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THE INSTITUTE OF CHARTERED ACCOUNTANTS OF SRI LANKA

# CL 02 – Financial Reporting and Governance

## Corporate Level

(SLFRS 15 – Revenue from Contract with Customers-P2)



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## 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)***.

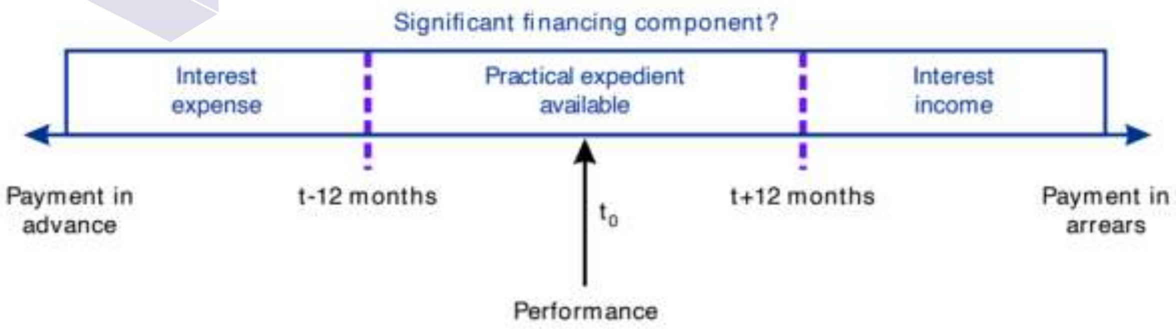
This is **because**, the transaction price should reflect the cash price of the goods or services provided at the date when control of those goods or services passes to the customer.

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?

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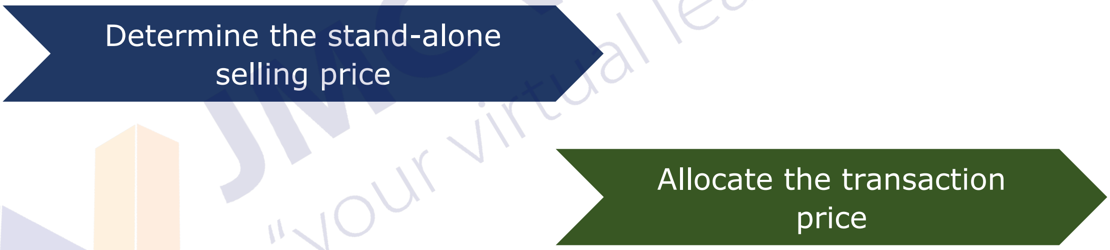
## STEP 04 - ALLOCATE THE TRANSACTION PRICE TO THE PERFORMANCE OBLIGATIONS IN THE CONTRACT

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.

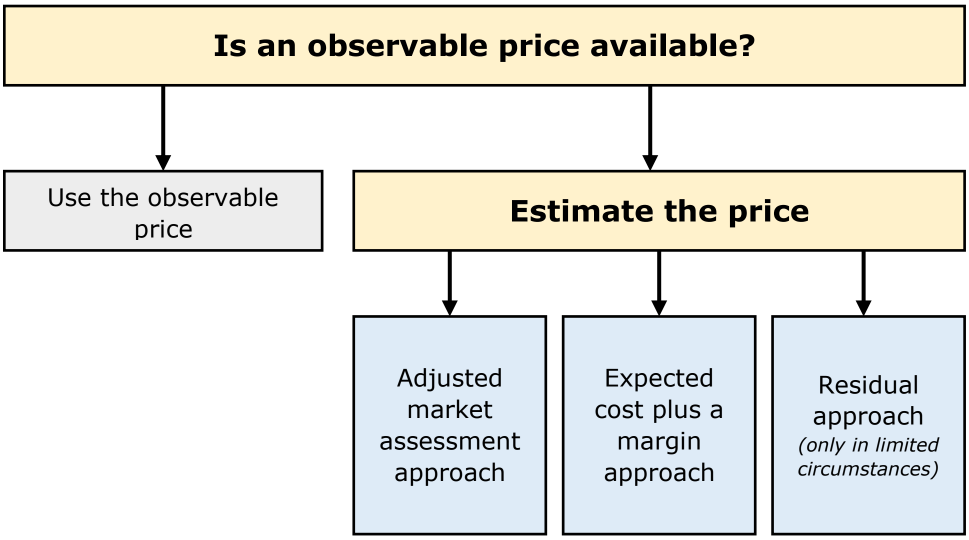





### Determine the stand-alone selling price

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** |

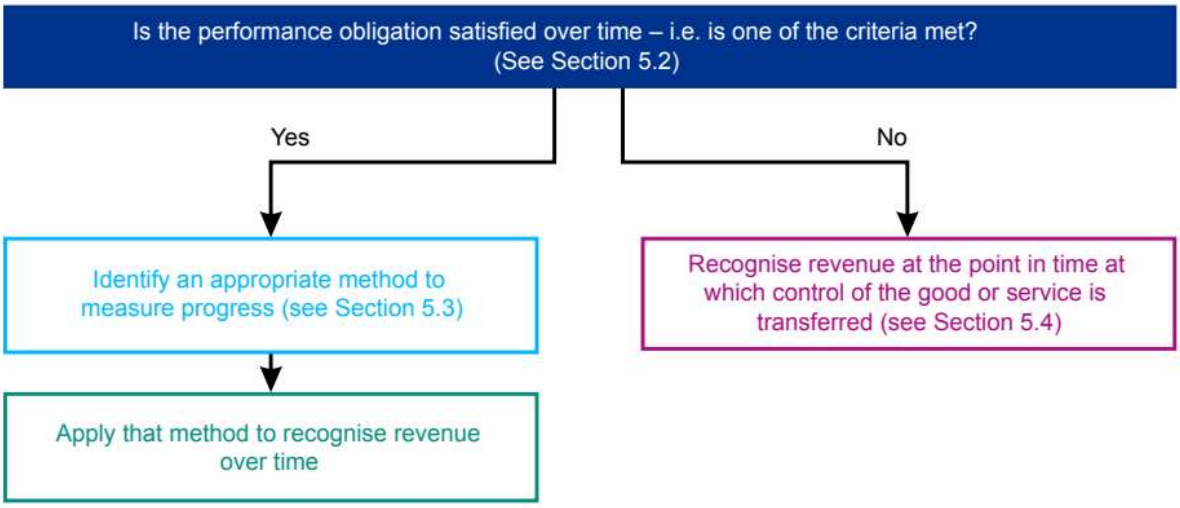
**Required**: Explain how this need to be treated as per SLFRS 15.

## 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:<br>○ deploy the asset in its activities<br>○ allow another entity to deploy the asset in its activities<br>○ 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:<br>○ use of the asset<br>○ consumption of the asset<br>○ sale or exchange of the asset<br>○ pledging the asset<br>○ 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<br>• Appraisals of results achieved<br>• Milestones reached<br>• 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<br>• Costs incurred<br>• Time elapsed<br>• Labour hours expended<br>• 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.

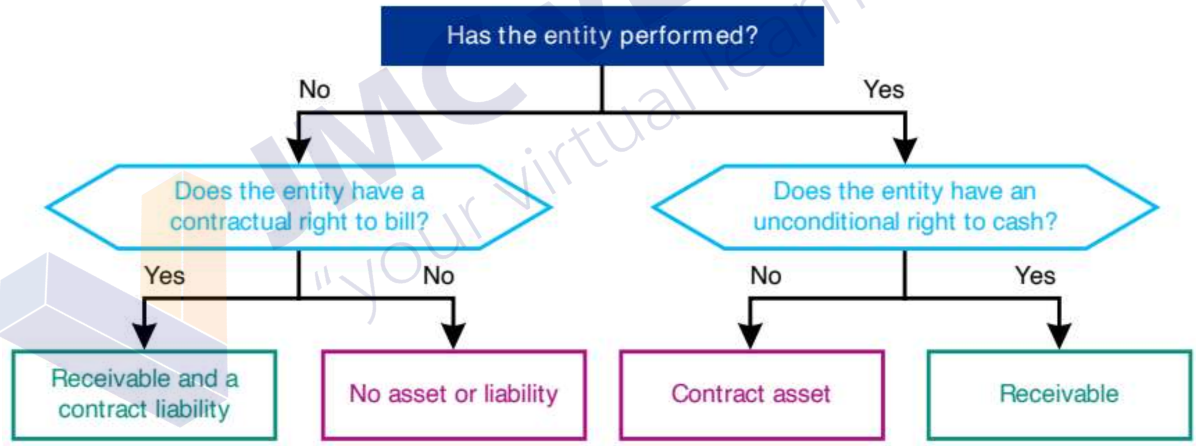
**Required**: Should Clarence recognize revenue from the above transaction in the year ended 31 December 2021?

## 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** | |
| | **Notes** | | **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:

| Segments | For the year ended 31 December 2024 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 2024 | 31 December 2023 | 1 January 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** |