



# **Insights on SLFRS 15 Revenue from Contracts with Customers**

## Insights on SLFRS 15 *Revenue from Contracts with Customers*

### 1. Overview

SLFRS 15 establishes a five steps model for determining when and how to recognise revenue from contract with customers, which includes:

- 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: Recognise revenue when (or as) the entity satisfies a performance obligation

### 2. Effective Date

SLFRS 15 is applicable for annual reporting periods beginning on or after 01 January 2018. Earlier application is permitted

### 3. Key Terms

**Revenue** : Income arising in the course of an entity's ordinary activities.

**Contract** : An agreement between two or more parties that creates enforceable rights and obligations.

**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.

### 4. Withdrawal of Other Standards

SLFRS 15 supersedes the following Standards:

- LKAS 18 - Revenue
- LKAS 11 - Construction Contracts
- IFRIC 13 - Customer Loyalty Programmes
- IFRIC 15 - Agreements for the Construction of Real Estate
- IFRIC 18 - Transfers of Assets from Customers
- SIC 31 - Revenue - Barter Transactions involving Advertising Services

### 5. Scope exclusions of SLFRS 15

An entity shall apply SLFRS 15 to all contracts with customers, except the following.

- Lease contracts in terms of SLFRS 16 *Leases*
- Insurance contracts in terms of SLFRS 4 *Insurance Contracts*
- Financial instruments and other contractual rights or obligations in terms of:
  - SLFRS 9 *Financial Instruments*
  - SLFRS 10 *Consolidated Financial Statements*
  - SLFRS 11 *Joint Arrangements*
  - LKAS 27 *Separate Financial Statements*
- LKAS 28 *Investments in Associates and Joint Ventures*
- Non-monetary exchanges between entities in the same line of business to facilitate sales to customers or potential customers

## 6. Key Changes

| Area                                  | LKAS 18 and LKAS 11  | SLFRS 15  |
|---------------------------------------|--|---|
| Focus                                 | Focus on risk and rewards  | Focus on control  |
| Guidance                              | Limited guidance was available for Multiple element arrangements, variable consideration and licences. | Comprehensive guidance is provided for separating elements, allocating the transaction price, variable consideration. Licences, options, repurchase arrangements, contract modifications, contract costs etc. |
| Availability of separate treatment(s) | Separate accounting models were available for construction contracts, goods and services.              | A single model available for performance obligations. Accordingly, revenue shall be recognised when satisfied either at over time or at a point in time.  |

## 7. Recognition and Measurement

Revenue is recognised and measured using the five steps model and each step is detailed out below:

### Step 01: Identify the contract with a customer

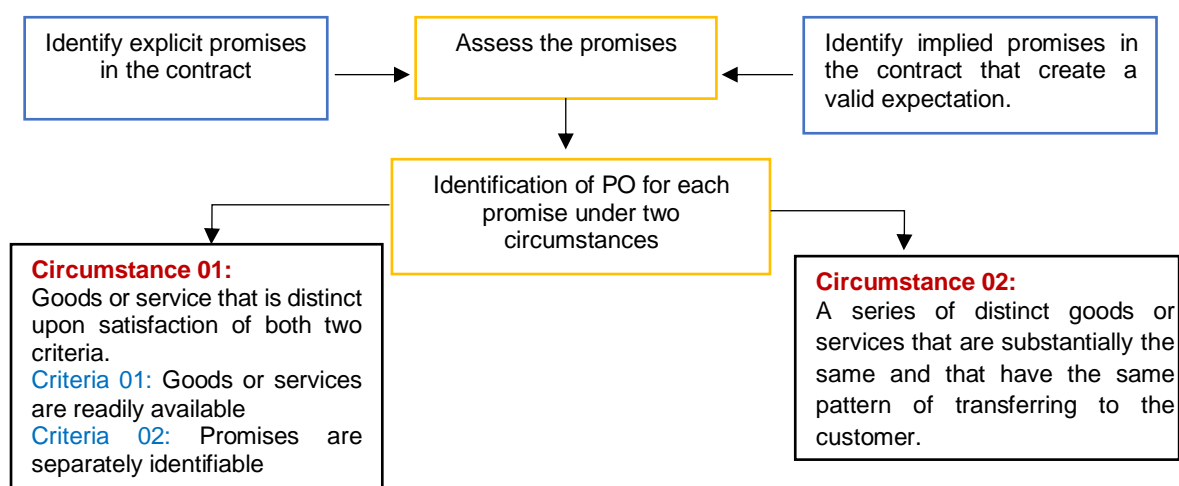
An entity shall account for a contract with a customer only when all of the following criteria are met:

- the parties to the contract have approved the contract;
- the parties are committed to perform their respective obligations;
- the entity can identify each party's rights;
- the entity can identify the payment terms;
- the contract has commercial substance; and
- it is probable that the entity will collect the consideration

### Step 02 : Identifying Performance Obligations

Steps in identifying of performance obligations are depicted in figure 1.

**Figure 1: Steps in identifying Performance Obligations (PO)**



### Step 03 : Determine the transaction price

**Transaction price** is 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).

The consideration promised in a contract with a customer may include fixed amounts, variable amounts, or both. When determining the transaction price, an entity shall consider the **effects** of all of the following:

- A. Variable consideration;
- B. The existence of a significant financing component in the contract
- C. Non-cash consideration
- D. Consideration payable to a customer

#### A. Variable Consideration

The contract may include following variable considerations

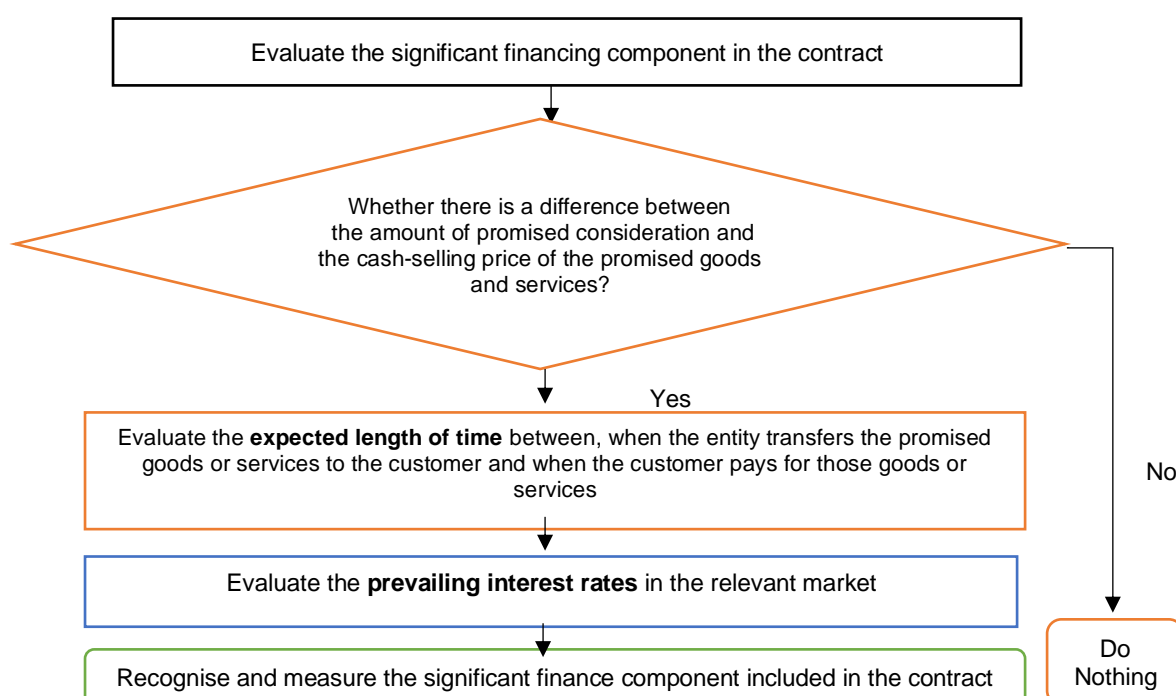
- Discounts
- Rebates
- Refunds
- Credits
- Price Concessions
- Performance Bonuses
- Penalties
- Incentives

An entity shall estimate an amount of variable consideration using either the expected value or the most likely amount.

#### B. The existence of a significant financing component in the contract

An entity shall adjust the promised amount of consideration for the effects of the **time value of money**, if the timing of payments agreed to by the parties to the contract (either explicitly or implicitly) provides the customer or the entity with a significant benefit of financing. How to assess whether a contract includes a significant financing component is depicted in figure 2.

**Figure 2 : Evaluation of the Significant Financing Component in the contract**



### C. Non-cash consideration

An entity shall measure the non-cash consideration at **fair value**. If an entity can't reasonably estimate the fair value of the non-cash consideration, the entity shall measure the consideration by reference to the **stand-alone selling price** of the goods or services promised to the customer.

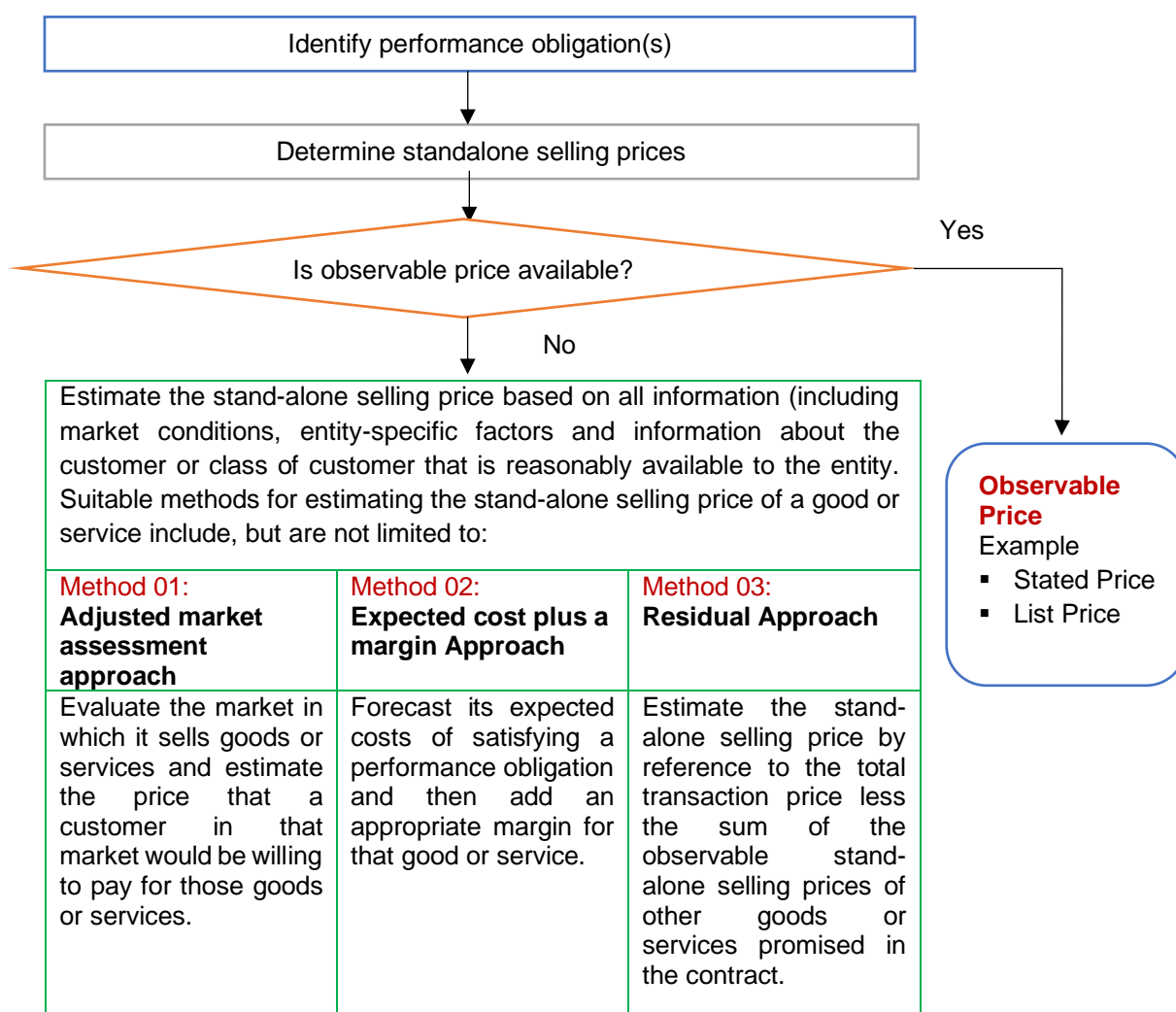
### D. Consideration payable to a customer

An entity shall account for consideration payable to a customer **as a reduction of the transaction price**. It includes the cash amounts that an entity pays, or expects to pay, to the customer and credit or other items that can be applied against amounts owed to the entity. (eg: a coupon or voucher)

## Step 04: Allocating the transaction price to the performance obligations

An entity shall allocate the transaction price to each performance obligation identified in the contract on a relative standalone selling price. It is depicted in figure 3:

**Figure 3: Allocation of the Transaction Price to Performance Obligations**



## Step 05: Satisfaction of Performance Obligation

An entity shall recognise revenue when the entity satisfies a performance obligation by transferring a promised good or service to a customer.

### Indications of transfer of control:

A promised good/services is transferred when the customer obtains control of that asset and the indications of transfer of control are listed below.

- The entity has a present right to payment for the asset
- The customer has a 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

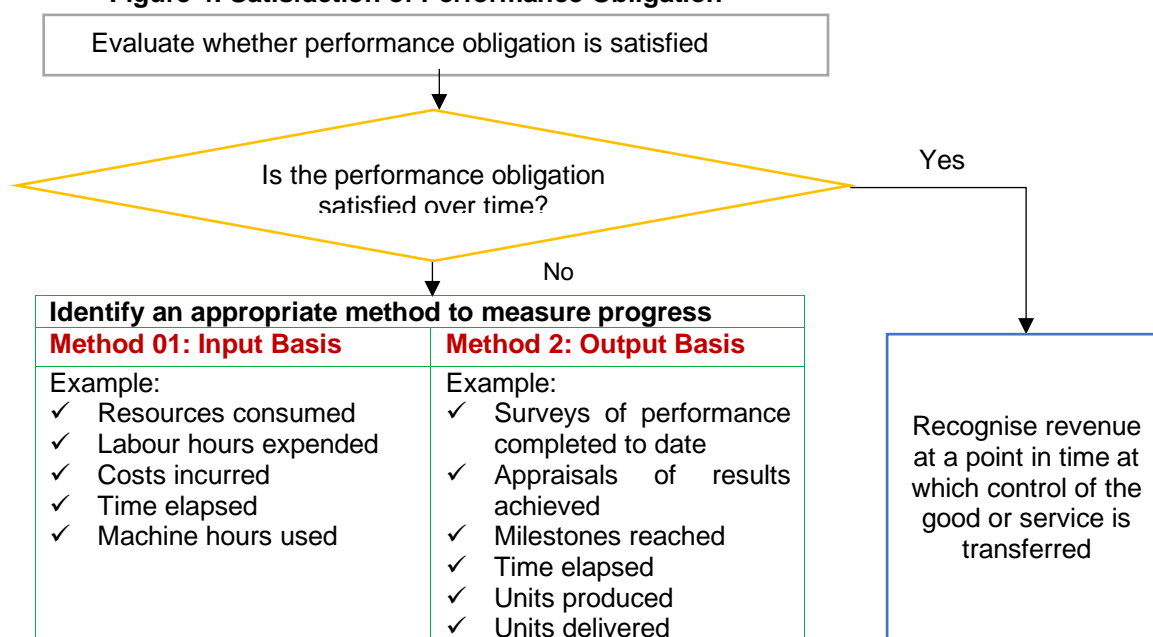
### Criteria for satisfying performance obligation satisfies the performance obligation over time:

At the contract inception, an entity shall determine whether it satisfies performance obligations over time or at a point in time for each performance obligation identified. The criteria for satisfying performance obligation over time are listed below.

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

If an entity does not satisfy a performance obligation over time, the performance obligation is satisfied at a point in time. The satisfaction of performance obligation is illustrated in Figure 4.

**Figure 4: Satisfaction of Performance Obligation**



## 7.1 Contract Costs

An entity shall recognise the incremental costs of obtaining a contract with a customer as an asset if the entity expects to recover those costs. If the costs incurred in fulfilling a contract with a customer are not within the scope of another Standard, an entity shall recognise an asset from the costs incurred to fulfil a contract only if those costs meet all of the following criteria:

- a) the costs directly relate to a contract or to an anticipated contract that the entity can specifically identify
- b) the costs generate or enhance resources of the entity that will be used in satisfying (or in continuing to satisfy) performance obligations in the future; and
- c) the costs are expected to be recovered.

| Cost can be capitalized   | Cost have to be expensed   |
|---|--|
| <ul style="list-style-type: none"><li>▪ Direct labour</li><li>▪ Direct materials</li><li>▪ Allocation of costs that relate directly to the contract or to contract activities</li><li>▪ Costs that are explicitly chargeable to the customer under the contract</li><li>▪ Other costs that are incurred only because an entity is entered into the contract</li></ul> | <ul style="list-style-type: none"><li>▪ General and administrative costs unless those costs are explicitly chargeable to the customer under the contract.</li><li>▪ Costs of wasted materials, labour or other resources to fulfil the contract that are not reflected in the price of the contract</li><li>▪ Costs that relate to satisfied performance obligations in the contract</li><li>▪ Costs for which an entity cannot distinguish whether the costs relate to unsatisfied performance obligations or to satisfied performance obligations.</li></ul> |

## 8. Presentation

An entity shall present the contract in the statement of financial position as a contract asset or a contract liability, based on the entity's performance and the customer's payment.

## 9. Disclosure

| Type of the Disclosure  | Disclosures to be made  |
|---|---|
| Contracts with customers  | <ul style="list-style-type: none"><li>▪ Revenue recognised from contracts with customers</li><li>▪ Any impairment losses recognised on any receivables or contract assets arising.</li></ul>  |
| The significant judgements, and changes in the judgements, made in applying this Standard to those contracts. | <ul style="list-style-type: none"><li>▪ The timing of satisfaction of performance obligations</li><li>▪ The transaction price and the amounts allocated to performance obligations.</li></ul>   |
| Any assets recognised from the costs to obtain or fulfil a contract with a customer                           | <ul style="list-style-type: none"><li>▪ The judgements made in determining the amount of the costs incurred to obtain or fulfil a contract with a customer</li><li>▪ The method it uses to determine the amortisation for each reporting period.</li></ul>  |
| Disaggregation of revenue   | <ul style="list-style-type: none"><li>▪ disaggregate revenue recognised from contracts with customers into categories that depict how the nature, amount, timing and uncertainty of revenue and cash flows are affected by economic factors.</li><li>▪ Revenue information that is disclosed for each reportable segment, if the entity applies SLFRS 8 Operating Segments.</li></ul> |

## 10. Application Guideline Notes for Real estate Sector issued by CA Sri Lanka

Accordingly, management has to exercise the judgement in evaluating whether one of the criteria in the paragraph 35 of SLFRS 15 is met, in order to consider that the performance obligation is satisfied and revenue can be recognised over time and otherwise it satisfies the performance obligation at a point in time.

| Criteria  | Recommendation   |
|---|--|
| The customer simultaneously receives and consumes the benefits provided by the entity's performance as the entity performs. | Since, the entity's performance creates an asset (ie the real estate unit) and that is not likely to be consumed immediately, this criteria may not be met.  |
| The entity's performance creates or enhances an asset that the customer controls as the asset is created or enhanced.       | The customer does not have the ability to direct the use of the real estate unit as it is being constructed, unless it is permitted under the agreement and thus the customer is highly unlikely control the part constructed unit.  |
| The entity's performance does not create an asset with an alternative use to the entity                                     | As the contractual restriction on the entity's ability to direct the promised residential property for another use is substantive, the promised residential property does not have an alternative use to the entity.   |
| The entity has an enforceable right to payment for performance completed to date  | <p>In assessing the existence and enforceability of a right to payment for performance completed to date, an entity shall consider the contractual terms as well as any legislation or legal precedent that could supplement or override those contractual terms.</p> <p>In the absence of no legislations or legal precedents, in determining whether the entity has an enforceable right to payment for performance completed to date, contractual terms (eg: specific performance clause) that allows enforceability will have to be considered in making the judgement of the management in revenue recognition.</p> |

Further, in circumstances where an entity is not be able to reasonably measure the outcome of a performance obligation, but expects to recover the costs incurred in satisfying the performance obligation, it shall recognise revenue only to the extent of the costs incurred until such time that it can reasonably measure the outcome of the performance obligation.

## 11. Transition

At the transition, one of the following options could be used.

### Option 01:

- a) Retrospectively to each prior reporting period presented in accordance with LKAS 8 *Accounting Policies, Changes in Accounting Estimates and Errors*, subject to the practical expedients.

| Practical Expedients   | Accounting Treatment  |
|--|---|
| For completed contracts that begin and end within the same annual reporting period or are completed contracts at the beginning of the earliest period presented. | Need not to restate contracts.  |
| For completed contracts that have variable consideration   | May use the transaction price at the date when the contract was completed rather than estimating variable consideration amounts in the comparative reporting periods.   |
| For contracts that were modified before the beginning of the earliest period presented,  | Shall reflect the aggregate effect of all of the modifications that occur before the beginning of the earliest period presented when: <ul style="list-style-type: none"><li>o identifying the satisfied and unsatisfied performance obligations;</li><li>o determining the transaction price; and</li><li>o allocating the transaction price to the satisfied and unsatisfied performance obligations</li></ul> |
| For all reporting periods presented before the date of initial application   | Need not to disclose the amount of the transaction price allocated to the remaining performance obligations and an explanation of when the entity expects to recognise that amount as revenue.  |

### Option 02:

Retrospectively with the cumulative effect of initially applying this Standard recognised at the date of initial application.