

Oncioiu, Ionica

## Article

# Revenue from contracts with customers under IFRS 15

**Provided in Cooperation with:**  
Danubius University of Galati

*Reference:* Oncioiu, Ionica Revenue from contracts with customers under IFRS 15.

This Version is available at:  
<http://hdl.handle.net/11159/390>

## Kontakt/Contact

ZBW – Leibniz-Informationszentrum Wirtschaft/Leibniz Information Centre for Economics  
Düsternbrooker Weg 120  
24105 Kiel (Germany)  
E-Mail: [rights\[at\]zbw.eu](mailto:rights[at]zbw.eu)  
<https://www.zbw.eu/>

## Standard-Nutzungsbedingungen:

Dieses Dokument darf zu eigenen wissenschaftlichen Zwecken und zum Privatgebrauch gespeichert und kopiert werden. Sie dürfen dieses Dokument nicht für öffentliche oder kommerzielle Zwecke vervielfältigen, öffentlich ausstellen, aufführen, vertreiben oder anderweitig nutzen. Sofern für das Dokument eine Open-Content-Lizenz verwendet wurde, so gelten abweichend von diesen Nutzungsbedingungen die in der Lizenz gewährten Nutzungsrechte. Alle auf diesem Vorblatt angegebenen Informationen einschließlich der Rechteinformationen (z.B. Nennung einer Creative Commons Lizenz) wurden automatisch generiert und müssen durch Nutzer:innen vor einer Nachnutzung sorgfältig überprüft werden. Die Lizenzangaben stammen aus Publikationsmetadaten und können Fehler oder Ungenauigkeiten enthalten.

<https://savearchive.zbw.eu/termsfuse>

## Terms of use:

*This document may be saved and copied for your personal and scholarly purposes. You are not to copy it for public or commercial purposes, to exhibit the document in public, to perform, distribute or otherwise use the document in public. If the document is made available under a Creative Commons Licence you may exercise further usage rights as specified in the licence. All information provided on this publication cover sheet, including copyright details (e.g. indication of a Creative Commons license), was automatically generated and must be carefully reviewed by users prior to reuse. The license information is derived from publication metadata and may contain errors or inaccuracies.*

## Revenue from Contracts with Customers under IFRS 15: New Perspectives on Practice

Ionica Oncioiu<sup>1</sup>, Alin-Eliodor Tănase<sup>2</sup>

**Abstract:** This article offer an overview of the characteristics of IFRS 15 requirements regarding revenue. Revenue is the gross inflow of economic benefits during the period arising in the course of the ordinary activities of an entity when those inflows result in increases in equity, other than increases relating to contributions from equity participants. This new standard intends to cover the gaps from the previous standards such as IAS 18 and IAS 11. IAS 18 provided limited guidance on many important revenue topics such as accounting for multiple-element arrangements. Fair value measurement and impairment methodology based on the incurred loss model are discussed in this context. This new standard offers detailed guidelines for different type of transactions such as sale with a right of return, like non-refundable upfront fees (and some related costs), principal versus agent considerations and consignment arrangements, others. Based on the results of this analysis, will show these views suggest practitioners 'confusion about IFRS 15.

**Keywords:** gross inflow of economic benefits; fair value measurement; accounting estimates

**JEL Classification:** H20; H27

### 1. Introduction

Today, revenue recognition to depict the transfer of promised goods or services to customers in an amount interferes with the process of assessment. In an uncertain world with imperfect and incomplete markets (financial crisis), no particular measurement objective should be regarded as having a monopoly, and different measurements should be regarded as complementing one another. However revenue and income are important figures from financial statements. So it is very important that the transfer of promised goods or services to customers to be established and presented – by the preparers of financial statements - at an amount that reflects the consideration to which the preparers expect to be entitled in exchange for those goods or services.

The problem is how to choose the best of them in the context of satisfying consumers' motivations in the purchasing process requirements, on the one hand and complying with accounting principles and fundamentals, on the other hand.

On the other hand, accountants, in their turn, reflect accounting estimates only in registers and certainly not the value generated by the presentation of materials. It is a clear dichotomy between the historical cost accounting and fair value in accounting measurement, which creates a productive tension in discussions related to economy based on knowledge.

<sup>1</sup> Titu Maiorescu University, Romania, ionicaoncioiu@yahoo.ro.

<sup>2</sup> Titu Maiorescu University, Romania, alin.tanase@everet.ro.

IFRS standard offers two different definitions - in its Appendix A - for revenue and income, as follow: revenue - income arising in the course of an entity's ordinary activities; income - Increases in economic benefits during the accounting period in the form of inflows or enhancements of assets or decreases of liabilities that result in an increase in equity, other than those relating to contributions from equity participants.

Income includes revenue and gains but it is important to present distinctly the revenue and gains in financial statements because revenue are generated by selling goods and rendering of services activities of entity (entity's ordinary activities) while gains are not from ordinary activities.

IFRS 15 defines also other several terms such as contract, contract asset, contract liability, customer, transaction price or standalone selling price. However there are many other terms which must be considered when revenue from contracts with customers are dealt such as agent, bill-and-hold arrangement, control, contract modification, highly probable, probable, etc.

Applying of this standard (after 1st of January, 2017) suspends the following standards in force: IAS 11 Construction Contracts, IAS 18 Revenue; IFRIC 13 Customer Loyalty Programmes; IFRIC 15 Agreements for the Construction of Real Estate; IFRIC 18 Transfers of Assets from Customers; and SIC-31 Revenue—Barter Transactions Involving Advertising Services. Early adoption is permitted under IFRS, but not for public entities reporting under US GAAP. Entities will transition following either a full retrospective approach or a modified retrospective approach.

If an entity applies IFRS 15 before 1st of January, 2017 this fact must be mentioned in financial statements. This standard applies to all the contracts with customers, except for the mentioned bellow:

- a) lease contracts within the scope of IAS 17 Leases;
- b) insurance contracts within the scope of IFRS 4 Insurance Contracts;
- c) financial instruments and other contractual rights or obligations within the scope of IFRS 9 Financial Instruments (IAS 39 Financial Instruments: Recognition and Measurement), IFRS 10 Consolidated Financial Statements, IFRS 11 Joint Arrangements, IAS 27 Separate Financial Statements and IAS 28 Investments in Associates and Joint Ventures;
- d) certain non-monetary exchanges (e.g. non-monetary exchanges between entities in the same line of business to facilitate sales to customers or potential customers).

According to IFRS 1 distinct lines for revenue and impairment must be presented within Statement of profit or loss and other comprehensive income. Entities should disclose (except this values are already included in Statement of profit or loss and other comprehensive income): amount of revenue recognized (which must be disclosed separately from other revenue sources) and impairment losses recognized on any receivables or contract assets.

This paper is organized into two sections. The first section contain the introduction and an overview of necessity of a new standard regarding revenue recognition. The final section provides a discussion of the results, the relevance of this research to literature and presents the conclusions and recommendations reached from the study.

## **2. Evaluation and Presentation the Revenue from Contracts with Customers under IFRS 15: Impact and Limits**

A possible question that may arise is about the necessity of this standard. It is necessary a new standard related to revenue from contracts with customers? Yes, is the answer because, in May 2014, the Financial Accounting Standards Board (FASB) and the International Accounting Standards Board (IASB) issued a new joint standard on revenue's recognition. The purpose of this new standard is to replace the accounting standards for revenue recognition that currently exist under U.S. GAAP and IFRS. The reasons for issuing a new standard under U.S. GAAP are a little bit different than the reasons for issuing under IFRS. Related U.S. GAAP revenue recognition guidance the frequent criticism refers mainly at broad revenue recognition concepts together with numerous revenue requirements for particular industries or transactions. These numerous requirements frequently resulted in different accounting for economically similar transactions.

On the other hand, IFRS provided limited guidance and the main standards, IAS 18 - Revenue and IAS 11 - Construction Contracts, were difficult to apply to complex transactions. IAS 18 presented limited guidance on important revenue topics such as accounting for multiple-element arrangements. IFRS 15, which is converged with Accounting Standards Update 2014-09 Revenue from Contracts with Customers issued by the FASB, establishes a single, comprehensive framework for revenue recognition. The framework will be applied consistently across transactions, industries and capital markets, and will improve comparability in the 'top line' of the financial statements of companies globally. Replacing the previous requirements with a comprehensive framework, contracts with customers that are economically similar will be accounted for on a consistent basis.

There are clearly several plausible alternatives to revenue from contracts with customers under IFRS 15. Anywise, IFRS 15 contains specific guidance for other issues, such as:

- a) *Licensing* – A license arrangement establishes a customer's rights related to an entity's intellectual property and the obligations of the entity to provide those rights. The entity has to establish if the license *is distinct / is not distinct* from other goods or services;
- b) *Sale with a right of return* - Understanding the contractual rights and obligations of both parties in an arrangement when return rights exist is critical to determining the accounting. Generally the goods are returned for difference reasons (e.g. goods become obsolete, new products appeared and the old ones are returned, the return goods upon termination of agreement) or are returned for any reason (the customer has the right to return the goods without explanations);
- c) *Warranties* – Generally the nature of warranties, written in contract or implicit, is wide and depend the contract, the product sold or the industry. It may be a standard warranty, a manufacturer's warranty, or an extended warranty;
- d) *Repurchase agreements* – these agreements represent an obligation or a right to repurchase a good after it is sold to a customer. These rights may be included or not in the sales contract. The repurchased product may be the same asset or a substantially similar asset or a new asset of which the originally purchased asset is a component. There are the following forms of repurchase rights: forward – the seller has the obligation to repurchase the good, call option – the seller has the right to

repurchase the good and put option – the customer has the right to require the entity to repurchase the good;

e) *Customer acceptance* – the main idea, related to a customer acceptance clause, is represented by existence of a protection to a customer by allowing it to either cancel a contract or force a seller to take corrective actions if goods or services do not meet the requirements in the contract. The moment in time when the control of a good or service is transferred must be established by the entity. Customer acceptance and all indicators of transfer of control should be analysed from the customer's perspective;

f) *Customers' unexercised rights* – customers may chose not to exercise the all rights or options from a contract. The applying of the proper accounting treatment the guidelines should be carefully analysed. Examples of such kind of unexercised rights may include: sale of gift cards, customer loyalty points, customer loyalty points, reassessment of breakage estimate;

g) *Bill-and-hold arrangements* - these arrangements arise when a customer is billed for goods that are ready to be delivered, but the entity does not ship the goods to the customer until a later date.

Other details guidelines are included in this standard for transaction like non-refundable upfront fees (and some related costs), principal versus agent considerations and consignment arrangements.

But the process doesn't stop here. After getting the accountancy information it must be furnished to the interested one and has to be interpreted in the scope to take decisions. As a result it is some problems of credibility and meaningfulness vis-à-vis these new reports according with IFRS 15. Also the revenue represented by the date which can be in conflict with their reliability.

IFRS 15 establishes the steps of valuation techniques that varies based on the availability of observable accounting information, as follows: Step 1 - Identify the contract(s) with a customer; Step 2 - Identify the performance obligations in the contract; Step 3 - Determine the transaction price; Step 4 - Allocate the transaction price to the performance obligations in the contract; Step 5 - Recognize revenue when (or as) the entity satisfies a performance obligation.

For this step an entity must analyse the following aspects regarding the contract:

a) *Main object of the contract*: it has to be established if the contract represents a sale of nonfinancial assets or a transfer of nonfinancial assets. Some of principle related to transfer of nonfinancial assets may be out of the scope of this standard;

b) *Identifying the customer*: the standard defines the *customer* as being *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*. It is considered that no contract exist under IFRS 15 as long as each party to the contract has a unilateral enforceable right to terminate a wholly unperformed contract without compensating the other party (or parties). There may be difficulties to identify the customer when there are multiple parties involved in a transaction;

c) *Identifying the contract*: the standard defines the *contract* as being *an agreement between two or more parties that creates enforceable rights and obligations*. A contract can be written, oral, or

implied by an entity's customary business practices. The standard requires that a contract to have the following four characteristics:

- the contract has been approved;
- the contract has commercial substance;
- the rights and payment terms regarding goods and services to be transferred can be identified;
- it is probable that the consideration will be received (considering only the customer's ability and intention to pay).

d) *Combining contracts*: there are cases when contracts must be combined. IFRS 15 requires that contracts are combined if they are entered into at (or near) the same time, with the same customer, if either:

- the contracts are negotiated as a package with a single commercial objective;
- the consideration for each contract is interdependent on the other, or
- the overall goods or services of the contracts represent a single performance obligation.

e) *Contract modifications*: The contract modification is a change in rights or obligations of a contract that is approved by the parties to the contract. The modification creates new rights or obligations or changes the old ones. The contract modification must be accounted for either:

1. as a *separate contract*, if the following criteria are met:

- the contract scope changes due to the addition of distinct goods or services, and
- the change in contract price reflects the standalone selling price of the distinct good or service,

2. or *not* as a *separate contract*. In this case the contract modification will be accounted for either a replacement of the original contract with a new contract or continuation of the original contract or both.

For identifying the performance obligations the next aspects must be taking into consideration:

a) *promises in a contract* - IFRS 15 defines *performance obligation* as being a promise in a contract with a customer to transfer to the customer either of the following:

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

If the entity's activities that do not result in a *transfer of goods or services* to the customer than there are not performance obligations of the contract with the customer. Thereupon these activities do not give rise to revenue. Promised goods or services include, but are not limited to the mentioned bellow transaction included in IFRS 15:

1. transferring produced goods or reselling purchased goods;

2. arranging for another party to transfer goods or services;
3. standing ready to provide goods or services in the future;
4. building, designing, manufacturing, or creating an asset on behalf of a customer;
5. granting a right to use or access to intangible assets, such as intellectual property;
6. granting an option to purchase additional goods or services that provides a material right to the customer;
7. performing contractually agreed-upon tasks.

*b) establish if the goods or services are distinct* - under IFRS 15, if the following criteria are met, the good or service may be considered as being *distinct*:

- the customer must be able to benefit from the good or service either on its own or together with other readily available resources;
- the good or service is separately identifiable from other goods or services in the contract.

A good or service may *be separable or not be separable* from other promised goods or services in the contract. A good or service *may not be separable* from other promised goods or services in the contract, if:

1. there are significant integration services with other promised goods or services;
2. it modifies other promised goods or services; and
3. it is highly dependent with other promised goods or services.

The transaction price is represented by the amount of consideration in a contract to which a company expects to be entitled in exchange for transferring to a customer the promised goods or services. The consideration received or receivable may be a *cash consideration* or a *non-cash consideration* or a *combination of them*. The price of the transaction may be affected by different factors such as the nature, timing, and amount of consideration. The transaction price may include different types of considerations, such as:

1. *consideration that includes a significant financing component* - the significant financing component can either be explicit or implicit. Establishing if a consideration exist or not may be based by different factors such as:

- a) difference between the consideration and cash selling price;
- b) combined effect of interest rate and length of time between transfer of control of the goods or services and payment.

Anyway, IFRS 15 considers that there is no significant financing component in these cases:

- a) timing of the transfer of control of the goods or services is at the customer's discretion;
- b) the difference between the consideration and cash selling price arises for other non-financing reasons;

c) the consideration is variable with the amount or timing based on factors outside of the control of the parties.

2. *variable consideration* - IFRS 15 presents the accounting guidelines for discounts (volume discounts, prompt payment discounts), rebates, refunds, credits, pricing based on index, price protection and price matching, concessions, incentives, performance bonuses, penalties, and contingent payments. An entity must assess the value of variable consideration using one of the following two methods:

- a) *Expected value method*: based on probability weighted amounts within a range (i.e. for large number of similar contracts);
- b) *Single most likely amount*: the amount within a range that is most likely to eventuate (i.e. where there are few amounts to consider).

3. *consideration payable to the customer* – according IFRS 15 consideration payable to a customer includes cash amounts that an entity pays, or expects to pay, to a customer or to other parties that purchase the entity's goods or services from the customer. Consideration payable to a customer also includes credits, coupons or vouchers that can be applied against amounts owed to the entity or to other parties that purchase the entity's goods or services from the customer. The consideration payable to a customer will be accounted as:

- a) a reduction of the transaction revenue (reduction of transaction price) or
- b) an expense if the payment to the customer is in exchange for a distinct good or service that the customer transfers to the entity. IFRS offers guideline for these situations.

4. *non - cash amounts* - is accounted for at fair value when the fair value is reliably determinable. Otherwise it is measured indirectly by reference to stand-alone selling price of the goods or services).

Generally the transaction price is allocated to each performance obligation on the basis of the relative stand-alone selling prices of each distinct good or service promised in the contract. An entity must estimate stand-alone selling price if it is not observable. Methods used for estimation may include: adjusted market assessment approach; expected cost plus a margin approach; residual approach.

If the sum of the stand-alone selling price of each performance obligation exceeds the consideration payable, in this case the transaction includes a discount. Generally the discounts are allocated on a proportionate basis. The allocation is done after meeting all of the following criteria: the goods or services (or bundle thereof) in the performance obligation are regularly sold on a stand-alone basis, and at a discount; the discount is substantially the same in amount to the discount that would be given on a stand-alone basis.

The transaction price allocated to each performance obligation is recognized as/when the performance obligation is satisfied, either: at a point in time - especially for promises to transfer goods to a customer or over time - especially for promises to transfer services to a customer.

The revenue is recognized at a point in time if the criteria for over time's recognition are not met. Actually revenue is recognised at the point in time at which the entity transfers control of the asset to the customer.



This standard is a complex one and for applying it in a proper manner it's crucial to understand very clear the rights and obligations from the contract with the customers. This takes us back to the academically traditional debates on the pros and cons of the various theories of income measurement and valuation. Many academics have strongly held view on these issues.

### **3. Discussion of Results**

IASB issued in 2011 the Exposure Draft for Revenue from Contracts with Customers and after respondents' feedback the board answered and issued, in May 2014, the final version of IFRS 15 Revenue from Contracts with Customers. The respondents have focused on the following areas: performance obligations satisfied over time, identifying performance obligations, customer credit risk, constraining estimates of variable consideration, retrospective application, onerous performance obligations and disclosure requirements. Next we will present some important requirements from IFRS 15.

The use of fair values to record transactions is particularly important in more complex transactions for example, restructuring of debt or a sale and leaseback transaction. The resulting amounts are again used as cost. Again, the use of fair values to measure the transactions does not, in itself, require the use of fair values at subsequent balance sheet dates. While IFRS have long required the use of fair value to measure revenue, the IASB has begun to require that assets and liabilities should be measured at initial recognition at fair value even when this amount differs from cost (i.e. the fair value of the consideration given or received). The IASB has subsequently issued a discussion paper Measurement Bases for Financial Accounting — Measurement on Initial Recognition which proposes that all assets and liabilities should be measured on initial recognition at their fair values.

It is also far from true to say that the new approach gives rise to day gains and losses when the fair value of an asset or liability differs from the fair value of the consideration given or assumed. It also places an immense burden of financial statements that will have to determine the fair value of every transaction in order to consider whether it should be recorded at fair value instead of cost. The approach is absurd in those cases in which the use of fair values in IFRS financial statements is nowhere near as extensive. The reality is that the use of fair values in IFRS for the subsequent measurement of revenue is very limited - both in theory and in practice.

It is true to say that IFRS are placing much more emphasis on the use of fair values to record transactions and to allocate the initial amount of transactions among its constituent parts. This process began almost twenty-five years ago and reflects the practice in many national standards. The growth in such requirements also reflects the increasing complexity of many business transactions as well as the IASB's desire (and that of business entities and their auditors) to ensure that IFRS deal with a large proportion of these transactions. If the use of fair values in such circumstances is new, the previous financial statements lacked relevant information.

Moreover, the authors believe that due to the high influence, both positively and negatively, of the revenue value is necessary conducting more detailed studies of diagnostic analysis to identify and

recognising them, and also to determine a set of evaluation methods that leads to a correct result, close to the market.

#### **4. Conclusion**

It's important that entities which apply these new standards to start to analyse the impact of the new requirements on their business, including the taxation area (e.g. tax on income or transfer pricing). Understanding the new requirements may involve different costs for public/ non-public entities such as: costs for changing/ updating the software, costs for training the professional staff from accounting, sales, tax, juridical, or other departments, etc.

IFRS 15 addresses those deficiencies by specifying a comprehensive and robust framework for the recognition, measurement and disclosure of revenue. IFRS 15 sets out the requirements for recognising revenue that applies to all contracts with customers. There are exceptions for contracts that are within the scope of the Standards on Leases, Insurance contracts and financial instruments. With other words, this standard improves the comparability of: revenue from contracts with customers and revenue recognition practices among industries, entities within those industries, jurisdictions and capital markets.

IFRS 15 establishes a comprehensive guideline for determining when recognizing revenue and how much revenue to compute and recognise. Consequently, it reduces the need for interpretive guidance to be developed on a case-by-case basis to address emerging revenue recognition issues.

An entity should recognise revenue to depict the transfer of promised goods or services to the customer in an amount that must reflect the consideration to which the company expects to be entitled in exchange for those goods or services.

The requirements under IFRS 15 will result in changes in the accounting for only some revenue transactions for some companies. The industries that may be impacted by new standard IFRS 15 would be software industry, construction and real-estate industry, manufacturing and distribution areas, and telecommunications. Also these new requirements will have an impact on other areas such as: loyalty& reward programs: an entity - under the actual requirements- may choose to recognize a cost deferral or a revenue deferral for such programs. Applying the new standard, entity will allocate the transaction price (revenue deferral) to the loyalty/reward performance obligation; variable consideration: under the new standard estimates must be computed and recorded for vendor allowances or incentives when there is uncertainty about the outcome; warranties: if a warranty is provided that the entity need to distinguish between the assurance-type warranty and separate services if any. The estimated cost of the assurance-type warranty will be recorded (accrual). A portion of the transaction price will be allocated to the service.

One obvious conclusion that there is some uncertainty about revenue meaning and some confusion about what amounts are, and what are not, fair values. Another obvious conclusion is that, as explained in more detail below, the primary use of fair value has been for the measurement of transactions or the components of transactions on initial recognition.

It is likely that the IASB will continue to use fair values as the means of ensuring that transactions are represented faithfully in the financial statements. Any significant extension of the use of fair values for the subsequent measurement of assets and liabilities is likely to meet strong resistance both in the IASB itself as well as its constituency. Those who resist, however, should bear in mind that the current reliance on historical cost-based amounts provides less relevant information and omits some assets and, possibly, liabilities from the financial statements. And those who criticize the limited use of fair values in IFRS should question their application of national GAAP and whether previous financial statements really had the qualities they claimed.

Also other areas, such as debt-covenants, revenue-based employee bonus and compensation arrangements, and right of return, will be affected. So, the implications of the new standard are complex and must be carefully implemented. This standard provides more useful information for users of financial statements.

## 5. References

Power, M. (2010). Fair Value Accounting, Financial Economics, and the Transformation of Reliability. *Accounting and Business Research*. Vol. 40, No. 3.

Ernest & Young (2015). Implementing the new revenue recognition standard, September, [http://www.ey.com/Publication/vwLUAssets/EMEIA\\_FAAS\\_Implementing\\_the\\_new\\_revenue\\_recognition\\_standard\\_slipsheet/\\$FILE/EMEIA\\_FAAS\\_IFRS\\_15\\_Implementing\\_the\\_new\\_revenue\\_recognition\\_standard\\_slipsheet.pdf](http://www.ey.com/Publication/vwLUAssets/EMEIA_FAAS_Implementing_the_new_revenue_recognition_standard_slipsheet/$FILE/EMEIA_FAAS_IFRS_15_Implementing_the_new_revenue_recognition_standard_slipsheet.pdf).

\*\*\*FASB, Fair Value Measurements, Statement of Financial Accounting Standards No. 157, 2011. <http://www.fasb.org/summary/stsum157.shtml>.

\*\*\*(2012). IASB, IFRS 13 Fair Value Measurement- [www.ifrs.org](http://www.ifrs.org),

\*\*\*<http://www.pwc.com/mx/es/servicios/archivo/2014-07-ifs-15.pdf>.

PWC Global Edition 2016, Revenue from contracts with customers <http://www.pwc.com/us/en/cfdirect/publications/accounting-guides/revenue-recognition-accounting-financial-reporting-guide.html>.