

Financial Reporting and Accounting Guide

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Accounting for contracts with customers

This publication provides a summary of the key steps to be considered when accounting for contracts with customers under AASB 15 *Revenue from Contracts with Customers*.

Principal requirements of the standard

AASB 15 applies to annual reporting periods beginning on or after 1 January 2018. AASB 15 provides (except in relation to some specific exceptions, such as lease contracts and insurance contracts) a single source of accounting requirements for all contracts with customers, thereby replacing all current accounting pronouncements on revenue.

The core principle of AASB 15 is that an entity recognises revenue to depict the transfer of promised goods or services to a customer in an amount that reflects the consideration to which the entity expects to be entitled in exchange for those goods or services.

Accordingly, in contrast to the approach under AASB 118 *Revenue*, AASB 15 does not prescribe different patterns of revenue recognition depending on whether the entity provides a good or service to the customer.

The 5-step model

To give effect to this principle, AASB 15 requires the adoption of the following 5-step model.

Step 1 – Identify the contract(s) with a customer

A contract with a customer is an agreement between two or more parties (one being the customer) that creates enforceable rights and obligations. Such rights and obligations include those relating to the goods or services to be transferred and the payment terms for those goods or services.

Step 2 – Identify the performance obligations under the contract(s)

At contract inception, an entity is required to assess the goods or services promised in the contract, and identify as a performance obligation each promise to transfer to the customer either:

- a good or service (or a bundle of goods or services) that is distinct; or
- a series of distinct goods or services that are substantially the same and that have the same pattern of transfer to the customer.

A good or service (or a bundle of goods or services) is considered distinct if:

- the customer can benefit from the good or service on its own or together with other resources that are readily available to the customer (including goods or services that the customer has already received under the contract); and
- the entity's promise to transfer the good or service to the customer is separately identifiable from other promises in the contract.

Step 3 – Determine the transaction price

The transaction price is the amount of consideration in the contract to which the entity expects to be entitled to in exchange for transferring the promised goods or services to the customer. When determining the transaction price, an entity considers the effects of any variable consideration, the existence of a significant financing component, any non-cash consideration, and any amounts payable to the customer.

Step 4 – Allocate the transaction price to each performance obligation

An entity will generally allocate the transaction price to each performance obligation in proportion to its stand-alone selling price. The best evidence of the stand-alone selling price is an observable price from stand-alone sales of that good or service to similarly situated customers. If the stand-alone selling price is not directly observable, an entity estimates the selling price by using either an adjusted market assessment approach, an expected cost plus margin approach or, in specified circumstances, a residual approach.

Step 5 - Recognise revenue when (or as) the entity satisfies each performance obligation

Under AASB 15, an entity recognises revenue when (or as) it satisfies a performance obligation by transferring the promised good or service to the customer, which is when the customer obtains control of the good or service. Control of a good or service may be transferred over time or at a point in time.

An entity transfers control of a good or service over time and, therefore, satisfies a performance obligation – and recognises revenue – over time when one of the following criteria is met:

- (a) the customer simultaneously receives and consumes the benefits provided by the entity's performance as the entity performs;
- (b) the entity's performance creates or enhances an asset that the customer controls as the asset is created or enhanced; or
- (c) 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.

If a performance obligation does not meet one of the above criteria, the performance obligation is satisfied at a point in time, in which case the entity recognises the amount of the transaction price allocated to the performance obligation as revenue at the point in time when control of the good or service passes to the customer.

Further information and assistance

Contact Pitcher Partners for further information and assistance on accounting for contracts with customers.

Contact us



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