MALAYSIAN INSTITUTE OF ACCOUNTANTS

FREQUENTLY-ASKED QUESTIONS (FAQs) FOR MFRS 15 *REVENUE FROM CONTRACTS WITH CUSTOMERS*

MFRS 15 *Revenue from Contracts with Customers* was issued by the Malaysian Accounting Standards on 2 September 2014. MFRS 15 will be effective for financial period beginning on or after 1 January 2018 with early application being permitted.

Below are some of the implementation questions that the staff of the Institute received in relation MFRS 15. The answers to the questions have been prepared by the staff of the Institute and are not necessarily the views of the Institute.

Auditors and preparers are expected to use professional judgement in determining if the questions are both appropriate and relevant to their circumstances.

Introduction

MFRS 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.

MFRS 15 supersedes the following MASB approved accounting standards and IC Interpretations:

1. MFRS 111 *Construction Contracts;*
2. MFRS 118 *Revenue;*
3. IC Interpretation 13 *Customer Loyalty Programmes;*
4. IC Interpretation 15 *Agreements for the Construction of Real Estate;*
5. IC Interpretation 18 *Transfers of Assets from Customers;* and
6. IC Interpretation 131 *Revenue – Barter Transactions Involving Advertising Services*.

MFRS 15 introduces the 5-step model for entities to recognise revenue as follows:

1. Step 1: Identify the contract(s) with a customer;
2. Step 2: Identify the performance obligations in the contract;
3. Step 3: Determine the transaction price;
4. Step 4: Allocate the transaction price to the performance obligations in the contract; and
5. Step 5: Recognise revenue when (or as) the entity satisfies a performance obligation.

FREQUENTLY-ASKED QUESTIONS (FAQs) ON MFRS 15 *REVENUE FROM CONTRACTS WITH CUSTOMERS*

IDENTFYING THE CONTRACT

Q1. In a sale and purchase of a residential unit, a buyer is required to pay a deposit (a certain amount out of the total purchase price). More often than not, property developers do not perform any credit assessment (credit standing) of the buyer. Without evidence of the financial standing of the customer, in this case, does the contract satisfy the probability test as required in paragraph 9(e) of MFRS 15?

As required by paragraph 9(e), it is important for property developers to be able to demonstrate a customer's ability and intention to pay the amount of consideration. Property developers should not presume collectability is probable for all customers. Credit evaluation is one of the examples of how an entity assesses the customer's ability to pay for the amount of consideration.

Basis for conclusion:
Paragraph 9 of MFRS 15 states that a contract with customer falls within the scope of MFRS 15 only when all of the following criteria are met:

(a) the parties to the contract have approved the contract (in writing, orally or in accordance with other 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 to which it will be entitled in exchange for the goods or services that will be transferred to the customer.

The requirements in paragraphs 9(a) to 9(d) are normally stated in the contract with customers while paragraph 9(e) requires an entity to assess the probability to collect from customers. However, property developers do not have customers' records on his/her ability to pay the amount on initial recognition. As such, to satisfy the requirement in paragraph 9(e), property developers shall, for example, perform credit evaluation on the buyers before a contract can be identified as a contract with customer.

DETERMINING WHETHER GOODS OR SERVICES ARE DISTINCT

Q2. It is common for property developers to provide the following goods or services at no additional consideration to customers:

i. white goods (e.g. furniture and fittings, electrical fittings);
ii. club house/club membership;
iii. common areas (e.g. swimming pool, sport facilities, gymnasium); or
iv. other facilities (e.g. car park).

Are these goods or services distinct performance obligation(s) from the residential unit?

The above goods or services are considered distinct as it meets the criteria in paragraphs 27(a) and (b). However, if the items are highly integrated with the residential unit, it may be an indicator that the above are not distinct within the context of the contract.

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Basis for conclusion:
Paragraph 27 of MFRS 15 states that "A good or service that is promised to a customer 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 (ie the good or service is capable of being distinct); and
(b) the entity's promise to transfer the good or service to the customer is separately identifiable from other promises in the contract (ie the promise to transfer the good or service is distinct within the context of the contract)."

The goods and services stated above are normally given to customers when they purchase the housing unit. As such, it is critical to assess whether the additional goods or services given are distinct within the context of the contract as stated in paragraph 27(b).

Paragraph 29 further clarified that "in assessing whether an entity's promises to transfer goods or services to the customer are separately identifiable in accordance with paragraph 27(b), the objective is to determine whether the nature of the promise, within the context of the contract, is to transfer each of those goods or services individually or, instead, to transfer a combined item or items to which the promised goods or services are inputs. Factors that indicate that two or more promises to transfer goods or services to a customer are not separately identifiable include, but are not limited to, the following:

(a) the entity provides a significant service of integrating the goods or services with other goods or services promised in the contract into a bundle of goods or services that represent the combined output or outputs for which the customer has contracted. In other words, the entity is using the goods or services as inputs to produce or deliver the combined output or outputs specified by the customer. A combined output or outputs might include more than one phase, element or unit.
(b) one or more of the goods or services significantly modifies or customises, or are significantly modified or customised by, one or more of the other goods or services promised in the contract.
(c) the goods or services are highly interdependent or highly interrelated. In other words, each of the goods or services is significantly affected by one or more of the other goods or services in the contract. For example, in some cases, two or more goods or services are significantly affected by each other because the entity would not be able to fulfil its promise by transferring each of the goods or services independently."

Generally, the above goods or services do not satisfy any one of the indicators as stated in paragraph 29. As such, they are distinct from one another.

Q3. Certain property developers also develop the following buildings/facilities in a development project:

i. Place of worship (e.g., mosque, church, temple);
ii. Hospital;
iii. School; or
iv. Playground or park

Are these buildings/facilities distinct performance obligation from the residential unit?

The above buildings/facilities are outside the scope of MFRS 15 as property developers do not owe such obligation to customers but to the respective local authorities. This issue will be addressed by FRSIC Issue No 60 *Provision for Common Infrastructure Costs.*

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Basis for conclusion:
Contract with customers for residential properties in Malaysia are governed under the:

1. *Housing Development (Control and Licensing) Act 1966 ("HDA") for Peninsular Malaysia;*
2. *Housing Development (Control and Licensing) Enactment 1978 ("HDE") for Sabah; and*
3. *Housing Development (Control and Licensing) Ordinance 2013 ("HDO") for Sarawak.*

The above regulations state clearly the mandatory infrastructure that property developers are required to build for the customers as stipulated in the Sale and Purchase Agreement ("SPA") entered between customers and property developers. However, it is noted that the above items are not included in the SPA. As such, the above items are outside the scope of MFRS 15 because they relate to obligations to a local authority.

Q4. A property developer has two pieces of land (land A and land B) which are adjacent to each other. The property developer sells land A to another property developer. The basic infrastructure (e.g. drainage, piping) is linked and integrated with one another. Is the basic infrastructure a distinct performance obligation from land A?

The basic infrastructure represents a distinct performance obligation from the land if the buyer can take control of the vacant land before the construction of the basic infrastructure (for e.g. vacant possession on the land is passed before the completion of the basic infrastructure). This is consistent with the criteria in paragraphs 27 (a) and (b).

Basis for conclusion:
Paragraph 27 of MFRS 15 states that "a good or service that is promised to a customer 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 (ie the good or service is capable of being distinct); and
(b) the entity's promise to transfer the good or service to the customer is separately identifiable from other promises in the contract (ie the promise to transfer the good or service is distinct within the context of the contract)."

Paragraph 28 explains that "a customer can benefit from a good or service in accordance with paragraph 27(a) if the good or service could be used, consumed, sold for an amount that is greater than scrap value or otherwise held in a way that generates economic benefits. For some goods or services, a customer may be able to benefit from a good or service on its own. For other goods or services, a customer may be able to benefit from the good or service only in conjunction with other readily available resources. A readily available resource is a good or service that is sold separately (by the entity or another entity) or a resource that the customer has already obtained from the entity (including goods or services that the entity will have already transferred to the customer under the contract) or from other transactions or events. Various factors may provide evidence that the customer can benefit from a good or service either on its own or in conjunction with other readily available resources. For example, the fact that the entity regularly sells a good or service separately would indicate that a customer can benefit from the good or service on its own or with other readily available resources."

Paragraph 29 clarified the requirement in paragraph 27 (b) where it states "in assessing whether an entity's promises to transfer goods or services to the customer are separately identifiable in accordance with paragraph 27(b), the objective is to determine whether the

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nature of the promise, within the context of the contract, is to transfer each of those goods or services individually or, instead, to transfer a combined item or items to which the promised goods or services are inputs. Factors that indicate that two or more promises to transfer goods or services to a customer are not separately identifiable include, but are not limited to, the following:

(a) the entity provides a significant service of integrating the goods or services with other goods or services promised in the contract into a bundle of goods or services that represent the combined output or outputs for which the customer has contracted. In other words, the entity is using the goods or services as inputs to produce or deliver the combined output or outputs specified by the customer. A combined output or outputs might include more than one phase, element or unit.

(b) one or more of the goods or services significantly modifies or customises, or are significantly modified or customised by, one or more of the other goods or services promised in the contract.

(c) the goods or services are highly interdependent or highly interrelated. In other words, each of the goods or services is significantly affected by one or more of the other goods or services in the contract. For example, in some cases, two or more goods or services are significantly affected by each other because the entity would not be able to fulfil its promise by transferring each of the goods or services independently."

Generally, an entity would be able to benefit from the land once it has control over the land although without the basic infrastructure once vacant possession is given to the customers. This is because an entity would still be able to build its own infrastructure with a different contractor after taking control of the land. Accordingly, the basic infrastructure and the land are not interdependent and interrelated.

However, it is important to assess the contractual terms of the contract with customers. For instance, if the contract states that the customer has a right not to accept the land without the basic infrastructure, it can be argued that the basic infrastructure is highly interrelated to the land and hence, shall not be a distinct performance obligation.

DETERMINING TRANSACTION PRICE

Q5. How should property developers recognise and measure liquidated damages (or liquidated and ascertained damages) payable to the house buyers?

Consistent with the requirements of paragraphs 50 and 51 of MFRS 15 relating to variable consideration, the amount for liquidated damages (or liquidated and ascertained damages) shall be accounted for as a reduction in the transaction price.

Basis for conclusion:

Paragraph 50 states that "if the consideration promised in a contract includes a variable amount, an entity shall estimate the amount of consideration to which the entity will be entitled in exchange for transferring the promised goods or services to a customer" while paragraph 51 explained that "an amount of 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, an amount of consideration would be variable if either a product was sold with a right of return or a fixed amount is promised as a performance bonus on achievement of a specified milestone."

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Liquidated and ascertained damages arise from the failure to deliver the property to the customer at a stipulated time. As such, the amount represents penalties to the property developers in the context of the contract with customers, which is a variable consideration.

Q6. How should property developers account for the following costs:
i. Customer's legal fees borne by property developers; and
ii. Referral fees?

Consistent with the requirements of paragraph 70, property developers should account for customer's legal fees borne by them as consideration payable to the customers and accordingly, as a reduction of the transaction price. On the other hand, the referral fees represent incremental costs of obtaining a contract with customers, similar to sales commission, and should be accounted for as cost to obtain a contract.

Basis of conclusion:

i. Legal fees borne by property developers
Paragraph 70 states that "consideration payable to a customer includes cash amounts that an entity pays, or expects to pay, to the customer (or to other parties that purchase the entity's goods or services from 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 (or to other parties that purchase the entity's goods or services from the customer). 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 (as described in paragraphs 26–30) that the customer transfers to the entity. If the consideration payable to a customer includes a variable amount, an entity shall estimate the transaction price (including assessing whether the estimate of variable consideration is constrained) in accordance with paragraphs 50–58."

Based on the above paragraph, the legal fees borne by property developers in relation to its contracts with customers, shall reduce the transaction price.

ii. Referral fees
Paragraph 91 states that "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. Paragraph 92 clarified that "the incremental costs of obtaining a contract are those costs that an entity incurs to obtain a contract with a customer that it would not have incurred if the contract had not been obtained (for example, a sales commission)."

As referral fees is incurred as an incentive to introduce potential customers, it shall be treated as part of the costs to obtain a contract.

RECOGNISE REVENUE WHEN (OR AS) THE ENTITY SATISFIES A PERFORMANCE OBLIGATION

Q7. How should property developers recognise revenue when a contract does not specify the entity's right to payment over the performance completed to date and are silent on the termination compensation?

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Property developers are advised to obtain legal advice on the issue including the entity's rights and obligation if the contract is terminated by customers.

Basis for conclusion:
Paragraph 9 of MFRS 15 states that a contract with customer falls within the scope of MFRS 15 only when all of the following criteria are met:

(a) the parties to the contract have approved the contract (in writing, orally or in accordance with other 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 (ie 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 to which it will be entitled in exchange for the goods or services that will be transferred to the customer.

In such a situation, an entity shall obtain legal advice to determine whether it has enforceable rights to payment for work completed to date and enforceable right over the completion of the contract.

PRESENTATION

Q8. Are there any significant changes to the presentation of property development costs under MFRS 15?

Prior to the adoption of MFRS 15, all property development costs are presented collectively as a single line item classified as "Property Development Cost" in the statement of financial position. Upon adoption of MFRS 15, property development cost should be analysed and presented in accordance with the nature of the expenditure. For example, costs that meet the definition of an inventory as defined in MFRS 102 *Inventories* should be recognised, measured and presented in accordance with MFRS 102. Cost incurred to fulfil a contract which meets the criteria in MFRS 15 should be accounted for in accordance with MFRS 15. If an entity transfers goods or services to a customer before the payment is due, the amount is presented as a contract asset as defined in MFRS 15.

Basis for conclusion:

An entity shall account for property development costs as inventory consistent with MFRS 102 when it has performed its promise to the customer but yet to transfer the promised good or service to the customer. When the entity has transferred the good or service promised, such property development costs will be recognised as expense in the profit and loss as required by paragraph 34 of MFRS 102.

Paragraph 105 states that "When either party to a contract has performed, an entity shall present the contract in the statement of financial position as a contract asset or a contract liability, depending on the relationship between the entity's performance and the customer's payment. An entity shall present any unconditional rights to consideration separately as a receivable."

Paragraph 107 further states that "if an entity performs by transferring goods or services to a

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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".

Paragraph 108 then states that "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".

Accordingly, when the entity has transferred the promised goods or services before payment is made or due, depending on whether the entity's right to consideration is conditional or unconditional, the entity shall present it as a contract asset or receivable respectively.

Q9. How should property developers present the liquidated damages (or liquidated and ascertained damages)? Should it be shown as a provision or should the amount be netted off against contract asset?

The liquidated damages should be accounted for in deriving the carrying amount of contract asset or contract liability.

Basis for conclusion:
Paragraph 51 states that "An amount of 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, an amount of consideration would be variable if either a product was sold with a right of return or a fixed amount is promised as a performance bonus on achievement of a specified milestone."

As the liquidated damages (or liquidated and ascertained damages) represents penalties to the property developers, the amount is reflected in the transaction price rather than as a separate cost. Accordingly, liquidated damages should be accounted for in deriving the carrying amount of contract asset or contract liability.

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