Revenue from Contracts – Essential Issues Under the International Financial Reporting Standards

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ABSTRACT

Contracts with customers are an important area of commercial activities. Internationally, the revenues from contracts with the customers have to be appropriately accounted for to avoid any discrepancies in the process. The International Accounting Standards Board has ensured the necessary guidance for this accounting in the International Financial Reporting Standards itself as adopted in 2014 and made effective from 2018. This is known as IFRS 15 and the issues emerging from the IFRS 15 are discussed in this paper.

Keywords: commercial activities, contracts, financial reporting, revenue

I. INTRODUCTION

Revenue is the life blood of all business and several aspects of accounting in terms of absolute revenue, comparative revenue, total revenue, net revenue, per capita revenue etc. are terms used in accounting standards and are important for accounting purposes as well. Revenue is a critical metric for the statements to be prepared under the Financial Statement for the various types of users. However, there have been confusions, contradictions and debates about the elements to be used for defining revenue. Therefore, various definitions of revenue are existing in the revenue literature especially with different Boards relying on different aspects. For example the IASB and FASB have different definitions and connotations for revenue calculations. Even within each Board there are different guidelines for revenue calculations and guidance for similar transactions of accounting under different standards. The International Accounting Standards Board itself considers that its guidance for revenue is not detailed sufficiently and accurately.

II. OBJECTIVES

This paper aims to achieve the following objectives:

1. To understand the issues of revenue calculations from the contracts assigned in the context of IFRS
2. To discuss the IFRS 15 and the details thereto.

III. METHODOLOGY

For the purpose of this paper, the methodology adopted is analysis of secondary data and content analysis.

IV. BRIEF OVERVIEW OF LITERATURE

Way back in 2002, nearly two decades ago itself, the International Accounting Standards Board initiated its work on the revenue project. Nearly six years later in 2008, the IASB brought out the issues for discussion describing what should constitute accounting for revenue from contracts. The standards were later improved upon in 2010 and 2011 too and was finalized in 2014.

Several studies have been carried out examining the issues of revenue from contracts which later became IFRS 15. The real effects of a new accounting standard: the case of IFRS 15 Revenue from Contracts with Customers was a study that adopted an approach of identifying companies by performing a Google Search for about 48 sample companies.(CJ Napier, C Stadler, 2020). The real effects of a new accounting standard as a case of IFRS 15 of revenue from contracts with customers was also reported.(CJ Napier, C Stadler - 2020). An exploratory study in telecom and construction sectors was carried out as compliance with IFRS 15. In this, literature was reviewed addressing studies on compliance with mandatory disclosures (S Boujelben, S Kobbi-Fakhfakh, 2020). Yet another study was IFRS 15 Early adoption and accounting information: case of real estate companies in Dubai(NS Trabelsi , 2018). Understanding the potential impact of IFRS 15 on the listed companies of telecommunication, by the disclosures' study was another one. (G Mattei, N Paoloni , 2019). Does the IFRS 15 impact earnings management? Initial evidence from Italian listed companies was a study in Italy which wanted to explore the answer to this question. The aim of the present work was to evaluate the impact of IFRS 15which has hypothesized a different level of impact of IFRS 15 (M. Tutino, C. Regoliosi, G. Mattei, 2019). Revenue from Contracts with

Customers under IFRS 15: new perspectives on practice was a study that offered overview of the characteristics of IFRS 15 requirements regarding the confusion of the practitioners.(I Oncioiu, AE Tănase, 2016). A study was conducted in Indonesia where the Tax Administration Issues on Revenue Recognition after IFRS 15 Adoption in Indonesia was analysed. This study aimed to provide a brief and analytical reporting on IFRS 15 adoption in Indonesian Taxpayers' need to underline the burden of compliance arising from the IFRS 15 , it was argued.(PB Saptono, I Khozen, 2021). Revenue recognition practices in South Africa: An analysis of the decision usefulness of IFRS 15 disclosures was also analyzed. The study stressed the importance of the initial implementation of IFRS 15 and the JSE's thematic review of IFRS 15 to ensure quality disclosure and improving the revenue calculations.(D Coetsee and A Mohammadali-Haji, 2022) . Fluctuations of stock price and revenue after the early adoption of IFRS 15, revenue from contracts with customers was investigated (M Aladwan, 2019). Revenue recognition under IFRS 15: a critical evaluation of predefined purposes and implications for improvement and accountants involved or in charge of the implementation of IFRS 15 was considered. IFRS 15 is mainly addressing specific industries, which had difficulties in applying previous IFRS(S Haggenmüller, 2019). Another important literature was "Auditors as intermediaries in the endogenization of an accounting standard: The case of IFRS 15 within the telecom industry". Here, the telecommunications industry representatives around the draft IFRS 15 on revenue recognition, as to the partial endogenization of the draft IFRS 15 was included. (H Kohler, C Pochet, A Le Manh, 2021. Impact of implementation of IFRS 15 on the financial statements of telecommunication company (case study of PT XYZ) was also studied(M Bernoully, LS Wondabio, 2019). IFRS 15 itself will be effective on January 1, 2018, whereas. This study aims to quantify the impact of IFRS 15 to be taken to anticipate the enactment of IFRS 15 and its effective date of implementation. The adequacy of IFRS 15 for revenue recognition in the construction industry, adequacy of the guidance of the IFRS 15 to deal with the IFRS 15 to construction contracts, a structured approach was followed based on the five step approach followed in the IFRS 15 (D. Coetsee, and M Van Wyk, 2020). Perception of Auditors and preparers on IFRS 15: Evidence from Malaysia was studied. The long awaited IFRS 15 Revenue from Contracts with IFRS 15 was in focus. Results of the study revealed that generally Malaysian accountants surveyed are still not ready to adopt IFRS 15 (Y Lim, SS Devi, N Mahzan , 2015). Cumulative effect of IFRS 15 and IFRS 16 on maritime company financial statements: a hypothetical case was reported(N Belesis, J Sorros, A Karagiorgos, 2021). The preparedness to adopt new accounting standards: a study of European companies on the pre-adoption phase of IFRS 15 to the adoption of IFRS 15—"Revenue from Contracts with Customers" was recorded. IFRS 15 draft was also issued. Therefore, IFRS 15 overcomes the previous difference between revenues arising from the contracts (A Quagli, E. Roncagliolo, G. D'Alauro, 2021).

V. THE FIVE STEPS OF IFRS 15 REVENUE MODEL

It can be seen from the above studies that there are Five Steps for the IFRS Revenue Model. These can be mentioned as under:

1. Identification of the contract with a Customer.
2. Identification of all the individual performance obligations within the contract.
3. Determination of the transaction price.
4. Allocation of the price to the performance obligations.
5. Recognition of the revenue as the performance obligations are completed and fulfilled.

Identification of the contract with a customer

For the identification of the contract, certain factors have to be considered such as:

a. The contract has to be approved by the parties to the contract and must committed for the performance.
b. Any entity should be able to identify the rights and obligations in the terms of the contract clearly and unequivocally.
c. The payment terms in the contract and the contract itself should have "Commercial Substance".

Identification of all the individual performance obligations within the contract

Goods or services are to be delivered in terms of any contract with a customer qualifies as a performance obligation if the good or service are "distinct". In this context a goods or services will be distinct if:

a. The stipulated item can be consumed by the customer, either on its own, or in combination with other items that are regularly available to the customer; and
b. The promise to transfer goods or services to a customer can be separately identified from other transfers stipulated in the contract.

Determination of the transaction price

The price to be paid for the transactions will be stipulated in the contract and will be quite easy to calculate. However, certain circumstances require that a transaction price should be estimated by other available methods. For instance, an entity has to measure the amount of non-cash consideration in a contract in terms of IFRS 13: fair value measurement. This is one issue.

Another issue is that a contract can have variable consideration (for example, the transaction price is subject to settlement discount should the client pay within a certain time frame). In this case, the transaction price can be calculated by two methods:

a) The most likely amount: the amount that of considerations that has the highest probability of realizing will be measured as the transaction price, or
b) Expected value approach; in this case the weighted average of possible amounts will be measured as the transaction price.

Both of the above-mentioned are estimates, and should the estimates change, the entity will apply the change prospectively in terms of the criteria of IAS 8.

Lastly IFRS 15 requires that the entity should test for the existence of a "significant financing component" in the contract, this will occur if: "the timing of payments agreed by the parties to the contract provides the customer or the entity with a significant benefit of financing the transfer of goods or services to the customer.

If the above-mentioned is applicable, the transaction price will be adjusted to eliminate the effect of this benefit. This is simply done by calculating the net present value of the payments (if the satisfaction of performance obligations is prior to the payment date), or by calculating the net future value (if the payment date is prior to the satisfaction of performance obligations). The difference (between the amount recognized after adjustment for a significant financing component and amount of consideration to be received) is simply recognized as interest income/ expense in terms of the accrual basis of accounting as mentioned in IAS.

Recognize revenue as the performance obligations are recognized and fulfilled

An entity can recognize revenue when performance obligations have been settled, a performance obligation has been settled when the customer has received all the benefits associated with the performance obligation, and is able to use and enjoy the asset to his or her own discretion.

Performance obligations settled over time

The performance obligations will be settled in the measure of progress towards completion, the measure of progress can be either based on the inputs (in the case of manufactured goods), or the output method.

Contract Asset being recognized

IFRS 15 introduced a new accounting term: contract asset. It is an asset corresponding to accrued revenue when the payment from a customer is conditional not only on the passage of time and hence a typical trade receivable cannot be recognized.

Implementation Date

IFRS 15, as amended, is effective for the first interim period within annual reporting periods beginning on or after January 1, 2018, with early adoption permitted. The FASB's standard (ASC 606) is effective for public entities for the first interim period within annual reporting periods beginning after December 15, 2017 (nonpublic companies have an additional year).

VI. CONCLUSION

Thus, it can be noted that IFRS 15 as a reporting standard has attempted to address the concerns of calculation of the revenue arising from contracts. Studies have brought out the different dimensions of the International Financial Reporting Standards pertaining to the IFRS 15 which has an impact on the revenue calculation from the contracts.

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