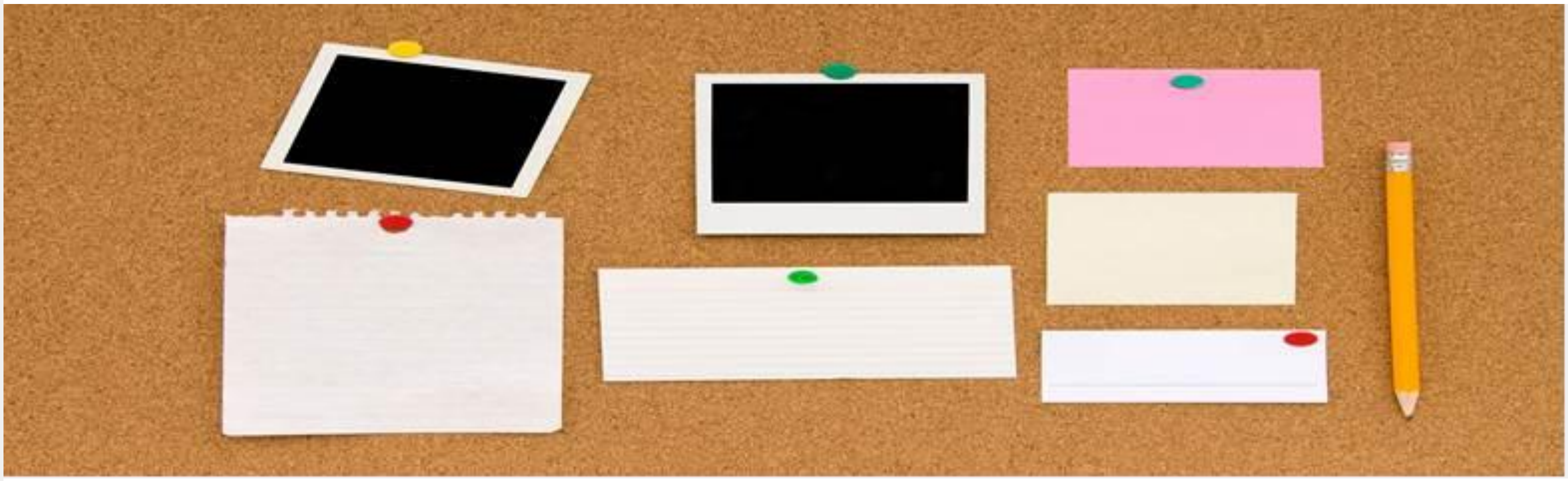
NavarroAmper&Co.

Philippines | Technical Research | 30 September 2014 (Issue 10)



Accounting & Auditing News

IFRS 15 — *Revenue from Contracts with Customers*: Part 3E – Impact on Industrial Products Sector

How to identify and allocate revenue to the different goods and services?

Background

Previously, given the lack of specific guidance in IFRSs, there was greater room for judgment when identifying the goods and services within a contract and then allocating the revenue to those goods and services identified. Entities may have to amend their current accounting policies as a result of the more detailed guidance in IFRS 15. The new standard requires the revenue from a contract to be allocated to each distinct good or service provided on a relative standalone selling price basis, though a 'residual' approach is permitted in limited circumstances.

Effect

This may significantly change the profile of revenue recognition for some entities where an entity has a large number of customers with different options, there may be some significant practical challenges to overcome in order to ensure systems are in place to deal with the new requirements.

It is uncommon in this sector for entities to sell two or more component parts of finished product to a third party entity that may be responsible for transforming or assembling those parts into the finished product that is eventually put back to the original entity. In this scenario, entities will have to consider whether they sell those separate parts and repurchase the product, or whether in substance they have paid the third party entity for the service of transforming the parts to produce the final product.

Should Revenue be Recognized Over Time or at a Point in Time?

Background

IFRS 15 introduces a new approach to determine whether revenue should be recognized over time or at a point in time. Three scenarios are specified in IFRS 15 in which revenue will be recognized over time. If revenue is to be recognized over time, a method should be used which best reflects the pattern of transfer of goods or services to the customer. If a transaction does not fit into any of the three scenarios specified in IFRS 15, revenue will instead be recognized at a point in time, when control passes to the customer.

Effect

In the industrial product sector, if an entity is manufacturing items for a specific customer, this may require careful analysis in light of the new requirements. Quite small differences between otherwise similar contracts could have a fundamental impact on the timing of revenue recognition. It will often be particularly important to focus on contractual terms that allow the customer to cancel, curtail or significantly modify a contract and whether, in such cases, the seller is entitled to adequate compensation for work performed to date. In addition, due to long term nature of contracts in this industry, particular consideration will need to be given as the most appropriate basis for measuring revenue over time and the consequences of the basis adopted for the matching of revenues of the cost incurred.

Should revenue be adjusted for the effects of the time value of money?

Background

IFRS 15 introduces new and more extensive guidance on financing arrangements and the impact of the time value of money. Sale by industrial products entities may include financing arrangements in that the timing of cash inflows from the customer may not correspond with the timing of recognition of revenue.

Effect

Under the new standard, the financing component, if it is significant, is accounted for separately from revenue. This applies to payments in advance as well as in arrears, but subject to an exemption where the period between payment and transfer of goods or services will be less than one year. This new guidance may change current accounting practices in some cases.

When should variable or uncertain revenues be recognized?

Background

Contracts in the industrial product sector can be of a long-term nature and include significant variable elements, such as performance bonuses or penalties, discounts, as well as the potential for subsequent downwards price renegotiations. There are new specific requirements in respect of variable consideration such that it is only included in the transaction price if it is highly probable that the amount of revenue recognized would not be subject to significant future reversals when the uncertainty is resolved.

Effect

The approach to variable and contingent consideration is different from that previously reflected in IFRSs and, in certain scenarios, will require a significant degree of judgment to estimate the amount of consideration that should be taken into account. Accordingly, the profile of revenue recognition may change for some entities as a result.

What is the impact if a contract is modified?

Background

In the past, IFRSs included only limited guidance on how to account for modifications to a contract. IFRS 15 includes detailed guidance on whether a contract modification should be accounted for prospectively or retrospectively.

Effect

It is common for the scope of price of arrangements in the industrial products sector to be modified and therefore these requirements may result in a change of practice for some entities.

Please contact the Technical Research Group at +63 2 581 9000 local 9088/9165/9078 or e-mail phtr@deloitte.com for questions regarding this publication.

Member of Deloitte Touche Tohmatsu Limited

19th Floor Net Lima Plaza
5th Avenue corner 26th Street
Bonifacio Global City, Taguig
Philippines 1634

Deloitte refers to one or more of Deloitte Touche Tohmatsu Limited, a UK private company limited by guarantee (“DTTL”), its network of member firms, and their related entities. DTTL and each of its member firms are legally separate and independent entities. DTTL (also referred to as “Deloitte Global”) does not provide services to clients. Please see www.deloitte.com/about for a more detailed description of DTTL and its member firms.

Deloitte provides audit, tax, consulting, and financial advisory services to public and private clients spanning multiple industries. With a globally connected network of member firms in more than 150 countries and territories, Deloitte brings world-class capabilities and high-quality service to clients, delivering the insights they need to address their most complex business challenges. Deloitte’s more than 200,000 professionals are committed to becoming the standard of excellence.

About Deloitte Southeast Asia

Deloitte Southeast Asia Ltd – a member firm of Deloitte Touche Tohmatsu Limited comprising Deloitte practices operating in Brunei, Cambodia, Guam, Indonesia, Lao PDR, Malaysia, Myanmar, Philippines, Singapore, Thailand and Vietnam – was established to deliver measurable value to the particular demands of increasingly intra-regional and fast growing companies and enterprises.

Comprising over 270 partners and 6,300 professionals in 24 office locations, the subsidiaries and affiliates of Deloitte Southeast Asia Ltd combine their technical expertise and deep industry knowledge to deliver consistent high quality services to companies in the region.

About Deloitte Philippines

In Philippines, services are provided by Navarro Amper & Co. and its subsidiaries and affiliates.