MAZARS' LONG-TERM CONTRACTS CLUB

Revenue recognition on transfer of control

Recognising revenue

A company recognises revenue when (or as) the company satisfies a performance obligation. A performance obligation is satisfied by transferring control of a promised good or service to a customer, with control being the ability to direct the use of, and obtain substantially all of the remaining benefits from, the promised good or service.

At contract inception, a company determines whether it satisfies the performance obligation over time or at a point in time. The performance obligation is satisfied over time, and therefore revenue is recognised over time, if one of the following three criteria are met:

Criterion 1 The customer simultaneously receives and consumes the benefits provided by the company's performance as the company performs, eg routine or recurring services; or

Criterion 2 The company's performance creates or enhances an asset that the customer controls as the asset is created or enhanced; or

Criterion 3 The company's performances creates an asset which does not have an alternative use to the company **and** the company has an enforceable right to payment for performance completed to date.

If none of these criteria are met, then the performance obligation is satisfied at a point in time, and therefore revenue is recognised at a point in time.

Key implication

The determination of whether a company recognises revenue over time or at a point in time may result in a change in current accounting practices, with a change from recognising revenue over time to at a point in time or at a point in time to over time. In particular, we expect the second part of the third criterion, relating to the company having an enforceable right to payment for performance completed to date, to cause the most problems for companies and note that the payment schedule does not necessarily indicate whether this part of the criterion is met because, for example, the consideration may be refundable for reasons other than the company's failure to perform as promised in the contract.

This could impact the timing of the company's revenue and profit recognition.

Measuring progress

A company recognises revenue over time by measuring the progress towards complete satisfaction of that performance obligation. A company applies a single method of measuring progress for each performance obligation satisfied over time and the company applies that method consistently to similar performance obligations and in similar circumstances. At the end of each reporting period, a company re-measures its progress towards complete satisfaction of that performance obligation, with any changes being accounted for as a change in accounting estimate.

A company may apply output or input methods to measure progress:

Output methods recognise revenue on the basis of direct measurements of the value to the customer of the goods or services transferred to date relative to the remaining goods or services promised in the contract.

Caution: These methods may not be a faithful depiction of the company's performance if the output selected fails to measure some of the goods or services for which control has transferred to the customer eg work in progress.

Key implication:

Companies may no longer be able to apply output methods which result in significant amounts of work in progress eg the milestones method and may need to change to input methods eg the cost-to-cost method.

OR

Input methods recognise revenue on the basis of the company's efforts or inputs to the satisfaction of a performance obligation relative to the total expected inputs to the satisfaction of that performance obligation.

Caution: These methods may not be a direct relationship between a company's inputs and the transfer of control of goods or services to a customer.

Key implication:

Companies applying the cost-to-cost method may need to make adjustments for uninstalled materials and significant inefficiencies.

Companies could therefore face changes to the timing of their revenue and profit recognition.

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About Mazars' Long-term Contracts Club

Mazars' Long-term Contracts Club is a series of hands-on, technical workshops designed for organisations involved in long-term contracts. IFRS 15 comes into effect on 1 January 2018 and brings a number of changes for companies with long-term contracts. These workshops consider some of the most pressing issues related to the new standard and help organisations understand the requirements, anticipate the challenges and implement the standard effectively.

The series includes:

- Introduction to the main principles of IFRS 15
- Identification of performance obligations
- Revenue recognition on transfer control
- Incremental costs of obtaining a contract
- Identification of contracts, including contract modifications
- Variable consideration
- Existence of a significant financing component
- Disclosures on remaining performance obligations
- Presentation of contract assets and liabilities

Mazars' Financial Reporting Advisory team

Mazars' technical experts have impressive experience in a wide variety of accounting, financial reporting and narrative reporting matters. We support numerous technical projects, including GAAP conversions, and have a proven track record in helping our clients to successfully apply new accounting and financial reporting standards, important in today's fast-changing technical environment.

How we can help you

We can help you prepare for IFRS 15 and, more immediately, IAS 8 which requires companies to disclose information relating to the impact of IFRS 15 on their financial statements.

Impact assessments

IAS 8 requires a company to disclose information relating to the impact of IFRS 15 on their financial statements. With regulators expecting more and more detailed qualitative and quantitative disclosures in respect of the application of IFRS 15, we can perform impact assessments to assist with identifying the key areas of differences.

Contract analysis

With the effective date of the new Standard fast approaching, we can use our contract analysis tool to help you understand IFRS 15's impact on existing contracts, as well as future contracts you are negotiating, giving you the opportunity to prepare for transition, as well as avoid or mitigate unwanted implications.

Please get in touch

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