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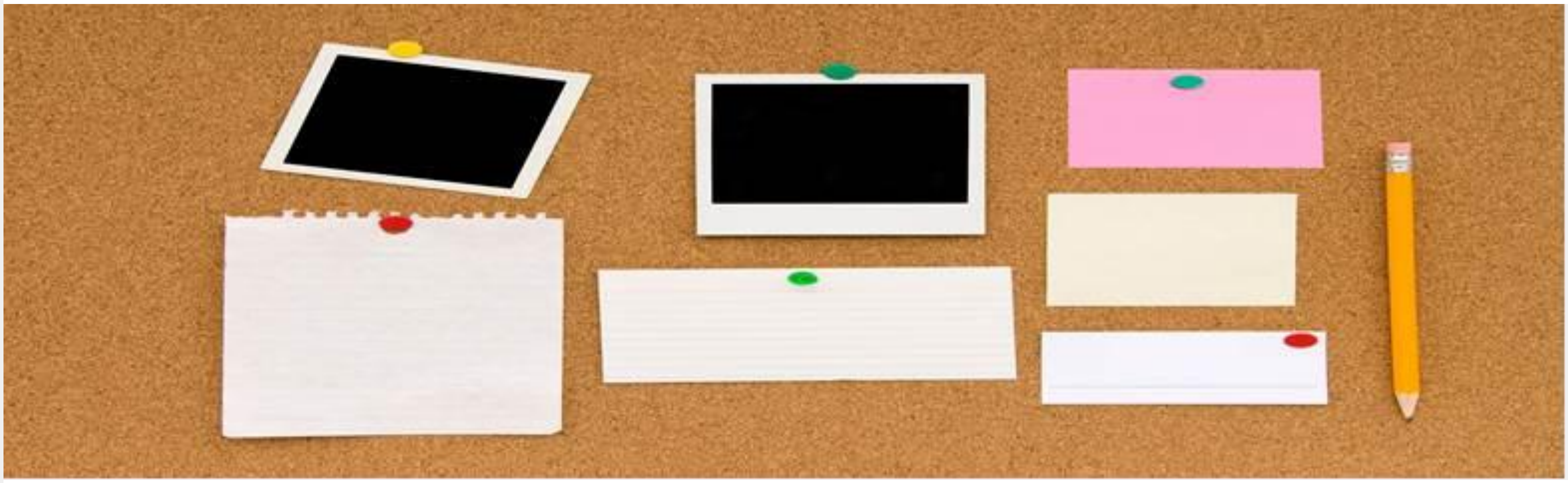

Accounting & Auditing News

IFRS 15 — *Revenue from Contracts with Customers*: Part 3L – Impact on Power Sector

<u>How to identify and allocate revenue to different goods and services?</u>

Background

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 and in particular, the new rules on how revenue is allocated between different items. For example, in the power sector, a single contract may include the sale of both gas and electricity

Effect

Careful analysis and judgment may be required to determine whether the sale of each type of utility and should be regarded as distinct and, if so, to determine the appropriate allocation of revenue between them. It will also be necessary to consider the appropriate allocation of any discount offered to the customer for purchasing more than one kind of utility from the company.

When should variable or uncertain revenues be recognized?

Background

Entities in the Power sector often have contracts that include some form of variable pricing arising from uncertain events. 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 as a result of subsequent re-estimation.

Effect

This 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 not uncommon for the scope of price arrangements in the power sector to be modified – for example blend and extend modifications – sand therefore this requirements may result in a change of practice for some entities.

Should contract costs be capitalized?

Background

The new standard introduces specific criteria for determining whether to capitalized certain costs, distinguishing between those costs associated with obtaining a contract (e.g. sales commissions) and those costs associated with fulfilling a contract.

Effect

This becomes an issue for power companies where significant costs are incurred that are directly attributable to obtaining contracts with customers, for example sales commissions that is only payable when the contract is obtained. Success fees will be capitalized under the new standard as they are incremental costs of obtaining a contract. At present, different entities might treat various types of cost differently so there may be an impact on operating profits.

The new standard requires capitalized contract costs to be amortized on a systematic basis that is consistent with the pattern of transfer of the goods or services. Entities will need to exercise judgment to determine the appropriate basis and time period for this amortization.

<u>When should upfront fees be recognized?</u>

Background

New detailed guidance is provided on how to account upfront fees which may lead to a change in practice when accounting for such fees. This guidance may also be applicable to the provision of contributed assets such as property, plant and equipment which are often used to connect customers to a network and provide them with ongoing access to a supply of goods and services such as electricity and gas.

Effect

Unless control of distinct services is transferred to the customer at the outset, an upfront fee should be regarded as an advance payment for future services and so should be recognized as revenue when those future services are provided. The reason that upfront fees are charged to cover initial sign-up costs would not justify its direct recognition.

<u>Are exchanges of goods and services within the scope of the new standard?</u>

Background

The new standard scoped-out non-monetary exchanges between entities in the same line of business to facilitate sales to customers other than the parties to the exchange. Entities in the power sector may swap goods or services with other entities to reduce delivery costs or manage capacity.

Effect

Such entities will need to consider whether the different scoping requirements will change any of their current practices.

<u>How should breakage be recognized?</u>

Background

It power sector, it is common for customers to agree, under a ‘take or pay’ contract to purchase a specified minimum quantity of a particular good or service over a specified period of time. However, the customer has to pay the full amount stated in the contract, irrespective of whether the customer takes delivery of the minimum quantity. In a scenario in which customers do not always exercise all of their contractual rights, the unexercised rights are referred to as breakage. IFRS 15 include specific guidance on breakage. If an entity expect to benefit from breakage, it should recognized the estimated breakage amount as revenue in proportion to the pattern of rights exercised by the customer. Otherwise, the entity should recognized any breakage amount as revenue when the likelihood of the customer exercising its remaining rights becomes remote.

Effect

Entities will need to consider whether their current accounting needs to be amended in order to meet the requirements of IFRS 15.

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