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Revenue Recognition

EVROPSKÁ UNIE
Evropské strukturální a investiční fondy
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1FU59x Intermediate Accounting: Presentation

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Step 1
- Identify the contract(s) with a customer

Step 2
- Identify the performance obligations in the contract

Step 3
- Determine the transaction price

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

Step 5
- Recognise revenue when (or as) the entity satisfies a performance obligation

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Contract:

- An agreement between two or more parties that creates enforceable rights and obligations

Performance obligation:

- A promise in a contract with a customer to transfer to the customer either (a) a good or service (or a bundle) that is distinct or (b) a series of distinct goods or services that are substantially the same and that have the same pattern of transfer to the customer

Contract asset:

- An entity's right to consideration in exchange for goods or services that the entity has transferred to a customer when that right is conditioned on something other than the passage of time (for example, the entity's future performance)

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Contract liability:

- An entity's obligation to transfer goods or services to a customer for which the entity has received consideration (or the amount is due) from the customer

Customer:

- 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

Revenue:

- Income arising in the course of an entity's ordinary activities

Income:

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- Increases in economic benefits during the accounting period that result in an increase in equity, other than those relating to contributions from equity participants

Stand-alone selling price:

- The price at which an entity would sell a promised good or service separately

Transaction price:

- 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.

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1 Step 1: Contract(s) with a customer

- The parties to the contract have approved the contract
- The entity can identify each party’s rights regarding the goods or services to be transferred
- The entity can identify the payment terms for the goods or services to be transferred
- The contract has commercial substance (ie the risk, timing or amount of the entity’s future cash flows is expected to change as a result of the contract):
  - monetary or non-monetary exchanges between entities in the same line of business to facilitate sales to customers or potential customers are not revenue-generating transactions
  - similarly round-trip sales“ or „capacity swaps“ are not revenue

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- It is 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:
  - recognition threshold
  - an entity shall consider only the customer's ability and intention to pay that amount of consideration when it is due
  - amount may be less than the price stated in the contract if the consideration is variable because the entity may offer the customer a price concession
- Contract combinations:
  - an entity shall combine two or more contracts entered into at or near the same time with the same customer (or related parties of the customer) and account for the contracts as a single contract if at least one out of three criteria is met

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

- Contract modifications:
  - a contract modification is a change in the scope or price (or both) of a contract that is approved by the parties to the contract
  - an entity shall account for a contract modification as a separate contract if (a) the scope of the contract increases because of the addition of promised goods or services that are distinct and (b) the price of the contract increases by an amount of consideration that reflects the entity's stand-alone selling prices of the additional promised goods or

services and any appropriate adjustments to that price to reflect the circumstances of the particular contract

- an entity shall account for the contract modification as if it were a termination of the existing contract and the creation of a new contract, if the remaining goods or services are distinct from the goods or services transferred on or before the date of the contract modification
- an entity shall account for the contract modification as if it were a part of the existing contract if the remaining goods or services are not distinct and, therefore, form part of a single performance obligation that is partially satisfied at the date of the contract modification

2 Step 2: Performance obligations (PO)

- At contract inception, an entity shall assess the goods or services promised in a contract with a customer and shall identify as a performance obligation each promise to transfer to the customer either:
  - a good or service (or a bundle of goods or services) that is distinct; or
  - a series of distinct goods or services that are substantially the same and that have the same pattern of transfer to the customer
- A good or service is distinct if (a) the customer can benefit from it either on its own or together with other resources that are readily available to the customer (ie the good or service is capable of being distinct); and (b) the entity's promise to transfer the good or service to the customer is separately identifiable from other promises in the contract (ie

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the good or service is distinct within the context of the contract)

- PO is the smallest unit-of-account to be accounted for separately
- PO also include promises that are implied by an entity's customary business practices, if, at the time of entering into the contract, those promises create a valid expectation of the customer that the entity will transfer a good or service to the customer
- PO examples:
  - sale of goods produced by an entity
  - resale of goods purchased by an entity
  - resale of rights to goods or services purchased by an entity
  - performing a contractually agreed-upon task (or tasks) for a customer

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- providing a service of standing ready to provide goods or services
- providing a service of arranging for another party to transfer goods or services to a customer
- granting rights to goods or services to be provided in the future that a customer can resell or provide to its customer
- constructing, manufacturing or developing an asset on behalf of a customer
- granting licences
- granting options to purchase additional goods or services

3 Step 3: Transaction price

- When (or as) a performance obligation is satisfied, an entity shall recognise as revenue the amount of the transaction price that is allocated to that performance obligation
- 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
- Changes in transaction price:
  - an entity shall allocate to the performance obligations in the contract any subsequent changes in the transaction price on the same basis as at contract inception
  - an entity shall not reallocate the transaction price to reflect changes in stand-alone selling prices after contract inception

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- amounts allocated to a satisfied performance obligation shall be recognised as revenue, or as a reduction of revenue, in the period in which the transaction price changes

- The consideration promised in a contract with a customer may include fixed amounts, variable amounts, or both
- An entity shall consider the terms of the contract and its customary business practices to determine the transaction price, including:
  - variable consideration and its constraints
  - the existence of a significant financing component in the contract
  - non-cash consideration
  - consideration payable to a customer

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- Variable consideration:
  - may arise because of discounts, rebates, refunds, credits, price concessions, incentives, performance bonuses, penalties
  - the expected value or the most likely value shall be used to estimate variable consideration; an entity shall use which one is better to predict the amount
  - an entity shall include in the transaction price some or all of an amount of variable consideration only to the extent that it is highly probable that a significant reversal in the amount of cumulative revenue recognised will not occur when the uncertainty associated with the variable consideration is subsequently resolved
  - at the end of each reporting period, an entity shall update the estimated transaction price to represent faithfully the circumstances present at the end of the reporting period

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and the changes in circumstances during the reporting period

- a refund liability is also variable consideration

- The existence of significant financing component:
  - the promised amount of consideration shall be adjusted for the effects of the time value of money if the timing of payments agreed to by the parties to the contract provides the customer or the entity with a significant benefit of financing the transfer of goods
  - the adjustment shall reflect the price that a customer would have paid for the promised goods or services if the customer had paid cash for those goods or services when (or as) they transfer to the customer (ie the cash selling price)
  - an entity shall assess the difference between amount of promised consideration and cash selling price; the length between payment and transfer of the goods combined with

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prevailing interest rates

- a contract would not have a significant financing component if (a) the customer paid for the goods or services in advance and the timing of the transfer of those goods or services is at the discretion of the customer; (b) a substantial amount of the consideration promised by the customer is variable and the amount or timing of that consideration varies on the basis of the occurrence or non-occurrence of a future event that is not substantially within the control of the customer or the entity; (c) the difference between the promised consideration and the cash selling price of the good or service arises for reasons other than the provision of finance to either the customer or the entity, and the difference between those amounts is proportional to the difference
- as a practical expedient, an entity need not adjust the promised amount of consideration for the effects of a significant financing component for the contracts shorter than a year

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- Non-cash consideration:
  - shall be measured at its fair value (directly or indirectly by reference to the stand-alone selling price of the goods or services promised to the customer)
- Consideration payable to a customer:
  - an entity shall account for consideration payable to a customer as a reduction of the transaction price and, therefore, of revenue unless the payment to the customer is in exchange for a distinct good or service that the customer transfers to the entity

4 Step 4: Allocating the transaction price to performance obligations

- An entity shall allocate the transaction price to each performance obligation in an amount that depicts the amount of consideration to which the entity expects to be entitled in exchange for transferring the promised goods or services to the customer
- The allocation shall be based on a relative stand-alone selling price of each performance obligation satisfied
- An entity shall determine the stand-alone selling price at contract inception of the distinct good or service underlying each performance obligation in the contract and allocate the transaction price in proportion to those stand-alone selling prices
- The stand-alone selling price is the price at which an entity would sell a promised good or service separately to a customer

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- The best evidence of a stand-alone selling price is the observable price of a good or service when the entity sells that good or service separately in similar circumstances and to similar customers
- A contractually stated price or a list price for a good or service may be (but shall not be presumed to be) the stand-alone selling price of that good or service
- An indirect estimation can be made using:
  - adjusted market assessment approach (e.g. referring to competitors' prices)
  - expected cost plus a margin approach
  - residual approach
- Allocation of discounts:

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- any discount shall be allocated to all PO based on their relative stand-alone selling prices unless an entity has an objective evidence that the discount relate to one or more (but not all) PO

5 Step 5: Recognising revenue

- An entity shall recognise revenue when (or as) the entity satisfies a performance obligation by transferring a promised good or service (ie an asset) to a customer
- An asset is transferred when (or as) the customer obtains control of that asset
- For each PO, an entity shall determine at contract inception whether it satisfies the PO over time or at a point in time
- PO satisfied over time:
  - the customer simultaneously receives and consumes the benefits provided by the entity's performance as the entity performs
  - the entity's performance creates or enhances an asset that the customer controls as the asset is created or enhanced

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  - the entity's performance does not create an asset with an alternative use to the entity and the entity has an enforceable right to payment for performance completed to date

- If an entity does not satisfy a performance obligation over time, the PO is satisfied at a point in time when the control over asset is passed from the entity to the customer
- The indicators of the transfer of control:
  - the entity has a present right to payment for the asset
  - the customer has legal title to the asset
  - the entity has transferred physical possession of the asset
  - the customer has the significant risks and rewards of ownership of the asset
  - the customer has accepted the asset

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- Measuring progress towards complete satisfaction of a PO:
  - an entity shall apply a single method of measuring progress for each performance obligation satisfied over time and the entity shall apply that method consistently to similar performance obligations and in similar circumstances
  - at the end of each reporting period, an entity shall remeasure its progress towards complete satisfaction of a performance obligation satisfied over time
  - an entity may use output and input methods for the measurement of the progress; the latter can be only used if it is cheaper and provides a good approximation of progress

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6 (Step 6): Contract costs

- Recognition of revenue from a contract with a customer is accompanied with costs
- An entity shall recognise as an asset the incremental costs of obtaining a contract with a customer if the entity expects to recover those costs
- Costs to fulfil a contract under scope of another standard (i.e. IAS 2, IAS 16, IAS 38) shall be dealt with according to the guidance of respective standard
- Other costs to fulfil a contract shall recognise an asset only if:
  - the costs relate directly to a contract or to an anticipated contract that the entity can specifically identify
  - the costs generate or enhance resources of the entity that will be used in satisfying (or in continuing to satisfy) PO in the future

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- the costs are expected to be recovered

- If any contract costs are capitalised, an entity shall test them for impairment at least at the end of the period