Revenue from contracts with customers
What is your implementation effect?
Table of contents

Introduction 3
Five-step model 4
Complex issues 11
  - Long-term contracts and POC measurement 11
  - Variable consideration 14
  - Principal-Agent 15
  - Licenses 16
  - Recognition of accounts receivable 17
Implementation 18
Transition 19
Disclosure 21
Resources 22
Contacting PwC 23
Introduction

The objective of IFRS 15 is to establish the principles that an entity shall apply to report useful information to users of financial statements about the nature, amount, timing, and uncertainty of revenue and cash flows arising from a contract with a customer. Companies using IFRS must implement IFRS 15 Revenue from Contracts with Customers for reporting periods beginning on or after 1 January 2018. IFRS 15 has been endorsed by the EU. IFRS 15 replaces IAS 18 and IAS 11, which currently provide separate revenue recognition guidance for goods and services and for construction contracts. IFRS 15 is based on a single revenue recognition model that distinguishes between promises to a customer that are satisfied at a point in time and those that are satisfied over time based on the transfer of control. IFRS 15 does not distinguish between sales of goods, services or construction contracts. A key feature of IFRS 15 is the concept of defining revenue transactions based on specific contractual performance obligations with revenue recognized over time or at a point in time.

Revenue is recognised when control of a good or service transfers to a customer. The notion of control expands upon the current concept of risks and rewards in the existing guidance. The IFRS 15 focus on control is a broader definition that includes transfer of risks and rewards as one of the indicators of control. A significant change with IFRS 15 is that this standard provides additional guidance as compared to the existing standards. For example, IFRS 15 has more detail on multiple element arrangements and variable consideration and provides specific guidance on the accounting for licences, customer options and repurchase arrangements. This is likely to affect existing practice, especially in complex arrangements where existing guidance is limited.

IFRS 15 will significantly change how many entities recognise revenue. The implementation process will involve individuals across many levels in the organisation and, at a minimum, will necessitate a thorough documentation of customer contracts within the scope of IFRS 15 and a revamping of revenue related financial statement disclosures.
The current revenue standards focus on an earnings process, but difficulties often arise in determining when revenue is earned and can therefore be recognised. IFRS 15 establishes a more consistent application by using a single, contract-based model where revenue recognition is based on changes in contract assets (rights to receive consideration), and liabilities (obligations to provide a good or perform a service). Under the new model, revenue is recognised based on the satisfaction of performance obligations. In applying the new model, entities will follow this five-step process, which is performed at contract inception and always in the given order:

**Five-step model**

The current revenue standards focus on an earnings process, but difficulties often arise in determining when revenue is earned and can therefore be recognised. IFRS 15 establishes a more consistent application by using a single, contract-based model where revenue recognition is based on changes in contract assets (rights to receive consideration), and liabilities (obligations to provide a good or perform a service). Under the new model, revenue is recognised based on the satisfaction of performance obligations. In applying the new model, entities will follow this five-step process, which is performed at contract inception and always in the given order:

1. **Step 1 - Identify the contract with a customer**
   The first step is to identify the customer contract. The definition of a contract emphasises that a contract exists when an agreement between two or more parties creates enforceable obligations between those parties. The concept of enforceable might vary based on governing laws, regulations or practice. Consultations with legal counsel are advisable when implementing IFRS 15 or evaluating new contracts, especially related to the seller’s enforceable right to payment, which is a key consideration in Step 3 Determine the transaction price.

   IFRS 15 specifies the attributes of a contract that must be present before an entity would apply the proposed revenue requirements. These attributes are:

   1. The parties to the contract have approved the contract - in writing, orally or in accordance with other customary business practices - and are committed to perform their respective obligations,
   2. the entity can identify each party’s rights regarding the goods or services to be transferred,
   3. the entity can identify the payment terms for the goods or services to be transferred,
   4. the contract has commercial substance (i.e. the risk, timing or amount of the entity’s future cash flows is expected to change as a result of the contract), and
   5. it is highly 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.

   One of the criteria to determine whether a contract exists is the customer’s ability to pay. If there is significant doubt about whether the customer will pay the amount to which the entity is entitled, there is no contract. Once a contract has been determined to exist and revenue is recognised, any subsequent impairment of receivables as a result of customer default is recognised in accordance with the existing guidance for financial asset impairment.
It is important to note that income from transactions or events that does not arise from contracts with a customer is not in scope of IFRS 15, and should continue to be recognised in accordance with other standards. Such transactions or events typically include dividends, fair value changes of investment property and gains or losses from the sale of property, plant and equipment.

**Contract modifications**
A change to an existing contract that creates or changes the enforceable rights and obligations of the contractual parties is a contract modification. Modifications are either accounted for as part of the original contract or as a separate contract depending on the nature of the modification. The following figure summarizes the accounting for contract modifications.

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**Figure 1: Accounting for contract modifications**

1. **Is the contract modification approved?**
   - Yes
   - No → No change to accounting until modification approved

2. **Does the modification only affect the transaction price?**
   - Yes
   - No

3. **Does the modification add distinct goods or services?**
   - Yes
   - No → Account for modification through a cumulative catch-up adjustment

4. **Does the contract price increase by an amount that reflects the standalone selling price of the additional distinct goods or services?**
   - Yes
   - No

5. **Are the remaining goods or services distinct?**
   - Yes
   - No → Account for modification prospectively

6. **Account for modification as a separate contract**
Step 2 – Identify the performance obligations

A performance obligation is a promise in a contract with a customer 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. Examples of promised goods or services include:

- Goods produced for sale or purchased for resale
- Standing ready to provide goods and services
- Construction services
- Granting licences
- Granting options to purchase additional goods and services

When determining at contract inception the number of performance obligations in a contract, it is necessary to understand what it is the customer expects to receive as the final product. This evaluation is made from the point of view of the customer. For example, building a house will naturally include the delivery of a series of distinct goods and services, but the customer will perceive the house as one, integrated delivery. Sale of the house is therefore one performance obligation.

Significant judgement is often required to identify the performance obligations within a contract. Performance obligations do not include activities that an entity undertakes to fulfil a contract unless it results in the transfer of a good or service to a customer. For example, administration costs or on-boarding activities to set up a customer account would not be a separate performance obligation (and therefore not give rise to revenue recognition when performed or invoiced). A good or service that is separately identifiable from other promises in the contract might be a separate performance obligation, e.g. shipping and handling services, if control of the goods transfers to the customer before shipment.

A performance obligation is a key building block in applying this standard. In Step 3 the transaction price is determined, in Step 4 the transaction price is allocated to each separate performance obligation and in Step 5 the recognition criteria are applied individually to each separate performance obligation to determine correct revenue recognition timing.

Step 3 – Determining the transaction price

The transaction price is the amount of consideration to which an entity expects to be entitled in exchange for transferring goods or services and includes those amounts to which the entity has rights under the present contract.

Determining the transaction price can be straightforward, such as where a contract is for a fixed amount of consideration in return for a fixed number of goods or services in a reasonably short time frame. However, complexities can arise where a contract includes elements like variable consideration, a significant financing component, non-cash consideration or consideration payable to a customer. IFRS 15 includes specific guidance dealing with these issues and a number of other transaction price complexities.

In the case of variable consideration, IFRS 15 requires an entity to estimate the amount of variable consideration to which it will be entitled at contract inception. Common forms of variable consideration include price discounts, refunds, rebates, credits, incentives, performance bonuses and royalties. Variable consideration is estimated using a best estimate or weighted average approach, whichever best reflects the amount to which the entity expects to be entitled. If an entity cannot reasonably estimate, for example, the fair value of non-cash consideration received, the entity shall measure the consideration indirectly by reference to the stand-alone selling price of the goods or services given in exchange for the non-cash consideration.

The case of volume discounts is illustrated below. Please also refer to the section Complex Issues - Variable consideration for a more detailed discussion related to the measurement of variable consideration.
Example: Volume discounts

Volume discounts are offered to customers as an incentive to encourage additional purchases and maintain customer loyalty. Some volume discounts apply retroactively once the customer completes a specified volume of purchases. Other volume discounts only apply prospectively to future purchases that are optional.

Discounts that are retroactive should be accounted for as variable consideration because the transaction price is uncertain until the customer completes their purchases or the contract term expires. Discounts that apply only to future, optional purchases should be assessed to determine if they provide a material right. Both prospective and retrospective volume discounts will typically result in the deferral of revenue if the customer is expected to make future purchases in order to obtain the volume discount.

On 1 January 2017 Chemical AS enters into a one-year contract with a government municipality to deliver water treatment chemicals. The contract stipulates that the price per container will be adjusted retroactively once the municipality reaches a certain sales volume, defined as follows:

<table>
<thead>
<tr>
<th>Price per container</th>
<th>Containers</th>
</tr>
</thead>
<tbody>
<tr>
<td>NOK 100</td>
<td>0–1,000,000</td>
</tr>
<tr>
<td>NOK 90</td>
<td>1,000,001–3,000,000</td>
</tr>
<tr>
<td>NOK 85</td>
<td>3,000,001 containers and above</td>
</tr>
</tbody>
</table>

Volume is determined based on sales during the calendar year. There are no minimum purchase requirements. Chemical AS estimates that the total sales volume for the year will be 2.8 million containers based on experience with similar contracts and forecasted sales to the municipality. Chemical AS sells 700,000 containers to Municipality during the first quarter ended 31 March 2017 for a contract price of NOK 100 per container.

How should Chemical AS determine the transaction price?
The transaction price is NOK 90 per container based on Chemical AS’s estimate of total sales volume for the year, since the estimated cumulative sales volume of 2.8 million containers would result in a price per container of NOK 90. Chemical AS concludes that, based on a transaction price of NOK 90 per container, it is highly probable that a significant reversal in the amount of cumulative revenue recognized will not occur when the uncertainty is resolved. Revenue is therefore recognized at a selling price of NOK 90 per container as each container is sold.

Chemical Co will recognize a liability for cash received in excess of the transaction price for the first one million containers sold at NOK 100 per container (that is, NOK 10 per container) until the cumulative sales volume is reached for the next pricing tier and the price is retroactively reduced.

For the quarter ended 31 March 2017, Chemical AS recognizes revenue of NOK 63 million (700,000 containers * NOK 90) and a liability of NOK 7 million (700,000 containers * (NOK 100–90)).

Chemical AS will update its estimate of the total sales volume at each reporting date until the uncertainty is resolved.
Customer contracts often provide the customer or the entity with a significant financing benefit. A significant financing benefit will exist when performance by an entity and payment by its customer occur at significantly different times, due to both advance payments from customers and customer credits. In accordance with IFRS 15 an entity shall adjust the transaction price for the time value of money if the contract includes a significant financing component. IFRS 15 allows for a practical expedient to disregard the time value of money if the time between the transfer of goods or services and payment is less than twelve months. Identification of a significant financing component will result in dividing the cash received from the customer between the profit or loss line time Revenue and a Financial line item.

Customer contracts in some instances will specify terms that can lead to consideration paid to a customer. These payments will reduce the transaction price unless such consideration is a payment for a distinct good or service received by the seller from the customer. This includes both cash amounts and credit that can be applied against amounts owed to the entity. An entity will recognise the reduction of revenue when the later of the following occurs:

1. The entity recognises revenue for the transfer of the related goods or services to the customer; or
2. The entity pays or promises to pay the consideration even if the payment is conditional on a future event. That promise might be implied by the entity’s customary business practices.

**Step 4 – Allocating the transaction price**

Many customer contracts involve the sale of more than one good or service. Entities that sell multiple goods or services in a single arrangement must allocate the consideration to each of those goods or services. This allocation is based on the price an entity would charge a customer on a stand-alone basis for each good or service. Management should first consider observable data to estimate the stand-alone selling price. An entity will need to estimate the stand-alone selling price if such data does not exist. Some entities will need to determine the stand-alone selling price of goods or services that have not previously required this assessment.

If management estimates the selling price because a stand-alone selling price is not available, they should maximize the use of observable inputs. Possible estimation methods include:

- Expected cost plus reasonable margin
- Assessment of market prices for similar goods or services
- Residual approach, in certain circumstances

A residual approach may be used to calculate the stand-alone selling price when the selling price is highly variable or uncertain for one or more goods or services, regardless of whether that good or service is delivered at the beginning or at the end of the contract. A selling price is highly variable when an entity sells the same good or service to different customers for a broad range of prices. A selling price is uncertain when an entity has not yet established a price for a good or service or the good or service has not been sold previously.

Changes to the transaction price, including changes in the estimate of variable consideration, might only affect one performance obligation. Such changes would be allocated to that performance obligation rather than all performance obligations in the arrangement if both of the following criteria are met:

- The contingent payment terms relate to a specific performance obligation or outcome from satisfying that performance obligation, and
- Allocating the contingent amount of consideration entirely to the separate performance obligation is consistent with the amount of consideration that the entity expects to be entitled for that performance obligation.
Step 5 – Recognition of revenue

IFRS 15 has replaced the separate models for goods, services and construction contracts with a single model that distinguishes between performance obligations satisfied at a point in time and those that are satisfied over time. The recognition framework is applied to each performance obligation separately - that is, each distinct good or service.

The recognition model requires that management consider whether a performance obligation is satisfied over time.

A performance obligation is satisfied over time if one of following three criteria is met:

1. Revenue is recognised over time if the customer simultaneously receives and consumes all of the benefits provided as the entity performs, typically a daily cleaning service, or

2. Revenue is recognised over time if performance creates or enhances an asset that the customer controls,

3. Revenue is recognised over time when performance does not create an asset with an alternative use and the entity has an enforceable right to payment for performance completed to date.

Figure 2: When does control transfer over time?
This final criterion is more complicated and requires consideration of both whether an asset has an alternative use and the nature of any enforceable rights to payment. The most common example of an activity that does not create an asset with alternative use is a service where there is no asset created, for example, legal or audit services. It also applies when a physical asset is created but has no alternative use to the supplier, for example, the construction of highly customised equipment that could not be sold to another customer, even with modification.

It is also a necessary contract condition that the entity has the right to payment for work completed to date if the customer cancels the contract. This does not need to be in the form of an upfront payment or progress payments. It could be in other forms, for example, a cancellation penalty.

Judgment is required when the right to payment relies on a cancellation provision or milestone payments. The key consideration is whether the payment reflects the work performed to date including a reasonable profit margin. IFRS 15 is explicit that recovery of only cost incurred to date does not meet the standards criteria for right to payment.

If a performance obligation is satisfied over time, revenue is recognised by measuring the progress towards satisfaction of the performance obligation. This might be determined based on output or input methods, whatever best reflects the transfer of control to the customer. Specific guidance is given in IFRS 15 on selecting an appropriate performance measurement method. If the performance obligation is not satisfied over time, revenue is recognised when control is transferred to the customer, based on judgement based on indicators of control. No one indicator is definitive and all indicators should be considered when determining the point of transfer.

The timing of revenue recognition will change for some entities compared to the current guidance, which is more focused on the transfer of risks and rewards than on the transfer of control, which is a broader concept under IFRS 15. The transfer of risks and rewards is only one of five IFRS 15 indicators of whether control has transferred. All indicators should be considered when evaluating the transfer of control, both qualitatively and quantitatively.

The indicators are:

1. The entity has a present right to payment for the asset.
2. The customer has legal title to the asset unless legal title is retained solely as protection against the customer’s failure to pay.
3. The customer physically possesses the asset.
4. The customer is exposed to the significant risks and rewards of ownership of the asset.
5. The customer has accepted the asset.
Complex issues

Some contracts extend over a longer timeframe; for example delivering services over several years or manufacturing an asset for a customer over more than a 12 months’ time period. These long-term construction contracts have two specific revenue recognition issues that must be addressed by the entity when first adopting IFRS 15 or at the inception of each new contract. As the guidance and criteria in IFRS 15 are conceptually different from the current guidance in IAS 11, it cannot be assumed IAS 11 revenue recognition timing patterns or the measurement of progress over time will be the same as under IFRS 15.

Long-term contracts and POC measurement
Timing of revenue recognition
As described in the five-step model earlier there are three criteria for evaluating transfer of control and hence if revenue recognition occurs over time. If the criteria for over time recognition are not met, recognition is at a point in time. The three criteria are:

1. Customer consumes simultaneously
   The customer simultaneously receives and consumes the benefits provided by the entity’s performance as the entity performs.

2. Customer controls the assets
   The entity’s performance creates or enhances an asset that the customer controls as the asset is created or enhanced.

3. No alternative use with right to payment
   The entity’s performance does not create an asset with alternative use to the entity and the entity has an enforceable right to payment for performance completed to date.

For entities delivering services the first criterion of simultaneous consumption is often the determining relevant recognition criterion. Shipping services are an example where the customer receives and consumes the benefits as the entity fulfills its obligation. Another entity would not substantially reperform the work completed to date to satisfy the remaining obligation.

If the customer controls the work in progress as an entity manufactures or provides services the second criterion applies. Examples of such contracts include R&D contracts where the customer owns the findings or manufacturing contracts where the customer controls the work-in-progress.

The third criterion consists of two elements, that the asset has no alternative use and that there is an enforceable right to payment for the work completed to date. The asset has no alternative use if the entity is unable to redirect it for another use or to another customer, for example if the entity enters into a contract to build customized equipment such as a newbuild vessel that is built to the shipper’s specifications. The shipyard is unable to sell the vessel to another party due to contract terms or because the vessel is customised. However, for the point in time criterion to be applicable the entity must also have a clearly enforceable right to payment for the performance completed to date that includes a profit margin. If this is not the case, revenue cannot be recognized over time, but must be recognized when the asset is transferred at completion.
Example: 
Construction contract revenue recognition over time
A vendor enters into a contract to produce a significantly customised product for a customer. Management has determined that the contract is a single performance obligation. The contract has the following characteristics:
• The customisation is significant and customer’s specifications may be changed at the customer’s request during the contract term.
• Non-refundable, interim progress payments are required to finance the contract.
• The customer can cancel the contract at any time (with a termination penalty) and any work in process has no alternative use to the vendor.
• Physical possession and title do not pass until completion of the contract.

How should the vendor recognise revenue, over time or at a point in time?
The terms of the contract, in particular the customer specifications (and ability to change the specifications) indicate that the work-in-process has no alternative use to the vendor, and the non-refundable progress payments suggest that control of the asset is being transferred over the contract term. Revenue should be recognised over time as the asset is produced.

Example: 
Construction contract revenue recognition point in time
A vendor enters into a contract to construct several products for a customer. Management has determined that the contract is a single performance obligation. The contract has the following characteristics:
• The majority of the payments are due after the products have been installed.
• The customer can cancel the contract at any time (with a termination penalty) and any work in process remains the property of the vendor.
• The work in process can be completed and sold to another customer.
• Physical possession and title do not pass until completion of the contract.

How should the vendor recognise revenue?
The terms of the contract, in particular payment upon completion and the inability of the customer to retain work in process, suggest that control of the product is transferred at a point in time. The vendor will not recognise revenue until control of the product has transferred to the customer.
**Measures of progress over time**

Management will need to select the most appropriate measurement model (either an input or output method) to measure the revenue arising from the transfer of control of the product over time. IFRS 15 requires use of the method that best measures the transfer of control, and allows the use of either an input or output method for measuring progress completion of the performance obligations. Note that progress is measured for each performance obligation, and not at the contract level.

Management should select the method that best depicts the transfer of control of goods and services to the customer:

1. **Input methods**
   - Recognise revenue based on cost incurred, labour hours expended, time lapsed, or machine hours used.

2. **Output methods**
   - Recognise revenue based on units produced or delivered, contract milestones, or surveys of work performed.

Input methods should represent the transfer of control of the asset or service to the customer and should therefore exclude the costs of any activities that do not depict the transfer of control (for example, owner supplies, overhead incurred not related to transfer of control, abnormal amounts of wasted materials).

Outputs used to measure progress may not be directly observable and the information to apply them may not be available without undue cost. In such cases an input method may be necessary.

Output methods such as ‘units produced’ or ‘units delivered’ may not faithfully depict an entity’s performance if at the end of the reporting period the value of work-in-progress or finished goods controlled by the customer is material or if the contract provides both design and production services. In such cases, each item produced or delivered may not transfer an equal amount of value to the customer.

**Figure 3: Estimating progress over time**

- Management determines the total transaction price which includes an estimate of any variable consideration at contract inception.
- Reassess the estimate at each reporting date.
- Use the estimation method that best predicts.
- Method should be applied consistently throughout the contract.

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**Expected value**

The expected value is the sum of the probability weighted amounts in a range of possible consideration amounts.

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**Most likely amount**

The most most likely amount is the single most likely amount in a range of possible consideration amounts (that is, the most likely outcome of the contract).

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If an entity has a large number of contracts that have similar characteristics.

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If the contract has only two possible outcomes (e.g. an entity achieves a performance bonus or does not).
**Variable consideration**

The transaction price might include an element of consideration that is variable or contingent on the outcome of future events. Examples of such variables are price discounts, refunds, rebates, credits, incentives, performance bonuses and royalties. An entity’s practices, policies or statements might also result in variable consideration, for example, if they indicate that the entity will provide price concessions.

Variable consideration should be estimated using the most predictive method, either Expected value or Most likely amount.

The evaluation of variable consideration requires judgement. Entities that defer revenue recognition under the current guidance because prices could not be measured reliably could be significantly affected by the new standard. Entities could be required to recognize some minimum amount of revenue when control is transferred.

Variable consideration included in the transaction price is subject to a constraint. An entity should recognize revenue as performance obligations are satisfied only if it is “highly probable” that a change in the estimate of the variable consideration would not result in a significant reversal of the cumulative revenue recognized. The factors in the table to the right suggest aspects of variable consideration in the transaction price that could result in significant reversal of revenue.

Management needs to determine if there is a portion of the variable consideration (some minimum amount) that should be included in the transaction price, even if the entire estimate of variable consideration is not included due to the constraints.

<table>
<thead>
<tr>
<th>All of the following factors should be considered.</th>
</tr>
</thead>
<tbody>
<tr>
<td><strong>a) Factors outside the entities influence</strong> Can effect an entity's ability to estimate the amounts of variable considerations.</td>
</tr>
</tbody>
</table>
| • Volatility in a market  
• The judgement or actions of third parties  
• Weather conditions  
• High risk of obsolescence of the promised good or services |
| **b) Timeframe** The uncertainty of the amount of consideration is not expected to be resolved for a long time period. |
| **c) Entities previous experience** The entities experience (or evidence) with similar types of contracts is limited, or that experience (or other evidence) has limited predicative value. |
| **d) Entities previous practice for changing contract terms** The entity has a practice of either offering a broad range of price consessions or changing the payment term and conditions of similar contracts in similar circumstances - might find it more difficult to predict. |
| **e) Possible outcomes** The contract has a large number and broad range of possible considerations. |
Principals-Agent

Some arrangements involve two or more unrelated parties that contribute to providing a specified good or service to a customer. Management will need to determine, in these instances, whether the entity has promised to provide the specified good or service itself, as a principal, or to arrange for those specified goods or services to be provided by another party, as an agent. This determination often requires judgment and different conclusions can significantly impact the amount and timing of revenue recognition.

Examples of principal-agent arrangements include internet advertising, internet sales, sales of virtual goods and mobile applications/games, consignment sales, sales through a travel or ticket agency, sales where subcontractors fulfill some or all of the contractual obligations, and sales of services provided by a third-party service provider.

The difference in the amount and timing of revenue recognized can be significant depending on the conclusion of whether an entity is the principal in a transaction or an agent. This conclusion determines whether the entity recognizes revenue on a “gross” or “net” basis. The principal recognizes as revenue the “gross” amount paid by the customer for the specified good or service. The principal records a corresponding expense for the commission or fee it has to pay any agent in addition to the direct costs of satisfying the contract.

An agent records as revenue the commission or fee earned for facilitating the transfer of the specified goods or service. In other words, it records as revenue the net consideration it retains after paying the principal for the specified goods or services that were provided to the customer.

Example:

Entity is an agent

NettBok AS operates a website that sells books. NettBok AS enters into a contract with Bookstore to sell Bookstore’s books on-line. NettBok AS’ website facilitates payments between Bookstore and the customer. The sales price is established by Bookstore and NettBok AS earns a commission equal to 5% of the sales price. Bookstore ships the books directly to the customer; however, the customer returns the books to NettBok AS if they are dissatisfied. NettBok AS has the right to return books to Bookstore without penalty if they are returned by the customer.

Is NettBok AS the principal or agent for the sale of books to the customer?

NettBok AS is acting as the agent of Bookstore and should recognize commission revenue for the sales made on Bookstore’s behalf; that is, it should recognize revenue on a net basis. The specified good or service in this arrangement is a book purchased by the customer. NettBok AS does not control the books before they are transferred to the customer. NettBok AS does not have the ability to direct the use of the goods transferred to customers and does not control Bookstore’s inventory of goods. NettBok AS is also not responsible for the fulfillment of orders and does not have discretion in establishing prices of the books. Although customers return books to NettBok AS, NettBok AS has the right to return the books to Bookstore and therefore does not have substantive inventory risk. The indicators therefore support that NettBok AS is not the principal for the sale of Bookstore’s books.

NettBok AS should recognize commission revenue when it satisfies its promise to facilitate a sale - that is, when the books are purchased by a customer.

Entity is the principal

Nettreiser AS negotiates with major airlines to obtain access to airline tickets at reduced rates and sells the tickets to its customers through its website. Nettreiser AS contracts with the airlines to buy a specific number of tickets at agreed-upon rates and must pay for those tickets regardless of whether it is able to resell them. Customers visiting Nettreiser AS’s website search Nettreiser AS’s available tickets. Nettreiser AS has discretion in establishing the prices for the tickets it sells to its customers. Nettreiser AS is responsible for delivering the ticket to the customer, and will also assist the customer in resolving complaints with the service provided by the airlines. The airline is responsible for fulfilling all other obligations associated with the ticket, including the air travel services and the flight, and remedies for service dissatisfaction.

Is Nettreiser AS the principal or agent for the sale of airline tickets to customers?

Nettreiser AS is the principal and should recognize revenue for the gross fee charged to customers. The specified good or service is a ticket that provides a customer with the right to fly on the selected flight. Nettreiser AS controls the ticket prior to transfer of the ticket to the customer.

Nettreiser AS has the ability to direct the use of the ticket and obtains the remaining benefits from the ticket by reselling the ticket or using the ticket itself. Nettreiser AS also has inventory risk before the ticket is transferred to the customer and discretion in establishing the price of the ticket. The indicators therefore support that Nettreiser AS is the principal.

Nettreiser AS should recognize the gross revenue when it satisfies its promise to provide a right to a specific air travel flight - that is, when the tickets are purchased by a customer.
**Licenses**

A licence is the right to use an entity’s intellectual property including, among others: software and technology, media and entertainment rights, franchises, patents, trademarks, and copyrights. Given the diversity in the types of licences granted, there is not a ‘one size fits all’ approach to accounting for licences.

Entities that license their IP to customers will need to determine whether the licence transfers to the customer over time or at a point in time. IFRS 15 distinguishes between two types of licences, right to use and a right of access. If the customer has right to use the result will be revenue recognition at point in time. If the customer has right to access, revenue is recognised over time.

There are a number of examples in IFRS 15 and significant judgment is required in this area. The fact that licences come in a variety of forms and are common in a number of industries makes it challenging to apply a single, principles-based model.

It is important to remember that even licences for which the consideration is a sales- or usage-based royalty will be subject to the exception for variable consideration which permits revenue to be recognised only when the sales or usage occur.

**Figure 5: Intellectual property - two types**

<table>
<thead>
<tr>
<th>Right to use</th>
<th>Right to access</th>
</tr>
</thead>
<tbody>
<tr>
<td>Right to use IP as exists at a point in time.</td>
<td>Right to access to IP as at exists through out the licence period.</td>
</tr>
<tr>
<td>Revenue recognised at a point in time.</td>
<td>Revenue recognised over time.</td>
</tr>
</tbody>
</table>

**Right to access if all of the following criteria are met:**

- Licensor performs activities that significantly affect the IP.
- The rights expose customers to effects of those activities.
- Activities are not a separate good/service.

| Judgment required |

**Example:**

Programvare AS provides a fixed-term software license to Teknologi AS. The terms of the arrangement allow Teknologi AS to download the software by using a unique digital key provided by Programvare AS. Teknologi AS can use the software on its own server. The software is functional when it transfers to Teknologi AS. Teknologi AS also purchases customer support service with the software license. There is no expectation for Programvare AS to undertake any activities other than the customer support. The license and support are distinct as Teknologi AS can benefit from the license on its own and the license is separable from the customer support.

**What is the nature of the license in this arrangement?**

Customer support is not considered an “activity” that affects the IP because it is a separate performance obligation. The IP has significant standalone functionality and Programvare AS is not expected to perform any activities that affect that functionality. Therefore, Programvare AS’s does not perform activities that significantly affect the IP to which the customer has rights. The three criteria required for a right to access IP over time are not met.

The license provides a right to use IP. Programvare AS will recognize revenue at a point in time when Teknologi AS is able to use and benefit from the license.

Customer support is a separate performance obligation in this arrangement and does not impact the assessment of the nature of the license.
Recognition of accounts receivable
Implementing IFRS 15 can lead to changes in accounting principles for recognising accounts receivables for customer contracts where revenue is recognized over time. The new standard clearly states that an entity can only recognise a receivable if it has an unconditional right to the consideration. There is consequently no direct relationship between actual invoicing to the customers, and the recognition of the accounts receivables, as the recognition of a receivable is only dependent on satisfying the performance obligation.

Meeting the full performance obligation from a customer contract will always lead to a recognition of a receivable. Partial completion of a performance obligation may lead to the recognition of a contract asset or a contract receivable depending if the customer contract states an unconditional right to consideration.

The figure below summarises different scenarios resulting in the recognition of accounts receivables, contract assets and contract liabilities:

*An entity might conclude it has an unconditional right to consideration if the transaction price varies solely due to future changes in market price (for example, after the entity has already satisfied its performance obligations).
Implementation

The diagram below indicates an implementation timeline assuming the IFRS 15 analysis starts in 2016. IFRS 15 has an implementation date of 1 January 2018, so starting in 2016 will require sufficient resource allocation, valid assessments of the anticipated implementation effect and a well-formulated project plan to put into place needed internal controls, processes and IT-system changes in order to meet the implementation deadline. IFRS 15 implementation analysis occurs at the customer contract level; this analysis will potentially involve the entire organization, as the individuals responsible for the financial reporting work to understand the accounting impact of IFRS 15 on their organization.

Decisions in the implementation phase include deciding the new accounting principles related to revenue recognition, assessment of the entities revenue streams and how specific customer contract terms affect the timing and amount of revenue recognition based on the IFRS 15 principles. The transition method, full retrospective or modified approach should be decided as soon as possible so the organisation can work effectively collecting the needed data for the transition disclosures and adjustments to opening equity balances upon implementation.

Disclosures are required related to IFRS 15 even before the implementation date, in accordance with IAS 8.30-31 to give information about the effect of new standards not yet implemented.

According to ESMA the 2016 financial statement reporting should include a “Detailed description and explanation on how key IFRS 15 concepts will be implemented along the different revenue streams (e.g. identification of performance obligations, determination and allocation of the transaction price and how performance obligations are satisfied and revenue is recognised). Where relevant, highlight the differences to the current approaches….If known or reasonably estimable, quantification of the possible impact of the application of IFRS 15 either (e.g. in relation to the amount or timing of the revenue recognised in relation to the different revenue streams). When the quantitative information is not disclosed because it is unknown or not reasonably estimable, additional qualitative information enabling users to understand the magnitude of the expected impact on the financial statements of the issuer.”

Figure 7: Implementation timeline

<table>
<thead>
<tr>
<th>2016</th>
<th>2016/2017</th>
<th>2017</th>
<th>2018</th>
</tr>
</thead>
<tbody>
<tr>
<td><strong>Assess and plan</strong></td>
<td><strong>Design / build</strong></td>
<td><strong>Implement / Deploy</strong></td>
<td><strong>Go live</strong></td>
</tr>
<tr>
<td>• Effect on financial information</td>
<td>• Decide new accounting principles</td>
<td>• Data mitigation, testing</td>
<td>• Open GAP analysis</td>
</tr>
<tr>
<td>• IT-systems</td>
<td>• Data integration</td>
<td>• Impact analysis</td>
<td></td>
</tr>
<tr>
<td>• Internal control and processes</td>
<td>• Data mitigation, testing</td>
<td>• Reporting</td>
<td></td>
</tr>
<tr>
<td>• Project set-up</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>• Roadmap</td>
<td></td>
<td></td>
<td></td>
</tr>
</tbody>
</table>

Impact risk assessment (H/L) YE 2016 disclosure IAS 8.30 2017 shadow accounting IFRS 15 implementation
IFRS 15 and IAS 8 allow entities to apply one of two transition methods:

- Full retrospective application, or the
- Modified retrospective application.

Management should consider the information needs of investors and other users of the financial statements in deciding the preferred transition method to follow. The full retrospective application gives comparable information to investors as all comparative periods are presented using the same IFRS guidance (i.e. IFRS 15), whereas the modified retrospective application might be more easily applied by the entity, depending on the type and term of the customer contracts. Both methods have practical expedients and extensive disclosure requirements as described in the table on the following page.
### Transition overview

<table>
<thead>
<tr>
<th></th>
<th>Retrospective application</th>
<th>Modified retrospective application</th>
</tr>
</thead>
<tbody>
<tr>
<td><strong>Approach</strong></td>
<td>Restating all prior reporting periods: applying the new guidance to each prior reporting</td>
<td>Applying the new guidance only to contracts that are not completed at the adoption date.</td>
</tr>
<tr>
<td></td>
<td>period presented.</td>
<td>Do not adjust prior reporting periods.</td>
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<tr>
<td></td>
<td></td>
<td>Will recognize the cumulative effect of initially applying the revenue standard as an adjustment to the</td>
</tr>
<tr>
<td></td>
<td></td>
<td>opening balance of retained earnings in the period of initial application.</td>
</tr>
<tr>
<td><strong>Practical expedients</strong></td>
<td>For both methods an entity can elect to apply certain practical expedients, and are</td>
<td>Can elect to apply the revenue standard only to contracts that are not completed at date of initial</td>
</tr>
<tr>
<td>- both methods</td>
<td>allowed to use any combination of several practical expedients:</td>
<td>application.</td>
</tr>
<tr>
<td></td>
<td>• For completed contracts, an entity need not restate contracts that begin and end within</td>
<td></td>
</tr>
<tr>
<td></td>
<td>the same annual reporting period.</td>
<td></td>
</tr>
<tr>
<td></td>
<td>• For completed contracts that have variable consideration, an entity can use hindsight and</td>
<td></td>
</tr>
<tr>
<td></td>
<td>use the transaction price at the date the contract was completed.</td>
<td></td>
</tr>
<tr>
<td></td>
<td>• For all reporting periods presented before the date of initial application (for example,</td>
<td></td>
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<tr>
<td></td>
<td>1 January 2018 for an entity with a 31 December year-end), an entity is not required to</td>
<td></td>
</tr>
<tr>
<td></td>
<td>disclose the amount of transaction price allocated to the remaining performance obligations and an explanation</td>
<td></td>
</tr>
<tr>
<td></td>
<td>of when the entity expects to recognise that amount as revenue.</td>
<td></td>
</tr>
<tr>
<td></td>
<td>• For contracts that were modified before the beginning of the earliest period presented,</td>
<td></td>
</tr>
<tr>
<td></td>
<td>an entity need not retrospectively restate the contract for those contract modifications.</td>
<td></td>
</tr>
<tr>
<td></td>
<td>Instead, an entity shall reflect the aggregate effect of all of the modifications that</td>
<td></td>
</tr>
<tr>
<td></td>
<td>occur before the beginning of the earliest period presented.</td>
<td></td>
</tr>
<tr>
<td></td>
<td>Expedites also relate to: (IFRS 15.C5)</td>
<td></td>
</tr>
<tr>
<td></td>
<td>• Completed contracts</td>
<td></td>
</tr>
<tr>
<td></td>
<td>• Estimation of variable consideration</td>
<td></td>
</tr>
<tr>
<td></td>
<td>• Contract modifications</td>
<td></td>
</tr>
<tr>
<td><strong>Practical expedients</strong></td>
<td>..................................................................................................................................................</td>
<td></td>
</tr>
<tr>
<td>- modified</td>
<td>..................................................................................................................................................</td>
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<td></td>
<td>..................................................................................................................................................</td>
<td></td>
</tr>
<tr>
<td><strong>Disclosure in first</strong></td>
<td>..................................................................................................................................................</td>
<td></td>
</tr>
<tr>
<td>reporting period</td>
<td>..................................................................................................................................................</td>
<td></td>
</tr>
<tr>
<td>after implementation</td>
<td>..................................................................................................................................................</td>
<td></td>
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<tr>
<td>of IFRS 15</td>
<td>..................................................................................................................................................</td>
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<tr>
<td></td>
<td>If the entity uses any of the practical expedients the entity must disclose that they used the expedient and provide a qualitative assessment of the estimated effect of applying each expedient.</td>
<td>The amount by which each financial statement line item is affected in the current year as a result of applying the standard is a required disclosure.</td>
</tr>
<tr>
<td></td>
<td>The effect of adopting the revenue standard must be disclosed on each financial statement line item and the effect on basic and diluted earnings per share for the immediately preceding reporting period.</td>
<td>A qualitative explanation of the significant changes between reported results under the old and the new standards.</td>
</tr>
<tr>
<td><strong>Other Financial</strong></td>
<td>..................................................................................................................................................</td>
<td></td>
</tr>
<tr>
<td>statement line items</td>
<td>..................................................................................................................................................</td>
<td></td>
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<tr>
<td>that might be</td>
<td>..................................................................................................................................................</td>
<td></td>
</tr>
<tr>
<td>affected are:</td>
<td>..................................................................................................................................................</td>
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<tr>
<td></td>
<td>Assets recognized from the costs to obtain or fulfill a contract to the extent that such costs were expenses under prior guidance but should now be capitalized (or conversely)</td>
<td></td>
</tr>
<tr>
<td></td>
<td>• Employee compensation linked to revenue related metrics</td>
<td></td>
</tr>
<tr>
<td></td>
<td>• Current or deferred tax balances, depending on the tax laws</td>
<td></td>
</tr>
</tbody>
</table>
Disclosure

Extensive disclosures are required to provide greater insight into both revenue that has been recognised, and revenue that is expected to be recognised in the future from existing contracts. Quantitative and qualitative information will be provided about the significant judgments and changes in those judgments that management made to determine revenue that is recognised.

The following are some of the key disclosures required by IFRS 15:

1. Significant accounting principle - Disclosure of significant accounting principle related to revenue recognitions needs to reflect the requirements in IFRS 15. Significant accounting judgments, estimates and assumptions related to revenue recognition in accordance with the new standard a needs to be described.

2. Disaggregation of revenue – Disclosure of disaggregated revenue information in categories that depict how the nature, amount, timing, and uncertainty of revenue and cash flows are affected by economic factors and describe relationship with disaggregated revenue to revenue for reportable segments.

3. Contract balances - Disclosure of opening and closing balances of contract assets (such as unbilled receivables) and liabilities (such as deferred revenue) and provide a qualitative description of significant changes in these amounts.

4. Costs to obtain or fulfil contracts - Disclosure of the closing balances of capitalised costs to obtain and fulfil a contract and the amount of amortisation in the period. Disclose the method used to determine amortisation for each reporting period.

5. Remaining performance obligations – The aggregate amount of the transaction price allocated to the performance obligations that are unsatisfied (or partially unsatisfied) and an explanation of when the entity expects to recognise as revenue for such amounts, except when the performance obligation is part of a contract that has an original expected duration of one year or less or the entity recognises revenue when they receive the right to consideration because such right corresponds directly to the performance completed to date.

6. Other qualitative disclosures – Disclosure of significant judgements and changes in judgements that affect the amount and timing of revenue from contracts with customers. Disclose how management determines the minimum amount of revenue not subject to the variable consideration constraint. Describe the practical expedients, including those for transition, used in an entity’s revenue accounting policies.

Disclosures - the implications can be summarised as follows:

1. IFRS 15 disclosure requirements are more extensive than the requirements of IAS 18 and IAS 11.

2. Entities will need to assess how IT, accounting, and financial reporting systems can be leveraged to capture all required disclosure information.
Resources

Revenue from contracts with customers – 2016 Global edition

Industry guides
Industry supplements discuss the areas where the revenue standard (IFRS 15) is expected to have the most impact on that particular industry.

- IFRS 15 - Revenue from contracts with customers, Transportation and logistics industry supplement - PwC In depth
- IFRS 15 - Revenue recognition for the Oil and gas industry supplement - PwC In depth
- IFRS 15 - Revenue recognition for the Power and utilities industry supplement - PwC In depth
- IFRS 15 - Revenue recognition for the Engineering and construction industry supplement - PwC In depth
- IFRS 15 - Revenue recognition for the Industrial products and manufacturing industry supplement - PwC In depth
- IFRS 15 - Revenue recognition for the Technology industry supplement - PwC In depth
- IFRS 15 - Revenue recognition for the Retail and consumer industry supplement - PwC In depth

All resources are available at www.pwc.com
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