AGN International

IFRS 15 Case Study

Revenue Recognition

Pers Aswani

QUESTION 1

John enters into a 12-month telecom plan with the local mobile operator ABC. The terms of plan are as follows:

- John’s monthly fixed fee is CU 100.
- John receives a free handset at the inception of the plan.

ABC sells the same handsets for CU 300 and the same monthly prepayment plans without handset for CU 80/month.

(a) How should ABC recognize the revenues from this plan in line with IAS 18?

(b) How should ABC recognize the revenues from this plan in line with IFRS 15?

(Ignore a couple of things here, like a price of a SIM kit, or the situations when John hangs on the phone for hours and spends some minutes in excess of his plan. Let’s focus just on these 2 things).

AGN International

IFRS 15 Case Study

Pers Aswani

ANSWER QUESTION 1

Revenue under IAS 18

Current rules of IAS 18 say that ABC should apply the recognition criteria to the separately identifiable components of a single transaction (here: handset + monthly plan).

However, IAS 18 does not give any guidance on how to identify these components and how to allocate selling price and as a result, there were different practices applied.
For example, telecom companies recognized revenue from the sale of monthly plans in full as the service was provided, and no revenue for handset – they treated the cost of handset as the cost of acquiring the customer.

Some companies identified these components, but then limited the revenue allocated to the sale of handset to the amount received from customer (zero in this case). This is a certain form of a residual method (based on US GAAP’s cash cap method).

For the simplicity, let’s assume that ABC recognizes no revenue from the sale of handset, because ABC gives it away for free. The cost of handset is recognized to profit or loss and effectively, ABC treats that as a cost of acquiring new customer.

Revenue from monthly plan is recognized on a monthly basis. The journal entry is to debit receivables or cash and credit revenues with CU 100.

**Revenue under IFRS 15**

Under new rules in IFRS 15, ABC needs to identify the contract first (step 1), which is obvious here as there’s a clear 12-month plan with John.

Then, ABC needs to identify all performance obligations from the contract with John (step 2 in a 5-step model):

1. Obligation to deliver a handset
2. Obligation to deliver network services over 1 year

The transaction price (step 3) is CU 1 200, calculated as monthly fee of CU 100 times 12 months.

Now, ABC needs to allocate that transaction price of CU 1 200 to individual performance obligations under the contract based on their relative stand-alone selling prices (or their estimates) – this is step 4.

I made it really simple for you here, so let’s do it in the following table:

<table>
<thead>
<tr>
<th>Performance obligation</th>
<th>Stand-alone selling price</th>
<th>% on total</th>
<th>Revenue (=relative selling price = 1 200%)</th>
</tr>
</thead>
<tbody>
<tr>
<td>Handset</td>
<td>300.00</td>
<td>23.8%</td>
<td>285.60</td>
</tr>
<tr>
<td>Network services</td>
<td>960.00 (=80*12)</td>
<td>76.2%</td>
<td>914.40</td>
</tr>
<tr>
<td>Total</td>
<td>1 260.00</td>
<td>100.0%</td>
<td>1 200.00</td>
</tr>
</tbody>
</table>

The step 5 is to recognize the revenue when ABC satisfies the performance obligations. Therefore:

- When ABC gives a handset to John, it needs to recognize the revenue of CU 285.60;
- When ABC provides network services to John, it needs to recognize the total revenue of CU 914.40. It’s practical to do it once per month as the billing happens.
The journal entries are summarized in the following table:

<table>
<thead>
<tr>
<th>Description</th>
<th>Amount</th>
<th>Debit</th>
<th>Credit</th>
<th>When</th>
</tr>
</thead>
<tbody>
<tr>
<td>Sale of handset</td>
<td>285.60</td>
<td>FP – Unbilled</td>
<td>P/L – Revenue from sale of</td>
<td>When handset is given to John</td>
</tr>
<tr>
<td></td>
<td></td>
<td>revenue</td>
<td>goods</td>
<td></td>
</tr>
<tr>
<td>Network services</td>
<td>100.00 (=FP –</td>
<td>Receivable to John</td>
<td>P/L – Revenue from network</td>
<td>When network services are provided; on a monthly</td>
</tr>
<tr>
<td></td>
<td>monthly billing to John)</td>
<td>services</td>
<td>services</td>
<td>basis according to contract with John</td>
</tr>
<tr>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td></td>
<td>76.20 (=914.40/12)</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td></td>
<td>23.80 (=285.60/12)</td>
<td></td>
<td></td>
<td></td>
</tr>
</tbody>
</table>

So as you can see, John effectively pays not only for network services, but also for his handset.