IFRS accounting for
Reporting financial performance

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Addis Ababa

WORLD BANK GROUP

AABE

Accounting and Audit Board of Ethiopia

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Established under proclamation no 847/2006

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Aims

- Understand the concepts for reporting financial performance
- Understand the requirements and judgements for applying:
  - Revenue from contracts with customers
  - Functional and presentation currency
  - Government grants

The underlying concepts

Financial performance

Financial performance	=	Changes in entity's economic resources and claims	−	Debt and Equity transactions and events

- » Information about past financial performance helps to get an understanding of the return the entity has produced
- » Past financial performance and stewardship is helpful in predicting entity's future returns
- » Users identify those changes to assess prospects for future net cash inflows

Conceptual framework 1.15-1.20

Elements of financial performance

Element		Conceptual Framework
Changes in economic resources and claims, reflecting financial performance	Income	Income is increases in assets, or decreases in liabilities, that result in increases in equity, other than those relating to contributions from holders of equity claims.
	Expense	Expenses are decreases in assets, or increases in liabilities, that result in decreases in equity, other than those relating to distributions to holders of equity claims

Conceptual framework 4.68-4.69

Reporting financial performance

- » Income and expenses are the elements of financial statements that relate to an entity's financial performance.
- » Although income and expenses are defined in terms of changes in assets and liabilities, information about income and expenses is just as important as information about assets and liabilities.
- » Providing information separately about income and expenses with different characteristics can help users of financial statements to understand the entity's financial performance

Conceptual framework 4.71-4.72

Other comprehensive income

The Board may decide that changes in current value of an asset or liability are to be included in OCI when doing so results in profit or loss providing more relevant information, or a more faithful representation of financial performance for that period

- » Profit or loss is the primary source of information about financial performance, but all recognised income and expenses should be considered including OCI
- » In principle, income and expenses included in OCI in one period are reclassified into profit or loss in a future period

Conceptual framework 7.15-7.19

Other comprehensive income
Standards

Items of OCI that are reclassified subsequently to profit or loss (sometimes called recycling) are presented separately from those that are not.

» **not recycled** include: income/expenses presented in OCI from revaluing PPE, including bearer-plants, and some intangible assets) and financial assets FVOCI.

» **recycled** include: income/expenses presented in OCI from cash flow hedges.

IAS 1.81A-105

Selected sub-classifications of income

» Revenue (from contracts with customers)

» Changes in fair value less costs to sell of biological assets in agricultural activity

» Changes in fair value of investment property

» Income from government grants

» Dividends received

» Finance income

» (net) Profit on sale of property, plant and equipment

» (net) Income from associates JVs using the equity method

Selected sub-classifications of expenses

- Analysis of expenses by their function
  - cost of sales
  - selling and distribution expenses
  - administrative expenses
- Analysis of expenses by their nature
  - inventory derecognised when sold
  - depreciation/amortisation
  - staff costs
- Finance costs
- Income tax expense

IFRS 15 *Revenue from Contracts with Customers*

Scope

- IFRS 15 applies to a contract with a customer
  - 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
  - a contract is an agreement between two or more parties that creates enforceable rights and obligations. Contracts can be written, oral or implied by an entity's customary business practices

IFRS 15.5 – 15.6 and 15.10

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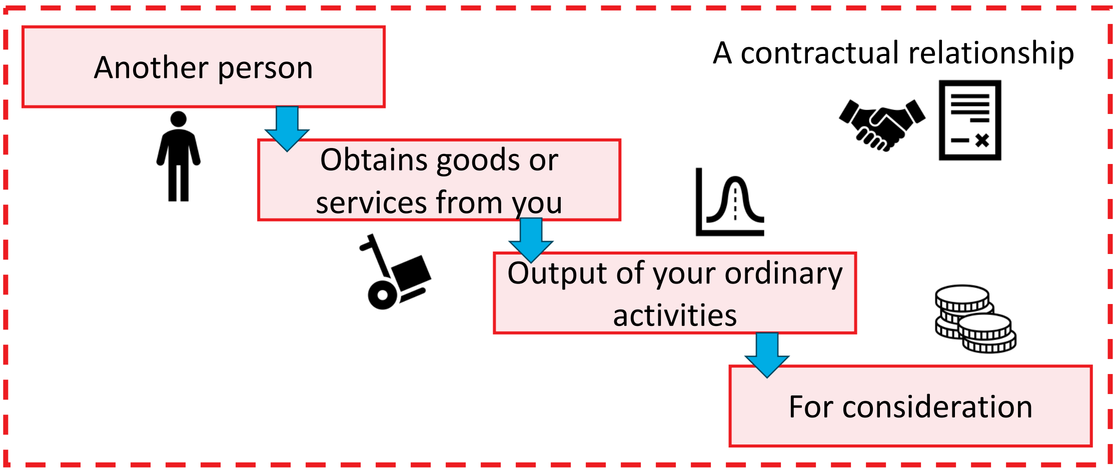
Scope



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Scope exceptions

- IFRS 15 does not apply to:
  - **financial instruments** and other contractual rights or obligations within the scope of IFRS 9, IFRS 10, IFRS 11, IAS 27 and IAS 28
    - IFRS 9 (paragraphs B5.4.1 to B5.4.3) provides guidance on whether fees are in the scope of IFRS 9 or IFRS 15
  - lease contracts
  - insurance contracts
  - non-monetary exchanges between entities in the same line of business to facilitate sales to customers or potential customers.

IAS 15.5

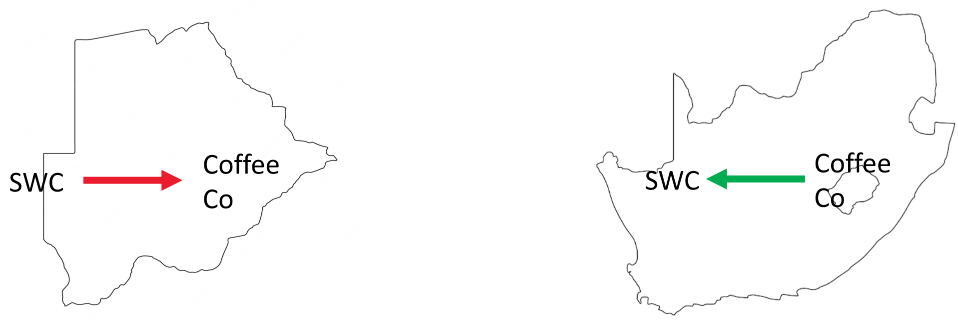
Example
Coffee Co wholesale

- SWC sells processed coffee beans to Coffee Co, a wholesaler with operations with warehouses in South Africa, Botswana and Namibia
- SWC has direct customers in those jurisdictions and its own warehouses
- In June 2022, SWC agreed with Coffee Co that:
  - 100 tons of beans in SWCs' warehouse (price $615k) in Gaborone be transferred to Coffee Co's warehouse in Gaborone, and
  - 100 tons of coffee beans (price $615k) in Coffee Co warehouse in Johannesburg be transferred to SWCs' warehouse in that city

Example
Coffee Co wholesale

Should SWC record revenue (and cost of sales) for a sale to Coffee Co of $615 000?

No. This is a non-monetary exchange to facilitate sales



Example
South West Coffee Limited (SWC)

SWC Ltd trading globally in coffee beans.

» It buys and sells beans on cash and credit, in Birr and in US Dollars.

» It enters into forward purchases and sale of coffee beans.

» It lends money to suppliers to secure and expand supplies.

» To limit volatility, it has permission to hold US Dollars for expenses.

» Excess cash is invested in Ethiopian government treasuries.

» It also holds a small stock of gold coins as protection against devaluation of the Birr.

Example
Revenue or other income

SWC supports suppliers by importing and selling farming equipment.

- Although intended to secure supply chain, business
  - sells equipment at a market related price,
  - is profitable in its own right,
  - has own dedicated resources, and
  - is reported as a separate segment
- The business does continue to focus on farmers that supply SWC.

Are the contracts with suppliers for the sale of farming equipment 'contracts with customers as defined in IFRS 15?

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Example
Revenue or other income

Are the contracts with suppliers for the sale of farming equipment 'contracts with customers as defined in IFRS 15?

This will require judgement but almost certainly these are contracts with customers. The contract is assessed in own right and represents the business of selling equipment to customers.

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Example
Revenue under IFRS 15 or other income

For each source of SWC income below choose 1 of: 1) revenue from contracts with customers; or 2) other income (specify).

	Revenue	Other income
1. Income from the sale of Coffee Beans		
2. Income from Forward sale derivatives		
3. Income from Loans to suppliers		
4. Income from Treasury bills		
5. Profit or loss on valuation of gold coins		

Example
Revenue under IFRS 15 or other income

For each source of SWC income below choose 1 of: 1) revenue from contracts with customers; or 2) other income (specify).

	Revenue	Other income
1. Income from the sale of Coffee Beans	Yes	
2. Income from Forward sale derivatives	Maybe	Or Trading
3. Income from Loans to suppliers	Maybe	Interest
4. Income from Treasury bills		Interest
5. Profit or loss on valuation of gold coins		Fair value

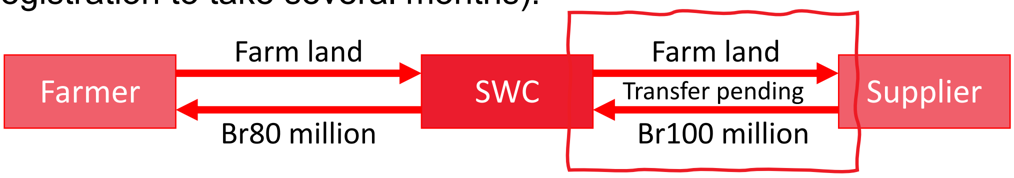
Example
Scope - normal sale agreement

» SWC speculatively purchased farmland on the death of the owner for Br80 million.

» 6 months later, SWC sold the farmland to one of its regular suppliers for Br100 million.

» At year end, contracts had been signed, and supplier had paid.

» However, registration of the transfer had not occurred (it is normal for registration to take several months).



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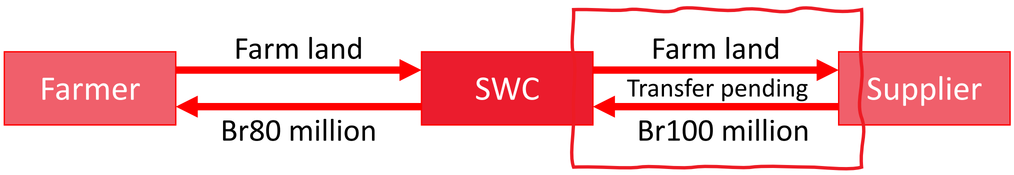
Example
Scope - normal sale agreement



On 7 Jul 2023, SWC recognises cash of Br100 million **<u>and</u>**:

1) *Br100 million revenue (and Br80 million cost of sales expense from derecognising the building)*
2) *Br100 million financial liability (because property <u>not</u> yet transferred to supplier)*
3) *Br20 million profit on sale of property?*

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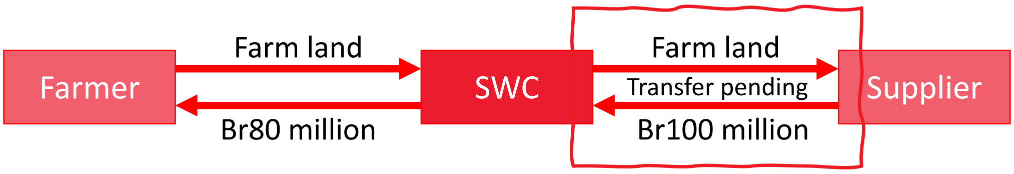
Example
Scope - normal sale agreement



On 7 Jul 2023, SWC recognises cash of Br100 million and:

1) *Br100 million revenue (and Br80 million cost of sales expense from derecognising the building)*
2) *Br100 million financial liability (because property not yet transferred to supplier)*
3) *Br20 million profit on sale of property?*

Measurement exceptions

» Although IFRS 15 does not specify exceptions from its scope for the following, it is difficult to envisage how it would be applied

- » **biological assets in agricultural activity** the illustrative examples of IAS 41 have not been updated to reflect application of IFRS 15
- » **producers of agricultural and forest products, agricultural produce after harvest, and minerals and mineral products**, to the extent that they are measured at NRV in accordance with established practices in those industries; and
- » **commodity broker-traders** who measure their inventories at fair value less costs to sell

Partially in scope

Is the contract partially in scope of IFRS 4 *Insurance Contracts*; IFRS 16 *Leases*, or financial instruments and other contractual rights and obligations in scope of IFRS 9, IFRS 10, IFRS 11, IAS 27, IAS 28?

Yes

Does the **other Standard**(s) specify how to separate and/or initially measure one or more parts of the contract?

Yes

Apply the separation and/or measurement requirements in the other Standard

No

Apply IFRS 15 to separate and/or initially measure the parts of the contract

IAS 15.5 and 15.7

Satisfying performance obligations

» **Recognise** revenue when (or as) the seller satisfies a performance obligation (**point in time** or **over time**) by transferring a promised good or service (ie an asset) to a customer (ie when the customer obtains **control** of the asset)

» However, recognise expected loss immediately (**onerous contract**)

» **Measure revenue** at customer consideration adjusted for the financial effects of significant **financing components**

  » measure **non-cash consideration** at its fair value

Five-step revenue recognition model

1. Identify the contract(s) with a customer
2. Identify the performance obligation(s) in the contract
3. Determine the transaction price
4. Allocate transaction price to the performance obligations in the contract
5. Recognise revenue when/as the entity satisfies a performance obligation

Step 1: identify the contract

Account for a contract only **when**:

» parties are committed to perform their respective obligations;

» entity can identify each party's rights regarding goods/services;

» payment terms for the goods/services can be identified;

» the contract has commercial substance; **and**

» it is probable entity will collect the consideration (considering only customer's ability and intention to pay consideration when it is due).

  » note: the amount of consideration to which the entity will be entitled may be less than the price stated in the contract because the entity may offer the customer a price concession.

IFRS 15.9

Step 1: identify the contract

When a contract does not meet the criteria, the entity recognises consideration received as revenue only when:

» it has no remaining obligations to transfer goods or services and all, or substantially all, the consideration has been received; or

» the contract has been terminated and consideration received is non-refundable

IFRS 15.15 and 16

Example
Identify the contract

On 7 Jul 2023, SWC enters into a sales arrangement with one of its big international customers:

» Customer has a 30 June yearend

» Customer agrees to buy Br1 million of excess SWC inventory on credit

» SWC agrees to buy back the inventory on 31 July 2023, unless customer exercise options to retain it

Should SWC recognise revenue?

Example
Scope - normal sale agreement

Should SWC recognise revenue?

Requirement	Met?
Parties are committed to perform their respective obligations;	
Entity can identify each party's rights regarding goods/services;	
Payment terms for the goods/services can be identified;	
The contract has commercial substance; <u>and</u>	
It is probable entity will collect the consideration	

Example
Scope - normal sale agreement

Should SWC recognise revenue?

Requirement	Met?
Parties are committed to perform their respective obligations;	Yes
Entity can identify each party's rights regarding goods/services;	Yes
Payment terms for the goods/services can be identified;	Yes
The contract has commercial substance; <u>and</u>	<u>No</u>
It is probable entity will collect the consideration	No

Example
Identify the contract

SWC has operated in Ethiopia for many years, and has a range of relationships. Are the following 'contracts with customers'?

Relationship	Yes/No
1. Cash sales <u>unbranded</u> coffee beans to street vendors	
2. Cash sales <u>unbranded</u> excess stock to local roastery	
3. Agrees to exchange beans with a competitor for logistical reasons (too much stock in one location)	
4. Provides coffee beans to IT service provider in part payment for IT services	
5. Verbal agreement to sell coffee ever month to a bar	

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Example
Identify the contract

SWC has operated in Ethiopia for many years, and has a range of relationships. Are the following 'contracts with customers'?

Relationship	Yes/No
1. Cash sales unbranded coffee beans to street vendors	Yes
2. Cash sales unbranded excess stock to local roastery	Yes
3. Agrees to exchange beans with a competitor for logistical reasons (too much stock in one location)	No
4. Provides coffee beans to IT service provider in part payment for IT services	Yes
5. Verbal agreement to sell coffee ever month to a bar	Yes

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Step 2: identify performance obligations

Performance obligation is a promise to transfer a distinct good or service

Customer can benefit from good or service	» On its own, or » Together with other readily available goods or services (including those previously acquired from entity)
Promised good or service is separable from other promises	» **No significant service of integrating the good or service** » Good or service is not highly dependent on or interrelated with other goods or services

IFRS 15.5 and 15.7

Step 2: identify performance obligations - warranties

Warranties provide a customer with either:

Assurance that product will function as intended	A service in addition to assurance
» Not a separate performance obligation » Accounted for applying IAS 37	» Is a separate performance obligation » accounted for applying IFRS 15

IFRS 15.B28 and B33

Example
Multiple element sale (1 of 3)

- SWC supports suppliers by importing and selling specialist farming equipment. Sales contracts provide Customer with:
  - The machinery;
  - a standard manufacturers warranty;
  - an extended warranty underwritten by SWC
  - 40 hours in-person training on how to operate the machinery
  - Extended credit terms
- SWC regularly sells machines **without** the training services, without the extended warranty and without deferred credit terms. It always provides the standard warranty.

Example
Multiple element sale (2 of 3)

How many separate performance obligations must SWC account for?

	A	B	C	D	E	F	G
Number of performance obligations	1	2	3	3	4	4	5
Contract as a whole	Y						
Sale of goods and services		Y					
Sale of goods			Y	Y	Y	Y	Y
Training services			Y	Y	Y	Y	Y
Both Warranties		Y	Y				
Standard warranty					Y		Y
Extended warranty				Y	Y	Y	Y
Financing						Y	Y

Example
Multiple element sale (3 of 3)

How many separate performance obligations must Manufacturer account for?

	D	Explanation
Number of performance obligations	3	See below:
Contract as a whole		
Sale of goods and services		The sale of machine is distinct from the other items
Sale of goods	Y	
Training services	Y	Training provided is distinct
Both Warranties		The standard warranty is accounted for under IAS 37
Standard warranty		
Extended warranty	Y	The additional warranty is distinct
Financing		Financing accounted for as FI

Step 3: determining the transaction price

<u>Constraining</u> estimates of variable consideration:

» Include variable consideration in transaction price only to extent it is *<u>highly probable</u> a significant reversal of revenue will not occur* when uncertainty is resolved

» Likelihood of revenue reversal assessed using indicators

  » factors outside entity's influence (market, 3rd-party actions etc)

  » entity's level of experience with similar types of contracts

  » length of time before uncertainty resolved

IFRS 15.56-58

Step 3: determining the transaction price
Significant Financing

- Objective: how much would the customer have paid if the date of payment aligned with performance obligation
- Consider:
  - If there is a price difference
  - The effect of time value of money (duration and rate)
- Do not apply if delivery at the discretion of customer, or consideration is variable or difference in price is for some other reason
- Practical expedient not to apply if less then 1 year

IFRS 15.56-58

Example
Significant financing component?

Contract A: a prepaid card entitles customer to 100 hours of airtime using Telco's network. The card expires 2 years after purchase. Does Contract A contain a significant finance component that must be accounted for separately by Telco in accordance with IFRS 15?

1) Yes; 2) No; or 3) it depends (explain).

Applying paragraphs 60 to 63 of IFRS 15

Example
Significant financing component?

Contract A: a prepaid card entitles customer to 100 hours of airtime using Telco's network. The card expires 2 years after purchase. Does Contract A contain a significant finance component that <u>must</u> be accounted for separately by Telco in accordance with IFRS 15?

1) Yes; 2) No; or 3) it depends (explain). Timing of the transfer of the service is at the discretion of the customer.

Example
Significant financing component?

Contract B: Retailer offers a 10% discount to cash customers but sells goods on 12 months 'interest-free' credit. Does Contract B contain a significant finance component that <u>must</u> be accounted for separately…?

1) Yes; 2) No; or 3) it depends (explain).

Applying paragraphs 60 to 63 of IFRS 15

Example
Significant financing component?

Contract B: Retailer offers a 10% discount to cash customers but sells goods on 12 months 'interest-free' credit. Does Contract B contain a significant finance component that must be accounted for separately…?

1) *Yes; 2) No; or 3) it depends (explain). Only because the 12-month practical expedient applies*

Example
Significant financing component?

Contract C: same as Contract B except 24-months 'interest-free' credit and Retailer does not offer 10% discount to cash customers. Does Contract C contain a significant finance component…

1) Yes; 2) No; or 3) it depends (explain).

Applying paragraphs 60 to 63 of IFRS 15

Example
Significant financing component?

Contract C: same as Contract B except 24-months ‘interest-free' credit and Retailer does not offer 10% discount to cash customers. Does Contract C contain a significant finance component…

1) Yes; 2) No; or 3) it depends (explain). Depends on whether there is in substance a financing arrangement

Example
Significant financing component?

Contract D: in accordance with contract, Entity receives Br10,000 upfront from Customer in exchange for providing Customer with 2 years of asset management services. Does Contract D contain a significant finance component that must be accounted for separately applying IFRS 15?

1) Yes; 2) No; or 3) it depends (explain).

Applying paragraphs 60 to 63 of IFRS 15

Example
Significant financing component?

Contract D: in accordance with contract, Entity receives Br10,000 upfront from Customer in exchange for providing Customer with 2 years of asset management services. Does Contract D contain a significant finance component that must be accounted for separately applying IFRS 15?

1) Yes; 2) No; or 3) it depends (explain). Period between receiving upfront payment and transferring services exceeds 1 year.

Example
Significant financing component?

Contract E: same as Contract D except, in accordance with the contract, Customer pays Entity Br11,000 at end of contract period. Does Contract E contain a significant finance component…?

1) Yes; 2) No; or 3) it depends (explain).

Applying paragraphs 60 to 63 of IFRS 15

Example
Significant financing component?

Contract E: same as Contract D except, in accordance with the contract, Customer pays Entity Br11,000 at end of contract period. Does Contract E contain a significant finance component…?

1) Yes; 2) No; or 3) it depends (explain). Period between transferring services in 2016 and receiving payment exceeds 1 year.

Example
Significant financing component?

Contract F: same as Contract D and E except, Customer pays Entity Br5,000 at the beginning of each year. Does Contract F contain a significant finance component…?

1) Yes; 2) No; or 3) it depends (explain).

Applying paragraphs 60 to 63 of IFRS 15

Example
Significant financing component?

Contract F: same as Contract D and E except, Customer pays Entity Br5,000 at the beginning of each year. Does Contract F contain a significant finance component…?

1) Yes; 2) No; or 3) it depends (explain). Fee is received within one year of services

Step 3: determining the transaction price
Significant Financing

» If there is significant financing, then:

  » Use the discount that that would be reflected in a separate financing transaction

  » May be able to determine the rate using the rate inherent in the transaction

  » Do not update the rate over time

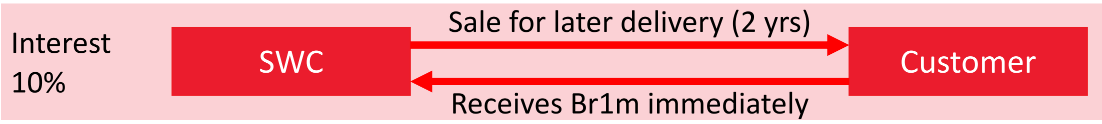
IFRS 15.56-58

Example
Significant financing (1 of 7)

SWC enters into a contact with Customer to sell Customer 1 ton of coffee beans in 2 years time at whatever the ruling price is at that point, in exchange for:

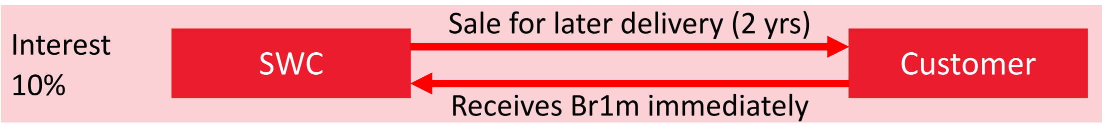
» Prepayment Br1 million (=95% of expected normal based on current price)

<u>At inception</u> SWC <u>estimates</u> that it's own incremental borrowing rate is 10%



IFRS 15 Illustrated example 29

Example
Significant financing (2 of 7)

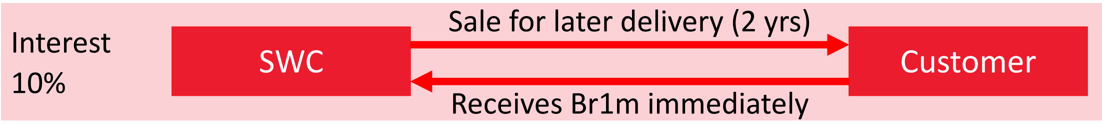


<u>**SWC immediately recognises cash of Br1 million and:**</u>

1) *Revenue of Br1 million*
2) *Revenue of Br1.21 million (Br1 million of revenue plus value of receiving money two years early at 10%)*
3) *Revenue of Br1.052 million (normal selling price)*
4) *Br1 million financial liability (because coffee beans not delivered to customer)*

IFRS 15 Illustrated example 29

Example
Significant financing (3 of 7)

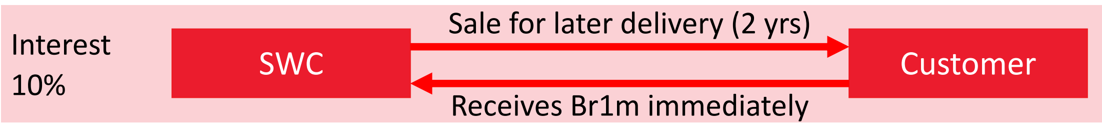


SWC immediately recognises cash of Br1 million and:

1) *Revenue of Br1 million*
2) *Revenue of Br1.21 million (Br1 million of revenue plus value of receiving money two years early at 10%)*
3) *Revenue of Br1.052 million (normal selling price)*
4) *Br1 million liability (because coffee beans not delivered to customer)*

IFRS 15 Illustrated example 29

Example
Significant financing (4 of 7)



If **SWC only recognises revenue in two years, how much should it recognise assuming coffee prices do not change:**

1) *Revenue of Br1 million*
2) *Revenue of Br1.21 million (Br1 million of revenue plus value of receiving money two years early at 10%)*
3) *Revenue of Br1.052 million (normal selling price)*

IFRS 15 Illustrated example 29

Example
Significant financing (5 of 7)

Interest 10%

SWC — Sale for later delivery (2 yrs) → Customer

SWC ← Receives Br1m immediately — Customer

If SWC only recognises revenue in two years, how much should it recognise assuming coffee prices do not change:

1) *Revenue of Br1 million*
2) *Revenue of Br1.21 million (Br1 million of revenue plus value of receiving money two years early at 10%)*
3) *Revenue of Br1.052 million (normal selling price)*

IFRS 15 Illustrated example 29

Example
Significant financing (6 of 7)

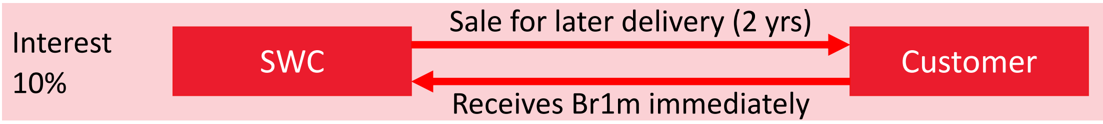
Interest 10%

SWC — Sale for later delivery (2 yrs) → Customer

SWC ← Receives Br1m immediately — Customer

	Debit	Credit
At inception		
Dr Cash	1 000 000	
Cr Liability		1 000 000
End of first year		
Dr Interest paid	100 000	
Cr Liability		100 000

Example
Significant financing (7 of 7)



	Debit	Credit
End of second year		
Dr Interest paid	110 000	
Cr Liability		110 000
End of first year		
Dr Liability	1 210 000	
Cr Revenue		1 210 000

Step 4: allocating transaction price to performance obligations

Transaction price allocated to separate performance obligations based on relative stand-alone selling prices. Stand-alone selling price can be estimated using:	
Adjusted market assessment approach	Evaluate market in which goods or services are sold and estimate price that customers in market would pay
Expected cost plus a margin approach	Forecast expected costs of satisfying a performance obligation and add appropriate margin for good or service
Residual approach (see paragraphs 79(c) and 80 for the limited circumstance in which it applies)	The total transaction price less the sum of the observable stand-alone selling prices of other goods or services promised in the contract

IFRS 15.79

Step 4: allocating transaction price: discounts

Allocate discount proportionately. However, allocate entirely to one or more, but not all, performance obligations if **all** the following are met:

(a) entity regularly sells each distinct good or service on a stand-alone basis;

(b) entity regularly sells some of those distinct goods or services at a discount; and

(c) discount attributable to goods or services in (b) is substantially the same as discount in the contract and analysis provides observable evidence of the performance obligation to which entire discount in contract belongs.

Allocate the discount before using the residual approach to estimate the stand-alone selling price of a good or service.

IFRS 15.81-83

Example
Multiple element sale (1 of 2)

» SWC supports suppliers by importing and selling specialist farming equipment. Sales contracts provide Customer with:

Identified obligation	Contract price	Stand-alone price	IFRS 15 price?
Farm machinery	3 000 000	2 904 000	
Standard manufacturers warranty	0	0	
Extended warranty	0	330 000	
Training	0	66 000	
Total contract price	3 000 000	3 300 000	

Example
Multiple element sale (2 of 2)

» SWC supports suppliers by importing and selling specialist farming equipment. Sales contracts provide Customer with:

Identified obligation	Contract price	Stand-alone price	IFRS 15 price?
Farm machinery	3 000 000	2 904 000	2 640 000
Standard manufacturers warranty	0	0	0
Extended warranty	0	330 000	300 000
Training	0	66 000	60 000
Total contract price	3 000 000	3 300 000	3 000 000

Step 4: allocating transaction price: variable consideration

» Variable consideration is attributable to a specific performance obligation if:

(a) the variable payment relate specifically to the performance obligation; and

(b) faithfully depict the consideration entity expected for transferring these goods or services to the customer

» Allocate the remaining amount of the transaction price using the 'normal' requirements

IFRS 15.84-86

Step 5: recognition of revenue

» Recognise revenue when entity satisfies a performance obligation by transferring a promised good or service (ie an asset) to a customer.

» Asset is transferred when customer obtains control of that asset

  » Control is the ability to direct the use of, and obtain substantially all of the remaining benefits from, the good or service

» Benefits can be obtained directly or indirectly (para 33 includes examples)

IFRS 15.31-33

Step 5: recognition of revenue

Recognise revenue when control transfers (point in time) unless it is recognised over time because (any one of the following are satisfied):

» Customer simultaneously receives and consumes benefits

» Entity's performance creates or enhances an asset the customer controls (eg constructing a building on customer's land)

» 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 (eg building a specialised machine bespoke to the customer's design and specifications)

IFRS 15.35-38, IFRS 15.B3-B13 provide application guidance

Example
Multiple element sale (1 of 2)

» SWC supports suppliers by importing and selling specialist farming equipment. Sales contracts provide Customer with:

Identified obligation	Point in time/over time
Farm machinery	
Standard manufacturers warranty	
Extended warranty	
Training	

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Example
Multiple element sale (1 of 2)

» SWC supports suppliers by importing and selling specialist farming equipment. Sales contracts provide Customer with:

Identified obligation	Point in time/over time
Farm machinery	Point in time: on delivery of machine
Standard manufacturers warranty	Point in time: on delivery of machine
Extended warranty	Over time: warranty period
Training	Point in time: When training is provided

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Contract costs

Incremental costs of obtaining contract	Costs to fulfil a contract

• **Recognised as an asset** if:
  • Incremental eg sales commissions
  • Expected to be recovered
• Cost incurred regardless of whether contract was obtained → expense
• Practical expedient: if amortisation period is ≤ 1 year → may expense
	If not within scope of another standard, **recognised as an asset** if:
	• Relates directly to a contract or anticipated contract
	  • Relate to future performance
	  • Expected to be recovered
	eg: Pre-contract or setup costs

- Asset recognised ⟶ amortised on a systematic basis
- Asset impaired if, remaining consideration less than costs not already expensed = impairment loss in profit or loss

IFRS 15.91-101

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Impact on construction contracts

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Applying 5 step approach to construction contracts

Step 1:
» contract modifications usually (not always) part of same contract
Step 2: usually 1 performance obligation because of high integration
Step 3:
» variable consideration: incentives, penalties, variations
» adjust transaction price for financing component
Step 5: point-in-time or over-time? Generally over-time if building:
i. asset on Customer's site; or
ii. specialised asset that only the customer can use, or building an asset to a customer order.

Estimating the stage of completion (over-time)

Methods of estimating the stage of completion
» Usually on the basis of inputs
  » % of contract costs incurred to date over estimated total contract costs.
    » exclude costs incurred for future activities (for example, raw materials inventory and prepayments)
» On the basis of outputs is also permitted:
    » engineering survey of work performed
    » physical portion of work that has been completed (for example, kilometers of road constructed)

Construction contracts
Example 1

» SWC has a fixed price contract to **construct** a road at a 100% margin

» Due to delays caused by Covid, cost estimates increase by 1.2m in 2022

	Original estimates	2021	2022	2023
Revenue	2,000,000	2,000,000	2,000,000	2,000,000
Costs incurred	-	200,000	1,100,000	2,100,000
Estimated future costs	1,000,000	800,000	1,100,000	-
Total expected costs	1,000,000	1,000,000	2,200,000	2,100,000

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Construction contracts
Example 1 continued

» SWC calculates **percentage of completion**.

	2021	2022	2023
Costs incurred	200,000	1,100,000	2,100,000
Estimated future costs	800,000	1,100,000	-
Total expected costs	1,000,000	2,200,000	2,100,000
Costs incurred/Total expected costs	20%	50%	100%

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Construction contracts
Example 1 *continued*

» Revenue and costs determined on the basis of % of completion

» Provision for onerousness raised in 2022 (see IAS 37)

	for 2021	for 2022	Cumulative end 2022	for 2023	Cumulative end 2023
% complete	20%	+30%	50%	+50%	100%
Revenue	400,000	600,000	1,000,000	1,000,000	2,000,000
Costs	(200,000)	(900,000)	(1,100,000)	(1,000,000)	(2,100,000)
Onerousness		(100,000)	(100,000)	100,000	-
Profit (loss)	200,000	(400,000)	(200,000)	100,000	(100,000)

Construction contracts
Example 2

» SWC Roads has a **fixed price contract to construct a bridge** using new technologies

» It cannot initially determine the outcome of the contract.

	Original estimates	2021	2022	2023
Revenue	2,000,000	2,000,000	2,000,000	2,000,000
Costs incurred	-	200,000	750,000	1,200,000
Estimated future costs	?	?	250,000	-
Total expected costs	?	?	1,000,000	1,200,000

Construction contracts
Example 2 *continued*

» SWC calculates percentage of completion.

	2021	2022	2023
Costs incurred	200,000	750,000	1,200,000
Estimated future costs	?	250,000	-
Total expected costs	?	1,000,000	1,200,000
Costs incurred/Total expected costs	n/a	75%	100%

Construction contracts
example 2 continued

» Revenue is initially limited to recoverable contract costs; then on % of completion when outcome more reliable.

	for 2021	for 2022	Cumulative end 2022	for 2023	Cumulative end 2023
% complete	n/a		75%	+25%	100%
Revenue	200,000	1,300,000	1,500,000	500,000	2,000,000
Costs	(200,000)	(550,000)	(750,000)	(450,000)	(1,200,000)
Profit	-	750,000	750,000	50,000	800,000

Breakage (customers' unexercised rights that are non-refundable)

Breakage: non-refundable prepaid rights that customers may not exercise.

» Considering requirements on constraining variable consideration, determine whether entity has right to breakages - recognition issue

» Breakage is expected to expire unexercised: recognise expected breakage as revenue in proportion to pattern of rights exercised by customer.

» Breakage is not expected to expire unexercised: recognise breakage amount as revenue when likelihood of customer exercising remaining rights becomes remote.

» Recognise a liability for any breakage amount that entity is required to remit to another party (eg a government)

IFRS 15.B45-B47

Example
Breakage

SWC enters into a joint venture with independent coffee shops in Ethiopia.

» Coffee shops sell their customers gift cards that can be used in any coffee shop in Ethiopia

» Card seller keeps 5% of the proceeds and pays the rest to SWC

» If the card is used, SWC refunds the merchant the value of the card

» The cards expire after two years

» SWC expects that 40% of the cards will expire unused (breakage)

Example
Breakage

When does SWC recognise revenue for breakage? Choose one of:

1) *when the ultimate customer purchases the gift cards*
2) *when the gift card expires unused*
3) *straight-line over the 24 month contract term*
4) *in proportion to the pattern of rights exercised by the ultimate customer over the two years (ie not necessarily straight-line)*

Example
Breakage

When does SWC recognise revenue for breakage? Choose one of:

1) *when the ultimate customer purchases the gift cards*
2) *when the gift card expires unused*
3) *straight-line over the 24 month contract term*
4) *in proportion to the pattern of rights exercised by the ultimate customer over the two years (ie not necessarily straight-line)*

Functional and presentation currency

Aims

» Understand the <u>concept</u> of a functional currency in general purpose financial information;

» Understand how to determine the functional currency; and

» Understand some of the <u>main judgements</u> made in determining the functional currency.

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Relevant defined terms

» **Functional currency** is the currency of the primary economic environment in which the entity operates (paragraph 8 of IAS 21)

» **Foreign currency** is a currency other than the functional currency of the entity (paragraph 8 of IAS 21)

» **Presentation currency** is the currency in which the financial statements are presented (paragraph 8 of IAS 21)

Application guidance
Functional currency

» Functional currency is determined (not chosen)

» Functional currency is the entity's measurement currency

- » a foreign currency transaction is recorded, on initial recognition in the functional currency (paragraph 21 of IAS 21)
- » at the **end of each reporting period** foreign currency (paragraph 23 of IAS 21):
  - » **monetary items** are translated using the closing rate
  - » **non-monetary items** measured at historical cost are translated at historic rates
  - » **non-monetary items** measured at fair value of translated at the rate on the date fair value was measured (usually the closing rate)

Determining functional currency

- Functional currency is the currency of the primary economic environment in which the entity operates
- Normally, it's the currency in which the company makes and spends money. And, in most cases it will be just the currency of the country where you operate.
- IAS 21 lists some indicators to consider when determining your functional current
- If it is still not obvious from those indicators, then the management must use its judgment to determine the functional currency.

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Application guidance
Presentation currency

- Presentation currency is chosen
- If presentation currency differs from functional currency, at the end of each reporting period convert:
  - All assets and liabilities at the closing rate
  - All income statement events at the rate when the events occurred (average rate can be used if it is is reflective)
  - Take the resulting exchange differences to OCI

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Government grants

Relevant defined terms

» **Government assistance** is action by government designed to provide an economic benefit specific to an entity or range of entities qualifying under certain criteria.

» **Government grants** are assistance by government in the form of transfers of resources to an entity in return for past or future compliance with certain conditions relating to the operating activities of the entity.

» ***Grants related to assets*** are government grants whose primary condition is that an entity qualifying for them should purchase, construct or otherwise acquire long-term assets..

» ***Grants related to income*** are government grants other than those related to assets.

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Accounting

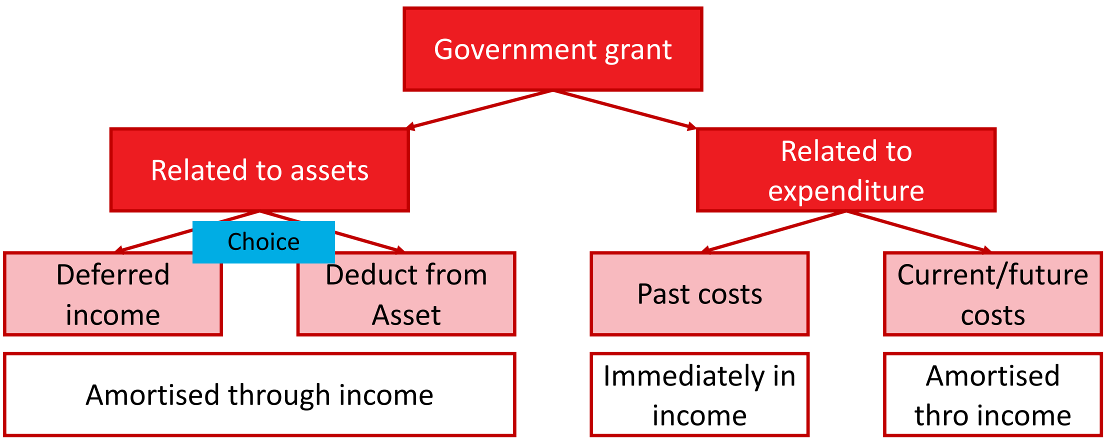
» An entity is required to use the income approach (ie the grant is recognised as income)

» Accounting is dependent on the purpose of the grant (related to assets or related to income)

» Government grants are only recognised when there is reasonable assurance that the entity will comply with the conditions attaching to them; and the grants will be received.

» Government grants doesn’t include government assistance with a value cannot be reasonably measured or benefits in determining taxable income

Accounting



Recognition

» Government grants are recognised in profit or loss on a systematic basis over the periods in which the entity recognises the related costs as expenses

» A government grant for expenses or losses already incurred or for immediate financial support no future related costs is be recognised in profit or loss when it becomes receivable.

» Non-monetary grants, such as land or other resources, are usually accounted for at fair value, although recording both the asset and the grant at a nominal amount is also permitted

Disclosures

The following must be disclosed:

» accounting policy adopted for grants, including method of balance sheet presentation

» nature and extent of grants recognised in the financial statements

» unfulfilled conditions and contingencies attaching to recognised grants

Questions