SLFRS 15: Revenue from Contracts with Customers

Introduction

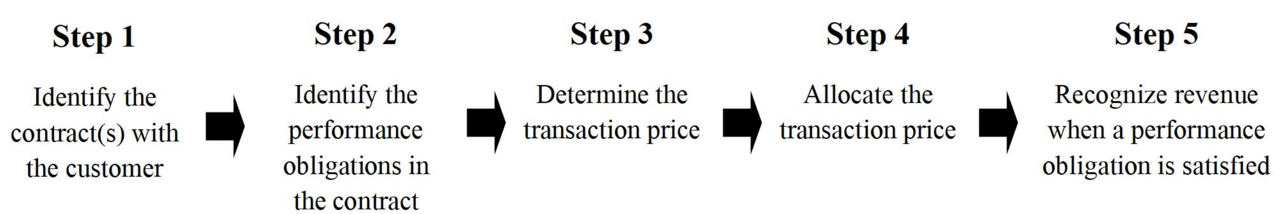
The objective of this Standard is to establish the principles that an entity shall apply to report useful information to users of financial statements about the nature, amount, timing and uncertainty of revenue and cash flows arising from a contract with a customer. The core principle of this Standard is that an entity shall recognize 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.

Main Features of SLFRF15 Revenue from Contract with Customers

This standard adopts an asset-liability approach as the basis for revenue recognition. The asset-liability approach recognizes, and measures, revenue based on changes in assets and liabilities. Under this approach, it is required to account for revenue based on assets or liability arising from contracts with customers.

SLFRF15 introduces a revenue model in which the key objective is that an entity should recognize revenue to depict the transfer of promised goods or services to the customer in an amount that reflects the consideration to which the entity expects to be entitled in exchange for those goods or services. To recognize revenue the five steps model should be applied.

Five Step Model



Step 1: Identify the contract(s) with the customer

A contract is an agreement between two or more parties that creates enforceable rights and obligations. A contract can be written, oral or implied by an entity’s business practice. The requirements of SLFRS 15 apply to each contract that has been agreed upon with a customer and meets the specified criteria. Accordingly, a contract with a customer will fall within the scope of SLFRS 15 when all of the following criteria are met:

- The contract has a commercial substance
- Parties committed to performing their respective obligations
- The parties to the contract have approved the contract

- The entity can identify each party's rights in relation to the goods or services to be transferred
- The entity can identify the payment terms and conditions for the goods or services to be transferred
- It is probable that the entity will collect the consideration to which it will be entitled

If the above criteria are not met in the contract, the entity will continue to re-assess the contract going forward to determine whether the criteria are subsequently met. Revenue is recognized only when a valid contract exists. On entering into a contract with a customer, an entity obtains rights to receive consideration from the customer and assumes obligation to transfer goods or services to the customer (performance obligation).

Example: 1
On 01.04.20X4, ABC PLC came to an agreement with a customer to sell a motor vehicle and provide two services for total consideration of Rs. 6,080,000. The right and the performance obligations to ABC PLC are as follows:

Right: Right to receive Rs. 6,080,000 of consideration upon satisfying the performance obligations
Performance obligations: Deliver the vehicle & provide two services

Step 2: Identify the performance obligations in the contract
A contract includes promises to transfer goods or services to a customer. This is referred to as a performance obligation. The performance obligation may be explicit, implicit, or based on customary business practice.

If goods or services are distinct, it requires to account for each performance obligation separately. A good or service is distinct if the entity's promise to transfer the good or service to the customer is separately identifiable from other promises in the contract. In other words, if the performance obligation is not highly dependent on, or interrelated with, other promises in the contract, then each performance obligation should be accounted for separately.

For example, selling a motor vehicle and providing a service are distinct obligations. Because the vehicle can be used without the service and the customer can obtain the service from other service providers. Hence, these two obligations are not dependent on each other. Here, the revenue applicable to each obligation is recognized by the seller when each obligation is satisfied.

In contrast, if each of these promises are interdependent and interrelated, these performance obligations are combined and reported as one performance obligation.

For example, selling a power plant and installing it are not distinct obligations. In other words, these two obligations are dependent on each other. Because, without the installation, the customer cannot use the plant, and the customer cannot get this installation done by other suppliers. Here, the total revenue is recognized by the seller when the installation is satisfied.

Step 3: Determine the transaction price

The transaction price is the amount of consideration in a contract which an entity expects to receive from a customer in exchange for transferring promised goods or services. The transaction price is **usually a fixed amount of consideration**, but it may sometimes include variable consideration or a non-cash consideration.

Step 4: Allocate the transaction price to the performance obligations in the contract

If there is only one performance obligation in the contract, allocating the transaction price is straight forward. However, where a contract has many performance obligations, an entity shall allocate the transaction price to the performance obligations in the contract with reference to their relative stand-alone selling prices. If a stand-alone selling price is not directly observable, an entity will need to estimate it.

Example: 2

With reference to example 1 above, assume that the stand-alone selling price of each performance obligation is as follows:

Motor vehicle	Rs. 6,000,000
One service	Rs. 40,000

Hence, the allocation of the transaction price of Rs. 6,080,000 is as follows:
performance obligation is as follows:

Motor vehicle	6,000,000
Two services	80,000 (40,000 x 2)
Total	**6,080,000**

It is clear that there is no discount given to the customer.

Allocation of discounts

Sometimes the transaction price may include a discount. Any overall discount is allocated between the performance obligations on a relative stand-alone selling price basis (Proportionate allocation). In some circumstances, it may be appropriate to allocate the discount to some but not all of the performance obligations.

Example: 3
With reference to example 1 above, assume that the transaction price is Rs. 5,472,000. The stand-alone selling price of each performance obligation is as follows:

Motor vehicle	Rs. 6,000,000
One service	Rs. 40,000

Hence, the allocation of the transaction price of Rs. 5,472,000 is as follows:
performance obligation is as follows:

Performance obligation	Stand-alone selling price	Discount	Allocated price	
Motor vehicle	6,000,000	600,000	5,400,000	(5,472,000/6,080,000*6,000,000)
Two services	80,000	8,000	72,000	(5,472,000/6,080,000*80,000)
	6,080,000	**608,000**	**5,472,000**	

It is clear that the total discount given to the customer is Rs. 608,000.

Step 5: Recognize revenue when the entity satisfies a performance obligation
An entity recognizes revenue **when it satisfies a performance obligation** by transferring a promised good or service to a customer. An entity satisfies a performance obligation when the customer obtains control of that good or service.

Control of an asset means having the ability to direct the use of and obtain substantially all of the remaining benefits from the asset. The amount of revenue recognized is the amount allocated to the satisfied performance obligation.

In the case of the sale of goods, the performance obligation may be satisfied at a point in time. The factors which may indicate that control is passed *at a point in time* include:

- The entity has a present right to payment for the asset
- The entity has transferred legal title to the asset
- The entity has transferred physical possession of the asset
- The customer has significant risks and rewards related to the ownership of the asset; and
- The customer has accepted the asset.

In the case of services, the performance obligation is satisfied when the service is performed.

Example: 4

With reference to example 3 above, assume that the vehicle was delivered on 30.04.20X5 and the first service was performed on 31.07.2025. The second service was performed on 30.04.20X6. The revenue to be recognized during the year ending 31.03.20X5 is as follows:

Sale of goods on 30.04.20X5	Rs. 5,400,000
Service income on 31.07.20X5	Rs. 36,000 (72,000/2)
Total revenue	**Rs. 5,436,000**

Presentation

An entity shall present the performance of a contract in the Statement of Financial Position as a contract asset or contract liability, depending on the relationship between the entity's performance and the customer's payment.

Contract Asset

A contract asset arises when the performance obligation is satisfied, but the corresponding consideration has not yet been received. Any rights (unconditional) to consideration shall be presented separately as receivable.

Example: 5

With reference to example 4 above, assume that the customer paid Rs. 5,000,000 during the year ending 31.03.20X5. The contract asset (trade receivable) is Rs. 436,000 (5,436,000 – 5,000,000)

Contract Liability

Where a customer has paid an amount of consideration prior to the entity transferring the related goods or service to the customer, a contract liability will be presented in the Statement of Financial Position. Contract liability is generally referred to as unearned sales revenue, unearned service revenue, or another appropriate account title.

Example: 6

With reference to example 4 above, assume that the customer paid the total truncation price of Rs. 5,472,000 during the year ending 31.03.20X5. The contract liability (unearned service revenue) is Rs. 36,000 (5,472,000 – 5,436,000)

Disclosure

Sufficient information to enable users of financial statements to understand the nature, amount, timing and uncertainty of revenue and cash flows arising from contract with customers shall be disclosed. To achieve this, an entity shall disclose the qualitative and quantitative information for all of the following:

a) **Contracts with customers** – These disclosures include the disaggregation of revenue into appropriate categories, presentation of opening and closing balances of contract assets and contract liabilities and significant information relating to their performance obligations.
b) **Significant judgments**–These disclosures include judgments and changes in these judgments that affect the determination of the transaction price, the allocation of the transaction price, and the determination of the timing of revenue.

c) **Assets recognized from the costs to obtain or fulfill a contract** – These disclosures include the closing balances of assets recognized to obtain or fulfill a contract, the amount of amortization recognized, and the method used for amortization.