

IFRS 15 Revenue from contracts with customers: Are you ready for the “Big Change?”

The recognition criteria of revenue in accounting standards is about to change—and your entity might be significantly affected, maybe even more than you expect!

Revenue is one of, if not the most, critical component of an entity's financial statements. It is among the key performance indicators of a business, monitored closely by different stakeholders including market analysts, and often used in benchmarking different players within the same industry. It also has a direct impact on the calculation of income taxes. Accordingly, it is critical that the accounting policy appropriately captures the nature of the business, the terms of agreements with customers, and is in accordance with the applicable accounting standards.

What is the “Big Change?”

In May 2014, IFRS 15 (International Financial Reporting Standards) Revenue from Contracts with Customers was issued. It established a single comprehensive model for entities to use in accounting for revenue arising from contracts with customers. IFRS 15 supersedes the current revenue recognition standards including IAS 18 Revenue, IAS 11 Construction Contracts and their related interpretations. It will become effective on 1 January 2018, with retrospective application, and early adoption is permitted.

What triggered the change?

IFRS 15 was a result of the convergence work between the International Accounting Standards Board (IASB), the body that promulgates IFRS, and the Federal Accounting Standards Board (FASB), the standard setting body for US GAAP (Generally Accepted Accounting Principles.) It was created to fill the gap between IFRS and US GAAP, provide a robust revenue framework, and improve comparability among reporting entities through consistent and extensive disclosure requirements. It also provides guidance on a few of the gray areas on revenue recognition such as contracts involving multiple elements, treatment of costs to obtain and fulfill a contract, and accounting for contract modifications.

What are the key changes?

The core principle is to recognize revenue as depicting “the transfer of goods or



services” to customers for an “amount that reflects the consideration” to which the “entity expects to be entitled in exchange for those goods or services.”

The Standard introduces a 5-step approach to revenue recognition:

Step 1 – Identify the contract with a customer: a contract is defined as an agreement (including oral and implied), between two or more parties, that creates enforceable rights and obligations and sets out the criteria for each of those rights and obligations. The contract needs to have commercial substance and it is probable that the entity will collect the consideration to which it will be entitled.

Step 2 – Identify the performance obligations in the contract: a performance obligation in a contract is a promise (including implicit) to transfer a good or service to the customer. Each performance obligation should be capable of being distinct and is separately identifiable in the contract.

Step 3 – Determine the transaction price: transaction price is the amount of consideration that the entity can be entitled to, in exchange for transferring the promised goods and services to a customer, excluding amounts collected on behalf of third parties

Step 4 – Allocate the transaction price to the performance obligations in the contract: for a contract that has more than one performance obligation, the entity will allocate the transaction price to each performance obligation separately, in exchange for satisfying each performance obligation. The acceptable methods of allocating the

transaction price include:

- Adjusted market assessment approach,
- Expected cost plus a margin approach, and,
- The residual approach in limited circumstances. Discounts given should be allocated proportionately to all performance obligations unless certain criteria are met and reallocation of changes in standalone selling prices after inception is not permitted.

Step 5 – Recognize revenue as and when the entity satisfies a performance obligation: the entity should recognize revenue at a point in time, except if it meets any of the three criteria, which will require recognition of revenue over time:

- The entity's performance creates or enhances an asset controlled by the customer,
- The customer simultaneously receives and consumes the benefit of the entity's performance as the entity performs,
- The entity does not create an asset that has an alternative use to the entity and the entity has the right to be paid for performance to date.

Which industries will be most affected?

Actual impact will vary on each specific customer contract and will depend on the accounting treatment prior to implementation of IFRS 15. Also, depending on the industry and nature of the business, each of the five steps will have varying impact.

It is interesting to understand why some of the big real estate players in Europe chose an early adoption of IFRS 15, and the majority of key telecommunication companies are making significant investments to assess its impact and have initiated

implementation plans even prior to the date of adoption of the standard.

Telecommunication, software development, and automotive industries

These industries will be greatly affected by steps (2) and (4) with respect to the unbundling of contracts and allocation of total revenue to the unbundled parts. For example, telecommunication companies do provide mobile plans that include a mobile handset, call minutes and data package. Currently, telecom companies account for revenue differently. Some companies treated the value of mobile handsets as a cost of acquiring the customer, and recognize revenue based on the sale of monthly plans. Under IFRS 15, telecom companies are required to identify the performance obligations included in the bundled contract (i.e. handset, call minutes and data packages) and, accordingly, allocate the transaction price to each performance obligation based on an acceptable method. As such, the amount of revenue to be recognized under IFRS 15 will be significantly different than that recognized with the current accounting standards.

Real estate and contract manufacturer industries

These industries will be mostly affected by step (5) that provides guidance as to when an entity can recognize revenue as it satisfies a performance obligation. For example, real estate companies currently recognize revenue upon the transfer of risks and rewards to customers in accordance with the IFRS Interpretations Committee (IFRIC) 15, which is practically upon completion of the project development and handover of real estate units to customers. With IFRS

15, real estate companies may now recognize revenue over time as they satisfy performance obligations during the construction period of the development project. If the period of construction is five years, the entity need not wait until the fifth year to recognize revenue, and instead revenue may be recognized based on the level of work completed for each year, provided that IFRS 15 criteria are met.

How to prepare for the change An IFRS 15 impact assessment should be performed, which would include among others, the review of existing contracts with customers and its related accounting treatment, contract renegotiation and modification, to appropriately reflect the economic terms of the transaction, the engagement of legal and accounting advisors to better interpret the terms of the agreement and the applicability of IFRS 15, reconfiguration of front and back-end IT systems to adhere to the standard's requirements, and other necessary changes to ensure readiness for IFRS 15 adoption.

The complexities and extent of changes will depend on the nature of the business and the accounting policies and procedures currently implemented. It is highly advisable to act now and do the necessary assessment and collaborate with the experts on implementation plans to ensure that the entity will be ready when the “Big Change” comes.



Oduware Uwadiae, FCA
infonigeria@deloitte.com

This publication contains general information only and Deloitte & Touche is not, by means of this publication, rendering accounting, business, financial, investment, legal, tax, or other professional advice or services.

Deloitte refers to one or more of Deloitte Touche Tohmatsu Limited, a UK private company limited by guarantee (“DTTL”), its network of member firms, and their related entities. DTTL and each of its member firms are legally separate and independent entities. DTTL (also referred to as “Deloitte Global”) does not provide services to clients. Please see www.deloitte.com/about for a more detailed description of DTTL and its member firms.

Deloitte & Touche a member firm of Deloitte Touche Tohmatsu Limited, provides audit, tax, consulting, business process solutions, financial advisory and risk advisory services to public and private clients spanning multiple industries. Please visit us at www.deloitte.com/ng