MAZARS' LONG-TERM CONTRACTS CLUB

Variable consideration

IAS 11 reminder

Under IAS 11, contract revenue is measured at the fair value of the consideration received or receivable, with the measurement of contract revenue being affected by a variety of uncertainties that depend on the outcome of future events, e.g. cost escalation clauses and penalties arising from delays caused by the contractor in the completion of the contract.

IAS 11 defines incentive payments and states that they should be included in revenue to the extent that it is probable that they will result in revenue and they are capable of being measured reliably.

IFRS 15 states that an amount of consideration can vary because of discounts, rebates, refunds, credits, price concessions, incentives, performance bonuses, penalties or because the consideration is contingent on the occurrence or non-occurrence of a future event.

IFRS 15 requires a company to estimate an amount of variable consideration by using one of the following two methods, depending on which the entity expects to better predict the amount of consideration to which it will be entitled:

The expected value

- Sum of probability-weighted amounts in a range of possible consideration amounts
- Appropriate estimate for a large number of contracts with similar characteristics

The most likely amount

- Single most likely outcome of the contract
- Appropriate estimate for a contract with only 2 possible outcomes

The company then includes in the transaction price some or all of the amount of variable consideration estimated only to the extent that it is highly probable that a significant reversal in the amount of cumulative revenue recognised will not occur.

What increases the likelihood or magnitude of a revenue reversal?

- The amount of consideration is highly susceptible to factors outside the entity's influence.
- The uncertainty about the amount of consideration is not expected to be resolved for a long period of time.
- The entity's experience with similar types of contracts is limited or has limited predictive value.
- The entity has a practice of offering a broad range of price concessions or changing payment terms / conditions of similar contracts in similar circumstances.
- The contract has a large number and broad range of possible consideration amounts.

Key implications:

The requirement to estimate the amount of variable consideration, using one of two methods, and then constrain that estimate may lead to changes in accounting practices. We recommend that companies consider the need for changes to systems and processes to ensure compliance with the new requirements. The impact of any changes to reported figures should be assessed, as well as the need to communicate such changes to key stakeholders.

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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 of 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
- Licensing
- Principal versus spent considerations

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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