5 Steps to Recognize Revenue from Contracts with Customers

I am a financial statement analyst. I noted that Indonesia is now in the second phase of IFRS convergence, continuing the first phase in 2012. Can I have an update about the upcoming IFRS under convergence process, in particular, revenue recognition?

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Some standards under IFRS have undergone a significant change, for example IFRS 9, 15, and 16. Indonesian Financial Accounting Standard Board (DSAK-IAI) has committed to maintain the gap between IFRS and Indonesian Financial Accounting Standards (PSAK) for only one year. Thus many new standards issued by the International Accounting Standards Board (IASB) which will be mandatory effective by 2018, should be adopted in Indonesia by 2019. Financial statement preparers and auditors in Indonesia need to equip themselves for these new standards as early as possible to ensure smooth transition in their business systems.

On 23 November 2016, DSAK issued Exposure Draft (ED) PSAK 72 "Revenue from Contracts with Customers" to adopt IFRS 15 which is the result of a successful join-project between IASB and the US-based Financial Accounting Standards Board (FASB). The ED PSAK 72 ("the Standard") sets a single standard for revenue recognition. This standard set models of recognition of revenue from contracts with customers, so that the entity is expected to do the analysis before recognizing revenue. There are a number of industries that would be significantly affected by the Standard. This Standard will replace all standards related to revenue recognition currently available, namely Revenue (PSAK 23), Construction Contracts (PSAK 34), Customer Loyalty Program (Interpretation of Indonesian Financial Accounting Standards/ISAK 10), Construction Agreement Real Estate (ISAK 21), Transfer of Assets from Customers, (ISAK 27), Accounting for Real Estate Development Activities (PSAK 44).

Applicability

Revenue is a crucial number to users of the financial statements in assessing a company's performance and prospects. ED PSAK 72 or IFRS 15 clarify the principles for recognition of revenue from contracts with customers. It applies to all contracts with customers except leases, financial instruments and insurance contracts.

Steps of Revenue Recognition

The core principle is to recognize 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. So, it is a control-based model rather than primary focus on risks and rewards.

The revenue recognition principles in the standard are applied using a five-step model, as follows: (1) Identify the contract with a customer; (2) Identify the separate performance obligations in the contract; (3) Determine the transaction price; (4) Allocate the transaction price to the separate performance obligations; and (5) Recognize revenue when performance obligation is satisfied.

Key principles

First, a contract is an agreement between two or more parties that creates enforceable rights and obligations.

Second, a contract includes promises to transfer goods or services to a customer.

Third, the transaction price is the amount of consideration in a contract to which an entity expects to be entitled in exchange for transferring promised goods or services to a customer.

Fourth, an entity typically allocates the transaction price to each performance obligation on the basis of the relative stand-alone selling prices of each distinct good or service promised in the contract.

Fifth, an entity recognizes revenue when (or as) it satisfies a performance obligation by transferring a promised good or service to a customer (which is when the customer obtains control of that good or service). The amount of revenue recognized is the amount allocated to the satisfied performance obligation.

Preparation Needed

Like other new PSAKs and IFRSs implementation, the entity need to be ready as early as possible. Key initiative is to analyze all existing contracts with customers. Adjustments may be need in control environment and internal control process, and also IT systems.

KEY POINTS

- Revenue is the crucial number to users of the financial statements in assessing a company's performance and prospects
- Accounting standard for revenue recognition is applied to all contracts with customers, except leases, financial instruments, and insurance contracts
- 5 steps model to apply the core principle which is to recognize 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

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