Sizwe Ntsaluba Gobodo

AUDIT • ADVISORY • FORENSICS

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IFRS 15: Revenue from Contracts with Customers

Fact sheet

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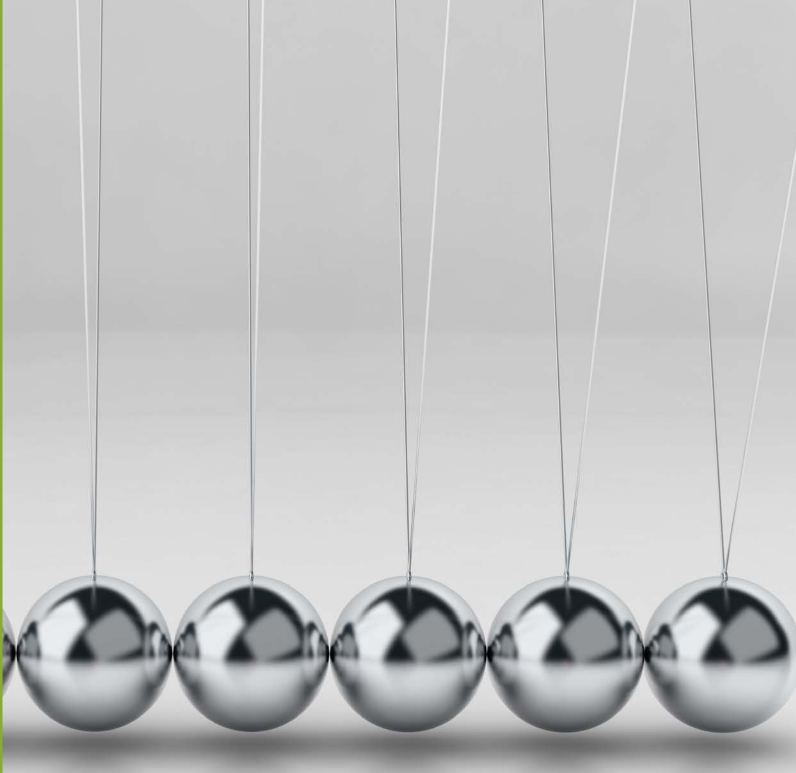
About us

SizweNtsalubaGobodo is the fifth largest accounting firm in Southern Africa and a leading partner of choice in Audit, Advisory and Forensic services. Led by our strong entrepreneurial spirit, we have a natural ability to connect experience with opportunity. We deliver quality services that support the growth of our clients, enable innovation and improve financial performance.

We strive to be regarded as long-term trusted advisers by all of our clients, despite the size and complexity of their organisations. Our ability to apply our technical expertise and specialist knowledge where appropriate ensures that we always provide objective advice and execution.

Locally, we have 11 offices around the country, with a presence in all nine provinces. While rooted in Africa, we have a global footprint through our professional membership network ensuring that our skills and expertise are available whenever and wherever our clients may need them.



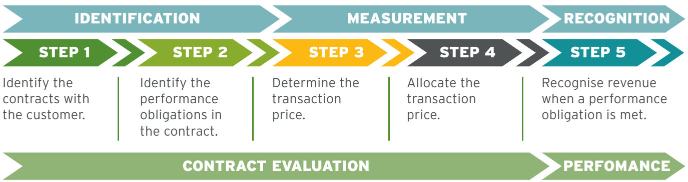
We deliver quality services that support the growth of our clients, enable innovation and improve financial performance.

IFRS 15 Background

IFRS 15 creates a comprehensive contract-based framework to determine how and when revenue from all contracts should be recognised except for financial instruments, insurance and lease contracts. IFRS 15 is effective from 1 January 2017.

The core principle of IFRS 15 is that an entity recognises 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 to in exchange for those goods or services. An entity recognises revenue in accordance with the above core principle by applying five-step model.

The five-steps should normally be assessed at the inception of the contract to document the appropriate accounting treatment.



Five-Step Model

**The IASB recently revised the effective date of the new revenue standard and defered it from 1 January 2017 to 1 January 2018.*

STEP 1 IDENTIFY THE CONTRACT(S) WITH THE CUSTOMER

Contracts may be written, verbal or in accordance with other customary business practices. Contracts must be enforceable. To be enforceable contracts need to be approved, the rights and obligations (the good or services and payments) identified and the parties committed to perform the obligations. For the IFRS 15 model to be applied contracts must also have commercial substance and the collection of the consideration must be probable. IFRS 15 is therefore not applied if there is significant doubt whether the customer will pay the consideration receivable.

Contracts are normally probable due to proper credit control procedures. However, if goods and services need to be delivered through legislation, regulation, business practices or improper credit control procedures probability could be an issue.

Two or more contracts with the same customer may be combined as a single contact if such contracts have been negotiated as a package with a single commercial objective, the amount of consideration payable are interlinked or when goods or services promised are a single performance obligation.

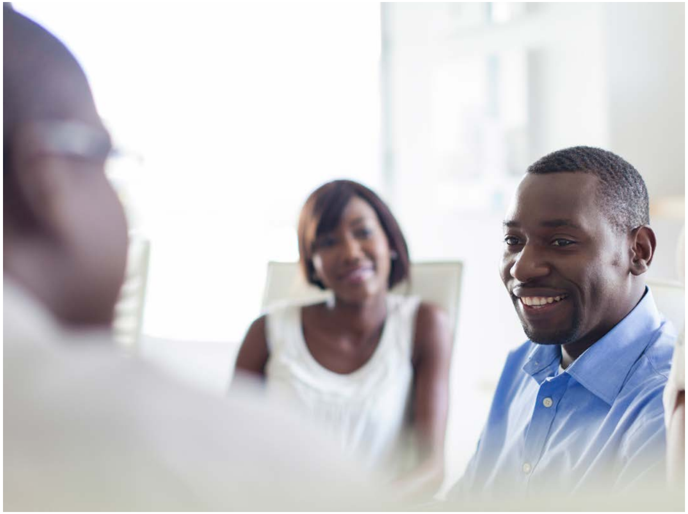
Specific contract modification requirements are provided. A modification could create a new stand-alone contract or could be an amendment of the original contract. Modifications of existing contracts are accounted either on a prospective basis or through a cumulative catch-up adjustment.

STEP 2 IDENTIFY THE PERFORMANCE OBLIGATIONS IN THE CONTRACT

An entity needs to assess which promised goods and services or bundle in a contract should be identified as separate performance obligations with the objective to recognise revenue for each performance obligation separately. Performance obligations are accounted for separately if they are distinct. Goods and services are distinct if the customer can benefit from the good or service on its own or together with other resources and the goods and services are separately identifiable.

Distinct promises are beneficial and separately identifiable.

Goods and services are separately identifiable if the entity does not bundle the goods or services in a combined output, the goods or services do not significantly modify or customise other goods or services promised or the goods or services is not highly dependent or interrelated with other goods or services 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. The transaction price could be fixed or variable. Variable transaction prices needs to be estimated and the estimation includes:

- Variable considerations, such as discounts, rebates, refunds, credits, price concessions, incentives, performance bonuses, penalties or other similar items.
- The existence of a significant financing component
- The fair value of non-cash consideration and
- Consideration payable to the costumer.

The transaction price could be fixed or variable. Variable prices need to be estimated.

The variable prices are estimated by either using the expected value (probability-weighted) or the most likely outcome. However, a constraint is applied. Variable considerations are only included 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. If there is a significant reversal possibility, the amount cannot be included in the transaction price in order to ensure that the transaction price is not overstated.

An entity should 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 should estimate the price based on reasonable available information.

Allocated on the basis of stand-alone selling prices.

Typically methods available to estimate the stand-alone selling price are adjusted market approach, expected cost plus margin approach and residual method approach. These methods are not exhaustive and entities may use any other method or a combination of methods that maximise the use of observable inputs. However, the residual approach may only be used if the stand-alone selling price is highly variable or uncertain.

A variable consideration, such as a discount, are normally proportionately allocated to each identified performance obligation. As an exception variable consideration could be allocated to a certain performance obligation(s), provided specific criteria are met.

STEP 5 RECOGNISE REVENUE WHEN A PERFORMANCE OBLIGATION IS SATISFIED

An entity shall recognise revenue when 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 or over time. An entity must first establish whether a performance obligation is satisfied over time, and if not, the default is at a point of time.

Revenue is either recognised at a point of time or over time. Point of time is the defualt.

A performance obligation is satisfied at a point of time if:

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

When the performance obligations are satisfied over time, an appropriate method that best depicts the transfer of control to recognising revenue is then applied, such as cost to date to total date or work performed. When by default the performance obligation is satisfied at a point of time, revenue is recognised when control is transferred. IFRS 15 provides different factors that could be considered to identify when transfer of control happens.

Contract cost

IFRS 15 also provides guidelines regarding incremental contract cost and cost to full a contract that is not in the scope of other standards, such as IAS 2 Inventory. Incremental cost of obtaining a contract will only be capitalised if the cost are expected to be recovered through the contract. Cost to full a contract, not within another standard will only be capitalised if:

- It relates directly to the contract or anticipated contract;
- The cost generate or enhance resources of the entity that will be used in satisfying the performance obligations;
- The cost are expected to be recovered.

Cost recoverable through a contact not in another standard are capitalised.

Presentation

Contracts are presented in the statement of financial position as a contract asset or a contract liability, depending on the relationship between the entity's performance and the customer's payment. An entity shall present any unconditional rights to consideration separately as a receivable.

Disclosure

The objective of enhanced disclosure requirements is to enable investors to better understand the nature, amount, timing and uncertainty of revenue and cash flows from contracts with customers, IFRS 15 requires a company to disclose quantitative and/or qualitative information about:

- revenue recognised from contracts with customers, including the disaggregation of revenue into appropriate categories;
- 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. In addition to the above, the entity will also make additional disclosures relating to:
- contract balances, including the opening and closing balances of receivables, contract assets and contract liabilities;
- performance obligations, including when the company typically satisfies its performance obligations and the amount of the transaction price that is allocated to the remaining performance obligations in a contract. This includes information regarding significant payment terms.

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