

IFRS 15 - Revenue from Contracts with Customers



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Objective

The objective of the standard is to establish the principles for reporting in financial statements about the nature, amount, timing and uncertainty of revenue and cash flows arising from a contract with customer.

Core Principle

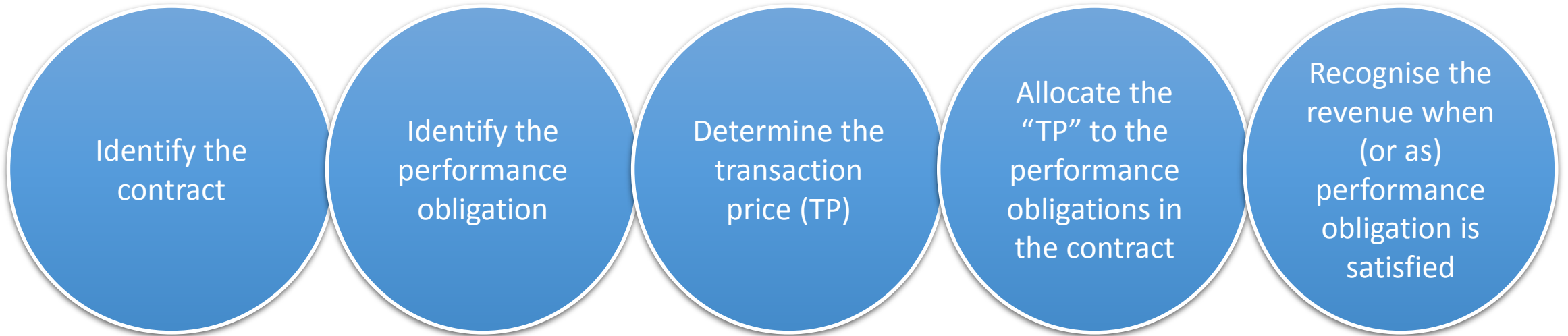
The entity shall recognise revenue to depict the transfer of promised goods or services to the customer in an amount that reflects the consideration to which the entity expects to be entitled in exchange of goods or services.

IFRS 15 is applicable for annual periods beginning from January 1, 2018.

It supersedes previously used revenue recognition standards and narrows down the differences between US revenue recognition standard (ASC 606) and IFRS.



The core principle of IFRS 15 is based on 5 step approach:





Huge impacts on:

- Manufacturing and retail companies
- Tele communication sectors
- Real estate developers
- Software development sectors



Few of the general factors that needs to be considered are:

- Transfer of control
- Time value of the money
- Risk factor
- Timing

Step 1

Identifying the contract- In order to identify a contract the following steps needs to be met

- The contract has been approved by both the parties. Contract can be verbal, oral or based on customary business practices
- Each parties rights and obligations can be identified
- The payment terms and conditions can be identified
- The contract has a commercial substance.
- The probability regarding the consideration exist.

Step 2

Identifying the performance obligations

- Performance obligation refers to transfer the promised good or services
- Performance obligation is achieved as and when the customer obtains control over the promised goods.
- Performance obligation can be implied also based on customary business practices.
- Performance obligations does not include administrative task incurred for the purpose of contract.

Step 3

Determine the transaction price

- Transaction price is the amount of consideration to which an entity expects to be entitled in exchange for transferring the promised goods or services.
- Items such as variable amount, rebates, discounts, refunds, credits, price concessions, incentives, performance bonus, penalties, right to return are included

Step 4 & 5

Allocating the transaction price based on performance obligation and recognizing the revenue as and when the performance obligation is satisfied

- The allocation should be based on relative stand alone selling price.
- The stand alone selling price is the price at which an entity would sell the promised goods or services to a customer. The best evidence of this is observable price of goods/services in a similar circumstances and to similar customers.
- Revenue is recognised when the performance obligation is fully satisfied .

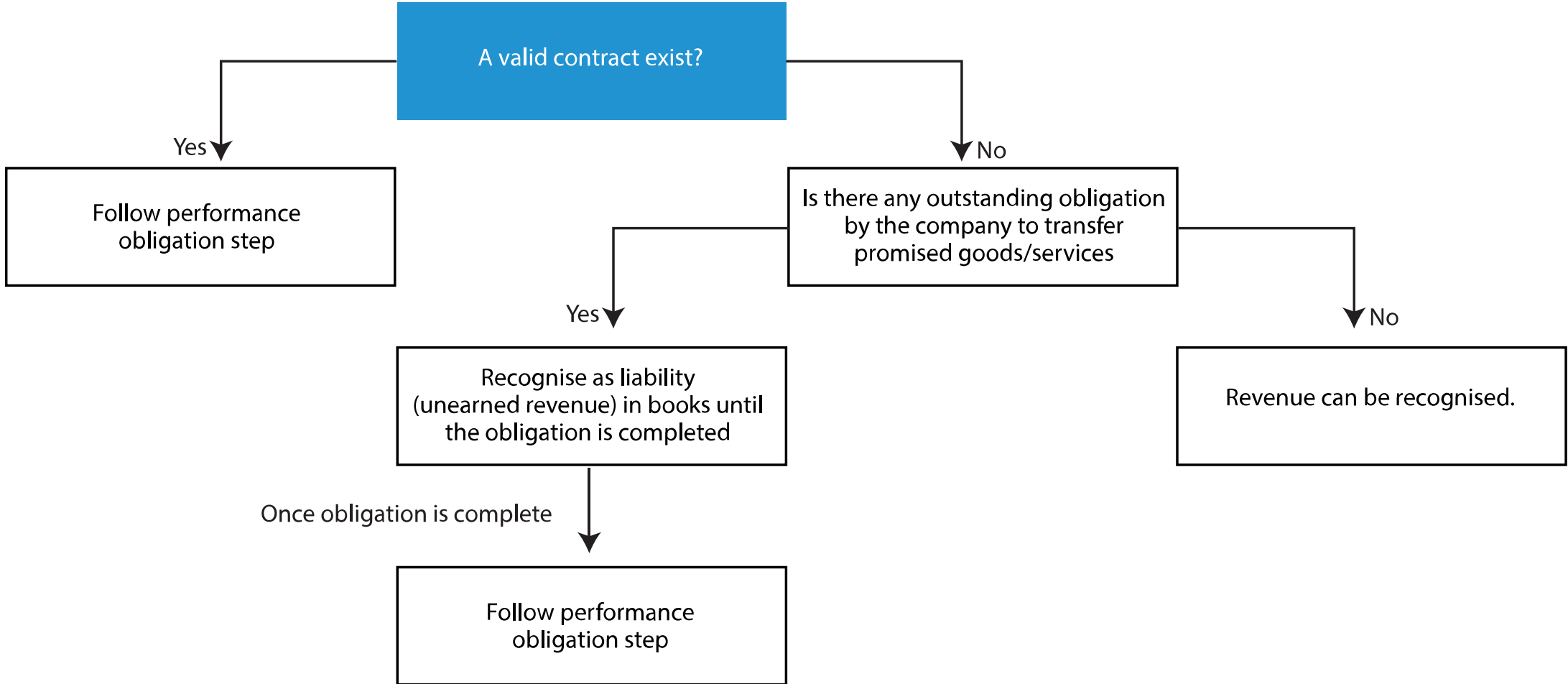
IFRS 15 Impact on trading companies



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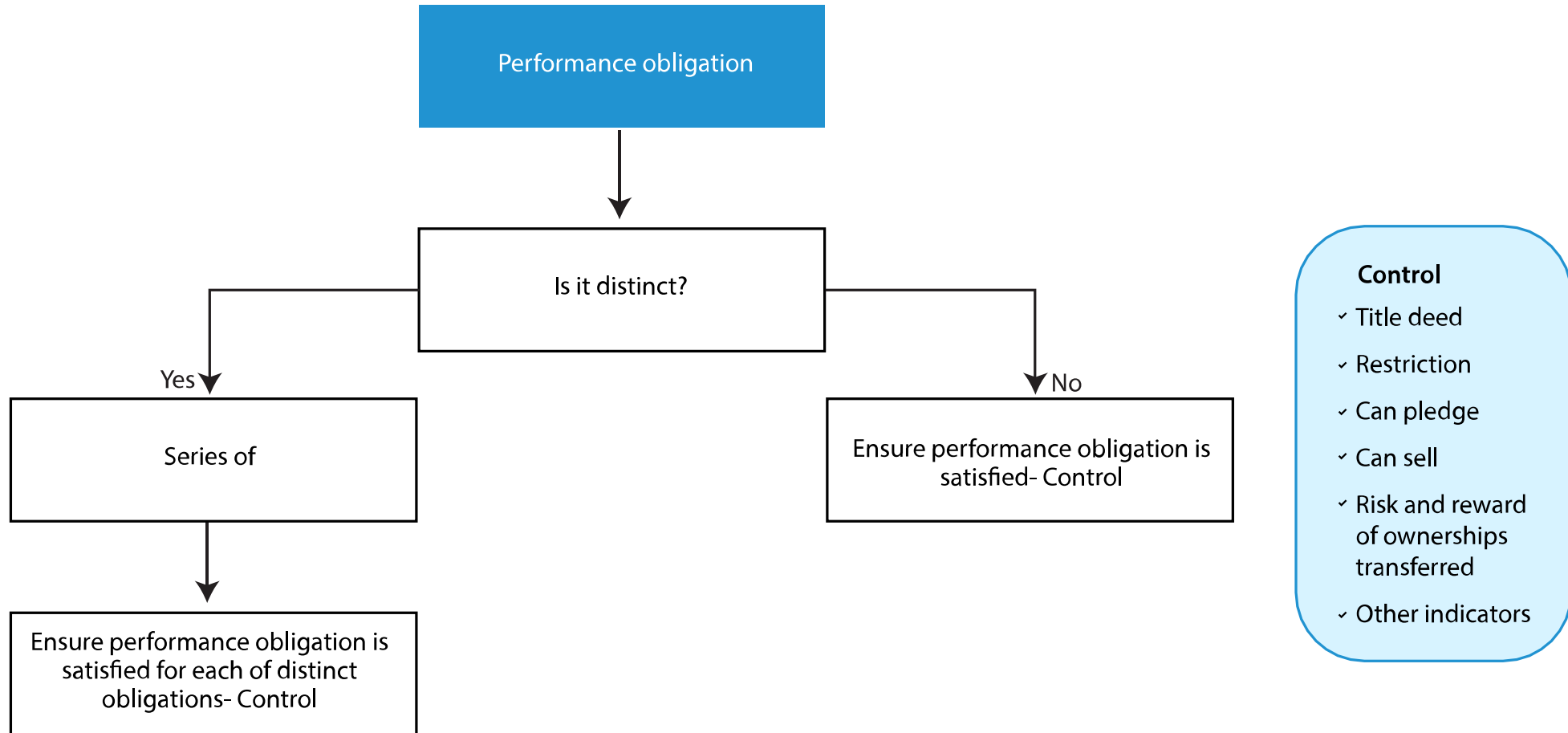
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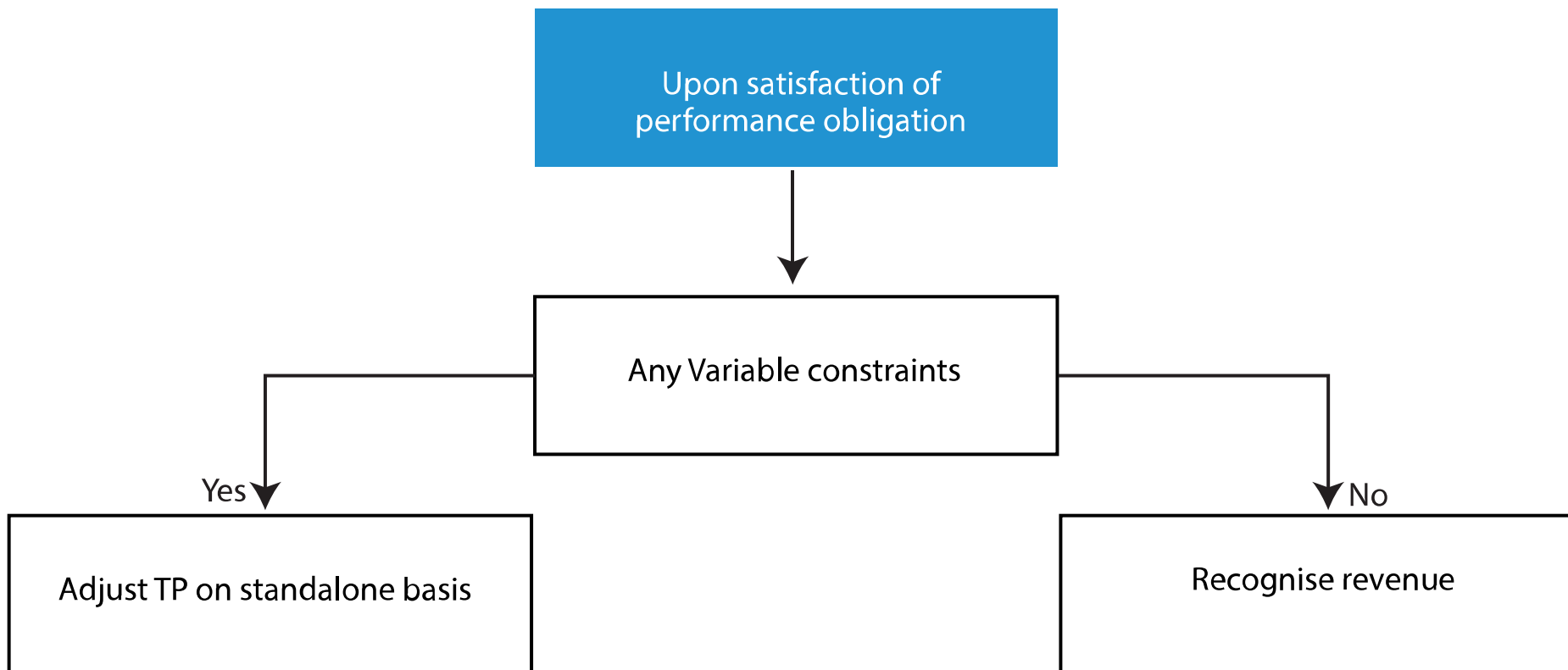
Step 1 : Identifying the contract with customer



Step 2 : Identifying the performance obligation

Performance obligation for a trading company or manufacturing company is to transfer the promised good as outlined in the contract. Now there can be cases where by the company may provide further services attached to the promised goods such as repairs/maintenance hence an entity needs to assess performance obligation either as distinct or as series of distinct goods or services. See the below

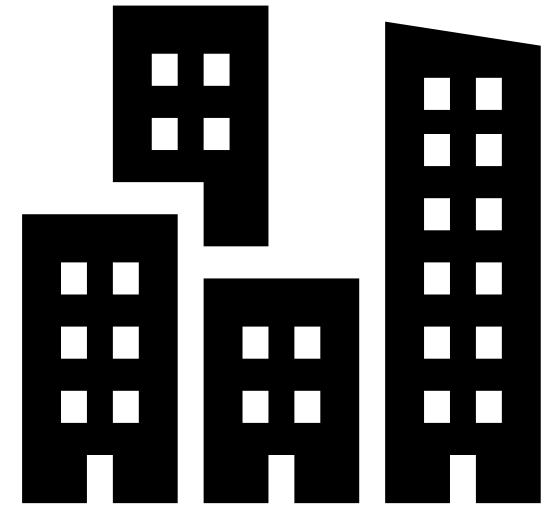




Variable constraints

- ✓ Discount
- ✓ Warranties
- ✓ Price concessions
- ✓ Coupons

IFRS 15 Impact on Real Estate



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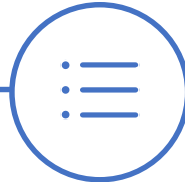
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Valid contract- (See Slide 5)

Identify performance obligation- (Point in time or Over a period of time)

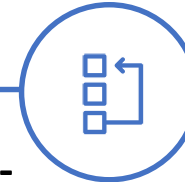
Satisfying the performance obligation

Determine the revenue based on progress towards performance obligation using -
Output or Input method



Point in time:

- Title deed
- Physical possession
- Right to payment
- Risk and rewards
- Ability to use



Over a period of time- (Any 1):

- Customer receives and consumes benefit
- The entity's performance creates or enhances an asset that the customer controls as the asset is created or enhanced
- The entity's performance does not create an asset with alternative use to the entity and the entity has right to payment for performance completed to date



Customer receives and consumes benefit:

- **Eg:** Cleaning services (project management scenarios)
- **IFRS 15. B4-** Another entity cannot reperform the work completed up to date.
- **IFRS Org Discussion paper-** Does not apply to real estate sales of unit in a multi unit complex, as the asset is not consumed immediately.



Entity's performance creates asset that the customer controls:

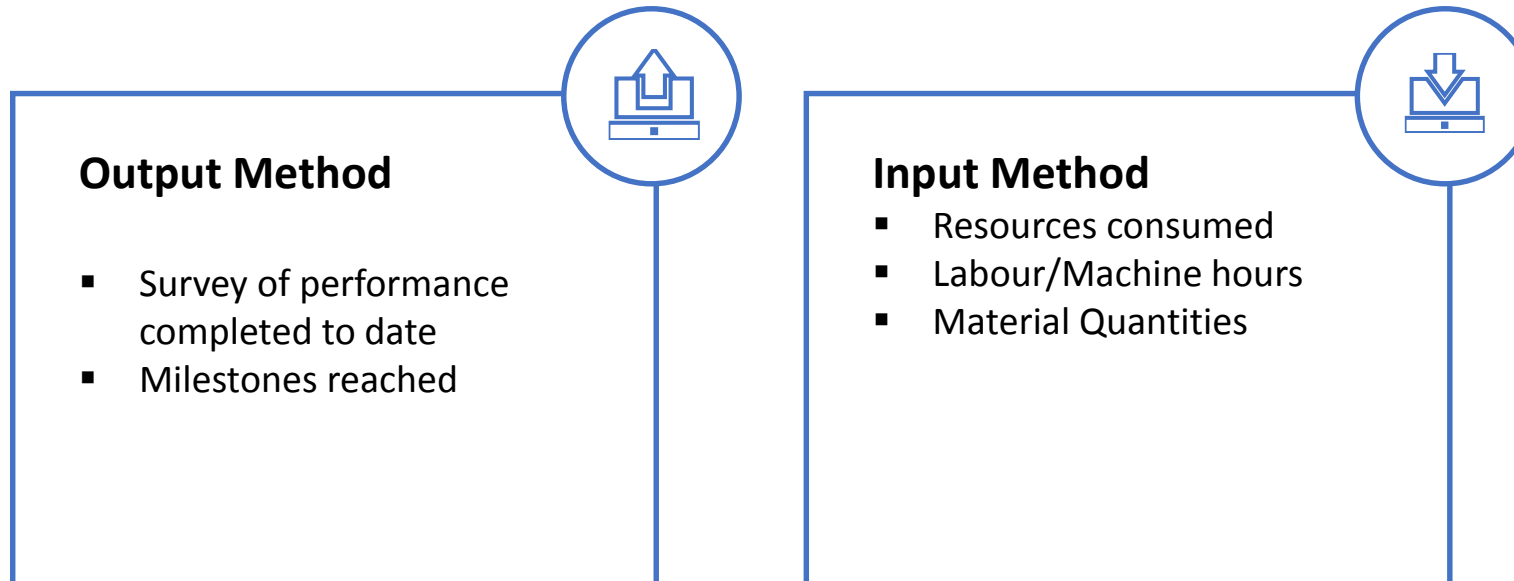
- Eg: Work in progress
- Can pledge
- Can sell
- Prevent other from directing the use.
- Economic benefit
- Discussion paper- In some jurisdiction customer can pledge work in progress units



Entity's performance does not create asset with alternative use and entity has right to payment:

- Contractually restricted to redirect the asset. (cannot sell it to another customer)
- Enforceable right to payment- Entity should be compensate for work already performed even upon termination.

Determine the transaction price (stand alone price after considering variable constrains as mentioned in Slide no 10). Real estate developers in case of performance obligation satisfied over a period of time shall consider either of the following methods to analyse progress towards performance obligation. An entity shall apply a single method of progress and apply it consistently IFRS 15.39.



Practical Expedients:

<https://gulfnews.com/business/property/50-per-cent-completion-required-before-off-plan-sales-can-begin-in-dubai-1.2176706>

- **UAE- 50% completion is required before off plan sales can begin**

Practical examples:

Company A property developer signed SPA with Customer A with following terms and conditions:

- 1) Upon approval of contract, the developer may not redirect the unit to another customer.
- 2) The customer has to pay non refundable deposit 10% of contract price and pay the reminder upon reaching each milestones as specified in the payment schedule.
- 3) In case of any default by Company B, the developer will be entitled for 10% of contract value and can retain remaining work in progress. Anything received above 10% will be refunded to the customer.

Analysis:

Step 1 : A valid contract exist

Step 2 : Performance obligation can be identified – Milestones as specified in payment schedule. However performance obligation point in time or over a period of time needs to be examined.

Point in time – Indicators as mentioned in Slide no 4 is not applicable here.

Over a period of time- One of three criterias as mentioned in Slide 4 needs to be examined

Criteria 1 - Customer receives and consumes the benefit- This is not applicable as the customer will not consume the benefit immediately (the asset).

Criteria 2 - The entity's performance creates or enhances the asset that the customer controls- Here those indicators as mentioned in Slide 5 needs to be considered- In some jurisdiction the customer can pledge unfinished apartment- In the above scenario it is not clearly indicated hence this criteria is not met.

Criteria 3 - The entity's performance should not create asset with alternate use and should have right to payment- This criteria matches with one of terms and condition however right to payment also needs to be examined. Upon termination the customer will have to pay penalty this is merely a payment to compensate the entity for inconvenience for loss of profit and the developer will retain remaining WIP.- In effect for the purpose of the entity right to payment is to an amount that at least compensates the entity for performance obligation completed to date IFRS 15 B9.- Hence this criteria is also not met. And therefore revenue recognition cannot not be done over a period of time.

THANK YOU

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