IFRS 15: REVENUE FROM CONTRACTS WITH CUSTOMERS – ACCOUNTING ISSUES IN SHIPPING

The accounting standard IFRS 15, Revenue from Contracts with Customers, came into force from 1 January 2018.

When IFRS 15 was issued, with the exception of some highly publicised sectors, its impact on the shipping industry was not expected to be material. Perhaps some additional disclosures would be required but the underlying revenue recognition would not have a material effect on the financial statements.

However, as the requirements of the standard became fully digested its effects were wider than initially thought. It excludes revenues under leasing contracts, so income from bareboat charters and the asset element of time charters will be unaffected by this standard. Rather, the effect is on voyage charters and the service element of time charters.

The key change is one of approach. Previous practice looked at revenue recognition by reference to what is being done by the seller. This standard looks at what is being received by the customer.

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WHAT DOES THE CUSTOMER RECEIVE?

IFRS 15 requires revenue to be recognised when, and only when, an entity transfers a promised good or service to a customer and not as the entity undertakes activities connected with a promised good or service. There is much greater focus on what the customer is getting from the seller, and recognising revenue as it receives this. This has a significant impact for thinking about when to recognise revenue.

The standard is built around the concept of a ‘performance obligation’ – a promise to transfer a distinct good or service to a customer. What does my customer want from me? Under a voyage charter, the transport of cargo from its loading port to its discharge port.

Prior to IFRS 15, various bases were used for voyage accounting, most commonly a ‘discharge to discharge’ or a ‘load to load’ basis. That made sense when looked at in terms of what the shipping company is doing, but not if we look at what the customer is receiving.

Does the customer get any benefit before loading? Does the customer get any benefit after discharge? In both cases the customer gets nothing, the performance obligation is the transport from load port to discharge port, and the revenue should be recognised accordingly.

Would a repositioning voyage, such as a ballast leg, ever amount to part of the performance obligation or be a separate performance obligation in its own right? This is highly unlikely. A performance obligation would only be separate if the customer benefits from this on its own. The repositioning is required to put the vessel owner into a position to be able to satisfy the transfer of the cargo from the load port and does not provide the customer with any separate benefit.

Repositioning costs can be carried forward prior to load if they meet all three conditions:

- they relate directly to a contract
- they generate or enhance resources to be used in meeting obligations under the contract
- they are expected to be recovered.

Where costs are carried forward, they will be written off over the period of the next voyage. The criteria might be met, although care will need to be taken to ensure that general and administrative overheads are not included. The final criterion also means costs cannot be carried forward where the charter is expected to result in a loss.

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For more information and advice on IFRS 15, please get in touch.

SO HOW IS REVENUE RECOGNISED?

The revenue should depict the transfer of the promised services. This leads to revenue being recognised over a period which commences with the loading of the cargo and ends when the vessel has discharged its cargo.

> “So how is revenue recognised? The revenue should depict the transfer of the promised services.”

So compared to the most common previous practice of recognising voyages on a ‘discharge to discharge' basis, revenue will start to be recognised a little later, and for fewer days each year. On those days when revenue is recognised, the amounts will, of course, be higher.

The change in total revenue, and profit, will arise only in relation to those voyages, or periods of relocation, which straddle the end of a year. This will also affect key performance measures, such as Time Charter Equivalent (TCE). Would a time charter suffer the same change? In most cases, the simple answer is no. However, it will be necessary to consider the terms of each time charter on a case by case basis.

What else has changed? IFRS 15 has a far more robust model for determining the amount of revenue to be recognised – the transaction price. Where a fixed price is agreed between the parties the transaction price is simple to determine. But if there are variations to that price, for whatever reason the amount of revenue will be variable, and this presents a greater challenge. An example of a variation would be demurrage.

If a vessel is delayed, either through late loading, or discharging beyond the allowed time, any additional sums payable would be variable consideration.

Variable consideration should only be included in the transaction price when it is highly probable that it will be due and that there will not subsequently be a significant reversal of the revenue. As a voyage progresses, the vessel owner will need to assess whether it is highly probable that demurrage will become due, and if so how much will be recieved.

When estimating the transaction price the vessel owner may use either an expected value method, or a most likely amount method. Is the data available to estimate any amount which may became due, will the charterer settle? For a single owning entity, the most likely amount will be the preferred approach. Expected value is more suited to average across multiple voyages in progress.

> “IFRS 15 has a far more robust model for determining the amount of revenue to be recognised...”

Will this affect the reporting of all voyage charters? Unless the entity is already using ‘load to discharge’, there will be an impact. As revenue will not start to be recognised until loading, this will lead to a timing difference compared with a ‘discharge to discharge’ policy as no revenue is recognised during repositioning. For a voyage in progress, because the amount recognised on an equivalent daily rate will be proportionately higher, in effect a ‘catchup’ of the revenue previously recognised during repositioning, there will be a timing difference that will continue until discharge.

GREATER VARIABILITY REPORTED

One outcome of this is that revenue will become more ‘lumpy’ as it is only to be recognised during the loading, carrying and discharging of cargo. This may make comparison of short-term, monthly, performance more problematic. For a period of a ballast voyage, where a vessel is repositioning for its next charter, the marginal costs of that voyage might be deferred to be subsequently released as an expense of the voyage.

OTHER PRACTICAL CONSIDERATIONS

Changing accounting requirements can have consequential effects. In nearly all instances of accounting changes, consideration must be given to the ability to obtain the information to reflect the changes through the existing accounting systems in place. Where the performance is assessed using measures other than the primary statements, will these be affected? If the period from which an entity recognises income changes, does this also change a measure such as off-hire relating to vessels on time charter; idle-time or periods of unemployment for vessels trading on the spot market? Should such a measure be redefined to exclude repositioning periods?

And if so, how is this dealt with when the changes are applied for the first time? Applying IFRS 15 for the first time will raise challenges. To assist preparers the standard provides a number of transitional exemptions. Having a greater impact will be the additional disclosure requirements.

But remember, for most in shipping, IFRS 15 only changes the timing of the recognition of revenue and not the amount of cash that is actually received.

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