

A Review of IFRS 15 *Revenue from Contracts with Customers*

By Tan Liong Tong

1. Background

In May 2014, the IASB issued the long-awaited IFRS 15 *Revenue from Contracts with Customers*, which sets a new model for revenue accounting. The issuance of IFRS 15 signifies a culmination of a joint project with the US FASB to clarify the principles and develop a common standard for recognising revenue. This new IFRS is effective for financial periods beginning on or after 1 January 2017, with earlier application permitted. It supersedes IAS 18 *Revenue*, IAS 11 *Construction Contracts*, and all revenue-related Interpretations: IFRIC 13 *Customer Loyalty Programmes*, IFRIC 15 *Agreements for the Construction of Real Estate*, IFRIC 18 *Transfer of Assets from Customers* and SIC-31 *Revenue – Barter Transactions Involving Advertising Services*. The new model would change the current practice for revenue accounting of some entities and in some industries. For transitioning entities in the property development sector, this new IFRS provides clear guidance that would resolve the interpretation problems in IFRIC 15.

This article examines the rationale for the new model, changes that have been made, salient features of the new IFRS and draws some implications on practice. It aims to assist preparers and users better understand the requirements of the new Standard.

2. Rationale for the New Model

Revenue is an important measure of an entity's performance. It is used widely by investors and other users for making comparisons and investment decisions. Currently, the two main Standards for revenue accounting in the IFRSs are IAS 18 *Revenue* and IAS 11 *Construction Contracts*. The IASB noted that there are inconsistencies and weaknesses in the current Standards.

Significant diversity in revenue recognition practices has arisen because the current Standards contain limited guidance on many important topics, such as accounting for arrangements with multiple elements. It is difficult to apply the current Standards to transactions other than the simple sales of goods or rendering of services, for example, arrangements that contain variable considerations. In agreements for the construction of real estate, IFRIC 15's guidance on transfer of control and the significant risks and rewards of ownership over time is not definitive and this has created diverse views, not just in Malaysia but also among different jurisdictions. Moreover, the existing Standards have only limited guidance on other emerging transactions such as licensing arrangements and warranties that include a service component. Thus, revenue recognition issues continue to arise as new types of transactions emerged. The IASB also noted that the disclosure requirements in the current Standards are inadequate for investors to understand an entity's revenue, and the judgements and estimates made by the entity in recognising that revenue. For instance, investors are concerned that the revenue information disclosed is often 'boilerplate' in nature or is presented in isolation and without explaining how the revenue recognised relates to other information in the financial statements.

To correct the inconsistencies and weaknesses in the current Standards and to cater for the emerging complex revenue transactions, the IASB, together with the US FASB, undertook a joint project to develop a common model for revenue accounting. An exposure draft (ED/2010/6) was issued in June 2010 and a revised exposure draft (ED/2011/6) was issued in November 2011.

The IASB believes that IFRS 15 provides a comprehensive and robust framework for recognition, measurement and disclosure of revenue. In particular, the new Standard improves the comparability of revenue from contracts with customers, reduces the need for interpretive guidance to be developed on a case-by-case basis to address emerging revenue recognition issues, and provides more useful information through improved disclosure requirements.

3. The Significant Changes Made

For contracts with multiple elements, an entity would need to identify the separate performance obligations in a contract and account for each component separately. This includes separating multiple goods and services in a transaction, separating a warranty if it contains a service component, and a licensing component in a sale of good or service transaction. The transaction price (i.e. consideration receivable) must be allocated to the separate performance obligations in a contract on the basis of the relative stand-alone selling prices.

For long-term contracts with customers, an entity would need to assess whether it satisfies a performance obligation over time or at a point in time. The assessment is based primarily on when (or as) it transfers control of an asset to the customer, with control being assessed from the perspective of the customer. If a performance obligation is satisfied over time, the entity recognises revenue over time by measuring the progress towards complete satisfaction of that performance obligation.

Costs that are related to a contract with a customer would include incremental costs to obtain and costs to fulfil a contract and must be recognised as an asset (the equivalent of a contract work in progress). The IFRS requires that the recognised asset must be subject to systematic amortisation and impairment test.

For disclosures, the IFRS requires extensive disclosures, both qualitative and quantitative information, about contracts with customers. These include judgements and estimates made, disaggregated information about recognised revenue into appropriate categories, and performance obligations remaining at the end of the reporting period.

4. Salient Features

The core principle of the IFRS is that an entity shall recognise revenue to depict the transfer of promised goods or services to customers in an amount that reflects the consideration to which the entity expects to be entitled in exchange for those goods or services.

To apply the core revenue principle, an entity needs to follow the following five main steps:

- (a) Identify the contract with the customer;
- (b) Identify the performance obligations in the contract;
- (c) Determine the transaction price;
- (d) Allocate the transaction price to the performance obligations; and
- (e) Recognise revenue when (or as) the entity satisfies a performance obligation.

In a straightforward sale of retail goods, applying these requirements to a single performance obligation would not pose any practical problem. However, in some cases of complex revenue transactions, the entity needs to consider the terms of the contract and related facts and circumstances when using judgements in the application of the IFRS.

4.1 Recognition

4.1.1 Identifying the Contract

This IFRS applies contract-based revenue reporting as contrast to other IFRSs, such as IAS 41 *Agriculture* which is activity-based income reporting. A contract is defined in the IFRS as “an agreement between two or more parties that creates enforceable rights and obligations”. Enforceability of the rights and obligations in a contract is a matter of law. Contracts can be written, oral or implied by an entity’s customary business practices. An entity shall consider those practices and processes in determining whether and when an agreement with a customer creates enforceable rights and obligations.

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

- (a) the parties to the contract *have approved* the contract (in writing, orally or in accordance with other customary business practices) and are committed to perform their respective obligations;
- (b) the entity can identify each *party's rights* regarding the goods or services to be transferred;
- (c) the entity can identify the *payment terms* for the goods or services to be transferred;
- (d) the contract has *commercial substance* (i.e. the risk, timing or amount of the entity's future cash flows is expected to change as a result of the contract); and
- (e) it is *probable* that the entity will collect the *consideration* to which it will be entitled for the goods or services that will be transferred to the customer. In evaluating whether collectability of an amount of consideration is probable, an entity shall consider only the customer's ability and intention to pay that amount of consideration when it is due. The amount of consideration to which the entity will be entitled may be less than the price stated in the contract if the consideration is variable because the entity may offer the customer a price concession.

A contract does not exist for the purpose of the IFRS if each party to the contract has the unilateral enforceable right to terminate a wholly unperformed contract without compensating the other party (parties). A contract is wholly unperformed if: (a) the entity has not yet transferred any promised goods or services to the customer; and (b) it has not yet received, and is not entitled to receive, any consideration in exchange for promised goods or services.

Combination of Contracts

The Standard specifies the accounting for an individual contract with a customer. In some cases, the entity needs to account for two or more contracts together. 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: (a) the contracts are negotiated as a package with a single commercial objective; (b) the amount of consideration to be paid in one contract depends on the price or performance of the other contract; or (c) the goods or services promised in the contracts (or some goods or services promised in each of the contracts) are a single performance obligation.

These criteria for combining contracts are largely similar as those in the current IAS 11, except that the combining of contracts into a single contract applies only if the contracts are with the same customer (or related parties of the customer). The current IAS 11 requires a group of contracts, whether with a single customer or with several customers, shall be treated as a single construction contract when the specified criteria are met.

IFRS 15 provides for a practical expedient in which an entity may apply this Standard to a portfolio of contracts (or performance obligations) with similar characteristics if the entity reasonably expects that the effects on the financial statements of applying this Standard to the portfolio would not differ materially from applying this Standard to the individual contracts (or performance obligations) within that portfolio. When accounting for a portfolio, an entity shall use estimates and assumptions that reflect the size and composition of the portfolio [IFRS 15.4].

Contract Modifications

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, for example, a change order, a variation or an amendment. It exists when the parties to a contract approve a modification that either creates new or changes existing enforceable rights and obligations of the parties to the contract. If a contract modification has not been approved by the parties to a contract, an entity shall continue to apply the IFRS to the existing contract until the contract modification is approved.

If a change in scope has been approved by the parties but the corresponding change in price has not yet been determined, an entity applies this IFRS to the modified contract when the entity has an expectation that the price of the modification will be approved. The entity needs to re-estimate the transaction price in such cases. If the contract modification results only in a change in the transaction price, an entity accounts for the modification as a change in the transaction price.

An entity accounts for a contract modification as a separate contract if: (a) the scope of the contract increases because of the addition of promised goods or services that are distinct and (b) the price of the contract increases by an amount of consideration that reflects the entity's stand-alone selling prices of the additional promised goods or services and any appropriate adjustments to those prices to reflect the circumstances of the particular contract.

For example, in a contract to construct an office building for a customer, a contract modification arises when the customer requests for an annexure block to be built next to the office building. The price of this annexure is negotiated separately. In this case, the contract modification is a separate contract because the scope of the contract increases due to the additional good that is distinct, and the price of the contract increases by an amount of consideration that reflects the entity's stand-alone selling price of the additional promised good.

If a contract modification is not accounted as a separate contract, an entity needs to evaluate the remaining goods and services on the modified contract (i.e. the promised goods or services not yet transferred at the date of the contract modification) and account for the modified contract depending on whether the remaining goods and services are distinct from the goods or services already transferred to the customer. The entity shall account for the contract modification as if it were a termination of the existing contract and the creation of a new contract if the remaining goods or services are distinct from the goods or services transferred on or before the date of the contract modification. If the remaining goods or services are not distinct, the modification forms a part of the existing contract in a single performance obligation that is partially satisfied at the date of the contract modification. If the remaining goods and services together with the modification are a combination of both distinct and non-distinct goods and services, the entity would need to separate the two components and account for the distinct component as a new performance obligation.

For example, an entity has a contract with an amount of RM800,000 not yet recognised as revenue. A contract modification is approved by the parties and the additional consideration for the modification is RM200,000. The entity concludes that the modification is part of the existing contract. If the remaining goods and services promised in the contract together with the modification are distinct from those already transferred to the customer, the entity allocates total consideration of RM1,000,000 to the contract as if it were a new contract. If the remaining goods or services are not distinct, the modification has an effect on the transaction price, and based on the stage of completion, the entity adjust for an increase in revenue at the date of the contract modification (i.e. the adjustment to revenue is made on a cumulative catch-up basis).

The requirement to segment a single contract and account for it as two or more separate contracts (in the current IAS 11) is not specifically provided for in the new IFRS. The segmentation guidance in IAS 11 is redundant when an entity applies the separate performance obligations approach of the new IFRS i.e. if a contract has separate performance obligations, each has to be accounted for separately, which is the same as the segmentation requirement of IAS 11.

4.1.2 Identifying Performance Obligations

An essential feature of this new IFRS is the concept of *performance obligation* embodied in a contract with a customer to provide goods and services in exchange for consideration. A performance obligation is defined as "a promise in a contract with a customer to transfer a good or service to the customer". The goods and services include not only those routinely sold or provided by the entity but also with the service for arranging for another party to transfer goods and services (for example, acting as an agent of another party), standing ready to provide goods and services, constructing or developing an asset on behalf of a customer, granting licences, rights to use and options, and performing a contractually agreed task.

At contract inception, an entity shall assess the goods or services promised in a contract with a customer and shall identify as a performance obligation each promise to transfer to the customer either: (a) a good or service (or a bundle of goods or services) that is distinct; or (b) a series of distinct goods or services that are substantially the same and that have the same pattern of transfer to the customer.

If an entity promises to transfer more than one good or service, the entity shall account for each promised good or service as a separate performance obligation only if it is distinct. If a good or service is not distinct, an entity shall combine that good or service with other promised goods and services until the entity identifies a “bundle” of goods or services that is distinct. In some cases, such bundling may result in an entity accounting for all the goods and services promised in the contract as a single performance obligation.

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

- (a) the customer can benefit from the good or service on its own or together with other resources that are readily available to the customer (i.e. the good or service is capable of being distinct), and
- (b) the entity's promise to transfer the good or service to the customer is separately identifiable from other promises in the contract (i.e. the good or service is distinct within the context of the contract).

For example, if a manufacturer enters into a contract with a customer to design and produce a customer-specific machine, together with commissioning and installation and after-sales services, it would need to identify the various components in the arrangement and account for each as a separate performance obligation because the customer can benefit from the good or service on its own.

In contrast, if an entity enters into a contract with a customer to construct a building, the customer would also benefit from the supply of bricks and other construction materials as well as the supply of labour. However, these items would not be distinct if the entity is providing the materials and construction labour to the customer as part of its promise in the contract to construct the building for the customer.

Similarly, if a software developer enters into a contract with a customer to transfer a software licence, perform an installation service and provide unspecified software updates and technical support (online and telephone) for a specified period, it would need to assess whether each promised good or service is distinct. It would probably identify four separate performance obligations of: (a) the software licence, (b) an installation service, (c) software updates, and (d) technical support.

Warranties

It is common for an entity to provide a warranty in connection with the sale of a product (whether good or service). Some warranties provide customers with assurance that the related product will function as the parties intended because it complies with agreed-upon specifications. Other warranties provide the customer with a service in addition to the assurance that the product complies with agreed-upon specifications.

If the customer has the option to purchase a warranty separately (for example, because the warranty is priced or negotiated separately), the warranty is a distinct service because the entity promises to provide the service to the customer in addition to the product that has the functionality described in the contract. In those circumstances, an entity shall account for the promised warranty as a separate performance obligation. The entity shall allocate a portion of the transaction price to that performance obligation in the recognition of revenue.

If the customer does not have the option to purchase a warranty separately, an entity shall account for the warranty in accordance with IAS 37, unless the promised warranty, or a part of the promised warranty, provides the customer with a service in addition to the assurance that the product complies with agreed-upon specifications. If an entity promises both an assurance-type

warranty and a service-type warranty but cannot reasonably account for them separately, the entity shall account for both of the warranties together as a single performance obligation.

Licensing

The IFRS provides guidance on revenue recognition of licensing arrangements. A licence establishes a customer's right to the intellectual property of an entity. Licences of intellectual property may include: (a) software and technology, (b) motion pictures, music and other forms of media and entertainment, (c) franchises, and (d) patents, trademarks and copyrights. In addition to a promise to grant a licence to a customer, an entity may also promise to transfer other goods and services to the customer.

If the promise to grant a licence is not distinct from other promised goods or services in the contract, an entity shall account for the promise to grant a licence and those other goods or services together as a single performance obligation (for example, a licence that forms a component of a tangible good and that is integral to the functionality of the good, or a licence that the customer can benefit from only in conjunction with related service, such as an online service provided by that entity that enables, by granting a licence, the customer to access content).

If the promise to grant the licence is distinct from the other promised goods or services in the contract, it is accounted for as a separate performance obligation. An entity shall determine whether the licence transfers to a customer either at a point in time or over time. In making this determination, an entity shall consider whether the nature of the entity's promise in granting the licence to a customer is to provide the customer with either:

- (a) a right to access the entity's intellectual property as it exists throughout the licence period (i.e. usage-based licence); or
- (b) a right to use the entity's intellectual property as it exists at the point in time at which the licence is granted (i.e. sales-based licence).

An entity considers whether a customer can direct the use of, and obtain substantially all of the remaining benefits from, a licence at the point in time at which the licence is granted. If the intellectual property to which the customer has rights changes throughout the licence period, the customer cannot direct the use of, and obtain substantially all of the remaining benefits from the licence granted. In this case, the licence provides the customer with a right to access the entity's intellectual property. In contrast, a customer can direct the use of, and obtain substantially all of the remaining benefits from, the licence if the intellectual property to which the customer has rights will not change.

The nature of an entity's promise in granting a licence is a promise to provide a right to access the entity's intellectual property if all of the following criteria are met:

- (a) the contract requires, or the customer reasonably expects, that the entity will undertake activities that significantly affect the intellectual property to which the customer has rights;
- (b) the rights granted by the licence directly expose the customer to any positive or negative effects of the entity's activities; and
- (c) those activities do not result in the transfer of a good or a service to a customer as those activities occur.

An entity recognises revenue for a sales-based or usage-based promised in exchange for a licence of intellectual property only when (or as) the later of the events occur: (a) the subsequent sale or usage occurs, or (b) the performance obligation to which some or all of the sales-based or usage based royalty that has been allocated has been satisfied (or partially satisfied). If a licence is a right to access an entity's intellectual property (usage-based licence), the entity accounts for the promise to grant a licence as a performance obligation satisfied over time because the customer will simultaneously receive and consume the benefit from the entity's performance of providing access

to its intellectual property as it occurs. If the licence is a right to use the entity's intellectual property as that intellectual property exists (in terms of form and functionality) at the point in time at which the licence is granted to the customer (sales-based licence), the entity accounts for the promise to provide a right to use the entity's intellectual property as a performance obligation satisfied at a point in time.

Incidental and Sales Incentives

Some entities provide sales incentives or otherwise incidental or ancillary services to the other promised goods or services in contract with a customer. For example, in the automotive industry, a manufacturer sells cars with an incentive such as free maintenance that will be provided for a specified period. In the real estate industry, a property developer may provide buyers of housing units with incentives such as free built-in cabinets, free air-conditioning units or free club membership. An entity would need to assess whether the promised goods or services from the incidental obligations and sales incentives are goods or services that are distinct. If they are distinct, the entity would need to account for them as a separate performance obligation.

4.1.3 Satisfaction of Performance Obligation

An entity shall recognise revenue when (or as) the entity satisfies a performance obligation 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. Transfer of control is thus the most critical criterion in determining when revenue should be recognised and it is assessed from the perspective of the customer. The amount recognised is the amount of the transaction price allocated to that performance obligation.

Goods and services are assets, even if only momentarily, when they are received and used (as in the case of many services). A good or service is transferred when (or as) the customer obtains control of that good or service. A customer obtains control of a good or service when the customer has the ability to direct the use of, and obtain the benefits from, the good or service. Control includes the ability to prevent other entities from directing the use of, and obtaining the benefit from, a good or service. Ability to use refers to the present right to use the asset for its remaining economic life or to consume the asset. Ability to obtain the benefit from an asset refers to the present right to obtain substantially all of the potential cash flows from that asset. The customer can obtain cash flows from an asset directly or indirectly in many ways such as by using, consuming, selling, exchanging, pledging or holding the asset. The criterion of transfer of legal title or physical possession is not a necessary requirement to assess the transfer of control.

For each separate performance obligation, an entity shall determine at contract inception whether it satisfies the performance obligation over time or satisfies the performance obligation at a point in time. If the entity does not satisfy a performance obligation over time, the performance obligation is satisfied at a point in time.

4.1.4 Recognising Revenue when a Performance Obligation is Satisfied

Performance obligation satisfied over time

The IFRS specifies that an entity transfers control of a good or service over time and, hence, satisfies a performance obligation and recognises revenue over time if one of the following criteria is met:

- (a) the customer simultaneously receives and consumes the benefits provided by the entity's performance as the entity performs;
- (b) the entity performance creates or enhances an asset (for example, work in progress) that the customer controls as the asset is created or enhanced; or
- (c) 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.

An asset created by an entity's performance does not have an alternative use to the entity if the entity is either restricted contractually from readily directing the asset for another use during the creation or enhancement of that asset or limited practically from readily directing the asset in its completed state for another use. The assessment of whether an asset has an alternative use to the entity is made at contract inception. After contract inception, an entity shall not update the assessment of the alternative use of an asset unless the parties to the contract approve a contract modification that substantially changes the performance obligation.

An entity shall consider the terms of the contract, as well as any laws that apply to the contract, when evaluating whether it has an enforceable right to payment for performance completed to date. The right to payment for performance completed to date does not need to be a fixed amount. However, at all times throughout the duration of the contract, the entity must be entitled to an amount that at least compensates the entity for performance completed to date if the contract is terminated by the customer or another party for reasons other than the entity's failure to perform as promised.

Performance obligation satisfied at a point in time

If a performance obligation is not satisfied over time, an entity satisfies the performance obligation at a point in time. To determine that point in time when a customer obtains control of a promised asset and the entity satisfies a performance obligation, the entity shall consider the requirements for control (i.e. the transfer of control of the asset to the customer) which include, but are not limited to, the following:

- (a) the entity has a present right to payment for the asset;
- (b) the customer has legal title to the asset;
- (c) the entity has transferred physical possession of the asset;
- (d) the customer has the significant risks and rewards of ownership of the asset; and
- (e) the customer has accepted the asset.

The above are indicators of transfer of control, which means that not one of the preceding indicators determines by itself whether the customer has obtained control of the good or service. Moreover, some of the indicators may not be relevant to a particular contract (for example, physical possession and legal title would not be relevant to services).

Example

A property developer constructs a high-rise multiple-unit condominium. A customer enters into a binding sale and purchase agreement with the developer for a specified unit that is under construction.

(a) Fact Patterns

The customer pays a non-refundable deposit upon entering into the contract and is required to make progress payments during the construction of the unit. The contract has substantive terms that preclude the developer from being able to direct the unit to another customer. In addition, the customer does not have the right to terminate the contract unless the developer fails to perform as promised. If the customer defaults on its obligations by failing to make the promised progress payments as and when they are due, the developer would have the right to all of the consideration promised in the contract if it completes the construction of the unit. The courts have previously upheld similar rights that entitle developers to require the customer to perform, subject to the developer meeting its obligations under the contract.

Based on these fact patterns, the asset (unit) created by the developer's performance does not have an alternative use to the developer because the contract precludes the developer from transferring the specified unit to another customer. In making the assessment, the developer does not consider the possibility of a contract termination in assessing whether the entity is able to direct the asset to another customer. The developer also has a right to payment for the performance completed to date. This is because if the customer were to default on its obligations, the developer would have an enforceable right to all of the consideration promised under the contract if it continues to perform as promised. Based on these fact patterns, the developer's performance obligation is a performance obligation satisfied over time.

(b) Fact Patterns

The customer pays a deposit upon entering into the contract and the deposit is refundable only if the developer fails to complete construction of the unit in accordance with the contract. The remainder of the contract price is payable on completion of the contract when the customer obtains physical possession of the unit. If the customer defaults on the contract before completion of the unit, the entity only has the right to retain the deposit.

In this case, the developer does not have an enforceable right to payment for performance completed to date because, until construction of the unit is complete, the entity only has a right to the deposit paid by the customer. Because the developer does not have a right to payment for work completed to date, the developer's performance obligation is not a performance obligation satisfied over time. Instead, the developer accounts for the sale of the unit as a performance obligation satisfied at a point in time.

(c) Fact Patterns

Same facts as in (a) and (b) above, except that in the event of a default by the customer, either the developer can require the customer to perform as required under the contract or the developer can cancel the contract in exchange for the asset under construction and an entitlement to a penalty of a proportion of the contract price.

Notwithstanding that the developer could cancel the contract (in which case the customer's obligation to the developer would be limited to transferring control of the partially completed asset to the entity and paying the penalty prescribed), the developer has a right to payment for performance completed to date because the developer could also choose to enforce its rights to full payment under the contract. The fact that the developer may choose to cancel the contract in the event that the customer defaults on its obligations would not affect the assessment, provided that the developer's right to require the customer to continue to perform as required under the contract (i.e. pay the promised consideration) is enforceable. Therefore, the developer's performance obligation is satisfied over time.

Measuring Progress towards Complete Satisfaction of a Performance Obligation

For each performance obligation satisfied over time, an entity recognises revenue over time by measuring progress towards complete satisfaction of that performance obligation. The objective when measuring progress is to depict an entity's performance in transferring control of goods and services promised to a customer (i.e. the satisfaction of an entity's performance obligation). This requirement is the same as the current revenue Standards in that an entity needs to measure the stage of completion for a performance obligation that is satisfied over time. The IFRS does not prescribe a particular method of measuring progress. An entity uses its judgement to select a method that most appropriately reflects the progress of the performance obligation. Appropriate methods of measuring progress include output methods and input methods.

For example, in a construction contract or a property development project, the output method used may be based on survey of performance completed to date. The input method used may be based on costs incurred to date as a per cent of estimated total costs.

When applying a method for measuring progress, an entity shall exclude from the measure of progress any goods or services for which the entity does not transfer control to a customer. Conversely, an entity shall include in the measure of progress any goods or services for which the entity does transfer control to a customer when satisfying that performance obligation.

For example, in a servicing contract that includes the supply of equipment bundled as a single performance obligation, the cost of equipment capitalised in contract costs is usually excluded in measuring the progress of the performance completed to date if an input method based on cost is applied.

As circumstances change over time, an entity shall update its measure of progress to reflect any changes in the outcome of the performance obligation. This is determined on a cumulative catch-up basis. Such changes to an entity's measure of progress shall be accounted for as a change in accounting estimates in accordance with IAS 8.

4.1.5 When the Outcome is Uncertain

In some circumstances (for example, in the early stages of a contract), an entity may not be able to reasonably measure the outcome of a performance obligation, but the entity expects to recover the costs incurred in satisfying the performance obligation. In those circumstances, the entity 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. This requirement is the same as the current Standards and it means that when there are uncertainties about the outcome of a contract, no profit should be recognised.

4.2 Measurement

When (or as) a performance obligation is satisfied, an entity shall recognise as revenue the amount of the transaction price (which exclude estimates of variable consideration that are constrained) that is allocated to that performance obligation.

4.2.1 Determining the Transaction Price

An entity shall consider the terms of the contract and its customary business practice to 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.

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

- (a) variable consideration;
- (b) constraining estimates of variable consideration;
- (c) the existence of a significant financing component in the contract;
- (d) non-cash consideration; and
- (e) consideration payable to a customer.

Variable Consideration

When the consideration receivable is variable or uncertain, an entity needs to estimate the amount of consideration to which the entity will be entitled in exchange for transferring the promised goods or services to a customer. An amount of consideration can vary because of discounts, rebates, refunds, credits, price concessions, incentives, performance bonuses, penalties or other similar items. The promised consideration can also vary if an entity's entitlement to the consideration is contingent on the occurrence or non-occurrence of a future event.

An entity shall estimate an amount of variable consideration by using either of the following methods, depending on which method the entity expects to better predict the amount of consideration to which it will be entitled:

- (a) The expected value – the expected value is the sum of probability-weighted amounts in a range of possible consideration amounts. An expected value may be an appropriate estimate of the transaction price if an entity has a large number of contracts with similar characteristics.
- (b) The most likely amount – the most likely amount is the single most likely amount in a range of possible consideration amounts (i.e. the single most likely outcome of the contract). The most likely amount may be an appropriate estimate of the transaction price if the contract has only two possible outcomes (for example, an entity either achieves a performance bonus or does not).

Refund Liabilities

An entity shall recognise a refund liability if the entity receives consideration from a customer and expects to refund some or all of that consideration to the customer. A refund liability is measured at the amount of the consideration received (or receivable) for which the entity does not expect to be entitled (i.e. amounts not included in the transaction price).

Constraining Estimates of Variable Consideration

An entity includes in the transaction price some or all of an amount of variable consideration estimated only to the extent that it is highly probable that a significant reversal in the amount of cumulative revenue recognised will not occur when the uncertainty associated with the variable consideration is subsequently resolved. This means that the entity must consider both the likelihood and the magnitude of the revenue reversal. Factors that could increase the likelihood or the magnitude of a revenue reversal include, but are not limited to, any of the following:

- (a) The amount of consideration that is highly susceptible to factors outside the entity's influence, such as volatility in a market, the judgement or actions of third parties, weather conditions and a high risk of obsolescence of the promised good or service.
- (b) The uncertainty about the amount of the consideration is not expected to be resolved for a long period of time.
- (c) The entity's experience (or other evidence) with similar types of contract is limited, or that experience (or other evidence) has limited predictive value.
- (d) The entity has a practice of either offering a broad range of price concessions or changing the payment terms and conditions of similar contracts in similar circumstances.
- (e) The contract has a large number and broad range of possible consideration amounts.

The Existence of Significant Financing Component

In determining the transaction price, 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 the transfer of goods or services to the customer. In those circumstances, the contract contains a significant financing component.

The objective when adjusting the promised amount of consideration for a significant financing component is for an entity to recognise revenue at an amount that reflects the price that a customer would have paid for the promised goods or services if the customer had paid cash for those goods or services when (or as) they transfer to the customer (i.e. the cash selling price).

As a practical expedient, an entity need not adjust the promised amount of consideration for the effects of a significant financing component if the entity expects, at contract inception, that the period between when the entity transfers a promised good or service to a customer and when the customer pays for that good or service will be one year or less.

For example, an entity sells good for a consideration of RM1,100 to a customer payable within one year from the date of sale. The equivalent cash purchase price is RM1,000. In this case, the entity measures the transaction price at RM1,100 without the need to discount the amount of the consideration receivable.

If a transaction has a significant financing component, an entity shall use the discount rate that would be reflected in a separate financing transaction between the entity and its customer at the contract inception and this should reflect the credit characteristics of the party receiving financing in the contact as well as any collateral or security provided by the customer. This may be equal to the rate that discounts the nominal amount of the promised consideration to the cash selling price of the good or service. If the entity has no equivalent cash selling price, it uses a market interest rate that reflects the credit risk of the customer.

For example, an entity sells good to a customer for consideration of RM5 million payable in five equal annual instalments of RM1 million each at the end of each year. The risk-free rate is 4% and the additional risk premium to reflect the credit characteristics of the customer is 2%. A similar risk-class instrument has a prevailing market interest rate of 6%. In this case, the entity discounts the five annual instalments receivable at 6% and this gives a net present value of RM4.21 million. The entity recognises revenue from the sale of good of RM4.21 million. The difference of RM0.79 million is recognised as interest income over the five-year period as follows:

Year	Opening receivable	Interest income	Intalment received	Closing receivable
	RM'm	RM'm	RM'm	RM'm
1	4.21	0.25	(1.00)	3.47
2	3.47	0.21	(1.00)	2.67
3	2.67	0.16	(1.00)	1.83
4	1.83	0.11	(1.00)	0.94
5	0.94	0.06	(1.00)	(0.00)
		0.79	(5.00)	

Non-Cash Consideration

If the customer promises consideration in a form other than cash, an entity shall measure the non-cash consideration (or promise of non-cash consideration) at fair value. If the fair value cannot be measured reliably, an entity measures the consideration indirectly by reference to the stand-alone selling prices of the goods or services promised to the customer in exchange for the consideration.

Consideration Payable to a Customer

If an entity pays, or expects to pay, consideration to a customer (or to other parties that purchase the entity's goods or services from the customer) in the form of cash, credit or other items that the customer can apply against amounts owed to the entity, the entity accounts for the consideration payable to the customer as a reduction of the transaction price (and therefore, of revenue) unless the payment is in exchange for a distinct good or service.

4.2.2 Allocating the Transaction Price to Performance Obligations

The objective when allocating the transaction price is for an entity to allocate the transaction price to each performance obligation (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.

To meet the allocation objective, an entity shall allocate the transaction price to each performance obligation identified in the contract on a *relative stand-alone selling price basis* (with some limited exceptions related to allocating of discounts and allocating consideration that includes variable amounts).

For example, an entity sells a good that includes free after-sale services for 2 years and the consideration receivable is RM11,000. The stand-alone selling price of the good is RM10,000 whilst the stand-alone service price per year is RM1,250. The relative stand-alone selling price ratio is 0.80 for the good and 0.20 for the after-sale services. The entity allocates RM8,800 to the sale of good component and RM2,200 to the after-sale services component.

If the good or service is not sold separately in similar circumstances, the entity would need to estimate its stand-alone selling price. Suitable methods for estimating the stand-alone selling price of a good or service include, but are not limited to, the following:

- (a) Adjusted market assessment approach – This approach evaluates the market in which the entity sells its goods and services by estimating the price that a customer in that market would be willing to pay for those goods or services. This might also include referring to prices from the entity's competitors for similar goods or services and adjusting those prices as necessary to reflect the entity's costs and margins.
- (b) Expected cost plus a margin approach – This approach forecasts the expected costs of satisfying a performance obligation and then adds an appropriate margin for that good or service.
- (c) Residual approach – This approach estimates the stand-alone selling price by reference to the total transaction price less the sum of the observable stand-alone selling prices of other goods or services promised in the contract.

Allocating Discount

A discount for purchasing a bundle of goods or services arises if the sum of the stand-alone selling prices of those promised goods and services exceeds the promised consideration in a contract. Except when there is observable evidence that the discount relates entirely to one or more, but not all, performance obligations in a contract, an entity shall allocate a discount proportionately to all the performance obligations in the contract. The proportionate allocation of the discount is a consequence of allocating the transaction price to each performance obligation on the basis of the relative stand-alone selling prices of the underlying distinct goods and services.

If an entity regularly sells each distinct good or service on a contract on a stand-alone basis, discount to the stand-alone selling price is regularly provided and is substantially the same as the discount in a bundle of goods and services, the discount in the bundle of goods and services is allocated entirely to that performance obligation in the contract.

For example, in a contract with a customer, an entity's performance obligations consist of sale of good and rendering of services. The transaction price is RM1,000,000. The stand-alone selling prices of the good and service are RM900,000 and RM200,000 respectively. A discount of RM100,000 is provided on the contract price. The discount would be allocated proportionately if there is no observable evidence to suggest that it is attributed entirely to one performance obligation, as follows:

	Stand-alone Selling price RM	Allocation of discount RM	Transaction price allocation RM
Good	900,000	(81,818)	818,182
Services	200,000	(18,182)	181,818
	-----	-----	-----
Total	1,100,000	(100,000)	1,000,000
	=====	=====	=====

If the entity regularly gives a discount of RM100,000 for the sale of good on a stand-alone basis, then the entire discount would be allocated to the sale of good. In this case, the allocation of the transaction price would be RM800,000 for the sale of good and RM200,000 for the rendering of services.

Allocating Variable Consideration

Variable consideration in contract may be attributable to the entire contract or to a specific part of a contract. If the variable consideration relates to a specific performance obligation in a contract, it is allocated entirely to that performance obligation in the contract in the allocation of the transaction price. Otherwise, it is allocated to the performance obligations using the relative stand-alone selling prices basis.

Changes in the Transaction Price

After contract inception, the transaction price can change for various reasons, including the resolution of uncertain events or other changes in circumstances that change the amount of consideration to which an entity expects to be entitled in exchange for the promised goods or services.

The entity shall allocate to the performance obligations in the contract any subsequent changes in the transaction price on the same basis as at contract inception. If the change in transaction price relates entirely to one performance obligation, the entity allocates the change in price to that performance obligation only. Consequently, an entity shall not reallocate the transaction price to reflect changes in stand-alone selling prices after contract inception. Amounts allocated to a satisfied performance obligation shall be recognised as revenue, or a reduction in revenue, in the period in which the transaction price changes.

5. Contract Costs

5.1 Incremental Costs of Obtaining a Contract

The IFRS requires an entity to 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, an agent's commission).

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. For example, costs incurred to tender or lobby for a contract is recognised as an expense regardless of whether the contract is eventually obtained.

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.

5.2 Costs to Fulfil 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 *Inventories*, IAS 16 *Property, Plant and Equipment* or IAS 38 *Intangible Assets*), 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 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);
- (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.

For costs incurred in fulfilling a contract with a customer that are within the scope of another Standard, an entity accounts for those costs in accordance those other Standards. For example, if a contract with a customer is for the supply of inventories, the entity accounts for the costs of inventories in accordance with IAS 2 *Inventories*. Similarly, if a contract with a customer is providing a usage-based licence to use the entity's intellectual property that is being developed, the costs of developing the intellectual property is accounted for in accordance with IAS 38 *Intangible Assets*.

Costs that relate directly to a contract (or a specific anticipated contract) include any of the following:

- (a) direct labour (for example, salaries and wages of employees who provide the promised services directly to the customer);
- (b) direct materials (for example, supplies used in providing the promised services to a customer);
- (c) allocation of costs that relate directly to the contract or to contract activities (for example, costs of contract management and supervision, insurance and depreciation of tools and equipment used in fulfilling the contract);
- (d) costs that are explicitly chargeable to the customer under the contract; and
- (e) other costs that are incurred only because an entity entered into the contract (for example, payments to subcontractors),

An entity shall recognise the following costs as expenses when incurred:

- (a) general and administrative costs (unless those costs are explicitly chargeable to the customer under the contract);
- (b) costs of wasted materials, labour or other resources to fulfil the contract that were not reflected in the price of the contract;
- (c) costs that relate to satisfied performance obligations (or partially satisfied performance obligations) in the contract (i.e. costs that related to past performance); and
- (d) costs for which an entity cannot distinguish whether the costs relate to unsatisfied performance obligations or to satisfied performance obligations (or partially satisfied performance obligations).

The IFRS requires that the costs incurred to fulfil a contract that are not within the scope of other Standards shall be recognised as an asset in accordance with this Standard. However, it does not describe or specify the “nature” of this asset. Any appropriate title may be used to describe the nature of the asset, such as contract in progress. The costs accumulated for a contract is recognised as an equivalent of a work in progress until the accumulated cost is amortised as cost of sales or direct expenses when the related revenue is recognised in comprehensive income, either over time or at a point in time.

For example, in a contract to construct a building for a customer, costs incurred amount to RM10 million. These costs are accumulated in the contract in progress account. If at the end of a reporting period, RM8 million is amortised as a contract expense when the related revenue is recognised in profit or loss, the balance of RM2 million in the contract in progress account is included in determining the amount of contract asset or contract liability in the statement of financial position.

5.3 Amortisation and Impairment

The IFRS requires the recognised asset (i.e. the contract in progress) shall be subject to systematic amortisation consistent with the transfer to the customer of the goods and services to which the asset relates. Some respondents to the exposure draft asked the IASB to clarify whether those goods or services could relate to future contracts. Consequently, the IASB clarified that in amortising the contract asset in accordance with the transfer of goods or services to which the asset relates, those goods or services could be provided under a specifically anticipated (i.e. future) contract. That conclusion is consistent with the notion of amortising an asset over its useful life and with other Standards.

For example, if the accumulated costs (incremental costs to obtain and costs to fulfil a contract) of contract in progress is RM12,000 and the entity transfers 60% of the good or service to the customer, the amortisation for the contract in progress is RM7,200, being 60% of the accumulated costs. If the transfer of the goods or services to the customer is fairly even over time, the entity may use a straight-line basis of amortisation over time (e.g. in some usage-based licensing arrangements when the usage of the licence is even over time).

The amortisation shall be updated to reflect a significant change in the entity's expected timing of transfer to the customer of the goods or services to which the asset relates. Such a change shall be accounted for as a change in accounting estimate in accordance with IAS 8.

An entity shall recognise an impairment loss in profit or loss to the extent that the carrying amount of the contract asset exceeds: (a) the remaining amount of consideration that the entity expects to receive in exchange for the goods or services to which the asset relates, less (b) the costs that relate directly to providing those goods or services and that have not been recognised as expenses.

Example

At the end of the financial year 20x6, a contract in progress is carried at the amortised cost amount of RM500,000. The remaining contractual consideration receivable from the customer is RM1,500,000. An adjustment of 10% is considered necessary to reflect the effects of the customer's credit risk. The contract costs that relate directly to providing the goods and services to the customer and that have not been recognised as expenses amount to RM900,000 (i.e. the estimated further costs to complete the contract). This impairment test is performed as follows:

	RM
Carrying amount of contract asset	500,000
Recoverable amount:	
Remaining contractual consideration receivable	1,500,000
Adjustment to reflect effects of credit risk (10%)	(150,000)

Expected amount receivable	1,350,000
Future contract costs not yet recognised as expenses	(900,000)

Recoverable amount	450,000

Impairment loss to be recognised in profit or loss	50,000
	=====

6. Presentation and Disclosure

6.1 Presentation

When either party to a contract has performed, an entity shall present the contract in the statement of financial position as a contract asset or a contract liability, depending on the relationship between the entity's performance and customer's payment. An entity shall present any unconditional rights to consideration separately as a receivable.

If a customer pays consideration, or an entity has a right to an amount of consideration that is unconditional (i.e. a receivable), before the entity transfers a good or service to the customer, the entity shall present the contract as a contract liability when the payment is made or the payment is due (whichever is earlier). A contract liability is an entity's obligation to transfer goods or services to a customer for which the entity has received consideration (or an amount of consideration is due) from the customer.

If an entity performs by transferring goods or services to a customer before the customer pays consideration or before payment is due, the entity shall present the contract as a contract asset, excluding any amounts presented as a receivable. A contract asset is an entity's right to consideration in exchange for goods or services that the entity has transferred to a customer.

Example

Entity K has two outstanding contracts (Contract A and Contract B) with two customers to design and deliver customer-specific machines. The contract prices of Contract A and Contract B are RM15 million and RM18 million respectively. Costs incurred that relate to Contract A amount to RM6 million and the expected further costs to be incurred to satisfy the performance obligation are estimated at RM4 million. For Contract B,

costs incurred to date amount to RM6 million and further costs to satisfy the performance obligation are estimated at RM6 million. At the end of the reporting period, the stage of completion for both contracts is determined at 50% using an output method to measure the progress. Based on the terms of contracts, the customer for Contract A is billed for 50% of the contract price whilst the customer for Contract B is billed for 60% of the contract price.

The relevant recognition requirements of the contracts are as follows:

	Contract A RM'000	Contract B RM'000
Revenue	7,500	9,000
Direct contract expenses	(5,000)	(6,000)
	-----	-----
Gross profit	2,500	3,000
	=====	=====
Receivable (financial asset)	7,500	10,800
	=====	=====
Contracts in progress:		
Costs incurred	6,000	6,000
Recognised profit	2,500	3,000
	-----	-----
	8,500	9,000
Less: Progress billings	(7,500)	(10,800)
	-----	-----
Contract asset / (liability)	1,000	(1,800)
	=====	=====

Note that the Standard uses the terms "contract assets" and "contract liabilities" but does not prohibit an entity from using alternative descriptions in the statement of financial position for those items. For example, an entity may continue to use the term of gross amount due from or to customers, as is currently used in IAS 11.

6.2 Disclosures

The objective of the disclosure requirements is for an entity to disclose sufficient information to enable users to understand the nature, amount, timing and uncertainty of revenue and cash flows arising from contracts with customers. To achieve the objective, an entity shall disclose qualitative and quantitative information about all of the following:

- its contracts with customers;
- the significant judgements, and changes to the judgements, made in applying the Standard to those contracts;
- any assets recognised from the costs to obtain or fulfil a contract with a customer.

An entity uses its judgements to decide on the level of detail necessary and how much emphasis to place on each of the various requirements.

In the statement of comprehensive income, an entity shall disclose;

- revenue recognised from contracts with customers separately from its other sources of revenue; and
- any impairment losses recognised (in accordance with IFRS 9) on any receivables or contract assets arising from an entity's contracts with customers, which shall be disclosed separately from impairment losses from other contracts.

An entity shall 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.

In addition, an entity shall disclose sufficient information to enable users to understand the relationship between the disclosure of disaggregated revenue and revenue information that is disclosed for each reportable segment, if the entity applies IFRS 8 *Operating Segment*.

The other disclosure requirements include information about:

- (a) contract balances;
- (b) performance obligations;
- (c) transaction price allocated to the remaining performance obligations;
- (d) significant judgements in the application of the Standard;
- (e) determining the timing of satisfaction of performance obligations; and
- (f) determining the transaction price and the amounts allocated to the performance obligations

7. Transition

This IFRS is effective for annual reporting periods beginning on or after 1 January 2017 with earlier application permitted. The date of the initial application of this Standard is the start of the reporting period in which an entity first applies this Standard. For example, if an entity applies this Standard for its financial year ending 31 December 2017, the date of initial application is 1 January 2017.

The Standard requires retrospective application with two mutually exclusive methods of effecting the adjustments. An entity applies the Standard:

- (a) retrospectively to each prior period reported in accordance with IAS 8 *Accounting Policies, Changes in Accounting Estimates and Errors* (with some expedient exceptions provided), or
- (b) retrospectively with the cumulative effect of initially applying this Standard recognised at the date of initial application.

8. Implications and How the new IFRS will affect Current Practice

The new IFRS differs from current practice in the following ways:

- (a) Recognition of revenue on long-term contracts with customers – Contracts for the development of an asset (for example, construction, manufacturing and customised software) would result in recognising revenue over time (i.e. using the percentage of completion method) only if the customer controls the asset as it is developed or if the asset has no alternative use to the entity and the entity has an enforceable right to payment for performance completed to date.
- (b) Identification of separate performance obligations – An entity would be required to divide a contract into separate performance obligations for goods or services that are distinct. As a result of those requirements, an entity might separate a contract into units of account that differ from those identified in current practice.
- (c) Licensing and rights to use – The current revenue recognition guidance on accounting for licences of intellectual property is broad. Different interpretations of that guidance have led to significant diversity in the accounting for licences. In IFRS 15, an entity is required to evaluate if a licence to use the entity's intellectual property (for less than the property's economic life) is distinct from other goods or services promised in a contract. If the licence granted is distinct, it is accounted for as a separate performance obligation. Otherwise it is part of the performance obligation to supply goods or services. In either case, the entity needs to determine whether the performance obligation is satisfied over time or at a point in time for revenue recognition. That pattern of revenue recognition might differ from current practice.

- (d) Product warranties – Under the current Standards, a product warranty is accounted as a provision (i.e. a cost accrual). In IFRS 15, if a product warranty includes a service component that is priced or negotiated separately, it is accounted for as a separate performance obligation. A portion of the transaction price would need to be allocated to that performance obligation.
- (e) Use of estimates – In determining the transaction price (for example, estimating variable consideration) and allocating the transaction price on the basis of stand-alone selling prices, an entity is required to use estimates more extensively than in applying existing IFRSs. In the software industry, the practice permitted by the current Standards is to defer revenue recognition when observable prices are not available for upgrades and additional functionality for computer software. IFRS 15 requires that if stand-alone selling prices of the promised goods or services are not available, an entity would allocate the transaction price on the basis of estimated stand-alone selling prices of those goods and services, using either a market assessment approach, a cost plus margin approach, or a residual approach. The entity will recognise revenue as each distinct good or service is transferred to the customer
- (f) Accounting for costs – The new IFRS has requirements for contract costs which might change how an entity would account for some costs. For example, incremental costs to obtain a contract and costs of an anticipated contract can be included in contract costs.
- (g) Disclosure – The new IFRS requires an entity to disclose more information about its contracts with customers than is currently required, including more disaggregated information about recognised revenue and more information about its performance obligations remaining at the end of the reporting period.

9. Conclusion

The new IFRS would correct the weaknesses and deficiencies that are apparent in the current IFRSs on revenue. The five-step approach to revenue accounting would result in systematic and consistent revenue recognition, and thus enhances the comparability characteristic of financial statements.

The nature and extent of the changes will vary between entities and industries. For straightforward contracts for sales of goods or rendering of services, the requirements IFRS 15 would have little, if any, effect on current practice. For other contracts, such as long-term service contracts and multiple-element arrangements, IFRS 15 could result in some changes either to the amount or timing of the revenue recognised by an entity. The changes will only affect some revenue transactions for some entities.

References:

1. ED/2010/6 *Revenue from Contracts with Customers*, June 2010, IASB.
2. ED/2011/6 *Revenue from Contracts with Customers*, November 2011, IASB
3. IAS 11 *Construction Contracts*, March 1979, IASC.
4. IAS 18 *Revenue*, December 1982, IASC.
5. IFRIC 15 *Agreements for the Construction of Real Estate*, July 2008, IFRIC.
6. IFRS 15 *Basis for Conclusions*, May 2014, IASB.
7. IFRS 15 *Project Summary and Feedback Statement*, May 2014, IASB
8. IFRS 15 *Revenue from Contracts with Customers*, May 2014, IASB

Tan Liong Tong is the Project Manager of the MASB Working Group (WG 63) on Consolidation. The views expressed in this article are those of the author and not the official views of the MASB.

Appendix: Accounting Procedures and Presentation

On 30 June 20x5, Entity M enters into a contract with a hotel owner to refurbish the entire 10-storey hotel building. The contract includes replacing and installing new elevators. The contract price is RM16 million, with a clause that if the refurbishment is completed by 30 June 20x6 (within a year), a performance bonus of RM1 million is payable.

Entity M concludes that in this service contract, the supply of labour, materials and the elevators to be installed are a single performance obligation in its promise to refurbish the entire hotel for the owner. It does not manufacture elevators and for the contract with the hotel owner, Entity M needs to acquire the elevators from a third party. The cost for the elevator is estimated at RM4 million and estimated total costs to fulfil the contract is RM12 million. Based on the most likely outcome, Entity M determines that it is highly probable that the refurbishment contract will be completed by 30 June 20x6. To measure the stage of completion, Entity M uses the costs incurred basis (an input method).

As at 31 December 20x5, the following costs are incurred:

	RM'000
Direct labour and supervision	2,000
Direct materials	1,500
Allocated overheads	500
Cost of elevators purchased from 3 rd party	4,000

Total costs incurred to date	8,000
Further costs to complete the contract	4,000

Estimated total costs	12,000
	=====

In this case, the transaction price is RM17 million and it includes the performance bonus because it is the most likely outcome. In measuring the progress at the end of 20x5, the entity excludes the cost of the elevators because that cost does not reflect the performance of the progress to date. The stage of completion is measured at $[8,000 - 4,000] / [12,000 - 4,000] = 50\%$. Based on the terms in the contract, Entity M bills the hotel owner at the end of the year for 40% of the contract price.

The summarised journal entries for this contract for the year ended 31 December 20x5 are as follows:

	RM'000	RM'000
Dr Contract in progress	8,000	
Cr Cash / payables / depreciation allocated etc.		8,000
- <i>to accumulate contract costs as an asset. [IFRS 15.95]</i>		
Dr Receivable (financial asset)	6,400	
Cr Progress billings (40% x 16,000)		6,400
- <i>to recognise receivable when customer is billed. [IFRS 15.105]</i>		
Dr Progress billings	8,500	
Cr Contract revenue in profit or loss (50% x 17,000)		8,500
- <i>to recognise revenue based on stage of completion. [IFRS 15.31]</i>		
Dr Contract expense in profit or loss (50% x 12,000)	6,000	
Cr Contract in progress (amortisation of asset)		6,000
- <i>to recognise amortisation of asset in profit or loss. [IFRS 15.99]</i>		

The relevant presentation in the financial statements for the year ended 31 December 20x5 is as follows:

	RM'000
<i>In the statement of comprehensive income:</i>	
Contract revenue	8,500
Contract expenses	(6,000)

Gross profit	2,500
	=====
<i>In the statement of financial position:</i>	
Receivable (financial asset)	6,400
Contract in progress:	
Costs incurred to date	8,000
Recognised gross profit	2,500

	10,500
Progress billings to date	(6,400)

Contract asset*	4,100
	=====

Note*: The amount is equal to the balance in the contract in progress account of RM2,000 and the accrued progress billings account of RM2,100.