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THE ANANTROY BHATT KNOWLEDGE CENTRE



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Introduction to IFRS 15: Revenue From Contracts With Customers

The core principle of IFRS 15 is that an entity recognises revenue:

- (a) to depict the transfer of promised goods or services to customers
- (b) at an amount that reflects the consideration to which the entity expects to be entitled in exchange for those goods or services

- **Revenue = Income arising in the course of an entity's ordinary activities.**
- **Customer = A party that has contracted with an entity to obtain goods or services that are an output of the entity's ordinary activities in exchange for consideration.**

Step 1: Identify The Contract(s) With A Customer

A contract is an agreement between two or more parties that creates enforceable rights and obligations. An entity shall account for a contract with a customer under IFRS 15 only when all of the following criteria are met:

- **the parties to the contract have approved the (binding) contract;**
- **the entity can identify each party's rights regarding the goods or services to be transferred;**
- **the entity can identify the payment terms for the goods or services to be transferred;**
- **the contract has commercial substance; and**
- **it is probable that the entity will collect the consideration considering only the customer's ability and intention to pay that amount of consideration when it is due.**

When a contract with a customer does not meet the above criteria and an entity receives consideration from the customer, the entity shall recognise the consideration received as revenue only when either of the following events has occurred:

- **the entity has no remaining obligations to transfer goods or services to the customer and all, or substantially all, of the consideration promised by the customer has been received by the entity and is non-refundable; or**
- **the contract has been terminated and the consideration received from the customer is non-refundable.**

An entity shall recognise the consideration received from a customer as a liability until one of the above-mentioned events occurs or until the recognition criteria are subsequently met. An entity shall combine two or more contracts entered into at or near the same time with the same customer (or related parties of the customer) and account for the contracts as a single contract if one or more of the following criteria are met:

- **the contracts are negotiated as a package with a single commercial objective;**
- **the amount of consideration to be paid in one contract depends on the price or performance of the other contract; or**
- **the goods or services promised in the contracts (or some goods or services promised in each of the contracts) are a single PO**

A promise in a contract with a customer to transfer to the customer either:

- good or service (or a bundle of goods or services) that is distinct; or
- a series of distinct goods or services that are substantially the same and that have the same pattern of transfer to the customer.

A good or service that is promised to a customer is distinct if both of the following criteria are met:

- the customer can benefit from the good or service either on its own or together with other resources that are readily available to the customer; and
- the entity's promise to transfer the good or service to the customer is separately identifiable from other promises in the contract.

If a good or service is regularly sold separately, this would indicate that customers generally can benefit from the good/service on its own or in conjunction with other available resources.

If a promised good or service is not distinct, an entity shall combine that good or service with other promised goods or services until it identifies a bundle of goods or services that is distinct. In some cases, that would result in the entity accounting for all the goods or services promised in a contract as a single PO.

Examples of promised goods and services include:

- Goods produced by an entity for sale
- Resale of goods purchased by an entity
- Resale of rights to goods or services purchased by an entity
- Performing a contractually agreed-upon task for a customer
- Standing ready to provide goods or services
- Providing a service of arranging for another party to transfer goods or services to the customer
- Granting rights to goods or services to be provided in the future that a customer can resell
- Constructing, manufacturing or developing an asset on behalf of a customer
- Granting licences
- Granting options to purchase additional goods/services

The amount of consideration to which an entity expects to be entitled in exchange for transferring promised goods or services to a customer, excluding amounts collected on behalf of third parties (for example, some sales taxes).

An entity shall consider the terms of the contract and its customary business practices to determine the TP.

The nature, timing and amount of consideration promised by a customer affect the estimate of the TP. When determining the TP, an entity shall consider the effects of all of the following:

- variable consideration;
- constraining estimates of variable consideration;
- the existence of a significant financing component in the contract;
- non-cash consideration (measured at fair value); and
- consideration payable to a customer (reduction in TP due to coupon or vouchers).

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Step 4: Allocating The Transaction Price (TP)

The objective when allocating the TP is for an entity to allocate the TP to each PO (or distinct good or service) in an amount that depicts the amount of consideration to which the entity expects to be entitled in exchange for transferring the promised goods or services to the customer.

The price at which an entity would sell a promised good or service separately to a customer.

Suitable methods for estimating the stand-alone selling price of a good or service include, but are not limited to, the following:

- Adjusted market assessment approach
- Expected cost plus a margin approach
- Residual approach

A combination of methods may need to be used to estimate the standalone selling prices of the goods or services promised in the contract

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Step 5: Satisfaction of Performance Obligation (PO)

An entity shall recognise revenue when (or as) the entity satisfies a PO by transferring a promised good or service (i.e. an asset) to a customer. An asset is transferred when (or as) the customer obtains control of that asset.

Satisfaction At A Point Of Time:

To determine the point in time at which a customer obtains control of a promised goods or services and the entity satisfies a PO, the entity shall consider the requirements for control. In addition, an entity shall consider indicators of the transfer of control, which include, but are not limited to, the following:

- The entity has a present right to payment for the asset.
- The customer has legal title to the asset.
- The entity has transferred physical possession of the asset.
- The customer has the significant risks and rewards of ownership of the asset.
- The customer has accepted the asset.

Satisfaction Over Time

When goods or services are transferred continuously, a revenue recognition method that best depicts the entity's performance should be applied (and updated as circumstances change).

Acceptable methods include:

- Output methods: units produced, units delivered, contract milestones, survey of work performed.
- Input methods: costs incurred, labour hours expended, machine hours worked.

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Contract Costs

Incremental Costs:

An entity shall recognise as an asset the incremental costs of obtaining a contract with a customer if the entity expects to recover those costs. The incremental costs of obtaining a contract are those costs that an entity incurs to obtain a contract with a customer that it would not have incurred if the contract had not been obtained (for example, a sales commission).

Non-Incremental Costs:

Costs to obtain a contract that would have been incurred regardless of whether the contract was obtained shall be recognised as an expense when incurred, unless those costs are explicitly chargeable to the customer regardless of whether the contract is obtained.

Less Than One Year Life

As a practical expedient, an entity may recognise the incremental costs of obtaining a contract as an expense when incurred if the amortisation period of the asset that the entity otherwise would have recognised is one year or less

Cost To Fulfill A Contract

If the costs incurred in fulfilling a contract with a customer are not within the scope of another Standard (for example, IAS 2, IAS 16, or IAS 38), an entity shall recognise an asset from the costs incurred to fulfil a contract only if those costs meet all of the following criteria:

- the costs relate directly to a contract or to an anticipated contract that the entity can specifically identify (for example, costs relating to services to be provided under renewal of an existing contract or costs of designing an asset to be transferred under a specific contract that has not yet been approved);
- the costs generate or enhance resources of the entity that will be used in satisfying (or in continuing to satisfy) POs in the future; and
- the costs are expected to be recovered.

Directly Related Costs

Costs that relate directly to a contract might include:

- direct labour and direct materials;
- allocations of costs that relate directly to the contract or to contract activities;
- costs that are explicitly chargeable to the customer under the contract; and
- other costs that are incurred only because an entity entered into the contract (e.g. payments to subcontractors).

Costs Charged To The SOPLOCI

The following costs must be recognised as expenses when incurred:

- general and administrative costs (unless those costs are explicitly chargeable to the customer under the contract);
- costs of wasted materials, labour or other resources to fulfil the contract that were not reflected in the price of the contract;
- costs that relate to satisfied performance obligations (or partially satisfied performance obligations) in the contract (i.e. costs that relate to past performance).

Amortization

An asset recognised for contract costs shall be amortised on a systematic basis that is consistent with the transfer to the customer of the goods or services to which the asset relates.

Impairment

An entity shall recognise an impairment loss in profit or loss to the extent that the carrying amount of an asset recognised exceeds the following:

= Remaining expected revenue – remaining cost

Contract Asset:

A supplier might transfer goods or services to a customer before the customer pays consideration or before payment is due. In this case the contract is presented as a contract asset (excluding any amounts presented as a receivable). A contract asset is a supplier's right to consideration in exchange for goods or services that it has transferred to a customer. A contract asset is reclassified as a receivable when the supplier's right to consideration becomes unconditional.

Receivable:

An unconditional right to consideration is presented as a receivable. The accounting treatment to record the transfer of goods for cash or for an unconditional promise to be paid consideration is straightforward.

Dr. Bank/Receivable
Cr. Revenue

Contract Liabilities:

A contract might require payment in advance or allow the supplier a right to an amount of consideration that is unconditional (i.e. a receivable), before it transfers a good or service to the customer. In these cases, the supplier presents the contract as a contract liability when the payment is made or the payment is due (whichever is earlier). The contract liability is a supplier's obligation to transfer goods or services to a customer for which it has received consideration (an amount of consideration is due) from the customer.

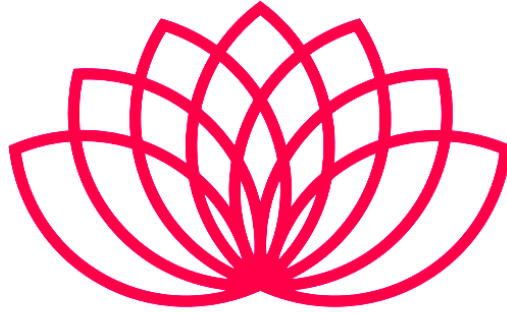
A contract modification is a change in the scope or price (or both) of a contract that is approved by the parties to the contract.

Modification Is A Separate Contract

An entity shall account for a contract modification as a separate contract if scope and price of the contract increases. Accounting treatment: Original contract is recognised as it is, and modification is recognised as a separate contract.

Modification Is Not A Separate Contract

Accounting treatment: An entity shall account for the contract modification as if it were a termination of the existing contract and the creation of a new contract. The amount of consideration to be allocated to the remaining POs is equal to unearned revenue under previous arrangement + additional revenue from modification



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