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COVID-19 | Are revenue estimates up to date?

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What's the issue?

Under IFRS 15 *Revenue from Contracts with Customers*, determining the timing and amount of revenue to be recognised often requires a company to make estimates and judgements. The COVID-19 coronavirus outbreak has disrupted many industries and created uncertainties that may affect these estimates significantly.

For example, companies may need to consider the following.

- To boost demand, are customers being offered new incentives that would reduce the estimated amount of revenue?
- When contracts include variable consideration, are there changes in the estimated amount of revenue?
- Do estimated stand-alone selling prices need to be updated for new contracts?
- When revenue is recognised over time, does the estimated progress towards completion reflect the latest expectations?

Companies need to update these estimates to reflect the current environment, which may require significant judgement.

Getting into more detail

Identifying variable consideration

Under IFRS 15, if a contract includes variable consideration, then a company estimates the amount of consideration to which it will be entitled. Variable consideration includes discounts, rebates, refunds, credits, price concessions, incentives, performance bonuses, penalties and other similar items. It may be explicit or implicit – e.g. based on the company's customary business practices or specific statements.

Companies need to consider carefully whether actions taken to respond to the COVID-19 outbreak result in additional variable consideration – e.g. incentives or concessions offered to customers. Additionally, if a company's supply chain or labour force is disrupted such that it cannot satisfy its obligations, then this could result in penalties that reduce the transaction price. *[IFRS 15.50–52]*

Revenue estimates need to be updated to reflect the latest expectations, which may impact the timing and amount of revenue recognised.

Estimating variable consideration

A company estimates variable consideration but includes it in the transaction price only to the extent that it is highly probable that a significant reversal of revenue will not occur ('the constraint'). *[IFRS 15.56]*

A company's estimate of the constrained amount may be impacted significantly by COVID-19. For example, falling demand may impact whether customers will qualify for rebates or volume discounts. Further, transport companies may need to update estimated revenue for an increase in refunds to customers for cancelled or delayed journeys.

Companies need to reassess the estimated transaction price at each reporting date. *[IFRS 15.59]*

Stand-alone selling prices

Under IFRS 15, a company allocates the transaction price to each performance obligation identified on a relative stand-alone selling price basis. The stand-alone selling price is the price at which a company would sell a promised good or service separately to a customer. When the stand-alone selling price is not directly observable, a company estimates it considering all reasonably available information and maximising the use of observable inputs. *[IFRS 15.74, 77–78]*

COVID-19 may impact these estimates significantly, either because observable selling prices change or because inputs to estimate techniques change. This may in turn affect the amount of revenue recognised as each good or service in the contract is transferred.

Companies need to ensure they use up-to-date estimates to allocate the transaction price for new contracts. However, after contract inception the transaction price is not reallocated to reflect subsequent changes in stand-alone selling prices. *[IFRS 15.88]*

Revenue recognition over time

When a company transfers control of a good or service over time, revenue is recognised by measuring the progress towards complete satisfaction of that performance obligation. This is common in sectors such as real estate, construction, engineering, aerospace and defence. A company applies a single method of measuring progress to depict its performance in transferring control of goods or services, using an output or an input method. *[IFRS 15.39–41]*

When a company uses an input method to measure progress – e.g. costs incurred as a percentage of expected total costs – it needs to estimate the total expected inputs that will be needed to satisfy the performance obligation. COVID-19 may impact project timelines if work cannot be completed to schedule. It may also push up the costs of key inputs.

Companies need to ensure that the estimated progress and revenue recognised reflect the latest expectations. Any changes in this estimate are accounted for prospectively.

Disclosures

In annual financial statements, companies are required to disclose information about the methods, inputs and assumptions used for estimating variable consideration (including the constraint) and estimating stand-alone selling prices. Companies may need to expand or update these disclosures for the impact of COVID-19. *[IFRS 15.126]*

In interim financial statements, companies need to include information about disaggregated revenue. However, companies should consider whether to provide other disclosures for revenue to meet the requirements in IAS 34 *Interim Financial Reporting* – e.g. if there is a change in a company's accounting policies for revenue.

Actions for management to take now

- Evaluate whether contracts include variable consideration – e.g. customer incentives or penalties for delayed performance.
- Update estimates of variable consideration, including the constraint.
- Assess whether estimated stand-alone selling prices need to be updated.
- When revenue is recognised over time using an input method, evaluate whether the progress towards satisfaction reflects the latest expected total inputs.
- Disclose information about the methods, inputs and assumptions used for estimating variable consideration and stand-alone selling prices.

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