Applying IFRS

The new revenue standard affects more than just revenue

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What you need to know

• In conjunction with the new revenue standard, the IASB issued several consequential amendments to other IFRSs that address the interaction with IFRS 15.

• Affected items include the sale of certain non-financial assets, advertising costs, service concession arrangements, onerous contracts and accounting for fees, interest and dividends.

• Entities should carefully review these amendments to understand whether they need to change their current practices.

• Most of the consequential amendments are applicable when IFRS 15 is applied.
1 Overview

In conjunction with the release of the new revenue recognition standard, IFRS 15 *Revenue from Contracts with Customers*, the International Accounting Standards Board (IASB or Board) issued consequential amendments to other International Financial Reporting Standards (IFRSs) in addition to replacing IAS 11 *Construction Contracts*, IAS 18 *Revenue*, IFRIC 13 *Customer Loyalty Programmes*, 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*.

The amendments address the interaction of IFRS 15 with other IFRSs and may require entities to change how they account for some items that are currently addressed in existing revenue standards that are replaced by IFRS 15. These changes may have been overlooked by some entities when initially considering the impact of IFRS 15.

This publication is intended as a companion to our *Applying IFRS, A closer look at the new revenue recognition standard* (general publication) issued in June 2014 and it provides some of the key highlights on the consequential amendments brought about by IFRS 15.

2 Key considerations

2.1 Sale of non-financial assets

IFRS 15 consequentially amended IAS 16 *Property, Plant and Equipment*, IAS 38 *Intangible Assets* and IAS 40 *Investment Property* requiring entities to use the requirements of IFRS 15 for the recognition and measurement of gains and losses arising from the sale of non-financial assets that are not an output of an entity’s ordinary activities.

An entity will be required to look to the control model in IFRS 15 to determine when to derecognise the non-financial asset (i.e., when control is transferred). The entity will estimate consideration to measure the gain or loss following the requirements in IFRS 15 for determining the transaction price. Any subsequent changes to the estimated consideration will also be accounted for following the requirements of IFRS 15. The measurement of any gain or loss resulting from the consequential amendments may differ from the gain or loss measured by following the requirements in IAS 18.

As part of the US consequential amendments arising from the new revenue standard, the US Financial Accounting Standards Board (FASB) introduced the concept of an in-substance non-financial asset. As a result, US GAAP preparers must apply the requirements of the measurement and recognition principles of the new revenue standard to the transfer of a subsidiary (or a group of assets) that is, in substance, a non-financial asset (e.g., the sale of shares of an entity that owns a single investment property - a corporate wrapper). However, the transfer of a subsidiary (or a group of assets) that is a business, but not an in-substance non-financial asset, will continue to be accounted for in accordance with existing US GAAP derecognition requirements.

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1 Available at www.ey.com/ifrs
IFRS does not have the concept of an in-substance non-financial asset and it has not been introduced by IFRS 15. IFRS 10 Consolidated Financial Statements² specifies how to account for a partial gain upon the derecognition of a subsidiary that is not a business. As a result, it appears that the accounting treatment may differ depending on whether a non-financial asset is transferred on its own (in which case, IAS 16, IAS 38 or IAS 40 would apply, as applicable) or within a subsidiary (in which case, IFRS 10 would apply).

2.2 Advertising costs
Entities that enter into arrangements to exchange rights, for example, to place advertisements on one another’s websites often conduct the exchange with no cash or similar amounts of cash. SIC-31 specifies that revenue from barter transactions cannot be measured reliably from the services received. Instead, a seller can reliably measure revenue at the fair value of the advertising services it provides in a barter transaction only by reference to non-barter transactions that meet all the following specific criteria:

- Involve advertising similar to the advertising in the barter transaction
- Occur frequently
- Represent a predominant number of transactions and amount when compared to all transactions to provide advertising that is similar to the advertising in the barter transaction
- Involve cash and/or another form of consideration (e.g., marketable securities, non-monetary assets, and other services) that has a reliably measurable fair value
- Do not involve the same counterparty as in the barter transaction

IFRS 15 replaces SIC-31 and does not specifically address such transactions. However, IFRS 15 requires that an arrangement has commercial substance in order to be considered a contract with a customer. Furthermore, commercial substance is defined as, “the risk, timing or amount of the entity’s future cash flows is expected to change as result of the contract”.⁴ Therefore, greater judgement of the specific facts and circumstances will be necessary when accounting for advertising barter transactions and assessing if they meet the commercial substance criterion.

2.3 Service concession arrangements
2.3.1 Identifying performance obligations
In order to recognise revenue for service concession arrangements, IFRIC 12 Service Concession Arrangements currently refers to IAS 18 and IAS 11 requirements. As a result of the consequential amendments, IFRIC 12 will refer to IFRS 15. Under IFRIC 12, there are separate requirements for accounting for operation services and construction or upgrade services. Currently, IFRIC 12 requires that, if an operator performs more than one service (e.g., construction or upgrade services and operation services) under a single contract or arrangement, consideration received or receivable must be allocated by reference to the relative fair values of the services delivered, when

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² As amended in September 2014 by Sale or Contribution of Assets Between an Investor and its Associate or Joint Venture
³ SIC-31.5
⁴ IFRS 15.9(d)
the amounts are separately identifiable.\(^5\) This has been deleted as part of the consequential amendments to IFRIC 12. As such, instead of determining the separately identifiable services, entities will have to identify the performance obligations in each contract in accordance with the requirements of IFRS 15.

To do this, entities will need to apply a two-step process to assess whether a promised good or service (or a bundle of goods and services) is distinct:

- **Step 1:** an assessment of whether the goods or services are capable of being distinct
- **Step 2:** an assessment of whether the goods or services are separately identifiable from other promises in the contract (i.e., the goods or services are distinct within the context of the contract)

Refer to Section 4.2 of the general publication for a further discussion on identifying performance obligations.

### How we see it

Generally, we expect entities to reach similar conclusions under IFRS 15 as they do under current IFRS that operation services and construction or upgrade services are two distinct services. However, entities must not assume that this will always be the case, given that service concession arrangements are contractually driven and vary across jurisdictions.

### 2.3.2 Determining and allocating the transaction price

Under IFRIC 12, items provided to the operator by the grantor are recognised as assets of the operator if the operator can keep or deal with the asset as it wishes. These assets are measured at fair value on initial recognition. The operator also recognises a liability in respect of unfulfilled obligations it has assumed in exchange for those assets. However, as a result of the consequential amendments, they will be treated as part of the transaction price, as defined in IFRS 15. The consequential amendments do not elaborate further. Therefore, it is unclear whether any particular requirements in IFRS 15 in respect of the transaction price will apply.

IFRS 15 requires that entities allocate the transaction price to the separate performance obligations on a relative stand-alone selling price basis. The stand-alone selling price is the price at which an entity would sell a good or service on a stand-alone basis at contract inception. IFRS 15 indicates that the observable price of a good or service sold separately provides the best evidence of stand-alone selling price. However, in many situations, stand-alone selling prices will not be readily observable. Therefore, the entity must estimate the stand-alone selling price. Currently, IFRIC 12 requires the consideration received or receivable to be allocated based on the relative fair values of the services delivered. It is unclear whether the fair values assessed under IFRIC 12, which are based on exit prices, will be the same as the estimated stand-alone selling prices determined under IFRS 15. Entities will have to determine whether the new requirements result in a change in the amounts allocated to each performance obligation.

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5 IFRIC 12.13

Entities with service concession arrangements will have to allocate the transaction price based on estimated stand-alone selling prices instead of the fair value of services delivered.
2.3.3 Satisfaction of performance obligations over time
Under current IFRS, revenue may be recognised over time by reference to the stage of completion. Construction or upgrade services are accounted for under IAS 11\(^6\) and operation services under IAS 18\(^7\). With the consequential amendments, both types of service must be assessed in accordance with the IFRS 15 requirements to determine if the revenue is recognised at a point in time or over time. IFRS 15 requires certain criteria be met in order to recognise revenue over time.\(^8\) If the criteria are not met, revenue must be recognised at a point in time. Refer to Section 7.2 of our general publication for a further discussion on this topic.

While construction or upgrade service revenue from service concessions may generally be recognised over time under IFRS 15, entities will not be able to assume that revenue from these types of arrangements will automatically have the same pattern of recognition as under current IFRS. This is because service concessions can vary greatly between jurisdictions. It is unclear how IFRS 15 will apply to aspects of service concession arrangements and, as such, these arrangements need to be considered carefully in the context of the new standard.

2.3.4 Presentation of contract assets
The Board has clarified that consideration given by the grantor to the operator during the construction or upgrade period is presented as a contract asset on the operator’s balance sheet, regardless of the type of consideration (i.e., consideration received as a financial asset and intangible asset will both be presented as a contract asset). IFRS 15 also defines the term ‘contract asset’ and requires it to be presented on the balance sheet separately from receivables. As these requirements were not specified in IFRIC 12 prior to the consequential amendments, the presentation of contract assets may change from current practice.

2.4 Financial instruments
2.4.1 Fees, interest and dividends
IAS 18 specifies the accounting treatment for the recognition and measurement of dividend revenue. Rather than including requirements in respect of dividends in IFRS 15, the Board moved these requirements to IFRS 9 \textit{Financial Instruments} and IAS 39 \textit{Financial Instruments: Recognition and Measurement}, as applicable, as a result of consequential amendments from IFRS 15.

For interest revenue, IAS 18 refers to the effective interest method in accordance with the relevant standard on financial instruments (IFRS 9 or IAS 39). However, it provides application guidance on fees that may be integral to the issuance of a financial instrument and, therefore, need to be included in the effective interest rate. The consequential amendments move this application guidance to IFRS 9 or IAS 39, as applicable.

IAS 18 requires specific disclosure of dividend and interest revenue. This is also no longer required as a result of IFRS 15 replacing IAS 18. Instead, an entity will need to look to the requirements of other standards, such as IAS 1 \textit{Presentation of Financial Statements} to determine if separate disclosure is required.

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\(^6\) IFRIC 12.14
\(^7\) IFRIC 12.20
\(^8\) Refer to IFRS 15.35
2.4.2 Initial recognition of trade receivables
Currently, IFRS 9 and IAS 39 require an entity to initially recognise trade receivables at fair value. As a result of the consequential amendments, at initial recognition, entities will be required to measure trade receivables that do not have a significant financing component (determined in accordance with IFRS 15) at their transaction price (defined in IFRS 15).

2.4.3 Impairment of trade receivables and contract assets
For trade receivables and contract assets arising under IFRS 15, with or without a significant financing component, any impairment losses are accounted for under IFRS 9, presented in accordance with the requirements of IAS 1 and disclosed in accordance with IFRS 7 Financial Instruments: Disclosures. However, IFRS 15 makes it clear that such amounts are disclosed separately from impairment losses from other contracts.

2.4.4 Financial guarantees and loan commitments
The consequential amendments made to IFRS 9 and IAS 39 change the requirements after initial recognition, for financial guarantees and loan commitments. Currently, after initial recognition, an entity considers the requirements of IAS 18 when determining when and how much to recognise in profit or loss related to such financial instruments.

IFRS 9 and IAS 39 have been revised such that entities will need to consider the principles of IFRS 15. Similar amendments have been made to IFRS 3 Business Combinations, for contingent liabilities recognised in a business combination, and to the examples in IAS 37 Provisions, Contingent Liabilities and Contingent Assets.

It is not yet clear whether this could result in a change in practice. For example, the revisions related to guarantees indicate that, instead of recognising the guarantee’s initial fair value in profit or loss on a time proportion basis, an entity would recognise such amounts when (or as) they are satisfied in accordance with the principles of IFRS 15. It is unclear whether this would require an entity to apply the requirements of IFRS 15 in respect of identifying the performance obligation under the guarantee and determining whether that performance obligation is satisfied over time (and, if so, the appropriate measure of progress) or at a point in time.

2.5 Onerous contracts
Under current IFRS, entities have to determine the contract revenues and costs to be considered in assessing the liability to recognise on onerous contracts. In such cases, entities may look to either IAS 11 or IAS 37 in calculating the contract costs.

IFRS 15 replaces IAS 11 and contains no specific requirements to address contracts with customers that are, or become, onerous. However, a consequential amendment brings such contracts into the scope of IAS 37. An onerous contract is defined under IAS 37 as “a contract in which the unavoidable costs of meeting the obligations under the contract exceed the economic benefits expected to be received under it”. It also states that the unavoidable costs under a contract reflect the least net cost of exiting from the contract, which is the lower of the cost of fulfilling it and any compensation or penalties arising from failure to fulfil it. However, IAS 37 does not define what is meant by ‘cost of fulfilling the contract’.  

9 IAS 37.68
How we see it

Under IAS 11, all contract costs that relate directly to the specific contract or are attributable to the contract activity are included under the ‘full cost’ method. However, since IFRS 15 replaces all of the requirements in IAS 11, it is unclear if this approach is acceptable under IAS 37.

The application of the requirements of IAS 37 may lead to diversity in practice when determining the unavoidable costs to meet the obligations under the contract, i.e., the costs of fulfilling the contract. This is likely to continue if the IASB does not provide additional application guidance.

2.6 Cost of services for service providers

Currently, IAS 2 Inventories specifies that, for a service provider, inventories include the costs of the service for which the entity has not yet recognised revenue. This was removed as part of the consequential amendments. As a result, inventories will only include:

- Goods purchased and held for resale, including, for example, merchandise purchased by a retailer and held for resale or land and other property held for resale
- Finished goods produced, or work in progress, by the entity and materials and supplies awaiting use in the production process

To the extent that costs of services incurred by a service provider do not meet the revised definition of inventories, such costs will need to be accounted for as costs incurred to fulfil a contract with a customer under IFRS 15. Under IFRS 15, entities will only capitalise the costs to fulfil a contract if they: (i) relate directly to the contract; (ii) generate or enhance the resources used to satisfy performance obligations under the contract; and (iii) are expected to be recovered. When determining whether costs meet the criteria for capitalisation, an entity will need to consider its specific facts and circumstances. For costs to meet the ‘expected to be recovered’ criterion, they will need to be either explicitly reimbursable under the contract or implicitly recoverable through the margin inherent in the contract.

In addition, the presentation of these costs as contract cost assets will differ from the current practice of recognising them as inventories.

How we see it

We generally expect that costs of services that are capitalised as inventories under current IFRS requirements would be capitalisable under IFRS 15. However, entities should not assume this to be the case, as the criteria for capitalisation in IFRS 15 are different from current requirements.
2.7 Interim financial reporting disclosures

The IASB also amended IAS 34 *Interim Financial Reporting* to require disaggregated revenue information. However, none of the other annual disclosures will be required in the interim financial statements.

**How we see it**

We believe entities may need to expend additional effort when initially preparing the required disclosures for their interim financial statements. Entities, particularly those operating in multiple segments with many different product lines, will need to ensure that they have the appropriate systems, internal controls, policies and procedures in place to collect and disclose the required information on an ongoing basis.