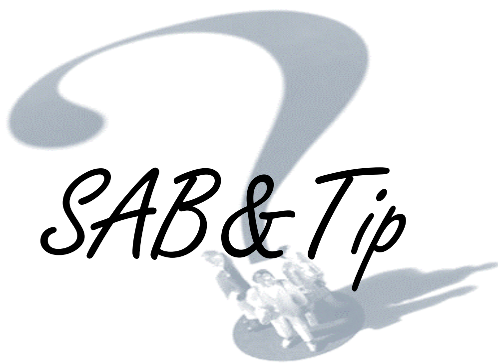

IFRS 15 Revenue Recognition

April 2015

Monthly Newsletter

IFRS 15 is a hot topic as we move closer to the effective date* for implementation. This month's Tip is a reminder of the principles and implications of the new standard.

The principles of the new standard:

Before revenue can be recognised, IFRS 15 requires five steps to be followed:

Step 1:

Identify the contracts with the customer: IFRS 15 must be applied to **each contract** with a customer that has commercial substance.

Step 2:

Identify the performance obligations in the contract: This is the good or service that is sold to the customer. The contract must be evaluated to identify performance obligations that are **distinct**.

Step 3:

Determine the transaction price: This is the amount of consideration which the entity expects to receive upon the fulfilment of the performance obligations.

Step 4:

Allocate the transaction price: The transaction price will be allocated to each performance obligation identified in Step 2. Guidance is provided regarding discounts.

Step 5:

Recognise revenue when a performance obligation is satisfied: The entity will recognise the revenue when (or as) it satisfies the performance obligation.

What are the main changes?

The requirements of IFRS 15 will result in changes in accounting for only *some* transactions for *certain* companies. However, *all* companies are required to follow the new disclosure requirements.

- IFRS 15 focuses on recognising revenue once the customer has obtained **control** of the good and not when risks and rewards have passed;
- The measurement of the total contract consideration, and how it is split between multiple elements deliverable under a single contract will change for many entities;
- As a result of the five step process, there will be changes to the timing and measurement of the revenue recognised. For example a car dealership will now have to recognise the motor vehicle separately from the maintenance plan as these items are two separate performance obligations, due to them being distinct;
- Entities must now be prepared for the significant increase in disclosures which include disclosures over quantitative and qualitative information about its contracts with customers. Careful thought is thus required for entities who will suffer minimal changes to their revenue recognition policies as to how they will gather the information necessary to satisfy the disclosure requirements;

Practical implications:

- New systems may be required to implement the new standard which would require implementing internal controls;
- Employee incentive plans are often linked to the financial performance and changes to revenue recognition might require entities to redesign their remuneration plans;
- There will be changes to profit and hence changes in tax;
- Some entities might consider redesigning their contracts with customers to avoid undesirable accounting consequences.

***Effective date**

The effective date is for years **beginning on or after 1 January 2017**. However, with most companies needing to restate comparatives on adoption or to amend current systems in place, entities should prepare to get ready for the new standard.

The IASB has tentatively decided to propose a deferral of the effective date by one year. An exposure draft is issued for comment on the proposal and discussions will be finalised by July 2015.