Your facilitators today

Kim Heng

Brendan Doyle

Brandon Dalton

Joe Rinarelli
Where are we at?

The day has (almost) arrived
Agenda

1. Non-refundable up-front fees
2. Accounting for a material right
3. Contract modifications
4. Principal vs agent
What does AASB 15 require?

Core principle
Recognise revenue to depict transfer of promised goods or services to customers in an amount that reflects consideration to which the entity expects to be entitled in exchange for those goods or service.

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

Risk and rewards model

Change

Control model

© 2017 KPMG, an Australian partnership and a member firm of the KPMG network of independent member firms affiliated with KPMG International Cooperative (“KPMG International”), a Swiss entity. All rights reserved. The KPMG name and logo are registered trademarks or trademarks of KPMG International. Liability limited by a scheme approved under Professional Standards Legislation.
Non-refundable up-front fees
Performance obligations and up-front fees

Does fee relate to specific goods or services transferred to customers?

Yes

Account for as promised good or services

Recognise allocated consideration as revenue on transfer of promised good or services

No

Account for as advanced payment for future goods or services

Recognise as revenue when future goods or services are provided

Over what period?

Consider whether material right exists

Change
Example 1: Up-front financial advice fee

Sierra Private (Sierra) prepares a financial package for Mr. Jones, an investor.

The financial package has investments in Sierra products A and B and non-Sierra product C. The financial package includes an up-front fee of $2,000 and an on-going advisor fee of $100 per month.

If the financial package is cancelled within 12-months, there is consequently a significant termination fee. Sierra has determined the term of the financial package contract is 1 year and the average customer life is 5 years.

The up-front fee is for the work involved in the research, preparation and implementation of the strategic and investment advice outlined in the financial plan. The on-going advisor fee is for active monitoring and optimisation of Mr. Jones’ portfolios.

Sierra typically provides separate financial planning services to other customers.

Q: How should Sierra account for the up-front fee?
Example 1 solution: Up-front financial advice fee

Does the fee relate to specific goods or services transferred to customer?

<table>
<thead>
<tr>
<th>Considerations</th>
<th>Met?</th>
</tr>
</thead>
<tbody>
<tr>
<td>a) Has a good or service been transferred to customer; and</td>
<td>✓</td>
</tr>
<tr>
<td>b) Is customer able to realise benefit from good or service received?</td>
<td>✓</td>
</tr>
<tr>
<td>Does entity separately price and sell development of financial plan services covered by the up-front fee?</td>
<td>✓</td>
</tr>
</tbody>
</table>

Account for development of the financial plan as a distinct performance obligation (e.g. promised service)
Example 2: Sign-up fee for cloud computing services

Congo Cloud Service (Congo) provides cloud based data storage services.

Congo and Jeff enter into a contract for 50 GB’s of storage for $300 a year and a one-off $50 sign-up fee. The sign-up fee is the same for each customer no matter the storage plan requested.

The sign-up fee is to cover the costs of creating a user interface that permits Jeff to access Congo’s online platform. Congo does not typically provide interface creation services separately.

A termination fee calculated pro-rata based on the remaining months left in the contract is payable if the contract is cancelled within 12-months. Congo has determined the term of contract is 1 year and the average customer life is 3 years.

If Jeff renews the contract, he will not incur another sign-up fee.
Example 2 solution: Sign-up fee for cloud computing services

Does the fee relate to specific goods or services transferred to customer?

<table>
<thead>
<tr>
<th>Considerations</th>
<th>Met?</th>
</tr>
</thead>
<tbody>
<tr>
<td>a) Has a good or service been transferred to customer; and</td>
<td>✗</td>
</tr>
<tr>
<td>b) Is customer able to realise benefit from good or service received?</td>
<td>✗</td>
</tr>
<tr>
<td>Does entity separately price and sell interface services covered by the up-front fee?</td>
<td>✗</td>
</tr>
</tbody>
</table>

Account for up-front fee as advanced payment for future services

Q: Is there a material right and over what period is the revenue recognised?
Non-refundable up-front fee that is a material right

A potential future benefit provided to the customer as a result of entering into the original contract

**Material right**

**Quantitative Factors**
- Compare up-front fee with total transaction price (fee for contract period)

**Qualitative Factors**
- Quality of service provided?
- Services and pricing provided by competitors?
- Inconvenience of changing service providers?

Does non-refundable up-front fee provide customer with a material right?

- No
- Yes

Recognise it **over initial contract period** as fee is, in effect, an advance payment for promised goods or services in that contract period.

Recognise it **over period during which customer is expected to benefit from not having to pay a fee upon renewal**.
Example 2 solution: Sign-up fee for cloud computing...

Quantitative Factors
- Fee makes up 14% of the total transaction price
- $350 in the first year, $300 in subsequent years

Qualitative Factors
- How easy is it to transfer data to a competitor?
- Does Congo provide the best service?
- How does Congo’s pricing compare to competitors?

Does non-refundable up-front fee provide customer with a material right?

No
Recognise $50 over the 12-month contract period.

Yes
Recognise over period Congo expects customer to benefit from not having to pay $50 again – 3 years.
Example 3: Mobilisation fees

Ipsum Engineering (Ipsum) enters into a master service agreement (MSA) with Hope Mines to be the predominant external contractor for their open cut mine in the Pilbara. Ipsum charges $1,000 an hour for mining engineering services. It is virtually certain they will be providing services to Hope Mines with 4,000 hours of service, a year.

Given the remote location of the mine, Ipsum charges a $1 million up-front mobilisation fee for the logistics involved of getting their equipment and employees to the mine. Ipsum does not typically provide mobilisation services separately.

Hope Mines submits a purchase order to Ipsum for 360 hours, on the same day it signs the MSA.

The average life for a mining engineering service agreement of this scope is 3 years.

Q: How should Ipsum account for the up-front mobilisation fee?
Example 3 solution: Mobilisation fees

Does the fee relate to specific goods or services transferred to customer?

<table>
<thead>
<tr>
<th>Considerations</th>
<th>Met?</th>
</tr>
</thead>
<tbody>
<tr>
<td>a) Has a good or service been transferred to customer; and</td>
<td></td>
</tr>
<tr>
<td>b) Is customer able to realise benefit from good or service received?</td>
<td></td>
</tr>
</tbody>
</table>

Does entity separately price and sell mobilisation activities covered by the up-front fee?

Account for up-front fee as advanced payment for future goods or services

Q: Is there a material right and over what period is the revenue recognised?
Example 3 solution: Mobilisation fees

**Quantitative Factors**
- Fee makes up 74% of total transaction price ($1m / $1.36m ($1,000 x 360hrs) + $1m))
- Next purchase orders will not incur the mobilisation fee

**Qualitative Factors**
- How easy is it to transfer to a competitor?
- Does Ipsum possess skills and machinery that is hard to replace?
- How does pricing compare to competitors?

Does non-refundable up-front fee provide customer with a material right?

- No
  - Recognise $1m over first purchase order.
- Yes
  - Recognise over the period Ipsum expects customer to benefit from not having to pay $1m again - 3 years.
Accounting for a material right
What is a material right?

Material right

A potential future benefit provided to the customer as a result of entering into the original contract

Examples include:

- Option to acquire additional goods at a discounted rate
- Non-refundable up-front fees
- Loyalty points
- Prospective volume discount or rebates
How to account for a material right

Accounting for a material right

...identify as separate performance obligation

...determine stand-alone selling price (SSP) on initial transaction date and do not revise SSP

...if breakage is expected, then account for breakage

...recognise as revenue when the underlying goods or services are delivered or expire (if breakage was not previously expected)
How to determine stand-alone selling price

Apply AASB 15.B42

- Observable price
- If not available, estimated price adjusted for:
  - any discount the customer could receive without exercising the option; and
  - the likelihood that the option will be exercised

Apply AASB 15.B43

Customer has material right to acquire future goods or services and those goods or services are ....

1) similar to the original in the contract
2) ... provided in accordance with the original terms of the contract

Practical alternative: allocate transaction price to the optional goods or services
Applicable where an entity may not have to provide all goods and services it is contracted to in order to be entitled to the related revenue

Do you expect the customer to take the full quantity of goods or services that they are entitled to?

Yes

No breakage expected
Recognise breakage amount when likelihood of customer exercising its remaining rights becomes remote

No

Breakage expected
Recognise revenue across the actual goods or services that we expect customer will take (consider the constraint)

If expectation changes
Example 4: Loyalty points

SuperGo (a retailer) offers a customer loyalty program whereby customers are rewarded 1 point for every $10 spent on goods purchased. Each point earned allows customers a $1 discount on future purchases and must be used within 4 years of issue date. Assume the loyalty points are considered a material right.

Historically, customers will redeem 97% of points earned.

In year 1, $100,000 of product is purchased (10,000 points earned). Revenue on products purchased are recognised point-in-time on delivery. No points are used during year 1.

Q: What is the accounting for this arrangement in year 1?
Example 4 solution: Loyalty points

Can we apply AASB 15.B43?

Customer has material right to acquire future goods or services and those goods or services are ....

1) similar to the original in the contract
2) ... provided in accordance with the original terms of the contract

B43 does not apply
Example 4 solution: Loyalty points

Year 1

<table>
<thead>
<tr>
<th></th>
<th>Stand-alone selling price</th>
<th>Selling price ratio</th>
<th>Allocation</th>
</tr>
</thead>
<tbody>
<tr>
<td>Products</td>
<td>$100,000</td>
<td>91%</td>
<td>$91,000</td>
</tr>
<tr>
<td>Loyalty points</td>
<td>*$9,700</td>
<td>9%</td>
<td>$9,000</td>
</tr>
<tr>
<td><strong>Total</strong></td>
<td><strong>$109,700</strong></td>
<td><strong>100%</strong></td>
<td><strong>$100,000</strong></td>
</tr>
</tbody>
</table>

* 10,000 points × $1 per point × 97% probability of redemption

Journal entries recorded in year 1

<table>
<thead>
<tr>
<th></th>
<th>DR Cash</th>
<th>CR Revenue</th>
<th>CR Contract liability</th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td>$100,000</td>
<td>$91,000</td>
<td>$9,000</td>
</tr>
</tbody>
</table>

Year 2, 4,500 points are redeemed.

Year 3, a further 4,000 points are redeemed and SuperGo updates its estimate as it now expects 9,900 points to be redeemed in total.

The remaining points are redeemed in year 4.

Q: What is the accounting in years 2, 3 and 4?
Example 4 solution: Loyalty points

Year 2

<table>
<thead>
<tr>
<th>Points redeemed</th>
<th>Estimated points</th>
<th>Cumulative Revenue</th>
</tr>
</thead>
<tbody>
<tr>
<td>4,500</td>
<td>9,700</td>
<td>$4,175</td>
</tr>
</tbody>
</table>

* (4,500 / 9,700) x $9,000

Journal entries

<table>
<thead>
<tr>
<th></th>
<th>DR Contract liability</th>
<th>CR Revenue</th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td>$4,175</td>
<td>$4,175</td>
</tr>
</tbody>
</table>

Year 3

<table>
<thead>
<tr>
<th>Cum. points redeemed</th>
<th>Estimated points</th>
<th>Cumulative Revenue</th>
<th>Rev. recg’d to date</th>
</tr>
</thead>
<tbody>
<tr>
<td>8,500</td>
<td>9,900</td>
<td>$7,727</td>
<td>$4,175</td>
</tr>
</tbody>
</table>

** (8,500 / 9,900) x $9,000

Journal entries

<table>
<thead>
<tr>
<th></th>
<th>DR Contract liability</th>
<th>CR Revenue</th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td>$3,552</td>
<td>$3,552</td>
</tr>
</tbody>
</table>

($7,727 - $4,175)
Example 4 solution: Loyalty points

Year 4

<table>
<thead>
<tr>
<th>Cum. points redeemed</th>
<th>Estimated points</th>
<th>Cumulative Revenue</th>
<th>Rev. recg’d to date</th>
</tr>
</thead>
<tbody>
<tr>
<td>9,900</td>
<td>9,900</td>
<td>$9,000*</td>
<td>$7,727</td>
</tr>
</tbody>
</table>

* \((9,900 / 9,900) \times 9,000\)

Journal entries

<table>
<thead>
<tr>
<th>DR Contract liability</th>
<th>$1,273</th>
</tr>
</thead>
<tbody>
<tr>
<td>CR Revenue</td>
<td>$1,273</td>
</tr>
</tbody>
</table>

\((9,000 - 7,727)\)

Q: What would happen if the estimate of loyalty points decreased from the original 9,700 at contract inception to 9,300?

- Do not recalculate standalone selling price
- Revise estimate and calculate cumulative catch-up

Similar to year 3 revision, but additional revenue to recognise
Example 5: Customer option to renew

Continuing from Example 2:

Congo Cloud Service (Congo) provides cloud based data storage services.

Congo and Jeff enter into a contract for 50 GB’s of storage for $300 a year and a one-off $50 sign-up fee. The sign-up fee is the same for each customer no matter the storage plan requested.

Assume Congo has determined that the option to renew the contract is a material right and expects the customer to renew for 2 years.

Q: What is the accounting for the arrangement, including the customer option to renew?
Example 5 solution: Customer option to renew

Can we apply AASB 15.B43?

Customer has material right to acquire future goods or services and those goods or services are ….

1) similar to the original in the contract

2) … provided in accordance with the original terms of the contract

Polling question 4: Has Congo met the criteria for B43? ✓

Initial allocation

<table>
<thead>
<tr>
<th>Contract price</th>
<th></th>
</tr>
</thead>
<tbody>
<tr>
<td>50 GB of data and sign-on fee</td>
<td>$350</td>
</tr>
<tr>
<td>Renewal year 1</td>
<td>$300</td>
</tr>
<tr>
<td>Renewal year 2</td>
<td>$300</td>
</tr>
<tr>
<td></td>
<td>$950</td>
</tr>
</tbody>
</table>

Journal entry in Year 1

<p>| | |</p>
<table>
<thead>
<tr>
<th></th>
<th></th>
</tr>
</thead>
<tbody>
<tr>
<td>DR Cash</td>
<td>$350</td>
</tr>
<tr>
<td>CR Revenue</td>
<td>$317*</td>
</tr>
<tr>
<td>CR Contract liability</td>
<td>$33</td>
</tr>
</tbody>
</table>

*$($950 total consideration / 3 year contract)
What questions do you have?
Contract modifications
Contract modifications

Is contract modification approved?

No

Do not account for contract modification until approved

Yes

Does it add distinct goods or services that are priced commensurate with stand-alone selling prices?

Yes

Account for as separate contract (prospective)

No

A promise to transfer to the customer a distinct good or service

Capable of being distinct
Can the customer benefit from promise on its own or together with other resources that are readily available?

Distinct within the context of the contract
Is it separately identifiable from other promises in the contract?
Example 6a: Does the modification add distinct goods or services?

Cleaning Co has an existing contract to clean Building A for $50k p/a with 3 years remaining.

Owners of Building A now also want Cleaning Co to provide maintenance services for the remainder of the contract period.

An addendum to the original contract added maintenance services at $75k p/a.

Cleaning Co typically sell maintenance services separately for $75k p/a.

Q: Is the maintenance service distinct from the cleaning service?

✓

Q: Is maintenance priced commensurate with its stand-alone selling price?

✓

Account for maintenance as a separate contract (prospectively)
Q: What if the price for added maintenance services was $60k p/a?

Does it add distinct goods or services that are priced commensurate with stand-alone selling prices?

No

Are remaining goods or services distinct from those already transferred?
Example 6b: Are remaining goods or services distinct from those already transferred?

Cleaning Co has an existing contract to clean Building A for $50k p/a with 3 years remaining.

Owners of Building A now also want Cleaning Co to provide maintenance services for the remainder of the contract period. An addendum to the original contract added maintenance services at $60k p/a.

Cleaning Co typically sell cleaning services separately for $70k p/a.

Cleaning Co typically sell maintenance services separately for $75k p/a.

Q: Are the remaining cleaning service & maintenance distinct from cleaning services already provided?

Account for as termination of existing contract and creation of new contract (prospective)
Cleaning Co has an existing contract to clean Building A for $50k p/a with 3 years remaining.

Owners of Building A now also want Cleaning Co to provide maintenance services for the remainder of the contract period. An addendum to the original contract added maintenance services at $60k p/a.

Cleaning Co typically sells cleaning services separately for $70k p/a, i.e. $210k for 3 years.

Cleaning Co typically sells maintenance services separately for $75k p/a, i.e. $225k for 3 years.

<table>
<thead>
<tr>
<th>Service</th>
<th>Stand-alone selling price</th>
<th>% Selling Ratio</th>
<th>Allocation</th>
</tr>
</thead>
<tbody>
<tr>
<td>Cleaning</td>
<td>$210,000</td>
<td>48% (210,000/435,000)</td>
<td>$158,400 (330,000 x 48%)</td>
</tr>
<tr>
<td>Maintenance</td>
<td>$225,000</td>
<td>52% (225,000/435,000)</td>
<td>$171,600 (330,000 x 52%)</td>
</tr>
<tr>
<td>Total</td>
<td>$435,000</td>
<td>100%</td>
<td>$330,000</td>
</tr>
</tbody>
</table>

Q: What is the accounting for this arrangement going forward?
Does it add distinct goods or services that are priced commensurate with stand-alone selling prices?

No

Are remaining goods or services distinct from those already transferred?

Yes

Account for as part of the original contract (cumulative catch-up)

No

Account for as termination of existing contract and creation of new contract (prospective)

Yes

Account for as separate contract (prospective)
Example 7: Are remaining goods or services distinct?

Architect is designing an apartment building with 10 apartments for $100k (estimated costs $70k).

Part way through builder requests a Penthouse be added to the design.

Architect estimates it will cost an additional $20k to design Penthouse.

Architect and builder agreed on 30 June 2017 an additional fee of $35k for the amendment.

Costs incurred to 30 June 2017 amounted to $55k.

Architect uses cost to complete method to measure progress.

Q: Does it add distinct goods or services that are priced commensurate with stand-alone selling prices?

Q: Are remaining services distinct from those already transferred?

Account for as part of the original contract (cumulative catch-up)
Example 7 solution: Account for as part of the original contract

Q: What is the impact of the cumulative catch up?

<table>
<thead>
<tr>
<th></th>
<th>As at 30 June 2017</th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td>Contract revenue</td>
</tr>
<tr>
<td>Initial contract</td>
<td>$100k</td>
</tr>
<tr>
<td>Updated contract</td>
<td>$135k</td>
</tr>
</tbody>
</table>

$3.9k revenue increase booked at 30 June 2017
Principal vs agent
Principal vs agent

**Principal**
An entity is a principal in a transaction if the performance obligation is transferring the specified good or service to the customer – gross revenue

**Agent**
An entity is an agent in a transaction if the performance obligation is arranging for another party to provide specified goods or services to the customer – net revenue
Principal vs agent

Does the entity obtain control over the specified goods or services in advance of transferring them to the customer?

Indicators of control:

- **Primary responsibility**: Primarily responsible for doing the service or providing the good and responsible to customer if something goes wrong. Responsibility to source another supplier or rectify the situation if something goes wrong.

- **Discretion to establish prices**: Setting the price paid by the end customer, including the benefit that the entity can receive from the sale of goods or services.

- **Inventory risk**: Exposure to inventory risk before or after the goods or services have been ordered by a customer, during shipping or delivery or on return.
When to do principal vs agent analysis?

Analysis required any time another party is involved in providing goods or services

**Supplier**
Will always be principal
Relevant question is: Who is the customer, the intermediary or the end customer?

**Intermediary**
Principal vs agent analysis assessed here
Assessed at a performance obligation level – not at a contract level

**End customer**
Example 8a: Provision of services

Foreign Co (Foreign) is a foreign multinational online video sharing service company.

Australia Co (Aust) sells the advertising services to their Australian customers. However, all customer ads are hosted on Foreign’s video sharing site.

Foreign works directly with Australian customers pre sale to understand the customers advertising needs and is responsible post sales for ensuring the ad meets those requirements.

Aust agrees to purchase 100,000 ads each week from Foreign to on sell to local customers. If all 100,000 ads are not purchased from Foreign, they will pay a $2,000 (a significant) penalty to Foreign.

Aust charges customers a fee based on Foreign’s schedule of rates with a 2% mark up as agreed with Foreign.

Q: Does Aust control advertising services prior to sale to end customer?
Example 8a solution: Provision of services

Q: Does Aust control advertising services prior to sale to end customer?

- Primary responsibility
  - Foreign delivers the service and is responsible to the customer for quality

- Discretion to establish prices
  - Foreign’ scheduled rates with a 2% mark up

- Inventory risk
  - Aust bears inventory risk because of the minimum take requirement

On balance, no Aust probably doesn’t control services prior to delivery to the customer. Aust will likely be an agent and recognise revenue net.
Example 8b: Provision of services

Foreign Co (Foreign) is a foreign multinational online video sharing service company.

Australia Co (Aust) sells the advertising services to their Australian customers. However, all customer ads are hosted on Foreign’s video sharing site.

Aust works directly with customer pre sale to understand the customer’s advertising needs and is responsible post sale for ensuring the ad meets those requirements. Aust provides instructions to Foreign in respect of what ads to place and when.

There is no minimum purchases required from Foreign.

Aust charges customers a fee based on their own schedule of rates.

Q: Would your view change?
Example 8b solution: Provision of services

Q: Does Aust control advertising services prior to sale to end customer?

- **Primary responsibility**: While Foreign delivers the services, the services are delivered at the request of Aust and Aust is responsible to the customer for quality.

- **Discretion to establish prices**: Aust sets price and absorbs costs.

- **Inventory risk**: There is no inventory risk to bear.

Yes, Aust likely controls services and will likely be principal and recognise revenue gross.
Example 9a: Provision of goods

GetWell is appointed as an exclusive Australian distributor of medical products of Tableting, a foreign company.

All sales related activities (such as customer liaison, negotiations, price setting etc.) are handled directly by Tableting. In doing so Tableting tells GetWell what products to order from Tableting.

GetWell is required to purchase the medical products from Tableting, i.e. it cannot purchase the particular products from any other vendors.

Tableting sets the price and GetWell has no discretion over the price of the products and cannot offer refunds to customers.

GetWell takes legal title of the medical products and is responsible for inventory management and warehousing. Tableting will repurchase any unsold items.

Q: Does GetWell control the medical products prior to sale to the end customer?
Example 9a solution: Provision of goods

Q: Does GetWell control the medical products prior to sale to the end customer?

- **Primary responsibility**: Tableting has all sales related responsibilities including Tableting determining customer needs
- **Discretion to establish prices**: Tableting has the discretion to set prices
- **Inventory risk**: Tableting has inventory risk as there is a repurchase arrangement

No, GetWell doesn’t appear to control the medical products, is likely to be an agent and recognise revenue net.
Example 9b: Provision of goods

GetWell is appointed as an exclusive Australian distributor of medical products of Tableting a Foreign company.

All sales related activities (such as customer liaisons, negotiations, price setting etc.) are handled directly by GetWell. GetWell then places the order with Tableting.

GetWell is required to purchase the medical products from Tableting, i.e. it cannot purchase the particular products from any other vendors.

GetWell sets the price however Tableting has set a minimum floor on the price of the products.

GetWell takes legal title of the medical products and is responsible for inventory management and warehousing. Tableting will repurchase any unsold items.
Example 9b solution: Provision of goods

Q. Does GetWell control the medical products prior to sale to the end customer?

- **Primary responsibility**: GetWell has all the sales related activities, including determining customer needs.
- **Discretion to establish prices**: GetWell has the discretion to set prices, however there is a floor set by Tableting.
- **Inventory risk**: Tableting has inventory risk as there is a repurchase arrangement.

Yes GetWell appears to control the medical products, is likely to be a principal and recognise revenue gross.
Key points to remember!

Key impacts
• Control based model from customer’s perspective
• Timing of up-front fees may change
• Transaction price allocated to material rights

More judgments
• Estimates to be used in calculating material rights?
• Indicators for principal vs agent assessment?

More guidance
• Determining stand-alone selling price for material rights
• Contract modification
• Assessing principal vs agent
What questions do you have?
Our people are ready to help but these publications also provide a good starting point.

First Impressions: IFRS 15 Revenue

IFRS 15 Revenue Transition options

Revenue Issues In-Depth

Guide to annual financial statements – IFRS 15 supplement
Thank you