Financial Reporting Advisory Board Paper

IFRS 15 Revenue from Contracts with Customers

Issue:	IFRS 15 *Revenue from Contracts with Customers* was issued in May 2014. The Standard will replace IAS 18 *Revenue* and IAS 11 *Construction Contracts* and a number of related interpretations. This paper provides a high level summary of the standard and requests that FRAB provides some commentary on the possible direction of the Stage 1 assessment.
Impact on guidance:	No impact at this stage.
IAS/IFRS adaptation?	None proposed at this stage.
Impact on WGA?	No impact at this stage.
IPSAS compliant?	Current IPSAS is based on IAS 18 *Revenue*.
Impact on budgetary regime?	No assessment yet – Stage 1.
Alignment with National Accounts	No assessment yet – Stage 1.
Impact on Estimates?	It is possible that there will be an impact on estimates as the new IFRS has an impact on the timing and recognition of some revenues.
Recommendation:	That the Board note this summary of IFRS 15 and provide any comments on the direction of the Stage 1 assessment by the relevant authorities.
Timing:	2017/18

DETAIL

Background

1. The objective of IFRS 15 *Revenue from Contracts with Customers* is to establish the principles an entity is required to apply to report useful information to the users of financial statements about the nature, amount, timing and uncertainty of revenues arising from contracts with customers.

2. The IASB issued IFRS 15 in May 2014. The Standard is effective for periods on or after 1 January 2017. Currently the EFRAG endorsement status report indicates that the Standard should be EU adopted by its effective date.

3. The development of IFRS 15 took place over a long period; the project was added to the IASB agenda in 2002. The project was also a joint project between the IASB and the FASB to develop a common revenue recognition standard for IFRS and US GAAP.

4. IFRS 15 replaces:

- IAS 11 *Construction Contracts*,
- IAS 18 *Revenue*,
- IFRIC 13 *Customer Loyalty Programmes*,
- IFRIC 15 *Agreements for the Construction of Real Estate*,
- IFRIC 18 *Transfers of Assets from Customers*, and
- SIC 21 *Revenue – Barter Transactions Involving Advertising Services.*

5. IFRS 15 applies to all contracts with customers (except those within the scope of IAS 17 *Leases*, IFRS 9 *Financial Instruments,* the Group Accounts Standards[1] and IFRS 4 *Insurance Contracts* and non-monetary exchanges between entities in the same line of business to facilitate sales to customers or potential customers).

6. The core principle in IFRS 15 is that entities should recognise revenue to depict the transfer of promised goods or services to the customer in an amount that reflects the consideration to which the company expects to be entitled in exchange for those goods or services. To recognise revenue the standard sets out five steps:

Step 1 - Identify the contract(s) with the customer	A contract is an agreement between two or more parties that creates enforceable rights and obligations. An entity would apply IFRS 15 to each contract with a customer that has commercial substance and meets other specified criteria. One criterion requires an entity to assess whether it is probable that the entity will collect the consideration to which it will be entitled in exchange for the promised goods or services. In some cases, IFRS 15 requires an entity to combine contracts and account for them as one contract. IFRS 15 also specifies how an entity would account for contract modifications.
Step 2 – Identify the performance obligations in the contract	Performance obligations are promises in a contract to transfer to a customer goods or services that are distinct. In determining whether a good or service is distinct, an entity considers if the customer can benefit from the good or service on its own or together with other resources that are readily available to the customer. An entity also considers whether the entity's promise to transfer the good or service is separately identifiable from other promises

[1] IFRS 10 *Consolidated Financial Statements*, IFRS 11 *Joint Arrangements*, IAS 27 *Separate Financial Statements* (2011) and IAS 28 *Investments in Associates and Joint Ventures* (2011)

	in the contract.
Step 3 – Determine 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. Usually, the transaction price is a fixed amount of customer consideration. Sometimes, the transaction price includes estimates of consideration that is variable or consideration in a form other than cash. Some or all of the estimated amount of variable consideration is included in the transaction price only to the extent that it is highly probable that a significant reversal in the amount of cumulative revenue recognised will not occur when the uncertainty associated with the variable consideration is subsequently resolved. Adjustments to the transaction price are also made for the effects of financing (if significant to the contract) and for any consideration payable to the customer.
Step 4 – Allocate the transaction price	An entity would typically allocate the transaction price to each performance obligation on the basis of the relative stand-alone selling prices of each distinct good or service. If a stand-alone selling price is not observable, the entity would estimate it. Sometimes, the transaction price may include a discount or a variable amount of consideration that relates entirely to a specific part of the contract. The requirements specify when an entity should allocate the discount or variable consideration to a specific part of the contract rather than to all performance obligations in the contract.
Step 5 - Recognise revenue when a performance obligation is satisfied	An entity would recognise revenue when (or as) it satisfies a performance obligation by transferring a promised good or service to a customer (which is when the customer obtains control of that good or service). A performance obligation may be satisfied at a point in time (typically for promises to transfer goods to a customer) or over time (typically for promises to transfer services to a customer). For a performance obligation satisfied over time, an entity would select an appropriate measure of progress to determine how much revenue should be recognised as the performance obligation is satisfied

Contract Costs

7. IFRS 15 also includes requirements for accounting for contract costs. The incremental costs of a contract must be recognised as an asset if the entity expects to recover those costs. However, those incremental costs are limited to the costs an entity would not have incurred if the contract had not been successfully obtained.

8. For costs to fulfil a contract that are not within the scope of other Standards, an entity would recognise an asset for those costs if the following criteria are met:

- the costs relate directly to a contract (or a specific anticipated contract);
- the costs generate or enhance resources of the entity that will be used in satisfying performance obligations in the future; and
- the costs are expected to be recovered.

Disclosures

9. The disclosure objective of IFRS 15 is for the users of the financial statements to better understand the nature, amount, timing and uncertainty of revenue and cash flows from contracts with customers. IFRS 15 requires an entity to disclose quantitative and/or qualitative information about:

- revenue recognised from contracts with customers, including the disaggregation of revenue into appropriate categories;
- contract balances, including the opening and closing balances of receivables, contract assets and contract liabilities;
- performance obligations, including when the entity typically satisfies its performance obligations and the amount of the transaction price that is allocated to the remaining performance obligations in a contract;
- significant judgements, and changes in judgements, made in applying the requirements; and
- assets recognised from the costs to obtain or fulfil a contract with a customer.

Impact on Accounting for Revenue in the Public Sector

10. For many contracts in the public sector, the accounting for revenue will remain unchanged.

11. For other contracts, including long-term service contracts, there may be changes to the timing and amount of revenue recognised, depending on how entities previously accounted for these contracts. Possible areas where practice may change include:

- sales with incidental obligations (eg equipment sales with maintenance agreements),
- transfers of goods and services where there is no observable evidence of the stand-alone price of each of the goods and services,

- licences of intellectual property,
- situations where there is uncertainty about whether revenue should be recognised at a point in time or over time (eg development of a service provided over time or a good transferred on completion)
- estimates where consideration is variable, and
- situations where customers pay in advance or arrears and financing of the contract needs to be considered.

Any changes may have budgetary implications. Where contacts include a variable consideration, this is measured at either expected value (ie probability-weighted amount) or the most likely amount, depending on which is the best predictor of the amount of consideration to which the entity is entitled).

12. CIPFA/LASAAC in its early deliberations has considered that it will need to review the application of this standard with larger local authorities that have performance related contracts.

Impact on disclosures in the financial statements

13. The disclosure requirements outlined above are more extensive than the current requirements included in IAS 18 as adopted by the relevant manuals.

IAS/IFRS compliance

14. No adaptations are currently proposed.

Impact on WGA

15. There is no impact at this stage.

IPSAS compliance

16. Current IPSAS is based on IAS 18 consequently the adoption of IFRS 15 in the Manuals will not be fully IPSAS compliant in these areas until the relevant IPSASs are updated in line with the IPSASB ‘rules of the road’.

Impact on the budgetary regime

17. As the standard will change the timing and recognition of some revenues there may be some budgetary impact but this has not yet been full assessed as this is the first Stage 1 report.

Summary and recommendation

18. The Board is requested to note this summary of IFRS 15 and provide any comments on the direction of the Stage 1 assessment by the relevant authorities.

CIPFA
November 2014