



PFRS 15:

Revenue from Contracts with Customers

(effective January 1, 2018)

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LEARNING OBJECTIVES:



- I. Industries that will be affected and their issues
- II. Understand and explain the scope and purpose of PFRS 15
- III. Identify the key differences of PAS 18/PAS11 and PFRS 15
- IV. Identify the five step model framework of PFRS 15
- V. Determine and explain the Five-Step Model
- VI. Explain how and when to recognize revenue

There are four (4) *important industries* that will face probably the biggest challenges:

- **Telecommunications** (**Issues on:** Identifying individual performance obligations and allocating transaction price)
- **Manufacturers** (Issues on: Contract modifications)
- **Real estate and property development** (Issues on: Revenue over time/at the point of time)
- **Software development and technology** [Issues on: splitting the contract into two (2) separate obligations]



Scope



- The scope of PFRS 15 applies to all contracts provided the counterparty to the contract is a customer
- All contracts (defined as an *agreement between two or more parties* that *creates enforceable rights and obligations*) with customers are within the scope of PFRS 15, *EXCEPT the following*:
 1. lease contracts within the scope of PAS 17 Leases
 2. insurance contracts within the scope of PFRS 4 Insurance Contracts
 3. financial instruments and other contractual rights or obligations within the scope of PFRS 9 Financial Instruments
 4. PFRS 10 Consolidated Financial Statements,
 5. PFRS 11 Joint Arrangements,
 6. PAS 27 Separate Financial Statements
 7. PAS 28 Investments in Associates and Joint Ventures
 8. Non-monetary exchanges between entities in the *same line of business* to facilitate sales to customers or potential customers.

PURPOSE:

WHEN & HOW TO RECOGNIZE REVENUE?



Before

- PAS 18 - Revenue
- PAS 11 - Construction Contracts
- SIC 31 Revenue – Barter Transaction Involving Advertising Services
- PFRIC 13 Customer Loyalty Programs
- PFRIC 15 Agreements for the Construction of Real Estate and
- PFRIC 18 Transfer of Assets from Customers



After

PFRS 15

January 2018						
S	M	T	W	T	F	S
	1	2	3	4	5	6
7	8	9	10	11	12	13
14	15	16	17	18	19	20
21	22	23	24	25	26	27
28	29	30	31			

Monday, Jan 1st 2018

The **realization principle** required that revenue be recognized when **both**:

- It is probable that **economic benefits will flow to the enterprise**, and
- That economic benefits can be **reasonably estimated**.



Core Principle: Recognize revenue -

- **When:** upon *transfer* to customers
- **How much:** amount the seller is *entitled* to receive



The *core principle of IFRS (PFRS) 15*

- **GUIDANCE:** PFRS 15 contains *guidance* for transactions not previously addressed (service revenue, contract modifications);
- **MULTIPLE-ELEMENT ARRANGEMENTS:** PFRS 15 improves guidance for *multiple-element arrangements*;
- **DISCLOSURES:** PFRS 15 requires enhanced *disclosures* about revenue.



The major areas of impact that are probably affected by PFRS 15:

1. Is the revenue recognized:
 - ***over time*** (spread between the periods during contract duration)
or
 - ***at the point of time*** (upon completion)?
2. If the revenue is to be ***recognized over time***, how should the company ***measure the progress towards completion*** (in the previous standards the phrase “stage of completion” were used)?
3. How shall companies account for ***revenue from bundled offers*** (with multiple deliverables)? Should they ***split the contract*** into several components?
4. How shall companies deal with ***contract modifications***?
5. How shall companies treat the ***contract costs***, including cost of obtaining the contract? Shall they expense these costs in profit or loss, or capitalize and defer?
6. Are there any ***financing components*** in the contract? If it is in the affirmative, how to deal with the ***time value of money***?





KEY DIFFERENCES

PAS 18/11

Separate models for

- Goods (PAS 18)
- Services (PAS 18)
- Construction contracts (PAS 11)

Focuses on:

Risk and rewards

PFRS 15

Single model for performance obligations (single or multiple):

- Satisfied over time
- Satisfied at a point in time

Focuses on:

Control



Concept Check 1

Recognition of revenue under PFRS 15 is based on

- a. Risk and rewards;
- ☒ b. Control;
- c. Cash receipt;
- d. Transfer of title.





Five Steps to Revenue Recognition

Five Steps to Recognizing Revenue

1. Identify the contract

2. Identify the performance obligation(s)

3. Determine the transaction price

4. Allocate the transaction price

5. Recognize revenue when (or as) each performance obligation is satisfied

Transactions: Single/Multiple POs*

Legal rights of seller and customer established

Performance obligation

Single

Multiple

Amount seller is entitled to receive from customer

Amount seller is entitled to receive from customer

No allocation required

Allocate a portion to each performance obligation

At a point in time

Over a period of time

At whatever time is appropriate for each performance obligation

POs* - Performance Obligations



Concept Check 2

To address inconsistencies and weaknesses, a comprehensive revenue recognition model was developed entitled the:

- a. Revenue Recognition Principle
- b. Principle-based Revenue Accounting
- c. Principle-based Revenue Accounting
- ☒ d. Revenue from Contracts with Customers





Step 1: Identify Contract with Customers

Contract – an agreement that creates enforceable rights and obligations.
Customers – the party who obtain goods or services in exchange for consideration.





Step 1: Identify Contract with Customers

Contract must have five criteria:

Approved

Rights and obligations
are identified

Payment terms
are identified

Commercial
Substance

Consideration due is
expected to be collected

Note: All criteria must be met !



Concept Check 3

Contract with customers may be

- a. In writing;
- b. Orally;
- c. In accordance with other customary business practice;
- ☒ d. Any of the above.





Concept Check 4

Revenue from a contract with a customer

- a. is recognized when the customer receive the rights to receive consideration
- b. is recognized even if the contract is still wholly unperformed
- c. can be recognized even when a contract is still pending
- ☒ d. cannot be recognized until a contract exists



Other Issues on Contract:



- **Combination of contract**
- **Contract modifications**
 - **Separate contract**
 - **Not a separate contract**



Concept Check 5

A company must account for a contract modification as a new contract if:

- a. Goods or services are interdependent on each other.
- b. The promised goods or services are distinct.
- c. The company has the right to receive consideration equal to standalone price.
- ☒ d. Goods or services are distinct and company has right to receive the standalone price



Step 2: Identify separate performance obligations

- ✓ A promise to transfer:
 - A good or service (or bundle of or services) that is **distinct (separable)**; or
 - A series of goods or services that are substantially the same and transferred in the same way.

○ No transfer = No performance obligation



Concept Check 6

A performance obligation exists when


- a. a company receives the right to receive consideration.
- b. a contract is approved and signed.
- ☒ c. a company provides a distinct product or service.
- d. a company provides interdependent product or service.





Revenue Recognition in Multiple Performance Obligations

Multiple Performance Obligation

- The goal is to separate the contract into parts that can be viewed on a **stand-alone basis**.
 - Goods and services are viewed as separate performance obligations if they are **distinct**.
- 

A good or service is **distinct** if it is both:

Capable of being distinct /
Separate usage to the customer

&

Separately identifiable *from other goods of services in the contract*

- *Example of failing the “separately identifiable” criterion: Construction contracts*



Concept Check 7

SoftTech Inc. licenses customer-relationship software to Lopez Company. In addition to providing the software itself, SoftTech promises to provide consulting services by extensively customizing the software to Lopez's information technology environment, for a total consideration of P600,000.

In this case, SoftTech is providing a significant service by integrating the goods and services (***the license and the consulting service***) ***into one combined item for which Lopez has contracted***. In addition, the software is significantly customized by SoftTech in accordance with specifications negotiated by Lopez. Do these facts describe a single or separate performance obligation?

Number of performance obligations in the contract: 1.

The license and the consulting services are **distinct but interdependent**, and therefore should be accounted for as **one performance obligation**.



Concept Check 8

eLean is an online fitness community, offering access to workout routines, nutrition advice, and eLean coaches. Customers pay a P50 fee to become registered on the website, and then pay P5 per month for **access to all eLean services**. How many performance obligations exist in the implied contract when a customer registers for the services?

Number of performance obligations in the contract: 1.

Access to **eLean services is one performance obligation**. Registration on the website is not a performance obligation, but rather is **part of the activity eLean must provide** to satisfy its performance obligation of providing access to eLean's on-line services. The P50 payment is an upfront payment that is **part of the total transaction price** associated with the service, and the monthly payments are the other component. – **NOT DISTINCT**



Concept Check 9

Precision Equipment, Inc., specializes in designing and installing customized manufacturing equipment. On February 1, 2017, it **signs a contract to design a fully automated wristwatch assembly line for P2 million**, which will be settled in cash upon completion of construction. Precision Equipment will install the equipment on the client's property, furnish it with a customized software package that is integral to operations, and provide consulting services that integrate the equipment with Precision's other assembly lines. How many performance obligations exist in this contract?

Number of performance obligations in the contract: 1.

The separate goods and services that Precision Equipment has agreed to provide (equipment, customized software package, and consulting services) might be *capable of being distinct*, but they are **not separately identifiable**. In the **context of the contract, the goods and services are highly dependent on and interrelated with each other**. The contractor's role is to integrate and customize them to create one automated assembly line.



Concept Check 10

On December 20x8, Wade receives an order from a customer for a **computer** as well as 12 months of **technical support**. Wade **delivers the computer (and transfers its legal title) to the customer on the same day**.

The customer paid P420 upfront. The **computer sells for P300** and the **technical support sells for P120**.

Number of performance obligations in the contract: 2

A good or service is distinct **if it is both:**

- Capable of being distinct
- Separately identifiable from other goods or services in the contract

There are **two performance obligations** (promises) within the contract which are considered DISTINCT and SEPARATELY IDENTIFIABLE:

The supply of a computer

The supply of technical support



Concept Check 11

Allen Co. wrote a contract that involves two performance obligations. Product A has a stand-alone selling price of P100, and product B has a stand-alone selling price of P200. The price for the combined product is P240. How much of the transaction price would be allocated to the performance obligation for delivering product A?

- a. P 40.
- b. P 60.
- ☒ c. P 80.
- d. P100.

$$(P100 \div (P200 + P100)) \times P240 = P\mathbf{80}$$



Step 3: Determine the Transaction Price

Transaction price – the amount of consideration exchanged for transfer of goods or services.

- ✓ Ignore sales tax (VAT)
- ✓ Allow for time value of money
 - Significant financing component
 - Insignificant financing component
- ✓ Include fair value of non-cash consideration
- ✓ Variable consideration:
 - Expected value Most likely amount



Step 3: Determine the Transaction Price

- ✓ Variable consideration must be estimated/expected value:

Examples include:

- ✓ ☐ Volume discounts;
- ✓ ☐ Incentives;
- ✓ ☐ Penalties;
- ✓ ☐ Customer referral bonuses;
- ✓ ☐ Rebates and refunds; and
- ✓ ☐ Price concessions.



Step 4: Allocate the Transaction Price

The **total transaction price** should be allocated to each or **separate performance obligation** in proportion to **stand-alone selling price** of the goods or services.

- ☐ The **best evidence of stand-alone selling** price is the **observable price of a good or service** when it is ***sold separately***.
- ☐ If a stand-alone selling price is ***not directly observable***, then the entity ***estimates the stand-alone selling price***.



Concept Check 12

The amount of revenue recognized under PFRS is the:

- a. Historical cost;
- ☒ b. Transaction price;
- c. Settlement price;
- d. Face value.





Concept Check 13

The transaction price for multiple performance obligations should be allocated:

- a. based on selling price from the company's competitors.
- ☒ b. based on what the company could sell the goods for on a stand-alone basis.
- c. based on forecasted cost of satisfying performance obligation.
- d. based on total transaction price less residual value.



A close-up photograph of several interlocking puzzle pieces made of a light-colored wood or cardboard. The pieces are arranged in a way that they fit together, with some pieces slightly offset to show the interlocking mechanism. The background is a solid light blue.

Concept Check 14

Transaction price does not include

- a. Cash consideration;
- b. Non-cash consideration;
- c. Variable and fixed consideration;
- ☒ d. Output VAT.





There are *three ways of allocating transaction price*:

1. **Adjusted market assessment approach** – determine how goods or services will be sold and estimate the price those customers are willing to pay.
2. ***Estimated cost plus a margin approach*** – project the estimated costs of satisfying a performance obligation and add a normal profit
3. ***Residual approach*** – estimate the standalone sales price by reference to total transaction price less the sum of the observable standalone selling prices the goods or services made in the contract.



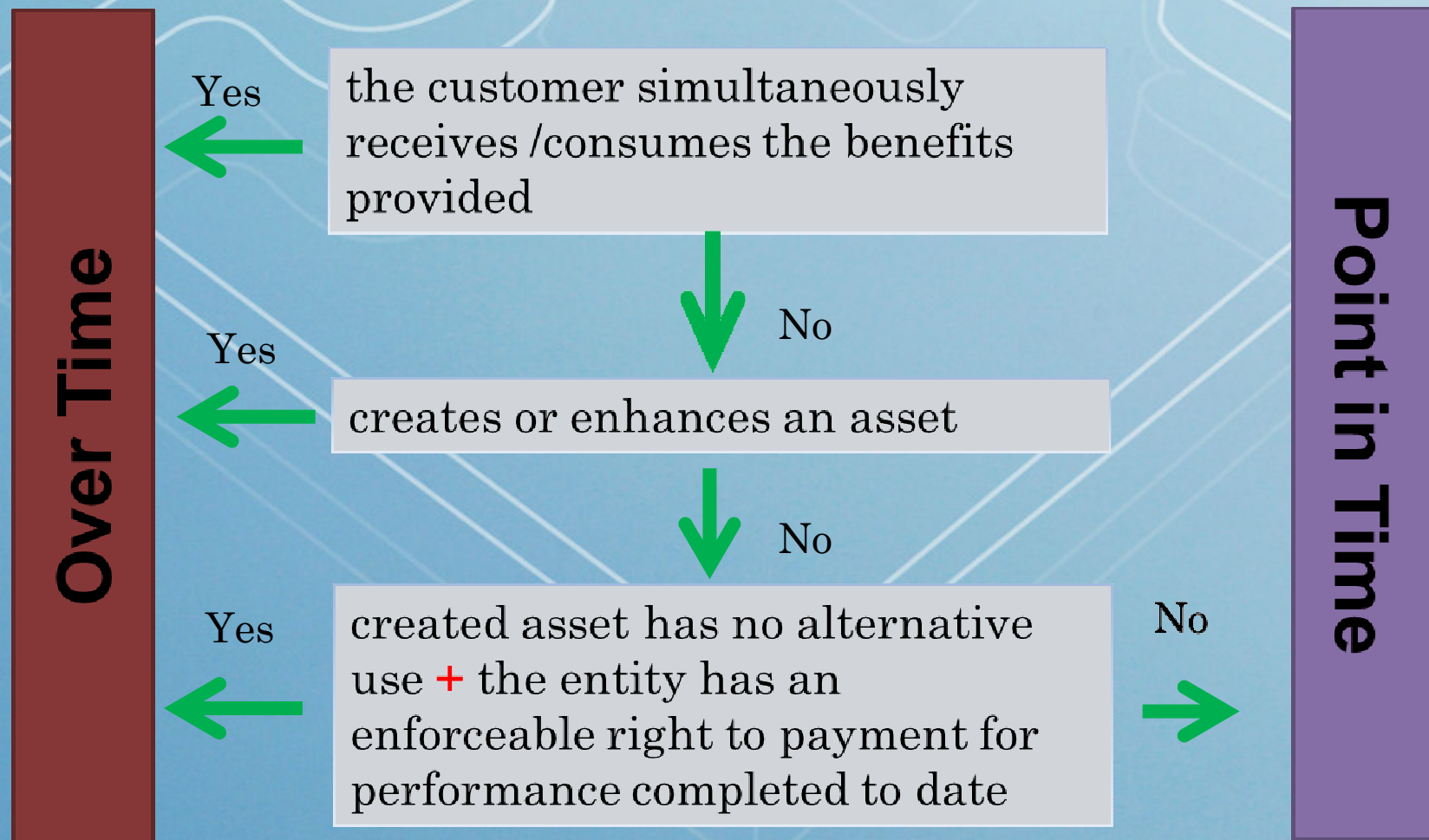
Step 5: Recognize Revenue

- Revenue is recognized when performance obligation is satisfied
- Performance obligation is satisfied when the promised good or service is transferred to a customer.





Step 5: Recognize Revenue





Recognizing Revenue at a Single Point in Time

- Indicators are used to determine when **control** has transferred from the seller to the customer
 - **Control** means that the customer has direct influence over the use of the good or service and obtains its benefits
- A customer is more likely to control a good or service if the customer has:
 - An **obligation to pay** the seller
 - **Legal title** to the asset
 - **Physical possession** of the asset
 - Assumed the **risks and rewards of ownership**
 - **Accepted** the asset



Concept Check 15

Revenue recognition under PFRS 15 is based on

- a. Transfer of risk and rewards of ownership;
- b. Transfer of control;**
- c. Transfer of title;
- d. Payment of consideration.





Concept Check 16

Indicators of transfer of control for an obligation satisfied at a point in time includes:

- a. Physical possession;
- b. Transfer of legal title;
- c. Acceptance of the asset;
- ☒ d. All of the above



Concept Check 17

Which of the following is **not** an indicator that control of a good has passed from the seller to the buyer?

- a. Buyer has legal title.
- b. Buyer has an unconditional obligation to pay.
- ☒ c. Buyer has scheduled delivery.
- d. Buyer has assumed the risk and rewards of ownership.

Whether the buyer has **scheduled** delivery is not an indicator of passage of control. Delivery, so that the customer has physical possession, is a control indicator.



Illustration 1:

Recognizing Revenue at a Single Point in Time

TrueTech Industries sells the Tri-Box, a gaming console that allows users to play video games individually or in multiplayer environments over the Internet. A Tri-Box is only a gaming module and includes no other goods or services. When should TrueTech recognize revenue for the following sale of 1,000 Tri-Boxes to CompStores?

- **December 20, 20x5:** CompStores orders 1,000 Tri-Boxes at a price of P240 each, promising payment within 30 days after delivery.

No entry

Recognizing Revenue at a Single Point in Time

(Illustration continued)

- **January 1, 20x6:** TrueTech delivers 1,000 Tri-Boxes to CompStores, and title to the Tri-Boxes transfers to CompStores.

Journal Entry	Debit	Credit
Accounts receivable	240,000	
Sales revenue (P240 x 1,000)		240,000



Recognizing Revenue at a Single Point in Time

(Illustration continued)

- **January 25, 20x6:** TrueTech receives P240,000 from CompStores.

Journal Entry	Debit	Credit
Cash	240,000	
Accts receivable		240,000





Recognizing Revenue Over a Period of Time

- Revenue is recognized **over a period of time** if one of the following three conditions hold:
 - The customer **consumes the benefit** of the seller's work as it is performed (example: a cleaning service)
 - The customer **controls the asset as it is created** (example: a building extension)
 - The seller is creating an **asset that has no alternative use** to the seller and the seller has the legal right to receive payment for progress to date even if the contract is cancelled (example: an order of jets customized for the Philippine Air Force)
- If a seller can't recognize revenue over time, it recognizes revenue at a point in time

Concept Check 18

Which of the following is an indicator that revenue for a service should be recognized over time?

- a. The seller is enhancing an asset that the buyer controls as the service is performed.
- b. The seller is providing continuous effort to the buyer.
- c. The seller can estimate the percent of work completed.
- d. The sales price is fixed and determinable.

Revenue is recognized over a period of time if one of the following three conditions hold:

- The customer consumes the benefit of the seller's work as it is performed
- **The customer controls the asset as it is created**
- The seller is creating an asset that has no alternative use to the seller and the seller has the legal right to receive payment for progress to date even if the contract is cancelled.

Illustration 2:

Recognizing Revenue over a Period of Time

TrueTech Industries sells one-year subscriptions to the Tri-Net multi-user platform of Internet-based games. TrueTech sells 1,000 subscriptions for P60 each on cash basis on January 1, 20x6.

Journal Entry at contract inception	Debit	Credit
Cash (P60 × 1,000)	60,000	
Deferred revenue		60,000

	Deferred Revenue	
1/1		60,000



Recognizing Revenue over a Period of Time

(Illustration continued)

At the end of each of the 12 months following the sale, TrueTech would record the following entry to recognize Tri-Net subscription revenue:

Journal Entry each month	Debit	Credit
Deferred revenue (P60,000 ÷ 12)	5,000	
Service revenue		5,000

	Deferred Revenue	
1/1		60,000
1/31	5000	
2/28	5000	
...	...	
12/31	5000	
12/31		-0-

	Service Revenue	
1/1		-0-
1/31		5,000
2/28		5,000
...		...
12/31		5,000
12/31		60,000





Recognizing Revenue from a Performance Obligation Over Time/Over A Period of Time . The following are factors for performance obligation that change over time:

- Measure progress toward completion
- Method for measuring progress should depict transfer of control from company to customer.
- Most common are cost-to-cost and units-of-delivery methods.
- Objective of methods is to measure extent of progress in terms of costs, units, or value added.



Estimating Progress Toward Completion

- To recognize revenue over time, a seller needs to estimate progress towards completion
- *Output-based* estimate
 - Measured as the proportion of the goods or services transferred to date
- *Input-based* estimate
 - Measured as the proportion of effort expended thus far relative to the total effort expected to satisfy the performance obligation



A decorative header featuring several interlocking puzzle pieces in shades of brown and tan, arranged in a jagged, overlapping pattern at the top of the slide.

Concept Check 19

For performance obligation satisfied over time, progress may be measured using

- a. Input methods;
- b. Output methods;
- ☒ c. Either a or b;
- d. Neither a nor b.



Recognizing Revenue for Contracts that Contain Multiple Performance Obligations

- If we suspect a contract has **multiple performance obligations**, steps 2 and 4 of the revenue recognition process come into play.
 - Step 1: Identify the contract
 - **Step 2: Identify the performance obligation(s)**
 - Step 3: Determine the transaction price
 - **Step 4: Allocate the transaction price to each performance obligation**
 - Step 5: Recognize revenue when (or as) each performance obligation is satisfied



Illustration 3:

Recognizing Revenue for Contracts that Contain Multiple Performance Obligations

TrueTech Industries manufactures the Tri-Box System, a **multiplayer gaming system** allowing players to compete with each other over the Internet.

- The Tri-Box System includes the physical **Tri-Box module** as well as a **one-year subscription** to the Tri-Net multiuser platform of Internet-based games and other applications.
- TrueTech sells individual **Tri-Box modules** for **P240**.
- TrueTech sells individual **one-year subscriptions** to the Tri-Net platform for **P60**.
- As a **package deal**, TrueTech sells the Tri-Box System (**module plus subscription**) for **P250**.

On January 1, 20x6, TrueTech delivers 1,000 Tri-Box Systems to CompStores at a price of P250 per system. TrueTech receives P250,000 from CompStores on January 25, 20x6.



Recognizing Revenue for Contracts that Contain Multiple Performance Obligations

(Illustration

continued)

- Step 1: Identify the contract: **Yes**
- **Step 2: Identify the performance obligation(s)**

A good or service is distinct if it is **both**:

- *Capable of being distinct*
- *Separately identifiable from other goods or services in the contract*

A Tri-Box System contains two distinct goods and services:

- ***Tri-Box module (Performance Obligation)***
- ***Tri-Net subscription (Performance Obligation)***
- Therefore, a Tri-Box System includes **2 PO** (performance obligations).



Recognizing Revenue for Contracts that Contain Multiple Performance Obligations

(Illustration continued)

- Step 1: Identify the contract: **Yes**
- Step 2: Identify the performance obligation(s):
(PO1) Tri-Box module and (PO2) Tri-net subscription

- **Step 3: Determine the transaction price**

$$\begin{aligned}\text{Transaction price} &= \text{P250 per system} \times 1,000 \text{ systems} \\ &= \text{P250,000}\end{aligned}$$



Recognizing Revenue for Contracts that Contain Multiple Performance Obligations

(Illustration continued)

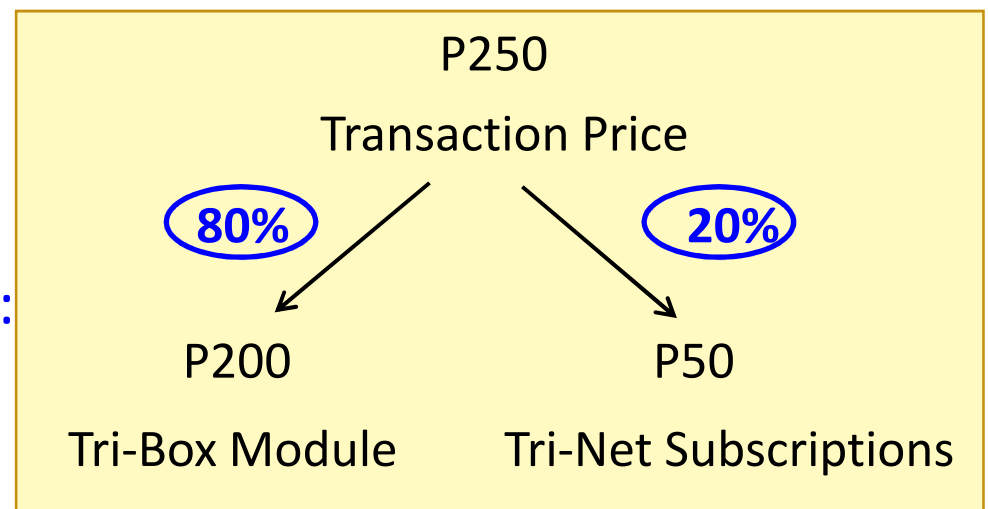
- Step 1: Identify the contract: **Yes**
- Step 2: Identify the performance obligation(s):
(PO1) Tri-Box module and (PO2) Tri-net subscription
- Step 3: Determine the transaction price: **P250,000**
- **Step 4: Allocate the transaction price to each performance obligation (stand-alone selling prices)**

(PO1) Tri-Box modules:

$$P240 \div (P240 + P60) = 80\%$$

(PO2) Tri-Net subscriptions:

$$P60 \div (P240 + P60) = 20\%$$



Recognizing Revenue for Contracts that Contain Multiple Performance Obligations (illustration continued)

- **Step 5: Recognize revenue when (or as) each performance obligation is satisfied**

On January 1, 20x6, TrueTech records the revenue from the **Tri-Box** modules (that performance obligation is satisfied – **POINT in TIME**) but **defers revenue** for the **Tri-Net** subscriptions (**OVER TIME**).

Journal Entry	Debit	Credit
Accounts Receivable	250,000	
Sales Revenue (P250,000 × 80%)		200,000
Deferred Revenue (P250,000 × 20%)		50,000

Deferred Revenue
50,000

Tri-Box modules

Tri-Net subscriptions



Recognizing Revenue for Contracts that Contain Multiple Performance Obligations

(Illustration

continued)

- **Step 5: Recognize revenue when (or as) each performance obligation is satisfied**

Every end of the month 12 months following the sale, TrueTech records the following entry to recognize Tri-Net subscription revenues.

Journal Entry	Debit	Credit
Deferred Revenue (P50,000 ÷ 12)	4,167	
Service Revenue		4,167

	Deferred Revenue	
1/1		50,000
1/31	4,167	
2/28	4,167	
...	...	
12/31	4,167	
12/31		-0-

	Service Revenue	
1/1		-0-
1/31		4,167
2/28		4,167
...		...
12/31		4,167
12/31		50,000



Special Issues for Step 1:

Identify the Contract

- Contracts can be explicit or implicit, oral or written
- A contract only **exists** if it:
 - has **commercial substance**
 - has been **approved** by the seller and customer
 - specifies the **rights** of the seller and customer
 - specifies **payment terms**
 - is **probable** that the **seller will collect** the amount it is entitled to receive under the contract
- A contract **does not exist** if:
 - neither the seller nor the customer has performed any obligations under the contract, **and**
 - both the seller and the customer can terminate the contract without penalty



Special Issues for Step 2:

Identify the Performance Obligation(s)

Not performance obligations:

- **Prepayments** (part of the transaction price)
- **Quality-assurance warranties** (part of the performance obligation to deliver goods and services that are free of defects)
- **Right of return** (part of the performance obligation to deliver acceptable goods and services)

Performance obligations:

- **Extended warranties.** A warranty is an extended warranty if either
 - the customer has the option to purchase the warranty separately, or
 - the warranty provides a service to the customer beyond quality assurance
- **Options** that provide a **material right** (a material right is something the customer wouldn't get anything else, so the seller is obligated to provide it)



Concept Check 20 - Quality Assurance Warranty



Vacuums sells the Tornado **vacuum cleaner**. Each **vacuum cleaner** has a **one-year warranty (quality-assurance)** that covers any product defects. When customers purchase a vacuum cleaner, they also have the **option to purchase an extended three-year warranty** that covers any breakage or maintenance. The **extended warranty** * **sells for the same amount** regardless of whether it is purchased at the **same time** as the vacuum cleaner or at **some other time**. How many performance obligations?

Number of performance obligations in the contract: 1.

We need to consider three aspects of the vacuum contract: delivery of the vacuum, the one-year quality-assurance warranty, and the option to purchase the three-year extended warranty. **Delivery of the vacuum cleaner is a performance obligation.** The **one-year warranty that is included as part of the purchase (the quality-assurance warranty)** is not a performance obligation, but rather is **part of the obligation to deliver a vacuum of appropriate quality.**

Concept Check 21 - Quality Assurance Warranty



Vacuums sells the Tornado **vacuum cleaner**. Each **vacuum cleaner** has a **one-year warranty (quality-assurance)** that covers any product defects. When customers purchase a vacuum cleaner, they also have the *** option to purchase an extended three-year warranty** that covers any breakage or maintenance. The **extended warranty** ***sells for the same amount** regardless of whether it is purchased at the **same time** as the vacuum cleaner or at **some other time**.

However, if the **option to purchase an extended 3-year warranty is simply providing** the customer with the ability to **acquire additional goods or services** at a price **reflective of the stand-alone selling price**, then **this option does not provide a “material right”** even though **such an option may only be obtained as a result of entering into a contract**.

The extended warranty* sells for the same amount regardless of whether it is purchased at the same time as the vacuum cleaner or at some other time

***The option to purchase a three-year extended warranty is not a performance obligation within the contract to purchase a vacuum, because customers can purchase that warranty for the same amount at other times**, so the opportunity to buy it at the **sough** such an option may only be obtained as a result of entering into a contract.



Material Right

What is a “material right” and how do you make this assessment?

If the customer is in effect ***paying in advance for future goods and services***. If such an ***option provides the customer with a “material right”***, then the ***option should be accounted for as a separate performance obligation***.

If the option provides a right the customer would not have received had they not entered into this contract, (e.g., a right incremental to the rights provided to other customers in the same region or market), the ***customer is in effect paying in advance for future goods and services***. If such an option provides the customer with a “material right”, then the option should be accounted for as a ***separate performance obligation***.

Concept Check 22 - Extended Warranty

Vacuums sells the Tornado **vacuum cleaner**. Each **vacuum cleaner** has a **one-year warranty (quality-assurance)** that covers any product defects. When customers purchase a vacuum cleaner, they also have the * **option to purchase an extended three-year warranty** that covers any breakage or maintenance. The **extended warranty*** sells for the **same amount** regardless of whether it is purchased at the **same time** as the vacuum cleaner or at **some other time**.

Henly Pahilagao **pay 20% less for the extended warranty if they buy it at the same time they buy a Tornado**. How many performance obligations exist in the implied contract for the purchase of a vacuum cleaner? How many performance obligations?





Concept Check 22 - Extended Warranty

Vacuums sells the Tornado **vacuum cleaner**. Each **vacuum cleaner** has a **one-year warranty (quality-assurance)** that covers any product defects. When customers purchase a vacuum cleaner, they also have the *** option to purchase an extended three-year warranty** that covers any breakage or maintenance. The **extended warranty*** sells for the **same amount** regardless of whether it is purchased at the **same time** as the vacuum cleaner or at **some other time**.

Henly Pahilagao *pay 20% less for the extended warranty if they buy it at the same time they buy a Tornado*. How many performance obligations exist in the implied contract for the purchase of a vacuum cleaner? How many performance obligations?

Number of performance obligations in the contract: 2.

We need to consider three aspects of the vacuum contract: delivery of the vacuum, the one-year quality-assurance warranty, and the option to purchase the three-year extended warranty. ***Delivery of the vacuum cleaner is a performance obligation.*** The one-year warranty that is included as part of the purchase (the quality-assurance warranty) ***is not a performance obligation***, but rather it is part of the obligation to deliver a vacuum of appropriate quality. The **option to purchase the extended warranty, though, is a performance obligation within the contract to purchase a vacuum**. Customers can **purchase that warranty at a 20% discount** if they do so when they buy the vacuum, so the **opportunity to buy the extended warranty constitutes a material right**. Also, the option is ***capable of being distinct***, as it could be sold or provided ***separately***, and it is ***separately identifiable***, as the vacuum could be sold without the option to purchase an extended warranty, so the ***option is distinct, and qualifies as a performance obligation.***



Concept Check 23 - Extended Warranty

Doringer and Ramelo Computer Inc. manufactures and ***sells computers that include a warranty*** to make good on any defect in its computers for 120 days (often referred to as an ***assurance warranty***).

In addition, it ***sells separately an extended warranty***, which provides protection from defects for three years beyond the 120 days (often referred to as a service warranty). How many performance

Number of performance obligations in the contract: 2

In this case, ***two performance obligations exist, one related to the sale of the computer and the assurance warranty, and the other to the extended warranty (service warranty).***

The sale of the computer and related assurance warranty are ***one performance obligation*** as ***they are interdependent and interrelated*** with each other. However, the ***extended warranty*** is separately sold and is ***not interdependent***.

Special Issues for Step 2:

Identify the Performance Obligation(s)



- In some contracts, performance obligations are so tangled that it doesn't make sense to view them separately. ***For example***, in most long-term construction contracts, the contractor's role is to combine many products and services such as lumber, concrete, design, electrical, plumbing, and actual construction, to provide a single completed building or other constructed asset to the customer. ***Therefore, each of these separate products and services are not considered distinct in the context of a contract.***
- Most ***long-term construction contracts*** are viewed as including a ***single performance obligation*** ***because the individual goods and services needed to construct the asset are highly interrelated.*** Even ***though these goods and services might be capable of being distinct*** outside the context of the contract, the contract itself causes them to be more appropriately thought of as being ***provided together as a single performance obligation.***



Concept Check 24 - Performance Obligation

Bobadilla, Ochotorena, Caliwan & Co., sells a subscription to its anti-virus software along with a subscription renewal option that allows renewal at half the prevailing price for a new subscription. How many performance obligations exist in this contract?

Number of performance obligations in the contract: 2

In addition to the subscription since it was already sold, the *renewal option (was already sold) is a separate performance obligation* because it provides a material right (different sales price) that allows the customer to renew at a better price than could be obtained without the right. The renewed protection is *capable of being distinct*, as it could be sold or provided separately, and it is *separately identifiable*, as the customer can use the renewed protection on its own. Therefore, the **renewed protection is distinct**, and qualifies as a performance obligation.



Concept Check 25 - Performance Obligation

On January 1, 20x7, **Flong Tugan** Construction Company signed a contract to build a custom garage for a customer and received P10,000 in advance for the job. The new garage will be built on the customer's land. To complete this project, Lego must first build a concrete floor, construct wooden pillars and walls, and finally install a roof. Lego normally charges stand-alone prices of P3,000, P4,000, and P5,000, respectively, for each of these three smaller tasks if done separately. How many performance obligations exist in this contract?

Number of performance obligations in the contract: 1

The separate goods and services that Precision Equipment has agreed to provide (equipment, customized software package, and consulting services) might be *capable of being distinct*, but they are **not separately identifiable**. In the context of the contract, the goods and services are highly dependent on and interrelated with each other. The contractor's role is to integrate and customize them to create one automated assembly line.

Concept Check 26 - Right of Return

Allan Silva Perfume, Inc., sold 3,210 boxes of white musk soap during January of 20x7 at the price of P90 per box. The company offers a full refund for any product returned within 30 days from the date of purchase. Based on historical experience, **Allan Silva** expects that 3% of sales will be returned. How many performance obligations are there in each sale of a box of soap? How much revenue should **Allan Silva** recognize in January?

Number of performance obligations in the contract: 1.

A **right of return is not a performance obligation**. Instead, the right of return represents a potential failure to satisfy the original performance obligation to deliver goods to the customer. Because the total amount of cash received from the customer depends on the amount of returns, **a right of return is a type of variable consideration**. **Allan Silva** should estimate sales returns and reduce revenue by that amount in order to arrive at “net revenue,” which would be the transaction price (the amount to be recorded as revenue on the seller’s books). The total net revenue in this situation is **P280,233**:

Revenue P288,900 ($P90 \times 3,210$ units)

Sales returns 8,667 ($P288,900 \times 3\%$)

Net revenue **P280,233**



Special Issues for Step 3:

Determine the Transaction Price

Variable Consideration: Part of the transaction price depends on the outcome of some future event.

- Examples:
 - Entertainment and media - **Royalties**
 - Health care - Medicare and Medicaid **reimbursements**
 - Manufacturing - Volume **discounts** and product **returns**
 - Construction - **Incentive payments**
 - Telecommunications - **Rebates**
- Methods of estimation:
 - Expected value
 - Most likely amount



Special Issues for Step 4:

Allocate the Transaction Price to the Performance Obligations

Various approaches available to estimate stand-alone selling prices:

- **Adjusted market assessment approach**
 - Price if the product or services were sold in the market
- **Expected cost plus margin approach**
 - Estimate the costs of satisfying a performance obligation and then add an appropriate profit margin
- **Residual approach**
 - Subtract the sum of the known or estimated stand-alone selling prices of other goods and services in the contract from the total transaction price of the contract



Special Issues for Step 5:

Recognize Revenue When (Or As) Each Performance Obligation Is Satisfied

Some common arrangements can have complicated revenue recognition timing:

- Warranties
 - Quality Assurance (Concept Check 7)
 - Extended (Concept Check 8)
- Licenses (Concept Check 11)
- Right of Return (Concept Check 10)
- Bill-and-hold arrangements (Concept Check 12)
- Franchises (Concept Check 13)
- Principal-Agent Relationship (Concept Check 14)
- Consignment arrangements (Concept Check 15)
- Gift cards (Concept Check 16)



Special Issues for Step 5:

Licenses

- A license transfers a **right of use** if the seller's activities during the license period are not expected to affect the intellectual property being licensed to the customer.

Example: a music download.

Revenue is *recognized at the start of the license period*, when the right is transferred.

- A license provides a **right of access** to the seller's intellectual property if the seller's ongoing activities affect the benefit the customer receives.

Example: an NFL trademark granted to a company over a period of time.

In that case revenue is recognized *over the period of time* for which access is provided.





Concept Check 27

Which of the following is **not** true?

- a. License fees are recognized over time for any license that is viewed as providing a right of access.
- b. Licensing fees are recognized as revenue over time for any licenses for which the seller expects its ongoing activities to affect the benefits that the buyer receives from intellectual property.
- c. License fees are recognized as revenue at a point in time if the buyer expects that the seller's future activities will not affect the benefit the buyer derives from the intellectual property.
- d. Licensing fees always are recognized as revenue at the end of the license period, when the seller has completed its performance obligation to provide access to its intellectual property.

If the seller provides **access** to its intellectual property, revenue is recognized **over the period of time for which access is provided**, not deferred until the end of the license period.

Special Issues for Step 5:

Bill and Hold Arrangements

- A bill-and-hold sale is an arrangement where a **customer purchases goods but requests that the seller not ship the product until a later date.**
- Since the customer doesn't have physical possession of the asset until the seller has delivered it, transfer of **control has not occurred**, so **revenue typically should not be recognized until actual delivery to the customer occurs.**





Concept Check 28

Which of the following is typically true for a bill-and-hold arrangement?

- a. Revenue is recognized when goods are manufactured.
- b. Revenue is recognized when the arrangement is made.
- ☒ c. Revenue is recognized when the delivery of goods is made.
- d. Revenue is recognized at the point in time at which payment from the customer is received.

Bill-and-hold arrangements normally do not qualify for revenue recognition until **delivery** is made to the customer. Prior to that point, control of goods usually is not viewed as having passed to the customer.

Special Issues for Step 5:

Repurchase Agreement



A **repurchase agreement** is where an entity **sells an asset** but **retains a right to repurchase the asset**. This is **often not recognized as a sale**, but as a **secured loan against the asset**. Indications that this should not be recognized as a sale may include:

1. Sale is below fair value
 2. Option to repurchase is below the expected fair value
 3. Entity continues to use the asset
 4. Entity continues to hold the majority of risks and rewards associated with ownership of the asset
 5. Sale is to a bank or financing company
- Transfer control of (sell) an asset to a customer but **have an obligation or right to repurchase**.
 - If obligation or right to repurchase is for an amount **greater than or equal to** selling price, then **transaction is a financing transaction**.



Repurchase Agreement

There are **three forms of repurchase agreements**:

1. An entity's **obligation to repurchase the asset (a forward)**;
2. An entity's **right to repurchase the asset (a call option)**;
3. An entity's **obligation to repurchase the asset at the customer's request (a put option)**

Special Issues for Step 5:

Non-refundable Upfront Fees



- Payments from customers before
 - Delivery of product and/or
 - Performance of a service
- Related to a good or service
- Generally relate to initiation, activation, or setup of a good or service to be provided or performed in the future.
 - Most cases, upfront payments are nonrefundable.
 - Examples include:
 - Membership fee in a health club.
 - Activation fees for phone, Internet, or cable.

Special Issues for Step 5:

Principal-Agent Relationship



- An entity that is a **principal** in a contract may satisfy a performance obligation by itself or it may engage another party (for example, a subcontractor) to satisfy some or all of a performance obligation on its behalf.
- An entity is an **agent** if the entity's performance obligation is to arrange for the provision of goods or services by another party.



Principal-Agent Relationship

Is the Seller a Principal or Agent?

	Principal	Agent
<i>Performance obligation</i>	<ul style="list-style-type: none">• To deliver goods and services (so is vulnerable to risks associated with holding inventory)	<ul style="list-style-type: none">• To facilitate/arrange a transaction between a principal and a customer
<i>Recording revenue</i>	<ul style="list-style-type: none">• Revenue from sales price paid by customers = Gross consideration• Also recognizes cost of goods sold	<ul style="list-style-type: none">• Revenue = Only the Commission or Fee it receives on the transaction



Concept Check 29

Giged Tong Consulting Services operates a website that links experienced statisticians with businesses that need data analyzed. Statisticians post their rates, qualifications, and references on the website, and **Giged Tong Consulting Services** receives 25% of the fee paid to the statisticians in exchange for identifying potential customers. **Elvie, Edith, Paz and Associates** contacts **Giged Tong Consulting Services** and arranges to pay a consultant P4,500 in exchange for analyzing some data. Giged's income statement would include the following with respect to this transaction:

- a. Revenue of P4,500
- b. Revenue of P4,500, and cost of services of P3,375
- ☒ c. Revenue of P1,125
- d. Revenue of P5,625 and cost of services of P4,500

Giged is an agent. It doesn't have primary responsibility for delivering the statistics services and doesn't collect payment from the customer. Rather, Giged's primary performance obligation is to facilitate transactions between customers and statisticians. Therefore, Giged would recognize as revenue only its commission of P1,125 (computed as 25% x P4,500).

Special Issues for Step 5:

Franchises



- In a franchise arrangement, a franchisor grants to the franchisee the right to sell the franchisor's products and use its name.
- Franchises often include a **license**, as well as **goods and services transferred** at the start of the franchise as well as over the life of the franchise.
- Each of these aspects must be evaluated to determine if they qualify as separate performance obligations and accounted for accordingly.



Concept Check 30

Which of the following is **not** true about accounting for revenue from franchise arrangements?

- a. Franchise arrangements often include a performance obligation for a license as well as for delivery of goods and services.
- b. Franchise arrangements typically include one or more performance obligations for which revenue is recognized at a point in time.
- c. Franchise arrangements typically include one or more performance obligations for which revenue is recognized over a period of time.
- ☒ d. Franchise arrangements typically include one performance obligation because the goods and services included in the arrangement are not separately identifiable.

Franchise arrangements typically include multiple performance obligations because the goods and services included in the arrangement are both capable of being distinct and are separately identifiable.



Special Issues for Step 5:

Consignment Arrangements

- The “consignor” physically transfers the goods to the other company, the consignee, but the **consignor retains legal title**.
- If a buyer is found, the consignee remits the **selling price less commission** and approved expenses to the consignor.
- If the consignee can’t find a buyer within an agreed-upon time, the consignee **returns the goods to the consignor**.
- Given that the consignor retains the risks of ownership, it **postpones revenue recognition until sale to a third party occurs**.



Concept Check 31

Asser Tamayo is an artist who sells his work under consignment (he displays his work in local coffeeshops, and customers purchase his work there). Asser recently transferred a painting on consignment to a local coffeeshop. After Asser has transferred a painting to a coffeeshop, the painting:

- a. Should be counted in the coffeeshop's inventory, as the coffeeshop now possesses it.
- ☒ b. Should be counted in Asser's inventory until the coffeeshop sells it.
- c. We lack sufficient information to know who should carry the painting in inventory.
- d. Should be counted in either Asser's or the coffeeshop's inventory, depending on which incurred the cost of preparing the painting for display.

Consignment arrangements normally do not qualify for revenue recognition until delivery is made to the end customer. Prior to that point, control of goods is viewed as having been retained by the consignor, not by the consignee, so the consignor retains the goods in the consignor's inventory. In this case, that means that Asser will retain the painting in its inventory until the painting is sold to an end customer.

Special Issues for Step 5:

Others such as Gift Cards

- Sales of gift cards are recognized as **deferred revenue**, and then revenue is recognized *when a gift card is redeemed or the likelihood of redemption is viewed as remote*.



Concept Check 33

Edwin and Bryan sells gift cards redeemable for EdBry products either Paul Garcia in-store or online. During 20x6, Edwin and Bryan sold P6,000,000 of gift cards, and P5,400,000 of the gift cards were redeemed for products. As of December 31, 20x6, P450,000 of the remaining gift cards had passed the date at which Edwin and Bryan concludes that the cards will never be redeemed. How much gift card revenue should Edwin and Bryan recognize in 20x6?

- a. P5,400,000
- b. P5,550,000
- ☒ c. P5,850,000
- d. P6,000,000

The sale of a gift card creates deferred revenue, as it is a prepayment by a customer for goods or services to be delivered at a future date. Revenue is recognized when goods or services are delivered or when the likelihood of redemption is remote. In this case, P5,400,000 were redeemed and another P450,000 were viewed as broken, yielding total revenue of P5,850,000.





Statement of Financial Position

- A contract asset or contract liability should be presented in the statement of financial position when either party has performed in a contract.

- **Contract asset**
 - **Contract liability**
- 



Contract assets

• **Contract asset** = Rights received >
Performance obligation

- A contract asset are of two types:
Unconditional rights - receivable
Conditional rights

Contract liabilities

- **Contract liability** = Rights received < performance obligation
If the cash received exceeds the revenue recognized to date, there will be a contract liability (acting effectively as deferred income).
A contract liability is generally referred to as **Unearned Sales Revenue, Unearned Service Revenue**, or any appropriate account title.

Some Important Changes in Revenue Recognition Under IFRS 15



	Previous GAAP	IFRS 15
Key concept underlying revenue recognition	The realization principle: Recognize revenue when both the earnings process is complete and there is reasonable certainty as to collectibility of the asset(s) to be received.	The core revenue recognition principle: Recognize revenue when goods or services are transferred to customers for the amount the company expects to be entitled to receive in exchange for those goods and services.
Role of collectibility in determining whether revenue is recognized.	Defer revenue recognition if cash collection is not reasonably certain. Use installment method or cost-recovery method to tie revenue recognition to subsequent cash collection.	Defer revenue recognition until cash collection is probable. Installment and cost-recovery methods eliminated.
Criteria for recognizing revenue over time	Depends on the earnings process. For long-term contracts, recognizing revenue over time is generally required unless reliable estimates of progress towards completion can't be made.	Depends on characteristics of the contract and of the performance obligations being satisfied.

Some Important Changes in Revenue Recognition (cont.)



	Previous GAAP	IFRS 15
Accounting for multiple performance obligations	Depends on the industry. Sometimes performance obligations are ignored (e.g., “free” smartphones in cell phone contracts); sometimes revenue recognition is constrained (e.g., software for which there is not sufficient evidence of stand-alone prices).	Regardless of industry, apply criteria for determining whether goods and services are distinct to identify performance obligations, allocate transaction price to performance obligations, and recognize revenue when each is satisfied.
Treatment of customer options for additional goods or services	Depends on the industry. Sometimes treated as a separate deliverable (e.g., software upgrades), other times ignored (e.g., frequent flyer miles).	Regardless of industry, treat an option as a separate performance obligation if it provides a material right to the customer that the customer would not have otherwise.
Treatment of variable consideration	Typically only recognize revenue associated with variable consideration when uncertainty has been resolved.	Include estimated variable consideration in the transaction price, but only to the extent it is probable that a significant revenue reversal will not be required in the future.
Treatment of time value of money	Interest revenue recognized for long-term receivables but interest expense typically not recognized for long-term prepayments.	Interest revenue or interest expense recognized for both long-term receivables and long-term prepayments if amount is significant.



**The only thing that
stands between a man
and what he wants from
life is often merely the
will to try it and the faith
to believe that it is
possible.**

**Thank You and
GOD Bless!!!**

