CA GLOBAL

Case Studies on IFRS 15-**Revenue from Contracts with Customers**

(Few samples taken from our publication are presented below for your self assessment. For more, visit our E-Book Store section)

IAS 18 *vs.* IFRS 15-Manufacturers and contract modifications

Question:

Masi PC, computer manufacturer, enters into contract with Mesoy to deliver 300 computers for total price of CU 600 000 (CU 2 000 per computer). Due to necessary preparation works, Mesoy agrees to deliver computers in 3 separate deliveries during the forthcoming 3 months (100 computers in each delivery). Mesoy takes control over the computers at delivery.

After the first delivery is made, Mesoy and Masi PC amend the contract. Masi PC will supply 200 additional computers (500 in total).

How should Masi PC account for the revenue from this contract under IAS 18 and IFRS 15 for the year ended 31 December 20X1 if:

- Scenario 1: The price for additional 200 computers was agreed at CU 388 000, being CU 1 940 per computer. Masi PC provided a volume discount of 3% for additional delivery which reflects the normal volume discounts provided in similar contracts with other customers.
- Scenario 2: The price for additional 200 computers was agreed at CU 280 000, being CU 1 400 per computer. Masi PC provided a discount of 30% for additional delivery

because it hopes for the future cooperation with Mesoy (nothing even discussed yet).

As of 31 December 20X1, Masi PC delivered 400 computers (300 as agreed initially and 100 under the contract amendment).
<u>Response:</u>

Revenue under IAS 18

Well, here, nothing much to say. By definition of revenue in line with IAS 18, the revenue for the delivery is simply accounted at the time of delivery, in the *fair value of consideration received* for the computers – which is whatever amount under 2 above scenarios.

You are not required by IAS 18 to examine whether this additional delivery reflects stand-alone selling prices or not. The revenue for the year ended 31 December 20X1:

- Scenario 1: CU 600 000 (the first 300 computers) + CU 194 000 (additional 100 computers delivered) = *CU 794 000* (for all 400 computers already delivered).
- Scenario 2: CU 600 000 (the first 300 computers) + CU 140 000 (additional 100 computers) = *CU 740 000* (for all 400 computers already delivered)

Revenue under IFRS 15

Here, the additional contract represents *typical contract modification*, as the amount of computers changes and the total transaction price changes, too.

IFRS 15 precisely specifies *how to account for contract modifications*, based on the terms of modification. There are 2 basic types of contract modification:

1. Contract modification is a separate contract

   Contract modification is accounted for as for a separate contract (meaning that the original contract is left as it is), when 2 criteria are fulfilled:

   - Additional goods and services in the modification must be distinct from the goods or services in the original contract.
   - In both scenarios, this is met, as additional computers are quite distinct from the original computers.
   - Amount of consideration expected for the additional goods/services must reflect the stand-alone selling price of these goods/services.

2. Contract modification is not a separate contract

   If the above criteria are not fulfilled (or one of them is not met), then the contract modification is not a separate contract and the accounting depends on further analysis.

Here, as we concluded that additional goods are distinct, the main question is whether the additional consideration reflects their stand-alone selling prices.

Scenario 1: 3% discount agreed on additional delivery

The price for additional computers indeed reflects their stand-alone selling prices, because Masi PC normally provides 3% volume discount.

Therefore, this contract modification is accounted for as a separate contract and revenue for the year 20X1 (400 computers delivered) is:

- CU 600 000 from the original contract for 300 computers;
- CU 194 000 from the contract modification for additional 100 computers delivered.

Total revenue in the year 20X1 is therefore CU 794 000 – exactly as under IAS 18.

Scenario 2: 30% discount agreed on additional delivery

Here, it’s clear that the price for additional computers does not reflect their stand-alone selling prices, because 30% discount is exceptional and tied to the overall contract with the Mesoy.

It means that the second criterion is not met.

As a result, the contract modification is NOT a separate contract, but it is bundled with the original contract.

In this case, as additional goods are distinct, you need to account as you would terminate the original contract and start the new one.

Let us simply recognize the revenue from the delivery already made before contract modification under the original contract.

For the remaining goods from the original contract and additional goods, you recognize total revenue amounting to:

- That part of consideration in the original contract that hasn't been recognized as revenue yet (in other words, price for goods yet to be delivered); PLUS
- The consideration agreed in the contract modification.

You need to allocate this amount to individual performance obligations, or individual computers.

In the scenario 2, contract modification was made after the first delivery, so Masi PC needs to recognize revenue for the first 100 computers in line with the original contract:

100 computers x CU 2 000 per computer = CU 200 000

Total transaction price to allocate after the contract modification is:

- CU 400 000, being the part of original consideration related to undelivered 200 computers (300 per contract less 100 delivered; times 2 000 per unit);
- CU 280 000, being total consideration for additional 200 computers;
- Total: CU 680 000

We need to allocate CU 680 000 to 400 computers in total (200 undelivered before contract modification + 200 additional computers), which means that Masi PC allocates CU 1 700 to one computer (680 000/400).

So what's the total revenue recognized in 20X1 during which 400 computers were delivered? Let's calculate:

- Revenue for 100 computers delivered before contract modification: CU 200 000 (CU 2000/computer)
- Revenue for 300 computers delivered after contract modification: CU 510 000 (CU 1700/computer);
- Total: CU 710 000.

Here you can clearly see that in this second scenario (additional delivery with 30% discount):

- Under IAS 18, revenue for the year 20X1 is CU 740 000.

  The revenue to be recognized in the next period is remaining 100 computers at CU 1 400 = 140 000; that gives us total CU 880 000 per contract.
- Under IFRS 15, revenue for the year 20X1 is CU 710 000.

  The revenue to be recognized in the next period is remaining 100 computers at CU 1 700 = 170 000; that gives us total CU 880 000 per contract.

The totals are the same, but the timing of revenue is different. And exactly this timing can impact your taxes, dividends, financial ratios etc.