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Alerte de votre conseiller – IFRS

Aperçu d’IFRS 15 *Produits des activités ordinaires tirés de contrats conclus avec des clients*

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Résumé

Grant Thornton International Ltd a publié les deux premiers bulletins de la série *Insights into IFRS 15* (en anglais seulement) :

- *Overview and scope*;
- *Step 1: Identifying a contract with a customer*.

La comptabilisation des produits ordinaires est essentielle dans toutes les entreprises. Il est en outre important que la méthode de comptabilisation soit utilisée de manière cohérente et comparable dans tous les secteurs et sur tous les marchés financiers. IFRS 15 *Produits des activités ordinaires tirés de contrats conclus avec des clients* provient du projet commun de l’Accounting Standards Board (IASB) et du Financial Accounting Standards Board (FASB) afin d’améliorer la présentation financière des produits conformément aux normes comptables IFRS et aux principes comptables généralement reconnus des États-Unis (US GAAP). La norme précise clairement que son objectif n’est pas de redéfinir le concept de « produits », mais plutôt de garantir que ceux-ci sont comptabilisés de manière cohérente, au moment opportun et au montant le plus juste.

La série *Insights into IFRS 15* résume les éléments clés de la norme, tout en mettant l’accent sur certains d’entre eux qui sont difficiles à appliquer, afin d’aider les entités présentant l’information financière à respecter les exigences d’IFRS 15.

Le premier bulletin inclus dans cette publication se concentre sur l’objectif et le champ d’application de la norme IFRS 15. Le deuxième bulletin, quant à lui, porte sur la première étape du modèle en cinq étapes pour la comptabilisation des produits. Elle explique comment identifier un contrat avec un client et détermine ce qui constitue un contrat dans le champ d’application de la norme. Les publications sont les suivantes :

- *Overview and scope;*
- *Step 1: Identifying a contract with a customer.*

Ressources

Les bulletins mentionnés ci-dessus sont joints à la présente *Alerte de votre conseiller.*

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Insights into IFRS 15

Overview and scope

Revenue recognition is fundamental in all businesses, and it is important that it is recognised in a consistent and comparable way across industries and capital markets. IFRS 15 'Revenue from Contracts with Customers' was a result of the joint International Accounting Standards Board (IASB) and Financial Accounting Standards Board (FASB) project to improve the financial reporting of revenue under the IFRS Accounting Standards and US GAAP. The Standard makes it clear that its purpose is not to redefine the concept of revenue, but rather to ensure that revenue is consistently recognised at the appropriate time and at the most reliable amount.

Our 'Insights into IFRS 15' series summarises the key areas of the Standard, highlighting some areas that are challenging to apply in practice, to assist reporting entities in understanding how to apply IFRS 15's requirements. This article focuses on the objective and scope of IFRS 15.

Overview: A single model for revenue recognition

IFRS 15 is based on a core principle that requires an entity to recognise revenue:

- in a manner that depicts the transfer of goods or services to a customer, and
- at an amount that reflects the consideration the entity expects to be entitled to in exchange for those goods or services.

IFRS 15 sets out a control-based model built around the following five steps:

The five-step model

An entity recognises revenue to depict the transfer of promised goods or services to customers in an amount that reflects the consideration to which the entity expects to be entitled in exchange for those goods or services.

Step 1		Step 2		Step 3		Step 4		Step 5
Identify the contract with the customer	→	Identify the performance obligations	→	Determine the transaction price	→	Allocate the transaction price to the performance obligation	→	Recognise revenue

In the following pages we will run through these individual steps in more detail.

Step 1 – Identifying the contract with a customer

IFRS 15 applies specifically to contracts with customers, so Step 1 in the model is to identify those contracts. A customer is defined as a party that contracts with an entity to obtain goods or services that are an output of its ordinary activities. A contract is defined as an agreement between two or more parties that creates enforceable rights and obligations and can be written, oral or implied by an entity's customary business practices. However, a contract does not exist if each party has a unilateral right to terminate a wholly unperformed contract without compensating the other party.

The five criteria for a contract within the scope of IFRS 15

In addition to meeting the definition of a legal contract, a contract falls within the scope of IFRS 15 only when all of the following criteria are met:

- the parties have approved the contract and are committed to performing their respective obligations
- the entity can identify each party's rights
- the entity can identify the payment terms
- the contract has commercial substance, and
- it is probable that the entity will collect the consideration to which it will be entitled.

If a contract does not meet all five criteria, then it would not be in scope of IFRS 15 and the following steps of the model would not be applied.

Combination of contracts

IFRS 15 also requires that entities consider the impact of multiple contracts entered into, at or near the same time with the same customer. If this occurs, the contracts must be accounted for as a single contract if one or more of the following criteria are met:

- the contracts are negotiated as a package with a single commercial objective
- the amount to be paid in one contract depends on the price or performance of the other contract, or
- the goods or services promised in the contracts are a single performance obligation in accordance IFRS 15.

This is discussed in more detail in our article '**Insights into IFRS 15 – Identifying a contract with a customer**'.

As a practical expedient, contracts that meet specific criteria may be combined as a portfolio for accounting purposes, including recognising profits and determining the need for a provision for losses (where the criteria should be applied consistently to all contracts with similar criteria).

Reassessing the contract

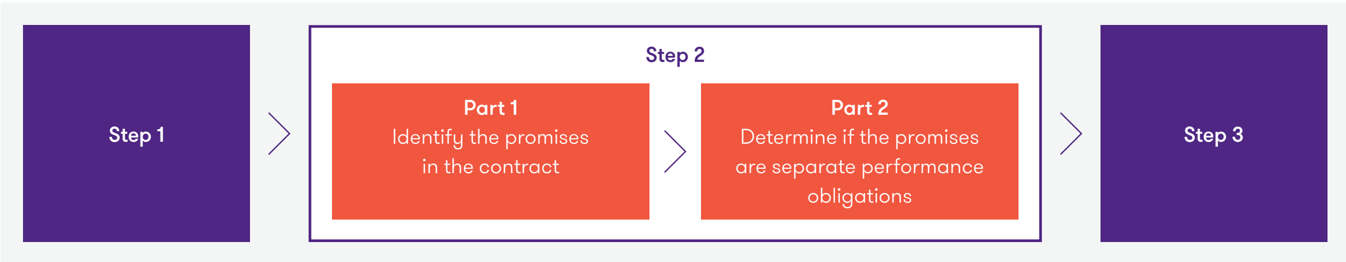
When conditions established at the inception date of the contract are unchanged, the contract should not be reassessed. Reassessment only occurs if there are significant changes in facts and circumstances of either the contract itself or the economic environment. During recent years we have seen some external factors, such as the COVID-19 global pandemic and the Russia-Ukraine War, that could affect collectability, as customers may experience an increased risk of economic difficulty. In such situations, the entity should reassess the contract to determine whether or not it is probable that the customer will be able to pay the consideration to which the entity was entitled, and thereby satisfy the collectability criterion.

There are certain other scenarios, such as when the criteria for a contract are not initially met or performance obligations are partially satisfied, which might require reassessment of the contract. These will be discussed in our article '**Insights into IFRS 15 – Identifying a contract with a customer**'.

Step 2 – Identify the performance obligations in the contract

Step 2 is a two-part process. Before an entity can identify its performance obligations, it must first identify all of the promised goods or services in the contract. Promises can be either explicitly stated in the contract or may be implied by an entity's customary business practices, but the key element is that the promise creates a reasonable expectation of the customer that the entity will transfer a good or service. Only after an entity identifies its promises can it then determine which of those promised goods or services constitute performance obligations.

The diagram below demonstrates this process:



After identifying the implicit and explicit promises in the contract, the entity must evaluate each promise to determine if that promise constitutes a performance obligation.

Under IFRS 15, a performance obligation is a promise in a contract with a customer to transfer either (1) a good or service, or a bundle of goods or services, that is 'distinct', or (2) a series of distinct goods or services that are substantially the same and have the same pattern on transfer to the customer.

Accordingly, an entity accounts for a promise as a separate performance obligation if the promise meets the criteria to be distinct or if it represents a series of distinct goods or services. A promised good or service is 'distinct' if both:

- the customer benefits from the item on its own or together with other readily available resources, and
- it is separately identifiable from other promises (eg the supplier does not provide a significant service integrating, modifying or customising the promised goods or services).

In other words, the promised good or service must be capable of being distinct as well as distinct within the context of the contract.

For example, if an undelivered service is essential to the functionality of the delivered product, the undelivered service is not inconsequential or perfunctory, and revenue for the entire unit of accounting should be deferred until the seller fulfills the remaining performance obligations. Each performance obligation should be accounted for as separated deliverable.

For more details on this topic, refer to our article '**Insights into IFRS 15 – Identify the performance obligations in the contract with a customer**'.

Step 3 – Determine the transaction price

After an entity has applied Steps 1 and 2, it can then go on to determining the transaction price. The transaction price is the amount of consideration to which an entity expects to be entitled in exchange for transferring promised goods or services to a customer, excluding amounts collected on behalf of third parties (eg sales taxes). The consideration promised in a contract with a customer may include fixed amounts, variable amounts, or both. In order to determine transaction price, IFRS 15 requires an entity to consider the terms of the contract as well as its customary business practices. Once an estimate of transaction price is determined at inception, an entity must update the estimate at each reporting period to reflect any changes in facts and circumstances.

In addition to the fixed component of the transaction price, an entity should consider the following components and their effects:

- variable consideration, such as discounts and bonuses
- constraining estimates of variable consideration
- the existence of a significant financing component in the contract, which can affect the consideration due to the time value of money
- non-cash consideration (eg the customer contributes materials, goods or services to fulfill the contract), and
- consideration payable to a customer, which could include credits or other items such as a coupons or vouchers, which can be applied against amounts owed to the entity.

For the purpose of determining the transaction price, an entity should assume that the goods or services will be transferred to the customer as promised in accordance with the existing contract and that the contract will not be cancelled, renewed or modified.

In a situation where the transaction price includes any of the components listed above, the entity must take them into consideration before recognising revenue. Determining the transaction price can be complex and careful considerations should be made by the entity in order to correctly account for the revenues in accordance with IFRS 15. For more information on this topic refer to our article '**Insights into IFRS 15 – Determining the transaction price**'.

Step 4 – Allocate the transaction price to the performance obligations in the contract

The objective of Step 4 is for an entity to allocate the transaction price to each performance obligation (or distinct good or service) in a manner that best represents the amount of consideration which the entity expects to receive in exchange for transferring the promised goods or services. This implies that Step 4 is only applicable if the entity has identified more than one performance obligation or if the entity has identified a series of distinct goods or services as a single performance obligation (application of 'series guidance'). The best way to achieve this objective is typically to allocate the transaction price to each identified performance obligation based on relative stand-alone selling price.

IFRS 15 defines the stand-alone selling price ('SSP') as the price at which an entity would separately sell a promised good or service to a customer. The observable selling price charged by the entity in similar circumstances to similar customers, if available, provides the best evidence of SSP. If the SSP is not observable, which may be the case in certain industries such as real estate or construction, the entity must estimate the price using all available information including market conditions, entity specific factors and information about the customer, maximising the use of observable inputs. IFRS 15 suggests, but does not require, three possible methods for estimating the SSP shown in the table below:

Estimating the SSP	
Adjusted market assessment approach	Involves evaluating the market in which an entity sells goods or services and estimating the price that customers in that market would pay. An entity might also consider price information from its competitors and adjust that information for differences in product features, cost structure and expected margins
Expected cost plus margin approach	Involves forecasting expected costs of providing the goods or services and adding an appropriate margin
Residual approach	Involves beginning with the total transaction price and subtracting the sum of the observable SSP for other goods and services promised under the contract. This method is permitted only if an entity: • sells the same good or service to different customers (at or near the same time) for a broad range of amounts, or • has not yet established a price for the good or service and has not previously sold it on a stand-alone basis

When estimating the SSP, a combination of methods may need to be used if two or more of those goods or services promised in the contract have highly variable or uncertain SSPs. For example, an entity may use a residual approach to estimate the aggregate SSP for those promised goods or services with highly variable or uncertain SSPs and then use another method to estimate the SSP of the individual goods or services relative to that estimated aggregate SSP determined by the residual approach. When an entity uses a combination of methods, it is critical to ensure that the entity maximises reliance on observable inputs and that the entity meets the objective of the allocation principle (ie that the allocation is representative of the consideration received for the specified goods or services).

Allocating discounts and variable consideration

A discount is present in a contract whenever the sum of the SSPs for the promised goods or services exceeds the total consideration to be paid. The relative selling price method allocates this discount proportionately to each of the identified performance obligations, as illustrated in the example below. In certain cases, such as when there is observable evidence that the discount relates to a specific performance obligation, it is possible to allocate the discount to the relevant performance obligation rather than ratably to all. Similar to discounts, variable consideration may be allocated to either the entire contract ratably or to specific performance obligations depending on the circumstances. For example, if a bonus is contingent on completion of a specific performance obligation, then the entire variable consideration would be allocated to that performance obligation.

Example 1 – Relative SSP method

A construction services company enters into a contract for the construction of a hospital and adjacent pharmacy for a total contract price of CU250 million. Assume for purposes of this example that construction of the hospital and pharmacy are determined to be separate performance obligations.

Analysis

The company is required to allocate the total contract price between the hospital and pharmacy using the relative selling price method. The company is able to observe or estimate SSPs for the hospital and pharmacy at CU280 million and CU20 million, respectively. The total contract price of CU250 million is allocated as follows:

	SSP (CU)	Relative SSP (%)	Relative SSP (CU)
Hospital	280 million	93.3%[1]	233.3 million[2]
Pharmacy	20 million	6.7%	16.7 million
Total	300 million	100%	250.0 million

[1] 280/300 = 93.3%
[2] 93.3% x 250 million = 233.3 million

Step 5 – Recognise revenue as and when the entity satisfies a performance obligation

Step 5 is the final step of the revenue recognition model and specifies when revenue is to be recognised and at what amounts. The model specifies that revenue should be recognised as an entity transfers control of goods or services to customers for the amount that the entity expects to have the right to receive. This transfer can occur either over time or at a point in time.

A customer obtains control of an asset, whether it is a good or a service, when it can direct the use of and obtain substantially all the remaining benefits from it. Control includes the ability to prevent other entities from directing the use of and obtaining the benefits from an asset. Control is transferred over time if any of three following conditions are met:

- the customer receives and consumes the benefits as the entity performs (this applies to most services)
- the customer controls the asset as it is created or enhanced, or
- the asset has no alternative use to the seller and the seller has an enforceable right to payment for its performance to date.

If none of these conditions are satisfied, the seller recognises revenue at a point in time. Note that for this purpose, services are also considered to be assets, even if only momentarily, when they are received and consumed by the purchaser. The first of these criteria is most often (and most readily) satisfied when dealing with routine services like office cleaning, building maintenance or administrative support. But for certain leasing or development activities it may be less clear whether the benefit of those services is received and consumed at the time the services are performed.

Practical insight – Revenue versus income

An important aspect of IFRS 15 is the differentiation of revenue and income. IFRS 15 defines 'Revenue' as income arising in the course of an entity's ordinary activities. Income is defined as increases in economic benefits during the accounting period in the form of inflows or enhancements of assets or decreases of liabilities that result in an increase in equity, other than those relating to contributions from equity participants.

This distinction can be important to reporting entities as income is a broader term than revenue and as a result, not all income is in scope of IFRS 15.

Example:

For a manufacturer of cement, the income from the sale of cement is revenue. However, if the same entity sells its surplus land, the profit on sale of land is a gain and not revenue. Total income would be made up of both revenue from the sale of cement as well as the gain on sale of land. It may be noted that changes in equity that relate to contributions from or distributions to owners are excluded from the definition of income and expenses in accordance with IAS 1 'Presentation of Financial Statements'.

In addition to the five-step model, the Standard provides application guidance on specific topics such as:

- performance obligations satisfied over time
- methods for measuring progress towards complete satisfaction of a performance obligation
- sale with a right of return
- warranties
- principal versus agent considerations
- customer options for additional goods or services
- customers' unexercised rights
- non-refundable upfront fees (and some related costs)
- licensing
- repurchase agreements
- consignment arrangements
- bill-and-hold arrangements
- customer acceptance, and
- disclosure of disaggregated revenue.

Many of these topics are covered in separate articles in our 'Insights into IFRS 15' series.

Scope

IFRS 15 applies to contracts with customers to provide goods or services that are an output of the entity's ordinary activities in exchange for consideration. It does not apply to certain contracts within the scope of other IFRS Accounting Standards such as lease contracts, insurance contracts, financial instruments, guarantees other than product warranties and non-monetary exchanges between entities in the same line of business to facilitate sales to customers or potential customers.

It is also important to note that revenue can only be recognised when the five steps are met. For example, in a scenario where a contract does not meet Step 1 because collectability is not reasonably assured, the contract or transaction is not within the IFRS 15 scope at the inception date and should be accounted for under other IFRS Accounting Standards.

In scope of IFRS 15

Revenue from contracts with customers (subject to specific exceptions), including contracts for
- Sales of goods
- Rendering of services, including construction services
- Licensing of intellectual property
- Exchanges of non-monetary assets other than scoped-out exchanges (see scope exclusions)

Not in scope of IFRS 15

Non-contractual income (eg fair value of agricultural produce recognised under Ind IAS 41 'Agriculture')

Contracts within the scope of:
- IFRS 16 'Leases'
- IFRS 17 'Insurance contracts' *
- IFRS 9 'Financial instruments' and other contractual obligations within other IFRS Accounting Standards

Contracts that are not with customers (eg some risk and benefit sharing contracts)

Non-monetary exchanges between entities in the same line of business to facilitate sales to customers

* Note: an entity may choose to apply IFRS 15 to insurance contracts that have as their primary purpose the provision of services for a fixed fee in accordance with IFRS 17.

The IASB decided that IFRS 15 should apply only to a subset of revenue – revenue from contracts with customers. Revenue from a transaction or event that does not arise from a contract with a customer is not within the scope of IFRS 15 and, therefore, those transactions or events will continue to be recognised in accordance with other IFRS Accounting Standards, for example:
- dividends received (although these requirements existed in the previous IFRS revenue standard, the IASB has moved them without changing their effect into IFRS 9 'Financial Instruments')
- non-exchange transactions (eg, donations or contributions received)
- for IFRS Accounting Standards, changes in the value of biological assets, investment properties and the inventory of commodity broker-traders, and
- for US GAAP, changes in regulatory assets and liabilities arising from alternative revenue programmes for rate-regulated entities in the scope of Topic 980 on regulated operations. (The FASB decided that the revenue arising from those assets or liabilities should be presented separately from revenue arising from contracts with customers. Therefore, the FASB made amendments to Subtopic 980-605 Regulated Operations—Revenue Recognition.)

It is also possible that a contract with a customer may be partially within the scope of IFRS 15 and partially within the scope of other IFRS Accounting Standards or have under scope of both, as is the case for fixed fees in insurance contracts noted above.

In certain cases such as contracts with collaborators or partners, an entity needs to consider all relevant facts and circumstances, such as the purpose of the activities undertaken by the counterparty, to determine whether the counterparty is a customer. A counterparty to the contract would not be a customer if, for example, the counterparty has contracted with the entity to participate in an activity or process in which the parties to the contract share in the risks and benefits that result from the activity or process (such as developing an asset in a collaboration arrangement) rather than to obtain the output of the entity's ordinary activities.

Arrangements like this are common in the pharmaceutical, bio-technology, oil and gas and health care industries. However, depending on the facts and circumstances, these arrangements may also contain a vendor-customer relationship component. Such contracts could still be within the scope of IFRS 15, at least partially, if the collaborator or partner meets the definition of a customer for some, or all, aspects of the arrangement.

Sales of non-financial assets

As a result of the new revenue guidance, certain conforming changes have been made to other IFRS Accounting Standards. IAS 16 'Property, Plant, and Equipment' and IAS 38 'Intangible Assets' now include new requirements for sales of non-financial assets that are not an output of the entity's ordinary activities. For example, for a gain or loss on the sale of fixed assets, an entity should now apply the guidance in IFRS 15 related to the transfer of control and measurement of the transaction price including the constraint on variable consideration, to evaluate the timing and amount of the gain or loss recognised for the sale of the asset before continuing with the guidance in IAS 16.

Example 2 – Sale of manufacturing facility – Transfer of control

Quality Paper (QP) is a manufacturer of paper goods that operates in seven locations across India. QP builds a new facility in Manesar, Haryana and sells its existing facility in Biwandi, Haryana to a third party. The sale of manufacturing facilities is not an output of QP's ordinary activities.

Analysis

Although the sale of manufacturing facilities is not an output of QP's ordinary activities, QP should still apply the contract existence, control and measurement provisions in IFRS 15 to the sale of its Biwandi facility. However, applying those provisions will not affect QP's profit or loss presentation of any resulting gain or loss from the facility sale.

Interaction with other IFRS Accounting Standards

A contract with a customer may be partially within the scope of IFRS 15 and partially within the scope of other IFRS Accounting Standards. If the other IFRS Accounting Standards specify how to separate and measure a portion of the contract, then that guidance should be applied first. The amounts measured under other IFRS Accounting Standards should be excluded from the transaction price and the remaining amount should be allocated to each performance obligation within the scope of IFRS 15. This results in any discount in the overall arrangement being allocated to the portion of the arrangement within the scope of IFRS 15.

If the other IFRS Accounting Standards do not stipulate how to separate and/or measure a portion of the contract, then IFRS 15 would be used to separate and initially measure that portion of the contract.

Example 3 – Lease or service contracts

An entity contracts with a customer to lease equipment and perform maintenance services for a two-year period. What guidance should be applied when separating the leasing and nonleasing components?

Analysis

The entity first applies the separation and measurement guidance in IFRS 16 to separate the leasing component from the nonleasing component (the maintenance services) and to determine the portion of the contract price that relates to the leasing component. The entity then applies the leasing guidance to subsequently account for the leasing component and the revenue guidance to the maintenance services component of the contract.

Non-monetary exchanges

IFRS 15 provides guidance for contracts involving non-cash consideration in exchange for goods, services or non-financial assets but excludes non–monetary exchanges between entities in the same line of business to facilitate sales to customers or potential customers. For example, if an entity transfers its inventory in exchange for non-cash consideration, that transaction will generally be in the scope of IFRS 15, because inventory is typically an output of the entity's ordinary activities. However, exchanges of inventory for inventory are not in scope of IFRS 15.

Example 4 – Relative SSP method

Entity A and Entity B both are engaged in manufacturing homogenous bottles. Entity A operates in northern, eastern and central India. Entity B operates in western and southern India. Entity A fulfils the demands of its customers in western and southern India by using the bottles manufactured by Entity B. Similarly, Entity B fulfils the demand of customer in northern, eastern and central India by delivering bottles manufactured by Entity A. How should Entity A and Entity B recognise the revenue?

Analysis

IFRS 15 does not apply to non-monetary exchanges between entities in the same line of business to facilitate sales to customers or potential customers. In industries with homogenous products, it is common for entities in the same line of business to exchange products in order to sell them to customers or potential customers other than parties to the exchange.

In addition, Step 1 requires that contracts (including contracts for non-monetary exchanges) have commercial substance in order to meet the criteria for identifying a contract. If this criterion is not met, the contract would not be in scope of IFRS 15 and the following steps of the model should not be applied.

Therefore, the exchange of bottles qualifies as a non-monetary exchange between customers in the same line of business. Accordingly, Entity A and Entity B. should not recognise any revenue related to the exchange of goods as the contract is not in the scope of IFRS 15.

How we can help

We hope you find the information in this article helpful in giving you insight into aspects of IFRS 15. If you would like to discuss any of the points raised, please speak to your usual Grant Thornton contact or visit **www.grantthornton.global/locations** to find your local member firm.

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Insights into IFRS 15

Step 1: Identifying a contract with a customer

Revenue recognition is a critical aspect of financial reporting for all reporting entities. Ensuring it is applied consistently and comparably across industries and capital markets is essential. IFRS 15 'Revenues from Contracts with Customers' provides comprehensive guidance on accounting for revenue recognition. Nonetheless, there are some aspects of IFRS 15 that are complex and can pose practical challenges for reporting entities to apply and implement effectively.

Our 'Insights into IFRS 15' series summarises the key areas of the Standard, highlighting some areas that are challenging to apply in practice, to assist reporting entities in understanding how to apply IFRS 15's requirements.

IFRS 15 introduces the five-step model for revenue recognition which applies specifically to contracts with customers. Given this limitation in scope, the first step of the model is to identify contracts with customers. This article focuses on this step, and explains how to identify a contract with a customer as well as what constitutes a contract within the scope of the Standard.

An overview of the five-step model is below; however for a detailed discussion of the five steps, refer to our article '**Insights into IFRS 15 – Overview and scope**'.

The five-step model

An entity recognises revenue to depict the transfer of promised goods or services to customers in an amount that reflects the consideration to which the entity expects to be entitled in exchange for those goods or services.

Step 1
Identify the contract with the customer

→ **Step 2**
Identify the performance obligations

→ **Step 3**
Determine the transaction price

→ **Step 4**
Allocate the transaction price to the performance obligation

→ **Step 5**
Recognise revenue

Definitions from IFRS 15

A **contract** is an agreement between two or more parties that creates enforceable rights and obligations.

A **customer** is a party that has contracted with an entity to obtain goods or services that are an output of the entity's ordinary activities in exchange for consideration.

The guidance in IFRS 15 makes it clear that the rights and obligations in a contract must be 'enforceable' before an entity applies the five-step revenue model. Enforceability is a matter of law, so an entity needs to consider the local relevant legal environment to determine whether rights and obligations are enforceable. That said, while the contract must be legally enforceable, oral or implied promises may give rise to performance obligations in the contract under Step 2 'Identify the performance obligations in the contract'.

An agreement does not need to be in writing to be a contract. Whether the agreed-upon terms are written, oral or evidenced otherwise (eg by electronic assent), a contract exists if the agreement creates rights and obligations that are enforceable against the parties. Although there must be enforceable rights and obligations between parties for a contract to exist, the performance obligations within the contract could include promises that result in the customer having a valid expectation that the entity will transfer goods or services to the customer, even though those promises are not enforceable.

To assist entities in determining if an arrangement is within the scope of IFRS 15, the guidance specifies five criteria that the arrangement must meet. This article discusses the five criteria in detail and explores some examples to help illustrate.

Five criteria for recognising a contract

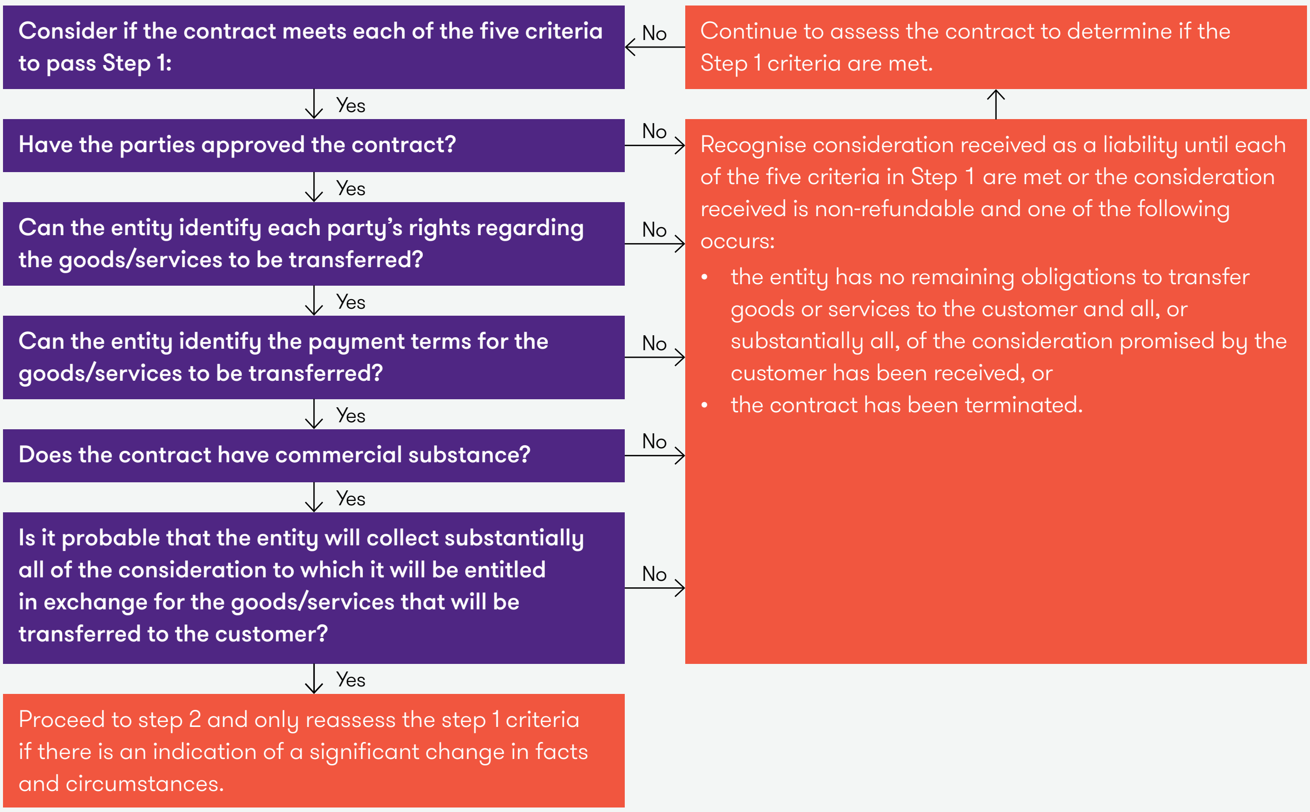
Step 1 serves as a 'gate' through which a contract must pass before an entity applies the later steps of the model. In other words, if at the inception of an arrangement, an entity concludes that the criteria below are not met, it should not apply the remaining steps of the model until it determines that the Step 1 criteria are subsequently met. Significant judgement may be required to conclude whether an accounting contract exists. When a contract meets the five criteria and 'passes' Step 1, the entity will not reassess the Step 1 criteria unless there is an indication of a significant change in facts and circumstances.

An accounting contract for the purposes of IFRS 15 exists only when an arrangement with a customer meets the following five criteria:

- the parties have approved the contract and are committed to perform their contractual obligations
- the entity can identify each party's rights
- the entity can identify the payment terms
- the contract has commercial substance, and
- it is probable that the entity will collect substantially all of the consideration to which it expects to be entitled.

If the arrangement does not meet the five criteria for recognising a contract, an accounting contract does not exist, even though a legal contract may exist. Therefore, the entity follows the guidance in IFRS 15 described on page 6 of this article. These criteria are assessed at the inception of the arrangement. If the criteria are met at that time, an entity does not reassess the criteria unless there is an indication of a significant change in facts and circumstances.

Five criteria for recognising a contract



The parties have approved the contract and are committed to perform

The previous revenue recognition Standard, IAS 18 'Revenue', did not have any specific guidance related to contracts and focused primarily on the transfer of risk and rewards as the basis for revenue recognition. In contrast, IFRS 15 provides a control-based approach for revenue recognition, and an approved contract is the foundation for the five-step model.

To pass the first criterion for recognising a contract, the parties must approve the contract. This approval may be written, oral, or implied, as long as the parties intend to be bound by the terms and conditions of the contract.

Whether evidence of an arrangement exists is based on the normal business practice of an entity. Some entities document the terms of all customer arrangements in written contracts. For these entities, evidence of an arrangement does not exist until a written contract is finalised and signed by both the vendor and the customer. If a vendor's customary practice is to use approved third-party purchase orders or online authorisations to document customer arrangements, the purchase order or online authorisation is appropriate evidence of the arrangement. The documentation used by the vendor to demonstrate persuasive evidence of an arrangement must be final and should include (or reference) all pertinent terms and conditions of the arrangement. Legal assistance may be required to determine whether persuasive evidence of an arrangement exists if the vendor does not have a customary practice of using written documentation.

The parties should also be committed to performing their respective obligations under the contract. This does not mean that the parties need to be committed to fulfill all their respective rights and obligations in order for this criterion to be met. For example, an entity may include a requirement in a contract for the customer to purchase a minimum quantity of goods each month, but the entity may have a history of not enforcing the requirement. In this example, the contract approval criterion can still be satisfied if evidence supports that the customer and the entity are both substantially committed to the contract. The standard setters noted that requiring all rights and obligations to be fulfilled would have inappropriately resulted in no recognition of revenue for some contracts in which the parties are substantially committed to the contract.

For example, there are cases where after a contract between two parties expires and before they execute a new contract, both parties will continue to perform under the terms of the expired contract. This indicates that even in the absence of a formally executed contract, a contract may exist since both parties remain committed to perform.

Additionally, typically when an entity enters into a master service arrangement or master supply arrangement (MSA), purchases are subsequently made by the customer by issuing a purchase order that explicitly references the MSA and specifies the products, services and quantities to be delivered. Entities need to evaluate both the MSA and the subsequent purchase order(s) together to determine whether and when the criteria in IFRS 15 are met.

Some entities offer free trial periods to prospective customers to entice business. These trial periods must be carefully evaluated to determine if evidence exists to support that the customer has approved the contract and the entity is committed to perform.

Example 1 – Evaluating trial periods

Members of a wine club receive a bottle of wine each month for 12 months for CU200 per month. The wine vendor is offering a promotional trial period to prospective customers starting 1 January 20X5. Under the terms of the promotion, the vendor offers new participants up to a free two-month trial period. If participants wish to join the club, they must notify the vendor any time before the trial period lapses (28 February 20X5). Participants that join the club receive an invoice for the 12-month membership period, which will end 28 February 20X6.

Analysis

Until the customer gives notice to the wine vendor of its acceptance of the offer (either oral or written), the entity might not conclude that the customer has approved the contract and is committed to perform.

Determining whether a contractual right or obligation is enforceable is a question to be considered within the context of the relevant legal framework. It is essential to note that the factors that determine enforceability may differ between jurisdictions. Significant judgement may be involved in certain jurisdictions or for some arrangements, and it is important to keep in mind that a different conclusion may result for similar contracts in different jurisdictions or different industries. In cases of significant uncertainty about enforceability, a legal interpretation may be sought from qualified counsel to support the conclusion.

In some cases, a service provider is entitled to consideration for its services only if a specific outcome is achieved and the customer has a right to cancel the contract at any point in time without compensating the entity. These kinds of arrangements are very common in service industries such as law firms, real estate agents and travel agents. Since the outcome of the service would determine the amount of consideration, such arrangements would not be a contract with a customer within the scope of IFRS 15 until the outcome has been achieved. The service provider in these type of arrangements does not have right to payment for services performed and the recipient of the services does not have an obligation to pay.

The entity can identify each party's rights

An entity must be able to identify its rights, as well as the rights of all other parties to the contract. An entity cannot assess the transfer of goods or services if it cannot identify each party's rights regarding those goods or services.

An entity may utilise an MSA with its customers. Each MSA must be evaluated to determine if the MSA alone establishes enforceable rights and obligations.

The MSA may establish only basic terms and conditions with customers and the entity may require its customers to also submit purchase orders specifying quantify and/or type of goods or services. In such cases, the MSA alone may not establish enforceable rights and obligations of the parties. Assuming all of the other criteria in IFRS 15 are met, the MSA might not pass Step 1, and a contract might not exist, until a purchase order is submitted and approved. Often this will lead to each purchase order being a contract, depending on facts and circumstances.

An MSA that specifies minimum purchase quantities may create enforceable rights and obligations. However, if the entity has a past practice of waiving the minimum purchase requirement and such practice would render the term legally unenforceable, then the term is not considered when determining if the MSA alone creates legally enforceable rights and obligations.

The entity can identify the payment terms for the goods or services

An entity must also be able to identify the payment terms for the promised goods or services within the contract. The entity cannot determine how much it will receive in exchange for the promised goods or services (the 'transaction price' in Step 3 of the model for revenue recognition) if it cannot identify the contractual payment terms. The payment terms do not need to be fixed, but the contract must contain enough information to allow an entity to reasonably estimate the consideration that it expects to be entitled to.

Practical insight – Unpriced change orders

It is common practice in the construction industry for entities to utilise unpriced change orders. This occurs when an entity identifies the payment terms for change orders for which the scope of work has been defined even though the specific amount of consideration for that work has not yet been determined and may not be finally determined for a period of time. The Standard does not preclude revenue recognition for this type of order if the scope of the work has been approved and the entity expects that the price will be approved. Therefore, in those cases, the entity would consider the requirements for contract modifications.

The contract has commercial substance

A contract has commercial substance if the risk, timing, or amount of the entity's cash flows is expected to change as a result of the contract. In other words, the contract must have economic consequences. This criterion was added to prevent entities from transferring goods or services back and forth to each other for little or no consideration to artificially inflate their revenue. This criterion is applicable for both monetary and non-monetary transactions, because without commercial substance, it is questionable whether an entity has entered into a transaction that has economic consequences.

It is probable the entity will collect substantially all of the consideration

To pass Step 1, an entity must determine that it is probable that it will collect substantially all of the consideration to which it will be entitled under the contract in exchange for goods or services that it will transfer to the customer. This criterion is also referred to as the 'collectability assessment'. In determining whether collection is probable, the entity considers the customer's ability and intention to pay when amounts are due. Probable is defined by IFRS 15 as:

Probable – The future event or events are 'more likely than not' to occur.

The objective of the collectability assessment is to evaluate whether there is a substantive transaction between the entity and the customer. When evaluating collectability, an entity bases its assessment on whether the customer has the ability and intention to pay the promised consideration in exchange for the goods or services that will be transferred under the contract, rather than assessing the collectability of the consideration agreed for all of the promised goods or services.

An entity should determine whether the contractual terms and its customary business practices indicate that it has the ability to mitigate credit risk. For example, some contracts may require upfront payments before any goods or services are transferred to the customer. Any consideration received before the entity transfers the goods or services would not be subject to credit risk. In other cases, such as a telecom providing wireless network access to a building, the entity may be able to stop transferring goods or services under the contract upon a customer's failure to pay. In that situation, the entity would consider the likelihood of payment for only the promised goods or services that would be transferred to the customer.

The provisions related to collectability are similar to the previous revenue standard – IAS 18. Under the guidance in IAS 18, revenue was recognised only when it is probable that the economic benefits associated with the transaction would flow to the entity. This principle has been retained in IFRS 15. However, when an uncertainty arises about the collectability of an amount already included in revenue, the uncollectible amount, or the amount in respect of which recovery has ceased to be probable, is recognised as an expense, rather than as an adjustment of the amount of revenue originally recognised.

Example 2 – Collectability assessment: liquidity issues and issue of letter of credit

Entity A has a customer, Entity P, which is undergoing restructuring due to issues related to liquidity. Entity A has decided not to do any further business with Entity P. In response, Entity P informed Entity A that it would get a letter of credit from a nationalised bank against which Entity A can despatch goods.

Entity A has already manufactured the goods exclusively for Entity P, but the letter of credit has not yet been finalised. When should Entity A recognise the revenue?

Analysis

IFRS 15 requires that for revenue to be recognised, it should be probable that the entity will collect the consideration to which it will be entitled in exchange for the goods or services that will be transferred to the customer. In this case, as the customer has liquidity issues, collection is not considered to be probable. Accordingly, until the time the letter of credit is finalised, the collectability criterion is not met. However, if Entity A is able to demonstrate through any other means that the collectability criterion would be met, then it may recognise the revenue in accordance with the principles of IFRS 15, assuming all other conditions are met.

Furthermore, if a contract with a customer does not meet the initial criteria in IFRS 15 for identifying contracts with customers that are with the scope of the Standard, an entity must continue to assess the contract to determine whether the criteria are subsequently met. Additionally, if the initial criteria are not met but an entity receives consideration from the customer, there are additional criteria to assess to determine whether to recognise revenue. In this case, Entity A will need to continue to reassess whether the criteria for a contract with a cusomer are subsequently met.

Price concessions

In determining the consideration to which an entity will be entitled for purposes of the collectability assessment, an entity needs to evaluate at contract inception whether it expects to provide a price concession that will result in receiving less than the full contract price from the customer. Although price concessions are a form of variable consideration and are more fully evaluated when determining the transaction price under Step 3, when evaluating collectability under Step 1, an entity should also assess at the onset of an arrangement whether it expects to provide a price concession.

When an entity expects to accept less than the contractual amount for goods and services that will be transferred to the customer, it should evaluate all relevant facts and circumstances, which may require significant judgement, to determine whether it has accepted a customer's credit risk or has provided an implicit price concession. Price concessions may take the form of a discount, refund or credit, among others, and are a form of variable consideration.

It can sometimes be difficult to distinguish between a price concession and a collectability issue. The ramifications could impact the accounting because one path (a collectability concern) might lead an entity to conclude that it does not pass Step 1 for a particular arrangement, while another path (a price concession) may result in variable consideration and allow the entity to proceed to Step 2 with a lower transaction price. Judgement will be required to determine which path is appropriate.

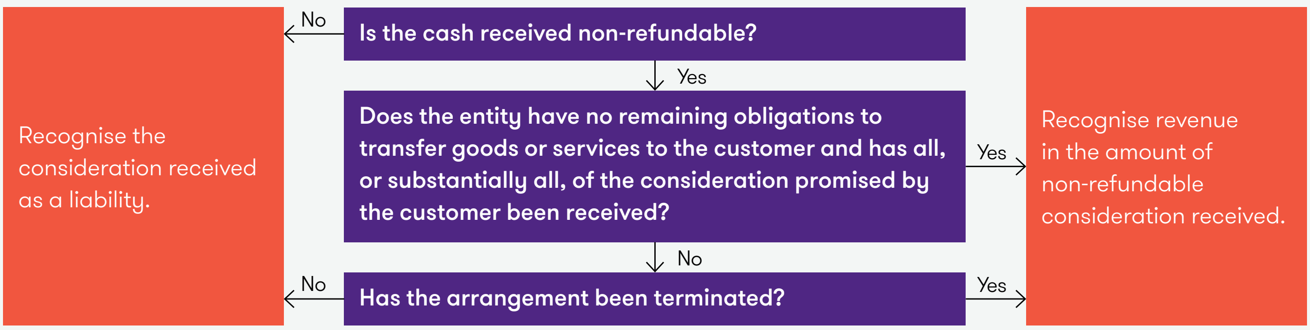
Contracts that do not 'pass' Step 1 (Identifying the contract with a customer)

If an entity determines at an arrangement's inception that one or more of the criteria in IFRS 15 for identifying a contract with a customer have not been met, an accounting contract, for purposes of applying IFRS 15, does not exist, and the entity should continue to reassess whether the five criteria are subsequently met.

A contract may not pass Step 1 but the entity may still transfer goods or services to the customer and receive non-refundable consideration in exchange for those goods or services. In that circumstance, the entity cannot recognise revenue for the non-refundable consideration received until either the Step 1 criteria are subsequently met, or one of the events discussed in the flowchart below has occurred.

Until the contract passes Step 1 or one of the above criteria is met, an entity should recognise the consideration received from a customer as a liability that is measured at the amount of consideration received from the customer.

When cash is received for a contract that does not pass Step 1



Example 3 – Non-refundable receipt – payment term not identified

On 1 March 20X5, Entity P agrees to sell 1,000 bath fittings to Entity X, which are manufactured by using customised screws supplied by a specific vendor. The payment terms between Entity P and Entity X have not been decided as they are dependent on the price of the customised screws which is yet to be finalised. Entity P received a non-refundable amount of CU1,000. How should Entity P Account for this transaction under IFRS 15 if Entity P is the principal in this transaction?

Analysis

Since the payment terms are not identified, the contract does not meet all of the criteria in IFRS 15 for identifying a contract with a customer that is within the scope of the Standard.

Entity P must account for the non-refundable amount of CU1,000 as a liability, as none of the events described in IFRS 15 for when a contract does not meet the criteria for a contract with a customer within the scope of the Standard but consideration has been received have occurred – that is, the entity has neither received substantially all of the consideration nor has it has terminated the contract.

Consequently, Entity P will continue to account for the non-refundable amount, as well as any future payments, as a liability until the criteria for identifying a contract with a customer that is within the scope of the Standard are met (ie the payment terms are identified) or one of the events described above has occurred. Further, Entity P will continue to assess the contract to determine whether the criteria to be considered a contract with a customer in the scope of the Standard are subsequently met or whether the specific events that allow for recognition of revenue after consideration has been received have occurred.

Practical insight – At the crossroads

The goal of the requirements in IFRS 15 is to filter out contracts that may not be valid and that do not represent genuine transactions. In such cases, recognising revenue would not provide a faithful representation of the transaction. The requirements therefore preclude an entity from recognising any revenue until the contract is either complete or cancelled or until a subsequent reassessment indicates that the contract meets all of the criteria in IFRS 15 for identifying a contract.

Reassessing the Step 1 criteria

When an entity determines that a contract passes Step 1, it should not reassess contract existence unless there is an indication of a significant change in facts and circumstances. It is important to reassess the criteria in these cases because that change might clearly indicate that the remaining contractual rights and obligations are no longer enforceable.

Example 4 – Reassessing the criteria for identifying a contract

An entity licences a trademark to a customer in exchange for a usage-based royalty. At contract inception, the contract meets all the criteria for a contract with a customer within the scope of the Standard and the entity accounts for the contract with the customer in accordance with the requirements in IFRS 15. The entity recognises revenue when the customer's subsequent usage occurs in accordance with the guidance in IFRS 15 on usage-based royalties.

Throughout the first year of the contract, the customer provides quarterly reports of usage and pays within the agreed-upon period.

During the second year of the contract, the customer continues to use the entity's trademark, but the customer's financial condition declines. The customer's current access to credit and available cash on hand are limited. The entity continues to recognise revenue on the basis of the customer's usage throughout the second year. The customer pays the first quarter's royalties but makes nominal payments for the usage of the patent in quarters two to four. The entity accounts for any impairment of the existing receivable in accordance with IFRS 9 'Financial instruments'.

During the third year of the contract, the customer continues to use the entity's trademark. However, the entity learns that the customer has lost access to credit and its major customers, and thus the customer's ability to pay significantly deteriorates. The entity therefore concludes that it is unlikely that the customer will be able to make any further royalty payments for ongoing usage of the entity's trademark.

Analysis

As a result of this significant change in facts and circumstances, in accordance with the reassessment requirements outlined in IFRS 15, the entity reassesses whether the contract now meets the criteria to be considered a contract with a customer within the scope of the Standard, and determines that they are not met because it is no longer probable that the entity will collect the consideration to which it will be entitled. Accordingly, the entity does not recognise any further revenue associated with the customer's future usage of its trademark. The entity must account for any impairment of the existing receivable by measuring the loss allowance at an amount equal to lifetime expected losses in accordance with IFRS 9.

Practical insight – Significant change in facts and circumstances

When a contract 'passes' Step 1, what constitutes a 'significant change in facts and circumstances' necessitating a reassessment in the Step 1 criteria?

The determination of what constitutes a 'significant change in facts and circumstances' will often require judgement. If the entity determines that it is no longer probable that it will collect the consideration, the entity should not recognise revenue for the remaining goods and services as they are transferred to the customer, and would instead apply the guidance for contracts that do not meet the criteria of a customer contracts.

When the entity concludes that collectability is no longer probable, only the revenue related to the remaining goods or services yet to be transferred is impacted. Other than impairment considerations, the reassessment has no impact on revenue recognised to date, receivables recorded, or assets recognised as a result of satisfied performance obligations.

Contract term

An entity applies IFRS 15 to the contractual period over which the parties to the contract have present enforceable rights and obligations. Enforceability of the rights and obligations is a matter of law. Because practices and processes for establishing contracts with customers may vary across jurisdictions and entities, each entity should consider its established practices and processes when determining whether its agreements create enforceable rights and obligations.

Termination provisions

Some contracts can be terminated by either party at any time while others may only be terminated by one party. An accounting contract does not exist if each party to a contract has the unilateral enforceable right to terminate a wholly unperformed contract without paying a termination penalty. A 'wholly unperformed' contract is one that the entity hasn't yet performed and is not entitled to any consideration.

In some situations, only the customer has the ability to terminate the contract without penalty. In those situations, the contract term for accounting purposes may be shorter than the stated contract term. Management should apply judgement in determining whether a termination penalty is substantive. For example, a substantive penalty might exist if a customer must repay a portion of an upfront discount if the customer terminates the contract.

Example 5 – Ability to terminate without penalty

A tennis club enters into a contract with a new member to provide access to its tennis courts for a 12 month period at CU10,000 per month. The member can cancel their membership without penalty after six months.

Analysis

As the member can cancel without penalty after six months, the enforceable rights and obligations of this contract are for six months. Therefore, the contract term is six months.

Practical insight – How should termination clauses be evaluated in determining the duration of a contract?

The International Accounting Standards Board (IASB)/Financial Accounting Standards Board (FASB) joint Transition Resource Group (TRG) discussed the accounting for termination clauses at its October 2014 meeting. According to that discussion, when each party to the contract has the unilateral right to terminate the contract by paying a termination penalty, the contract exists throughout the period covered by the termination penalties because the penalties are evidence of enforceable rights and obligations throughout the term of the contract. That said, the mere existence of a penalty by itself would not mean that the contract term includes the periods covered by the penalties. The penalties must be substantive.

A common business model for some entities is to sell goods at a loss and to make money through sales of consumables that the customer has to purchase again and again (for example, a razor and razor blades, or a printer and printer cartridges). Sometimes these contracts are structured in such a way that if the customer does not purchase a minimum amount of consumables, it must pay a termination penalty. These contracts may effectively include a substantive termination penalty, which creates enforceable rights and obligations that may impact the contract term.

Practical insight – Customer has the right to cancel without cause

At its November 2015 meeting, the TRG discussed a scenario where only one party has the termination right. The TRG considered a contract for equipment and consumable parts in which the standalone selling price of the equipment and parts is CU10,000 and CU100, respectively. The entity sells the equipment for CU6,000 and provides the customer with an option to purchase each part for CU100. If the customer does not purchase at least 200 parts, it must pay a penalty that repays some or all of the CU4,000 discount, and that penalty decreases as each part is purchased at a rate of CU20 per part. The example assumes that the equipment and consumables are distinct goods, revenue is recognised at a point in time, and a discount of CU10 would be a material right to the customer.

How should an entity evaluate the contract term when only the customer has the right to cancel without cause, and how do termination penalties affect that analysis? The TRG generally agreed that substantive termination penalties create enforceable rights and obligations, effectively creating a minimum purchase obligation for 200 parts in the example above. The TRG debated what constitutes a 'substantive' penalty and acknowledged that significant judgement would be required to make that determination. One consideration in assessing whether a penalty is substantive would be to evaluate how many customers opt to pay the penalty. A significant number of customers opting to pay the penalty might indicate that the penalty is not substantive. If the penalty is not substantive, the entity must still evaluate whether the termination right (which is similar to an option for additional goods or services) gives rise to a material right. Said differently, if the existence of a contractual penalty does not create a longer contract term, it still could impact whether a material right is present for the optional goods or services.

At a separate meeting, the TRG discussed whether an entity's past practice of waiving termination penalties would impact the assessment of the contract term and generally agreed that the answer depends on whether the past practice changes the legally enforceable rights and obligations, as explained below.

Practical insight – Contract term: past practice of waiving termination penalty

At its October 2014 meeting, the TRG discussed a fact pattern whereby an entity enters into a contract to provide services for 24 months. Either party can terminate the contract by compensating the other party. The entity has a past practice of not enforcing collection of the termination penalty when customers cancel after at least 12 months.

When an entity has a past practice of not enforcing the collection of termination penalties, does the past practice affect the assessment of the contract term?

The TRG agreed that the determination of whether the contractual period is 24 months or 12 months depends on whether the past practice legally restricts the enforceable rights and obligations of the parties, which may vary by jurisdiction. The entity's past practice would affect the contract term only if that past practice changes the parties' legally enforceable rights and obligations. If that past practice does not change the parties' legally enforceable rights and obligations, then the contract term is 24 months.

Practical insight – Determining contract term – evergreen contract

When assessing the contract term of an arrangement that automatically renews and is cancellable by either party each month without penalty, it can be useful to compare to contracts where each party renews the contract at the end of each month via written contract. In both cases the entity would determine the contract term to be one month and would not assume a longer contract term.

Portfolio practical expedient

The guidance in IFRS 15 applies to an individual contract with a customer but allows entities to apply the guidance to a portfolio of contracts or performance obligations with similar characteristics as a practical expedient. However, an entity may apply the practical expedient only if it expects that the effects of applying the guidance on a portfolio basis would not differ materially from applying the guidance on an individual contract-by-contract basis.

An entity will need to exercise judgement to determine how to group particular contracts or performance obligations for purposes of applying the portfolio practical expedient.

Practical insight – Use of evidence from other similar contracts to develop an estimate using the expected value method

Is an entity applying the portfolio practical expedient when it considers evidence from other, similar contracts to develop an estimate using the expected value method?

At its July 2015 meeting, the TRG generally agreed that an entity can consider evidence from other, similar contracts to develop an estimate of variable consideration using the expected value method without applying the portfolio practical expedient. Said differently, considering historical experience does not necessarily mean that the entity is applying the portfolio practical expedient. This view is further supported by the guidance on estimating the standalone selling price of a good or service. IFRS 15 states that a suitable method for estimating the standalone selling price of a good or service would include referring to prices of similar goods or services.

The portfolio approach may be particularly useful in some industries in which an entity has a large number of similar contracts and applying the model separately for each contract may be impractical. For example, entities in the telecommunications industry implementing accounting systems to determine the standalone selling price for the promised goods or services in each contract and, in turn, allocating the transaction price to the performance obligations identified in that contract would be complex and costly.

Practical insight – How should an entity evaluate whether contracts have similar characteristics?

IFRS 15 does not include prescriptive guidance on how to determine if contracts may be grouped within the same portfolio.

An entity will need to exercise judgement to determine which contracts have similar characteristics when evaluating whether the contracts may be grouped within the same portfolio. One way to categorise contracts by portfolio may be by contract type. If an entity typically uses standard contract language, this may indicate that grouping the contracts into a single portfolio may be appropriate.

Another possible way to categorise contracts by portfolio would be by class of customer and the customer's behaviour pattern. For example, a healthcare entity may have evidence that suggests that uninsured patients (customers) act similarly while insured patients (customers) act similarly and result in similar revenue recognition patterns. Additionally, insured patients might fall into different portfolios based on the terms of their insurance coverage.

Combining contracts

An entity should combine two or more contracts and account for them as a single contract in certain circumstances because the substance of the individual contracts cannot be understood without considering the entire arrangement. For example, a group of separate contracts may need to be combined for accounting purposes if they are so closely related that they are, in effect, a single project with an overall profit margin. That includes recognising profits and determining the need for a provision for losses. This evaluation takes place at contract inception.

The following flow chart illustrates the process to assess whether two or more contracts need to be accounted for as a single contract:

Are the contracts entered into at or near the same time with the same customer or related parties of the customer?

No → Account for as separate contracts

Yes ↓

Are one or more of the following criteria met?
- **contracts were negotiated as a single commercial package**
- **consideration in one contract depends on the other contract, or**
- **goods or services (or some of the goods or services) are a single performance obligation**

No → Account for as separate contracts

Yes ↓

Account for contracts as a single contract

The guidance does not specify what constitutes 'at or near the same time', so an entity will need to exercise judgement to determine what constitutes this time frame as well as develop processes to evaluate whether the criteria are met.

Practical insight – combining two or more contracts

In the basis for conclusions to IFRS 15, the IASB clarifies that for two or more contracts to be combined, they should be with the same customer. However, the IASB acknowledged that in some situations, contracts with related parties (as defined in IAS 24 'Related Party Disclosures') should be combined if there are interdependencies between the separate contracts with those related parties. As a result, in those situations, combining the contracts with related parties results in a more appropriate depiction of the amount and timing of revenue recognition.

The IASB also considered whether to specify that all contracts should be combined if they were negotiated as a package to achieve a single commercial objective, regardless of whether those contracts were entered into at or near the same time with the same customer. However, the IASB decided not to do this, primarily because they were concerned that doing so could have the unintended consequence of an entity combining too many contracts and not faithfully depicting performance. Furthermore, the IASB decided that an entity should apply judgement to determine whether a contract is entered into 'at or near the same time'. However, the longer the period between the commitments of the parties to the contracts, the more likely it is that the economic circumstances affecting the negotiations have changed.

How we can help

We hope you find the information in this article helpful in giving you insight into aspects of IFRS 15. If you would like to discuss any of the points raised, please speak to your usual Grant Thornton contact or visit **www.grantthornton.global/locations** to find your local member firm.

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