METHODS FOR MEASUREMENT OF PROGRESS OF PERFORMANCE OBLIGATION UNDER IFRS 15

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Abstract
The article focuses on the recognition of revenues when the transfer of goods and services under the contract and the performance obligation accordingly, covers more than one reporting period. Performance obligation is satisfied at some point in time or over time. According to IFRS 15, when the performance obligation is satisfied over time, revenue should be recognized based on the percentage of performance of the obligation.
The article analyzes the methods permitted by the Standard for measuring the progress of performance of contractual obligation. These are the Output methods and the Input methods.
When the performance obligation is satisfied over time, the calculation of the volume of completed work via the output methods and the input method and accordingly the determination of revenues are discussed by situational examples.

Keywords: At some point in time, over time; Performance obligations; Output methods; Input methods.

JEL Classification: M41

I. INTRODUCTION

With the transition to IFRS 15 "Revenue from Contracts with Customers", a scheme of recognition of revenues has changed in many areas. In particular, the amendment referred to the rule of recognition of the revenues from construction, telecommunications (mobile, cable networks), licensing (media sector, science, franchise), real estate, software and other contracts.

"By introducing universal criteria for various contracts, IFRS 15 more broadly examines and specifies all possible options for recognition and measurement of revenues" which is more accurate and consistent in comparison to the existing standards. (Vardiashvili, Maisuradze, 2017).

The Standard establishes the principles that an entity should apply in measuring and recognizing revenues and associated cash flows. The basic principle requires an entity to recognize the revenues in the amount that an enterprise is entitled to receive in exchange for the transfer of goods or services.

IFRS 15 is applicable to all contracts concluded with customers, except for lease and insurance contracts, financial instruments and other contractual rights or obligations, non-monetary exchange transactions between enterprises of the same industry etc., for which separate standards are developed.

The introduction of IFRS 15 has changed significantly the procedure for recognition of revenues during long-term work. From contracts that are to be satisfied over time, the measurement and recognition of revenues depends on the progress of performance obligation.

The measurement of the progress of the performance obligation is the basis for the recognition of revenues. According to the Standard, "An entity shall recognize revenue for a performance obligation satisfied over time only if the entity can reasonably measure its progress towards complete satisfaction of the performance obligation". (IFRS 15 P.44). The article analyzes the IFRS 15 approaches for recognition of the revenues from such contracts, which are considered in a unified conceptual framework developed for different areas.

Generally, the standard does not consider a long-term contract separately (the term "contract duration" is used only once, for example, short-term and long-term contracts) according to IFRS 15 B.89. Correspondingly, neither the rule for accounting the revenues from long-term contracts is defined separately.

The dates of commencement and completion of the operations under the long-term contracts, as a rule, go beyond one reporting period. Distribution of the revenues from this type of contracts and of the expenses incurred for the reporting periods during which the supply of goods and services was carried out, is one of the main issues of accounting. A purpose of this study is to identify the key concepts of IFRS 15 by which the companies should be guided in recognizing revenues from the long-term contracts.

IFRS 15 introduces the concept of performance obligations. Performance obligations are each distinct good or service (or a bundle of goods or services) that the entity promises to transfer to the customer mainly with the same pattern.

The term “distinct good” means that the entity's promise to transfer the good or service to the customer is separately identifiable from other promises in the contract (i.e. the promise to transfer the good or service is distinct within the context of the contract. (IFRS 15, P.27).

One of the main changes introduced with IFRS 15 is that an entity must recognize the revenue when it has transferred the performance obligation i.e. the promised goods or services (such as assets) to the customer. An asset is deemed transferred when the customer gains control over it.

If the performance obligation is satisfied over time, the entity has to measure the progress towards its satisfaction based on input or output factors, i.e. e.g. units produced or costs incurred or machine hours used. In case a point in time realization is pertinent, the transfer of control is the decisive point in time a recognition can take place. Indicators are mainly that the seller has a right to receive the payment, the customer has the legal title and physical possession of the good or service, the customer accepts the good or service and also that the customer is assuming risks and rewards of ownership. (Haggenmüller, S., 2019).

II. PERFORMANCE OBLIGATION SATISFIED OVER TIME OR AT SOME POINT IN TIME

Performance obligation may be satisfied art some point in time or over time. At the starting date of the contract, an entity must determine the period of fulfillment for each performance obligations in order to apply an appropriate method for the recognition of revenues.

Recognition of the revenue over time (in different reporting periods) does not depend on the long-term prospects of the contract as it was before when IAS 11 was in operation. Now, certain criteria envisaged in IFRS 15 must be met. If they are not satisfied, then the entire income received from the contract will be recognized after the full performance of the contractual obligations.

The most frequent cases of recognition of revenues over time, can be found in construction and other long-term contracts. This method provides for the transfer of control over the objects under construction to the customer over time (transfer of control over time) and, accordingly, the fulfillment of contractual obligations (performance obligations) over time, also.

An entity transfers control of a good or service over time and, therefore, satisfies a performance obligation and recognizes 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

(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. (IFRS 15, P.35).

If any of the above criteria are met, the revenues s will be recognized during the contract implementation period. If none of the listed criteria is met, then it is considered that the performance obligation is satisfied at some point in time, i.e. the income from the contract must be recognized at one point in time only after completion of the works. In this case the revenue must be recognized in full at the moment of fulfilment of the obligation and obtaining the right of control over the asset by the customer.

III. METHODS FOR MEASURING THE PROGRESS OF PERFORMANCE OBLIGATION

In some cases, payments are determined in stages, by the contract. Step-by-step payments received from the customer often do not reflect the volumes of the performed works. Thus, payments shall not be automatically recognized as revenues.

For each obligation to be satisfied over time, an entity must recognize the revenues within a certain period by evaluating the progress of the performance obligation.

With measuring the progress, the entity enterprise provides the results of its activities in transferring control over the promised goods or services to the consumer (i.e. illustrates the progress of the performance obligations).

To determine the progress of performance of the contractual obligations, the entity must choose a method by which the volume of the performed works will be measured most reliably. The methods permitted by the Standard are as follows:

- Output methods

- Input methods

In determining the appropriate method for measuring progress, an entity shall consider the nature of the good or service that the entity promised to transfer to the customer according to the relevant contract.

Output methods recognize 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.

Possible ways of the output methods are listed in B15 of the standard and, envisage the following:

- Surveys of performance completed to date;
- Appraisals of results achieved, milestones reached, time elapsed and units produced or units delivered. (IFRS 15, B15).

The standard focuses on the fact that the selected method should reflect as fairly as possible the activities carried out by the contractor in order to meet the contractual obligations.

If measurement of the outcome by the chosen method does not take into account some goods and services, for example, unfinished production or delivery of finished products, the control of which was transferred to the customer and these works are important, then the revenues cannot be assessed fairly.

With this method, there is a direct logical link between performance and income. Its advantage is that the value of goods and services transferred to the consumer is measured directly. Situational example of measurement by the output method

The enterprise has signed a fixed-price contract for overpass construction in the amount of 500,000 CU. . The project will take two years to complete.

At the end of the first year of the project (31 December 20X1), the enterprise determined that the stage of performance of the construction contract can be most reliably assessed by the output method.

An independent researcher has verified according to the inspection of the performed works that 28% of the contractual volume has been done. The contract did not become unprofitable.

Since the stage of fulfillment of the contractual obligation as at 31 December 20X1 was determined by 28%, therefore, during the year ending 31 December 20X1, the enterprise will recognize revenues in the amount of 140,000 CU (500,000 CU x 28%).

The main shortcoming of this method is a complexity of obtaining information and large volumes of expenditures. Therefore, the Standard considers an alternative method that was widely used earlier during the period of use of IAS 11 was effective. This method is called the Input Method.

The input methods recognize revenue on the basis of the entity's efforts or inputs to the satisfaction of a performance obligation relative to the total expected inputs to the satisfaction of that performance obligation.

The enterprise may use inputs, spent working time, spent expenses, elapsed time or used machine-hours to assess the costs incurred. For example, how much percent of the total expected expenditure are inputs.

If the entity's efforts or inputs are expended evenly throughout the performance period, it may be appropriate for the entity to recognize revenue on a straight-line basis. (IFRS 15, B18).

The advantage of the input method is that to compare to the measurements by the output methods, it requires less costs, since it is much easier to measure volumes of the inputs. A shortcoming of input methods is that there may not be a direct relationship between an entity's inputs and outputs. Indeed, expenses and income are not always directly correlated with each other. This is especially evident if there are inefficient costs, job defects, and losses. In this case, costs will be incurred, but they will not result in the fulfillment of the contractual obligation.

To recognize income, it is necessary to measure the assets (goods and services) over which the customer was given control during the reporting period. If there is no direct link connection between the inputs by the enterprise and the transfer of control to the consumer over the goods or services, then the use of the input method may, for the reporting period, lead to a distortion of the amount of income expected under the contract.

Therefore, when using the input methods, the company must exclude the costs which do not contribute to the entity's progress in satisfying the performance obligations. If the entity chooses this method, then it must adjust the calculation of the inputs from which income is measured. For example, an entity should exclude from the cost of inputs the costs of the cost of unexpected amounts of wasted materials, labor or other resources that were incurred to satisfy the performance obligation. While when a cost incurred is not proportionate to the entity's progress in satisfying the performance obligation, in those circumstances, the best depiction of the entity's performance may be to adjust the input method to reflect the outputs of the entity.

A faithful depiction of an entity's performance might be to recognize revenue at an amount equal to the cost of a good used to satisfy a performance obligation if the entity expects at contract inception that all of the following conditions would be met:

(i) The good is not distinct;
(ii) The customer is expected to obtain control of the good significantly before receiving services related to the good;
(iii) The cost of the transferred good is significant relative to the total expected costs to completely satisfy the performance obligation; and

(iv) The entity procures the good from a third party and is not significantly involved in designing and manufacturing the good I(IFRS 15, B19)

The Company shall use one chosen method to measure the progress of the performance obligation during the contract. In addition, the same method should be applied to all contracts under similar circumstances and with similar performance obligations.

Basis for Conclusions of the Standard says that the existence of two methods does not at all mean that the company has "free choice". The contractor must select a measurement method that best demonstrates the company's performance in satisfying the performance obligation. To do this, the company must analyze the nature of its activities, and on the basis of this analysis make a choice of the most appropriate method.

Measurement of the revenue by the input methods. According to the illustrative example in IFRS 15, the company concluded a contract with the customer for the renovation of the building, including the installation of elevators. The company buys elevators from the manufacturer and installs them in the customer's building without any changes.

Fixed income from the contract is 10,000,000 CU (currency unit), while expected expenses amount to 7,500,000 CU, of which 2,000,000 CU is the cost of elevators. On 32 December 2021 the company incurred expenses in the amount of 1,375,000 CU, excluding the cost of elevators. Elevators were delivered to the customer in early December 2021, but their installation is not expected until June 2022.

In similar projects, to measure the interim results, the company uses the input methods (the ratio of the incurred costs to total contractual costs). According to IFRS 15, an entity shall exclude from an input method the effects of any inputs that do not depict the entity's performance in accordance with the objective of measuring progress in the performance obligation. Therefore, the cost of elevators is not included in the total of resources used.

The progress of fulfillment of contractual obligations is 25% (1,375,000 /5,500,000 CU).

Estimated income from the project is 10 MIO CU.

Revenue (without the elevators) is 2,000,000 CU [25% × (10,000,000 – 2,000,000)].

From the sale of elevators, the company according to IFRS 15 B19 recognizes the revenues in the amount equal to the cost of the goods used to satisfy the performance obligation, with zero margin. Thus, a total revenue for the year ended 31 December 2021 is 2,000,000 + 2, 000,000 = 4,000,000 CU, the cost is equal to 1,375,000 + 2,000,000 = 3,375,000 CU; and the profit is 625,000 CU.

This example illustrates the input method when the materials were not installed in the process of work (uninstalled materials). If the customer gains control over the asset (goods) before its installation by the contractor, then it will be inappropriate to recognize such goods as reserves on the contractor's balance sheet. Instead, the contracting company must recognize income in an amount equal to the cost of the goods used.

Therefore, the authors of the Standard decided that under certain circumstances, the company should recognize income for the transfer of goods, but only in the amount of expenses incurred. In this case, the value of these costs should be excluded from the calculations by the input methods. (IFRS 15, B19).

The company must periodically update the measurement of the progress in satisfying the performance obligations, in order to reflect in the final result of the obligation any changes that occur due to changes in circumstances. Any such changes should be considered as changes in the accounting estimates.

When the revenue is recognised over time, the company must disclose information about the applied method, for providing the users of the financial statement with a clear idea of to what extent performance obligation is satisfied, including an explanation of why the chosen method reflects the transfer of goods and services more fairly.

IV. CONCLUSION

Thus, if the company fulfills its contractual obligation over time, in each reporting period before the completion of the project, it must recognize the revenues by measuring the progress of the performance obligation. Of the methods chosen for measuring the performance obligation, the company should choose the method by which the volume of the work performed will be measured most reliably.

At the same time, the method of measuring the progress of the performance obligation should reflect clearly the works implemented to fulfill the obligation, i.e. transfer of control over the asset or services to the customer.

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