REVENUE

Under ASPE there is one Handbook section (S3400) that relates to revenue from various sources including construction contracts. Under IFRS there is one IFRS which deals with revenue from contracts with customers. (IFRS 15)

(The following lecture notes for IFRS have used examples from the Handbook, as well as from – KPMG Revenue Issues in Depth, 2nd Edition, May 2016 / BDO IFRS in Practice, IFRS 15 Revenue from Contracts with Customers / CPA/Deloitte IFRS 15 Revenue from Contracts with Customers, Your Questions Answered)

Since the IFRS Section is so large (over 100 pages when printed), the following notes deal with IFRS 15 and then the ASPE Section 3400 is summarized separately.

IFRS 15 – REVENUE FROM CONTRACTS WITH CUSTOMERS

The following IFRS Section is divided up into 4 areas and an important summary for students follows. They 4 areas are:

A. The 5 steps to go through in recognizing revenue
B. Contact costs – how to account for them
C. Other issues
D. Presentation and Disclosure

SCOPE

The scope of IFRS 15 applies to all contracts with customers in all industries, except for:

(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 and obligations – within the scope of IFRS 9 Financial instruments, IFRS 10 Consolidated F/S, IFRS 11 Joint Arrangements, IAS 27 Separate F/S and IAS 28 Investments in Associates and Joint Ventures

- If a contract is partially in IFRS 15 and partially in one of the above sections, if the other Section specifies how to separate/measure that part of the contract, that is done first and any residual amount then falls into IFRS 15

- IFRS 15 does not apply to non-monetary exchanges between entities in the same line of business to facilitate sales to customers or potential customers (i.e. 2 oil companies exchanging oil for their respective markets)

- IFRS 15 would apply to related party transactions

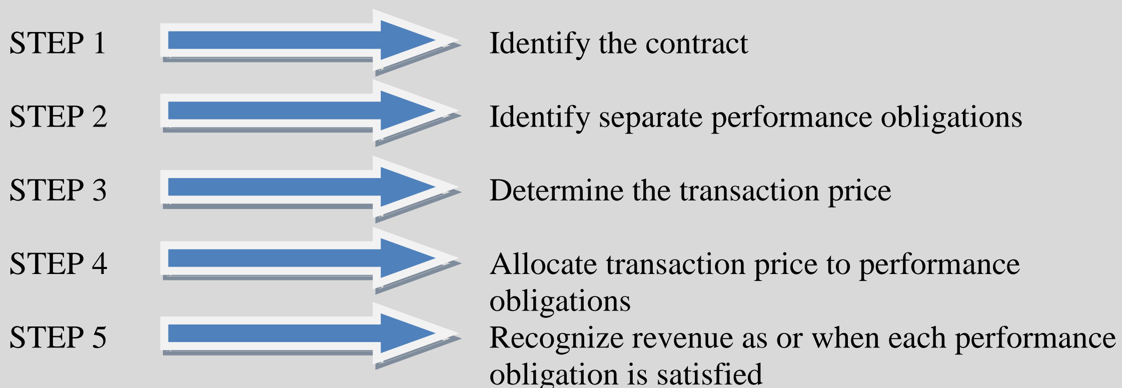
A/ THE 5 STEPS IN REVENUE RECOGNITION

PURPOSE OF THE SECTION

To establish a single and comprehensive framework which sets out how much revenue is to be recognized and when.

Core Principle – A vendor should recognize revenue to depict the transfer of promised goods or services to customers in an amount that reflects the consideration to which the vendor expects to be entitled in exchange for those goods or services.

The core principle is carried out in 5 steps:



Step 1 – Identify the Contract

This is applied when 5 criteria are met:

1) Contract approved orally or in writing and parties are committed to perform obligations
2) Goods or services to be transferred can be identified
3) Payment terms for good or services to be transferred can be identified
4) Contract has commercial substance – risk, timing or amount of cash flow expected to change because of contract
5) Collection is probable – more likely than not – (51%)

- Probability of collection is based on "ability and intent" to pay

- Price concessions should first be considered but would not negate probable collection

- If collection not probable – can't recognize revenue. Any cash received is a liability (unearned revenue) and recognized when either (a) entity has no remaining performance obligation and all or most of the consideration has been received and is not refundable OR (b) contract is terminated and consideration received is non-refundable

- Combination of contracts – if entered into 2 contracts around the same time, with same customer, account as 1 contract if 1 of the following is met:

  (a) Contract negotiated as a package with a single commercial objective
  (b) Amount of consideration in one contracts depends on the price or performance of the other contract
  (c) Goods or services promised in the contracts represent a single performance obligation

Step 2 – Identify the Performance Obligations in the Contract

The "Performance Obligations" are the promised goods or services in the contact

- Goods or services must be (A) Distinct OR (B) Part of a series of distinct goods or services, that are substantially the same

- (A) Distinct – 2 criteria must be met:

  (a) Capable of Being Distinct - Customer can benefit from goods or services on its own or with other resources (i.e. used, consumed, sold, generate economic benefits); and
  (b) Distinct within the context of the contract - Goods and services are separately identifiable in the contract (i.e. not highly dependent or interrelated with other goods)

- The objective of (b) is to determine whether the vendor is attempting to transfer the goods individually or combined (so other promised goods would be inputs to the combined output). Therefore, some factors to consider would include:

  - Are goods integrated with other goods, to form an output?
  - Does one good significantly modify or customize another good?
  - Are 2 goods highly interdependent or interrelated? Does one depend on the other? Can the vendor fulfill their promise by only transferring one good (would it work)?

- For all of these 3 questions, by answering NO, the implication is each good is distinct and a separate performance obligation. By answering YES, the implication is they are not distinct and are combined and 1 performance obligation

- If the promise does not transfer a good or service (i.e. a promise to defend a patent), it will not be distinct

- Therefore, key points to look at in determining if good/service is distinct are: (a) Is each separately identified in the contract (b) Can others provide the good/service (c) Is one item dependent on the other and (d) Does one item significantly modify or customize another item

- In final analysis, the facts must be weighed and a judgement call is made

  Example – A plane manufacturer sells planes and kitchens in planes. When a plane is purchased, is the kitchen in the plane distinct?

  No – It meets criteria (a) as it could be sold separately, but not (b) as it is not separately identified in the contract as the purchaser bought the entire plane

- (B) Series of distinct goods or services – 2 criteria must be met:

  (a) Obligation satisfied over time
  (b) Same method is used to measure progress toward satisfaction of performance obligation

- If not distinct, must combine with other goods or services and account as a single performance obligation

  Example 1 – Sub-contracting – A manufacturer of a house who sub-contracts out some of the construction, would account for the sale of the house as 1 performance obligation.

  It meets criterion (a) for distinct, as the subcontracting services are obtained elsewhere, but not (b) as they are integrated into the house and the house is being sold (the sub-contract services are not separately identified)

  Example 2 – A vendor sells a software licence and installs the software. Is the licence and installation service distinct or combined?

  If both are separately identified in the contract and other unrelated vendors could install the software, treat as 2 distinct products. However, if the installation is customized and this customization is necessary to enable the software to work, and in the contract it is mentioned with the licence, even if the customization

could be done by others, treat as 1 combined service. (As not separately identified in the contract).

- The Handbook lists many examples to determine if there is one or more performance obligations. Some of these examples are:

Example	**Conclusion**
Entity builds a building and delivers a single output to customer	Single performance obligation
Entity provides customer with installation services that involve significant customization of the underlying software	Single performance obligation
Entity provides customer with software, installation, unspecified upgrades and telephone support from which it will benefit separately	Multiple performance obligations
Entity provides customer with equipment and a separately identifiable installation service. Customer required to use installation service	Multiple performance obligations (Restrictions do not prevenet multiple performance obligations)
Entity provides customer with a good and an implicit OR explicit promise to provide a service to the customer's customer who purchases the good	Multiple performance obligations (Promises, explicit or implicit, can be distinct and mult. Perf. Obligations)

Step 3 – Determine the Transaction Price

The transaction price is usually the price specified in the contract, but other factors need to be considered, including:

(a) Variable consideration
(b) Constraining estimates of variable consideration
(c) Financing components
(d) Non-cash consideration
(e) Consideration payable to a customer

A. Variable Consideration

- Any amount under the contract that is variable – i.e. performance bonuses, discounts, penalties, rebates, incentives, right to return, price concessions etc. should be considered in the calculation of revenue

- Vendor should estimate the amount of consideration expected, using one of the following methods:

  (a) Expected value method – a probability weighted method; or
  (b) Most likely amount

- The probability method assigns a weighting to each option and adds them up. The most likely amount will take one option that is most likely (even if not 100%)

- Same method should be used throughout the contract, but if there are different uncertainties, could use one method for one uncertainty and another method for the other uncertainty

B. Constraining Estimates of Variable Consideration

In order to avoid a vendor from recognizing too much revenue and being overly optimistic, a constraint has been introduced.

Constraint – An amount of variable consideration can only be included if it is highly probable there will not be a subsequent reversal of revenue.

In a case scenario, use judgement and consider the criteria of "highly probable" when determining if there are factors that will lead to a revenue decrease in the future.

Refunds

If the customer can return the product, and it is expected this will happen, the vendor should not recognize revenue. Instead, the vendor should account as follows:

Dr. the asset to be returned
Dr. cost of sales
  Cr. inventory

Dr. cash (for sales)
  Cr. refund liability
  Cr. revenue

When refund happens: Dr. refund liability and cr. cash

A Sale with a Right to Return	
Item	**Measurement**
Revenue	Measured at the gross transaction price, less the expected level of returns calculated using the guidance on estimating variable consideration and the constraint
Refund liability	Expected level of returns – difference between the cash or receivable amount and the revenue as measured above
Asset	Carrying amount of the product expected to be returned, less the expected recovery costs
Cost of goods sold	Carrying amount of product sold less the asset as measured above
Reduction of inventory	Carrying amount of product transferred to customer

- At each reporting period, update the measurement of the refund liability and asset and recognize adjustments to:
  - Refund liability as revenue; and
  - Asset as an expense

C. Financing Components

If payments are made over time, this financing component should be considered in the overall revenue recognition.

Determine discount rate at inception of contract.

Some key considerations would be:

- Typically, do not consider the financing component, if paid within 1 year
- This is applicable if payments are made up-front or deferred until much later
- Compare when cash is received to when control of the goods are transferred
- 2 key factors that must be considered:
  - (a) difference between amount of promised consideration and cash selling price (if any); and

- (b) (i) length of time from when vendor transfers control and customer pays and (ii) interest rate in the market place

No financing component if:

- payment made in advance and customer also has discretion when control of goods transfers (example – prepaid phone card or customer loyalty points)
- future payments are not in the control of customers or vendors
- there is another reason why payments are over time, besides for financing (i.e. payment terms provide protection to one party in some manner)

If customer pays in advance – recognize as interest expense

When customer pays in arrears – recognize as interest income (present separately from revenue from customer)

D. Non-Cash Consideration

Measure at fair value.

If fair value not reasonably estimable, look at the stand alone selling price of the goods.

E. Consideration Payble to a Customer

Examples would be: Coupons, vouchers, signing bonuses, listing fees etc.

Account for as a reduction in revenue (unless customer is providing goods or services and then it is a regular purchase) (as opposed to marketing expense or some other expense).

Step 4 – Allocate the Transaction Price to the Performance Obligation

If a vendor sells multiple products, for 1 price, allocate the price among all products at the individual product's stand along selling price.

2 Steps:

- Step 1 – Determine the stand-alone selling price – the price at which the entity would sell the product separately to a customer
- Step 2 – If the stand-alone price is not directly observable, estimate the amount using one of the methods below

  Example 1 – A vendor sells products A, B and C for a combined price of $1,200. If sold separately, product A would sell for $400 and B would sell for $600 and product C for $500.

Allocate the price as follows:

Product A - $1,200 x ($400 / $400 + $600 + $500) =	*$ 320*
Product B - $1,200 x ($600 / $400 + $600 + $500) =	*$ 480*
Product C - $1,200 x ($500 / $400 + $600 + $500) =	*$ 400*
	$1,200

This approach is called the "Adjusted Market Assessment" approach (how much each product would for individually).

Could also use an "Expected Cost Plus Margin" approach (estimate how much each individual product would sell plus a margin).

If not sure how much a product would sell for, use the "Residual" approach and allocate prices to other products first and remainder to the product you are unsure about. (This method is to be used only in limited circumstances – only if stand-alone selling price is highly variable or uncertain).

There are no circumstances when revenue recognition is postponed because it is difficult to determine a stand-alone selling price. (i.e. just use judgement – Handbook does not even say it has to be "reliably" estimated).

Discounts

- Usually allocate proportionally to all of the performance obligations in the contract

- Unless – observable evidence that discount relates to one or more (not all) performance obligations

Step 5 – Recognize Revenue When Each Performance Obligation is Satisfied

Transfer of Control

Definition of control – Ability to direct the use of and obtain substantially all of the benefits of the asset.

Definition of benefits of the asset – potential cash inflows or savings in outflows.

Indicators that control passes are, when the customer has:

- A present obligation to pay
- Physical possession of the asset
- Legal title

- Risks and rewards of ownership
- Accepted the asset

- *IFRS 15 moves away from a risk and reward basis to a control model*

- Consignment arrangements – entity may transfer goods physically, but still maintain control

- Bill and hold arrangement – entity may hold goods physically, but still transferred control

Always ask the Question if Control Transfers Immediately or Over Time

Control transfers over time if 1 of the following 3 criteria are met:

1) Customer simultaneously receives and consumes economic benefits provided by the vendor's performance;

    - Example – providing cleaning services over the course of a year

2) Vendor creates or enhances an asset controlled by the customer

    - Example – building being built on customer's premises

3) Vendor's performance does not create an asset for which the vendor has an alternative use and vendor has an enforceable right to payment for performance completed to date

    - Alternative use – (a) specialized asset only customer can use
      (b) standard asset, (others could use) but there is a particular restriction so only this customer can use it
      (c) vendor would incur significant losses if asset sold elsewhere

    - Enforceable payment – vendor can enforce payment for work done to date in all circumstances

What are the Methods to Use if Measuring Progress Over Time?

Suggested methods include "Output" and "Input" methods.

Output Methods	Input Methods
-- Appraisals of results achieved	-- Resources consumed
-- Milestones reached	-- Machine hours used
-- Survey of work completed	-- Labour hours expended

-- Time elapsed
-- Units produced or delivered

-- Time elapsed
-- Costs incurred

(No longer referred to percentage of completion method, but fairly consistent with percentage of completion method).

May also still be applicable to use the “zero profit method” – recognize revenue only to the extent of costs incurred to date as difficult to measure the final outcome.

B/ CONTRACT COSTS

2 types of contract costs:

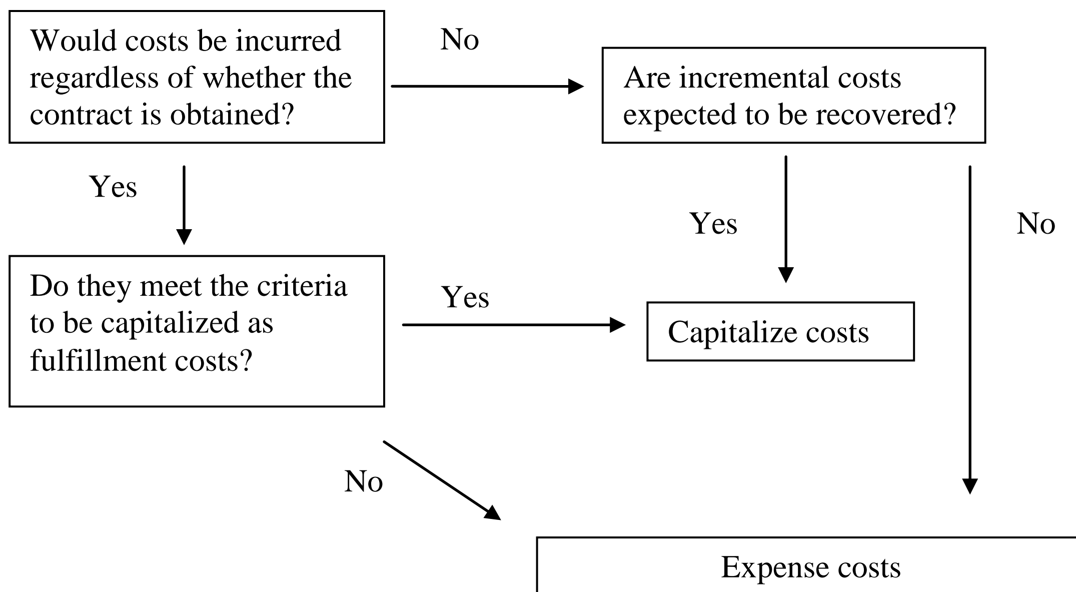
1) Incremental costs of obtaining a contract
2) Costs to fulfill a contract

<u>Incremental Costs of Obtaining a Contract</u> (i.e. selling, marketing costs)

- Capitalize costs if they would not have been incurred had contract not been obtained (must be incremental)
- To be an asset, must expect to recover the costs

-- If expected period of amortization is 1 year or less, expense costs

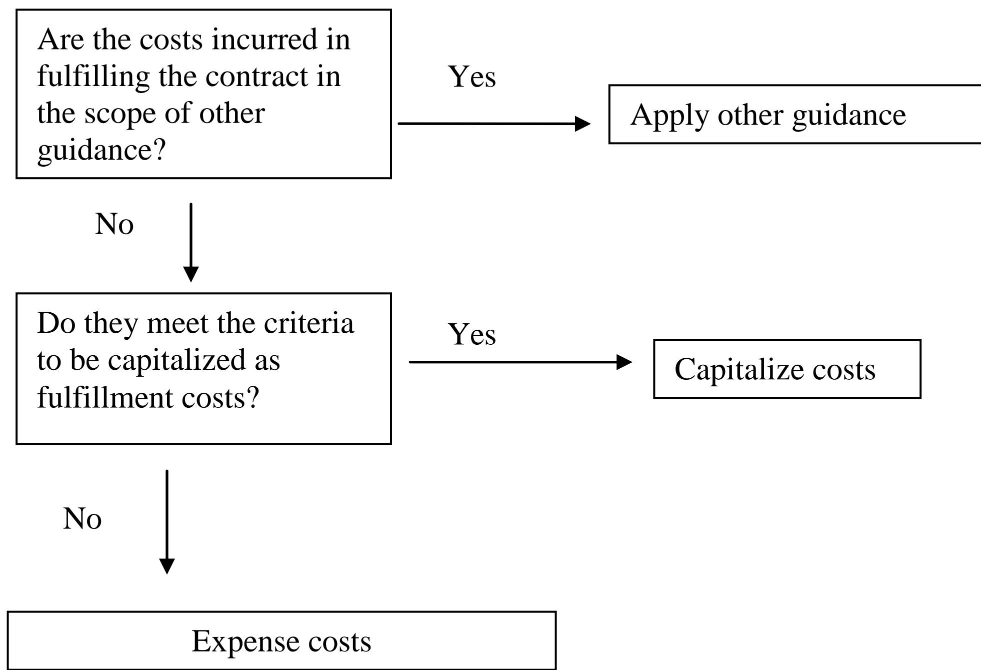
<u>Flowchart to determine if you should capitalize or expense</u>



Costs to Fulfill a Contract

(a) Determine if other Sections apply (i.e. Inventories, PPE etc.) – if yes, apply other Sections
(b) If other Sections do not apply, capitalize costs if all criteria met:
    i. Costs are identifiable to the contract
    ii. Costs generate or enhance resources of the vendor that will be used to satisfy performance obligations in the future
    iii. Costs are expected to be recovered

Flowchart to determine if you should capitalize or expense



Example – A vendor operates a radio station and sells advertising. A new contract with a customer was signed, with the following costs:

Legal fees - $5,000
Advertising executive - $10,000 (salary allocation based on time designing ads)
Meals and entertainment - $3,000

Answer
- *Legal fees are incremental – capitalize*
- *Advertising executive – meets 3 criteria of costs to fulfill a contract (i.e. identifiable to contract; provided a resource (Ad exec) to satisfy performance obligation and costs expected to be recovered*
- *Meals and entertainment – expense (would be incurred regardless of contract and not identifiable)*

Costs capitalized should be amortized on a systematic basis (normal policy).

Examples of Costs

Direct costs eligible for capitalization if other criteria are met	**Costs required to be expense when they are incurred**
Direct labour – i.e. employee wages	General and Admin costs – unless explicitly chargeable under the contract
Direct materials – i.e. supplies	Costs that relate to satisfied performance obligations
Allocation of costs that relate directly to the contract – i.e. depreciation	Costs of wasted materials, labour or other contract costs
Costs that are explicitly chargeable to the customer under the contract	Costs that do not clearly relate to unsatisfied or partially satisfied performance obligations
Other costs incurred because of the contract – e.g. subcontractor costs	

Impairment

IFRS 15 introduces a new impairment model for costs that are capitalized.

An impairment loss should be recognized when the carrying amount of the asset exceeds the recoverable amount

Recoverable amount is defined as:

- Remaining expected amount of consideration to be received in exchange for the goods or services to which the asset relates; less

- Costs that relate directly to providing those goods or services and that have not been recognized as expenses

An entity should apply the impairment model in the following order:

1) First - Apply existing impairment guidance (ie. Inventory section)
2) Second – Apply IFRS 15
3) Third – Apply impairment model for CGUs

In other words, if an asset is impaired under this Section, it would still be included as impaired in the CGU.

Discounting may be relevant (not required, as it is in IAS 36), for the impairment test.

Impairment reversal

- Reverse impairment loss when impairment conditions cease to exist.

- Reversal is limited to the carrying amount, net of amortization, had no impairment loss been recognized

C/ OTHER ISSUES

1) Gift Cards (or Customer's Unexercised Rights)

- As gift cards are sold, recognize a contract liability
- As cards are redeemed for goods or services, revenue is recognized

If gift card not redeemed in full, unredeemed amount (called "breakage") should only be recognized if it is "highly probably" customer will not redeem amount.

If can't predict whether customer will redeem or not, only recognize breakage if likelihood of customers exercising their right of redemption is remote.

2) Warranties

Account for the warranty as a performance obligation if the warranty is distinct, including:

- Customer can purchase the warranty separately; or
- Additional services are provided as part of the warranty

- If the customer can purchase the warranty, with or without the goods and services, then the warranty is a distinct service

2 types of warranties:

1) Assurance warranties – assurance product will function as intended
    - Account for warranty in accordance with IAS 37 Provisions, Contingent Liabilities and Contingent Assets

2) Service-type warranties – provides a service in addition to the assurance warranty
    - Account for as a performance obligation
    - Allocate a portion of the transaction price

Example 1 – A vendor sells a cherry picker to a customer, with a 1 year standard warranty. The customer then purchases a 3 year additional warranty for $5,000.

This is a service type warranty and should be accounted as a separate performance obligation.

Vendor defers revenue of $5,000 until performance obligation is satisfied (after 3 years).

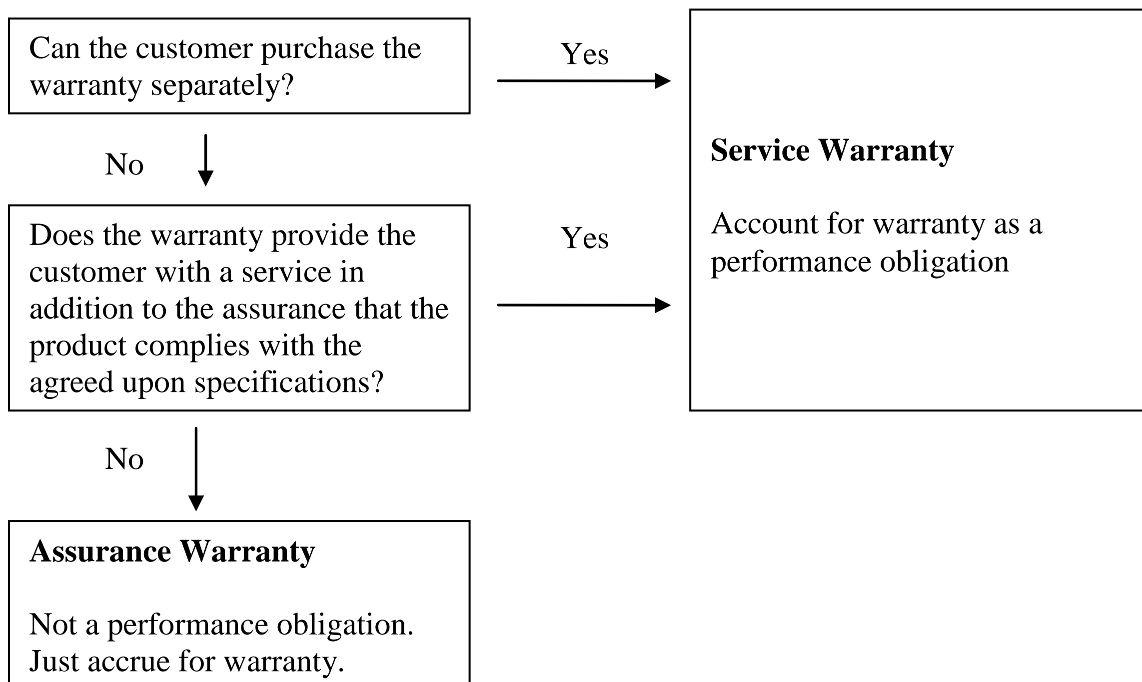
Example 2 – A luggage company provides a lifetime warranty on all bags. There is no regulatory requirement to do this. If a bag is damaged, the company will fix it with no charge.

Consider the following factors:

- *(i) No legal requirement – suggests that it is a separate performance obligation*
- *(ii) Longer coverage period – other manufactures probably do not offer lifetime warranties, so this suggests a performance obligation*
- *(iii) Promises beyond agreed-upon specification – since it includes repairing the luggage after the customer has control of the product, this suggests it is a separate performance obligation*

Conclusion – It is a service warranty and should be accounted for as a separate obligation

To distinguish between the 2 warranties, do the following:



- If a warranty has both an assurance element and a service element and the entity cannot account for each separately, then account for both as one performance obligation

- If the warranty is a performance obligation, then the entity allocates a portion of the transaction price to the service performance obligation by applying the requirements in Step 4 of the model

3. Principal vs Agent

If an entity controls the goods or services transferred, they are the principal in the transaction. However, if another party controls, then the entity is an agent.

The principal records revenues on the gross basis. The agent records revenue on the net basis.

Principal – Assumption that vendor controls the goods or service, before transfer

Agent – Factors indicating agent include:

- Another party is responsible for fulfilling the contract
- Vendor does not have inventory risk
- Vendor does not have discretion in establishing prices (therefore benefit it can receive is limited)
- Vendor's consideration is in the form of a commission
- Vendor is not exposed to credit risk for the amount receivable from the customer

Significant judgment is necessary to make the determination.

4. Non-Refundable Upfront Fees

Issue is whether the upfront fees relate to a separate performance obligation.

Examples – Joining fees for a health club or activation fee for cell phones

If Yes – Follow 5 step model (beginning with Step 2 – Identifying performance obligation). (Upfront fee would be a material right to be recognized)

If No – Relates to set-up fees or admin tasks, account as an advance payment and recognize as revenue when those future goods or services are provided.

Usually these fees relate to setup activities, not separate performance obligations. This is because:

(i) No good or service is received by the customer or no value without obtaining other goods; and
(ii) The entity does not separately price and sell the initiation right covered by the up-front payment (so it does not relate to a promised good or service)

5. Customer Options for Additional Goods or Services (Material Right)

Customer can acquire additional goods or services for a discount or for free, ie. Sales incentives, discounts on future goods etc.

If the customer receives "a right" they would not have received, were it not for the contract (i.e. it is incremental), they are paying in advance for future goods/services.

Therefore, account for the "material right" as a separate performance obligation

A portion of the total transaction price should be allocated to the "material right"

A "material right" should be (i) significant and (ii) incremental. Otherwise it is probably a marketing or promotional item

When a material right exists, there are 2 ways to account:

1) Continuation of the original contract – treat the material right as an addition to the consideration for the goods and services in the contract – i.e. a change in the transaction price (prospectively)

2) Contract modification – apply the contract modification guidance and account prospectively or with a cumulative catch-up adjustment

Coupons Issued at the Point of Sale

If a store gives out coupons when they sell a product, and the customer is often not aware they will receive a coupon, how should they be accounted for?

Normally, they are often part of a firm's marketing and customers can access them without making the purchase.

Also, they are often not redeemed.

Therefore, usually they have little impact on the revenues and would probably not be a material right.

Rather, they would be recognized as a reduction in revenue upon redemption.

6. Customer Loyalty Programs

A customer loyalty program that provides a customer with a material right is accounted for as a separate performance obligation.

Example – A retailer offers a customer loyalty program. For every $10 spent, customers earn $1, as a cash discount on future purchases. During year 1, customers purchased $100,000, earning 10,000 points and based on historical experience, the retailer expects 97% to cash in their points.

The program provides customers with a material right, as customers would not receive the discount without making the purchases. Therefore, the retailer concludes that the points are a performance obligation in each sales contract.

The retailer calculates the stand-alone selling price of the loyalty points based on the likelihood of redemption.

They allocate the price between the products and the points based on the relative selling price, as follows:

Products - $100,000 / ($100,000 + $9,700) = 91% x $100,000 = $91,000

Points - $10,000 / ($100,000 + $9,700) = 9% x $10,000 = $9,000

($9,700 is 97% expected redemption on the 10,000 points)

JE would be: Dr. Cash $100,000
Cr. Point liability $9,000
Cr. Revenue $91,000

(as the firm only really earned $91,000 revenue on the sales)

During year 2, 4,500 points are redeemed and the retailer expects the full 9,700 to be redeemed. Therefore, in year 2, the calculation is:

9,000 x 4,500 / 9,700 = $4,175 (price allocated to points multiplied by points redeemed in year 2 divided by total points expected to be redeemed)

So the journal entry would be: *Dr. Point liability* *$4,175*
Cr. Revenue *$4,175*

In year 3, a further 4,000 points are redeemed and the retailer now expects 9,900 rather than 9,700 to be redeemed. The calculation is:

9,000 x (4,500 + 4,000) / 9,900 – 4,175 = 3,552 (price allocated to points multiplied by points redeemed in Year 2 and Year 3 divided by total points expected to be redeemed minus revenue recognized in Year 2)

So the journal entry would be: *Dr. Point liability* *3,552*
Cr. Revenue *$3,552*

- There would be no financing built in to the customer loyalty program, as the redemption is at the discretion of the consumer

- Even though the customer loyalty program can usually be changed or cancelled by the employer, there is an implicit promise for it to continue and there is a valid expectation on behalf of consumers it will continue

7. Renewal Options

Renewal option – provides the customer the right to acquire additional goods / services of the same type as those specified in the contract.

A renewal option is distinguishable from other options if:

(a) The additional goods or services are similar to the original goods or services (vendor continues to provide what is already being provided)
(b) The additional goods or services are provided in accordance with the terms of the original contract (so vendor cannot change the terms or pricing beyond what is in the initial contract)

Therefore, a renewal option provides a "material right" to the customer and revenue is usually deferred to future periods.

8. Licencing Intellectual Property (IP)

A licence establishes a customer's rights over intellectual property, such as software and technology, patents, trademarks, franchises etc.

Must first determine if the licence is distinct.

Yes – Licence is a separate performance obligation.

--Recognize revenue at a point in time (right to intellectual property when licence is granted) or over time (vendor continues to be involved with its intellectual property)

--Right to access – recognize over time
--Right to use – recognize at a point in time

No – Licence is not a separate performance obligation

--Recognize licence with other goods and services. Example – software which requires on-going maintenance in order to be useable

--Example – licence is a component and is integral to functioning of a tangible good / licence that can only function with a related service

Non Distinct Licences	**Examples**
Licence is a component and integral to the functioning of a tangible good	Software embedded in the operating system of a car
Customer can only benefit if licence functions with a related service	Media content that the customer can access only via an online service Drug compound that requires R&D from the entity

9. Bill and Hold Arrangements

A vendor invoices a customer for a product, but does not deliver the product to the customer until a later date.

The customer may not have sufficient space to accept the product.

In order to recognize revenue, the vendor must transfer control (typical criteria, except for transfer of physical asset) plus:

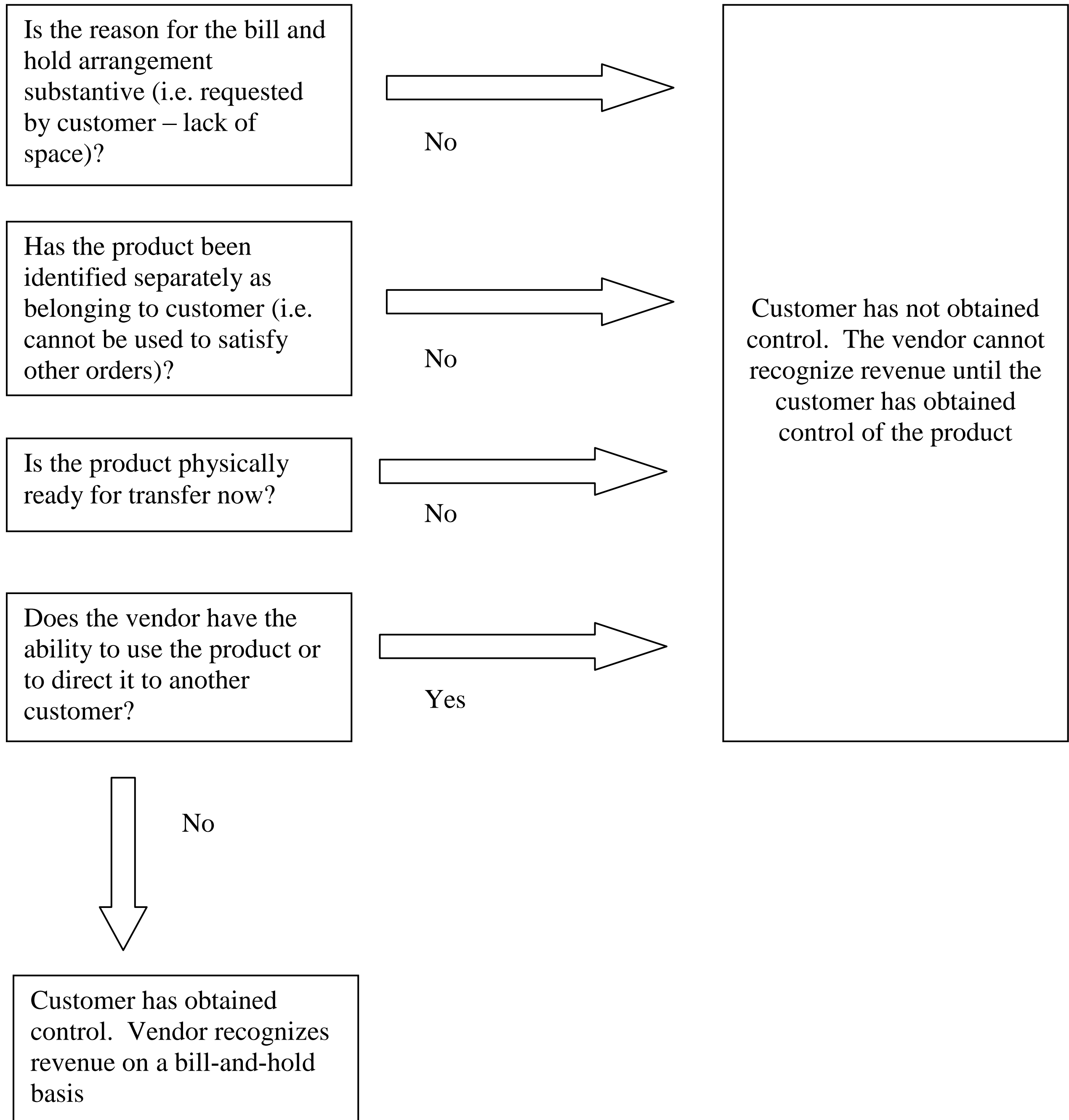
(i) The reason for the bill and hold arrangement must be substantive (i.e. requested by customer – lack of space)

(ii) Product must be identified separately as belonging to customer (i.e. cannot be used to satisfy other orders)

(iii) Product must be physically ready for transfer now

(iv) Vendor cannot have the ability to use the product or to direct it to another customer

Illustration



A vendor that meets the control criteria as well as the other 4 criteria, must also consider if they are providing other services (custodial services) and if yes, a portion of the transaction price needs to be allocated (i.e. to each of the goods and the custodial service, as there are 2 separate performance obligations).

10. Repurchase Agreements

This arises when a vendor sells an asset to a customer and the vendor is either required or has the right to repurchase the asset.

In this case, the customer's ability to use the asset is limited. Therefore, vendor does not recognize revenue from a sale and accounts for the transaction as a lease or financing arrangement.

Repurchase agreements typically take 1 of 3 forms:

A forward – entity has an obligation to repurchase
A call option – entity has a right to repurchase
A put option – entity has an obligation to repurchase at the customer's request

Forward and Call Arrangements

In these arrangement, the customer does not obtain control. They result in:

Lease arrangement – Repurchase price is lower than original selling price (follow Lease Section)

OR

Financing arrangement – Repurchase price is greater than or equal to the original selling price – vendor recognizes a financial liability for any consideration received and continue to recognize the asset)

Illustration

Forward (Seller obligated to repurchase the asset)	**Call Option** (Seller's right to repurchase the asset)
Customer does not obtain control	

⇩

Asset repurchased for less than original selling price?

⇩ Yes → Lease arrangement

⇩ No → Financing arrangement

Put Options

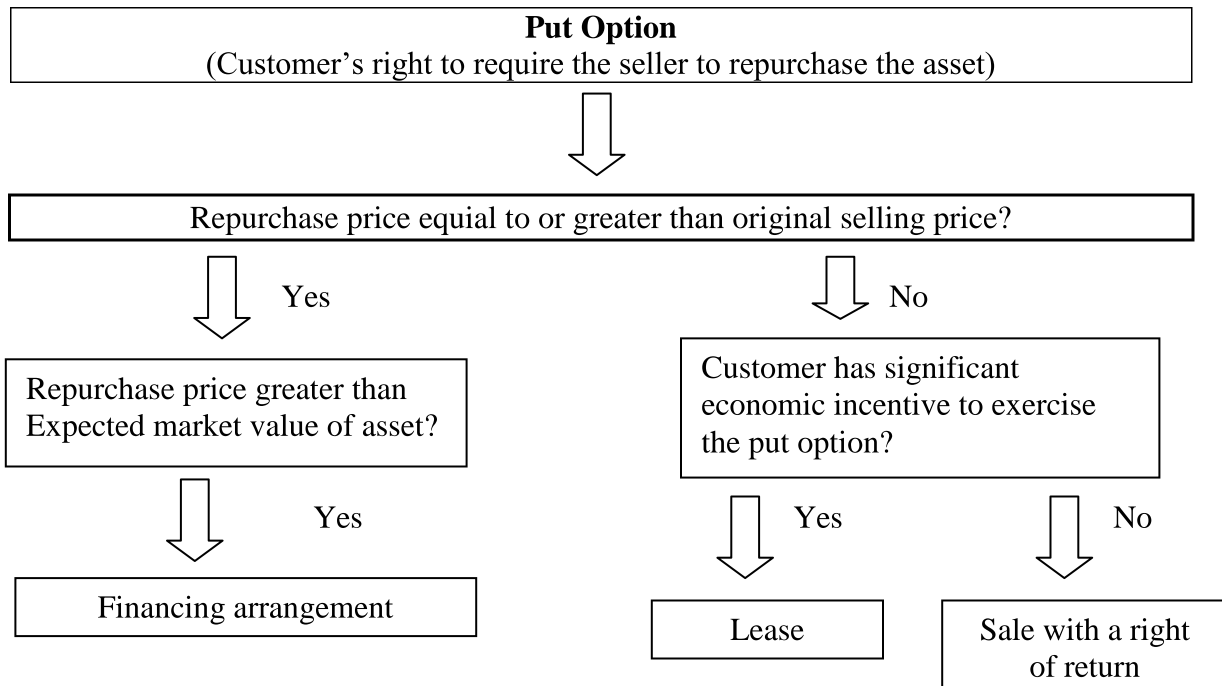
Vendor has an obligation to repurchase the asset at the customer's request.

Accounting will depend on the relationship between the repurchase price of the asset and the original selling price of the asset.

(i) Repurchase price is lower than original selling price –
- Consider if customer has economic incentive to exercise right
  - If yes – account as a lease.
  - If no – account as a sale of a product with right of return

(ii) Repurchase price is equal or greater than original selling price –
- Repurchase price more than expected market value – a financing arrangement
- Repurchase price less than expected market value and no economic incentive to exercise right – sale of product with right of return

Illustration



11. Consignment Arrangements

A vendor delivers a product to a customer (dealer or retailer), for sale to an end customer.

A vendor does not recognize revenue for consignment goods. This is because the dealer or retailer does not have control.

A consignment arrangement happens when:

- Product is controlled by the vendor until a specified event occurs (e.g. sale of the product to a customer or until a specified period expires);
- Vendor is able to require the return of the product or transfer to a third party; and
- Dealer or retailer does not have an unconditional obligation to pay for the product (but could be a requirement for a deposit to be paid).

When is consignment revenue recognized?	
If vendor retains control of the product	Performance obligation not satisfied and revenue is not recognized
When control transfer to the intermediary or customer	Performance obligation is satisfied and revenue is recognized

12. Contract Modifications (Changes in the Transaction Price after Contract Inception)

First determine if the modification is approved.

Once approved, determine if it should be a separate contract.

Separate contract

2 conditions must exist:

1) Scope of contract increases because of the addition of promised goods or services that are distinct; and
2) Price of contract increases by the stand alone selling price of the additional goods and services

Assuming both conditions met:

- Modification is treated as a separate contract
- Apply the 5 step model separately to this contract
- Existing contract remains unchanged – 5 step model being applied
- Apply prospectively.

If conditions not met but remaining goods and services distinct:

- Treat modification as if it is a new contract
- Effectively, original contract is terminated
- Treat prospectively

If conditions not met, and remaining goods and services not distinct:

- Modification is part of remaining performance obligation in the contract

- Adjust revenue based on modification
- Apply retrospectively

D/ PRESENTATION AND DISCLOSURE

PRESENTATION

Must separately present Contract Assets, Contract Liabilities and Receivables due from customers.

Contract Assets – Not the same as a contract receivable

-- It is a vendor's right to consideration in exchange for goods or services transferred to the customer, when the right is conditional on the vendor's future performance

-- A receivable is the vendor's unconditional right to consideration and is accounted for in accordance with IFRS 9 Financial Instruments or IAS 39 Financial Instruments: Recognition and Measurement

- Key difference between a contract asset and receivable – A contract asset is conditional on some future performance by the vendor (not just the passage of time), while for a receivable, it is unconditional, just based on the passage of time

Customer right to a refund – does not make the consideration conditional and would be a liability.

Payments paid in advance – would be a contract liability

Bad debts should not be netted against revenues

DISCLOSURE

- Disclose an overall disclosure objective

There are some main categories of disclosure:

- Contracts with customers
- Significant judgments in the application of IFRS 15
- Assets recognized from the costs to obtain or fulfill a contract with a customer
- Practical expedients

SUMMARY FOR STUDENTS – IFRS 15

Students should refer to the more detailed notes for elaboration

A) The 5 Steps

- Know the 5 steps in the revenue recognition process
  - Identify the contract (Step 1)
    - 5 criteria
  - Identify the performance obligations in the contract (Step 2)
    - Distinct (one performance obligation) vs. a series
    - Distinct 2 criteria
  - Determine the transaction price (Step 3)
    - 5 factors to consider
    - 2 methods – expected value method vs. most likely amount
    - Highly probably constraint
    - How to account for a right to return
  - Allocate the transaction price to the performance obligation (Step 4)
    - Know how to allocate price among several products
    - 3 approaches – adjusted market assessment, expected cost plus margin, residual
  - Recognize revenue when each performance obligation is satisfied (Step 5)
    - Always refer to the 5 indicators when control passes
    - Consider if control passes immediately or over time – 3 criteria if over time

B) Contract Costs

- 2 types of costs:
  1) Incremental costs
     - Know criteria leading to exp vs cap decision
     - Expense if 1 year or less
  2) Costs to fulfill a contract
     - Know criteria leading to exp vs cap decision

C) Other issues

1) Gift Cards (or Customer's unexercised rights)
   i. How to account for gift cards / breakage

2) Warranties
    i. Determine if warranty is distinct (separate performance obligation) or not
    ii. Assurance vs. service-type warranties

3) Principal vs. Agent
    i. Know criteria to determine if principal or agent
    ii. Know accounting impact of each (i.e. how they are reflect on the F/S)

4) Non-Refundable Upfront Fees
    i. Know basic criteria to determine if they are a separate performance obligation or not

5) Customer Options for Additional Goods or Services (Material Right)
    i. Identify if there is a material right
    ii. Know 2 ways to account for a material right
    iii. How to account for coupons issued at the point of sale

6) Customer loyalty programs
    i. Understand how to account for customer loyalty programs (as a separate material right)

7) Renewal Options
    i. Identify if a renewal option is distinguishable from other operations (i.e. provides a material right)

8) Licencing Intellectual Property (IP)
    i. Determine if licence is distinct
    ii. Right to access vs. right to use

9) Bill and Hold Arrangements
    i. Know the 4 criteria to determine if it is bill and hold and vendor can recognize revenue

10) Repurchase Agreements
    i. Know the 3 forms – Forward, call option, put option
    ii. Know the accounting for each – whether lease arrangement or financing arrangement or sale with a right of return

11) Consignment Arrangements
    i. Know factors to identify if it is a consignment arrangement and how to account

12) Contract Modifications (Changes in the Transaction Price after Contract Inception)
    i. Determine if a separate contract (2 conditions) and if distinct

Key Paragraphs in the Handbook you May Want to Reference in a Case

Key Paragraphs in IFRS 15 You May Want to Reference in a Case	
Paragraph in handbook	**Content**
9	5 Criteria for identifying a contract (Step 1)
20	Contract modifications – 2 conditions necessary if a separate contract
22	Identifying performance obligations (Step 2)
27	2 criteria to determine if a promise is distinct
31	Satisfaction of Performance Obligation (Step 3)
35	3 criteria (1 necessary) to determine if control passes over time
38	5 indicators of a transfer of control
46, 47	The transaction price (Step 4)
48	5 considerations when determining the transaction price
73	Allocating transaction price to performance obligation (Step 5)
79	3 suitable methods for estimating stand-alone price
82	Criteria to allocate a discount
85	Allocating variable consideration based on 2 criteria
91, 95	Standards for incremental costs and costs to fulfill a contract
Appendix B	Provides guidance on Other Issues (See C above)
Appendix C	63 Examples are provided for illustration