中汇 ZHONGHUI

HKFRS Update

HKFRS 15
"Revenue from Contracts with Customers"

Introduction

HKFRS 15 establishes principles for reporting useful information to users of financial statements about the nature, amount, timing and uncertainty of revenue and cash flows arising from an entity's contracts with customers. HKFRS 15 supersedes the following Standards and Interpretations:

- HKAS 11 "Construction Contracts"
- HKAS 18 "Revenue"
- HK(IFRIC)-Int 13 "Customer Loyalty Programmes"
- HK(IFRIC)-Int 15 "Agreements for the Construction of Real Estate"
- HK(IFRIC)-Int 18 "Transfers of Assets from Customers"
- HK(SIC)-Int 31 "Revenue - Barter Transactions Involving Advertising Services"

The core principle of HKFRS 15 is that an entity recognises revenue to depict the transfer of promised goods or services to customers in an amount that reflects the consideration to which the entity expects to be entitled in exchange for those goods or services. An entity recognises revenue in accordance with this core principle by applying the following five steps:

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

HKFRS 15 also includes a cohesive set of disclosure requirements that would result in an entity providing users of financial statements with comprehensive information about the nature, amount, timing and uncertainty of revenue and cash flows arising from the entity's contracts with customers.

Effective Date and Transitional Provision

HKFRS 15 is effective for annual reporting periods beginning on or after 1 January 2017. Earlier application is permitted. If an entity applies HKFRS 15 earlier, it shall disclose that fact.

For the purposes of the following transition requirements:

- the date of initial application is the start of the reporting period in which HKFRS 15 is first applied (for example, 1 January 2017 for December year end and 1 April 2017 for March year end); and
- a completed contract is a contract for which an entity has transferred all of the goods or services identified in accordance with HKAS 11, HKAS 18 and related Interpretations.

An entity shall apply HKFRS 15 using one of the following two methods:

(a) retrospectively to each prior reporting period presented and may use one or more of the following three practical expedients ("Retrospective Approach"); or

(b) retrospectively with the cumulative effect of initially applying HKFRS 15 recognised at the date of initial application ("Modified Retrospective Approach").

Retrospective Approach

The three practical expedients when using the Retrospective Approach are:

- for completed contracts before the date of initial application, an entity need not restate contracts that begin and end within the same annual reporting period;
- for completed contracts before the date of initial application that have variable consideration, an entity may use the transaction price at contract completion rather than estimating variable consideration amounts; and
- for all comparative periods presented, an entity need not disclose the amount of the transaction price allocated to the remaining performance obligations and an explanation of when the entity expects to recognise that amount as revenue.

For any of the above three practical expedients used, the entity shall apply that expedient consistently to all contracts within all reporting periods presented. In addition, the entity shall disclose the expedients used and to the extent reasonably possible, a qualitative assessment of the estimated effect of applying each of those expedients.

Modified Retrospective Approach

An entity using the Modified Retrospective Approach shall apply HKFRS 15 retrospectively only to contracts that are not completed contracts at the date of initial application and shall recognise the cumulative effect of initially applying HKFRS 15 as an adjustment to the opening balance of retained earnings (or other component of equity, as appropriate) at that date. Comparative period figures are not restated.

For the reporting period in which an entity first applies HKFRS 15, the entity shall disclose the amount by which each financial statement line item is affected by applying HKFRS 15 as compared to HKAS 11, HKAS 18 and related Interpretations and an explanation of the reasons for significant changes.

Scope

HKFRS 15 applies to all contracts with customers, except the following:

- lease contracts within the scope of HKAS 17 "Leases".
- insurance contracts within the scope of HKFRS 4 "Insurance Contracts'.
- financial instruments and other contractual rights or obligations within the scope of HKAS 39 or HKFRS 9 "Financial Instruments", HKFRS 10 "Consolidated Financial Statements", HKFRS 11 "Joint Arrangements", HKAS 27 "Separate Financial Statements" and HKAS 28 "Investments in Associates and Joint Ventures". As a result, dividend income is outside the scope of HKFRS 15.
- non-monetary exchanges between entities in the same line of business to facilitate sales to customers or potential customers. For example, a contract between two oil companies that agree to an exchange of oil to fulfil demand from their customers in different specified locations on a timely basis.

HKFRS 15 applies to a contract only if the counterparty to the contract is a customer. A customer is a party that has contracted with an entity to obtain goods or services that are an output of the entity's ordinary activities in exchange for consideration.

Summary of Requirements of HKFRS 15

Step 1: Identifying Contracts

An entity shall account for a contract only when all of the following criteria are met:

(a) the parties to the contract have approved the contract (writing, oral or customary business practices) and are committed to perform their respective obligations;

(b) the entity can identify each party's rights regarding the goods or services to be transferred;

(c) the entity can identify the payment terms for the goods or services to be transferred;

(d) the contract has commercial substance (i.e. the risk, timing or amount of the entity's future cash flows is expected to change as a result of the contract); and

(e) it is probable that the entity will collect the consideration.

If a contract meets the above criteria at contract inception, an entity shall not reassess those criteria unless there is an indication of a significant change in facts and circumstances. For example, if a customer's ability to pay the consideration deteriorates significantly, an entity would reassess whether it is probable that it will collect the consideration for the remaining goods or services that will be transferred. If a contract does not meet the above criteria, an entity shall continue to assess the contract to determine whether the criteria are subsequently met.

Step 1: Identifying Contracts

Example

Illustrative example 3 of HKFRS 15:

An entity, a hospital, provides medical services to an uninsured patient in the emergency room. The entity has not previously provided medical services to this patient but is required by law to provide medical services to all emergency room patients. Because of the patient's condition upon arrival at the hospital, the entity provides the services immediately and, therefore, before the entity can determine whether the patient is committed to perform its obligations under the contract in exchange for the medical services provided. Consequently, the contract does not meet the revenue recognition criteria of HKFRS 15 and the entity will continue to assess its conclusion based on updated facts and circumstances.

After providing services, the entity obtains additional information about the patient including a review of the services provided, standard rates for such services and the patient's ability and intention to pay the entity for the services provided. During the review, the entity notes its standard rate for the services provided is CU10,000. The entity also reviews the patient's information and designates the patient to a customer class based on the entity's assessment of the patient's ability and intention to pay.

The entity expects to accept a lower amount of consideration. Accordingly, the entity concludes that the transaction price is not CU10,000 and, therefore, the promised consideration is variable. The entity reviews its historical cash collections from this customer class and other relevant information about the patient. The entity estimates the variable consideration and determines that it expects to be entitled to CU1,000.

On the basis of its collection history from patients in this customer class, the entity concludes it is probable that the entity will collect CU1,000. In addition, on the basis of an assessment of the contract terms and other facts and circumstances, the entity concludes that other criteria in HKFRS 15 are also met. Consequently, the entity accounts for the contract with the patient in accordance with HKFRS 15.

Contract modification

A contract modification is a change in the scope and/or price of a contract that is approved by the parties to the contract. A contract modification may exist even though the parties have approved a change in the scope of the contract but have not yet determined the corresponding change in price. The entity shall then estimate the change to the transaction price arising from the modification in accordance with the requirements regarding estimating variable consideration and constraining estimates of variable consideration.

An entity shall account for a contract modification as a separate contract if both of the following conditions are present:

(a) the scope of the contract increases because of the addition of promised goods or services that are distinct; and

(b) the price increases by an amount that reflects the entity's stand-alone selling prices of the additional promised goods or services and any appropriate adjustments (e.g. discount) to that price to reflect the circumstances of the particular contract. The stand-alone selling price is the price at which an entity would sell a promised good or service separately to a customer.

Step 1: Identifying Contracts

A good or service is distinct if both of the following criteria are met:

(a) the customer can benefit from the good or service either on its own or together with other resources that are readily available to the customer; and

(b) the entity's promise to transfer the good or service to the customer is separately identifiable from other promises in the contract.

Example

Illustrative example 10 of HKFRS 15:

An entity, a contractor, enters into a contract to build a hospital for a customer. The entity is responsible for the overall management of the project and identifies various goods and services to be provided, including engineering, site clearance, foundation, procurement, construction of the structure, piping and wiring, installation of equipment and finishing.

The customer can benefit from the goods and services either on their own or together with other readily available resources. This is evidenced by the fact that the entity, or competitors of the entity, regularly sells many of these goods and services separately to other customers. In addition, the customer could generate economic benefit from the individual goods and services by using, consuming, selling or holding those goods or services.

However, the entity's promise to transfer individual goods and services in the contract are not separately identifiable from other promises in the contract. This is evidenced by the fact that the entity provides a significant service of integrating the goods and services (the inputs) into the hospital (the combined output) for which the customer has contracted.

The goods and services are not distinct. The entity accounts for all of the goods and services in the contract as a single performance obligation.

If a contract modification is not accounted for as a separate contract, an entity shall account for the remaining promised goods or services not yet transferred at the date of the contract modification in one of the following ways:

(a) As if it were a termination of the existing contract and the creation of a new contract, if the remaining goods or services are distinct from the goods or services transferred before contract modification. The consideration to be allocated to the remaining promised goods or services is the sum of the previous consideration not been recognised as revenue and the additional consideration.

(b) As if it were a part of the existing contract if the remaining goods or services are not distinct. The effect on the transaction price and on the measure of progress towards complete satisfaction of the performance obligation, is recognised as an adjustment to revenue.

Step 2: Identifying Performance Obligations

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

(a) a good or service (or a bundle of goods or services) that is distinct; or

(b) a series of distinct goods or services that are substantially the same and that have the same pattern of transfer to the customer.

Activities that do not transfer a good or service to a customer are not performance obligations.

A series of distinct goods or services has the same pattern of transfer to the customer if both of the following criteria are met:

(a) each distinct good or service in the series would meet the criteria of a performance obligation satisfied over time; and

(b) the same method would be used to measure the entity's progress towards complete satisfaction of the performance obligation to transfer each distinct good or service in the series to the customer.

If a promised good or service is not distinct, an entity shall combine that good or service with other promised goods or services until it identifies a bundle of goods or services that is distinct. This might sometimes result in accounting for all the goods or services as a single performance obligation.

Implicit promises in a contract

A contract with a customer may include promises that are implied by an entity's customary business practices, published policies or specific statements if, at the time of entering into the contract, those promises create a valid expectation of the customer that the entity will transfer a good or service to the customer.

Example

Illustrative example 12(b) of HKFRS 15:

An entity, a manufacturer, sells a product to a distributor who will then resell it to an end customer. The entity has historically provided maintenance services for no additional consideration to end customers that purchase the entity's product from the distributor. The entity does not explicitly promise maintenance services during negotiations with the distributor and the final contract between the entity and the distributor does not specify terms or conditions for those services.

However, on the basis of its customary business practice, the entity determines at contract inception that it has made an implicit promise to provide maintenance services as part of the negotiated exchange with the distributor. That is, the entity's past practices of providing these services create valid expectations of the entity's customers. Consequently, the entity identifies the promise of maintenance services as a performance obligation.

Step 2: Identifying Performance Obligations

Warranties

The nature of a warranty can vary significantly across industries and contracts. Some warranties provide a customer with assurance that the related product will function as intended because it complies with agreed-upon specifications. Other warranties provide the customer with a service in addition to the assurance-type warranty.

If a customer has the option to purchase a warranty separately, the warranty is a distinct service and therefore a performance obligation because the entity promises to provide the service in addition to the product.

If a customer does not have the option to purchase a warranty separately and the warranty, or a part of the warranty, provides the customer with a service in addition to the assurance-type warranty, the promised service is a performance obligation. If an entity promises both an assurance-type warranty and a service-type warranty but cannot reasonably account for them separately, the entity shall account for both of the warranties together as a single performance obligation.

In other cases, an entity shall account for the warranty in accordance with HKAS 37 "Provisions, Contingent Liabilities and Contingent Assets". For example, a law that requires an entity to pay compensation if its products cause harm or damage does not give rise to a performance obligation. Similarly, an entity's promise to indemnify the customer for liabilities and damages arising from claims of patent, copyright, trademark or other infringement by the entity's products does not give rise to a performance obligation.

Principal versus agent considerations

When another party is involved in providing goods or services to a customer, the entity shall determine whether the nature of its promise is a performance obligation to provide the specified goods or services itself (principal) or to arrange for the other party to provide those goods or services (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. A principal may satisfy a performance obligation by itself or engage another party to satisfy some or all of a performance obligation on its behalf. The principal recognises revenue in the gross amount of consideration.

The agent recognises revenue in the amount of any fee or commission in exchange for arranging for the other party to provide its goods or services. 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;

(c) the entity does not have discretion in establishing prices for the goods or services;

(d) the entity's consideration is in the form of a commission; and

(e) the entity is not exposed to credit risk for the receivable from a customer.

Step 2: Identifying Performance Obligations

Customer options for additional goods or services

If an entity grants a customer the option to acquire additional goods or services, that option gives rise to a performance obligation only if the option provides a material right to the customer that it would not receive without entering into the contract. The customer in effect pays the entity in advance for future goods or services and the entity recognises revenue when those future goods or services are transferred or when the option expires.

HKFRS 15 requires an entity to allocate the transaction price to performance obligations on a relative stand-alone selling price basis. If the stand-alone selling price for a customer's option to acquire additional goods or services is not directly observable, an entity shall estimate it. That estimate shall reflect the discount that the customer would obtain when exercising the option, adjusted for both of the following:

(a) any discount that the customer could receive without exercising the option; and

(b) the likelihood that the option will be exercised.

Non-refundable upfront fees

Examples of non-refundable upfront fee include joining fees in health club membership contracts, activation fees in telecommunication contracts, setup fees in some services contracts and initial fees in some supply contracts. If the fee relates to the transfer of a promised good or service, this is a performance obligation. The upfront fee is then an advance payment for future goods or services and, therefore, would be recognised as revenue when those future goods or services are provided.

Step 3: Determining Transaction Price

The transaction price is the amount of consideration to which an entity expects to be entitled in exchange for transferring promised goods or services to a customer, excluding amounts collected on behalf of third parties (for example, sales taxes). The consideration may include fixed amounts, variable amounts, or both. When determining the transaction price, an entity shall consider the terms of the contract, its customary business practices and the effects of all of the following:

- variable consideration;
- constraining estimates of variable consideration;
- significant financing component in the contract;
- non-cash consideration; and
- consideration payable to a customer.

Variable consideration

Consideration can vary because of discounts, rebates, refunds, credits, price concessions, incentives, performance bonuses, penalties or other similar items. The promised consideration can also vary if an entity's entitlement to the consideration is contingent on the occurrence or non-occurrence of a future event (for example, product sold with a right of return or performance bonus). In addition to the terms of the contract, the promised consideration is variable if either of the following circumstances exists:

(a) the customer has a valid expectation arising from an entity's customary business practices, published policies or specific statements that the entity will accept an amount of less than the price stated in the contract.

(b) other facts and circumstances indicate that the entity's intention is to offer a price concession to the customer.

An entity shall estimate a variable consideration by using either of the following methods, depending on which method the entity expects to better predict the consideration:

(a) The expected value – the expected value is the sum of probability-weighted amounts in a range of possible consideration amounts. An expected value may be an appropriate estimate if an entity has a large number of contracts with similar characteristics.

(b) The most likely amount – the most likely amount is the single most likely amount in a range of possible consideration amounts. The most likely amount may be an appropriate estimate if the contract has only two possible outcomes.

An entity shall apply one method consistently throughout the contract.

中汇 ZHONGHUI

Step 3: Determining Transaction Price

Refund liability and sale with a right of return

An entity shall recognise a refund liability if the entity receives consideration from a customer and expects to refund some or all of that consideration to the customer. A refund liability is measured at the amount of consideration received (or receivable) for which the entity does not expect to be entitled. The refund liability shall be updated at the end of each reporting period for changes in circumstances.

In some contracts, an entity transfers control of a product to a customer and also grants the customer the right to return the product for various reasons (such as dissatisfaction with the product). To account for the transfer of products with a right of return (and for some services that are provided subject to a refund), an entity shall recognise all of the following:

(a) revenue for the transferred products in the amount of consideration to which the entity expects to be entitled;

(b) a refund liability; and

(c) an asset (and corresponding adjustment to cost of sales) for its right to recover products from customers on settling the refund liability.

An asset recognised for an entity's right to recover products from a customer on settling a refund liability shall initially be measured by reference to the former carrying amount of the product (for example, inventory) less any expected costs to recover those products (including potential decreases in the value to the entity of returned products). An entity shall present the asset separately from the refund liability.

Illustrative example 22 of HKFRS 15:

Example

An entity enters into 100 contracts with customers. Each contract includes the sale of one product for CU100 (100 products × CU100 = CU10,000 total consideration). Cash is received when control of a product transfers. The entity's customary business practice is to allow a customer to return any unused product within 30 days and receive a full refund. The entity's cost of each product is CU60.

Because the contract allows a customer to return the product, the consideration received from the customer is variable. To estimate the variable consideration to which the entity will be entitled, the entity decides to use the expected value method and estimates that 97 products will not be returned.

The entity concludes that it is highly probable that a significant reversal in the cumulative amount of revenue recognised (i.e. CU9,700) will not occur as the uncertainty is resolved (i.e. over the return period). The entity estimates that the costs of recovering the products will be immaterial and expects that the returned products can be resold at a profit.

Upon transfer of control of the 100 products, the entity does not recognise revenue for the three products that it expects to be returned and recognises the following:

(a) revenue of CU9,700 (CU100 × 97 products not expected to be returned);

(b) a refund liability of CU300 (CU100 × 3 products expected to be returned); and

(c) an asset of CU180 (CU60 × 3 products for its right to recover products from customers on settling the refund liability).

Step 3: Determining Transaction Price

Constraining estimates of variable consideration

An entity shall include in the transaction price some or all of a variable consideration only to the extent that it is highly probable that a significant reversal in the amount of cumulative revenue recognised will not occur when the uncertainty associated with the variable consideration is subsequently resolved. Factors that could increase the likelihood or the magnitude of a revenue reversal include, but are not limited to, any of the following:

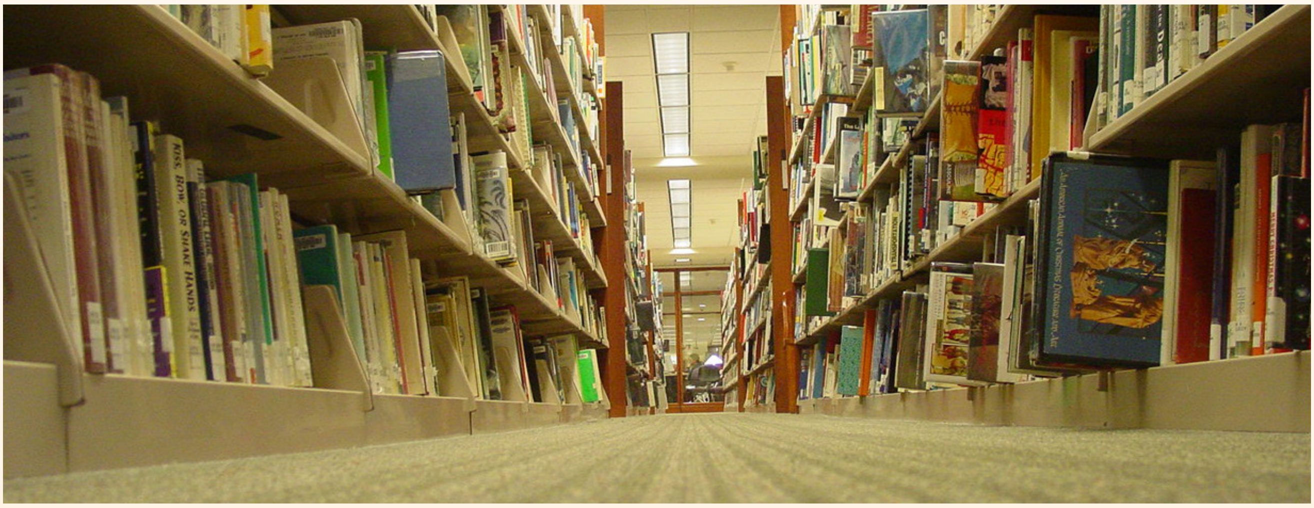
(a) the amount of consideration is highly susceptible to factors outside the entity's influence.

(b) the uncertainty about the consideration is not expected to be resolved for a long period of time.

(c) the entity's experience (or other evidence) with similar types of contracts is limited or has limited predictive value.

(d) the entity has a practice of either offering a broad range of price concessions or changing the payment terms and conditions of similar contracts in similar circumstances.

(e) the contract has a large number and broad range of possible consideration amounts.



Notwithstanding the above requirements, an entity shall recognise revenue for a sales-based or usage-based royalty promised in exchange for a licence of intellectual property only when the later of the following events occurs:

(a) the subsequent sale or usage occurs; and

(b) the performance obligation to which some or all of the sales-based or usage-based royalty has been allocated has been satisfied (or partially satisfied).

At the end of each reporting period, an entity shall update the estimated transaction price (including whether an estimate of variable consideration is constrained) to represent faithfully the circumstances present at the end of the reporting period and the changes in circumstances during the reporting period.

Step 3: Determining Transaction Price

Significant financing component in the contract

An entity shall adjust the consideration for the effects of the time value of money if the timing of payments agreed to by the parties to the contract (either explicitly or implicitly) provides the customer or the entity with a significant benefit of financing the transfer of goods or services. The objective when adjusting the consideration is to recognise revenue at an amount that reflects the price that a customer would have paid for the promised goods or services if the customer had paid cash (i.e. the cash selling price).

A contract with a customer would not have a significant financing component if any of the following factors exist:

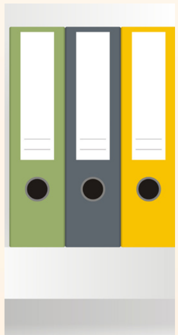
(a) the customer paid for the goods or services in advance and the timing of the transfer of those goods or services is at the discretion of the customer.

(b) a substantial amount of the consideration is variable and the amount or timing of that consideration varies on the basis of the occurrence or non-occurrence of a future event that is not substantially within the control of the customer or the entity (for example, sales-based royalty).

(c) the difference between the promised consideration and the cash selling price arises for reasons other than the provision of finance and the difference is proportional to the reason for the difference. For example, the payment terms might provide the entity or the customer with protection from the other party failing to adequately complete some or all of its obligations under the contract.

As a practical expedient, an entity need not adjust the consideration for the effects of a significant financing component if the entity expects, at contract inception, that the period between when the entity transfers a promised good or service and when the customer pays for that good or service will be one year or less.

Non-cash consideration



An entity shall measure the non-cash consideration at fair value. If an entity cannot reasonably estimate the fair value, the entity shall measure the non-cash consideration indirectly by reference to the stand-alone selling price of the goods or services.

If a customer contributes goods or services (for example, materials, equipment or labour) to facilitate an entity's fulfilment of the contract, the entity shall assess whether it obtains control of those contributed goods or services. If so, the entity shall account for the contributed goods or services as non-cash consideration received from the customer.

Consideration payable to a customer

Consideration payable to a customer includes cash amounts that an entity pays, or expects to pay, to the customer. Consideration payable to a customer also includes credit or other items (for example, a coupon or voucher) that can be applied against amounts owed to the entity. An entity shall account for consideration payable to a customer as a reduction of the transaction price and, therefore, of revenue unless the payment to the customer is in exchange for a distinct good or service that the customer transfers to the entity.

If the amount of consideration payable to the customer exceeds the fair value of the distinct good or service that the entity receives from the customer, the entity shall account for such an excess as a reduction of the transaction price. If the entity cannot reasonably estimate the fair value of the good or service received from the customer, it shall account for all of the consideration payable to the customer as a reduction of the transaction price.

Step 4: Allocating Transaction Price to Performance Obligations

The objective when allocating the transaction price is to allocate the transaction price to each performance obligation (or distinct good or service) in an amount that depicts the amount of consideration to which the entity expects to be entitled in exchange for transferring the promised goods or services to the customer. An entity shall allocate the transaction price to each performance obligation on a relative stand-alone selling price basis except for allocating discounts and for allocating variable consideration.

Allocation based on stand-alone selling prices

An entity shall determine the stand-alone selling price at contract inception of the distinct good or service underlying each performance obligation and allocate the transaction price in proportion to those stand-alone selling prices. The best evidence of a stand-alone selling price is the observable price of a good or service when the entity sells that good or service separately in similar circumstances and to similar customers. A contractually stated price or a list price for a good or service may be (but shall not be presumed to be) the stand-alone selling price of that good or service.

If a stand-alone selling price is not directly observable, an entity shall estimate it by considering all information (including market conditions, entity-specific factors and information about the customer or class of customer) that is reasonably available to the entity. An entity shall maximise the use of observable inputs and apply estimation methods consistently in similar circumstances. Suitable estimation methods include, but are not limited to, the following:

(a) Adjusted market assessment approach – an entity could evaluate the market in which it sells goods or services and estimate the price that a customer in that market would be willing to pay for those goods or services.

(b) Expected cost plus a margin approach – an entity could forecast its expected costs of satisfying a performance obligation and then add an appropriate margin.

(c) Residual approach – an entity may estimate the stand-alone selling price by reference to the total transaction price less the sum of the observable stand-alone selling prices of other goods or services promised in the contract (suitable only when the entity sells the same good or service to different customers, at or near the same time, for a broad range of amounts; or the entity has not yet established a price for that good or service and the good or service has not previously been sold on a stand-alone basis.)

A combination of methods may need to be used if two or more of those goods or services have highly variable or uncertain stand-alone selling prices.

Step 4: Allocating Transaction Price to Performance Obligations

Allocation of discount

Except when an entity has observable evidence that the entire discount relates to only one or more, but not all, performance obligations in a contract, the entity shall allocate a discount proportionately to all performance obligations in the contract.

Allocation of variable consideration and changes in transaction price

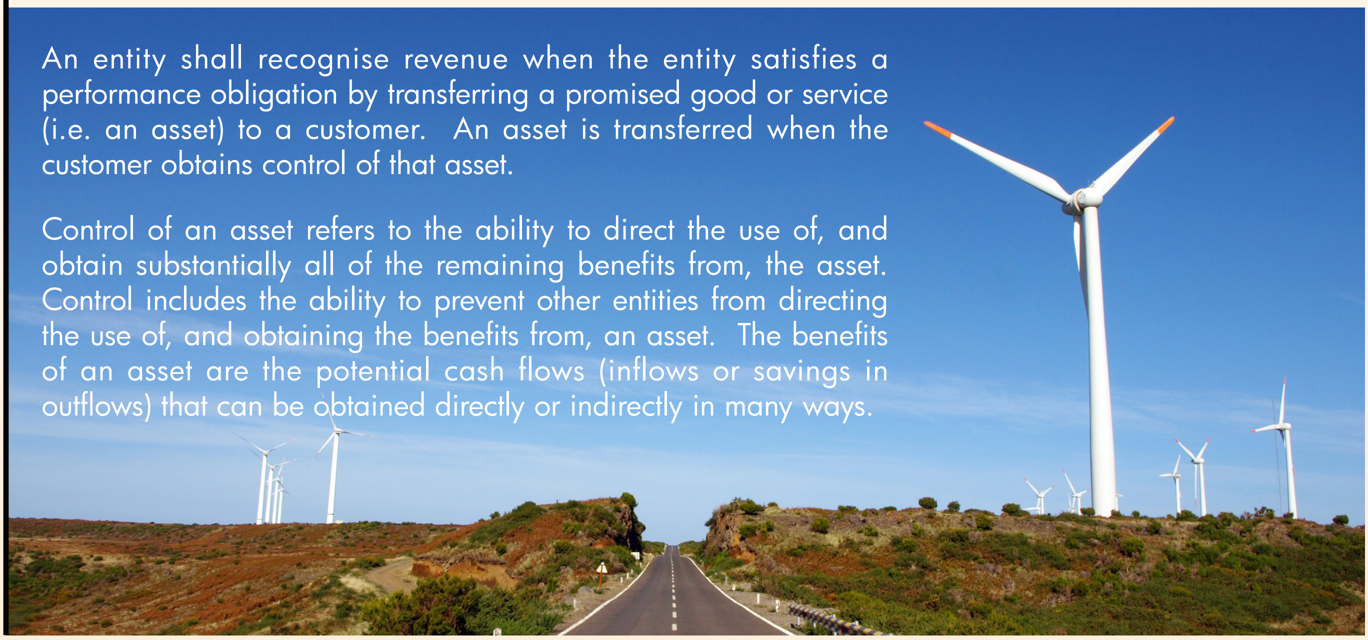
Variable consideration that is promised in a contract may be attributable to the entire contract or to a specific part of the contract. An entity shall allocate a variable amount and change in the transaction price entirely to a performance obligation or to a distinct good or service promised in a series that forms part of a single performance obligation if both of the following criteria are met:

(a) the terms of a variable payment relate specifically to the entity's efforts to satisfy the performance obligation or transfer the distinct good or service; and

(b) allocating the variable amount of consideration entirely to the performance obligation or the distinct good or service is consistent with the allocation objective when considering all of the performance obligations and payment terms in the contract.

After contract inception, the transaction price can change for various reasons, including the resolution of uncertain events or other changes in circumstances that change the amount of consideration. An entity shall allocate to the performance obligations any subsequent changes in the transaction price on the same basis as at contract inception. Consequently, an entity shall not reallocate the transaction price to reflect changes in stand-alone selling prices after contract inception. Amounts allocated to a satisfied performance obligation shall be recognised as revenue, or as a reduction of revenue, in the period in which the transaction price changes.

Step 5: Satisfying Performance Obligations



An entity shall recognise revenue when the entity satisfies a performance obligation by transferring a promised good or service (i.e. an asset) to a customer. An asset is transferred when the customer obtains control of that asset.

Control of an asset refers to the ability to direct the use of, and obtain substantially all of the remaining benefits from, the asset. Control includes the ability to prevent other entities from directing the use of, and obtaining the benefits from, an asset. The benefits of an asset are the potential cash flows (inflows or savings in outflows) that can be obtained directly or indirectly in many ways.

Step 5: Satisfying Performance Obligations

Repurchase agreements

When evaluating whether a customer obtains control of an asset, an entity shall consider any agreement to repurchase the asset. The repurchased asset may be the asset that was originally sold, an asset that is substantially the same as that asset, or another asset of which the asset that was originally sold is a component. Repurchase agreements generally come in three forms:

- an entity's obligation to repurchase the asset (a forward);
- an entity's right to repurchase the asset (a call option); and
- an entity's obligation to repurchase the asset at the customer's request (a put option).

Forward or call option

If an entity has an obligation or a right to repurchase the asset (i.e. a forward or a call option), a customer does not obtain control of the asset because the customer is limited in its ability to direct the use of, and obtain substantially all of the remaining benefits from, the asset even though the customer may have physical possession of the asset. Consequently, the entity shall account for the contract as either of the following:

(a) a lease in accordance with HKAS 17 if the repurchase price is less than the original selling price; or

(b) a financing arrangement if the repurchase price is equal to or more than the original selling price.

Put option

If an entity has an obligation to repurchase the asset at the customer's request (a put option) at a price that is lower than the original selling price, the entity shall consider at contract inception whether the customer has a significant economic incentive to exercise that right. If the customer has that incentive, the entity shall account for the agreement as a lease in accordance with HKAS 17. If the customer does not have that incentive, the entity shall account for the agreement as if it were the sale of a product with a right of return.

If the repurchase price of the asset is equal to or greater than the original selling price and is more than the expected market value of the asset, the contract is in effect a financing arrangement.

If the repurchase price of the asset is equal to or greater than the original selling price and is less than or equal to the expected market value of the asset, and the customer does not have a significant economic incentive to exercise its right, then the entity shall account for the agreement as if it were the sale of a product with a right of return.

If the call or put option lapses unexercised, an entity shall derecognise the liability and recognise revenue.

Step 5: Satisfying Performance Obligations

For each performance obligation identified, an entity shall determine at contract inception whether it satisfies the performance obligation over time or satisfies the performance obligation at a point in time. If an entity does not satisfy a performance obligation over time, the performance obligation is satisfied at a point in time.

Performance obligations satisfied over time

An entity transfers control of a good or service over time and, therefore, satisfies a performance obligation and recognises revenue over time, if 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 (e.g. cleaning service);

(b) the entity's performance creates or enhances an asset (for example, work in progress) 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.

An entity may not be able to readily identify whether a customer simultaneously receives and consumes the benefits from the entity's performance as the entity performs. In those circumstances, a performance obligation is satisfied over time if an entity determines that another entity would not need to substantially re-perform the work that the entity has completed to date if that other entity were to fulfil the remaining performance obligation to the customer.

An asset created by an entity's performance does not have an alternative use to an entity if the entity is either restricted contractually from readily directing the asset for another use during the creation or enhancement of that asset or limited practically from readily directing the asset in its completed state for another use.

The entity has an enforceable right to payment for performance completed to date if at all times throughout the duration of the contract, the entity is entitled to an amount that at least compensates the entity (cost plus a reasonable profit margin) for performance completed to date if the contract is terminated by the customer or another party for reasons other than the entity's failure to perform as promised.

Performance obligations satisfied at a point in time

If an entity satisfies the performance obligation at a point in time, it shall determine the point in time at which a customer obtains control of a promised asset. Indicators of the transfer of control include, but are not limited to, the following:

- The entity has a present right to payment for the asset.
- The customer has legal title to the asset.
- The entity has transferred physical possession of the asset.
- The customer has the significant risks and rewards of ownership of the asset.
- The customer has accepted the asset.

Step 5: Satisfying Performance Obligations

Measuring progress towards complete satisfaction of a performance obligation

For each performance obligation satisfied over time, an entity shall recognise revenue over time by measuring the progress towards complete satisfaction of that performance obligation. An entity shall apply a single method of measuring progress for each performance obligation and apply that method consistently to similar performance obligations and in similar circumstances. At the end of each reporting period, an entity shall remeasure its progress.

Appropriate methods of measuring progress include output methods and input methods. In determining the appropriate method, an entity shall consider the nature of the good or service promised to transfer to the customer.

When applying a method for measuring progress, an entity shall exclude from the measure of progress any goods or services for which the entity does not transfer control to a customer. Conversely, an entity shall include in the measure of progress any goods or services for which the entity does transfer control to a customer.

Output methods

Output methods recognise revenue on the basis of direct measurements of the value to the customer of the goods or services transferred to date relative to the remaining goods or services promised under the contract. Output methods include methods such as surveys of performance completed to date, appraisals of results achieved, milestones reached, time elapsed and units produced or units delivered.

As a practical expedient, if an entity has a right to consideration from a customer in an amount that corresponds directly with the value to the customer of the entity's performance completed to date (for example, a service contract in which an entity bills a fixed amount for each hour of service provided), the entity may recognise revenue in the amount to which the entity has a right to invoice.

Input methods

Input methods recognise revenue on the basis of the entity's efforts or inputs to the satisfaction of a performance obligation (for example, resources consumed, labour hours expended, costs incurred, time elapsed or machine hours used) relative to the total expected inputs to the satisfaction of that performance obligation. If the entity's efforts or inputs are expended evenly throughout the performance period, it may be appropriate for the entity to recognise revenue on a straight-line basis.

Step 5: Satisfying Performance Obligations

Reasonable measures of progress

An entity shall recognise revenue for a performance obligation satisfied over time only if the entity can reasonably measure its progress towards complete satisfaction of the performance obligation. In some circumstances (for example, in the early stages of a contract), an entity may not be able to reasonably measure the outcome of a performance obligation, but the entity expects to recover the costs incurred in satisfying the performance obligation. In those circumstances, the entity shall recognise revenue only to the extent of the costs incurred until such time that it can reasonably measure the outcome of the performance obligation.

Licensing

A licence establishes a customer's rights to the intellectual property of an entity. If the promise to grant the licence is distinct from the other promised goods or services and, therefore, the promise to grant the licence is a separate performance obligation, an entity shall determine whether the licence transfers to a customer either at a point in time or over time. In making this determination, an entity shall consider whether the nature of the entity's promise in granting the licence to a customer is to provide the customer with either:

(a) a right to access the entity's intellectual property as it exists throughout the licence period; or

(b) a right to use the entity's intellectual property as it exists at the point in time at which the licence is granted.

The nature of an entity's promise in granting a licence is a promise to provide a right to access the entity's intellectual property if all of the following criteria are met:

(a) the contract requires, or the customer reasonably expects, that the entity will undertake activities that significantly affect the intellectual property;

(b) the rights granted by the licence directly expose the customer to any positive or negative effects of the entity's activities; and

(c) those activities do not result in the transfer of a good or a service to the customer as those activities occur.

If the above criteria are met, an entity shall account for the promise to grant a licence as a performance obligation satisfied over time because the customer will simultaneously receive and consume the benefit from the entity's performance of providing access to its intellectual property as the performance occurs.

If the above criteria are not met, the nature of an entity's promise is to provide a right to use the entity's intellectual property as that intellectual property exists (in terms of form and functionality) at the point in time at which the licence is granted to the customer.

Step 5: Satisfying Performance Obligations

Consignment arrangements

Indicators that an arrangement is a consignment arrangement include, but are not limited to, the following:

(a) the product is controlled by the entity until a specified event occurs, such as the sale of the product to a customer of the dealer or until a specified period expires;

(b) the entity is able to require the return of the product or transfer the product to a third party (such as another dealer); and

(c) the dealer does not have an unconditional obligation to pay for the product (although it might be required to pay a deposit).

Bill-and-hold arrangements

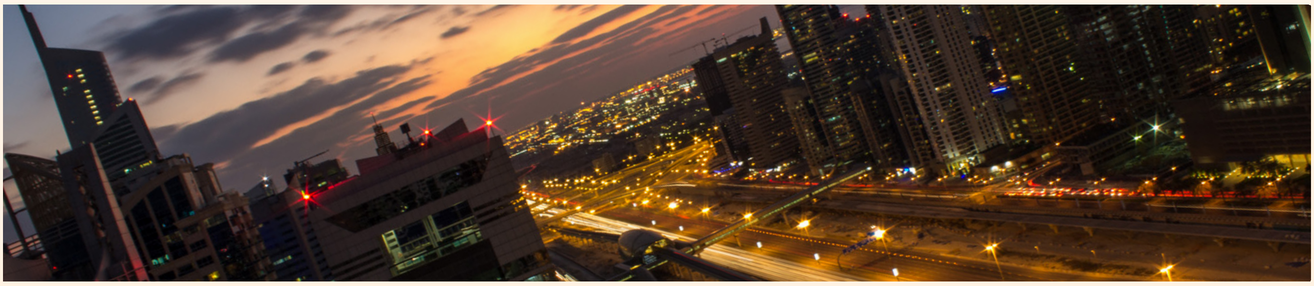
A bill-and-hold arrangement is a contract under which an entity bills a customer for a product but the entity retains physical possession of the product until it is transferred to the customer. For a customer to have obtained control of a product in a bill-and-hold arrangement, all of the following criteria must be met:

(a) the reason for the bill-and-hold arrangement must be substantive (for example, the customer has requested the arrangement);

(b) the product must be identified separately as belonging to the customer;

(c) the product currently must be ready for physical transfer to the customer; and

(d) the entity cannot have the ability to use the product or to direct it to another customer.



Customer acceptance

If an entity can objectively determine that control of a good or service has been transferred to the customer in accordance with the agreed-upon specifications in the contract, then customer acceptance is a formality that would not affect the entity's determination of when the customer has obtained control of the good or service.

If an entity cannot objectively determine that the good or service provided to the customer is in accordance with the agreed-upon specifications in the contract, then the entity would not be able to conclude that the customer has obtained control until the entity receives the customer's acceptance.

Contract Costs

Incremental costs of obtaining a contract

An entity shall recognise as an asset the incremental costs of obtaining a contract with a customer if the entity expects to recover those costs. The incremental costs are those costs that an entity incurs to obtain a contract that it would not have incurred if the contract had not been obtained (for example, a sales commission).

Costs to obtain a contract that would have been incurred regardless of whether the contract was obtained shall be recognised as an expense when incurred, unless those costs are explicitly chargeable to the customer regardless of whether the contract is obtained.

As a practical expedient, an entity may recognise the incremental costs of obtaining a contract as an expense when incurred if the amortisation period of the asset that the entity otherwise would have recognised is one year or less.

Costs to fulfil a contract

If the costs incurred in fulfilling a contract with a customer are not within the scope of another Standard (for example, HKAS 2 "Inventories", HKAS 16 "Property, Plant and Equipment" or HKAS 38 "Intangible Assets"), an entity shall recognise an asset from the costs incurred to fulfil a contract only if those costs meet all of the following criteria:

(a) the costs relate directly to a contract or to an anticipated contract that the entity can specifically identify;

(b) the costs generate or enhance resources of the entity that will be used in satisfying (or in continuing to satisfy) performance obligations in the future; and

(c) the costs are expected to be recovered.

Costs that relate directly to a contract include any of the following:

- direct labour;
- direct materials;
- allocations of costs that relate directly to the contract or to contract activities;
- costs that are explicitly chargeable to the customer under the contract; and
- other costs that are incurred only because an entity entered into the contract.

Amortisation and impairment

An asset (contract costs) recognised shall be amortised on a systematic basis that is consistent with the transfer to the customer of the goods or services to which the asset relates. An entity shall update the amortisation to reflect a significant change in the entity's expected timing of transfer to the customer of the goods or services to which the asset relates.

An entity shall recognise an impairment loss in profit or loss to the extent that the carrying amount of an asset exceeds the remaining amount of consideration that the entity expects to receive in exchange for the goods or services to which the asset relates; less the costs that relate directly to providing those goods or services and that have not been recognised as expenses.

An entity shall recognise in profit or loss a reversal of some or all of an impairment loss previously recognised when the impairment conditions no longer exist or have improved. The increased carrying amount of the asset shall not exceed the amount that would have been determined (net of amortisation) if no impairment loss had been recognised previously.

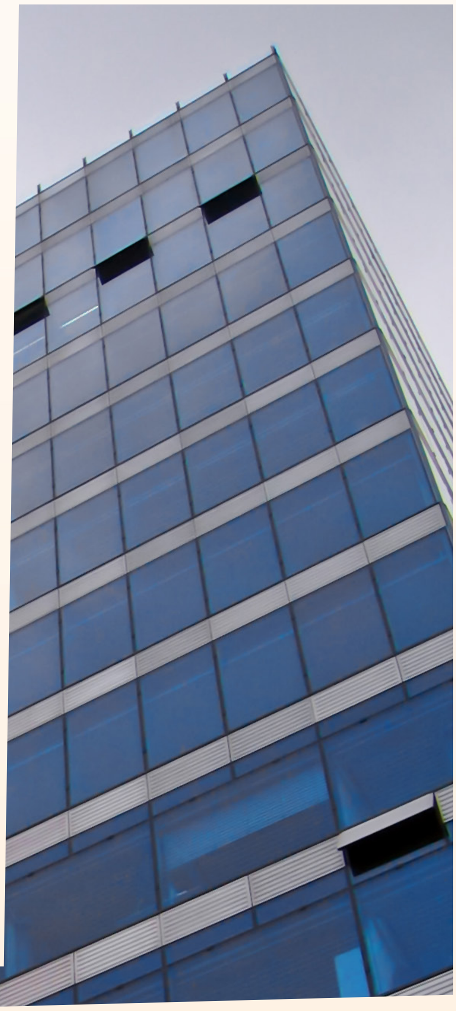
Presentation

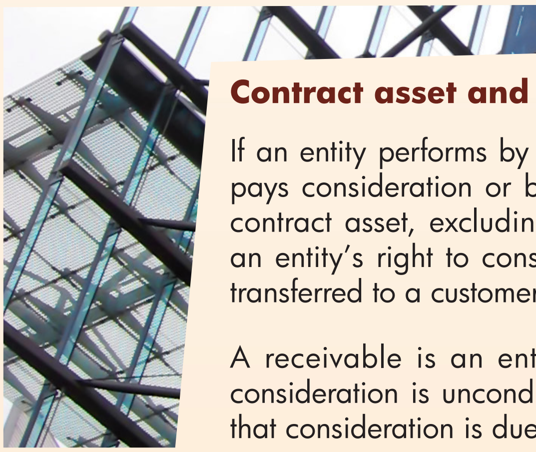
Contract liability and customers' unexercised rights

If a customer pays consideration, or an entity has a right to an amount of consideration that is unconditional (i.e. a receivable is due), before the entity transfers a good or service to the customer, the entity shall present the contract as a contract liability. A contract liability is an entity's obligation to transfer goods or services to the customer. An entity shall derecognise that contract liability (and recognise revenue) when it satisfies its performance obligation.

A customer's non-refundable prepayment to an entity gives the customer a right to receive a good or service in the future. However, customers may not exercise all of their contractual rights. Those unexercised rights are often referred to as breakage.

If an entity expects to be entitled to a breakage amount in a contract liability, the entity shall recognise the expected breakage amount as revenue in proportion to the pattern of rights exercised by the customer. If an entity does not expect to be entitled to a breakage amount, the entity shall recognise the expected breakage amount as revenue when the likelihood of the customer exercising its remaining rights becomes remote. To determine whether an entity expects to be entitled to a breakage amount, the entity shall consider the requirements on constraining estimates of variable consideration.





Contract asset and receivable

If an entity performs by transferring goods or services to a customer before the customer pays consideration or before payment is due, the entity shall present the contract as a contract asset, excluding any amounts presented as a receivable. A contract asset is an entity's right to consideration in exchange for goods or services that the entity has transferred to a customer.

A receivable is an entity's right to consideration that is unconditional. A right to consideration is unconditional if only the passage of time is required before payment of that consideration is due.

Example

Illustrative example 39 of HKFRS 15:

On 1 January 20X8, an entity enters into a contract to transfer Products A and B to a customer in exchange for CU1,000. The contract requires Product A to be delivered first and states that payment for the delivery of Product A is conditional on the delivery of Product B. The consideration of CU1,000 is due only after the entity has transferred both Products A and B to the customer. Consequently, the entity does not have a right to consideration that is unconditional (a receivable) until both Products A and B are transferred to the customer.

The entity identifies the promises to transfer Products A and B as performance obligations and allocates CU400 to Product A and CU600 to Product B. The entity recognises revenue for each respective performance obligation when control of the product transfers to the customer.

On transfer of Product A:			
Dr.	Contract asset	CU400	
Cr.	Revenue		CU400

On transfer of Product B:			
Dr.	Receivable	CU1,000	
Cr.	Contract asset		CU400
Cr.	Revenue		CU600

HKFRS 15 uses the terms 'contract asset' and 'contract liability' but does not prohibit an entity from using alternative descriptions in the statement of financial position. If an entity uses an alternative description for a contract asset, the entity shall provide sufficient information for a user of the financial statements to distinguish between receivables and contract assets.

Disclosure Requirements

An entity shall disclose qualitative and quantitative information about all of the following:

- its contracts with customers;
- the significant judgements (and changes) made in applying HKFRS 15; and
- any assets recognised from the costs to obtain or fulfil a contract with a customer.

Disclosures about contracts with customers include information about:

- revenue;
- contract balances;
- performance obligations; and
- transaction price allocated to the remaining performance obligations.

Disclosures about significant judgements include those determining:

- the timing of satisfaction of performance obligations; and
- the transaction price and the amounts allocated to performance obligations.

For details of the disclosure requirements, please refer to paragraphs 110 to 129 of HKFRS 15.

CONTACT US

HONG KONG OFFICE
Unit 701-3 & 8, Citicorp Centre, 18 Whitfield Road, Causeway Bay, Hong Kong
Tel: (852) 2155 8288 | Fax: (852) 2564 2297
Email: info@zhcpa.hk | Web: www.zhcpa.hk www.zhtraining.com

If you have any comments or require further information, please feel free to contact:

Mr. Joel Chan
Quality Assurance Partner
ZHONGHUI ANDA CPA Limited
Email: joel.chan@zhcpa.hk

Beijing | Shanghai | Tianjin | Hangzhou
Chengdu | Nanjing | Ningbo | Taiyuan
Shenzhen | Changsha | Xining | Fuzhou
Jinan | Urumqi | Hong Kong