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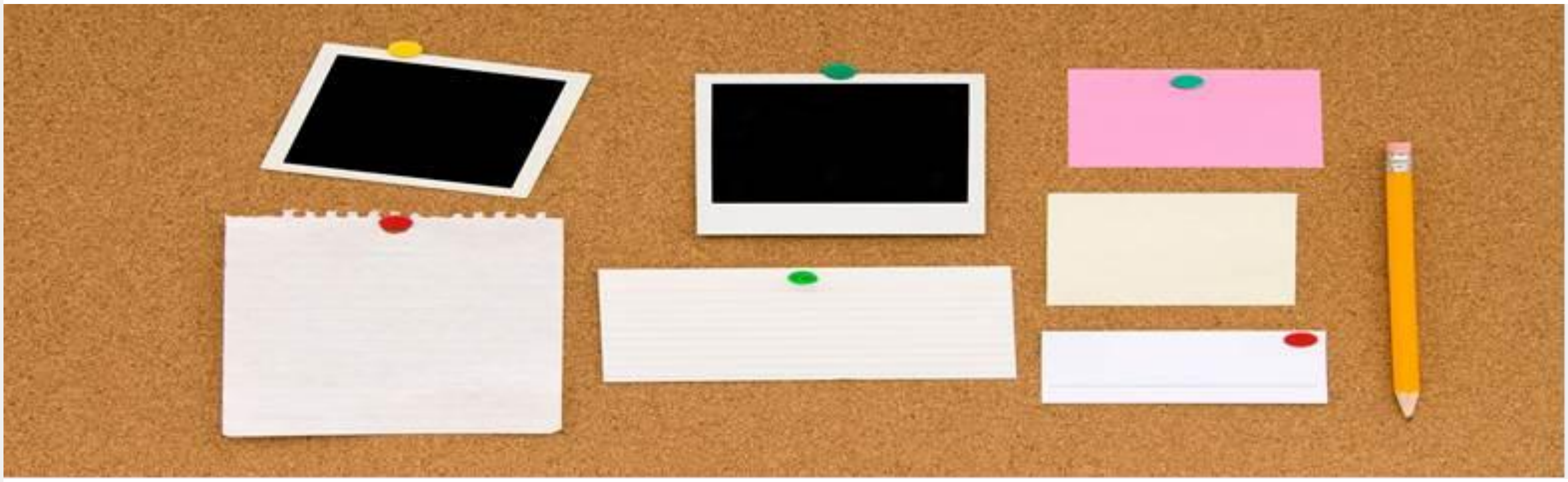

Accounting & Auditing News

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

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

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

Applying a new approach to a software license, for example, it will first be necessary for entities to consider whether any subsequent services, such as consulting services for customization/installation, customer support or upgrades, represent distinct elements to which revenue should separately allocated. Where it is concluded that certain elements should be accounted for separately, entities will then typically look to the standalone selling price to apportion the relevant amount of the transaction price to each distinct element in the contract.

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.

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 technology 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.

When should a sale of goods be recognized?

Background

Under IAS 18, the timing of revenue recognition from the sale of goods is based primarily on the transfer of risks and rewards. IFRS 15 instead focusses on when control of those goods has transferred to the customer.

Effect

The different approach between IAS 18 and IFRS 15 may result in a change of timing for revenue recognition for some entities.

When should variable or uncertain revenues be recognized?

Background

Contracts in the technology sector can be of a long-term nature and include significant variable elements, such as performance bonuses or penalties, discounts, fees based on usage, as well as the potential for subsequent downwards price negotiations. 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

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.

How will the type of license sold impact when revenue is recognized?

Background

IFRS 15 distinguishes between licenses that represent the transfer of a right to use an entity's intellectual property and licenses that represent the provision of access, over a period of time, to an entity's intellectual property, and specifies criteria to determine which type of license is being sold. Revenue for the former is typically recognized at a point in time; revenue for the latter will typically be recognized over the period of access.

Effect

Entities within the technology sector will need to examine license arrangements in the light of this new guidance, and may need to change their existing accounting in some cases. Where a change is required, this may have a significant impact on the timing of revenue recognition.

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 technology sector to be modified and therefore these requirements may result in a change of practice for some entities.

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