EFFECTS AND IMPLICATIONS OF THE IMPLEMENTATION OF IFRS 15 - REVENUE FROM CONTRACTS WITH CUSTOMERS

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Abstract:
The Standard IFRS 15 - Revenues from Contracts with Customers was developed by the IASB in order to replace some of the IAS and US GAAP standards still in force, as well as to introduce significant changes to the accounting of revenues. For most companies, the implementation of this standard will result in significant effects on accounting and reporting techniques, on the business processes and the IT systems, as it practically changes the reasoning used for revenue recognition. This paper is focused on the future implementation of the IFRS 15 and on its impact on the company's performance.

Keywords: IFRS 15, revenue, recognition and measurement, IAS/IFRS.

JEL Classification: M 41

1. INTRODUCTION

The IFRS 15 - Revenues from Contracts with Customers accounting standard was published, on May 28, 2014, under the IFRS-USGAAP convergence process initiated by the IASB (International Accounting Standard Board) and the FASB (Financial Accounting Standard Board); on the same date, the FASB published a document entitled: Accounting Standards Update 2014-09- Revenues from Contracts with Customers (FASB, topic 606, 2014).

The objectives of this standard, which are themselves convergent, are geared towards creating a complete reference frameworks in terms of revenue reporting, being applied to all commercial contracts, excluding leasing, insurance contracts, and financial instruments.

IFRS 15 practically replaces IAS 18 – Revenues, IAS 11 - Construction Contracts, IFRIC 13- Customer Loyalty Programs, IFRIC 15- Agreements on construction of real estate properties, IFRIC 18- Transfer of assets from customers, SIC 31- Revenues - Barter transactions involving advertising services. The applicable accounting standards for revenue recognition, such as IAS 18 - Revenues and IAS 11 - Construction Contracts, were issued more than 20 years ago, and most professionals consider them to be incomplete and outdated; these two accounting standards were supplemented, over the years, by many interpretations.

For example, IAS 11 defines a construction contract as a contract specifically negotiated for the construction of an asset or a combination of assets that are closely interrelated or interdependent in terms of their design, technology, function or their ultimate purpose or use." The objective of this standard is to prescribe the accounting treatment of construction contracts. The primary issue in accounting for construction contracts is the "allocation of contract revenue and contract costs to the accounting periods in which construction work is performed." This standard establishes, inter alia, the recognition criteria used to determine when contract revenue and contract costs should be recognised in the profit and loss account.

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It is known that the adoption of IAS/IFRS leads to changes in the financial reporting system of reporting entities and, obviously, to a review of the criteria for recognition, measurement, and presentation of property items in the financial statements (Grosu, 2010).

In our country, according to OMPF 881/2012, starting with the 2012 financial year, listed companies are required to adopt IFRS for individual annual financial statements.\(^1\) Since the objective of financial statements is to present information on the company’s performance, financial position, and evolution, aimed at a large number of users, in order to substantiate economic decisions, this information must be useful to determine both the capacity of the enterprise to generate future cash flows, as well as the amount, period, and safety of their generation (Tabără et al, 2009).

Returning to the new IFRS 15 standard, its role is to promote two types of approaches to revenue recognition, namely: the first approach is the recognition at a point in time and the second is gradual recognition, over time. At the same time, IFRS 15 distinguishes itself by the application of a five-step model, used to analyse transactions and to determine how the revenues are to be recognised, related both to the period of time when they were derived, and to their value.

![Figure 1 - The five-step model used for revenue recognition, under IFRS 15](image)


The basic principle of the IFRS 15 standard is that entities that adopt IAS/IFRS in the preparation of financial statements must recognise revenues when the transfer of goods or the provision of services occurs, and they must be expressed by an amount corresponding to the consideration or payment that the entity expects to receive.

IFRS 15 will therefore improve the accounting reporting of revenues and the overall increase in comparability of the information included in the financial statements. In this way, the new accounting standard will enable the optimisation of information related to revenues, will provide a series of guidelines for subsequent operations, which were not included expressly (such as revenues from services, revenues from additional services or from some contractual changes), and will also contribute to improving information on multiple-element arrangements.

The approval process of IFRS 15 is ongoing, and EFRAG concluded, in relation to its approval, that this accounting standard meets all relevant criteria, including those relating to the European public interest. EFRAG also considers that the advantages of applying IFRS 15 should exceed the related costs. In order to complete the approval process of IFRS 15, the EFRAG Council took into account all the remarks received from members and considered that this standard may have positive effects on the cost of capital, and was unable to identify any possible adverse effects on the European Commission. The final opinion on the approval, drawn up in

\(^1\) OMPF 881/2012 on the application of the International Financial Reporting Standards by companies whose securities are admitted for trading on a regulated market, Art. 1.
March 2015, contains this observation (Relazione Della Commissione Al Parlamento Europeo E Al Consiglio sulle attività della Fondazione IFRS, dell’EFRAG e del PIOB, 2014).

In 2014, EFRAG participated in the consultation process of the IASB and published a series of letters containing remarks, after the public consultation in relation to all IASB decisions, including the Conceptual Framework (EFRAG, Annual Review, 2014). EFRAG has also continued discussions on the draft regarding leasing operations and on the draft of IFRS 4 - Insurance Contracts.

2. EFFECTS AND IMPLICATIONS RELATED TO THE IMPLEMENTATION OF IFRS 5

Under IFRS 15, obligations (undertakings) and contractual provisions may be considered fulfilled at a given time (e.g. following the delivery of a good), or during a certain period of time (e.g. the provisions of a service).

IFRS 15 defines income as "increases in economic benefits during the accounting period in the form of inflows or enhancements of assets or decreases of liabilities, which result in an increase in equity, other than those relating to contributions from equity participants" (IFRS 15 - Revenue from contracts with Customers).

IAS 18 - Revenue, still in force until the implementation of IFRS 15, specifies that revenue (IAS 18 – Revenues, 2013) should be recognised when it is probable that the entity will obtain future economic benefits associated with the increase in value of an asset or with the decrease of a liability, and their measurement can be done reliably and with sufficient certainty. In practical terms, however, as required by IAS 18, the revenue recognition criteria are usually applied separately to each transaction in order to reflect economic reality. For example, when the selling price of a product includes an identifiable amount for successive services, this amount is recorded in advance and recognised as revenue over the period in which the service was performed.

Figure 2 - Transactions covered by IAS 18 - Revenues

We should also take into account the fact that legislative differences in different countries may cause the revenue recognition criteria to be fulfilled at different times (IAS 18, 2013).
The main new elements that can be identified in IFRS 15 (IFRS, News letter, 2010), at first reading, are:

- Concentrating (treating all accounting aspects) all types of revenue into a single standard;
- Introducing a model based on the concept of transfer of control; in fact, IFRS 15 indicates revenue recognition and transferability of control over goods and services to customers, while the basic criterion for revenue recognition is based, in the current standard, on the concept of transfer of risks and rewards;
- The measurement of revenues based on the consideration that the entity considers it is entitled to receive (or collect) under the contract, while IAS 18 requires revenues to be measured based on the fair value related to the received or expected consideration. Therefore, there is a shift from a neutral or subjective criterion, such as fair value, to a perspective that simplifies the subjectivity of measurement;
- The introduction of new and specific criteria to allocate the consideration for goods or services rendered under the same contract (unbundling);
- The introduction of a specific regulation to account for variable or potential consideration.

Also of note, the fact that IFRS 15 substitutes IAS 11 - Construction Contracts containing recognition criteria not only for revenues, but also for expenditure related to works in progress. These issues are partly reflected in IFRS 15. At the same time, IFRS 15 extends the mandatory information disclosed in the notes, in terms of quantity and quality, in order to enable users of financial statements to better understand the nature, value, appropriateness and potential uncertainties related to obtaining revenue and the related cash flow, derived from customer contracts. It is therefore necessary to pay more attention to the development of the Explanatory Notes, given that this information could include data on conducting business and prospects for investors, which in the past were not provided.

Among the expected effects resulting from the implementation of IFRS 15, we would like to mention the perfect timing (early or delayed, depending on the current standards in force) for revenue recognition, as well as the application of different methods (e.g. revenue recognition over time, rather than recognition upon obtaining or vice versa). However, the above topics will condition, directly or indirectly, the contract type or the business practices, especially when using clauses which specify the amount of the margin, but which can result, after the introduction of the new IFRS 15, in significant effects on the revenue recognition criteria.

In order for IFRS 15 to apply, the customer contracts must meet certain conditions, as shown in the Figure 3 below.

![Figure 3 – Conditions set out in IFRS 15 for customer contract recognition](http://www.pkf.com/media/31867/IFRS%2015%20Summary.pdf)
In conclusion, IFRS 15 could indirectly have relevant effects on tax procedures, on tax planning strategies, and on certain taxation obligations (constraints) (financial covenants), etc.

The implementation of IFRS 15 will occur in the financial year 2017 (or afterwards), early implementation being permitted only if the IASB document is already approved by the EU.

For the purposes of the first implementation, IFRS 15 will be implemented retroactively, and certain simplification techniques (practical expediens) are also allowed, as well as an alternative approach (cumulative effect approach) which will avoid the re-exposure of the years presented in the comparative information; in the latter case, the effects deriving from the application of the new standard will be presented in its equity structure, for the financial year in which the IFRS 15 is first applied. It should also be noted that, for the purposes of the implementation of the IFRS 15 accounting standard, the IASB and the FASB have created the Joint Transition Resource Group for Revenue Recognition, in order to identify and discuss possible issues regarding its implementation.

In other words, IFRS 15 is the only reference resource for entities and lines of business

**Example 1:** The company Enea delivers to the company Universia goods worth RON 10,000. After a short time, Universia's ability to pay is proven to have impaired significantly. In this situation, under IFRS 15, Enea analyses whether it can receive the consideration in exchange for the goods to be transferred to the customer.

If an amendment to a contract generates additional obligations, then such amendment constitutes a separate contract, and if it does not generate additional obligations, the amendment is considered an adjustment to the initial contract.

**Example 2:** A contract for the interior remodelling of a hostel has an estimated price of RON 50,000, the total costs incurred by the company which remodeling the hostel being of RON 35,000.

Near the end of the contract, the customer requests changes that result in a change in total costs amounting to RON 1,000 and in a change in price amounting to RON 2,000.

In this case, the change is treated like an adjustment to the initial contract, since it does not generate additional obligations.

**Identifying the performance obligations in the contract**

Any contract includes certain obligations to transfer goods or services to a customer. In this regard, an obligation to transfer a good or to render a service to a customer is deemed severable if the following conditions are met cumulatively:

- The customer can benefit from the goods or services transferred separately or together with other available resources;
- The promise of the entity to transfer the goods or services to the customer is identified separately from other promises under the contract.

**Example 3:** A construction company enters into a contract with a customer to build a warehouse, as well as interior fittings, connection to utility networks and other specific works. Based on this information, the construction company identifies the following obligations arising from the contract:

- building the warehouse;
- completing interior fittings
- connection to utility networks
- other specific works.
Remark: There are various companies that provide guarantees to customers for goods delivered or services rendered. If the customer receives the guarantee in question, this constitutes a separate obligation, because it provides the customer with an additional service. If the guarantee means that the delivered good meets certain specified conditions, then it does not constitute a separate obligation. Basically, the exact determination of the performance obligations requires the separate registration of all items.

Determining the transaction price

The entity must determine the amount of the consideration that it must receive in exchange for goods and services promised in the contract, in order to recognise revenue. The transaction price may be a fixed amount, and may vary as a result of discounts or bonuses granted.

Example 4: A company enters into a contract with a customer for the construction of a parking lot in an urban area with access to a national road, for the price de RON 75.50 million. The company must pay penalties if the deadlines for the completion of works are not observed.

The example shown includes a fixed component, the transaction price, i.e. the price of RON 75.50 million, and a variable component, i.e. the penalty.

Example 5: A company sells computing equipment to a customer in exchange for a price of RON 10,000. The cost of production of the equipment amounts to RON 8,000. The customer may return the products within a maximum of four months.

As evidenced by this example, the consideration obtained in exchange for the transfer of the equipment is variable, as it is influenced by the number of devices that are estimated not to be returned.

Let's assume that 90% of the equipment will not be returned.

The supplier believes that no significant cancellation of the accrued revenues will occur when the uncertainty associated with the variable consideration is removed (i.e. upon expiry of the 4-month period).

Therefore, the revenues recognised by the entity is of RON 10,000 * 90% = RON 900.

If the consideration received by the supplier from the customer is non-monetary in nature, it shall be measured at fair value (Girbina, 2014).

IFRS 13 - Fair value measurement defines fair value as "the price that would be received to sell an asset or paid to transfer a liability in an orderly transaction between market participants at the measurement date." Also, fair value measurement takes into account the characteristics of the asset or liability, such as asset location and restrictions on the sale or use thereof (IFRS, Part B, 2013).

If fair value cannot be determined, it is estimated indirectly, considering the selling price of the goods and services transferred to the customers.

If a customer makes available to the company goods and services to facilitate the performance of a contract by the company, the latter will establish whether it acquires control over such goods and services. Therefore, goods and services received are considered non-monetary consideration from the customer (Girbina, 2014).

Allocating the transaction price among the performance obligations generated by the contract

When a contract includes several separate obligations, the company allocates the transaction price to each obligation, depending on its individual price. The price of each obligation is determined considering the price in exchange for which the good or service is sold separately by the entity. If this price is not observable, the entity must estimate it.
As seen at this stage, the selling price specified in the contract is the price of all the goods or services sold to a customer. If the price is not specified for each item, it can be estimated.

Recognising revenue as the entity satisfies the performance obligation

According to the new rules, revenue is only recognised when a performance obligation is satisfied. In other words, the performance obligation is satisfied when control over the goods and services is transferred to the customer. This type of control implies the ability of the entity to decide on the use and to obtain benefits in relation to the transferred goods or services.

This obligation generated by the contract may be satisfied at a point in time (this usually happens in the case of a transfer of goods, or it can be completed over time) for promises to transfer goods or services at a certain point in time (Gîrbină, 2014).

The changes occurring under the new standard require the detailed identification of items of goods and services, of their price, as well as of the manner in which the performance obligations are recorded and satisfied. The changes can be made both by the termination of the original contract and drafting a new contract, and by means of an addendum to the original contract, if the nature of the goods or services is not different.

The change of the elements of the contract will have an impact on allocation and revenue recognition, compared to current date records. This revenue treatment, prescribed by IFRS 15, differs from the one accepted by IAS 18- Revenue. Under IAS 18, revenue is recognised when most risks and rewards of ownership of the goods are transferred to the customer.

IAS 18 also establishes different criteria for recognising revenues from the sale of goods and revenues from services, which are presented in Table 1.

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**Example 6:** A supplier enters into a contract with a customer that provides for the sale of three categories of products: detergents, beauty products and cleaning products, at the price of RON 7,000.

The company usually only sells detergents and beauty products, therefore the price of these products is directly observable. For the cleaning products, the prices may not be observable, as usually the entity does not sell these products separately. Under IFRS 15, the prices for the final product should be estimated.

The prices for the 3 products are:

- detergents: RON 4,000
- beauty products: RON 2,000
- cleaning products: RON 2,000

**TOTAL = RON 8,000**

The supplier gives the client a discount of RON 1,000, which is distributed between the 3 products proportionately to their selling price.

The selling price of RON 7,000 (RON 8,000 minus discount of RON 1,000) is allocated between the 3 products as follows:

- detergents - RON 4,000/RON 8,000*RON 7,000 = RON 3,500
- beauty products - RON 2,000/RON 8,000 lei*RON 7,000 lei=RON 1,750
- cleaning products - RON 2,000/RON 8,000 lei*RON 7,000 = RON 1,750
Table 1- Revenue recognition criteria under IAS 18

<table>
<thead>
<tr>
<th>The sale of goods</th>
<th>The rendering of services</th>
</tr>
</thead>
<tbody>
<tr>
<td>Revenue is recognised when all the conditions are met:</td>
<td>When the outcome of a transaction involving the rendering of services can be estimated</td>
</tr>
<tr>
<td>• the entity has transferred to the customer all the significant risks and rewards of the ownership of the goods;</td>
<td>reliably, the revenue associated with the transaction must be recognised depending on</td>
</tr>
<tr>
<td>• the entity retains neither continuing managerial involvement to the degree usually associated with ownership nor effective control over the goods sold;</td>
<td>the stage of completion of the transaction at the end of the reporting period (IFRS, part A, 2013).</td>
</tr>
<tr>
<td>• the amount of revenue can be measured reliably;</td>
<td></td>
</tr>
<tr>
<td>• it is probable that the economic benefits associated with the transaction will flow to the entity;</td>
<td></td>
</tr>
<tr>
<td>• the costs incurred or to be incurred in respect of the transaction can be measured reliably.</td>
<td></td>
</tr>
</tbody>
</table>

Source: IAS 18 - Revenues

In what concerns the revenue recognition criteria under IFRS 15, they can be observed in Table 2.

Table 2- Revenue recognition criteria under IAS 15

<table>
<thead>
<tr>
<th>At a certain point in time</th>
<th>Over time</th>
</tr>
</thead>
<tbody>
<tr>
<td>Revenue is recognised after analysing the following conditions:</td>
<td>Revenue is recognised when at least one of the following conditions is met:</td>
</tr>
<tr>
<td>• the entity has transferred the good to the customer;</td>
<td>• The customer receives the services rendered by the entity and enjoys the benefits as they are provided by the entity;</td>
</tr>
<tr>
<td>• the entity has the right to claim payment for the asset;</td>
<td>• the rendering of services by the entity gives rise to an asset or increase its value. In these circumstances, the asset is controlled by the customer as it is created or as its value is increased;</td>
</tr>
<tr>
<td>• the customer has accepted the asset;</td>
<td>• the rendering of services by the entity does not give rise to an asset that has an alternative use to the entity, and the entity is entitled to payment for the services rendered so far.</td>
</tr>
<tr>
<td>• all risks and rewards of ownership of the asset were transferred to the customer/the customer is the owner of the asset.</td>
<td></td>
</tr>
</tbody>
</table>

Source: IFRS 15 - Revenues from contracts with customers

To determine whether the asset has an alternative use, the seller will have to consider, at the beginning of the contract, if it can use the asset for a purpose other than that specified in the contract entered into with the customer. Regarding the costs incurred by the entity to obtain contracts, they must be recorded as expenses, except those that would have been incurred if the contract had not been obtained. The changes provided in IFRS 15 will have a major impact in terms accounting for long-term contracts.
As noticed from the examples mentioned, revenue is recognised as deferred income, as a result of the clause, stipulated in the contract, which specifies the rendering of services at a later date, that that have no connection with the object of the contract, i.e. the sale. The *performance obligation* is a promise to transfer a good or service, or a distinct group of goods or services.

The transfer of control determines the recording of revenue in the accounting records when the goods or services are transferred to the customer (IFRS 15, 2014).

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**Example 7:** A supplier sells a machine to a customer and undertakes to pay its upkeep for a period of 4 years.

Under IFRS 15, this clause creates an obligation that will contribute to an increase in performance (by the revenue generated by providing maintenance services) to be accounted for separately from the revenue resulting from the sale of the machine. These latest revenues will be estimated before being reported, since they can vary depending on factors that are still unknown, such as machine maintenance costs.

*If the supplier anticipates providing maintenance services, the related revenues can be recognised and recorded as deferred income.*

Under IAS 18, this revenue can only be recognised at the time the services themselves are performed.

Example 8: An author receives an offer from a publisher to publish an article for free, provided that the author takes up a monthly subscription to one of the publisher’s journals, the subscription amounting to RON 30/month. The minimum subscription period stated in the contract is of 3 years.

**Step 1. Identifying the contract with a customer**
There is a clear obligation between the two contracting parties, over a period of 36 months.

**Step 2. Identifying the performance obligations in the contract**
- the obligation to provide free publishing services
- the obligation to deliver the journal included in the subscription contract, for 36 months

**Step 3. Determining the transaction price**
The transaction price is RON 30 * 36 months = RON 1,080

**Step 4. Allocating the transaction price among the performance obligations generated by the contract**
The publishing house usually publishes an article in exchange for the price of RON 200, and a monthly subscription amounts to RON 20.

<table>
<thead>
<tr>
<th>Performance obligation</th>
<th>The sale price</th>
<th>%</th>
<th>Revenue recognised and recorded in the supplier’s (publisher’s) accounting records</th>
</tr>
</thead>
<tbody>
<tr>
<td>Article publication</td>
<td>200 *1 = RON 200</td>
<td>21.74%</td>
<td>RON 200 (21.74% * RON 920)</td>
</tr>
<tr>
<td>Subscription</td>
<td>720 (RON 20 * 36 months)</td>
<td>78.26%</td>
<td>RON 720 (78.26% * RON 920)</td>
</tr>
<tr>
<td>Total</td>
<td>RON 920</td>
<td>100%</td>
<td>RON 920</td>
</tr>
</tbody>
</table>

**Step 5. Recognising revenues as the entity satisfies the performance obligation**
When the publishing house publishes the work of the author, it must recognise and record revenues amounting to RON 200; the IFRS 15 standard allows the recording in the accounting books, during the month of the article publication, of a revenue equal to their real value. When the publishing house offers subscription services to the person who benefited from the free publication, it must recognise revenues amounting to RON 720.

During the month the article was published, revenues amounting to RON 200 are recorded, revenues that will be collected over a period of 3 years, as provided in the subscription contract.

<table>
<thead>
<tr>
<th>Type of operation</th>
<th>Debit</th>
<th>Credit</th>
<th>Amount</th>
<th>Time of revenue recognition, in the accounting books</th>
</tr>
</thead>
<tbody>
<tr>
<td>Monthly recording of the subscription to the journal published by the publishing house</td>
<td>Petty cash in RON</td>
<td>% Revenue from services VAT</td>
<td>37.2</td>
<td>Revenue from article publication</td>
</tr>
<tr>
<td></td>
<td></td>
<td></td>
<td></td>
<td>30 7.2</td>
</tr>
<tr>
<td></td>
<td></td>
<td></td>
<td>21.74 (RON 920/36 months)</td>
<td>Revenues from monthly subscription</td>
</tr>
<tr>
<td></td>
<td></td>
<td></td>
<td>78.26 (920/36 months)</td>
<td></td>
</tr>
</tbody>
</table>

We assume that the contract will start on March 1, 2017, and at year-end the publishing house will record the following values under profits earned as a result of applying IAS 18 and IFRS 15:

<table>
<thead>
<tr>
<th>Performance obligation</th>
<th>In accordance with IAS 18</th>
<th>In accordance with IFRS 15</th>
</tr>
</thead>
<tbody>
<tr>
<td>Publishing services</td>
<td>0</td>
<td>21.74</td>
</tr>
<tr>
<td>Revenues from monthly subscription</td>
<td>300 (10 months * RON 30/month)</td>
<td>782.60 (10 months * RON 78.26/month)</td>
</tr>
<tr>
<td>Total</td>
<td>300</td>
<td>804.34</td>
</tr>
</tbody>
</table>
As seen from the above example, the application of IFRS 15 will have a different effect on the amount of revenue recorded and, therefore, on the performance of the company. However, the most important element introduced by the new rules relates to how the contracts are drawn up. Contracts should contain new elements that can properly record all revenue items, depending on their nature and the date on which they can be recognised.

If the company applies IAS 18, it will not record any revenue at the beginning of the contract, and afterwards they will be at a constant level, because it will recognise revenue as invoices are issued to customers. Under IFRS 15, the final amount of the revenue is the same, but their recording is different, in terms of moments in time (IFRS 15 vs. IAS 18).

3. CONCLUSIONS

In 2014, the IASB completed and prepared two important accounting standards, which have an important contribution to the information of users of financial statements, namely IFRS 9 - Financial Instruments and IFRS 15 - Revenue from contracts with customers, also achieving considerable progress in other major projects. IFRS 15 is intended to provide economic entities with complete and updated information, for the purposes of revenue recognition.

After a positive assessment by EFRAG, this standard is currently under approval; the final opinion of EFRAG on the approval of IFRS 15, compared to the other IFRS standards, considers that it is an accounting norm that is flexible enough to cover the different types of business (however, attention should be paid to the conceptual accounting framework, which attaches great importance to types of business).

In conclusion, we can say that IFRS 15 is much more complex than the standards it replaces, and its preparation is justified, as old rules were unable to reflect the complexity of modern business operations. At the same time, due to the fact that IFRS 15 replaces older accounting standards and their related interpretations, the new provisions are contained in a single document.

IFRS 15 is also an effective tool in avoiding financial volatility, given that it contains specific provisions that apply to situations of uncertainty in relation to the recognition of future revenues.

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