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THE INSTITUTE OF CHARTERED ACCOUNTANTS OF SRI LANKA

SL-25-1 – Advanced Corporate Reporting

Strategic Level (2025 Curriculum)

- SLFRS 15 – Revenue from Contract with Customers

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Revenue from Contract with Customers

SLFRS 15

1. INTRODUCTION

SLFRS 15 Revenue from Contracts with Customers is applicable to all contracts with customers with limited exceptions. It provides guidance on the recognition and measurement of revenue, costs associated with a contract and amounts to be recognised in the statement of financial position.

1.1 Scope

SLFRS 15 applies to all contracts with customers except:

- Leases within the scope of SLFRS 16 Leases
- Insurance contracts within the scope of SLFRS 17 Insurance Contracts
- Financial instruments and other contractual rights and obligations within the scope of SLFRS 9, SLFRS 10, SLFRS 11, LKAS 27 or LKAS 28
- Non-monetary exchanges between entities in the same line of business in order to facilitate sales

1.2 Key definitions

Revenue	Income arising in the course of an entity's ordinary activities
Income	Increases in economic benefits during the accounting period in the form of inflows or enhancements of assets or decreases of liabilities that result in an increase in equity, other than those relating to contributions from equity participants
Customer	A party that has contracted with an entity to obtain goods or services that are an output of the entity's ordinary activities in exchange for consideration
Contract	An agreement between two or more parties that creates enforceable rights and obligations

Revenue does not include sales taxes, value added taxes or goods and service taxes which are only collected for third parties, because these do not represent an increase in economic benefit for the entity.

Revenue is generated through company's ordinary trading and operating activities. It can be different from company to company depending on the industry they are engaged in. Further, it may be called different names, such as sales, turnover or fees

2. REVENUE RECOGNITION PROCESS - The five-step model

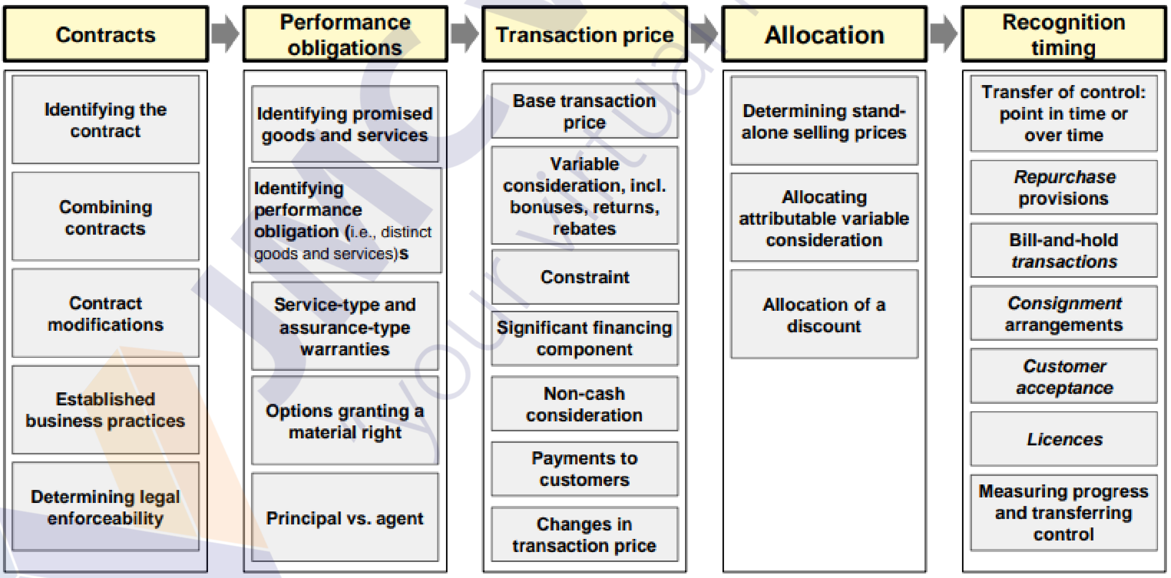
SLFRS 15 provides a five-step model to measure and recognise revenue; the principle of the model is that an entity recognises revenue to depict the transfer of promised goods/services in an amount that reflects the consideration to which the entity expects to be entitled.

Core principle	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.

The **five steps identified by SLFRS 15** are as follows. An entity have to recognize the revenue based on this 5 steps.

- **Step 1** Identify the contract(s) with the customer (as per SLFRS 15)
- **Step 2** Identify the performance obligations within the contract
- **Step 3** Determine the transaction price
- **Step 4** Allocate the transaction price to the performance obligations
- **Step 5** Recognise revenue when (or as) the entity satisfies a performance obligation

2.1 Overview of SLFRS 15



Question 01 – Five Step Model - Overview

On 1 December 2021, Wade receives an order from a customer for a computer as well as 12 months of technical support. Wade delivers the computer (and transfers its legal title) to the customer on the same day. The customer paid $420 on 1

December 2021. The computer normally sells for $300 and the technical support for $120.

Required: Apply the 5 stages of revenue recognition, per SLFRS 15, to determine how much revenue Wade should recognize in the year ended 31 December 2021

STEP 01 - IDENTIFY THE CONTRACT(S) WITH THE CUSTOMER

The standard defines a 'contract' as an agreement between two or more parties that creates enforceable rights and obligations and species that enforceability is a matter of law. Contracts can be written, oral or implied by an entity's customary business practices. ***(Para 10)***

A contract does not exist when each party has the unilateral right to terminate a wholly unperformed contract without compensation. ***(Para 12)***

- A contract is wholly unperformed when the entity has not yet transferred any promised goods or services to the customer and the entity has not yet received, and is not yet entitled to receive, any consideration in exchange for promised goods or services.

A contract with a customer is in the scope of the standard when it is legally enforceable and **meets all of the following criteria**. ***(Para 09)***

- the parties to the **contract have approved** the contract and are committed to perform their respective obligations
- the entity can identify **each party's rights** regarding the goods or services to be transferred
- the entity can identify the **payment terms** for the goods or services to be transferred
    - *When there is an enforceable right to payment and contract contains sufficient information to enable the entity to estimate the transaction price*
- the contract has **commercial substance** (ie the risk, timing or amount of the entity's future cash flows is expected to change as a result of the contract)
    - *The entity must be able to demonstrate a substantive business purpose exists, considering the nature and structure of its transactions.*
- it is probable that the entity **will collect the consideration** to which it will be entitled in exchange for the goods or services that will be transferred to the customer

These criteria are **assessed at the inception** of the arrangement

- If the criteria are met at inception, reassessment only occurs if there is a significant change in facts and circumstances

- If the criteria are not met at inception, continue to reassess

Collectability assessment

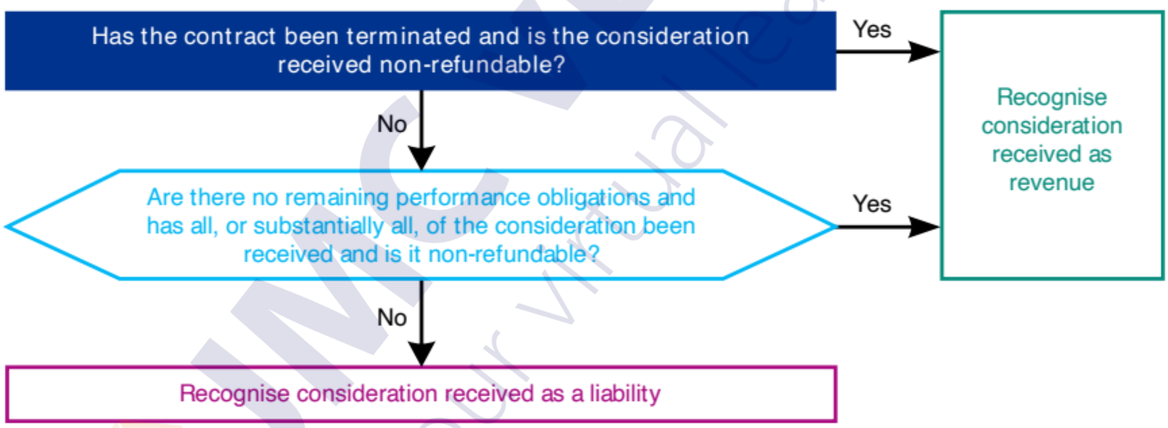
Collectability	Collectability refers to the customer's **intent** and **ability** to pay the amount of promised consideration

In making the collectability assessment, an entity considers the customer's **ability** and **intention** (which includes assessing its credit-worthiness) to pay the amount of consideration when it is due. This assessment is made **after taking into account any price concessions** that the entity may offer to the customer. So it will be assessed whether it is **probable** that the price will be collected.

However, **significant judgement** will be required to determine if a partial payment is an implied price concession or an impairment loss.

Consideration received before a contract exists *(Para 15-16)*

The following -flowchart outlines when consideration received from a contract that is not yet in the scope of the standard can be recognized.



The entity is, however, required to reassess the arrangement and, if Step 1 of the model is subsequently met, begin applying the revenue model to the arrangement.

Question 02 – Identifying the contract

An entity, a real estate developer, enters into a contract with a customer for the sale of a building for Rs.1 million. The customer intends to open a restaurant in the building. The building is located in an area where new restaurants face high levels of competition, and the customer has little experience in the restaurant industry.

The customer pays a non-refundable deposit of Rs.50,000 at inception of the contract and enters into a long-term financing agreement with the entity for the remaining 95% of the promised consideration. The financing arrangement is provided on a non-recourse basis, which means that if the customer defaults, the entity can repossess the building, but cannot seek further compensation from the customer, even if the collateral does not cover the full value of the amount owed.

The entity's cost of the building is Rs.600,000. The customer obtains control of the building at contract inception.

Required: Identify how the above arrangement would be treated under SLFRS 15.

STEP 02 - IDENTIFY THE PERFORMANCE OBLIGATIONS WITHIN THE CONTRACT

A contract contains **promises** to the customer (eg to deliver goods, provide a service or construct an asset). These **promises may form one or more separate performance obligations**.

Where a contract contains a single promise, it is clear that there is a single performance obligation; **where a contract contains a number of promises** (eg where an entity promises to deliver a training course and provide text books) then the **seller must determine how many performance obligations** are contained within the contract. The number of performance obligations may not be equal to the number of identified promises because promises may be combined.

Performance Obligation	An entity assesses the goods or services promised in a contract with a customer and identifies as a performance obligation either a: • **good or service** (or a bundle of goods or services) that is ***distinct*** • **series of *distinct* goods or services** that are substantially the same and that have the same pattern of transfer to the customer *(i.e. each distinct good or service in the series is satisfied over time and the same method is used to measure progress)*

Distinct goods or services *(Para 22)*

A single contract may contain promises to deliver to the customer more than one good or service.

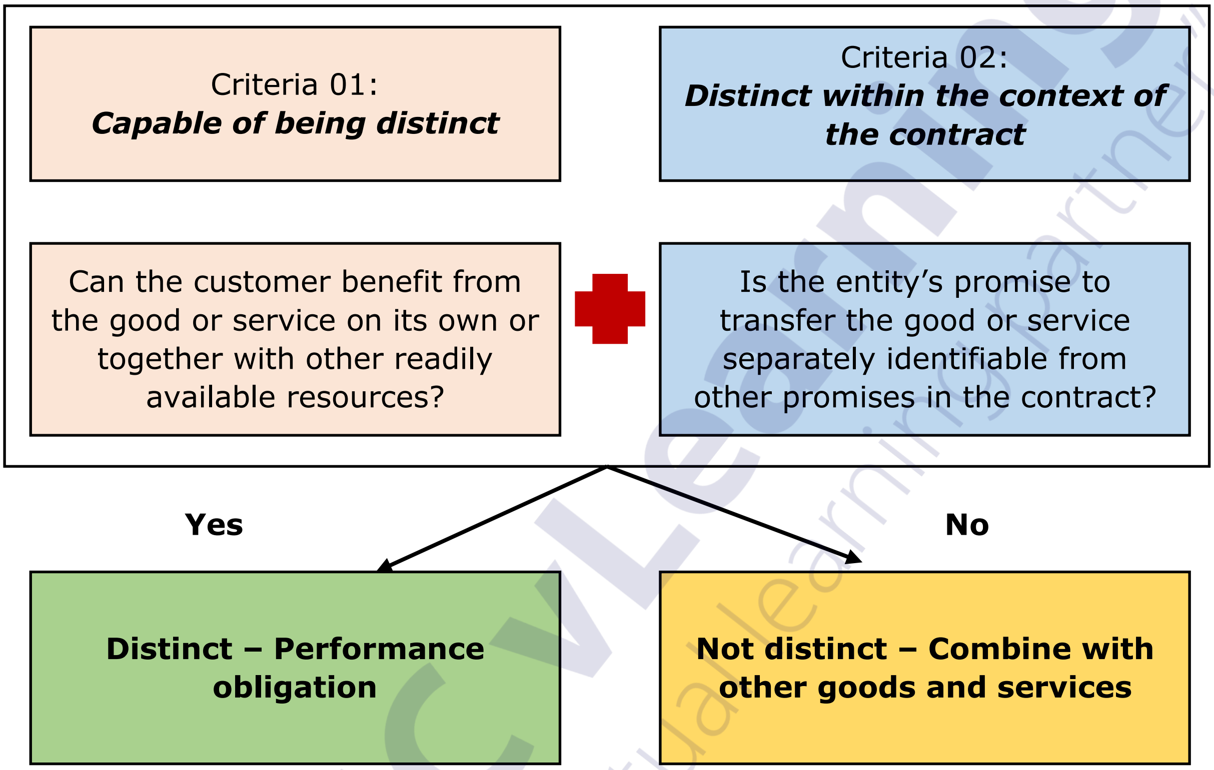
For example:

- *An entity may enter into a contract with a customer to **sell a car**, which includes one year's free **servicing and maintenance**.*

- *An entity might enter into a contract with a customer to provide 5 **lectures**, as well as to provide a **textbook** on the first day of the course.*

At **contract inception**, an entity evaluates the promised goods or services to determine which goods or services (or bundle of goods or services) are distinct and therefore constitute performance obligations. ***(Para 22)***

A good or service is '**distinct'** if **both of the following** criteria are met.



Citeria 01: Good or service is capable of being distinct *(28)*	A customer can benefit from a good or service if it can be used, consumed, sold for an amount that is greater than scrap value or otherwise held in a way that generates economic benefits. A customer can benefit from a good or service on its own or in conjunction with: • other readily available resources that are sold separately by the entity or by another entity; or • resources that the customer has already obtained from the entity (e.g. a good or service delivered up-front) or from other transactions or events. The fact that a **good or service is regularly sold separately** by the entity is an indicator that the customer can benefit from

	a good or service on its own or with other readily available resources.
Citeria 02: Good or service is capable of being distinct ***(29)***	The **objective** when assessing whether an entity's promises to transfer goods or services are distinct within the context of the contract is **to determine whether the nature of the promise** is to transfer each of those goods or services **individually**, or whether the promise is to transfer a **combined** item or items to which the promised goods or services are inputs. The standard provides the **following indicators** to help in evaluating whether two or more promises to transfer goods or services to a customer are **not separately identifiable**. • The entity provides a significant service of **integrating** the goods or services with other goods or services promised in the contract into a bundle of goods or services that represent the **combined** output or outputs for which the customer has contracted. This occurs when the entity is using the goods or services as inputs to produce or deliver the output or outputs specified by the customer. A combined output (or outputs) might include more than one phase, element or unit. • One or more of the goods or services **significantly modifies or customizes**, or is significantly modified or customized by, one or more of the other goods or services promised in the contract. • The goods or services are **highly interdependent** or **highly inter-related**, such that each of the goods or services is significantly affected by one or more of the other goods or services

If a promised good or service is determined not to be distinct, then an entity continues to combine it with other promised goods or services until it identifies a bundle of goods or services that is distinct. In some cases, this results in the entity accounting for all of the goods or services promised in a contract as a single performance obligation.

Question 03 – Identifying the performance obligations

Contractor Q, a construction firm, enters into a contract with a customer to **design** and **construct** a concert hall. The project has two phases, design and construction and the contract provides separate compensation for each phase. Assume that the individual goods and services provided in each phase are capable of being distinct.

Contractor Q provides a significant service of: (1) integrating the various design services to produce project plans in the design phase; and (2) integrating the various materials and construction services to build the concert hall in the construction phase.

Required: Identify how many performance obligations are included in the above arrangement as per SLFRS 15.

Question 04 – Identifying the performance obligations

Construction Company C enters into a contract with Customer D to design and build a hospital. C is responsible for the overall management of the project and identifies goods and services to be provided – including engineering, site clearance, foundation, procurement, construction, piping and wiring, installation of equipment and finishing.

C identifies goods and services that will be provided during the hospital construction that might otherwise benefit D on its own. For example, if each construction material is sold separately by other entities, then it could be resold for more than scrap value by D. It could also be sold together with other readily available resources such as additional materials or the services of another contractor.

Required: Identify how many performance obligations are included in the above arrangement as per SLFRS 15.

Question 05 – Identifying the performance obligations

Telco T has a contract with Customer R that includes the delivery of a handset and two years of voice and data services. The handset can be used by R to perform certain functions – e.g. calendar, contacts list, email, internet access, accessing apps via Wi-Fi and to play music or games.

Additionally, there is evidence of customers reselling handsets on an online auction site and recapturing a portion of the selling price of the phone. T also regularly sells its voice and data services separately to customers, through renewals or sales to customers who acquire handsets from an alternative vendor – e.g. a retailer.

Required: Identify how many performance obligations are included in the above arrangement as per SLFRS 15.

Question 06 – Identifying the performance obligations

Kandy Office Solutions (KOS) has developed a communications software package called CommSoft. KOS has entered into a contract with a customer to supply the following:

(a) License to use CommSoft
(b) Installation service. This may require an upgrade to the computer operating system, but the software package does not need to be customized.
(c) Technical support for three years
(d) Three years of updates for CommSoft KOS is not the only company able to install CommSoft, and the technical support can also be provided by other companies.

The software can function without the updates and technical support.

Required: Explain whether the goods or services provided to the customer are distinct in accordance with SLFRS 15 Revenue from contracts with customers.

Series of distinct goods or services *(Para 22)*

A contract may contain promises to deliver a series of distinct goods or services that are substantially the same. At contract inception, an entity assesses the goods or services promised in the contract and determines whether the series of goods or services is a single performance obligation. This is the case when they meet the following criteria.

The goods or services are substantially the same

+

Each distinct good or service in the series is a performance obligation satisfied over time

+

The same method would be used to measure progress towards satisfaction of each distinct good or service in the series

=

A single performance obligation

Question 07 – Identifying the performance obligations

Contract Manufacturer X agrees to produce 1,000 customized widgets for use by Customer C in its products. X concludes that the widgets will transfer to C over time because:

- they have no alternative use to X; and
- C is contractually obliged to pay X for any finished or in-progress widgets, including a reasonable margin, if C terminates the contract for convenience.

X already has the process in place to produce the widgets and is given the design by C, such that X does not expect to incur any significant learning curve or design and development costs. X uses a method of measuring progress towards complete satisfaction of its manufacturing contracts that takes into account work in progress and finished goods controlled by C.

Required: Identify how many performance obligations are included in the above arrangement as per SLFRS 15.

STEP 03 - DETERMINE THE TRANSACTION PRICE

The '**transaction price**' is the amount of consideration to which an entity expects to be entitled in exchange for transferring goods or services to a customer, excluding amounts collected on behalf of third parties – *e.g. certain sales taxes. To determine this amount, an entity considers multiple factors*

In determining the transaction price, an entity considers the following components.

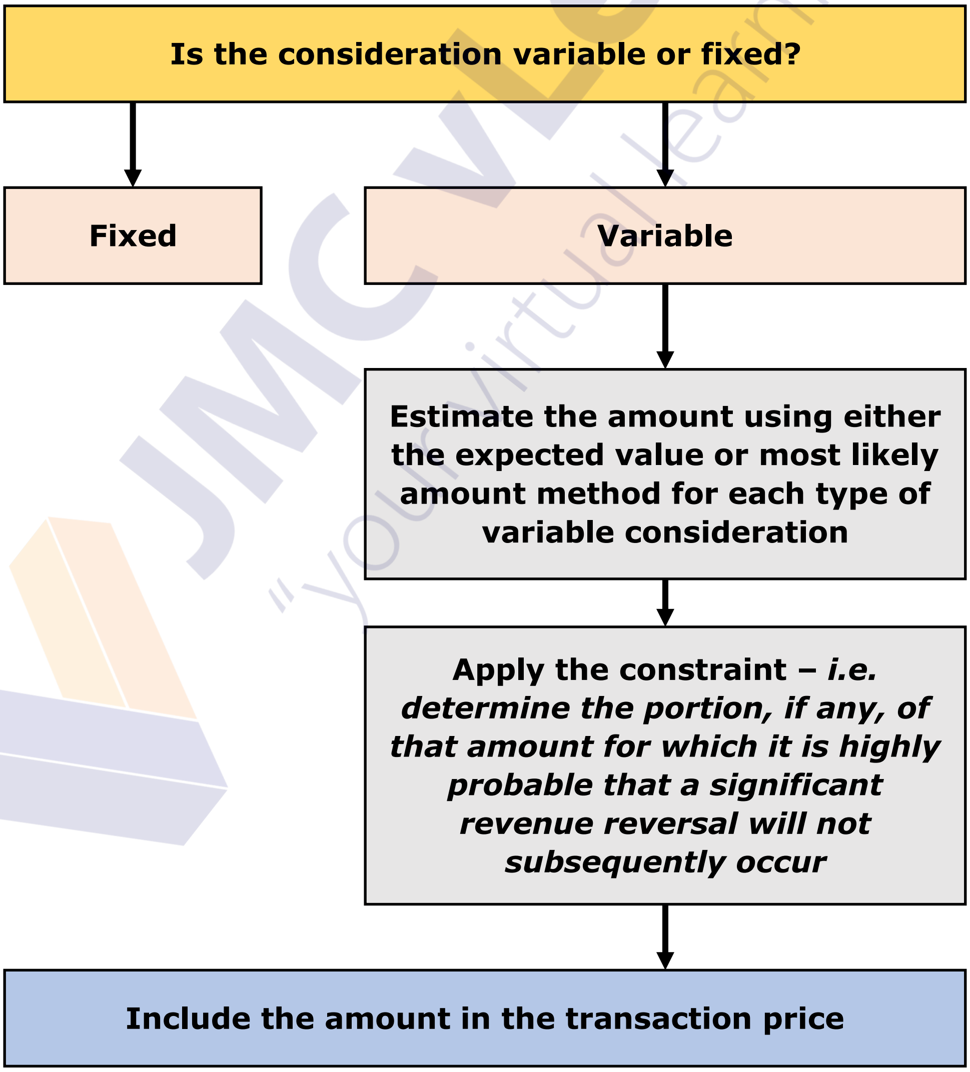
- **Variable consideration** (and the constraint)
  - *An entity estimates the amount of variable consideration to which it expects to be entitled, giving consideration to the risk of revenue reversal in making the estimate*
- **Significant financing component**
  - *For contracts with a significant financing component, an entity adjusts the promised amount of consideration to reflect the time value of money*
- **Non-cash consideration**
  - *Non-cash consideration is measured at **fair value**, if that can be reasonably estimated; if not, then an entity uses the stand-alone selling price of the good or service that was promised in exchange for non-cash consideration*
- **Consideration payable to a customer**
  - *An entity needs to determine whether consideration payable to a customer represents a **reduction of the transaction price**, a payment for a distinct good or service, or a combination of the two*

Variable consideration (and the constraint)

An entity assesses whether, and to what extent, it can include an amount of variable consideration in the transaction price at contract inception. This might include,

• Discounts	• Rebates	• Refunds	• Rights of return
• Early settlement discounts	• Credits	• Price concessions	• Incentives
• Performance bonuses	• Penalties		

- Promised consideration **can also vary if it is contingent** on the occurrence or non-occurrence of a future event – *e.g. the sale of an office building in which the consideration depends on the level of occupancy of the building at a future date*.
- Variability may be explicit or implicit, arising from customary business practices, published policies or specific statements, or any other facts and circumstances that would create a valid expectation by the customer.



An entity recognizes a refund liability for consideration received or receivable if it expects to refund some or all of the consideration to the customer.

Estimation of variable consideration *(Para 53)*

When estimating the transaction price for a contract with variable consideration, an entity's initial measurement objective is to determine which of the following **methods** best predicts the consideration to which the entity will be entitled.

Expected value	• The entity considers the **sum of probability-weighted amounts** for a range of possible consideration amounts. • This may be an appropriate estimate of the amount of variable consideration if an entity has **a large number of contracts** with similar characteristics
Most likely amount	• The entity considers the **single most likely amount** from a range of possible consideration amounts. • This may be an appropriate estimate of the amount of variable consideration if the **contract has only two (or perhaps a few) possible outcomes**.

Question 08 – Variable consideration – Expected Value

Electronics Manufacturer M sells 1,000 televisions to Retailer R for 500,000 (500 per television). M provides price protection to R by agreeing to reimburse R for the difference between this price and the lowest price that it offers for that television during the following six months. Based on M's extensive experience with similar arrangements, it estimates the following outcomes.

Price reduction in next 6 months	Probability
0	70%
50	20%
100	10%

Required: Identify what shall be the transaction price as per SLFRS 15.

Question 09 – Variable consideration – Most Likely Outcome

Construction Company C enters into a contract with Customer E to build an asset. Depending on when the asset is completed, C will receive either 110,000 or 130,000.

Outcome	Consideration	Probability
Project completes on time	130,000	90%
Project is delayed	110,000	10%

Required: Identify what shall be the transaction price as per SLFRS 15.

Question 10 – Variable consideration – Volume Discount

Fonseka Solutions Company (FSC) supplies laptop computers to large businesses. On 1 July 2015, FSC entered into a contract with a customer, under which the customer was to purchase laptops at Rs. 113,000 per unit.

The contract states that if the customer purchases more than 500 laptops in a year, the price per unit is reduced retrospectively to Rs. 100,000 per unit. FSC's year end is 30 June.

(a) As at 30 September 2015, the customer had bought 70 laptops from FSC. FSC therefore estimated that the customer's purchases would not exceed 500 in the year to 30 June 2016, and it would therefore not be entitled to the volume discount.

(b) During the quarter ended 31 December 2015, the customer expanded rapidly as a result of a substantial acquisition and purchased an additional 250 laptops from FSC. FSC then estimated that the customer's purchases would exceed the threshold for the volume discount in the year to 30 June 2016.

Required: Advise how much revenue is recognized in the quarters ended 30 September 20X5 and 31 December 2015.

Refunds

If a product is sold with a right to return it then the consideration is variable. The entity must estimate the variable consideration and decide whether or not to include it in the transaction price. The refund liability should equal the consideration received (or receivable) that the entity does not expect to be entitled to.

Question 11 – Variable consideration – Refund

Nardone enters into 50 contracts with customers. Each contract includes the sale of one product for $1,000. The cost to Nardone of each product is $400. Cash is received upfront and control of the product transfers on delivery. Customers can return the product within 30 days to receive a full refund. Nardone can sell the returned products at a profit.

Nardone has significant experience in estimating returns for this product. It estimates that 48 products will not be returned.

Required: How should the above transaction be accounted for?

STEP 03 - DETERMINE THE TRANSACTION PRICE *(Continued)*

Significant Financing Component Exists within the Contract

To estimate the transaction price in a contract, an entity adjusts the promised amount of consideration for the time value of money if that contract contains a significant financing component ***(para 60)***.

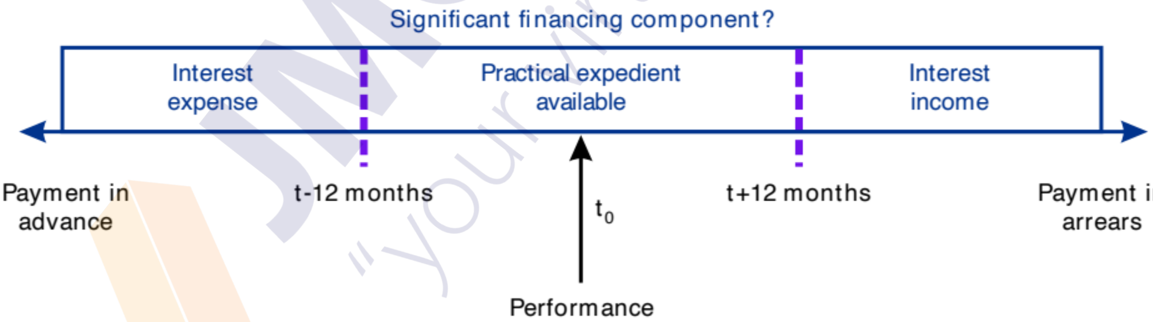
This is **because**, the transaction price should reflect the cash price of the goods or services provided at the date when control of those goods or services passes to the customer.

If payment is either before or after this date, the payable amount is adjusted for the time value of money and the seller recognizes a **finance cost** (in the case of payment before) or **interest income** (in the case of later payment). This finance income or finance cost is **recognized separately** from the revenue ***(Para 65)***.

Customer pays in arrears (In a later date after the control of good or service is passed)	Entity is providing financing to the customer
Customer pays in advance (In a date before the control of good or service is passed)	Entity is receiving financing from the customer

The **discount rate** used is the rate that would be reflected in a separate financing transaction between the entity and the customer at contract inception.

Available practical expedient	**Adjustment is not required** where payment is within one year of the date on which promises goods or services are transferred. ***(Para 63)***



Following can be identified as **indicators** that a financing component exists.

- the **difference** between the amount of promised consideration and the cash selling price of the promised goods or services
- the **length** of time between the transfer of the promised goods or services to the customer and the payment date.

However, contract **does not have a significant financing component** if any of the following factors exists.

- An entity receives an advance payment, and the timing of the transfer of goods or services to a customer is at the discretion of the customer
    - *Ex: A prepaid phone card or customer loyalty points*
- A substantial portion of the consideration is variable, and the amount or timing of the consideration is outside the customer's or entity's control
    - *Ex: A transaction whose consideration is a sales-based royalty*
- The difference between the amount of promised consideration and the cash selling price of the promised goods or services arises for non-finance reasons
    - *Ex: Protection against a counterparty not completing its obligations under the contract*

Question 12 – Significant Financing Component

During 2018, Kelani Construction enters into a contract to build a building for a customer. Completion of the building is scheduled for two year's time and control will pass to the customer at this time. Rather than pay Rs. 291.6 million on completion, the customer agrees to pay a reduced price of Rs. 250 million at the inception of the contract (two years before completion). A borrowing rate of 8% would apply to a loan between Kelani Construction and its customer.

Required: Explain the accounting treatment with accounting entries to recognize the sale transaction as per SLFRS 15.

Question 13 – Significant Financing Component

Kelani Construction enters into a contract to build a clinic for a private hospital chain. The clinic is completed and control passes to the hospital chain on 1 May 20X8 and Kelani agrees that the customer will benefit from 1 year's interest free credit, paying Rs. 180million on 1 May 2019 rather than Rs. 171million when control of the clinic passes.

Required: Explain the accounting treatment with accounting entries to recognize the sale transaction as per SLFRS 15.

Non-cash consideration

Non-cash consideration received from a customer is measured at **fair value**. If an entity cannot make a reasonable estimate of the fair value, then it refers to the estimated selling price (standalone selling price) of the promised goods or services. ***(Para 67)***

Question 14 – Non-cash consideration

Dan sold a good to Stan. Control over the good was transferred on 1 January 2021. The consideration received by Dan was 1,000 shares in Stan with a fair value of $4 each. By 31 December 2021, the shares in Stan had a fair value of $5 each.

Required: How much revenue should be recognized from this transaction in the financial statements of Dan for the year ended 31 December 2021?

Consideration payable to a customer

Consideration payable to a customer includes cash amounts that an entity pays or expects to pay to the customer or to other parties that purchase the entity's goods or services from the customer. (Para 70)

An entity evaluates the consideration payable to a customer to determine whether the amount represents a reduction of the transaction price, a payment for distinct goods or services or a combination of the two.

Accounting treatment depending on the scenario is as follows.

Scenario	Accounting Treatment
The consideration payable to a customer (or to the customer's customer) represent **a payment for a distinct good or service** and the entity reasonably **estimate the fair value** of the good or service received.	Consideration payable is accounted for as a **purchase from suppliers**
The consideration paid to a customer is **not in exchange for a distinct good or service**, and the entity **cannot estimate the fair value** of the good or service received.	Consideration payable is accounted for as a reduction in the **transaction price**.

Question 15 – Consideration payable to a customer

Golden Gate enters into a contract with a major chain of retail stores. The customer commits to buy at least $20 million of products over the next 12 months. The terms of the contract require Golden Gate to make a payment of $1 million to compensate the customer for changes that it will need to make to its retail stores to accommodate the products. By the 31 December 2021, Golden Gate has transferred products with a sales value of $4 million to the customer.

Required: How much revenue should be recognized by Golden Gate in the year ended 31 December 2021?

STEP 04 - ALLOCATE THE TRANSACTION PRICE TO THE PERFORMANCE OBLIGATIONS IN THE CONTRACT

The transaction price is allocated to each performance obligation *(generally each distinct good or service)* to depict the amount of consideration to which an entity expects to be entitled in exchange for transferring the promised goods or services to the customer ***(Para 75)***.

An entity generally allocates the transaction price to each performance obligation in proportion to its **stand-alone selling price** ***(Para 74)***. However, when specified criteria are met a **discount or variable consideration** is allocated to one or more performance obligations.

This step of the revenue model comprises two sub-steps that an entity performs at contract inception.

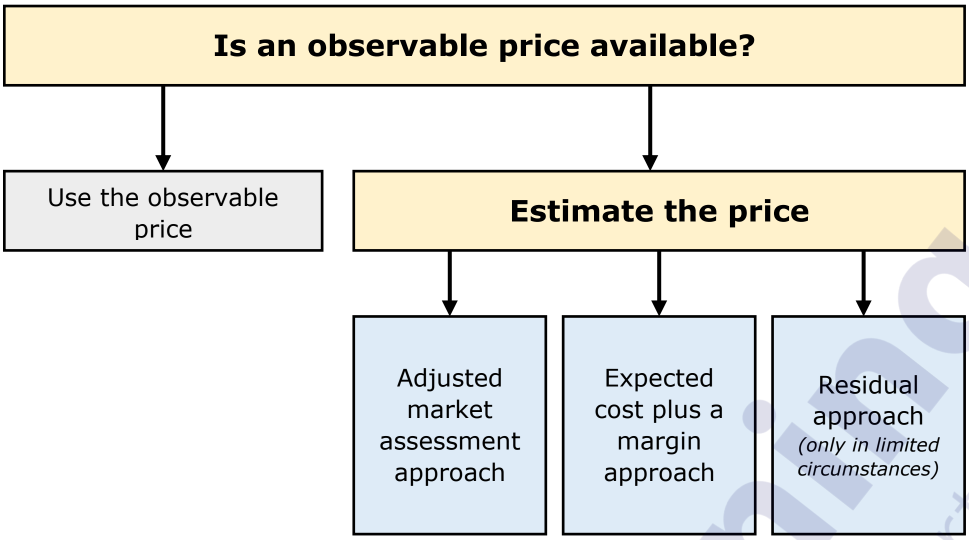
Determine the stand-alone selling price

Allocate the transaction price

Determine the stand-alone selling price

The 'stand-alone selling price' is the price at which **an entity would sell a promised good or service separately to a customer**. The **best evidence** of this is **an observable price from stand-alone sales** of the good or service to similarly situated customers ***(Para 77)***.

If the stand-alone selling price is not directly observable, then the entity estimates the amount using a suitable method as illustrated below. In limited circumstances, an entity may estimate the amount using the residual approach.



Estimating stand-alone selling prices

Adjusted market assessment approach	Evaluate the market in which goods or services are sold and estimate the price that customers in the market would be willing to pay
Expected cost plus a margin approach	Forecast the expected costs of satisfying a performance obligation and then add an appropriate margin for that good or service
Residual approach (limited circumstances)	Subtract the sum of the observable stand-alone selling prices of other goods or services promised in the contract from the total transaction price

Allocating a discount

If the sum of the stand-alone selling prices of a bundle of goods or services exceeds the promised consideration in a contract, then the discount is generally allocated proportionately to all of the performance obligations in the contract. However, this does not apply if there is observable evidence that the entire discount relates to only one or more but not all of the performance obligations.

Question 16 – Allocation of transaction price

Lankacom provides customers with package deals which include a mobile phone handset and network services for 12 months. The company advertises 'A free handset and 12 months of unlimited calls, texts and data for just Rs. 9,000 per month'. Lankacom also sells the handset on a stand-alone basis for Rs. 100,000 and provides a network sim card giving unlimited calls, texts and data for Rs. 2,500 a month.

Required: What is the transaction price and how is it allocated to the performance obligations in the package deal?

Question 17 – Allocation of transaction price

Shred sells a machine and one year's free technical support for $100,000. The sale of the machine and the provision of technical support have been identified as separate performance obligations. Shred usually sells the machine for $95,000 but it has not yet started selling technical support for this machine as a stand-alone product. Other support services offered by Shred attract a mark-up of 50%. It is expected that the technical support will cost Shred $20,000.

Required: How much of the transaction price should be allocated to the machine and how much should be allocated to the technical support?

Question 18 – Allocation of transaction price

Telco C enters into a contract with a residential customer to sell phone, internet and television services for a total amount of 120. C regularly sells the products individually for the following prices. C also regularly sells phone and internet services together for 75.

Product	Stand-alone selling prices
Phone	40
Internet	55
Television	45
Total	**140**

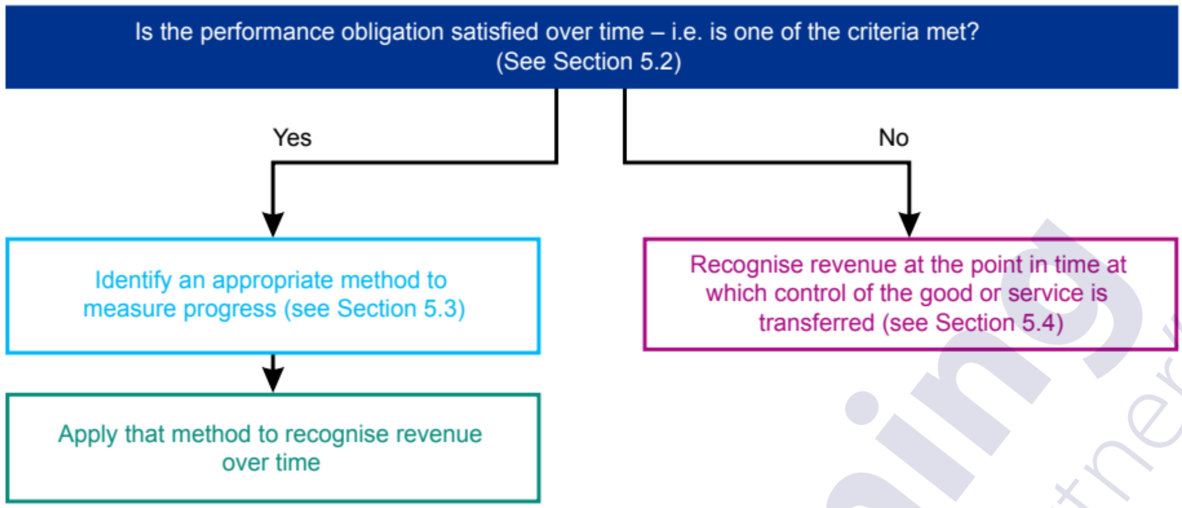
Required: Explain how this need to be treated as per SLFRS 15.

STEP 05 - RECOGNIZE REVENUE AS PERFORMANCE OBLIGATIONS ARE SATISFIED

An entity recognizes revenue when or as it satisfies a performance obligation by **transferring** a good or service to a customer, either at a point in time (when) or over time (as). A good or service is '**transferred'** when or as the customer obtains **control** of it. The analysis of when control transfers is performed primarily from the perspective of the customer.

Performance obligations can be satisfied in two different ways.

- Satisfies over time
- Satisfies at a point in time



Transfer of control

A good or service is transferred to a customer when the customer obtains control of it.

- '**Control**' refers to
  - the customer's ability to **direct the use** of, and
  - obtain **substantially all of the remaining benefits** from, an asset.
  - It also includes the **ability to prevent other entities** from directing the use of, and obtaining the benefits from, an asset.
- Potential cash -flows that are obtained either directly or indirectly – *e.g. from the use, consumption, sale or exchange of an asset – are benefits of an asset.*

Control is…	
the ability	• The customer has a present right
to direct the use of	• The right enables it to: ○ deploy the asset in its activities ○ allow another entity to deploy the asset in its activities ○ prevent another entity from deploying the asset
and obtain the remaining benefits from	• The right also enables it to obtain potential cash flows directly or indirectly – e.g. through: ○ use of the asset ○ consumption of the asset ○ sale or exchange of the asset ○ pledging the asset ○ holding the asset
… an asset	

Performance obligations satisfied over time

If one or more following criteria are met performance obligation in a contract is satisfied over time – i.e. control of the good or service transfers to the customer over time ***(Para 35)***.

	Criteria	Example
1	The customer **simultaneously receives** and consumes the **benefits** provided by the entity's performance as the entity performs	*Routine or recurring services – e.g. cleaning services*
2	The entity's **performance creates or enhances** an asset that the customer controls as the asset is created or enhanced	*Building an asset on a customer's site*
3	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	*Building a specialized asset that only the customer can use or building an asset to a customer's specifications*

For each performance obligation that is satisfied over time, an entity applies a **single method of measuring progress towards complete satisfaction** of the obligation. The objective is to depict the transfer of control of the goods or services to the customer.

To do this, an entity selects an appropriate **output** or **input method**. It then applies that method consistently to similar performance obligations and in similar circumstances.

Method	Description	Example
Output	**Based on direct measurements of the value to the customer** of goods or services transferred to date, relative to the remaining goods or services promised under the contract	• Surveys of performance to date • Appraisals of results achieved • Milestones reached • Time elapsed
Input	**Based on an entity's efforts or inputs** towards satisfying a performance obligation, relative to the total expected inputs into the satisfaction of that performance obligation	• Resources consumed • Costs incurred • Time elapsed • Labour hours expended • Machine hours used

An entity recognizes revenue over time **only** if it can **reasonably measure its progress** towards complete satisfaction of the performance obligation. However, if the entity **cannot reasonably measure** the outcome but expects to recover the costs incurred in satisfying the performance obligation, then it **recognizes revenue to the extent of the costs incurred**.

Performance obligations satisfied at a point in time

If a performance obligation is not satisfied over time, then an entity recognizes revenue **at the point in time** at which it transfers control of the good or service to the customer.

The **indicators** of when the transfer of control occurs are as follows ***(Para 38)***.

1. The supplier has a present **right to payment** for the asset
2. The customer has **legal title** to the asset
    a. *In some situations, controls can be passed but yet the legal title might not passed to customer as the supplier has retained it as a protective right.*
3. The supplier has transferred **physical possession** of the asset
    a. *In consignment arrangements and some repurchase arrangements a seller may have transferred physical possession but still retain control. In contrast in a bill and hold agreement the control is transferred to the customer but the possession will be held by the seller.*
4. The customer has the **significant risks and rewards** of ownership of the asset
5. The customer has **accepted** the asset

Question 19 – Revenue Recognition

Ratwatte Construction (RC) began the construction of a hotel complex for a customer during 2018. The agreed contract price is Rs. 7,500 million however this will be reduced by Rs. 250 million if RC completes the complex a fortnight or more behind schedule.

During the year ended 31 December 2018, costs incurred amounted to Rs. 2,100 million. The total cost of the project is estimated to be Rs. 5,400 million. Work certified at the year-end was Rs. 2,400 million. The construction is currently progressing in accordance with the agreed schedule.

Required:

(a) What is the transaction price?
(b) What amount of revenue is recognized in profit or loss in the year ended 31 December 2018 if an input method is used to assess progress?
(c) What amount of revenue is recognized in profit or loss in the year ended 31 December 2018 if an output method is used to assess progress?

Question 20 – Revenue Recognition

On 31 March 2021, Crawford enters into a contract to construct a specialized factory for a customer. The customer paid an upfront deposit which is only refundable if Crawford fails to complete construction in line with the contract. The remainder of the price is payable when the customer takes possession of the factory. If the customer defaults on the contract before completion of the factory, Crawford only has the right to retain the deposit.

Required: Should Crawford recognize revenue from the above transaction over time or at a point in time?

Question 21 – Revenue Recognition

On 1 January 2021, Baker enters into a contract with a customer to construct a specialized building for consideration of $2 million plus a bonus of $0.4 million if the building is completed within 18 months. Estimated costs to construct the building are $1.5 million. If the contract is terminated by the customer, Baker can demand payment for the costs incurred to date plus a mark-up of 30%.

On 1 January 2021, as a result of factors outside of its control, such as the weather and regulatory approval, Baker is not sure whether the bonus will be achieved. At 31 December 2021, Baker is still unsure whether the bonus target will be met. Baker decides to measure progress towards completion based on costs incurred. Costs incurred on the contract to date are $1.0 million.

Required: How should Baker account for this transaction in the year ended 31 December 2021?

Question 22 – Revenue Recognition

On 31 December 2021, Clarence delivered the January edition of a magazine (with a total sales value of $100,000) to a supermarket chain. Legal title remains with Clarence until the supermarket sells a magazine to the end consumer.

The supermarket will start selling the magazines to its customers on 1 January 2022. Any magazines that remain unsold by the supermarket on 31 January 2022 are returned to Clarence. The supermarket will be invoiced by Clarence in February 2022 based on the difference between the number of issues they received and the number of issues that they return.

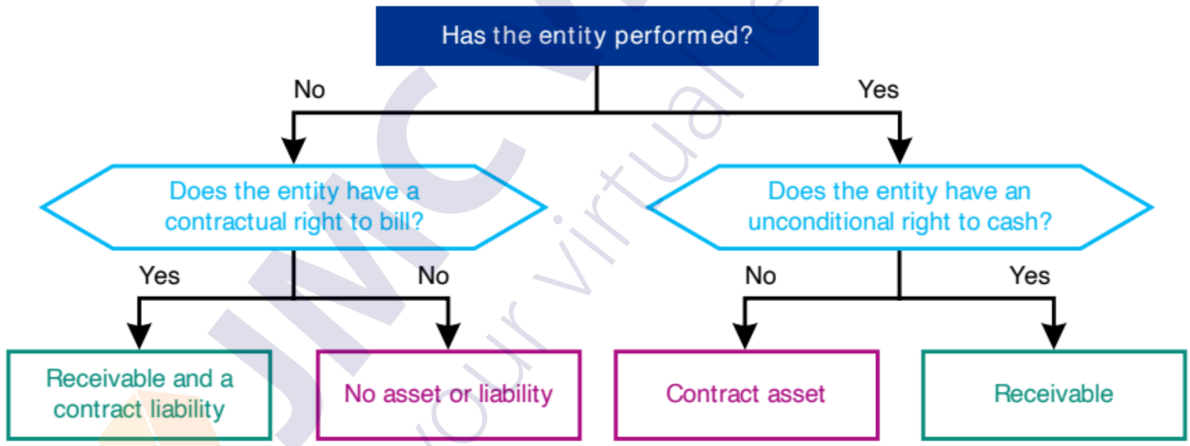
Required: Should Clarence recognize revenue from the above transaction in the year ended 31 December 2021?

PRESENTATION

Contracts with customers are presented in an entity's statement of financial position as a contract liability, a contract asset or a receivable, depending on the relationship between the entity's performance and the customer's mode of payment.

- A **contract liability** is recognized and presented in the statement of financial position where a customer has paid an amount of consideration prior to the entity performing by transferring control of the related good or service to the customer.
- When the entity has performed but the customer has not yet paid the related consideration, this will give rise to either a **contract asset** or a **receivable**.
    - A **contract asset** is recognized when the entity's right to consideration is **conditional** on something other than the passage of time, for instance future performance.
    - A **receivable** is recognized when the entity's right to consideration is **unconditional** except for the passage of time.

Following flowchart may detail further.



DISCLOSURE

The objective is for an entity to disclose sufficient information to enable users of financial statements to understand the nature, amount, timing and uncertainty of revenue and cash flows arising from contracts with customers.

The following amounts should be disclosed unless they have been presented separately in the financial statements in accordance with other standards.

(a) Revenue recognized from contracts with customers, disclosed separately from other sources of revenue

(b) Any impairment losses recognized (in accordance with SLFRS 9) on any receivables or contract assets arising from an entity's contracts with customers, disclosed separately from other impairment losses
(c) The opening and closing balances of receivables, contract assets and contract liabilities from contracts with customers
(d) Revenue recognized in the reporting period that was included in the contract liability balance at the beginning of the period
(e) Revenue recognized in the reporting period from performance obligations satisfied in previous periods (such as changes in transaction price)

Other information that should be provided:

(a) An explanation of significant changes in the contract asset and liability balances during the reporting period
(b) Information regarding the entity's performance obligations, including when they are typically satisfied (upon delivery, upon shipment, as services are rendered etc), significant payment terms (such as when payment is typically due) and details of any agency transactions, obligations for returns or refunds and warranties granted
(c) The aggregate amount of the transaction price allocated to the performance obligations that are not fully satisfied at the end of the reporting period and an explanation of when the entity expects to recognize these amounts as revenue
(d) Judgements, and changes in judgements, made in applying the standard that significantly affect the determination of the amount and timing of revenue from contracts with customers
(e) Assets recognized from the costs to obtain or fulfil a contract with a customer; this would include pre-contract costs and set-up costs; the method of amortization should also be disclosed

Below are extracts from illustrative financial statements.

Consolidated statement of profit or loss

for the year ended 31 December 2024

	Notes	2024	2023	
				IAS 1.10(b)
				IAS 1.51(c)
		€000	€000	
			Restated	*IAS 1.51((c)(e)*
Continuing operations			(Note 2.5)	*IAS 1.81A*
Revenue from contracts with customers	4	179,058	159,088	*IFRS 15.113(a)*
Rental income	18	1,404	1,377	
Revenue		**180,462**	**160,465**	*IAS 1.82(a)*

4.1 Disaggregated revenue information

Set out below is the disaggregation of the Group's revenue from contracts with customers:

	For the year ended 31 December 2024		
Segments	**Fire prevention equipment**	**Electronics**	**Total**
	€000	**€000**	**€000**
Type of goods or service			
Sale of fire prevention equipment	85,438	–	**85,438**
Sale of electronic equipment	–	69,263	**69,263**
Installation services	17,131	–	**17,131**
Others*	7,226	–	**7,226**
Total revenue from contracts with customers	**109,795**	**69,263**	**179,058**
Geographical markets			
Euroland	76,413	50,421	**126,834**
United States	33,382	18,842	**52,224**
Total revenue from contracts with customers	**109,795**	**69,263**	**179,058**
Timing of revenue recognition			
Goods and services transferred at a point in time	90,141	69,263	**159,404**
Services transferred over time	19,654	–	**19,654**
Total revenue from contracts with customers	**109,795**	**69,263**	**179,058**

* Includes revenue from procurement services and service-type warranties.

4.2 Contract balances

	31 December		1 January
	2024	**2023**	**2023**
	€000	**€000**	**€000**
Trade receivables (Note 23)	25,672	22,290	25,537
Contract assets	4,541	5,180	3,450
Contract liabilities (Note 29)	5,842	3,374	2,528

4.3 Right of return assets and refund liabilities

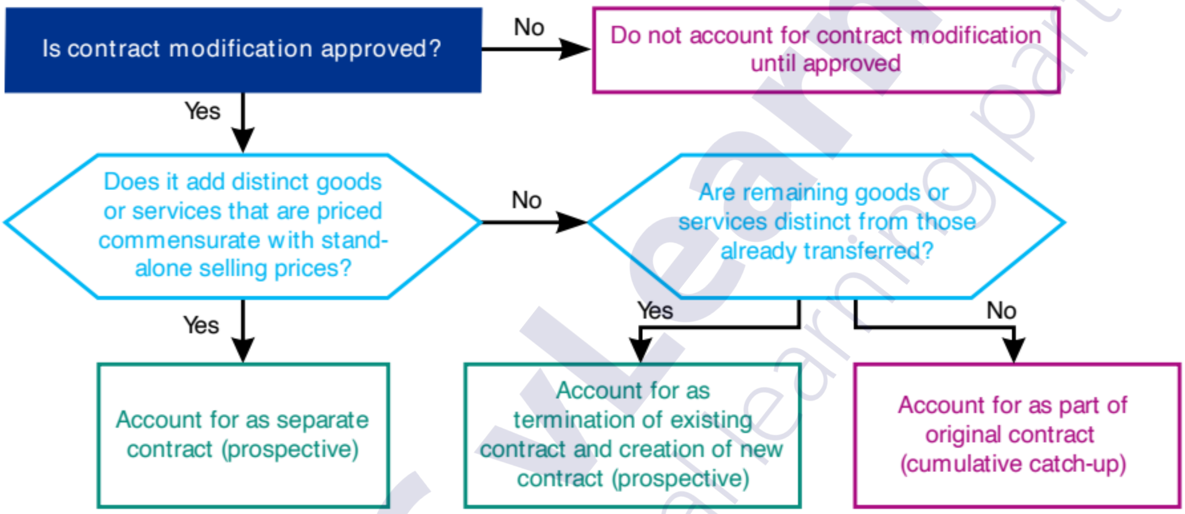
	2024	**2023**
	€000	**€000**
Right of return assets	**1,124**	**929**
Refund liabilities		
Arising from retrospective volume rebates	4,658	4,504
Arising from rights of return	1,584	1,340
	6,242	**5,844**

Other Aspects of SLFRS 15

01. CONTRACT MODIFICATIONS

A 'contract modification' occurs when the parties to a contract **approve** a **change** in its scope, price or both. The accounting for a contract modification depends on whether distinct goods or services are added to the arrangement and on the related pricing in the modified arrangement.

A contract modification is a **change** in the **scope** or **price** of a contract, or **both**. This may be described as a change order, a variation or an amendment.



Based on the above flowchart:

- A contract modification is treated as a **separate contract** (prospective treatment) if it results in ***(Para 20)***:
    - a promise to deliver **additional goods or services that are distinct**; and
    - an **increase in the price** of the contract by an amount of consideration that reflects the entity's stand-alone selling price for those goods or services adjusted to reflect the circumstances of the contract.
- A contract modification is treated as a **termination of existing contract and creation of new contract** (prospective treatment) ***(Para 21)*** when the goods and services transferred according to the new contract are distinct from previously transferred goods and services. Then the accounting treatment will be:
    - the original consideration not yet recognized: plus or minus
    - the additional consideration promised from the modification

- A contract modification is treated as a **a part of existing contract** (cumulative catchup) ***(Para 21)*** when the modification to the contract does not add distinct goods or services. Then the accounting treatment will be:
  - The modification is recognized as either an increase or reduction in revenue at the date of the modification

Question 23 – A new separate contract

Salty enters into a contract to supply 1,000 products to Sweet for $60 each. The products are transferred over an eight-month period, and control passes on delivery. After Salty has transferred 700 products the contract is modified to require an additional 200 products to be transferred (i.e. 1,200 in total). The price for the additional 200 products is $57, **which is the standalone** selling price at the date of the contract modification.

By the reporting date, Salty has transferred 900 products in total to Sweet.

Required: Discuss, with calculations, how much revenue should be recognized in relation to the above by the reporting date as per SLFRS 15.

Question 24 – Termination of existing and creation of new contract

Salty enters into a contract to supply 1,000 products to Sweet for $60 each. The products are transferred over an eight-month period, and control passes on delivery. After Salty has transferred 700 products the contract is modified to require an additional 200 products to be transferred (i.e. 1,200 in total). The price for the additional 200 products is $40, **which is not the standalone** selling price at the date of the contract modification. The normal standalone selling price at the modification date is $57.

By the reporting date, Salty has transferred 900 products in total to Sweet.

Required: Discuss, with calculations, how much revenue should be recognized in relation to the above by the reporting date as per SLFRS 15.

Question 25 – Part of existing contract

X Plc enters into a contract to construct a building for Y Plc for $1 million. X Plc determines that the contract contains a single performance obligation satisfied over time. X Plc uses costs incurred as a percentage of total expected costs as a measure of progress towards complete satisfaction of the performance obligation.

The following forecasts were made at the inception of the contract. Transaction price $ 1,000,000 and Total expected costs $700,000.

By the end of year 1 X Plc has incurred costs to date of $420,000 which is 60% of the total expected costs ($700,000).

The contract is modified, early in year 2, by changing the specification for the location of the stairwells. The customer agreed to pay an extra $250,000 for the modification resulting in a new total contract price of $1,250,000. The expected extra cost of the modification is $100,000 so that the total expected costs become $800,000.

Required: Discuss, with calculations, this need to be accounted in year 1 and 2 as per SLFRS 15.

02. CONTRACT COSTS

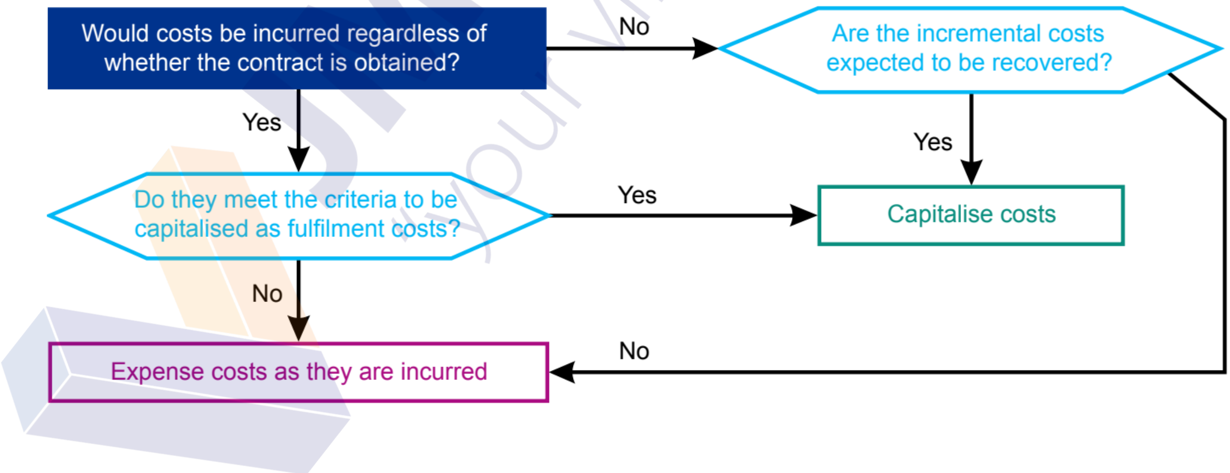
SLFRS 15 provides guidance on the costs of obtaining and the cost of fulfilling a contract.

Costs of obtaining a contract

An entity **capitalizes** incremental costs to obtain a contract with a customer – e.g. sales commissions – **if it expects to recover those costs (Para 91)**. However, as a **practical expedient** an entity is not required to capitalize the incremental costs to obtain a contract if the amortization period for the asset is one year or less.

Costs that will be **incurred regardless** of whether the contract is obtained – including costs that are incremental to **trying** to obtain a contract – **are expensed** as they are incurred, unless they meet the criteria to be capitalized as fulfillment costs.

- *An example is costs to prepare a bid, which are incurred even if the entity does not obtain the contract.*

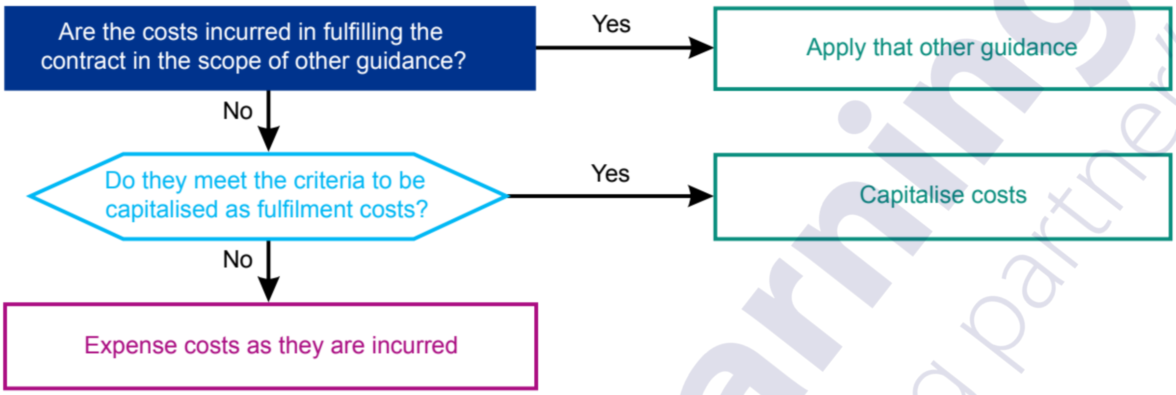


Costs of fulfilling a contract

If the costs incurred in fulfilling a contract with a customer are **not in the scope of other guidance** – *e.g. inventory, intangibles or property, plant and equipment* – then an entity **recognizes an asset** only if the fulfilling costs meet **the following criteria**:

- they **relate directly** to an existing contract or specic anticipated contract;
- they **generate or enhance resources** of the entity that will be used to satisfy performance obligations in the future; and
- they are **expected to be recovered**.

If the costs incurred to full a contract are in the scope of other guidance, then the entity accounts for them using the other guidance.



When costs are not in the scope of other guidance, an entity considers whether they are directly related to a contract or an anticipated contract. The following are **examples of costs that are capitalized** when the specified criteria are met and of **costs that cannot be capitalized**.

Direct costs that are eligible for capitalization if other criteria are met	Costs required to be expensed when they are incurred
• **Direct labour**: e.g. employee wages • **Direct materials**: e.g. supplies • **Allocation of costs that relate directly to the contract**: e.g. depreciation and amortization • **Costs that are explicitly chargeable to the customer under the contract** • **Other costs that were incurred only because the entity entered into the contract**: e.g. subcontractor costs	• **General and administrative costs**: unless they are explicitly chargeable under the contract • **Costs that relate to satisfied (or partially satisfied) performance obligations** • **Costs of wasted materials, labour or other contract costs** • **Costs that do not clearly relate to unsatisfied or partially satis-fied performance obligations**

<u>Amortization of capitalized costs</u>

An entity amortises the asset recognised for the costs to obtain and/or full a contract **on a systematic basis**, **consistent with the pattern of transfer** of the good or service to which the asset relates.

Question 26 – Contract Costs

Accounting for Asia (A4A) enters into service contracts to manage a customer's bookkeeping operations for four-year terms. The contracts may be subsequently renewed on a one-year rolling basis and the average customer term is eight years. A4A pays its marketing staff a commission of Rs. 100,000 when a new customer signs an initial contract. On 1 August 2015, the A4A sales staff secured a new customer contract.

Required: How is the cost of commission of Rs. 100,000 accounted for?

03. WARRANTIES

A warranty provided by a seller may be one of three types:

1. A **standard warranty** that provides assurance that the transferred item will function as intended for a specific period of time
2. An **extended (additional) warranty** that a customer has the **option to purchase** the warranty separately
3. An **extended (additional) warranty** that is **provided at no cost and provides an additional service** (which is distinct) **beyond a standard warranty**.

In the first case **LKAS 37 applies** and the selling entity should make a provision for expected warranty costs; in the second two cases the **warranty provided is identified as a separate performance obligation** within the contract and allocated a proportion of transaction price.

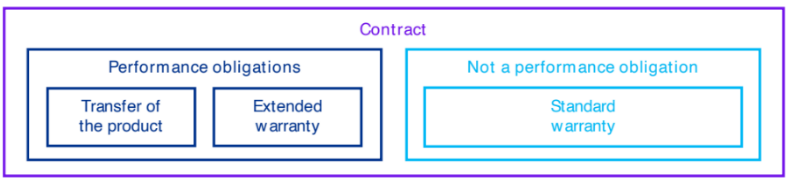
Example – Sale of a product with a warranty

Manufacturer M grants its customers a standard warranty with the purchase of its product. Under the warranty, M provides assurance that the product complies with agreed specifications and will operate as promised for three years from the date of purchase. Customer C also chooses to purchase an extended warranty for two additional years.

In this example, M concludes that there are **two performance obligations** in the contract.

1. To transfer the product underlying to the contract
2. To provide extended warranty

The **standard warranty** is **not** a separate performance obligation **(PO)**.



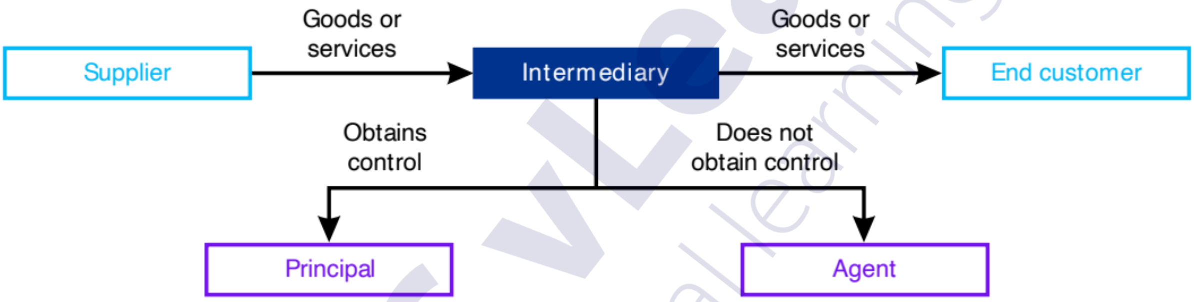
04. PRINCIPAL VERSUS AGENT CONSIDERATIONS

When **another party is involved** in providing goods or services to a customer, an entity evaluates the nature of its promise to the customer. If **an entity obtains control of another party's goods or services before transferring control to the customer**, then the entity's promise is to provide the goods or services itself. Therefore, the entity is acting as **a principal**.

However, if the **entity does not control the good or service before it is transferred to the customer**, then the entity is acting as an **agent** and arranges for that good or service to be provided by another party.

An entity identifies **each specified good or service** to be transferred to the customer and determines whether it is a principal or agent for **each one**. An entity may be a principal for some goods and services and an agent for others in a contract to transfer multiple goods or services.

Control Assessment



If an entity obtains control of a good or a right to services in advance of transferring those goods or services to the customer, then the entity is a **principal**. **Otherwise, it is an agent *(Para B35)***.

Indicators that the **seller controls the goods or services** before transfer to the customer (and is therefore a principal) include the following:

The seller is primarily responsible for fulfilling the promise to provide the specified goods or services	The Seller: • is responsible for acceptability of the specified good or service • has discretion with respect to accepting and rejecting orders from customers • can source the good or service ordered by the customer from more than one supplier • is responsible for delivery and any loss or damage between pick up from the supplier and delivery to the end customer • is responsible for the sales strategy • is the party the customer believes is responsible for fulfilling the promise

The seller has inventory risk	The seller: • obtains, or commits itself to obtaining, the specified good or service before obtaining a contract with a customer • is liable for damage and product loss for inventory in its possession before sale to the end customer, including loss in inventory value • is liable for customer returns • commits to a minimum order quantity • has no right to return unsold inventory to the supplier
The seller has discretion in setting prices for the specified goods or services	The amount paid to the supplier is: • a fixed price per unit • not a commission or fee basis, which is fixed in terms of either an amount of currency or a percentage of the value of the underlying goods or services

Revenue Recognition

If the entity acts as **principal**	Recognizes revenue and the related costs on a gross basis – corresponding to the consideration to which the entity expects to be entitled ***(Para B35)***
If the entity acts as **agent**	Recognizes revenue on a net basis corresponding to any fee or commission to which the entity expects to be entitled ***(Para B36)***

Amounts collected by an agent on behalf of a third party are accounted for as a **payable** in the statement of financial position until they are settled and do not gross up revenue and expenses. Similarly, amounts **prepaid by an agent** to a third party on behalf of customers are recognized as a **receivable** until they are recovered and do not gross up revenues and expenses.

Question 27 – Principal Vs Agent – ABR Past Paper

Fashion Stores PLC (FSP) is a company in Sri Lanka that manufactures clothes under its brand 'New Look' and exports them to clothes shop operators in India, the UK and Australia. With a view of expanding its sales to other international retail markets, FSP recently entered into an agreement with Unlimited Fashion, which operates a website to facilitate online clothes sales and purchases in the international market.

Based on the above agreement:

- FSP displays its New Look brand products on the website operated by Unlimited Fashion and the selling price will be decided by FSP.
- A 5% commission should be paid to Unlimited Fashion for each of the sales transactions.

- Once an order is placed on the website by a customer, it will be automatically communicated to FSP and the shipments/delivery should be done through FSP's centralised warehouse.
- Upon the delivery of goods from the warehouse, the legal title of the goods is transferred to Unlimited Fashion. However, the goods need to be insured by FSP.
- Customers will be given one week upon receipt of the goods to return any dissatisfied goods to Unlimited Fashion. These goods need to be returned back to FSP by Unlimited Fashion without a penalty

Required: **Evaluate** whether Unlimited Fashion is acting as an agent or principal in this agreement, based on the guidance given in SLFRS 15 Revenue from Contracts with Customers.

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05. REPURCHASE AGREEMENTS

An entity has executed a repurchase agreement if it **sells an asset** to a customer and **promises**, or has the **option**, to **repurchase** it.

- If the repurchase agreement meets the definition of a financial instrument, then it is outside the scope of the standard.
- If not, then the repurchase agreement is in the scope of the standard and the accounting for it depends on its type – e.g. a forward, call option or put option – and on the repurchase price.

Repurchase agreements generally come in three forms.

(a) An entity has **an obligation to repurchase** the asset (**a forward contract**)
(b) An entity has the **right to repurchase the asset** (**a call option**)
(c) An entity **must repurchase the asset if requested to** do so by the customer (**a put option**)

A Forward or A Call Option

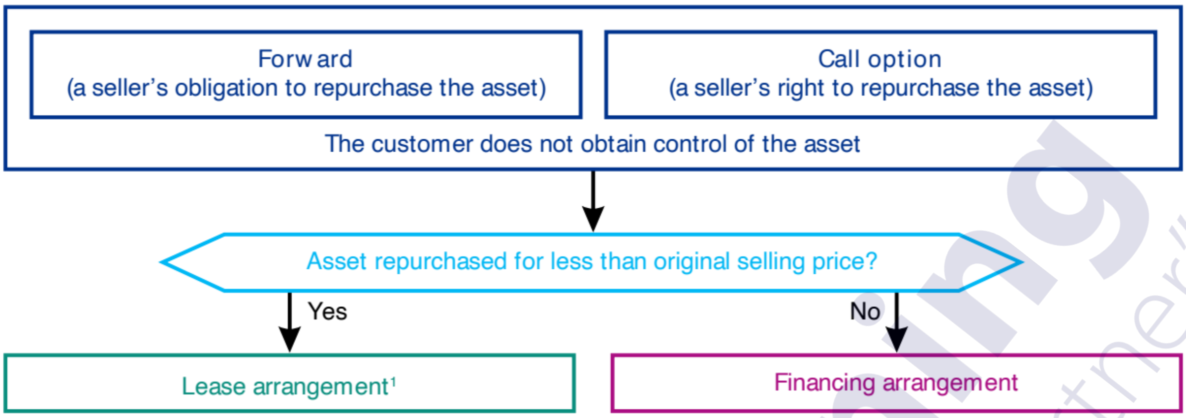
If an entity has an obligation (a forward) or a right (a call option) to repurchase an asset, then a customer does not have control of the asset ***(Para B66)***.

- *This is because the customer is limited in its ability to direct the use of, and obtain the benefits from, the asset despite its physical possession.*

If the entity:

- has an obligation or a right to repurchase the asset for **less than its original sales price**, then it accounts for the entire agreement as a **lease**, unless the contract is part of a sale-and-leaseback transaction.
- has an obligation or a right to repurchase the asset for an amount that is **greater than or equal to the original sales price**, then it accounts for the transaction as a **financing arrangement**.

When comparing the repurchase price with the selling price, the entity **considers** the **time value of money**.



1. Unless the contract is part of a sale-and-leaseback transaction.

A Put Option

If a **customer has a right to require the entity to repurchase** the asset (a put option) **at a price that is lower than the original selling price**, then at contract inception the entity assesses whether the customer has a significant economic incentive to exercise the right.

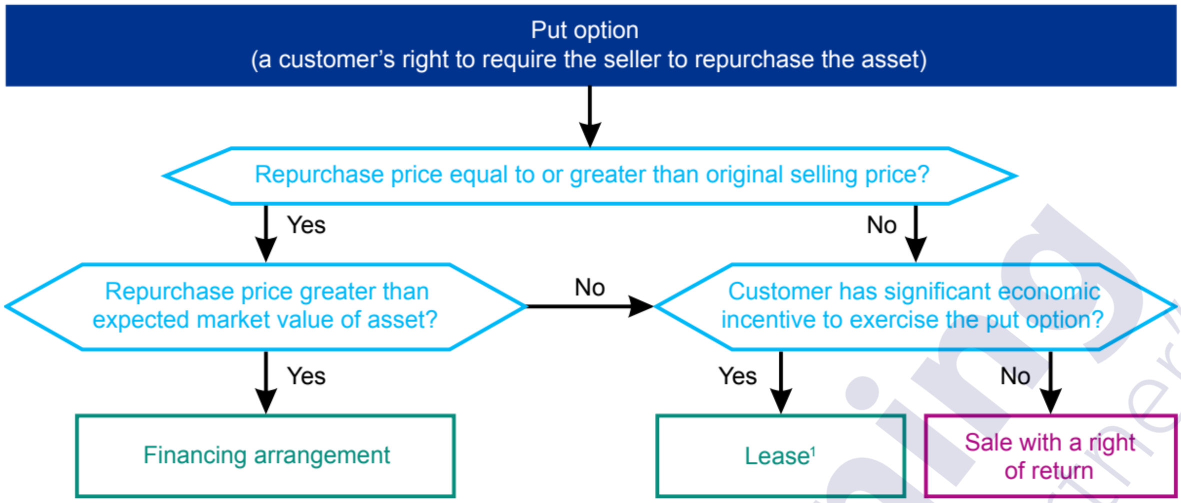
To make this assessment, an entity considers factors including the:

- relationship of the repurchase price to the expected market value of the asset at the date of repurchase
- amount of time until the right expires

The accounting treatment can be summarized as follows.

- If the **customer has a significant economic incentive** to exercise the put option, then the entity accounts for the **agreement as a lease**, unless the contract is part of a sale-and-leaseback transaction.
- Conversely, if the **customer does not have a significant economic incentive**, then the entity accounts for the agreement as the **sale of a product with a right of return**

If the **repurchase price** of the asset is **equal to or greater than the original selling** price and is more than the expected market value of the asset, then the entity accounts for the contract as a **financing arrangement**. In this case, if the option expires unexercised, then the entity derecognizes the liability and the related asset and recognizes revenue at the date on which the option expires.



1. Unless the contract is part of a sale-and-leaseback transaction.

Question 28 – Repurchase Agreements – Call Option

Ocean Life Ltd (OL) enters into a contract with a customer for the sale of a research vessel on 1 January 2017. The contract includes a call option that gives OL the right to repurchase the Rs. 150 million vessel for Rs. 165 million on or before 31 December 2017. OL exercises the call option.

Required: How should OL account for this transaction?

Question 29 – Repurchase Agreements – Put Option

Ocean Life Ltd (OL) enters into another contract with a customer for the sale of a research vessel on 1 January 2017 for Rs. 180 million. The contract includes a put option that gives the customer the right to enforce OL to repurchase the vessel for Rs. 165 million on or before 31 December 2017. The expected market value at 31 December 2017 is Rs. 142.5 million.

Required: How should OL account for this transaction?

06. CONSIGNMENT ARRANGEMENTS

When a product is delivered to a customer under a consignment arrangement, the **customer (dealer) does not obtain control** of the product at that point in time, so **no revenue is recognized upon delivery**.

Indicators of a consignment arrangement include:

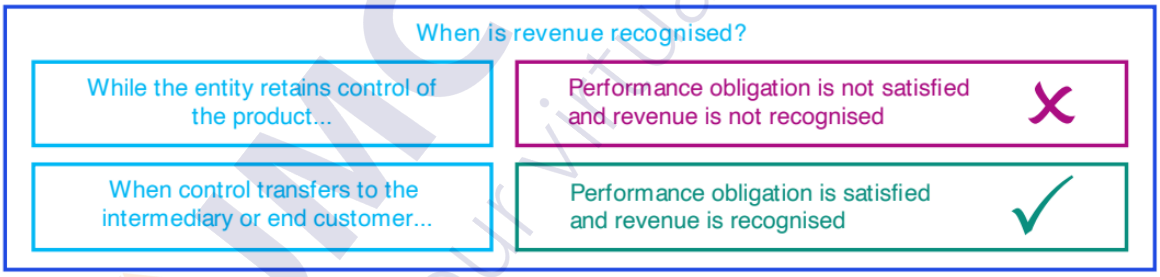
(a) The product is **controlled by the entity** until a specified event occurs, such as the product is sold on, or a specified period expires.

(b) The **entity can require the return of the product** or transfer it to another party.

(c) The **customer (dealer/distributor) does not have an unconditional obligation** to pay for the product.

Accounting treatment for inventory is as follows:

If the control of the inventory has been transferred to the dealer	**If the control of the inventory has been not transferred to the dealer**
• The inventory should be recognized as such in the dealer's statement of financial position, together with a corresponding liability to the manufacturer • Any deposit should be deducted from the liability and the excess classified as a trade payable	• The inventory should not be included in the dealer's statement of financial position until the transfer of control has taken place. • Any deposit should be included under 'other receivables'.



Question 30 – Consignment Sales

On 1 January 2023 Frod Motor Co, a car manufacturer, entered into an agreement to provide Dusty, a car retailer, with cars for resale. The terms of the agreement were as follows:

- Dusty pays the cost of insuring and maintaining the cars.
- Dusty can display the cars in its showrooms and use them as demonstration models.
- When a car is sold to a customer, Dusty pays Frod Motor Co the factory price prevailing at the time the car was originally delivered.

- All cars remaining unsold 90 days after their original delivery must be purchased by Dusty at the factory price prevailing at the time of delivery.
- Frod Motor Co can require Dusty to return the cars at any time within the90-day period. In practice, this right has never been exercised.
- Dusty can return unsold cars to Frod Motor Co at any time during the 90day period, without penalty. In practice, this has never happened.

At 31 December 2023 the agreement is still in force and Dusty holds several cars which were delivered less than 90 days earlier.

Required: How should these cars be treated in the financial statements of Dusty for the year ended 31 December 2023?

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07. BILL AND HOLD ARRANGEMENTS

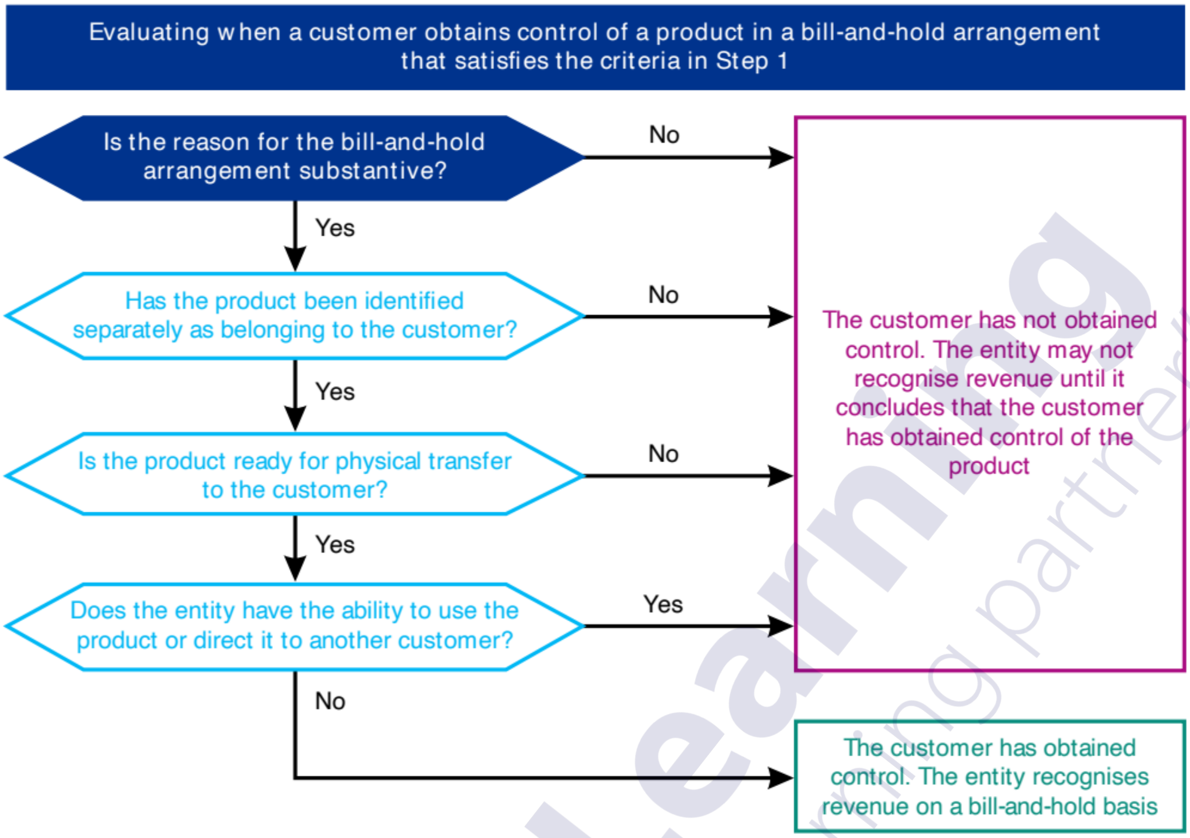
Under a bill and hold arrangement **goods are sold but remain in the possession of the seller** for a specified period, perhaps because the customer lacks storage facilities.

An entity will need to determine **at what point the customer obtains control** of the product.

- For some contracts, control will not be transferred until the goods are delivered to the customer.
- For others, a customer may obtain control even though the goods remain in the entity's physical possession. In this case the entity would be providing custodial services (which may constitute a separate performance obligation) to the customer over the customer's asset.

For a **customer to have obtained control** of a product in a bill and hold arrangement, the following **criteria must all be met**:

(a) The reason for the bill and hold must be substantive (for example, requested by the customer).
(b) The product must be separately identified as belonging to the customer.
(c) The product must be ready for physical transfer to the customer.
(d) The entity cannot have the ability to use the product or to transfer it to another customer.



Question 31 – Bill and Hold

Johan entered into the following sale transactions during the year:

(a) On 1 April 2016, Johan sold its factory to Cruyff, a finance company, for $800,000. Johan continued to use the factory and was responsible for the insurance and maintenance of the building. Johan has the right to repurchase the factory for $980,000 on 1 April 2019, representing a 7% growth in value each year. At 1 April 2016 the factory had a fair value of $1.5 million, with a carrying amount of $600,000. The fair value is expected to increase by April 2019.

(b) On 31 March 20X7, Johan sells an oven plus spare parts to Marco for $220,000. The price was split between $200,000 for the oven and $20,000 for the spare parts. Johan delivered the machine on 31 March 2017 but was asked to hold the spare parts by Marco, because Marco's factory was very close to Johan's warehouse. Johan expects to hold the spare parts for 2-4 years. The parts are kept separately in the warehouse, cannot be used or sold by Johan, and are ready for immediate delivery or collection at Marco's request. Johan agreed to the transaction as it decided that holding costs would be insignificant.

Required:

Explain the financial reporting treatment for the issues for the year ended 31 March 2017.

08. SALES WITH A RIGHT OF RETURN

A right of return means that a customer can return goods to the seller and receive in exchange a full or partial refund, a credit note, another product or any combination of these.

Under the standard, when an entity makes a sale with a right of return it recognises revenue at the amount to which it expects to be entitled by applying the variable consideration and constraint guidance set out in Step 3 of the model. The entity also recognises a refund liability and an asset for any goods or services that it expects to be returned. When an entity makes a sale with a right of return, it initially recognises the following.

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	Measured at the expected level of returns – i.e. the difference between the cash or receivable amount and the revenue as measured above. The nature of such a refund liability is different from contract liabilities and therefore it is not presented as such.
Return Asset	Measured with reference to the carrying amount of the products expected to be returned less the expected recovery costs, including potential decreases in the value to the entity of returned products. The nature of this return asset is different from trade and other receivables and therefore it is not presented as such.
Cost of Goods Sold	Measured as the carrying amount of the products sold less the return asset as measured above.
Reduction of Inventory	Measured as the carrying amount of the products transferred to the customer.

The entity updates its measurement of the refund liability and return asset at each reporting date for changes in expectations about the amount of the refunds. It recognises adjustments to the:

- refund liability as revenue; and
- return asset as an expense.

Question 32 – Right to Return

DIY Zora Ltd operates a number of retail outlets. On 30 March 20X7, it sells 10 identical power tools to different customers for Rs. 50,000 each. The tools cost Rs. 28,000 each. The customers have 28 days in which they can return purchases in return for a full refund and, based on past experience, DIY Zora Ltd expects a returns level of 10%. DIY Zora Ltd's sale starts on 1 April and the selling price of the power tools will be reduced to 75% of the original price from that date.

Required

How should DIY Zora Ltd account for the sale of the tools?