**

(ii) Explain to the CFO of BPL how revenue from the above contract should be accounted for.

**(5 marks)**

## ACCOUNTING FOR CONTRACT COSTS

### Contract costs

The incremental costs of **obtaining** a contract (such as sales commission) are **recognised as an asset** if the entity expects to recover those costs. These are costs that would not have been incurred had that individual contract not been obtained, e.g. sales commission.

Under IFRS 15 these costs are capitalized/recognised as an asset and amortized over the life of a contract if they are expected to be recovered from a customer.

Costs that would have been incurred regardless of whether the contract was obtained are recognised as an expense as incurred.

Costs incurred in **fulfilling** a contract, unless within the scope of another standard (such as IAS 2 *Inventories*, IAS 16 *Property, plant and equipment* or IAS 38 *Intangible assets*) are recognised as an asset if they meet the following criteria:

(a) The costs relate directly to an identifiable contract (costs such as labour, materials, management costs)
(b) The costs are expected to be recovered

Costs recognised as assets are amortised on a systematic basis consistent with the transfer to the customer of the goods or services to which the asset relates.

However, general and administrative costs that are not explicitly chargeable to the customer and costs of wasted materials, labour that were not reflected in the price of the contract are expensed.