IFRS 15 *Revenue from Contracts with Customers*

The new revenue standard

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Wilson P. Tan
SGV Assurance Head
Chairman, Philippine Interpretations Committee

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Scope and scope exceptions

What is in scope or affected by the standard?

- Contracts with customers
- Sale of some non-financial assets that are not an output of the entity’s ordinary activities (e.g., property, plant and equipment, intangible assets)

What is not in scope?

- Leasing contracts
- Insurance contracts
- Financial instruments contracts
- Certain non-monetary exchanges
- Certain put options on sale and repurchase agreements

Effective date and transition

- **Effective: 1 January 2017.** Early adoption permitted
- US GAAP public companies - 15 December 2016. Early adoption prohibited

Key considerations	Full retrospective approach *Excluding transition reliefs*	Modified retrospective approach
Applies to which periods presented?	All periods presented	Only the most current period presented
Applies to which contracts?	All contracts that would have existed during all periods presented had the new standard been applied from contract inception	Any contracts existing as of effective date (as if new standard had been applied since inception of contract), as well as any new contracts from that date forward
Recognition of the impact of adoption in the financial statements?	Cumulative effect of changes prior to periods presented are reflected in opening balance of retained earnings	Cumulative effect of changes to be reflected in the opening balance of retained earnings in the most current period presented

Summary of the model

Core principle: Recognise revenue to depict the transfer of promised goods or services to customers in an amount that reflects the consideration to which the entity ***expects to be entitled*** in exchange for those goods or services

Step 1 :	Identify the contract(s) with the customer
Step 2 :	Identify the performance obligations
Step 3 :	Determine the transaction price
Step 4 :	Allocate the transaction price to the separate performance obligations
Step 5 :	Recognise revenue as performance obligations are satisfied

Steps 1 & 2: Identify the contract and the performance obligations

- **Step 1:** Model applied to each contract (written, oral or implied)
  - Must meet the following criteria:
    - Contract has commercial substance
    - Parties have agreed to terms and are committed to perform
    - Payment terms can be identified and collection is probable
  - Can combine contracts if certain criteria are met
  - Modifications treated as a separate contract or part of the original contract, depending on what is modified
- **Step 2:** A **performance obligation (PO)** is a promise (explicit or implicit) to transfer a good or service to the customer
  - Identified at contract inception based on contractual terms and customary business practice
  - A series of distinct goods or services that are substantially the same is a single performance obligation if specified criteria met

Step 2: Identify the performance obligations

Two-step model to identify which goods or services are distinct

Part 1: Focus on whether the good or service is ***capable of being distinct***

Customer can benefit from the individual good or service on its own

Or

Customer can use good or service with other readily available resources

Part 2: Focus on whether the good or service is ***distinct in the context of the contract***

The good or service is:

- Highly dependent on
- Highly interrelated with

Or

- Significantly modifies or customises

other promised goods or services in the 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 a promised good or service
- Transaction price reflects the effects of the following:
  - Significant financing component (time-value of money)
  - Consideration paid or payable to a customer
  - Non-cash consideration
  - Variable consideration (including application of the constraint)
    - Estimate using the technique that better predicts the amount to which an entity will be entitled: expected value <u>or</u> most likely amount
    - Apply constraint: only include variable amounts if it is ‘highly probable’ that doing so would not result in a significant revenue reversal
      - Specific rule for sales and usage based royalties related to licences of intellectual property

Step 4: Allocate the transaction price

- Transaction price allocated to each separate performance obligation in proportion to stand-alone selling prices
  - If certain criteria are met, the model provides two potential exceptions relating to:
    - Variable consideration
    - Discounts
- When the stand-alone selling price is not observable, an entity is required to estimate the selling price by:
  - Maximising the use of observable inputs
  - Applying estimation methods consistently for goods and services, and customers with similar characteristics
  - Using a residual technique only when prices vary widely

Step 5: Recognise revenue when (or as) performance obligations are satisfied

- Revenue is recognised upon satisfaction of a performance obligation by transferring a good or service to a customer
  - A good or service is generally considered to be transferred when the customer obtains control
- Control transfers **over time** or at a **point in time**
  - First, the entity determines if control transfers over time
    - If control transfers over time, an entity selects a single input or output method to measure progress for a particular performance obligation
    - Apply consistent method for all similar arrangements
  - If control does <u>not</u> transfer over time, the default is point in time
    - Indicators provided to assist an entity when determining the point in time when control is transferred

Step 5: Recognise revenue when (or as) performance obligations are satisfied

Control of goods and services are transferred ***over time*** if **one** of the following three criteria is met:

Entity creates or enhances an asset that the customer controls as it is created or enhanced	Entity's performance does not create an asset with alternative use and the entity has an enforceable right to payment for performance completed to date	Customer simultaneously receives and consumes the benefits of the entity's performance as the entity performs and another entity would not have to re-perform work completed to date
		(a) Disregard potential limitations that would prevent it from transferring a remaining PO to another entity (b) Assume another company fulfilling the remaining PO would not have the benefit of any asset the company controls

Other aspects

- Application guidance provided to assist entities
- Contract costs:
  - Direct costs to fulfil, and incremental costs to obtain, a contract will be capitalised provided certain criteria are met
  - Capitalised costs will be amortised and tested for impairment
- Disclosures:
  - Key principle: to help users of financial statements understand the amount, timing and uncertainty of revenue and cash flows arising from contracts with customers
  - Significant increase in disclosures, including
    - Disaggregation of revenue
    - Significant judgements made in applying the standard
    - Assets recognised from costs to obtain or fulfil a contract

Potential issues for certain industries
Telecommunications

Arrangements / Products / Services	**Potential issues**
1. Contract modifications	▶ Modification of an existing contract or gives rise to a new contract ▶ Application of the standard on a contract-by-contract basis or portfolio approach – will require changes to accounting and IT systems
2. ‘Free’ handsets in postpaid plans	▶ Separate performance obligation ▶ Allocation of the transaction cost between the promised good (i.e., handset) and service (i.e., service plan) ▶ Determination of the standalone selling prices for purposes of allocating the transaction price
3. Subsidized handsets with a multiple year wireless services contract and handset installment plan	▶ Need to evaluate whether there is significant financing component to the arrangement

Potential issues for certain industries
Telecommunications (cont.)

Arrangements / Products / Services	Potential issues
4. Installation and set-up	► Need to evaluate whether they relate to the transfer of goods and services (i.e., separate performance obligation)
5. Costs to obtain a new contract (i.e., commissions paid to agents)	► Incremental costs will be capitalized if the entity expects to recover them. This may be through direct recovery or indirect recovery.
6. Costs to fulfill a contract	► Identification of costs that can be capitalized
7. Portfolio approach	► The approach will be based on specific facts and circumstances and may differ from other entities ► Application of portfolio approach to some or all of the business lines (i.e., wireless, wireline and enterprise) ► Use of estimates and assumptions to create portfolios

Potential issues for certain industries
Media and entertainment

Arrangements / Products / Services	Potential issues
1. Installation and set-up	▶ Need to evaluate whether they relate to the transfer of goods and services (i.e., separate performance obligation)
2. Commissions paid to advertising agencies	▶ Are commission costs incremental costs (i.e., capitalizable costs) of obtaining a contract?
3. Licenses	▶ Need to evaluate whether the license is distinct (i.e., separate performance obligation) ▶ Consideration of the nature of the promise to the customer (i.e., right to use the license exists at a point in time or throughout the license period) ▶ Accounting for a contract with a license for intellectual property and sales- or usage-based royalty
4. Costs to fulfill a contract	▶ Identification of costs that can be capitalized

Potential issues for certain industries
Media and entertainment (cont.)

Arrangements / Products / Services	Potential issues
4. Arrangements with co-producers, co-distributors, advertisers or digital providers	▶ Principal versus agent consideration
5. Cooperative advertising arrangements	▶ Determination of whether such arrangement represent a distinct good or service

Potential issues for certain industries
Retail and consumer products

Arrangements / Products / Services	Potential issues
1. Licenses and franchise arrangements	▶ Whether arrangements include distinct licenses of intellectual property (IP) ▶ Use of judgment in analyzing whether a license of IP is a right to access the IP or a right to use it
2. Initial franchise fees	▶ Assessment of the separate performance obligations under the franchise agreement ▶ Recognition of initial franchise fees as revenue as performance obligations are satisfied
3. Rights of return	▶ Recognition of return asset (and adjustment to cost of sales) for the entity's right to recover the goods returned by the customer
4. Options to purchase additional goods or services (i.e., sales incentives, loyalty or reward programs)	▶ Identify if option represents a separate performance obligation

Potential issues for certain industries
Power and utilities

Arrangements / Products / Services	Potential issues
1. Power and utility arrangements (i.e., take-or-pay contracts, long-term power purchase arrangements)	▶ Identification of separate performance obligations ▶ Evaluation of distinct goods and services
2. Fixed- and stepped-price arrangements	▶ Identification of separate performance obligations and allocation of transaction price to the performance obligations
3. Blend and extend modifications	▶ Determination if the modification creates a separate contract (i.e., if the new agreed rate is a standalone selling price or a blended rate)

Potential issues for certain industries
Mining

Arrangements / Products / Services	Potential issues
1. General - mining and metals arrangements	► Determining when to apply the revenue recognition model
2. Take-or-pay and other long-term supply arrangements	► Determination of performance obligations ► Allocation of the transaction price
3. Various pricing terms	► Evaluation of the pricing terms to determine transaction price ► Estimation of any variable consideration

Potential issues for certain industries
Financial institutions

Arrangements / Products / Services	Potential issues
1. Credit card arrangements	▶ Identification of the customer (i.e., merchant or cardholder ▶ Accounting for credit card fees (i.e., residual value approach) ▶ Determination of performance obligations (i.e., rewards program)
2. Annual fees for credit cards	▶ Amortization of credit card fees for a period of one year
3. Investment banking fees	▶ Determination if the arrangement involves multiple elements
4. Brokers' commission income	▶ Identification of the performance obligation/s ▶ Determination if the arrangement involves multiple elements

Potential issues for certain industries
Financial institutions (cont.)

Arrangements / Products / Services	Potential issues
5. Commissions/referral fees under a sale of real and other properties acquired in an installment basis	▶ Accounting for the commission or referral fees (i.e., whether to capitalize the said commissions or referral fees) ▶ Estimation of the period of amortization (if commission or referral fees will be capitalized)
6. Gain from foreclosure of assets/sale of foreclosed assets	▶ Timing of recognition of revenues (i.e., at the time of execution of contract to sell or contract of dacion en pago or at the time of foreclosure)

Resources

High-level guidance:

- *IFRS Developments,* Issue 80 IASB and FASB issue new revenue recognition standard – IFRS 15

Detailed guidance:

- *Applying IFRS: A closer look at the new revenue recognition standard* (June 2014) – Industry-specific publications to follow

Other:

- The full Standard can be found on the IASB and FASB websites (IFRS.org or FASB.org).
- Our Global IFRS website (www.ey.com/ifrs) offers online resources that provide more detail about IFRS, as well as issues to consider as you research the potential impact of IFRS on your entity.
- AccountingLink (ey.com/us/accountinglink) offers easy access to EY publications produced for a US GAAP audience.

Thank you

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