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Perceptions Regarding the Impact of IFRS 15 - Illustrative Examples Step by Step

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Abstract

As users' needs become larger, entities need to adapt their provided information. Thus, financial reporting suffers permanent changes. One of the recent changes that occurred at entities that report in line with the International Financial Reporting Standards, applicable from 2018, highlights the IFRS 15 revenue recognition approach, which amends IAS 18 and is based rather on a related approach transfer of control than on the commonly used risk transfer and benefit approach.
The areas that best reflect these changes are telecommunications, software development, real estate investment and construction.
In this paper it is emphasized the impact of the new IFRS 15 standard on income recognition, highlighting various illustrative examples.

Keywords*: IFRS 15, income recognition, customer contracts*
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1. Introduction

Changes, such as the evolution of global markets, the rapid development and dissemination of technology, customer requirements related to product differentiation, affect the organizational environment. At present the ability to adapt to change is one of the most useful features in the recipe of success.

The need to have financial statements that contain comparable information at international level has increased in Romania, especially in the public interest entities, but also in order to assess the performance in the whole business environment. One of the reporting frameworks that provide an important benchmark for this comparability is the International Financial Reporting Standards (IFRS).

Once with the economic changes, financial reporting has been in trend, so the technique underlying the accounting logic was a resource that has been continually modified according to user requirements.

In Romania, convergence towards compliance with IFRS has taken place over the last few years, the Romanian regulations being very close to international standards, but there are a number of differences that lead to different profit / loss results. Additionally, IFRSs have been amended, and are reflected in the amendments to national law that are mandatory for those entities that apply IFRSs.

The paper contains three significant parts, highlighting some of the latest changes to IFRS, namely IFRS 15, addressing the conceptual and legal framework, perceiving the impact of the new IFRS 15 on income recognition with illustrative examples, and benchmarking IFRS 15 against IAS 18.

2. Literature review

In recent decades, both in the international and national contexts, revenues accounting was intensely debated (eg Wüstemann J. & Kierzek S., 2005, Nobes CW, 2006, Gîrbina M., 2014, Grigoroi L., 2017), it was investigated the notion of revenue, being recommended new criteria for classifying them according to the purposes of the use of the information and examining problems of their recognition.

IFRS 15 "Revenue from contracts with customers" comes with a comprehensive approach, currently invalidating IAS 11 "Construction Contracts", IAS 18 "Revenue", IFRIC 13 "Customer Loyalty Programs", IFRIC 15 "Agreements for the Construction of Real Estate", IFRIC 18 "Transfers of Assets from Customers" and SIC-31 "Revenue - Barter Transactions Involving Advertising Services".

IFRS 15 "Revenue from contracts with customers" has combined all the recommendations regarding the recognition of revenues, which previously existed within different standards and changed conceptually the approach of their recognition (Grigoroi L., 2017).

IFRS 15 responds to different business models and reflects the real consequences of modern and complex economic transactions, important issues that radically distinguish it from the standards it replaces, avoiding the favouring of the short-term perspectives and of the volatility as regards the revenue recognition (Grigoroi L., 2017).

In Romania, officially, the mandatory application of IFRS for the economic and financial operations, carried out with emphasis in the individual annual financial statements, started on January 1st, 2013 for entities listed on a regulated market, according to OMFP no. 881/2012, respectively OMFP no. 1286/2012.

Moreover, some entities, especially those owned by foreign shareholders, apply both Romanian regulations and IFRSs, especially in reporting to the mother company.

Accounting regulations in line with International Financial Reporting Standards (IFRS) have recently been amended through OMFP no. 3189/2017, bringing substantial changes, among which we mention the replacement of IAS 18 by IFRS 15. The initial regulation was given by OMFP no. 2844/2016. We can consider the equally applying of IFRS 15 policies to the entities, being substantially identical to ASC 606 of the US GAAP, thereby ensuring thus a comparability across Europe and the United States of America.

IFRS 15 "Revenue from contracts with customers", applicable in Romania since 2018, although referring to the recognition of revenues from contracts with customers, is also a guide to the costs incurred in obtaining and fulfilling the terms of contracts with customers as well as current rules on receivables, contractual rights and obligations. Therefore, besides the significant impact on the financial performance and financial position situation, IFRS 15 also has an economic and legal impact at entity level.

IFRS 15 leads to a change in revenue recognition in general, with greater impact on telecommunications, software development, real estate investment and construction. The new revenue recognition model under IFRS 15 is based on a transfer control approach rather than the commonly used risk transfer and benefit approach in accordance with IAS 18 (Buhăescu O., 2019).

At national level, the accounting regulations (OMFP no. 3189/2017) complying with IFRS have brought to the fore the responsibility of the administrator or another person who is required to manage the entity including for the estimates made which form the basis of the accounting records and for determining the nature of economic and financial operations, depending on their economic reality.

According to OMFP no. 3189/2017 the expenses representing marginal costs of obtaining a contract, namely costs of fulfillment of a contract and which, according to IFRS 15, meet the criteria for recognition as assets, are recorded by nature, with the simultaneous reflecting of the related asset as follows:

474	=	713
"Deferred amounts related to obtaining and performing a contract"		*Revenue related to the cost of obtaining and fulfilling a contract "*

Amounts are to be staggered, according to the contractual provisions, being recognized as expenses of the period (account 6588 "Other operating expenses" / analytically distinct).
The main objective of this paper is to explore the provisions of IFRS 15 "Revenue from contracts with customers", highlighting the novelty of its content that results in changes in the way in which income is recognized and reported for entities that apply mandatory or voluntary IFRSs in Romania.

3. Research methodology

This paper analyzes the new approaches to IFRS 15, proposing solutions and practical applications and helping to improve accounting and financial reporting of revenues with a direct impact on the decisions taking.

In the paper, we used qualitative research methods, pursuing the broad interpretation of policies and options for financial recognition and reporting of revenue under the new IFRS 15 "Revenue from Contracts with Customers".

Using critical and empirical arguments, this paper is part of fundamental research, aiming at acquiring new knowledge on new approaches to financial revenue recognition and reporting and, on the other hand, in applied research, in support of practitioners and for educational purposes through numerous practical examples. Our reasoning also takes into account the comparative analysis of IFRS 15 versus IAS 18, highlighting the elements that add value to the quality of financial reporting of revenues. The contribution of this paper is to interpret how the new requirements will cause entities to recognize and present their income, followed by practical examples.

The results of the research can be used both in practice for entities that apply mandatory or voluntary IFRS and for didactic purposes.

4. Step by step in perceiving the impact of the new IFRS 15 regarding the revenues' recognition: illustrative examples

When identifying the contract with a client, one of the five conditions that must be met to assess whether we are in the presence of a contract is *the probability that the entity will recover the equivalent to which it is entitled.*

What does it mean and how does this condition is applied?

The requirement for recoverability is to integrate the customer's credit risk assessment into determining the validity of a contract (i.e. the probability that the entity will recover the equivalent to which it is entitled in exchange for goods or services).

It should be noted that according to IFRS an event is "probable" if it is "more likely than unlikely to occur" and the introduction of such a threshold obliges entities to determine whether the contract is valid and is a genuine transaction. Although this conclusion is subjective and based on judgment or reasoning, IFRS 15 provides guidance and asserts that this assessment takes into account the "ability and intent" of the customer to pay the consideration for which the entity is entitled (in reality, no contracts with entities with high credit risk).

When determining the equivalent of the performance (even if it is variable due to a price concession), it has to be assessed according to the customer's ability and willingness to pay.

Determining the probability of recovery is very important in accordance with IFRS 15. If the recovery condition is not met, then it is not possible to recognize the revenues of ordinary activity (and hence the cash accounting method will be used) and any equivalent received is recorded as a liability (i.e. as deferred income) to one of the following situations:

- the parties have approved the contract and have committed themselves to fulfilling their obligations,
- the entity can identify the rights of each party with respect to the goods or services to be provided,
- the entity may identify the terms of payment for the goods or services to be provided,
- the contract has a commercial substance and
- it is probable that the entity will recover the fee to which it is entitled in the future in the exchange. [IFRS 15.9].

In order to identify the performance obligations of the contract, the obligations regarding the promised goods or services will be identified.

In accordance with IFRS 15, a "performance obligation" refers to a promised separate good or service (that is, according to a promise in a contract).

A contract includes goods or services promised explicitly but also implicitly. An implicit promise stems from the standard business practices. Identifying the promised good or service involves the exercise of judgment or professional judgment. For example, if an item or activity provides an asset to the client, even a less significant one, is it a "promised good or service" to determine whether there is a performance or execution obligation?

Based on the conclusions of IFRS 15, "... all goods or services promised to a client under a contract give rise to an execution obligation because the promises were made in the context of the negotiated agreement between the entity and its client."

Also, in line with the Basis of conclusions of IFRS 15, entities "are not exempt from accounting or recognition of service obligations that the entity may consider unimportant or implemented only in accordance with the form. The entity shall only determine whether those performance obligations are insignificant in relation to its financial statements."

When all goods or services are identified as explicitly or implicitly promised in the contract, it will be necessary to assess whether those goods or services are execution obligations.

In order to assess what constitutes a performance obligation (performance), it must be determined whether:

- the good or service is distinct [IFRS 15.22 (a)];
- the good or service is part of a series of separate goods or services that are essentially the same and are provided to the customer at the same pace [IFRS 15.22 (b)].

Of course, the identification of the performance obligations requires once again the exercise of reasoning.

4.1. Identifying a distinct service or asset

In accordance with IFRS 15, in order for a good or service to be considered distinct or separate, two very precise conditions must be met:

- the client must be able to benefit (obtain economic benefits) in respect of the good or service in question in isolation or in combination with other available resources (i.e. the good or service may exist separately) [IFRS 15.27 (a)];
- the good or service can be identified separately from other goods or services under the contract (i.e. it is presented separately under the contract) [IFRS 15.27 (b)].

Factors indicating that a customer is in a position to seize or obtain economic benefits related to a good or service either in isolation or in combination with other readily available resources includes that the service or asset may be:

- used, consumed or sold for an amount greater than its residual value;
- held in another way that produces economic benefits.

An easily available resource is a resource that is usually sold separately. When a good or service is generally sold separately, it indicates that the customer can benefit from goods or services, taken separately or in combination with other readily available resources.

In particular, the following factors indicate that the promise of an entity to provide a good or service to a customer can be identified separately from other promises contained in the contract, namely:

- the entity does not carry out significant work integrating the good or service with the other goods or services promised in the contract to make it represent the group of goods or services that are the subject of the customer's contract. In other words, the entity does not use the asset or service as input to produce or deliver the results specified in the contract (IFRS 15.29 (a));
- the good or service does not substantially change or fails to adapt another client's good or service and has been promised in the contract (IFRS 15.29 (b));
- the good or service does not necessarily depend on other goods or services promised in the contract and is not closely related to it (IFRS 15.29 (c)).

EXAMPLES

a) Identify distinct (separate) goods

A truck manufacturer also sells full trucks and truck spare parts. When a customer purchases a complete truck, the truck consists of several inputs (such as engine, tires, bodywork etc.);

However, the customer does not receive these entries in isolation (such as only the engine, or just the tires). Entries are used to produce the outputs that are provided in the contract, in this case the truck.

Although the engine may be sold separately as a spare part and therefore the first condition relating to a separate good is fulfilled under a contract for the production of a complete truck, the engine is not considered a separate asset because it is an entry and the fact that the entity provides a significant service consisting of assembling the engine with the other goods and services provided in the contract, i.e. the engine does not exist separately under the contract.

Therefore, for this type of contract, the engine is not considered to be a separate asset or service and does not constitute a separate obligation of performance or execution.

This requirement is intended to simplify the application of the five-step model in the situations where an entity essentially provides the same good or service consecutively over a given period of time.

b) Separate or distinct series of goods

A manufacturer concludes a contract with a customer to supply a single set of similar personalized goods in a significant quantity that will be delivered consecutively and progressively. Under the contract, the customer acquires a right over ongoing production and gains control over it as the production process progresses.

The manufacturer has established an average cost estimate for the manufacture of the products and has also determined that the use of an input-based costing methodology for this specific contract is a good description of his benefit relating to the transfer of ownership control.

This contract refers to a series of distinct or separate goods which in fact constitute a single performance or obligation justified by the following aspects:

- the goods are similar and are delivered consecutively (i.e. for a period of N years);
- the contract is executed gradually and the client acquires a right to current production and gains control over it as production advances and therefore satisfies the condition of progressive recognition or accounting;
- the entity uses the same method (i.e. the cost of ownership method) to measure the extent to which the performance obligation related to the supply of each product is met.

Since the condition for a range of goods or services is met, the series must be accounted for as a single performance obligation. This treatment is not optional.

4.2. Separate service or good provided in the contract

What is the impact of outsourcing (sub-contracting) on the identification of performance or service obligations? For example, suppose a supplier offers a certain number of goods or services in a contract and these are offered to the client together. However, certain individual goods or services required to deliver the whole may be subcontracted by the supplier.

Outsourcing should not affect the question whether the good or service is distinct. However, considering each good or service as a promise, we could not represent a true image (it would not accurately reflect) the nature of the entity's promise to the client or the benefit of the entity.

Subcontracting services

A builder signs a contract with a customer to build a home. Different goods and services are needed throughout the year and the construction process.

In a construction project, goods and services are usually integrated so that the customer obtains only one output and the contract as a whole is considered as a single obligation of performance.

For example, if the builder does not perform all the services required to produce the results stipulated in the contract. For example, he subcontracted electrical and sanitary works to an independent third-party contractor. Outsourcing or subcontracting some services changes the valuation so that the contract is no longer a single execution obligation? Does the outsourcing ability mean that services are distinct performance obligations?

In this example, even if the electricity and sanitary services are provided by a subcontractor (and therefore may exist separately), the producer does, however, an integration work because the nature of the promise is the delivery of the results stipulated in the contract (i.e. house).

We can say that outsourcing should not affect the question whether the good or service is distinct.

Since the two conditions relating to a distinct good or service (i.e. which may exist separately and which are distinct in the contract) are not fulfilled, the entire contract is a single performance obligation.

These subcontracting arrangements should, however, be taken into account in the light of the principal-agent relationship (i.e. the subcontractor acts as an agent). Considerations should also be given to entities acting on their own behalf or as agents listed in Annex B to IFRS 15.

At determining the transaction price, we are looking at issues that relate to the paytable value that may be variable, meaning it includes any amount that may vary within a contract, including, for example, performance bonuses, penalties, discounts, concessions on to price incentives and the right of the customer to return a product. This is considered as a component of the transaction price and is part of the equivalent that the entity expects to obtain in exchange for the supply of the promised goods or services; therefore, it must be estimated and included in the transaction price for the purpose of revenue recognition.

When this is variable, the entity shall estimate it using ***the estimated value method*** (i.e. an amount weighted with the probability of occurrence) or ***the most probable quantum method***, i.e. the method that most accurately calculates the amounts to be taken into account.

Note:

> In all subcontracting relationships, the entity continues to act in its own name. The facts and circumstances of the relationship and the conditions involved must always be evaluated.
>
> The entity must include in the transaction price all or part of the estimated value of the variable to be recovered, but only to the extent that it is highly probable that the subsequent cancellation of the uncertainty of the variable to be paid does not result in an adjustment to the significant decrease in value accumulated earnings.

EXAMPLE

On January 1, 20XX, an entity enters into a contract with a customer to sell a product with a total value of **100 M.U.** per unit, for one year.

If the customer *buys more than 180 units/year*, the total value will be 90 M.U. per unit (this discount will be applied retrospectively, so the price of the units purchased will be 90 M.U. per unit). Initially, the entity does not believe that the customer will buy more than 150 units.

However, on May 15, 20XX, taking into account the customer's acquisition rhythm, the entity declares that the client will achieve that objective. Let's assume that the purchasing pace is as follows: January - 30 units, February - 20 units, March - 25 units, and during May, until May 15, other 30 units.

Because the total 100 M.U. includes a fixed component (e.g. 90 M.U. per unit) and a variable component (e.g. 10 M.U. per unit), an estimate of the variable amount should be made and determining if this estimate is subject a limitation.

Let's consider the following:

• **When signing the contract**

Based on past experience with this product and with this customer, the entity does not believe that the customer will achieve the desired target for the amount to be recovered to reach 90 M.U. The entity considers that there is a high probability that there will be no significant revenue adjustment as the expected purchases will not exceed 180 units and that the entity expects to be entitled to an estimate of 100 M.U. per unit rather than 90 M.U. per unit. The entity recognizes the total amount of the consideration, or the amount to be recovered, which is 100 M.U. per unit.

• **Issues related to the draws given**

- On March 31, 20XX

If the conclusions at the time the contract is concluded are still relevant, earnings for the period ended March 31, 20XX will be reported at 100 M.U. per unit.

- On May 15, 20XX

Currently, the entity estimates that, as a result of increased purchases, the customer will exceed 180 units. It is now very likely that there will be a significant downward adjustment.

As a result, earnings will need to be adjusted retrospectively to 90 M.U. per unit. This adjustment will be recognized in the current period, May 20 (i.e. in the second quarter).

Between January and March, the amount of revenue to be accounted will be **75,000 M.U.**, that is:

(30+20+25) units × 100 M.U./unit = **75,000 M.U.**

and in the April-May period will be of only **1,950 M.U.**, i.e.:

(30 units × 90 M.U./unit – (100-90) M.U./unit × × (30+20+25) = 2,700 M.U. - 750 M.U. = **1.950 U.M.**

4.3. The impact of the significant funding component

IFRS 15 sets out the specific requirements for the "significant funding component".

The adjustment of the estimated value to be recovered in order to take into account the significant funding component aims to recognize income in an amount that reflects the "cash sale price or on-site payment" of the asset or service provided in the transaction at the time of which good or service is provided.

Contracts for which the payment by the client as well as the performance or performance of the entity is made at very different times are to be assessed to determine whether the contract has a significant financing component. In accordance with IFRS 15, to determine whether the contract has a significant financing component, the relevant facts and circumstances should be assessed.

To do this, you need to consider the following two factors:

a. the difference, if any, between the amount receivable and the cash sale price of the promised goods or services [IFRS 15.61 (a)];

b. the combined effect of the following two elements [IFRS 15.61 (b)]:

- the expected interval between the time the entity provides the goods or services promised to the customer and the moment when he pays them,
- existence of significant interest rates on the market.

EXAMPLE

Payment made in advance and estimated discount rate

This example accompanies IFRS 15 but is not an integral part of it. It is intended to illustrate aspects of this standard and not to provide interpretative guidance.

An entity enters into a contract with a customer to sell an asset. Asset control will be transferred to the customer within two years (delivery will be completed at some point).

The contract provides for two possible payment methods:

- payment of 8,000 monetary units (MU) in two years in which the client obtains control of the asset,

or

- 7,000 UM at the time of signing the contract.

The customer chooses to pay 7,000 MU upon signing the contract. The entity concludes that the contract includes an important funding component due to the period that elapses between the time the client pays the asset and the moment the entity transfers the customer's asset, as well as taking into account prevailing market interest rates.

The default interest rate on that transaction is 11%, i.e. the interest rate required for the two payment methods to be equivalent at the economic level. However, the entity determines, in accordance with paragraph 64 of IFRS 15, that the interest rate at which the adjustment of the value of the promised consideration should be used is 6%, which corresponds to the entity's marginal debt ratio.

Accounting treatment of the significant funding component:

a. Recognition of a contractual obligation in respect of UM payment of 7.000 received at the time of award of the contract:

5xx	=	4xx	7,000
Bank		Debt for contract	

b. In the two years following the conclusion of the contract and until the asset is transferred, the entity adjusts the amount of the promised amount to be recovered (in accordance with paragraph 65 of IFRS 15) and recognizes the contractual obligations by recognizing an interest at 7,000 MU, of 6% for two years.

66x	=	4xx	900
Interest expense		Debt for contract	

c. Recognition of revenue in respect of the assets transfer:

4xx	=	7xx	4,900
Debt for contract		Ordinary revenues	

As a simplification, the entity is not required to adjust the transaction price in a contract to take into account the effects of an important component of financing if it is expected to receive the payment no later than twelve months after the supply of the good or service.

ANOTHER EXAMPLE

An engineering consultancy firm signs a 2-year contract to provide a consultancy service to a builder for electricity works in a new multi-billion trading complex.

Under the contract, the builder will make payments to the consultant at certain dates specified in the contract. Let's assume that the engineering firm has determined that this contract is a single execution / performance obligation that will be met progressively. The staggered payment amounts have been programmed to coincide with the benefit.

An amount representing 10% of each payment will be retained by the manufacturer and these deductions will be paid if the consultancy activity is complete and all complex electrical installations will be put into operation.

The engineering firm concludes that even if there is actually a delay between delivery and payment (that is a warranty retention), this delay is not a significant component of financing, since payments coincide with the provision of the entity and the retention of the guarantee only serves to protect the manufacturer against the possibility that the engineering firm will fail to fulfill its obligations under the contract. The reason for postponing the payment is therefore not related to funding, and the difference between the amounts is proportionate in relation to the reason for this difference.

However, if the contract provided for the manufacturer to make a payment equal to 50% of the total amount, at the time the contract was awarded, then there would be an important financing component. As the services will be provided for the entire duration of the two-year contract and not when the contract is signed, then the payment will no longer coincide with the benefit. This means that the entity will have to determine whether there is a significant funding component.

4.4. Returns or sales with returns right

Returns are a variable compensation form. IFRS 15 provides specific guidance for this type of variable. Entities in many sectors (for example, retail, industrial products, consumer goods etc.) often offer customers the right to return for the purchase of certain goods, which may lead to:

- a full or partial reimbursement of the paid counterparty;
- a credit note applicable to amounts that are or will be owed to the entity;
- another product offered in return.

In accordance with IFRS 15, revenue is accounted for as follows:

a. **Recognizing revenue** for an amount equal to the one the entity expects to be entitled to. In making its assessment, the entity should apply the variable counterparty guidance, including the limitation of estimates. Consequently, for the assets for which it expects to return, the entity does not recognize income (since it is highly probable that a significant adjustment will occur),

b. Write **a debt** for the amount the entity expects to repay (that is, for the goods it is expected to return).

c. Write **an asset** with an appropriate entry in the cost of sales as a right to recover the goods when the refund is paid (i.e. this will be at the cost of the original stock without estimated costs for the recovery of the goods).

EXAMPLE OF MERCHANDISING RETURNS ACCOUNTING

A retailer has a stated policy that any product can be returned within 30 days, subject to a 20% limit (i.e. with a maximum return of 20% of the total purchases within 30 days).

On January 1st, 20XX, the retailer launched a new product at a stock value of 40 M.U. Returns were made over three months: January - 5% returns, February - 20% returns, March - 10% returns.

On April 1st, 20XX, the retailer concludes a new deal and sells 150 units of the new product at 50 M.U./unit.

Although the product has just been launched, there is a wide variety of possible recoverable or receivable amounts (the example is proven by the percentage of returns in recent months) and the retailer is unable to say that there is a large possibility decreasing adjustment, quite significant for the variable component.

As a result, the variable share – that is, 20% of the transaction price being returned – will not be accounted before May 1st, 20XX, when the period of 30 days given as the deadline will end. We will be able to use the recommended accounts in accordance with the Ministry of Finance Order no. 3189/2017, such as:

474 "Deferred amounts related to obtaining and performing a contract",

713 "Revenue from the cost of obtaining and performing a contract",

4761 "Repayment debts related to return sales",

4762 "Claims related to the right to recover products from customers".

Thus, we will have on **April 1st:**

%	=	371	6,000 (150 pcs.× 40 U.M.)
4762		Stocks	1,200
Right of recovery (20%)			
607			4,800
Cost of sales			

and as the product is sold:

5XX	=	%	7,500 (1,500×50)
Banks		70X	6,000
		Ordinary revenue	
		4761	1,500 (20% ×
		Return debt	7,500 = 1,500)

and at **May 1st, 20XX*:***

4761	=	70x	1,500
Settlement Debt		Ordinary revenue	
607	=	4762	1,200
Cost of sales		Right of recovery	

when it comes to the end of the 30 days (assuming there is no return).

4.5. Loyalty or regular programs

A loyalty program that gives the customer a significant entitlement gives rise to a performance obligation, to which a part of the total recoverable amount provided in the contract is to be allocated.

An entity has a customer loyalty program based on which the customer obtains 1 loyalty point for every 10 purchased monetary units (MU). Each item can be redeemed for 1 point discount on any future purchase of the entity's products. During a fiscal year, customers buy products worth 100,000 and receive 10,000 points for future purchases.

The amount to be recovered is an amount to be determined and the specific sales price of the purchased products is 100,000. The entity estimates that 8,000 points will be used or exchanged. Given this probability, it is estimated that the specific sales price of a point will be 0.80 (i.e. a total of 8,000) in accordance with paragraph B42 of IFRS 15.

The points give clients a significant right that they would not have granted in the absence of a contract.

The entity concludes that the promise of giving points is a performance or execution obligation. It distributes or allocates the transaction price (100,000) between **Revenue**s and **Points** based on the specific sale price criterion, as follows:

Revenues = 92,592, i.e. 100,000 MU × 0.925 (allotment of Specific Selling Price according to the ratio 100,000 ÷ 108,000)

Points = 7,408, that is 100,000 MU × 0.7408 (allocated Sales Price Specific, according to the ratio 8,000 ÷ 108,000)

or 100,000 – 92,592

At the end of the first year, 4,000 points were exchanged and the entity continued to wait for a total of 8,000 points.

We account for *earnings from ordinary loyalty points* as follows:

4,000 (4,500 points ÷ 8,000 points) = **2,250**

and

a contractual liability of **1,750** = (4,000 – 2,250), as unused or unchanged points at the end of the first year period.

At the end of the second year, an amount of **7,500** points was used.

The entity updates the estimate of the points to be exchanged and expects to now make a total of 8,000 points.

It recognizes revenue from ordinary activities in terms of loyalty of 1,500, which is obtained as the difference between:

3,750 [(total redeemed points 7,500 ÷ total points that should have been exchanged 8,000) × initial allocation of 4,000 MU] and **2,250** (the amount that was recognized in the first financial year).

The debt balance is **500** MU (the initial allocation of 8,000 - the usual cumulative recognized activities of 7,500) or 8,000 – 4,000 – 3,500.

5. Parallel - Recognition of revenues under IFRS 15 versus IAS 18

The current IAS 18 disclosures provide applying the criteria for recognizing identifiable components, separately for a single transaction (for example, the case of S.C. ALFA: phone + monthly subscription). However, IAS 18 does not provide any indication regarding how to identify these components and how to allocate the sale price.

One way was to recognize the revenue from selling full monthly subscriptions as the service was provided and no income for the phone - the cost of the handset being treated as the cost of the customer's purchase.

Some companies have identified these components, but have then limited the revenue assigned to the sale of the phone to the amount received from the customer (more precisely zero), a form of a residual method.

For simplification, we suppose that S.C. ALFA does not recognize revenue from selling the phone because it offers it for free. The cost of the receiver is recognized in the profit or loss account and effectively, S.C. ALFA treats this as a new client's acquisition cost.

Revenue from monthly subscriptions is recognized monthly. The accounting record is to debit the receivables or petty cash /bank and to credit the income by 100 M.U., the cost of the receiver remaining at the expense, and the coverage of the receiver will be made until the contract is concluded by including proportionally the monthly invoiced revenues based on the subscription.

However, if we wish to recognize the income in accordance with IFRS 15, we can follow the case below:

SC ALFA must initially identify the contract (step 1); in this case it is a 12-month subscription with the client “Ana”, paid monthly for 100 M.U., offering free of charge the phone, which can be sold individually with 500 M.U./piece.

SC ALFA must identify all delivery obligations in the Ana’s contract (step 2) of the five-step model:

Step 1. Obligation to deliver a receiver

Step 2. Obligation to provide network services for 12 months (1 year)

The transaction price (**step 3**) is 1,800 M.U., representing the equivalent of the monthly subscription of 150 M.U. for 12 months.

SC ALFA must allocate the transaction price of 1,200 M.U. for individual contract obligations based on their relative sales prices (or their estimates) - this being **step 4**.

Obligation / Benefit	Individual selling price	% of total income	Revenue (relative sales price = 1,200*%)
Receiver	500	21.7%	395.60
Network services	1,800 (or 150×12)	78.3%	1,404.40
Total	**2,300**	**100%**	**1,800.00**

Step 5 is the recognition of revenue, when S.C. ALFA has fulfilled its execution obligations or performance.

Thus:

- When S.C. ALFA gives a **receiver** to Ana, it must recognize the income of **395.60 M. U.;**
- When S.C. ALFA provides **network services** for Ana, it must recognize a total revenue of **1,404.40 M.U.** during the 12 months. It's basically to record once a month, when billing takes place.

Description	Amount	Debit	Credit	When recording takes place
Telephone Receiver	**395.60**	**461 -** Settlement Income	**707X** (P/L) - Income from the sale of goods	When the handset is handed over to Ana
Network services	**117** (= monthly invoicing)	**411** Receivables to Ana	%	When network services are provided - monthly, according to the contract with Ana
	84 or (1,404.40/12)		**704X** (P/L) - Revenue from network services	
	33 (or 395.60/12)		**461** Revenues to be settled	

The biggest impact of the new IFRS 15 standard is that companies will report profits in a different way, and profit reporting patterns will change. In our telecommunication example, S.C. ALFA reported losses at the start of the contract and then continued profits under IAS 18 because it recognized revenue as invoiced to customers.

In accordance with IFRS 15, the profits reported by S.C. ALFA are the same in total, but the pattern of their recognition over time is different.

Why is it important to take this distinction into account? It is important due to the fact that some contracts exceed an accounting period (a financial exercise). These long-term contracts, earnings reported in incorrect accounting periods, could result in incorrect taxation, different stock exchange reporting, and other representational consequences.

If we look at the financial situation of S.C. ALFA, and we assume that this contract started on July 1st, 20XX and the end of the financial year of S.C. ALFA is December 31, 20XX, we will see deferred amounts of total revenue recognized in the 20XX financial exercise.

Execution obligation/ Revenues recognized	In accordance with IAS 18	In accordance with IFRS 15
Receiver	0.00	395.60
Network Services	900 (150×6)	702 (117×6)
Total	**900.00**	**1,097.60**

EXAMPLE

Goods production companies and contract changes

SC Beta PC, a computer manufacturer, signs a contract with S.C. Gamma to deliver **400** computers for a total price of 800,000 M.U. (2,000 M.U. per computer).

Because of the necessary arrangements, S.C. Gamma agrees to deliver computers in four separate delivery periods in the next four months (100 computers per period). SC Gamma takes over the computers on delivery.

After the first delivery stage, S.C. Gamma and S.C. Beta PC **changes the contract**.

SC Beta PC will provide 200 additional computers (600 in total).

How should S.C. Beta PC recognize the revenues related to this contract for the year ended at December 31,20X1 if:

- **Option A:** The price for the other 200 computers was set at 380,000 M.U., that is 1,900 M.U. per computer. SC Beta PC has offered a 3% discount for additional delivery, reflecting normal volume reductions provided in contracts similar to other customers.
- **Option B:** The price for 200 additional computers was set at 300,000 M.U., that is 1,500 M.U. for each computer. SC Beta PC has offered a great discount for extra delivery as it hopes for future cooperation with S.C. Gamma (but nothing has been discussed so far).

Until December 31, 20X1, S.C. Beta PC delivered 500 computers (400 as initially agreed and 100 on the basis of the contract amendment).

5.1. Revenue under previous rules (IAS 18)

By defining revenue in accordance with IAS 18, delivery revenue is simply accounted at the time of delivery, for the fair value of the performance made for the computers – which is any sum of the scenarios above.

IAS 18 does not require consideration to be given as to whether this additional delivery reflects or not the stand-by selling price.

Of course, again we are turning away from the "commercial substance", "transfer prices", "dumping prices" - this is just an example.

Income for the year ended at December 31, 20X1:

- For **Option A:** 800,000 M.U. (for the first 400 computers at 2,000 M.U. / piece) + 190,000 M.U. (other 100 computers delivered at 1,900 M.U. / piece) = **990,000 M.U.** (for all 500 computers delivered).
- For **Option B:** 800,000 M.U. (for the first 400 computers at 2,000 M.U. / piece) + 150,000 M.U. (100 additional computers at 1.500 M.U. / piece) = **950,000 M.U.** (for all 500 computers delivered).

5.2. Revenue in accordance with IFRS 15

In this approach, the additional contract is the typical change to the contracts, namely the change in *the number of computers* and *the total change in the transaction price*.

The IFRS 15 standard specifies how to account the changes in the contract, depending on the terms of the change.

There are two basic types of contract modification:

I. Amendment of the contract is considered as a separate contract

The resulting changes can be considered as a separate contract when two criteria are met:

- Additional products and services under the change must be distinct from the products or services in the original contract.
- In both scenarios, this is accomplished, as the additional computers are quite different from the original computers.

- **-** The anticipated price of the additional goods / services must reflect the individual (independent) selling price of these goods or services.

II. Modification of the contract is not a separate contract

If the above criteria are not met (or one of these is not met), then the change of the contract is not considered a separate contract, and the accounting depends on a further analysis.

For our case, we came to the conclusion that *the additional goods are distinct*, the main question is whether the additional extension reflects their independent sales prices.

Option 1: 3% discount for additional delivery.

The price of additional computers really reflects their sales prices because S.C. Beta PC normally offers a discount to exceed 3% of a buyer's quota.

Therefore, *this contract amendment is counted as a separate contract*, and the revenue for 20X1 (for the 500 delivered computers) is:

- 800,000 M.U. of the initial contract for 400 computers, at 2,000 M.U. / piece;
- 190,000 M.U. of the contract change for the other 100 additional computers delivered.

The total revenue for 20X1 is, therefore, **990,000 M.U. -** exactly as in IAS 18.

Option 2: Significant reduction in additional delivery

Here, it is clear that the price of additional computers *does not reflect their independent selling prices*, as the significant reduction is exceptional and is linked to the general contract with S.C. Gamma.

This means that *the second criterion is not met*.

Accordingly, the contract modification is NOT a separate contract but is associated with the original contract.

In this case, because additional goods are distinct, ***we must take into account, as we complete the original contract, to start the new one***.

We must simply acknowledge the revenue from the delivery made prior to the change of the contract under the initial contract.

For the remaining products of the original contract and for the additional goods, we recognize the total income of:

- That part of the value of the initial contract, which has not yet been recognized as revenue (that is, the price of the goods to be delivered); to which will be added
- the agreed payment in the contract modification.

We need to allocate this amount to individual or individual computers in this case.

In Option B, the contract was modified after *the first delivery*, so that S.C. Beta PC must recognize the revenue for the first 100 computers, according to the original contract:

- 200,000 M.U. for the first **100 computers** x 2.000 M.U. for each computer.

The total price of the transaction to be allocated after the contract is modified is:

- 600,000 M.U., being part of the initial value related to **300 unallocated computers** (400 per contract, less the first 100 delivered, to 2,000 M.U. per unit) related to the contract before the modification;
- 300,000 M.U., being the total for another **200 computers** at 1,500 M.U. / piece;
- **Total: 900,000 M.U.**

According to IFRS 15, we need to allocate this 900,000 M.U. for 500 computers in total (300 were not delivered before the contract modification + 200 additional computers), which means that S.C. Beta PC allocates 1,800 M.U. to a computer (900,000 / 500).

What is the total revenue recognized in 20X1 when the 500 computers were delivered? Let us calculate:

- Income for the 100 computers delivered before the contract modification: **200,000 M.U.**, i.e. (100 computers × 2,000 M.U. / computer)
- Revenues for the 400 computers delivered after the contract modification: **720,000 M.U.** (400 computers × 1,800 M.U. / computer);
- **Total: 920,000 M.U.**

Here we can clearly see that in this second scenario (for additional delivery with significant reduction):

• **In accordance with IAS 18**, the recognized income for the year 20X1 is **950,000 M.U.**

This amount includes 800,000 M.U. (for the first ***400 computers*** at 2,000 M.U. / piece) + 150,000 M.U. (100 additional computers at 1,500 M.U. / piece). We note that it is not take into account the moment when the contract change occurred.

The revenue to be recognized in the next period remains of 100 computers with 1,500 M.U. / computer, i.e. 150,000 M.U.; which leads to a total of **1,100,000 M.U.** for the entire contract.

• **In accordance with IFRS 15**, the income for the year 20X1 is of **920,000 M.U.**

This amount includes ***100 computers delivered before the contract modification***: for 100 computers × 2,000 M.U. / computer, that is 200,000 M.U. and ***400 computers delivered after the contract modification***: 720,000 M.U. (400 computers × 1,800 M.U. / computer).

The revenue to be recognized in the next period remains 100 computers at 1,800 M.U. = 180,000 M.U.; which leads to a total of **1,100,000 M.U.** for the entire contract.

In this situation, it is taken into account the moment when the contract change occurs.

We notice that totals are the same! Of course, the moment of revenue recognition is different. And precisely this moment can affect taxes, dividends, financial reports and everything.

Conclusions

In the last decade, a positive trend in improving the accounting regulations has been noted, being developed in terms of quality according to the economic and legal aspects of the entities in the context of modernization.

The paper addresses this aspect, giving a comprehensive insight into the novelty elements of the entity's current income recognition approach.

IFRS 15 "Revenue from contracts with customers" contains a new revenue recognition model and suggests a significant increase in disclosure requirements, with influences including information systems and internal data collection and reporting processes.

The IFRS 15 approach eliminates the different revenue recognition models, determined by the nature of the transaction (construction contracts, freight, provision of services, etc.), which had different principles and were sometimes difficult to understand and apply to more complex transactions.

Applying the unique model for all industries greatly improves the content and quality of information provided by entities as well as the level of comparability of revenue recognition practices in different areas.

Although the definition of income has not changed and has retained its meaning and content previously, IFRS 15 introduces new concepts such as customer contracts, transaction price, exposures, income recognition for multiple-item commitments, identification of execution obligations in a contract, assignment of transaction price to contract obligations, etc.

Contracts have become a fundamental element in initiating the revenue recognition process, IFRS 15 being applied only to those contracts where the co-contractor is a client.

The moment of income recognition refers to the notion of transferring control over the asset to clients rather than passing on the risks and benefits of the asset to customers, as considered in IAS 18.

IFRS 15 takes into account the principles of an entity for reporting useful information to users of the financial statements about the nature, value, timing, and uncertainty of revenue and cash flows arising from a contract with a client.

The new standard calls for the exercise of professional judgment by introducing the term "contract-related", which represents the entity's right to a consideration in exchange for the goods or services transferred by the entity to a client, where that right is conditional upon anything other than the passage of time. If that right is conditional only on the passage of time, then receivables are recorded.

In this case, it is important to understand the differences between the assets of the contract and the receivables, taking into account the risks associated with the seller's rights on the contra-payment of the contract. Both the asset of the contract and the receivables are subject to the risk of insolvency of the buyer. But, in addition, a contract asset is subject to other risks such as the risk of non-performance by the seller of its obligations (performance risk).

IFRS 15 has made a significant contribution to the harmonization and compatibility of the various revenue recognition and reporting practices, using a common revenue recognition model applicable to customer contracts, irrespective of the industry in which entities operate, thus creating the premises for ensuring comparability.

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