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SLFRS: 15 – Revenue From Contracts with Customers

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SLFRS 15 – REVENUE FROM CONTRACTS WITH CUSTOMERS

SLFRS 15 Revenue from contracts with customers

Key requirements – 5 step model
- 1.) Identify Contract with customer
- 2.) Identify performance obligations (PO) in the contract
- 3.) Determine transaction price
- 4.) Allocate txn price to POs
- 5.) Recognize revenue when entity satisfies POs

(1) Identify Contract – A contract exist if,
- It is approved and parties are committed to the obligations
- Collection of consideration is probable
- Rights to Goods/Services & payment terms can be identified
- It has commercial substance

(2) Identify performance obligations
- Understand whether contract has,
- Distinct performance obligations or Single PO
- Distinct if,
- Customer can benefit from each G/S separately
- Is distinct in the context of the contract

(3) Determine transaction price
- Consider, significant financing component
- Consideration payable to customers
- Variable considerations such a progressive discounts
- Exclude taxes

(4) Allocate transaction price to POs
- Allocate based on relative stand alone price
- If not available – estimate the price
- Use adjusted market assessment approach
- Use expected cost + margin approach
- Residual price – in limited instances

SLFRS 15 Revenue from contracts with customers

(5) Recognize revenue when POs are satisfied – Over a period of time
- POs are satisfied <u>over a period of time</u> if,
- Customer receives and consumes the benefit as the entity performs
- The customer controls the asset as the entity creates or enhances it
- Entity creates a unique asset with no alternative use and there is right to payment for performance to date

- Measuring POs satisfied over a period of time
- Output method
  - Surveys
  - Milestones reached
  - Units delivered
- Input method
  - Cost incurred
  - Labour hours
  - Machine hours

(5) Recognize revenue when POs are satisfied – at a point in time
- Customer obtains control over goods/service - indicated by customer having,
- Present obligation to pay
- Physical possession of the goods
- Legal title
- Risk and rewards of ownership
- Accepted the asset

Other topics
- Non refundable upfront fees
- Sales with right of return & Consignment sales
- Warranties
- Agent Vs Principal
- Customer loyalty programs
- Bill and hold transactions

- ***The Core Principle and the Five-Step Model***

Core Principle
An entity recognizes 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

I.) Identify the contract(s) with a customer
II.) Identify the performance obligations in the contract
III.) Determine the transaction price
IV.) Allocate the transaction price to the performance obligations in the contract
V.) Recognize revenue when (or as) the entity satisfies a performance obligation

- ***Step 1: Does a Contract Exist?***

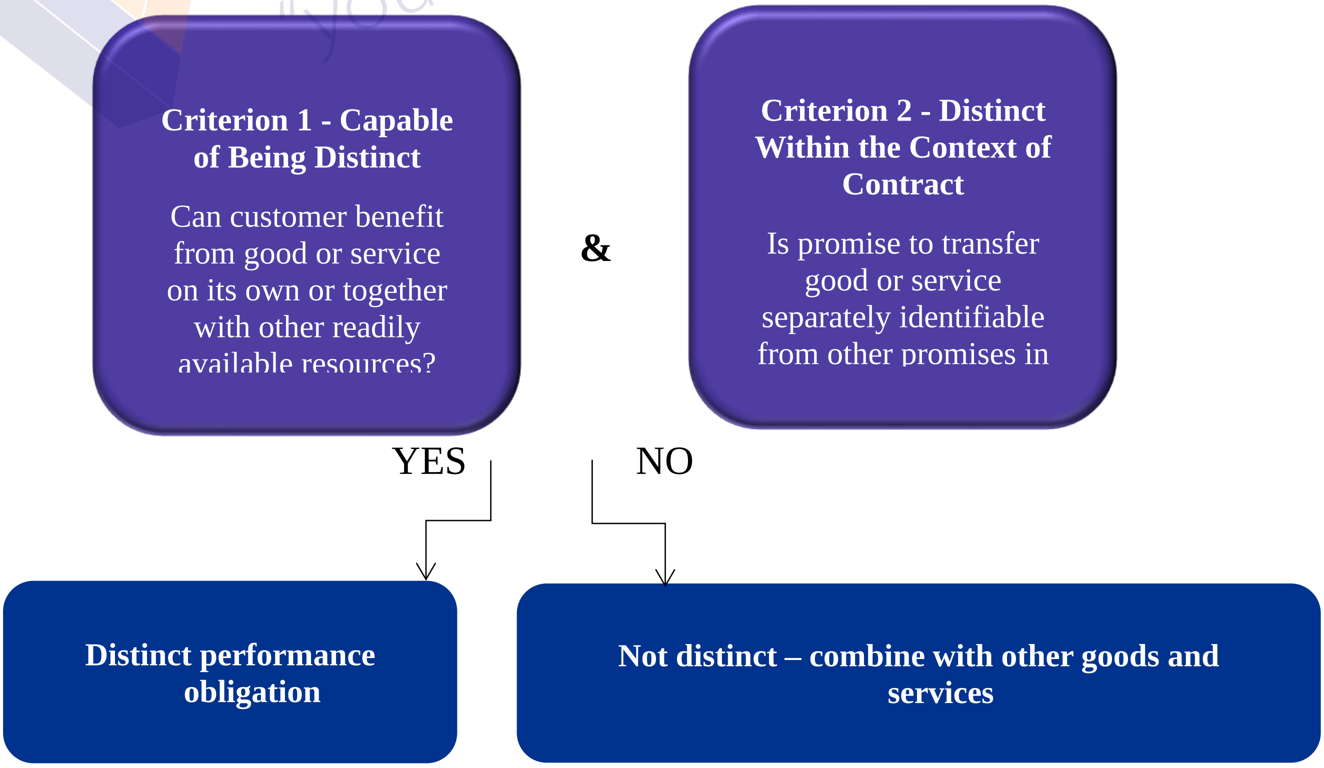
A contract is an agreement between two or more parties that creates enforceable rights and obligations. Enforceability is a matter of law. Contracts can be written, oral, or implied by an entity's customary business practices. Additionally:

A contract exists if…

- it is approved and the parties are committed to their obligations
- collection of consideration is probable
- rights to goods or services and payment terms can be identified
- it has commercial substance

- ***Step 2: Identify the Performance Obligations in the Contract***

Are promised goods and services distinct from other goods and services in the contract?



Capable of Being Distinct - Can the Customer Benefit from the Good/Service?

To determine if customer can benefit from the good or service either on its own or together with other resources that are readily available to it, consider:

- Is the good or service an asset that, on its own, can be used, consumed, sold for an amount that is greater than scrap value, or otherwise held in a way that generates economic benefits,

  <u>or</u>

- Does the customer have readily available resources (goods or services) that are sold separately by the entity or by another entity or resources that the customer already has obtained from the entity or from other transactions or events

<u>Example 1</u>

Company X enters into a contract to design and build a hospital. X is responsible for the overall management of the project and identifies various promised goods and services, including engineering, site clearance, foundation, procurement, construction of the structure, piping and wiring, installation of equipment, and finishing.

X identifies that many of the goods and services to be provided meet Criterion 1. This is because the customer could benefit from the goods or services on their own - each construction material is sold separately by numerous suppliers or could be resold for more than scrap value by the customer - or together with other readily available resources such as additional materials or the services of another contractor.

However, X determines that Criterion 2 is not met because it provides a significant service of integrating the goods and services to produce the output (the hospital) for which the customer has contracted.

As a result, because Criterion 2 is not met, X accounts for the contract as a single performance obligation

<u>Example 2</u>

Company Y enters into a contract to sell a machine to Customer C and provide a standard installation service. The installation service is also offered by third party providers.

Y determines that Criterion 1 is met for the machine because C can use it with a readily available resource (services from a third party installer). It is also met for the installation service because the service can be used with a resource owned by C (the machine).

Y further determines that Criterion 2 in is met for the machine and installation service because:

- Y does not provide a significant integration service that would combine the machine with the installation services to produce a combined output;
- the installation service does not significantly customise or modify the machine; and
- the installation service and the machine do not each significantly affect the other because they are not highly interdependent or highly inter-related.

As a result, because both criteria are met, Y accounts for the machine and installation as separate performance obligations.

- ***Step 3: Determine the Transaction Price***

Consider the following in determining the transaction price

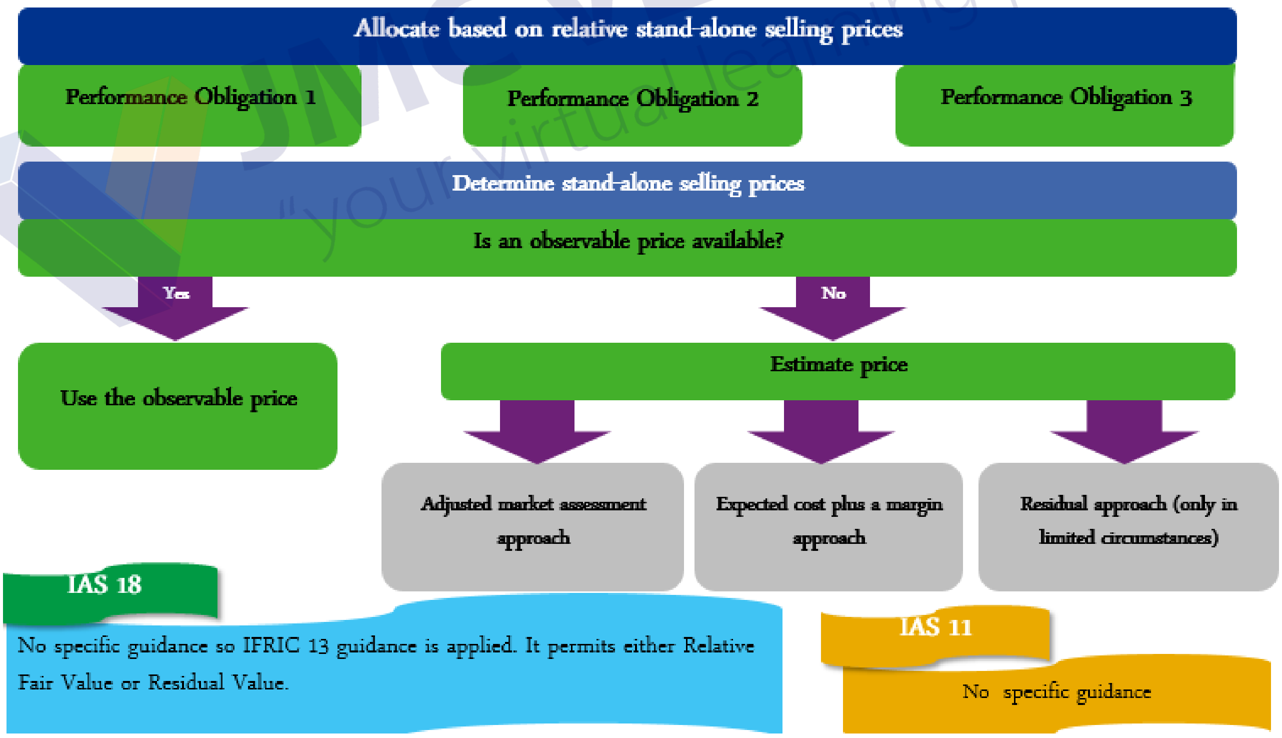
- Variable consideration and the constraint
- Consideration payable to a customer
  - reduction to the transaction price unless it's a payment for a distinct good or service
- Non-cash consideration
  - measured at fair value unless it cannot be reliably measured.
- Significant financing component

Variable consideration can be Discounts, Credits, Incentives, Performance bonuses etc

Variable consideration is estimated using most appropriate method of either:

- Expected Value
- Most Likely Amount

- ***Step 4: Allocate the Transaction Price to the Performance Obligations***



Example

Company T enters into a one-year mobile contract in which a customer is provided with a phone and a data/calls/texts plan (the wireless plan) for a price of 35 per month. T has identified the phone and the wireless plan as separate performance obligations.

The phone can be purchased from the manufacturer's website for a price of 200 and T offers a 12-month plan without a phone that includes the same level of data/calls/texts for a price of 25 per month, providing observable evidence of stand-alone selling prices for both performance obligations.

Therefore, the transaction price of 420 (35 x 12 months) is allocated to the performance obligations based on their relative stand-alone selling prices as follows

Stand alone price of a phone	200
Stand alone price of plan (25 x 12)	300
Total stand alone price	**500**
Total price under combined plan (35 x 12)	**420**

Allocation of selling price to each PO

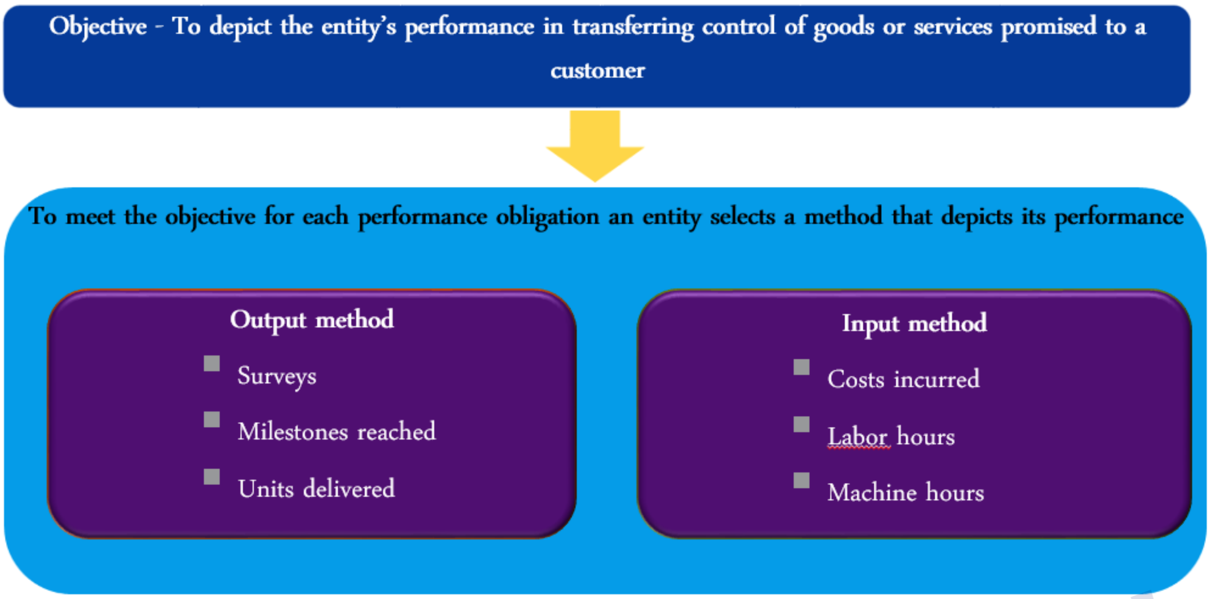
- Phone = 420 x 200/500 = 168
- Wireless plan = 420 x 300/500 = 252

Step 5: Recognize Revenue When or as Entity Satisfies Performance Obligation

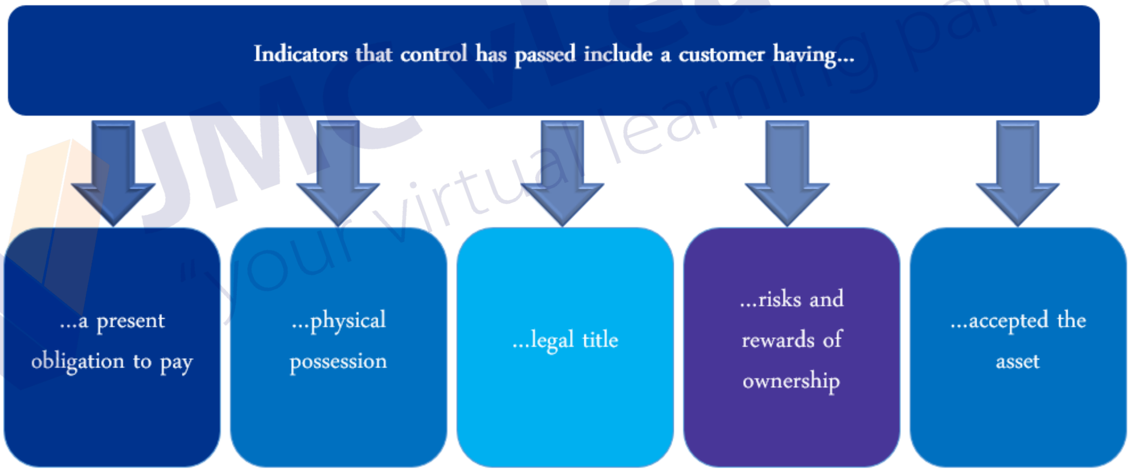
An performance obligation is satisfied over time if either:

- Customer simultaneously receives and consumes the benefits as the entity performs.
- The customers controls the asset as the entity creates or enhances it.
- The entity's performance does not create an asset for which the entity has an alternate use and there is a right to payment for performance to date

Measuring Progress for Performance Obligations Satisfied Over 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



<u>Example - Applying the over a period of time criteria - Professional consultant</u>

Company B enters into a contract to provide a consulting service to a customer that results in B providing a professional opinion based on facts and circumstances specific to the customer. If the customer were to terminate the consulting contract for reasons other than B's failure to perform as promised, then the contract requires the customer to compensate B for its costs incurred plus a 15% margin. The 15% margin approximates the profit margin that B earns from similar contracts.

B applies the criteria and determines the following.

If B does not issue the professional opinion and the customer hires another consulting firm, then that other firm would need to substantially reperform the work completed by B to date because it would not have the benefit of any work in progress performed by B. Accordingly, the customer does not simultaneously receive and consume the benefits of B's performance and Criterion 1 is not met.

B is not creating or enhancing an asset that the customer obtains control of as B performs. This is because B delivers the professional opinion to the customer only on completion. B therefore determines that Criterion 2 in is not met.

The development of the professional opinion does not create an asset with alternative use to B because it relates to facts and circumstances that are specific to the customer. Therefore, there is a practical limitation on B's ability to readily direct the asset to another customer. The contract's terms provide B with an enforceable right to payment for its performance completed to date for costs incurred plus a reasonable margin. B therefore determines that Criterion 3 is met.

Because Criterion 3 is met, B recognises revenue over time as it provides the consulting services.

<u>Example - Applying the over a period of time criteria – Bottle Manufacturer</u>

Company C enters into a framework agreement to manufacture bottles for Customer B under the following terms.

- The design of the bottles is the intellectual property of B.
- The sales price is cost plus 10%.
- There is no stated minimum purchase quantity.
- C is required to maintain a specific level of inventory of raw materials and finished goods.

If B terminates the framework agreement, then it is required to purchase inventory of raw materials at cost and work in progress and finished goods on hand at the agreed sales price at the date of termination.

The manufacturing process does not result in material amounts of work in progress.

C determines that the nature of the promise to B under the framework agreement is to manufacture bottles for use in B's operation.

C applies the criteria above and determines that it does not create an asset with an alternative use because C is legally prevented from selling the asset to another customer. The contract's termination clause provides C with an enforceable right to payment for its performance completed to date - i.e. for costs incurred plus a reasonable margin. C therefore determines that Criterion 3 is met.

Because Criterion 3 is met, C recognises revenue over time as it manufactures bottles.

<u>Example - Applying the over a period of time criteria – Real estate</u>

Real Estate Developer D in Country Y enters into a contract with Customer C for sale of a real estate unit in a multiunit residential complex. The contract contains the following terms.

C pays a 10% deposit at contract inception and the remainder of the purchase price after construction is complete.

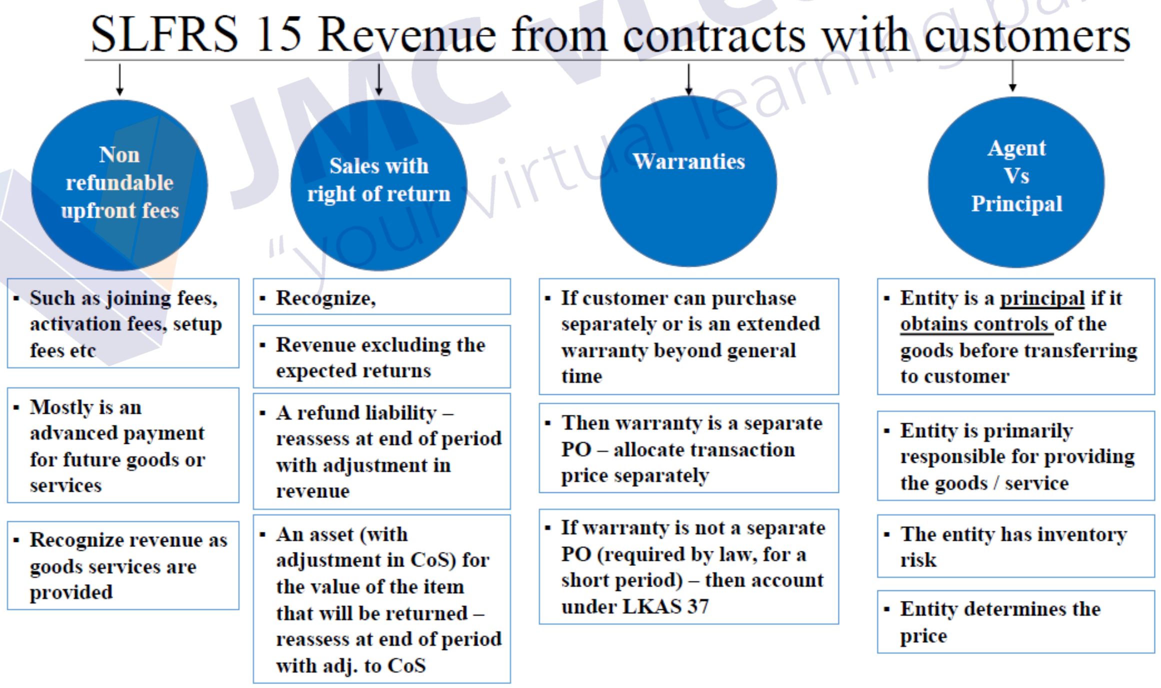
- D retains legal title until C has paid the full purchase price.
- C has the right to terminate the contract at any time before construction is complete.
- On termination, D is required to make reasonable efforts to resell the unit to a third party.

If the resale price obtained from the third party is less than the original purchase price in the contract with C, then C must pay the difference to D.

D applies the criteria above and determines that its performance does not create an asset with an alternative use under Criterion 3. However, the consideration to which D is entitled from C on termination is limited to reimbursement of any loss of profit on resale. This does not approximate to the selling price of the part-constructed real estate unit, and therefore does not compensate D for its performance completed to date. Based on its analysis, D concludes that Criterion 3 above is not met.

Because Criterion 3 is not met, D recognises revenue at the point in time when control of the unit transfers to C.

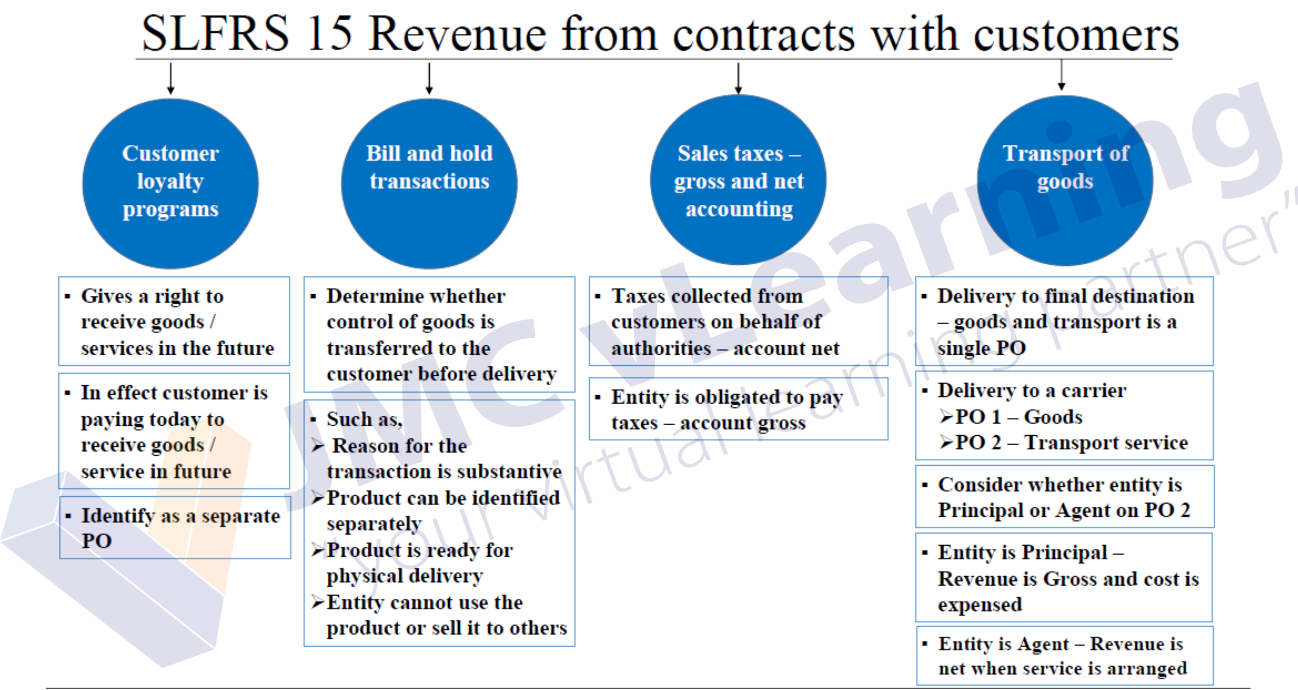
<u>OTHER TOPICS</u>



Example – Revenue recognition by Agent

Company V operates a website from which it sells Company T's products. Customers place orders directly on the website and provide credit card details for payment. V receives the order and authorisation from the credit card company, and passes the order on to T, which ships the product directly to the customer. V does not take title to the product and has no risk of loss or other responsibility for the function or delivery of the product. T is responsible for all product returns and defects. T sets the price of the product at 175, from which V receives a commission of 25.

V considers that it does not take title to the product, is not primarily responsible for providing the product, does not have inventory risk, and does not have discretion in establishing prices. Therefore, V determines that it does not control the product before it is transferred to the customer and acts as an agent. As a result, V recognises its fee of 25 as revenue when it passes the order to T.



Example - Customer loyalty programs

Company C operates a customer loyalty programme at its store, rewarding customers 1 point per 10 spent. Each point is redeemable for a cash value of 1 on future purchases. No other discounts or rebates are offered by C to customers.

During year 1, customers purchase products from the store for 100,000 and earn 10,000 points redeemable for future purchases at the store. C expects customers to redeem 97% of the points. The redemption estimate is made on the basis of C's past experience, which it assesses as being predictive of the amount of consideration to which it will be entitled. The stand-alone selling price of the products sold to customers without points is 100,000.

Because the points provide a material right to the customers that they would not receive without having purchased products from the store, C concludes that the points are a separate performance obligation of the contracts for the sale of those products - i.e. the customers paid for the points when purchasing products from the store.

Practice questions

There has been significant divergence in practice over recognition of revenue mainly because International Financial Reporting Standards (IFRS) have contained limited guidance in certain areas. The International Accounting Standards Board (IASB) as a result of the joint project with the US Financial Accounting Standards Board (FASB) has issued IFRS 15 *Revenue from Contracts with Customers*. IFRS 15 sets out a five-step model, which applies to revenue earned from a contract with a customer with limited exceptions, regardless of the type of revenue transaction or the industry. Step one in the five-step model requires the identification of the contract with the customer and is critical for the purpose of applying the standard. The remaining four steps in the standard's revenue recognition model are irrelevant if the contract does not fall within the scope of IFRS 15.

Required:
(a) (i) Discuss the criteria which must be met for a contract with a customer to fall within the scope of
IFRS 15. (5 marks)

(ii) Discuss the four remaining steps which lead to revenue recognition after a contract has been identified
as falling within the scope of IFRS 15. (8 marks)

(b) (i) Tang enters into a contract with a customer to sell an existing printing machine such that control of the printing machine vests with the customer in two years' time. The contract has two payment options. The customer can pay $240,000 when the contract is signed or $300,000 in two years' time when the customer gains control of the printing machine. The interest rate implicit in the contract is 11·8% in order to adjust for the risk involved in the delay in payment. However, Tang's incremental borrowing rate is 5%.

The customer paid $240,000 on 1 December 2014 when the contract was signed. (4 marks)

(ii) Tang enters into a contract on 1 December 2014 to construct a printing machine on a customer's premises for a promised consideration of $1,500,000 with a bonus of $100,000 if the machine is completed within 24 months. At the inception of the contract, Tang correctly accounts for the promised bundle of goods and services as a single performance obligation in accordance with IFRS 15. At the inception of the contract, Tang expects the costs to be $800,000 and concludes that it is highly probable that a significant reversal in the amount of cumulative revenue recognised will occur. Completion of the printing machine is highly susceptible to factors outside of Tang's influence, mainly issues with the supply of components.

At 30 November 2015, Tang has satisfied 65% of its performance obligation on the basis of costs incurred to date and concludes that the variable consideration is still constrained in accordance with IFRS 15.

However, on 4 December 2015, the contract is modified with the result that the fixed consideration and expected costs increase by $110,000 and $60,000 respectively. The time allowable for achieving the bonus is extended by six months with the result that Tang concludes that it is highly probable that the bonus will be achieved and that the contract still remains a single performance obligation. Tang has an accounting year end of 30 November. (6 marks)

Required:
Discuss how the above two contracts should be accounted for under IFRS 15. (In the case of (b)(i), the discussion should include the accounting treatment up to 30 November 2016 and in the case of (b)(ii), the accounting treatment up to 4 December 2015.)

Answer

(a) (i) The definition of what constitutes a contract for the purpose of applying the standard is critical. The definition of contract is based on the definition of a contract in the USA and is similar to that in IAS 32 Financial Instruments: Presentation. A contract exists when an agreement between two or more parties creates enforceable rights and obligations between those parties. The agreement does not need to be in writing to be a contract but the decision as to whether a contractual right or obligation is enforceable is considered within the context of the relevant legal framework of a jurisdiction. Thus, whether a contract is enforceable will vary across jurisdictions. The performance obligation could include promises which result in a valid expectation that the entity will transfer goods or services to the customer even though those promises are not legally enforceable.

The first criteria set out in IFRS 15 is that the parties should have approved the contract and are committed to perform their respective obligations. It would be questionable whether that contract is enforceable if this were not the case. In the case of oral or implied contracts, this may be difficult but all relevant facts and circumstances should be considered in assessing the parties' commitment. The parties need not always be committed to fulfilling all of the obligations under a contract. IFRS 15 gives the example where a customer is required to purchase a minimum quantity of goods but past experience shows that the customer does not always do this and the other party does not enforce their contract rights.

However, there needs to be evidence that the parties are substantially committed to the contract.
It is essential that each party's rights and the payment terms can be identified regarding the goods or services to be transferred. This latter requirement is the key to determining the transaction price.
The contract must have commercial substance before revenue can be recognised, as without this requirement, entities might artificially inflate their revenue and it would be questionable whether the transaction has economic consequences.

Further, it should be probable that the entity will collect the consideration due under the contract. An assessment of a customer's credit risk is an important element in deciding whether a contract has validity but customer credit risk does not affect the measurement or presentation of revenue. The consideration may be different to the contract price because of discounts and bonus offerings. The entity should assess the ability of the customer to pay and the customer's intention to pay the consideration. If a contract with a customer does not meet these criteria, the entity can continually re-assess the contract to determine whether it subsequently meets the criteria.

Two or more contracts which are entered into around the same time with the same customer may be combined and accounted for as a single contract, if they meet the specified criteria. The standard provides detailed requirements for contract modifications. A modification may be accounted for as a separate contract or a modification of the original contract, depending upon the circumstances of the case.

(ii) Step one in the five-step model requires the identification of the contract with the customer. After a contract has been determined to fall under IFRS 15, the following steps are required before revenue can be recognised.

Step two requires the identification of the separate performance obligations in the contract. This is often referred to as 'unbundling', and is done at the beginning of a contract. The key factor in identifying a separate performance obligation is the distinctiveness of the good or service, or a bundle of goods or services. A good or service is distinct if the customer can benefit from the good or service on its own or together with other readily available resources and is separately identifiable from other elements of the contract. IFRS 15 requires a series of distinct goods or services which are substantially the same with the same pattern of transfer, to be regarded as a single performance obligation. A good or service, which has been delivered, may not be distinct if it cannot be used without another good or service which has not yet been delivered. Similarly, goods or services which are not distinct should be combined with other goods or services until the entity identifies a bundle of goods or services which is distinct. IFRS 15 provides indicators rather than criteria to determine when a good or service is distinct within the context of the contract. This allows management to apply judgement to determine the separate performance obligations which best reflect the economic substance of a transaction.

Step three requires the entity to determine the transaction price, which is the amount of consideration which an entity expects to be entitled to in exchange for the promised goods or services. This amount excludes amounts collected on behalf of a third party, for example, government taxes.

An entity must determine the amount of consideration to which it expects to be entitled in order to recognise revenue. The transaction price might include variable or contingent consideration. Variable consideration should be estimated as either the expected value or the most likely amount. Management should use the approach which it expects will best predict the amount of consideration and should be applied consistently throughout the contract. An entity can only include variable consideration in the transaction price to the extent that it is highly probable that a subsequent change in the estimated variable consideration will not result in a significant revenue reversal. If it is not appropriate to include all of the variable consideration in the transaction price, the entity should assess whether it should include part of the variable consideration. However, this latter amount still has to pass the 'revenue reversal' test.

Additionally, an entity should estimate the transaction price taking into account non-cash consideration, consideration payable to the customer and the time value of money if a significant financing component is present. The latter is not required if the time period between the transfer of goods or services and payment is less than one year. If an entity anticipates that it may ultimately accept an amount lower than that initially promised in the contract due to, for example, past experience of discounts given, then revenue would be estimated at the lower amount with the collectability of that lower amount being assessed. Subsequently, if revenue already recognised is not collectable, impairment losses should be taken to profit or loss.

Step four requires the allocation of the transaction price to the separate performance obligations. The allocation is based on the relative standalone selling prices of the goods or services promised and is made at inception of the contract. It is not adjusted to reflect subsequent changes in the standalone selling prices of those goods or services. The best evidence of standalone selling price is the observable price of a good or service when the entity sells that good or service separately. If that is not available, an estimate is made by using an approach which maximises the use of observable inputs. For example, expected cost plus an appropriate margin or the assessment of market prices for similar goods or services adjusted for entity-specific costs and margins or in limited circumstances a residual approach. When a contract contains more than one distinct performance obligation, an entity allocates the transaction price to each distinct performance obligation on the basis of the standalone selling price.

Where the transaction price includes a variable amount and discounts, consideration needs to be given as to whether these amounts relate to all or only some of the performance obligations in the contract. Discounts and variable consideration will typically be allocated proportionately to all of the performance obligations in the contract. However, if certain conditions are met, they can be allocated to one or more separate performance obligations.

Step five requires revenue to be recognised as each performance obligation is satisfied. An entity satisfies a performance obligation by transferring control of a promised good or service to the customer, which could occur over time or at a point in time. The definition of control includes the ability to prevent others from directing the use of and obtaining the benefits from the asset. A performance obligation is satisfied at a point in time unless it meets one of three criteria set out in IFRS 15. Revenue is recognised in line with the pattern of transfer.

If an entity does not satisfy its performance obligation over time, it satisfies it at a point in time and revenue will be recognised when control is passed at that point in time. Factors which may indicate the passing of control include the present right to payment for the asset or the customer has legal title to the asset or the entity has transferred physical possession of the asset.

(b) (i) The contract contains a significant financing component because of the length of time between when the customer pays for the asset and when Tang transfers the asset to the customer, as well as the prevailing interest rates in the market. A contract with a customer which has a significant financing component should be separated into a revenue component (for the notional cash sales price) and a loan component. Consequently, the accounting for a sale arising from a contract which has a significant financing component should be comparable to the accounting for a loan with the same features.

An entity should use the discount rate which would be reflected in a separate financing transaction between the entity and its customer at contract inception. The interest rate implicit in the transaction may be different from the rate to be used to discount the cash flows, which should be the entity's incremental borrowing rate. IFRS 15 would therefore dictate that the rate which should be used in adjusting the promised consideration is 5%, which is the entity's incremental borrowing rate, and not 11·8%.

Tang would account for the significant financing component as follows:

Recognise a contract liability for the $240,000 payment received on 1 December 2014 at the contract inception:

Dr Cash $240,000

Cr Contract liability $240,000

During the two years from contract inception (1 December 2014) until the transfer of the printing machine, Tang adjusts the amount of consideration and accretes the contract liability by recognising interest on $240,000 at 5% for two years.

Year to 30 November 2015

Dr Interest expense $12,000

Cr Contract liability $12,000

Contract liability would stand at $252,000 at 30 November 2015.

Year to 30 November 2016

Dr Interest expense $12,600

Cr Contract liability $12,600

Recognition of contract revenue on transfer of printing machine at 30 November 2016 of $264,600 by debiting contract liability and crediting revenue with this amount.

(ii) Tang accounts for the promised bundle of goods and services as a single performance obligation satisfied over time in accordance with IFRS 15. At the inception of the contract, Tang expects the following:

Transaction price $1,500,000

Expected costs $800,000

Expected profit (46·7%) $700,000

At contract inception, Tang excludes the $100,000 bonus from the transaction price because it cannot conclude that it is highly probable that a significant reversal in the amount of cumulative revenue recognised will not occur. Completion of the printing machine is highly susceptible to factors outside the entity's influence. By the end of the first year, the entity has satisfied 65% of its performance obligation on the basis of costs incurred to date. Costs incurred to date are therefore $520,000 and Tang reassesses the variable consideration and concludes that the amount is still constrained.

Therefore at 30 November 2015, the following would be recognised:

Revenue $975,000

Costs $520,000

Gross profit $455,000

However, on 4 December 2015, the contract is modified. As a result, the fixed consideration and expected costs increase by $110,000 and $60,000, respectively. The total potential consideration after the modification is $1,710,000 which is $1,610,000 fixed consideration + $100,000 completion bonus. In addition, the allowable time for achieving the bonus is extended by six months with the result that Tang concludes that it is highly probable that including the bonus in the transaction price will not result in a significant reversal in the amount of cumulative revenue recognised in accordance with IFRS 15. Therefore the bonus of $100,000 can be included in the transaction price. Tang also concludes that the contract remains a single performance obligation. Thus, Tang accounts for the contract modification as if it were part of the original contract. Therefore, Tang updates its estimates of costs and revenue as follows:

Tang has satisfied 60·5% of its performance obligation ($520,000 actual costs incurred compared to $860,000 total expected costs). The entity recognises additional revenue of $59,550 [(60·5% of $1,710,000) – $975,000 revenue recognised to date] at the date of the modification as a cumulative catch-up adjustment. As the contract amendment took place after the year end, the additional revenue would not be treated as an adjusting event.

December 2019 Question 01

(a) Communiqué PLC (CP) operates in the communications industry and provides a variety of services to its customers. On 1 April 2018 the company entered into a two-year contract with a customer to provide a mobile package that includes voice and data for Rs. 5,000 per month. This price represents the standalone selling price of these services. Under this package the customer is entitled to the following facilities.

- A monthly data limit (anytime during the day) of 15GB. Extra usage will be charged at 20 cents per MB (1GB = 1,000 MB approximately)

- Outgoing call limit of 1,000 minutes to any network. Extra usage will be charged at Rs. 2 per minute.

At the time of entering the contract, the company charged Rs. 1,000 as connection fees for the mobile package. The customer was also given a free Wifi router under above contract. The company sells this type of Wifi router separately at a standalone selling price of Rs. 3,000.

During the year ended 31 March 2019, the customer has used 400 extra minutes of voice and 5GB extra of data.

Advise on the following matters based on SLFRS 15 Revenue from Contracts with Customers. Assume the financing component of the contract is insignificant.

-Whether each of the goods/services and connection fees mentioned in the contract represent a separate performance obligation.

-The amount to be recognised as revenue for each performance obligation for the year ended 31 March 2019.

-The accounting treatment for the connection fees paid. (13 marks)

June 2019 Q2

(b) NM (Pvt) Ltd (NM) entered into a contract with a customer, to build and install a new machine on 1 April 2019. The customer will obtain control over the completed machine in two years' time.

The contract has two payment options. The customer can either pay Rs. 350 million at inception of the contract, or pay Rs. 450 million in two years' time, when NM passes control.

The customer elected to pay Rs. 350 million at inception of the contract.

NM will have to incur Rs. 180 million during the first year ending 31 March 2020 and Rs. 120 million in the second year ending 31 March 2021, as the cost of the contract. At inception, this contract met the criteria in paragraph 9 of SLFRS 15, Revenue from Contracts with Customers.

Required:

Advise how the above transaction should be recognised in accordance with SLFRS 15, Revenue from Contracts with Customers, together with the accounting entries to be recognised at inception and during the years ending 31 March 2020 and 31 March 2021 in the books of NM.

(You may use Internal Rate of Return of 13.39% for any calculations required) (10 marks)

(c) GSK PLC (GSK), a machinery manufacturing company, entered into a long term contract, to build and install a large multi-unit plant, for a factory of B (Pvt) Ltd (B) on 1 October 2018.

As per the agreement;

- B makes progress payments during the construction and installation period, to compensate GSK for performance completed, and payments made are non-refundable.
- B does not have the right to terminate the contract, unless GSK fails to perform as promised.
- GSK has an enforceable right, to all of the consideration promised under the contract, if it continues to perform as promised.
- GSK had a right to terminate the contract, due to any significant liquidity issue of B.
- GSK is restricted from directing the plant for another use.

Up to 30 May 2019 GSK had recognised Rs. 40 million as revenue in respect of the performance completed relating to the aforesaid contract. Total contract price of this contract is Rs. 100 million. At inception, this contract met the criteria in paragraph 9 of SLFRS 15, Revenue from Contracts with Customers.

In June 2019, it was noted that, B's ability to pay had deteriorated significantly and GSK concluded that B will not be able to make any further payment.

At the operational team meeting, an accounts executive of GSK explained that, GSK has to reverse Rs. 40 million, the amount already recognised as revenue from the aforesaid contract, since it is no longer probable to collect the amount of consideration GSK will be entitled to and no further revenue should be recognised on this contract.

Required:

Evaluate the revenue recognition practice adopted by GSK and the statement made by the accounts executive based on requirements of SLFRS 15, Revenue from Contracts with Customers. (9 marks)

June 2018 Q2

(c) BEL (Pvt) Ltd (BEL) has entered into a contract with a customer to build an apartment complex. According to the contract, BEL is responsible for overall management of the project, site clearance, foundation, procurement, construction, piping, wiring, engineering, installation of the equipment and finishing. BEL and its competitors regularly sell many of these services separately to other customers.

Required:

Advise the management of BEL on identifying performance obligations of the above contract per SLFRS 15 Revenue from Contracts with Customers. (6 marks)

December 2016 Q1

2. Contract with DreamCars (Pvt) Ltd

During the year Luxury Motors entered into a contract with DreamCars (Pvt) Ltd to sell Type A cars of DreamCars at the company's showrooms. Per the contract, DreamCars will decide the price of the car to be sold to the customer. Luxury Motors is entitled to 10% of the value of each car sold. If a customer wishes to buy this type of car from Luxury Motors, the transaction should be arranged by Luxury Motors, and DreamCars will have the responsibility of providing the car to the customer. A major advantage of this contract to Luxury Motors is that it does not have to worry about bad debts.

Revenue and cost of sales included in the income statement of Luxury Motors for the year are as follows.

	Rs. million
Revenue (2 cars*20)	40
Cost of sales (40*90%)	36
Gross profit	4

Required:

(a) Validate the above adjustment mentioned in point 2 above, and propose required corrections together with explanations of relevant requirements from the accounting standards.

(b) Advise whether your answer to (a) above in relation to the contract with DreamCars (Pvt) Ltd (point 2) would change when SLFRS 15-Revenue from Contracts with Customers is applied. (5 marks)