IFRS 15 and IFRS 16 Refresher – Revenue and Leases

David Potts FCA

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Programme

- IFRS 15 – Revenue from contracts with customers
  - 5 step approach
  - Performance obligation and valuation issues
  - Possible problem areas
- IFRS 16 – Leases
  - Accounting for the leased asset – as lessee
  - Reporting lease obligations

IFRS 15 – Revenue from contracts with customers

IFRS 15 Revenue recognition – the key steps

- Step 1 – Identify the contract(s) with a customer
- Step 2 – identify the performance obligations
- Step 3 – Determine the transaction price
- Step 4 – Allocate the transaction price to the performance obligations in the contract
- Step 5 – Recognize revenue when (or as) the entity satisfies a performance obligation

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What is a performance obligation?

- A good or service that is distinct; or
- A series of distinct goods and services that are essentially the same

Transaction price

- Consideration entity expects to be entitled to
  - Exclude amounts collected on behalf of third parties
  - Include only amounts receivable under the contract

- Must take into account
  - Variable revenue
  - Non-cash consideration
  - Amounts payable to customer
  - Whether there is a significant financing element

- Only include revenue if highly probable there will not be a significant reversal in future

Costs relating to a contract

- Treatment of costs relating to the fulfilment of a contract; but incurred before goods or services are delivered?
- Covered by another part of IFRS?
- If not Capitalise when and only when:
  - Directly relate to the contract
  - Generate or enhance resources to deliver PO; and
  - Likely to be recovered

Satisfaction of performance obligations

- Point in time or over time
- When control of underlying goods or services transferred

- Control is:
  - Ability to direct use of and obtain substantially all of remaining benefits from the asset underlying the goods or services (tangible or intangible)
  - Includes ability to prevent others from using

Revenue recognition - examples

1. Deliver goods to the customer on 14 May, issue an invoice dated 31st May at the end of the month. Customer pays on 15th July.
2. Health club offers 40 year family membership for a non-returnable 'joining fee' of £10,000?
3. Mobile phone provider offers iPhone 12 for £100 + 2 year service contract at £50 per month minimum
4. Retailer sells a gift card for £20.

IFRS 16 - Leases

IFRS 16 – key messages

- Effective from 1 January 2019.
- If now converting to IFRS consider transition rules and guidance in IFRS 1 – First time adoption
- Lessee accounting
  - More transparent reporting of assets and lease liabilities
  - More guidance so more consistency
  - One form of accounting for lessees
- Lessor accounting
  - Will not change – still two lease types, operating and finance. Still need to assess and distinguish
  - Increased disclosures – residual value risk

IFRS 16 - scope

- All leases – as defined
- Except
  - Oil and gas and mineral rights
  - Biological assets
  - Service concession agreements
  - IP rights under IFRS 15 or intangibles under IAS 38 (film rights and similar)
- Exemption for short term lease (under 12 months) and assets of low value

What is a lease?

- Contract
- Right to control use of identified asset
- For a period of time
- In exchange for consideration

IFRS 16 – lessee accounting

Right of use asset

- Report at cost
  - Lease liability +
  - Initial and direct costs
  - Less incentives
- Depreciate
- Hold at fair value if investment property; or
- Can revalue

Lease liability

- Present value of payments
- Discounted using interest rate implicit
- Include assessment of variable payments – which can be varied

Lessee accounting – example

- An entity enters into a five year property lease at a cost of £100k per year
  - Lease would have been classed as an operating lease under IAS 17 and £100k per year would have been recognised as an expense. No asset or liability would have been recognised on the balance sheet
  - Under IFRS 16 the lease is brought on balance sheet
    - Assuming an incremental cost of borrowing of 4% the net present value of the lease liability is £445k
  - What are the accounting entries, to the nearest £1,000 to record this transaction over 5 year term?

Statement of Financial Position - solution

	Asset	Liability
	£	£
Inception	445,000	445,000
Year 1	356,000	363,000
Year 2		
Year 3		
Year 4		
Year 5		

Income Statement - solution

	Amortisation	Interest	Total
	£	£	£
Inception	-	-	-
Year 1	89,000	18,000	107,000
Year 2			
Year 3			
Year 4			
Year 5			

IFRS 16 – other issues to consider

Lease term

- Inception is earlier of:
  - Date of lease contract or
  - Date of commitment of parties to principal terms and conditions
- Non-cancellable period
- Including periods covered by option to extend (if reasonably certain)
- And excluding options to terminate if reasonably certain not to take option

Lease incentives

- Payments made by **lessor** to **lessee** associated with a lease; or
- Reimbursement or assumption by the lessor of costs of the lessee
- Will cover:
  - Relocation and fit-out
  - Rent free periods
  - Business rate free periods

Discount rate to apply

- Interest rate implicit in the lease – as usual
- Present value of:
  - Lease payment +
  - Unguaranteed residual value
  - = to fair value of underlying asset + direct incurred costs
- If not readily determinable = use incremental borrowing rate of the lessee
- How to identify:
  - 3 year car PCP contract?
  - 20 year commercial property lease?

Changes to lease agreement

- Modification to lease may result in accounting for a new lease agreement;
  - Scope increased by adding more underlying assets; and
  - Increase in use is reflected by an appropriate increase in consideration payments

- Assets is vacated or sub-let in full or in part?
  - No change to reported liability
  - Right of Use asset might now be impaired – perhaps to nil value?
  - Sub-lease will have to be accounted for as either an operating or a finance lease - classification is made by reference to the Right of Use asset

Leases – final typical problem areas

- Lease agreement includes parking spaces, office cleaning and reception services, include or exclude from lease payments?
- Lease payments are linked to the revenue generated by the lessee.
  - Lease rental is 5% of revenue; or
  - Annual revenue < £1,000 = lease rental £100 per year. Annual revenue > £1,000 = lease rentals are £50,000 per year?
  - In both cases the lessee averages annual revenue of £150,000, what would you include as the rental in the calculation of the lease liability?
- Sign a 10 year lease for a commercial property in New York, rental is $100,000 pa – you prepare in accounts in €.
  - How should the Right of Use asset be measured on the balance sheet?
  - And the lease liability?

Thank you and any questions?

Solutions to examples

Revenue recognition - examples

1. Deliver goods to the customer on 14 May, issue an invoice dated 31st May at the end of the month. Customer pays on 15th July.
    1. 14 May - usually
2. Health club offers 40 year family membership for a non-returnable ‘joining fee’ of £10,000?
    1. Spread over period of membership – 40 years?
3. Mobile phone provider offers iPhone 12 for £100 + 2 year service contract at £50 per month minimum
    1. Phone income on delivery, service spread over 2 years
    2. Consider fair value of separate obligations and financing element
4. Retailer sells a gift card for £20.
    1. When redeemed in store

Statement of Financial Position - solution

	Asset	Liability
	£	£
Inception	445,000	445,000
Year 1	356,000	363,000
Year 2	267,000	278,000
Year 3	178,000	189,000
Year 4	89,000	96,000
Year 5	-	-

Income Statement - solution

	Amortisation	Interest	Total
	£	£	£
Inception	-	-	-
Year 1	89,000	18,000	107,000
Year 2	89,000	15,000	104,000
Year 3	89,000	11,000	100,000
Year 4	89,000	8,000	97,000
Year 5	89,000	4,000	93,000

Leases – final typical problem areas

- Lease agreement includes parking spaces, office cleaning and reception services, include or exclude from lease payments?
  - Either is acceptable, to include in lease payments is a practical expedient available under IFRS 16
- Lease payments are linked to the revenue generated by the lessee.
  - Lease rental is 5% of revenue; or
    - £0 as all of revenue is connected to future use of the asset which cannot be reliably estimated
  - Annual revenue < £1,000 = lease rental £100 per year. Annual revenue > £1,000 = lease rentals are £50,000 per year?
    - £50,000 – the £100 rent is clearly never going to apply
  - In both cases the lessee averages annual revenue of £150,000, what would you include as the rental in the calculation of the lease liability?

Leases – final typical problem areas

- Sign a 10 year lease for a commercial property in New York, rental is $100,000 pa – you prepare in accounts in €.
  - How should the Right of Use asset be measured on the balance sheet?
    - Cost based on initial discounted lease liability based on future USD cash flows converted to € at date of asset recognition
  - And the lease liability?
    - At inception – as same value as Right of Use asset
    - Each subsequent year, as this is a foreign currency monetary item it must be remeasured to the year end exchange rate value – gains and losses will be reported immediately in profit and loss

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