# IFRS/IAS Update

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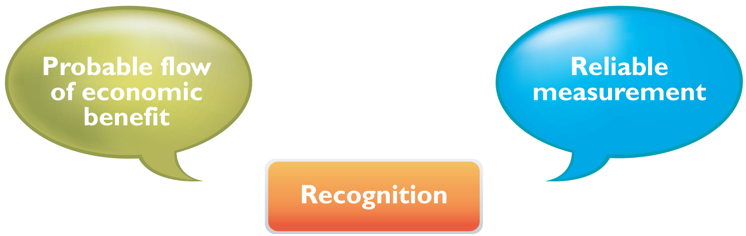
## IAS 18 - Revenue

## Abstract:

Accrual accounting is based on the matching of costs with the revenue they generate. It is crucially important under this convention that we can establish the point at which revenue may be recongnised so that the correct treatment can be applied to the related costs. For example, the costs of producing an item of finished goods should be carried as an asset in the statement of financial position until such time as it is sold; they should then be written off as a charge to the trading account. Which of these two treatments should be applied cannot be decided until it is clear at what moment the sale of the item takes place.

The decision has a direct impact on profit since it would be unacceptable to recognize the profit on sale had taken place in accordance with the criteria of revenue recognition.

IAS 18 governs the recognition of revenue in specific (common) types of transaction. Generally, recognition should be when it is probable that future economic benefits will flow to the entity and when these benefits can be measured reliably.




IAS 18 Revenue outlines the accounting requirements for when to recognise revenue from the sale of goods, rendering of services, and for interest, royalties and dividends. Revenue is measured at the fair value of the consideration received or receivable and recognised when prescribed conditions are met, which depend on the nature of the revenue.

IAS 18 was reissued in December 1993 and is operative for periods beginning on or after 1 January 1995.

## History of IAS 18:

| Date | Development & Comments |
|---|---|
| April 1981 | Exposure Draft E20 *Revenue Recognition* |
| December 1982 | IAS 18 *Revenue Recognition* |
| 1 January 1984 | Effective date of IAS 18 (1982) |
| May 1992 | E41 *Revenue Recognition* |
| December 1993 | IAS 18 *Revenue Recognition* (revised as part of the 'Comparability of Financial Statements' project) |
| 1 January 1995 | Effective date of IAS 18 (1993) *Revenue Recognition* |
| December 1998 | Amended by IAS 39 *Financial Instruments: Recognition and Measurement,* effective 1 January 2001 |
| 16 April 2009 | Appendix to IAS 18 amended for Annual Improvements to IFRSs 2009. It now provides guidance for determining whether an entity is acting as a principal or as an agent. |
| 1 January 2017 | IAS 18 will be superseded by IFRS 15 *Revenue from Contracts with Customers* |

## Related Interpretations:

- IFRIC 18 *Transfers of Assets from Customers*
- IFRIC 15 *Agreements for the Construction of Real Estate*
- IFRIC 13 *Customer Loyalty Programmes*
- IFRIC 12 *Service Concession Arrangements*
- SIC-27 *Evaluating the Substance of Transactions in the Legal Form of a Lease*
- SIC-31 *Revenue - Barter Transactions Involving Advertising Services*

**Revenue:** the gross inflow of economic benefits (cash, receivables, other assets) arising from the ordinary operating activities of an entity (such as sales of goods, sales of services, interest, royalties, and dividends). [IAS 18.7]

## Measurement of Revenue:

Revenue should be measured at the fair value of the consideration received or receivable. [IAS 18.9] An exchange for goods or services of a similar nature and value is not regarded as a transaction that generates revenue. However, exchanges for dissimilar items are regarded as generating revenue. [IAS 18.12]

If the inflow of cash or cash equivalents is deferred, the fair value of the consideration receivable is less than the nominal amount of cash and cash equivalents to be received, and discounting is appropriate. This would occur, for instance, if the seller is providing interest-free credit to the buyer or is charging a below-market rate of interest. Interest must be imputed based on market rates. [IAS 18.11]

## Recognition of Revenue:

Recognition, as defined in the IASB Framework, means incorporating an item that meets the definition of revenue (above) in the income statement when it meets the following criteria:

- it is probable that any future economic benefit associated with the item of revenue will flow to the entity, and
- the amount of revenue can be measured with reliability

IAS 18 provides guidance for recognising the following specific categories of revenue:

## Sale of Goods:

Revenue arising from the sale of goods should be recognised when all of the following criteria have been satisfied: [IAS 18.14]

- the seller has transferred to the buyer the significant risks and rewards of ownership
- the seller retains neither continuing managerial involvement to the degree usually associated with ownership nor effective control over the goods sold
- the amount of revenue can be measured reliably
- it is probable that the economic benefits associated with the transaction will flow to the seller, and
- the costs incurred or to be incurred in respect of the transaction can be measured reliably

## Rendering of Services:

For revenue arising from the rendering of services, provided that all of the following criteria are met, revenue should be recognised by reference to the stage of completion of the transaction at the balance sheet date (the percentage-of-completion method): [IAS 18.20]

- the amount of revenue can be measured reliably;
- it is probable that the economic benefits will flow to the seller;
- the stage of completion at the balance sheet date can be measured reliably; and
- the costs incurred, or to be incurred, in respect of the transaction can be measured reliably.

When the above criteria are not met, revenue arising from the rendering of services should be recognised only to the extent of the expenses recognised that are recoverable (a "cost-recovery approach". [IAS 18.26]

## Interest, Royalties, and Dividends:

For interest, royalties and dividends, provided that it is probable that the economic benefits will flow to the enterprise and the amount of revenue can be measured reliably, revenue should be recognised as follows: [IAS 18.29-30]

- interest: using the effective interest method as set out in IAS 39
- royalties: on an accruals basis in accordance with the substance of the relevant agreement
- dividends: when the shareholder's right to receive payment is established

## Disclosure [IAS 18.35]

- accounting policy for recognising revenue
- amount of each of the following types of revenue:
  - sale of goods
  - rendering of services
  - interest
  - royalties
  - dividends
  - within each of the above categories, the amount of revenue from exchanges of goods or services

## Implementation Guidance

**Appendix A to IAS 18 provides illustrative examples of how the above principles apply to certain transactions.**

## Quick Links

- Deloitte e-learning on IAS 18
- IAS 18 - Items not added to the agenda
- IFRS 15 'Revenue from Contracts with Customers'

## IFRS 15 - Revenue from Contracts with Customers

IFRS 15 specifies how and when an IFRS reporter will recognise revenue as well as requiring such entities to provide users of financial statements with more informative, relevant disclosures. The standard provides a single, principles based five-step model to be applied to all contracts with customers.

*IFRS 15 was issued in May 2014 and applies to an annual reporting period beginning on or after 1 January 2017.*

| Date | Development | Comments |
|---|---|---|
| June 2002 | Project on revenue added to the IASB's agenda | History of the project |
| 19 December 2008 | Discussion Paper *Preliminary Views on Revenue Recognition in Contracts with Customers* published | Comment deadline 19 June 2009 |
| 24 June 2010 | Exposure Draft ED/2010/6 *Revenue from Contracts with Customers* published | Comment deadline 22 October 2010 |
| 14 November 2011 | Exposure Draft ED/2011/6 *Revenue from Contracts with Customers* published (re-exposure) | Comment deadline 13 March 2012 |
| 28 May 2014 | IFRS 15 *Revenue from Contracts with Customers* issued | Effective for an entity's first annual IFRS financial statements for periods beginning on or after 1 January 2017 |

## Superseded Standards

IFRS 15 replaces the following standards and interpretations:

- IAS 11 Construction contracts
- IAS 18 Revenue
- IFRIC 13 Customer Loyalty Programmes
- IFRIC 15 Agreements for the Construction of Real Estate
- IFRIC 18 Transfers of Assets from Customers
- SIC-31 Revenue - Barter Transactions Involving Advertising Services

## Objective

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. [IFRS 15:1] Application of the standard is mandatory for annual reporting periods starting from 1 January 2017 onwards. Earlier application is permitted.

## Scope

IFRS 15 Revenue from Contracts with Customers applies to all contracts with customers except for: leases within the scope of IAS 17Leases; financial instruments and other contractual rights or obligations within the scope of IFRS 9Financial Instruments, IFRS 10Consolidated Financial Statements, IFRS 11Joint Arrangements, IAS 27Separate Financial Statements and IAS 28Investments in Associates and Joint Ventures; insurance contracts within the scope of IFRS 4Insurance Contracts; and non-monetary exchanges between entities in the same line of business to facilitate sales to customers or potential customers. [IFRS 15:5]

A contract with a customer may be partially within the scope of IFRS 15 and partially within the scope of another standard. In that scenario: [IFRS 15:7]

- if other standards specify how to separate and/or initially measure one or more parts of the contract, then those separation and measurement requirements are applied first. The transaction price is then reduced by the amounts that are initially measured under other standards;
- if no other standard provides guidance on how to separate and/or initially measure one or more parts of the contract, then IFRS 15 will be applied.

## Key Definitions

**Contract:** An agreement between two or more parties that creates enforceable rights and obligations.

**Customer:** 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.

**Income:** Increases in economic benefits during the accounting period in the form of inflows or enhancements of assets or decreases of liabilities that result in an increase in equity, other than those relating to contributions from equity participants.

**Performance Obligation:** 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.

**Revenue:** Income arising in the course of an entity's ordinary activities.

**Transaction price:** The amount of consideration to which an entity expects to be entitled in exchange for transferring promised goods or services to a customer, excluding amounts collected on behalf of third parties.