

Implementing IFRS 15 *Revenue from Contracts with Customers*

A practical guide to implementation issues for the travel, hospitality and leisure sector



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About this guide

A new revenue recognition accounting standard, IFRS 15 *Revenue from Contracts with Customers* ('the new Standard'), has been issued. For those contracts within its scope, it will apply for entities' accounting periods beginning on or after 1 January 2017 (early adoption is permitted). As at the date of this publication, the new Standard has not yet been adopted by the EU.

Although 2017 may seem some way off, the implementation date has been set because some entities will need significant time to prepare for the impact of the new Standard. In some cases, the Standard will require significant system changes or will significantly affect other aspects of operations (e.g. internal controls and processes, Key Performance Indicators, compensation and bonus plans, bank covenants, tax etc.), and, therefore, it is imperative that entities identify any such impacts early on.

This guide is intended to provide an overview of applying IFRS 15 within the travel, hospitality and leisure sector. The guidance provided here is not intended to be exhaustive, but aims to highlight some of the potential issues to consider and to indicate how those issues might be approached.

We hope you will find this implementation guide helpful and encourage you to reach out to one of our professionals identified in this guide for additional support as needed.

Overview

The International Accounting Standards Board ('IASB') has issued a new Standard on accounting for revenue recognition, IFRS 15, which will be applicable for entities reporting in accordance with International Financial Reporting Standards ('IFRSs') for periods beginning on or after 1 January 2017 with early application permitted. The new Standard is the result of a joint project by the IASB and the Financial Accounting Standards Board ('FASB') (collectively the 'Boards') to develop a converged set of accounting principles to be applied under both IFRSs and US generally accepted accounting principles ('US GAAP'). As at the date of this publication, IFRS 15 has not yet been adopted by the EU. The guidance is relevant across all industries and for most types of revenue transactions.

As a result of the issuance of IFRS 15, the following existing requirements in IFRSs have been superseded:

- 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*; and
- SIC-31 *Revenue – Barter Transactions Involving Advertising Services*.

At a glance

Current requirements		New requirements	
Revenue recognition		Revenue from contracts with customers	
IAS 11	Construction contracts	IFRS 15	Point in time or over time
IAS 18	Sales of goods		
IAS 18	Sales of services		
IFRIC 15	Real estate sales		
IAS 18	Royalties		New guidance on royalty revenue
IFRIC 13	Customer loyalty programmes	IFRS 15	New guidance on options for additional goods and services and breakage
IFRIC 18	Transfers of assets from customers		Guidance on non-cash consideration
SIC 31	Advertising barter transactions		
	Previously little guidance on costs of obtaining and fulfilling a contract		New guidance on costs of obtaining and fulfilling a contract
Other revenue		Other revenue	
IAS 18	Interest	IAS 39 or IFRS 9	Interest
IAS 18	Dividends	IAS 39 or IFRS 9	Dividends

The new Standard outlines a single comprehensive model of accounting for revenue arising from contracts with customers. Based around a five-step model, it is more detailed and prescriptive than the existing guidance. There are two significant impacts that entities will need to consider when implementing the new Standard.

The timing of revenue and profit recognition

Whereas previously IFRSs allowed significant room for judgement in devising and applying revenue recognition policies and practices, IFRS 15 is more prescriptive in many areas relevant to the travel, hospitality and leisure sector. Applying these new rules may result in significant changes to the profile of revenue and, in some cases, cost recognition. This is not merely a financial reporting issue. As well as **preparing the market and educating analysts** on the impact of the new Standard, entities will need to consider wider implications. Amongst others, these might include:

- changes to **key performance indicators** and other **key metrics**;
- changes to the **profile of tax cash payments**;
- availability of **profits for distribution**;
- for **compensation and bonus plans**, the impact on the timing of targets being achieved and the likelihood of targets being met; and
- potential non-compliance with **loan covenants**.

Current accounting systems may require significant changes to cope with the new Standard

Within the travel, hospitality and leisure sector, it is common for revenue recognition to be directly linked to billing systems. As explained throughout this document, IFRS 15 introduces new requirements to move to a more prescriptive approach based around a five-step model. The complexity of applying this approach and of producing the detailed disclosures required by the new Standard in the travel, hospitality and leisure sector may require modifications to existing accounting processes and, in some cases, entities may conclude that they should develop new systems solutions.

In determining the extent to which modifications will be required, entities will wish to consider the need for sufficient flexibility to cope with future changes in the pricing and variety of product offerings made to customers. The 1 January 2017 effective date may set a challenging timeframe for developing new systems.

Issues of particular relevance to the travel, hospitality and leisure industry

Issues that are likely to be of particular relevance to entities in the travel, hospitality and leisure industry include the following, which are discussed in detail in subsequent sections of this publication:

- unbundling of multiple performance obligations within a single contract;
- determination of whether an entity is acting as principal or agent;
- customer options to acquire additional goods or services at a discount;
- the treatment of upfront membership fees;
- the impact of variable consideration;
- the impact of customers' unexercised rights (breakage);
- assessing whether a significant financing component exists within a contract;
- allocating the transaction price to performance obligations; and
- capitalisation of costs of obtaining a contract.

Scope and core principle

Scope

IFRS 15 applies to all contracts with customers, except for those that are within the scope of other IFRSs. Examples of contracts that are outside the scope of IFRS 15 include, but are not limited to, leases (IAS 17 *Leases*), insurance contracts (IFRS 4 *Insurance Contracts*) and financial instruments (IFRS 9 *Financial Instruments* or, for entities that have not yet adopted IFRS 9, IAS 39 *Financial Instruments: Recognition and Measurement*). It is possible that a contract with a customer may be partially within the scope of IFRS 15 and partially within the scope of another standard.

The recognition of interest and dividend income is not within the scope of IFRS 15. However, certain elements of the new model will be applied to transfers of assets that are not an output of an entity's ordinary activities (such as the sale of property, plant and equipment, real estate or intangible assets).

Core Principle

The core principle underlying the new model is that an entity should recognise revenue in a manner that depicts the pattern of transfer of goods and services to customers. The amount recognised should reflect the amount to which the entity expects to be entitled in exchange for those goods and services. IFRS 15 provides five steps that entities will need to follow in accounting for revenue transactions.

The five steps of the revenue recognition model



The five steps are described in more detail in the following sections.

The five steps of the revenue recognition model

Step 1. Identify the contract with a customer

Summary of the requirements

What qualifies as a contract?

For many entities, Step 1 will be relatively straightforward. The key points are to determine when a contract comes into existence. A contract can be written, verbal, or implied. The following criteria are all required in order to qualify as a contract with a customer:

- the contract has been approved by the parties;
- the entity can identify each party's rights regarding the goods or services to be delivered;
- the entity can identify the payment terms for the goods or services to be delivered;
- the contract has commercial substance; and
- it is probable that the entity will collect the consideration to which it is entitled in exchange for the delivery of the goods or services.

Entities will additionally need to consider whether the contract should be combined with other contracts for accounting purposes, and how to account for any subsequent modifications that arise.

Contracts should generally be accounted for separately. However, contracts should be combined if:

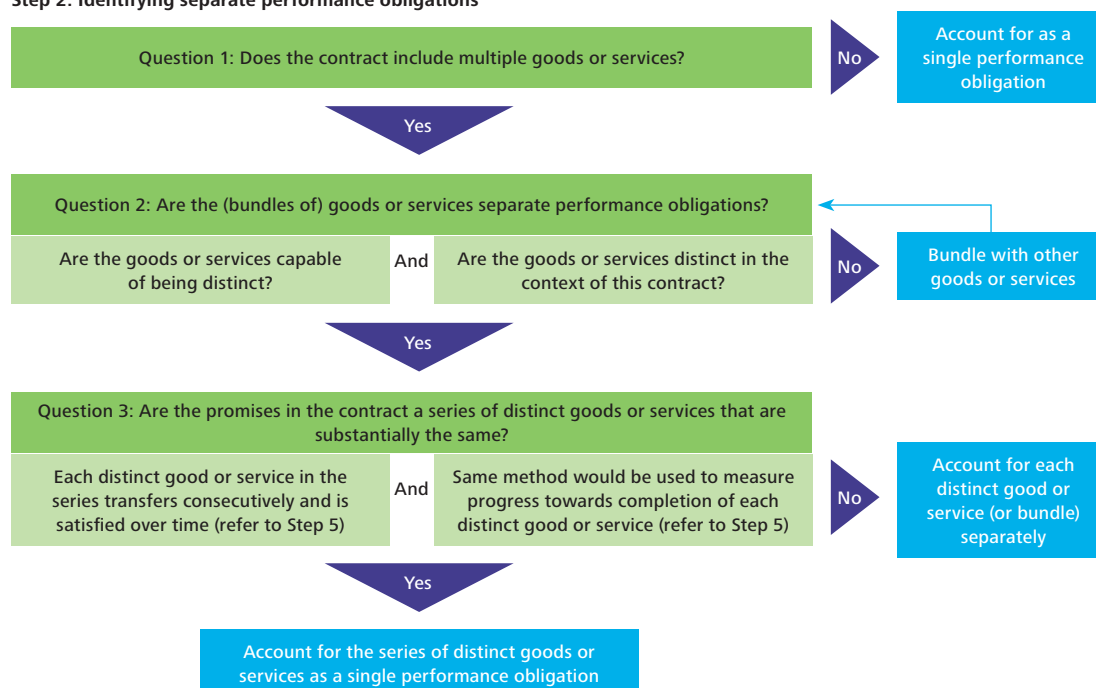
- they are negotiated as a package with a single commercial objective;
- the amount of consideration to be paid in one contract depends on the goods or services to be delivered in another contract; or
- the goods or services promised in the contracts are considered to be a single performance obligation.

Step 2. Identify the performance obligations in the contract

Summary of the requirements	
What is 'unbundling'?	Step 2 is concerned with how to identify those deliverables that are accounted for separately ('performance obligations'). This process is sometimes called 'unbundling'. For many entities, this will be a key judgement in recognising revenue. Previously, apart from the guidance in IAS 11 on segmentation of construction contracts, IFRSs contained little guidance on this topic; therefore the requirements of IFRS 15 may lead to a significant change in practice for some entities.
When should 'unbundling' happen?	The performance obligations need to be determined at contract inception, by identifying the 'distinct' goods or services in the contract. If distinct goods or services cannot be identified, entities should combine goods or services until they identify a bundle of goods or services that is distinct.
How do we identify separate performance obligations?	<p>In order to do this, an entity will typically first identify all the goods or services, or contract deliverables, which have been promised. These may be implicitly or explicitly promised in a contract. For example, a contract with a customer may also include promises that are implied by an entity's customary business practices or published policies. This requirement highlights the need to analyse the commercial objective of the contract in order to identify all the deliverables.</p> <p>An entity will then determine which of its promised goods or services should be accounted for as performance obligations, by determining which promised goods or services are distinct. For a good or service to be 'distinct', it must satisfy both of the following conditions:</p> <ul style="list-style-type: none"> • the customer can benefit from the good or service either on its own or in combination with other resources available to the customer; and • the entity's promise to transfer the good or service to the customer is separable from other promises in the contract, as discussed further below. <p>Customers are able to benefit from a good or service if that good or service can be used, consumed, sold for an amount other than scrap value, or otherwise held in a way that generates economic benefits.</p>
What else needs to be considered?	<p>Whether an entity's promise to transfer a good or service is separable from other promises in the contract is a matter that requires judgement and will depend on the facts and circumstances specific to each scenario. Factors that indicate a promised good or service is separable from other promises include, but are not limited to, the following:</p> <ul style="list-style-type: none"> • the entity does not use the good or service as an input to produce the combined output specified by the contract; • the good or service does not significantly modify or customise another good or service promised in the contract; and • the good or service is not highly dependent on, or highly interrelated with, other promised goods or services. <p>In certain circumstances, the provision of a series of distinct goods or services that are substantially the same and have the same pattern of transfer is to be treated as one performance obligation.</p>
Why does it matter?	The identification of performance obligations will have consequences in Steps 4 and 5 of the Standard's revenue model. These are discussed in further detail below.

All entities will need to consider this requirement carefully to determine whether their current approach will continue to be appropriate under IFRS 15. By applying the following process to contracts, entities should be able to identify their performance obligations.

Step 2. Identifying separate performance obligations



Unbundling multiple performance obligations

Entities in the travel, hospitality and leisure sector will often provide multiple services within one contract. For example, a safari package will contain a number of different goods and services that may be integrated in one contract including meals, game drives, room charge and entertainment. Under the new Standard, an entity within the travel, hospitality and leisure sector will be required to assess whether the deliverables it has promised to the customer give rise to separate performance obligations.

Equally, where an entity charges administrative fees or a fee for credit card payment to customers booking services through its website, it will need to determine whether the activities associated with these fees give rise to separate performance obligations.

Determining what constitutes a performance obligation is an area in which management may have to exercise a greater level of judgement, considering the guidance included in IFRS 15 as noted in the diagram above.

Determination of whether an entity is acting as principal or agent

Often, entities in the travel, hospitality and leisure industry sell goods or services to customers that are provided or rendered by third parties. In recognising revenue from these transactions, the entity will need to determine whether the nature of its promise is a performance obligation to provide the specified goods or services itself (acting as a principal) or to arrange for the other party to provide those goods or services (acting as an agent). An entity is a principal if the entity controls a promised good or service before the entity transfers the good or service to a customer. An entity is an agent if the performance obligation is to arrange for the provision of goods or services by another party. Although the guidance in IFRS 15 in relation to determining whether an entity is a principal or an agent is similar to that in IAS 18, when applying IFRS 15 the determination rests on the notion of whether the entity controls the good or service prior to transferring it to the customer whereas IAS 18 focusses on whether the entity is exposed to the significant risks and rewards associated with the transaction.

A particular instance of this is the issue of sales through online intermediaries. The determination of control can often be challenging in such arrangements as a result of the near-instantaneous transfer of electronic goods such as e-tickets. In addition, the ultimate vendor in such a transaction may not be aware of the amount charged by the intermediary to the ultimate customer, which may make it impractical to estimate a gross revenue amount even if it is determined that the intermediary is acting as an agent in the transaction. This issue was discussed by the joint IASB-FASB Transition Resource Group in July 2014 – further details of the discussions held can be found in our [IFRS in Focus](#) publication on the July meeting.

If the entity is a principal it recognises revenue based on the gross amount of payments received from the customer, with a related expense for payments to the third party provider. If the entity is an agent it recognises revenue based on the commission it receives from the sale (the gross amount of payments received from the customer, less payments to the third party provider).

Indicators that an entity is an agent include the following:

- (a) another party is primarily responsible for fulfilling the contract;
- (b) the entity does not have inventory risk at any point during the contract (i.e. before or after the goods have been ordered by a customer, during shipping or on return);
- (c) the entity does not have discretion in establishing prices for the other party's goods or services and, therefore, the benefit that the entity can receive from those goods or services is limited;
- (d) the entity's consideration is in the form of a commission; and
- (e) the entity is not exposed to credit risk for the amount receivable from a customer in exchange for the other party's goods or services.

The following two examples accompanying the Standard illustrate how this determination might be made in practice.

Example 1 – Entity enters into a promise to provide goods or services (entity is a principal)

[IFRS 15 Illustrative Example 47]

An entity negotiates with major airlines to purchase tickets at reduced rates compared with the price of tickets sold directly by the airlines to the public. The entity agrees to buy a specific number of tickets and must pay for those tickets regardless of whether it is able to resell them. The reduced rate paid by the entity for each ticket purchased is negotiated and agreed in advance.

The entity determines the prices at which the airline tickets will be sold to its customers. The entity sells the tickets and collects the consideration from customers when the tickets are purchased; therefore there is no credit risk.

The entity also assists the customers in resolving complaints with the service provided by airlines. However, each airline is responsible for fulfilling obligations associated with the ticket, including remedies to a customer for dissatisfaction with the service.

To determine whether the entity's performance obligation is to provide the specified goods or services itself (ie the entity is a principal) or to arrange for another party to provide those goods or services (ie the entity is an agent), the entity considers the nature of its promise. The entity determines that its promise is to provide the customer with a ticket, which provides the right to fly on the specified flight or another flight if the specified flight is changed or cancelled. In determining whether the entity obtains control of the right to fly before control transfers to the customer and whether the entity is a principal, the entity considers the indicators as follows:

- (a) the entity is primarily responsible for fulfilling the contract, which is providing the right to fly. However, the entity is not responsible for providing the flight itself, which will be provided by the airline.
- (b) the entity has inventory risk for the tickets because they are purchased before they are sold to the entity's customers and the entity is exposed to any loss as a result of not being able to sell the tickets for more than the entity's cost.
- (c) the entity has discretion in setting the sales prices for tickets to its customers.
- (d) as a result of the entity's ability to set the sales prices, the amount that the entity earns is not in the form of a commission, but instead depends on the sales price it sets and the costs of the tickets that were negotiated with the airline.

The entity concludes that its promise is to provide a ticket (ie a right to fly) to the customer. On the basis of the indicators, the entity concludes that it controls the ticket before it is transferred to the customer. Thus, the entity concludes that it is a principal in the transaction and recognises revenue in the gross amount of consideration to which it is entitled in exchange for the tickets transferred.

Example 2 – Entity arranges for the provision of goods or services (entity is an agent)

[IFRS 15 Illustrative Example 48]

An entity sells vouchers that entitle customers to future meals at specified restaurants. These vouchers are sold by the entity and the sales price of the voucher provides the customer with a significant discount when compared with the normal selling prices of the meals (for example, a customer pays CU100 for a voucher that entitles the customer to a meal at a restaurant that would otherwise cost CU200). The entity does not purchase vouchers in advance; instead, it purchases vouchers only as they are requested by the customers. The entity sells the vouchers through its website and the vouchers are non-refundable.

The entity and the restaurants jointly determine the prices at which the vouchers will be sold to customers. The entity is entitled to 30 per cent of the voucher price when it sells the voucher. The entity has no credit risk because the customers pay for the vouchers when purchased.

The entity also assists the customers in resolving complaints about the meals and has a buyer satisfaction programme. However, the restaurant is responsible for fulfilling obligations associated with the voucher, including remedies to a customer for dissatisfaction with the service.

To determine whether the entity is a principal or an agent, the entity considers the nature of its promise and whether it takes control of the voucher (ie a right) before control transfers to the customer. In making this determination, the entity considers the indicators as follows:

- (a) the entity is not responsible for providing the meals itself, which will be provided by the restaurants;
- (b) the entity does not have inventory risk for the vouchers because they are not purchased before being sold to customers and the vouchers are non-refundable;
- (c) the entity has some discretion in setting the sales prices for vouchers to customers, but the sales prices are jointly determined with the restaurants; and
- (d) the entity's consideration is in the form of a commission, because it is entitled to a stipulated percentage (30 per cent) of the voucher price.

The entity concludes that its promise is to arrange for goods or services to be provided to customers (the purchasers of the vouchers) in exchange for a commission. On the basis of the indicators, the entity concludes that it does not control the vouchers that provide a right to meals before they are transferred to the customers. Thus, the entity concludes that it is an agent in the arrangement and recognises revenue in the net amount of consideration to which the entity will be entitled in exchange for the service, which is the 30 per cent commission it is entitled to upon the sale of each voucher.

Customer options to acquire additional goods or services at a discount

Some entities in the travel, hospitality and leisure industry offer loyalty schemes to customers. These schemes give customers the option to purchase additional goods or services at a discount in the future by redeeming loyalty points. In these situations, the entity will need to consider whether the option the customer has to acquire additional goods or services provides the customer with a material right. Where this is the case, the customer is, in effect, paying in advance for future goods or services and a portion of the original transaction price must be allocated to that option and recognised as revenue when control of the goods or services associated with the option are transferred to the customer, or when the option expires. The effects of breakage (refer to Step 4) should be taken into account in determining the amount and timing of revenue recognition for customer options for additional goods and services, such as loyalty points.

This is illustrated by the following example which accompanies the Standard.

Example 3 – Customer loyalty programme

[IFRS 15 Illustrative Example 52]

An entity has a customer loyalty programme that rewards a customer with one customer loyalty point for every CU10 of purchases. Each point is redeemable for a CU1 discount on any future purchases of the entity's products. During a reporting period, customers purchase products for CU100,000 and earn 10,000 points that are redeemable for future purchases. The consideration is fixed and the stand-alone selling price of the purchased products is CU100,000. The entity expects 9,500 points to be redeemed. The entity estimates a stand-alone selling price of CU0.95 per point (totalling CU9,500) on the basis of the likelihood of redemption in accordance with paragraph B42 of IFRS 15.

The points provide a material right to customers that they would not receive without entering into a contract. Consequently, the entity concludes that the promise to provide points to the customer is a performance obligation. The entity allocates the transaction price (CU100,000) to the product and the points on a relative stand-alone selling price basis as follows:

CU

Product 91,324 $[CU100,000 \times (CU100,000 \text{ stand-alone selling price} / CU109,500)]$

Points 8,676 $[CU100,000 \times (CU9,500 \text{ stand-alone selling price} / CU109,500)]$

At the end of the first reporting period, 4,500 points have been redeemed and the entity continues to expect 9,500 points to be redeemed in total. The entity recognises revenue for the loyalty points of CU4,110 $[(4,500 \text{ points} \div 9,500 \text{ points}) \times CU8,676]$ and recognises a contract liability of CU4,566 $(CU8,676 - CU4,110)$ for the unredeemed points at the end of the first reporting period.

At the end of the second reporting period, 8,500 points have been redeemed cumulatively. The entity updates its estimate of the points that will be redeemed and now expects that 9,700 points will be redeemed. The entity recognises revenue for the loyalty points of CU3,493 $\{[(8,500 \text{ total points redeemed} \div 9,700 \text{ total points expected to be redeemed}) \times CU8,676 \text{ initial allocation}] - CU4,110 \text{ recognised in the first reporting period}\}$. The contract liability balance is CU1,073 $(CU8,676 \text{ initial allocation} - CU7,603 \text{ of cumulative revenue recognised})$.

Membership fees

Some entities in the travel, hospitality and leisure industry offer membership packages to customers in return for the payment of an upfront fee. IFRS 15 includes specific guidance on the treatment of such fees for revenue recognition purposes. In particular, unless distinct goods or services (beyond membership) are provided to the customer at the outset, an upfront fee should be recognised as revenue when future goods and services are provided. Even where a distinct good or service is provided up front (for example, a customer may receive a branded sweatshirt on signing up to a gym membership), deferral of a large portion of the membership fee may still be required.

The fact that an upfront fee may be charged to cover the administrative cost of processing the membership application is not sufficient to justify the recognition of revenue at that point. This guidance should be applied even when the upfront fee is non-refundable.

Step 3. Determine the transaction price

Summary of the requirements

What impacts the amount of revenue recognised?

Step 3 is concerned with how to measure the total revenue arising under a contract. IFRS 15 typically bases revenue on the amount to which an entity expects to be entitled rather than the amounts that it expects ultimately to collect. In other words, revenue is adjusted for discounts, rebates, credits, price concessions, incentives, performance bonuses, penalties and similar items, but it is not reduced for expectations of bad debts. There is, however, an exception for transactions that include a significant financing component. For these transactions, revenue is recognised based on the fair value of the amount receivable, which will reflect the customer's credit risk as it is incorporated into the discount rate applied.

An entity will need to determine the amount of consideration to which it expects to be entitled in exchange for the promised goods or services (including both fixed and variable consideration). When determining the amount to which the entity expects to be entitled, consideration should be given to past business practices, published policies or specific statements that create a valid expectation in the customer that the entity will only enforce payment of a portion of the stated contract price. For example, if past business practices with a particular customer demonstrate that the entity typically only requires payment of ninety per cent of the stated contract price (i.e. it forgives the balance), for a new contract with the same customer, the transaction price may be determined to be ninety per cent of the stated contract price.

The key considerations in determining the transaction price are the effects of any variable consideration, the time value of money (if a significant financing component exists), non-cash consideration and any consideration payable to the customer.

Variable consideration

Variable consideration is any amount that is variable under the contract. Variable consideration will only be included in the transaction price when an entity expects it to be 'highly probable' that the resolution of the associated uncertainty would not result in a significant revenue reversal. This assessment takes into account both the likelihood of a change in estimate and the magnitude of any revenue reversal that would result. If an entity is unable to include its full estimate of variable consideration, because that could give rise to a significant revenue reversal, it should recognise the amount of variable consideration that would be highly probable of not resulting in a significant revenue reversal. An exception to this exists when an entity earns sales or usage based royalty revenue from licences of its intellectual property. In these circumstances, the entity would typically include revenue from these licences when the subsequent sale or usage occurs.

Time value of money

If an entity determines that the contract provides the customer or the entity with a significant benefit of financing the transfer of goods or services to the customer, then the consideration should be adjusted for the time value of money. This may lead to interest expense being recognised if the customer pays for goods or services in advance of the transfer of control and interest income when the goods or services are paid for in arrears.

Practical expedient

For contracts in which, at inception, the period between the performance of the obligations and the associated payment is expected to be less than a year, the entity can choose not to account for the time value of money. If the period between the performance of the obligations and the associated payment is expected to be more than a year, an entity will always need to consider if there is a significant financing component.

When determining whether a contract contains a significant financing component, an entity should consider, among other factors:

- the difference between the promised amount of consideration and the cash selling price of the promised goods or services; and
- the combined effect of the period between an entity fulfilling its performance obligations and customer payment, and the prevailing interest rate in the relevant market.

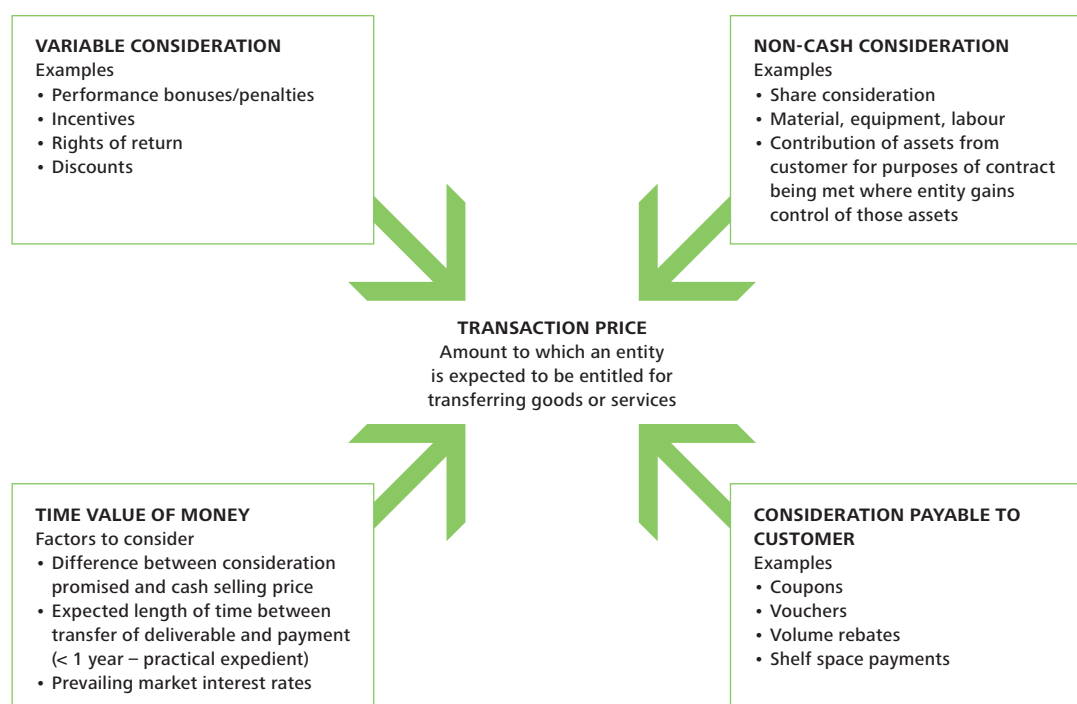
The discount rate used should be a rate that would be reflected in a separate financing transaction between the entity and its customer at contract inception, taking into account credit characteristics. The significant financing component arising on a contract will be accounted for in accordance with IFRS 9 *Financial Instruments* (or, if IFRS 9 has not yet been adopted, IAS 39 *Financial Instruments: Recognition and Measurement*).

Why does it matter?

Management's estimate of consideration will have consequences when applying Steps 4 and 5 of the revenue model. These are discussed in further detail below.

Step 3 requires careful consideration of multiple factors when determining the transaction price. The key considerations have been summarised below.

Step 3. Transaction price



Variable consideration

Entities in the travel, hospitality and leisure sector may enter into contracts that contain significant variable elements. Hotel management contracts, for example, may include incentive fees based on certain performance measures. Amounts may also vary depending on renegotiations or disputes which may result in price concessions (recorded as an adjustment to revenue) or bad debt (recorded separately from revenue). Another situation that arises commonly in the travel, hospitality and leisure sector is where an agent only earns its revenue from arranging for a third party provider (the principal) to provide services to a customer if the principal performs its obligations satisfactorily. Under IAS 18, the agent may have delayed recognition of any revenue until the principal has performed, on the basis that this is a contingent event outside the agent's control. When following the requirements of IFRS 15, it is likely that such an arrangement would fall within the guidelines on variable consideration, which would potentially give a different revenue recognition profile. In particular, although the receipt of payment is contingent upon the principal's performance, it is likely to relate to the agent's performance obligation of arranging a contract between the customer and the principal, which will already have been satisfied.

Correct application of the new requirements in IFRS 15 in respect of variable consideration is particularly important when assessing the probability of a significant amount of revenue being reversed in the future. In turn this determines how much consideration is included in the transaction price, which ultimately determines the amount of revenue that can be recognised (see Step 5 below). The standard also introduces a specific restriction for royalty payments relating to licenses of intellectual property, for example, some types of franchise licenses. If royalty payments are based on usage or onward sale, entities are restricted from recognising the associated revenue until the usage or onward sale has occurred, even if it is possible to make a reliable estimate of this amount based on historical evidence.

Customers' unexercised rights

Many entities in the travel, hospitality and leisure industry receive non-refundable upfront payments in respect of future goods or services, for example, prepayments for flights in a holiday package. Entities may also grant customers loyalty points under reward programs to use against future purchases. Customers do not always exercise all their contractual rights in these scenarios. Such unexercised rights are often referred to as 'breakage'. Entities should recognise the expected breakage amount as revenue in proportion to the pattern of rights exercised by the customer. Otherwise, the entity should recognise any breakage amount as revenue when the likelihood of the customer exercising its remaining rights becomes remote.

It is generally appropriate for the expected level of 'breakage' to be calculated on a portfolio basis. Entities will need to determine an appropriate portfolio level at which to do this calculation.

Significant financing component

Under the new Standard, a financing component, if it is significant, is accounted for separately from revenue. This applies to payments in advance as well as in arrears (but subject to a practical expedient that it is not necessary to separate out a financing component if the gap between payment and delivery never exceeds 12 months).

Sales by some entities in the travel, hospitality and leisure sector may include financing arrangements, in that the timing of cash inflows from the customer may not correspond with the timing of recognition of revenue. This is most likely to arise where a customer pays for services significantly in advance of delivery by the entity. For example, where a customer pays for a berth on a cruise liner more than a year in advance of its departure, the amount of revenue ultimately recognised for this transaction will be higher than the cash value paid, with the entity recognising a finance cost over the period for which it has 'borrowed' this money from its customer.

Step 4. Allocate the transaction price to separate performance obligations

Summary of the requirements	
Allocating the transaction price	After determining the transaction price at Step 3, Step 4 specifies how that transaction price is allocated between the different performance obligations identified in Step 2. Previously, IFRSs included very little in the way of requirements on this topic, whereas IFRS 15 is reasonably prescriptive. Accordingly, this could be an area of significant change for some entities, and entities will need to consider whether their existing systems are capable of allocating the transaction price in accordance with the Standard's requirements.
What method should be used to allocate the transaction price?	If there are multiple performance obligations identified in a single contract, the transaction price should be allocated to each separate performance obligation on the basis of relative stand-alone selling prices. The stand-alone selling price should be determined at contract inception and represents the price at which an entity would sell a promised good or service separately to a customer. Ideally, this will be an observable price at which an entity sells similar goods or services under similar circumstances and to similar customers.
Are any other methods available?	If the stand-alone selling price is not directly observable, the entity should estimate it. Estimation methods that may be used include an adjusted market assessment approach, an expected cost plus margin approach or a residual approach, but the last may only be used if certain conditions are met.
How should any discounts be allocated?	If the stand-alone selling prices are greater than the promised consideration in a contract with a customer, the customer is deemed to have received a discount. Unless the discount meets the criteria set out in the Standard to be allocated to only some of the performance obligations, the discount should be allocated proportionately to all the performance obligations in the contract. Variable consideration should also be allocated proportionately to all the performance obligations identified unless certain criteria are met.

Step 4. Inputs to allocate transaction price

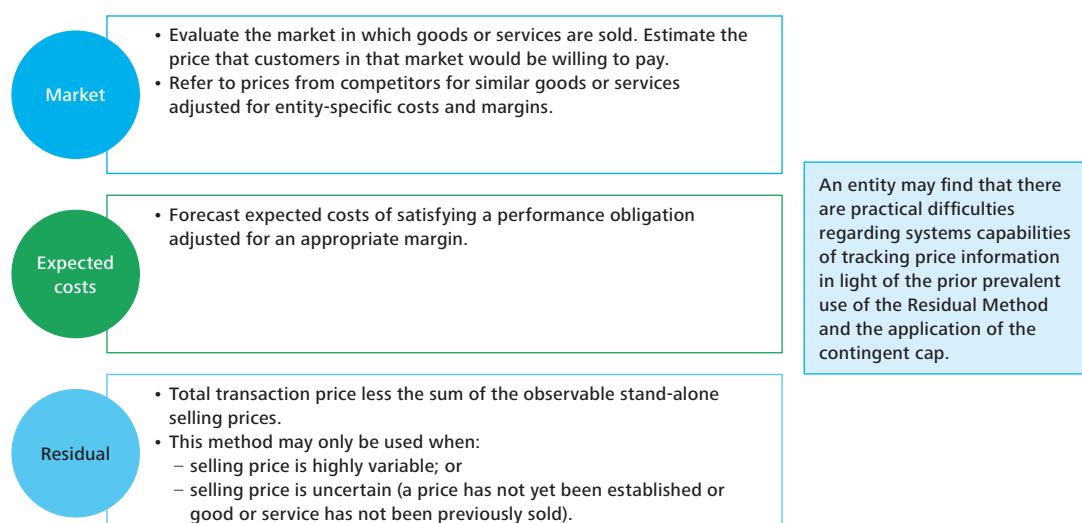
How to determine the stand-alone selling price?

Best evidence: observable price of a good or service when sold on a stand-alone basis

Not directly observable?



Must estimate! – maximise the use of observable inputs



Allocating the transaction price

As noted in Step 2 above, when there are two or more performance obligations within a contract, an entity will need to allocate the transaction price to the various performance obligations.

For example, a game lodge enters into a contract with a customer to sell the customer a safari package which includes 7 days and 6 nights stay at the lodge, breakfast each morning as well as four game drives and entertainment on the last night. The game lodge has determined that the safari package includes distinct goods and services and therefore has determined that there are four performance obligations. The price contained in the contract is CU4,000 and the game lodge expects to be entitled to this amount – CU4,000 is therefore determined to be the transaction price.

The stand-alone selling prices of these goods and services are directly observable and are CU2,500 for the six night stay, CU500 for the meals, CU1,000 for the game drives and CU400 for the entertainment (sum: CU4,400). The game lodge therefore allocates the total transaction price to the distinct goods and services as required by Step 4 based on their relative stand-alone prices. Therefore, the transaction price allocated is as follows:

1. Six night stay – $(2,500/4,400 \times 4,000) = \text{CU}2,273$
2. Meals – $(500/4,400 \times 4,000) = \text{CU}454$
3. Game drives – $(1,000/4,400 \times 4,000) = \text{CU}909$
4. Entertainment – $(400/4,400 \times 4,000) = \text{CU}364$

The pattern in which the entity will recognise revenue for each performance obligation will be determined by Step 5.

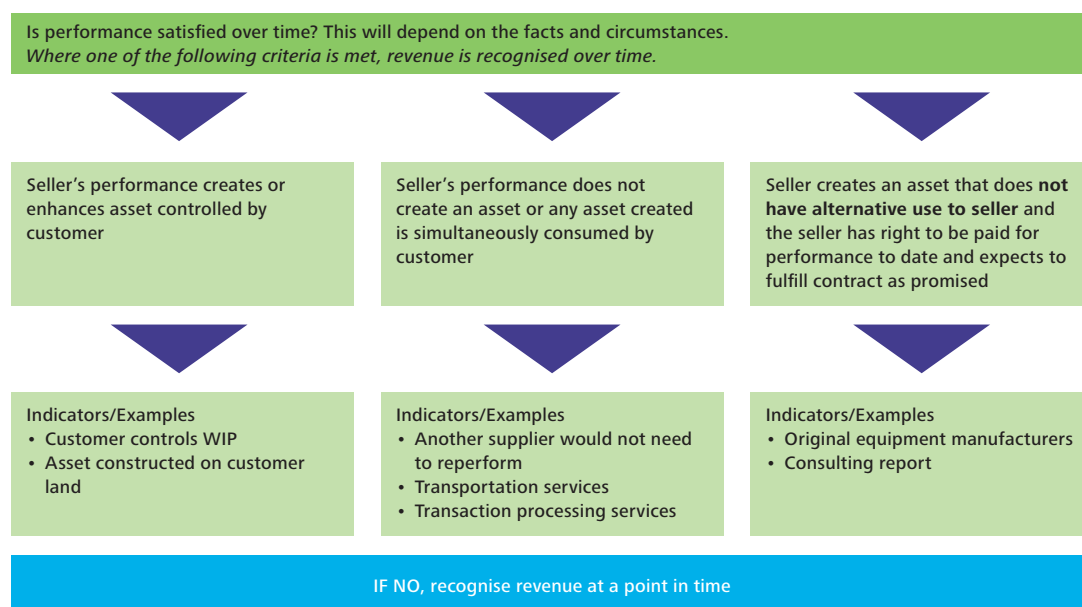
Step 5. Recognise revenue as the entity satisfies a performance obligation

Summary of the requirements

When should revenue be recognised?	<p>The final step is to determine, for each performance obligation, when revenue should be recognised. This may be over time or at a point in time. Previously, IAS 18 required revenue for services to be recognised over time and revenue for goods to be recognised at a point in time, but it did not include guidance on how to determine whether a particular item supplied under a contract should be regarded as a good or a service for these purposes. IFRS 15 does not distinguish between goods and services but instead includes specific and detailed guidance on when to recognise revenue over time and when to recognise revenue at a point in time. Some entities may find that items for which they previously recognised revenue at a point in time now have revenue recognised over time, or vice versa.</p>
What is control and how is it assessed?	<p>An entity should recognise revenue as the performance obligations are satisfied. A performance obligation is satisfied when control of the underlying goods or services for that particular performance obligation is transferred to the customer. 'Control' is defined as 'the ability to direct the use of and obtain substantially all of the remaining benefits from the asset' underlying the good or service. Control can transfer, and hence revenue be recognised, over time (for example, six night stay at a hotel), or at a point in time (for example, the provision of a meal).</p>
When is revenue recognised over time?	<p>Control is deemed to have transferred over time if any one of the following is met:</p> <ul style="list-style-type: none"> • the customer simultaneously receives and consumes all of the benefits provided by the entity's performance as the entity performs. This means that if another entity were to take over providing the remaining performance obligation to a customer, it would not have to substantially reperform the work already completed by the initial provider. This criterion applies to service contracts where the customer consumes the benefits of the services as they are provided (for example, six night stay at a hotel); • the entity's performance creates or enhances an asset that the customer controls as the asset is created or enhanced. Control refers to the ability to direct the use of and obtain substantially all of the remaining benefits from the asset. Therefore this criterion is satisfied if the terms of the contract transfer control of the asset to the customer as the asset is being built (i.e. control of work in progress). This asset may be tangible or intangible; or • the entity's performance does not create an asset with an alternative use to the entity and the entity has an enforceable right to payment for performance completed to date, including a reasonable profit margin. This criterion may apply in situations where the indicators of control are not immediately apparent. Entities will assess whether an asset has an alternative use at contract inception. An asset with no alternative use to an entity is one where the entity is unable to readily direct the use of the asset, which may be partially or wholly completed, for another use. This limitation may be imposed contractually or practically. A contractual restriction is one where the terms of the contract would allow the customer to enforce its rights to the promised asset if the entity attempted to redirect the asset for another use, whereas a practical restriction is one where the entity would incur significant economic losses to redirect the use of the asset, such as significant costs of rework or significant loss on sale of the asset.
When is revenue recognised at a point in time?	<p>If a performance obligation does not meet the criteria to be satisfied over time, entities should consider the following indicators in evaluating the point in time at which control of the asset has been transferred to a customer:</p> <ul style="list-style-type: none"> • the entity has transferred title to the asset; • the entity has transferred physical possession of the asset; • the entity has a present right to payment for the asset; • the customer has accepted the asset; and • the customer has the significant risks and rewards of ownership of the asset.

One of the key changes in IFRS 15 is the basis for the recognition of revenue. For goods, IAS 18 utilised the concept of the transfer of risks and rewards, whereas IFRS 15 utilises the concept of the transfer of control in all cases. Although applying the two different concepts will often not alter the timing of revenue recognition, it is nevertheless possible in some circumstances for entities to have a different pattern of revenue recognition based on a transfer of control as opposed to a transfer of risks and rewards, and this should be taken into careful consideration. It is possible that as a result of IFRS 15, revenue which was previously recognised over time will now be recognised at a point in time, or vice versa.

Step 5. Recognising revenue over time



Further areas of guidance

Contract modifications

Summary of the requirements

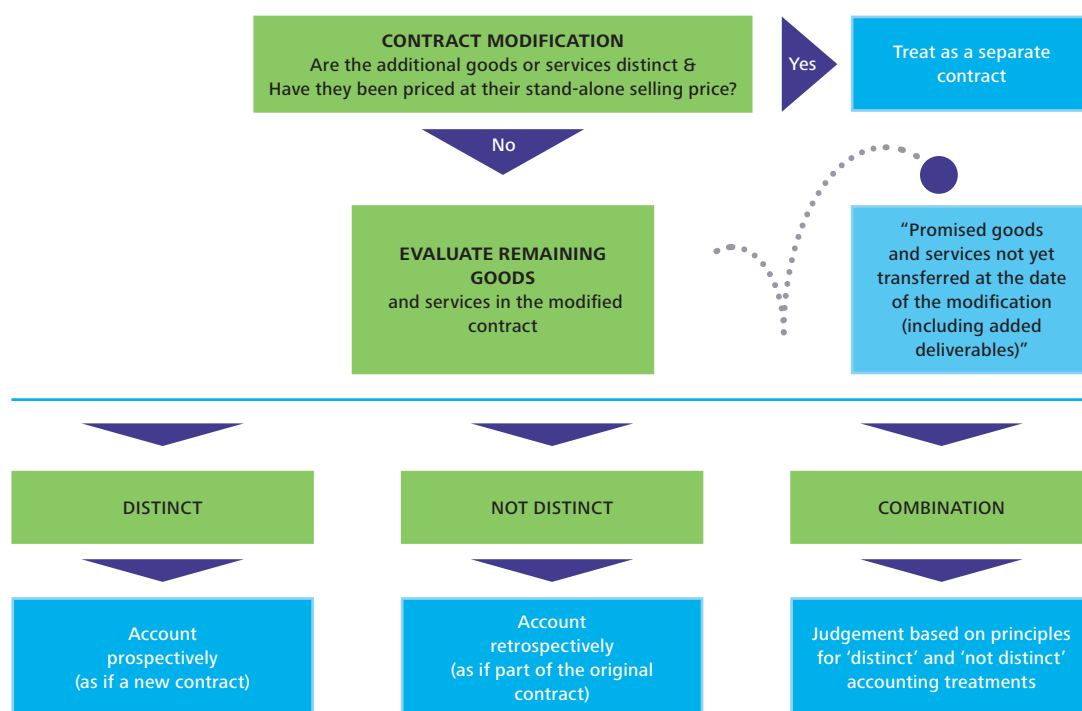
Should revenue be adjusted when a contract is modified?

Contract modifications (also sometimes referred to as a change order, variation or amendment) of price, scope or both will have accounting consequences when they are 'approved' such that they create enforceable rights and obligations. Modifications should be treated as an adjustment to the original contract unless they merely add a further performance obligation that is both 'distinct' (as defined by the Standard – see Step 2 above) and priced based on an appropriately adjusted stand-alone selling price. If both these conditions are met, the modification is treated as a new, separate contract.

If the modification is treated as an adjustment to the original contract, the appropriate accounting depends on the remaining goods or services to be delivered under the contract.

- If the remaining goods or services are distinct, the modification is accounted for prospectively by allocating the remaining transaction price to the remaining performance obligations in the contract.
- If the remaining goods or services are not distinct, the modification is accounted for retrospectively, by updating both the transaction price and the measure of progress for the part-complete performance obligation.

Contract modification



The only scenario in which the original contract will be left unchanged and therefore the modification will be accounted for as a new, separate contract is when the incremental price charged for the added distinct goods or services is commensurate with the stand-alone price of those goods or services. All other changes to a contract should be treated as a modification of the original contract.

Costs of obtaining or fulfilling a contract

Summary of the requirements	
Types of cost which can be capitalised	When assessing whether contract costs are eligible for capitalisation it is important to distinguish between the costs of obtaining a contract and the costs of fulfilling it. Both of these categories of cost may be eligible for capitalisation in accordance with the Standard. However, the rules for each category are different and care must be taken to apply the correct guidance.
When should costs of obtaining a contract be capitalised?	<p>Costs of obtaining a contract should be recognised as an asset and subsequently amortised (see below) if they are incremental and are expected to be recovered. Costs of obtaining a contract are incremental only if they would not have been incurred if the contract had not been obtained (e.g. a sales commission).</p> <div> <p>Practical expedient</p> <p>Where the asset that would be recognised as a result of capitalising the cost of obtaining a contract would be amortised over one year or less, an entity may choose to expense those costs when incurred.</p> </div> <p>Any costs incurred prior to obtaining a contract that do not relate to the fulfilment of the contract, and which would have been incurred regardless of whether the entity obtained the contract or not, should be recognised as an expense when incurred, unless they are explicitly chargeable to the customer regardless of whether the contract is obtained.</p>
When should costs of fulfilling a contract be capitalised?	<p>Where costs of fulfilling a contract are within the scope of another standard (e.g. inventories), they should be dealt with by that standard. Costs that are not within the scope of another standard should be capitalised as assets only if they meet all of the following criteria:</p> <ul style="list-style-type: none"> • they relate directly to a specifically identifiable contract (whether this has already been obtained or is anticipated to be obtained); • they generate or enhance resources that will be used in satisfying the contract; and • they are expected to be recovered. <p>Examples of such costs are direct labour costs, direct materials costs, allocations of costs and any costs that are explicitly chargeable to the customer.</p> <p>Notwithstanding the guidance above, the Standard includes specific requirements that certain costs should be recognised as expenses when incurred. These include general and administrative costs (unless they are explicitly chargeable to the customer), costs of wastage and any costs that relate to fully or partly satisfied performance obligations or where the entity cannot distinguish whether the costs relate to unsatisfied, partly satisfied or wholly satisfied performance obligations.</p>
When are capitalised costs amortised?	IFRS 15 includes guidance on amortisation and impairment of assets arising from the capitalisation of both types of cost noted above. Amortisation should be charged on a basis consistent with the transfer to the customer of the goods or services to which the capitalised costs relate. Where the carrying value of such an asset exceeds the amount of consideration still to be received in relation to the related goods or services, less the residual cost of providing those goods or services, an impairment loss should be recognised.

Entities within the travel, hospitality and leisure sector may incur significant costs that are directly attributable to obtaining contracts with customers. A typical example of this is success fees paid to travel agents for signing up new customers to a hotel/lodge.

Treatment of these costs is currently varied, with some entities within the travel, hospitality and leisure sector choosing to expense the costs and others choosing to capitalise the costs. When an entity incurs incremental costs that arise directly as a result of successfully obtaining a contract and certain criteria are met, IFRS 15 requires that these shall be recognised as an asset on the balance sheet (unless the practical expedient applies).

If entities within the travel, hospitality and leisure sector recognise an asset as a result of obtaining a contract, the entity will be required to determine the appropriate pattern of amortisation and assess for impairment. A change in treatment of these costs may result in a change in the profile of profit recognition.

Additional considerations

IFRS 15 provides detailed guidance in specific areas that may or may not be relevant to entities, depending on their industry and standard practices. One of the areas for which existing practice may change is listed below.

- **Licensing (excluding sales or usage based licences):** Where an entity sells a licence of its intellectual property, for example a license to operate a hotel, the timing of revenue recognition will depend in part on the nature of the licence. If the licence represents a promise to the customer to access the intellectual property, revenue will typically be recognised over the period for which access is granted, whereas a promise to transfer a right to intellectual property will typically give rise to revenue at a point in time when the transfer occurs.

Disclosures

IFRS 15 requires an increased level of disclosures about revenue recognition in comparison to previous Standards, which have been criticised for lacking adequate disclosure requirements. Under IFRS 15, the disclosure requirements are driven by the objective of providing users of the financial statements with information that will help them to understand the nature, amount, timing and uncertainty of revenue and cash flows arising from contracts with customers. As such, entities should not approach the disclosure requirements on a 'checklist' basis but should consider how to provide qualitative and quantitative disclosures around their contracts with customers, making clear any significant judgements made in applying IFRS 15 to contracts, and any assets recognised in relation to the cost of obtaining or fulfilling a contract. Updates or changes to the systems and processes of entities may be required to ensure that they are able to comply with the disclosure requirements.



The key disclosures required include the following.

- Contracts with customers
 - A disaggregation of revenue for the period into categories that depict how the nature, amount, timing and uncertainty of revenue and cash flows are affected by economic factors. Information must also be provided to demonstrate the relationship between the disaggregated revenue information and any segment revenue disclosures.
 - Information about the entity's contract assets and contract liabilities. This includes opening and closing balances of balance sheet items relating to contracts with customers. Entities will also be required to disclose the amount of revenue recognised in the current year that relates to the satisfaction of performance obligations in previous reporting periods. In relation to its performance obligations, entities will explain how the future pattern of satisfaction of these will impact on the contract asset and contract liability balance.
 - Information about the entity's remaining performance obligations. Entities will be required to disclose the total transaction price allocated to the remaining performance obligations at the end of each reporting period (unless the remaining performance obligation will be satisfied in less than a year). Other disclosures required include information about when the entity typically satisfies its performance obligations, the significant payment terms, the nature of the goods or services that the entity has promised to transfer and information about obligations relating to warranties, refunds and returns.
- Significant judgements
 - Information about entities' judgements, and any changes in judgements, in relation to the timing of, and the transaction price allocated to, the satisfaction of performance obligations. Entities will be required to disclose how they have made these judgements and why these are a faithful depiction of the transfer of goods or services.
- Assets recognised in relation to the costs of obtaining or fulfilling a contract
 - The closing balance of any assets recognised in relation to costs incurred to obtain or fulfil a contract, in addition to any judgements exercised in determining the amount to be capitalised.
 - Amortisation information for the amount recognised in profit or loss in the current period and the method of amortisation.

IFRS 15 also amends IAS 34 *Interim Financial Reporting* to require disaggregated revenue information to be disclosed in interim financial statements.

Transition

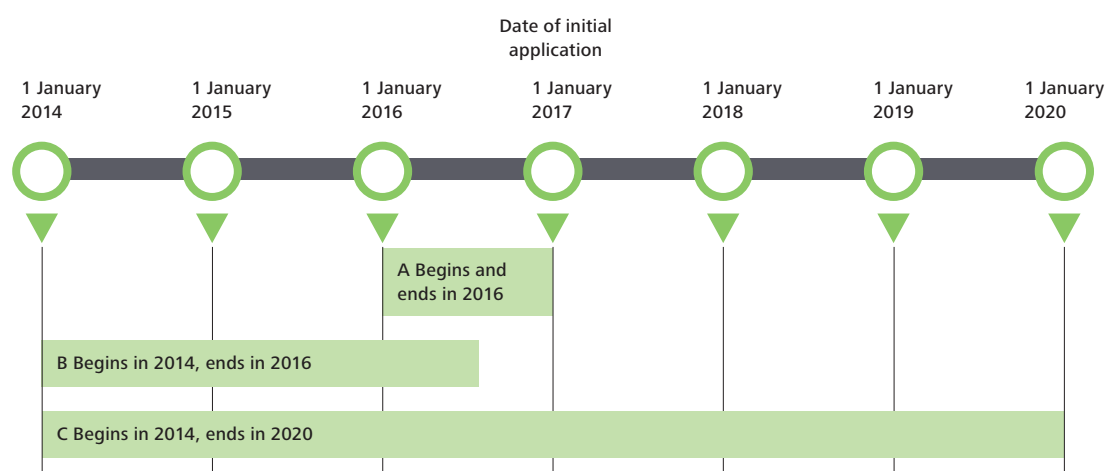
Entities have two options for transitioning to IFRS 15. Both options are fairly detailed but helpful in providing some relief on initial application of IFRS 15. Both of these options make reference to the date of initial application – which is the start of the reporting period in which an entity first applies the Standard. For example, entities applying the Standard for the first time in financial statements for the year ending 31 December 2017 will have a date of initial application of 1 January 2017.

Transition timeline

Example

Assume December 31 Y/E

Assume 1 year of comparatives only



Method 1 Full retrospective approach

Contract A Begins and ends in same annual reporting period and completed before the date of initial application – Practical expedient available

Contract B Adjust opening balance of each affected component of equity for the earliest prior period presented (1 January 2016)

Contract C Adjust opening balance of each affected component of equity for the earliest prior period presented (1 January 2016)

Method 2 Simplified transitional approach

Contract A Contract completed before the date of initial application – Do not apply IFRS 15

Contract B Contract completed before the date of initial application – Do not apply IFRS 15

Contract C Adjust opening balance of each affected component of equity at date of initial application. Disclose information per paragraph 134.2

Method 1

Full retrospective approach

Entities can apply the Standard retrospectively to all comparative periods presented. Under this option, prior year comparatives are restated, with a resulting adjustment to the opening balance of equity in the earliest comparative period. Where this option is chosen, the Standard provides a number of optional practical expedients. These include the following.

- For completed contracts, entities are not required to restate contracts that begin and end within the same annual reporting period. For example, if an entity first applying the Standard for a 31 December 2017 year end entered into and completed a contract in 2016, that contract will not need to be restated (that is, the interim periods in 2016 are not required to be restated).
- For completed contracts that have variable consideration, an entity may use the transaction price at the date the contract was completed rather than estimating variable consideration amounts in the comparative reporting periods. For example, for an entity first applying the Standard for a 31 December 2017 year end, if a contract was completed prior to 31 December 2016, rather than estimate variable consideration at earlier dates, the entity may base earlier revenue figures on the consideration (including any variable consideration) that was ultimately payable.
- For all periods presented before the date of initial application, an entity need not disclose the amount of the transaction price allocated to remaining performance obligations and an explanation of when the entity expects to recognise that amount as revenue. For example, for an entity first applying the Standard for a 31 December 2017 year end, if a contract is entered into on 1 January 2016 and is incomplete at 31 December 2016, the entity will not be required to provide disclosures on the contract's remaining performance obligations as at 31 December 2016.

Any practical expedients used should be used consistently for all prior periods presented and disclosure should be given with regards to which expedients have been used. To the extent possible, a qualitative assessment of the estimated effect of applying each of those expedients should be provided.

Method 2

Modified approach

Under the modified approach, entities can apply the Standard only from the date of initial application. If they choose this option, they will need to adjust the opening balance of equity at the date of initial application (i.e. 1 January 2017) but they are not required to adjust prior year comparatives. This means that they do not need to consider contracts that have completed prior to the date of initial application. Broadly, the figures reported from the date of initial application will be the same as if the Standard had always been applied, but figures for comparative periods will remain on the previous basis.

If this option is used, disclosure is required of the amount by which each financial statement line item is affected in the current period as a result of applying the guidance and an explanation of the significant changes between the reported results under IFRS 15 and the previous revenue guidance followed.

Transition Resource Group

IFRS 15 is the first comprehensive principles-based Standard on revenue. The previous guidance under IFRSs was fairly limited, and the previous guidance under US GAAP was rules-driven, with specific guidance available for different industries. The IASB and FASB are aware that, whilst they have put a lot of time and thought into the development of the Standard, issues will arise as entities begin to implement the Standard in practice. As a result, they have formed a joint "Transition Resource Group", which is intended to help the Boards resolve any diversity in practice and address implementation issues as they arise. Therefore, the Boards may issue additional revenue guidance or interpretations before the Standard's effective date in 2017.

Final thoughts and broader issues

The transition to IFRS 15 will affect all businesses, to varying degrees. Nevertheless, with an effective transition date of periods starting on 1 January 2017, this provides businesses with an opportunity to consider carefully the new requirements and resolve any potential accounting issues in advance. In addition to those potential accounting issues, IFRS 15 will have a wider effect on the business. The following list highlights aspects of the business that may be affected by the transition to IFRS 15, although it is not intended to be exhaustive.

- **Systems and processes** – as noted previously, in order to gather the information required for reporting under IFRS 15, an entity may require re-designs or modifications to its IT systems and to its processes (e.g. internal controls) more generally.
- **Training for employees** – entities should provide training to those employees affected by the changes. This will include accountants, internal auditors and those responsible for drawing up customer contracts.
- **Bank covenants** – changes in the revenue recognition accounting methods may change the amount, timing and presentation of revenue, with a consequent impact on profits and net assets. This may impact the financial results used in the calculation of an entity's bank covenants. As such, entities should seek early discussions with lenders, to establish whether renegotiation of covenants will be necessary.
- **KPIs** – where they are based on a reported revenue or profit figure, they may be impacted by the changes. As such, an entity may want to begin evaluating the impact of the Standard on key financial ratios and performance indicators that may be significantly impacted by the changes with a view to determining whether its KPI targets should be adjusted. Where there are changes, an entity will also need to consider how to explain these to investors.
- **Compensation and bonus plans** – bonuses paid to employees are sometimes dependent on revenue or profit figures achieved. Changes in the recognition of revenue as a result of IFRS 15 may have an impact on the ability of employees to achieve these targets, or on the timing of achievement of these targets.
- **Ability to pay dividends** – in certain jurisdictions, the ability to pay dividends to shareholders is impacted by recognised profits, which in turn are affected by the timing of revenue recognition. Where this is the case, entities will need to determine whether the changes will significantly affect the timing of revenue and profit recognition and, where appropriate, communicate this to stakeholders and update business plans.
- **Tax** – the profile of tax cash payments, and the recognition of deferred tax, could be impacted due to differences in the timing of recognition of revenue under IFRS 15.
- **Stakeholders** – users of the financial statements such as the Board of Directors, audit committee, analysts, investors, creditors and shareholders will require an explanation of the changes in IFRS 15 in order to understand how the financial statements have been impacted.

More information on the new Standard, as well as other UK accounting, reporting and corporate governance news and publications can be found at www.ukaccountingplus.co.uk

Contacts

If you would like further, more detailed information on the new Standard, please contact your local Deloitte partner.

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