(NBAA)
THE NATIONAL BOARD OF ACCOUNTANTS AND AUDITORS
TANZANIA

UPDATES OF INTERNATIONAL STANDARDS (ACCOUNTING) AND TAX LAWS

This is to inform our Esteemed Examination candidates, Tuition Providers, Training Institutions and other stakeholders that the Board shall be issuing regular updates on International Standards and Tax Laws whenever there are some updates, amendments or changes.

Regular changes, updates and amendments occur mainly in those areas related to International Standards (accounting) and Tax Laws. In this case some subjects in the Board's Examination Scheme are affected by the regular changes. These subjects include B2 Financial Reporting, B4 Public Finance & Taxation, C1 Corporate Reporting and C4 Advanced Taxation.

Attached herewith are updates related to the aforementioned subjects. You are kindly requested to use these updates and ignore the outdated topics/section in the Board's Learning Materials.

For any enquiry, please contact the undersigned:

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UPDATES ON THE INTENATIONAL STANDARDS

CONCEPTUAL FRAMEWORK

A conceptual framework is a statement of generally accepted principles which form the frame of reference for financial reporting. These theoretical principles provide the basis for development of the new accounting standards and the evaluation of those already in existence. In the absence of a conceptual framework, accounting standards are more difficult to develop since each standard must begin from scratch. It is also more likely that there will be inconsistencies and contradictions between one standard and another.

Advantages of a conceptual framework

(a) The situation is avoided whereby standards are developed on a patchwork basis, where a particular accounting problem is recognised as having emerged, and resources were then channelled into **standardising accounting practice** in that area, without regard to whether that particular issue was necessarily the most important issue remaining at that time without standardisation.

(b) As stated above, the development of certain standards (particularly national standards) have been subject to considerable **political interference** from interested parties. Where there is a conflict of interest between user groups on which policies to choose, policies deriving from a conceptual framework will be **less open to criticism** that the standard-setter buckled to external pressure.

(c) Some standards may concentrate on the **income statement** whereas some may concentrate on the **valuation of net assets** (statement of financial position).

Arguments against a conceptual framework

(a) Financial statements are intended for a **variety of users**, and it is not certain that a single conceptual framework can be devised which will suit all users.

(b) Given the diversity of user requirements, there may be a need for a variety of accounting standards, each produced for a **different purpose** (and with different concepts as a basis).

(c) It is not clear that a conceptual framework makes the task of **preparing and then implementing** standards any easier than without a framework.

The IASB's Conceptual Framework

In 1989 the IASB (then IASC) produced a document, Framework for preparation and presentation of financial statements ('Framewok'). This was superseded in 2010 by the *Conceptual framework for Financial Reporting,* though this revised document was only partially complete. It has now been replaced by the March 2018 version which has been issued in order to feel the gaps, update the content and clarify certain areas.

The 2018 Conceptual Framework

The *2018 Conceptual Framework* is structured into an introductory explanation on the status and purpose of the *Conceptual Framework* and eight chapters:

Chapter	Topic
	Status and purpose of the *Conceptual Framework*
1	The objective of general purpose financial reporting
2	Qualitative characteristics of useful financial information
3	Financial statements and the reporting entity

4	The elements of financial statements
5	Recognition and derecognition
6	Measurement
7	Presentation and disclosure
8	Concepts of capital and capital maintenance

The following sections consider the content of the Conceptual Framework in more detail

Status and purpose of the Conceptual Framework

The Conceptual Framework is not an IFRS and so does not overrule any individual IFRS. The Conceptual Framework will be revised from time to time on the basis of the Board's experience of working with it.

The purpose of the Conceptual Framework is to:

(a) assist the International Accounting Standards Board (Board) to develop IFRS Standards (Standards) that are based on consistent concepts;

(b) assist preparers to develop consistent accounting policies when no Standard applies to a particular transaction or other event, or when a Standard allows a choice of accounting policy; and

(c) assist all parties to understand and interpret the Standards.

Chapter 1: The objective of general purpose financial reporting

The conceptual Framework states that:

'The objective of general purpose financial reporting1 is to provide financial information about the reporting entity that is useful to existing and potential investors, lenders and other creditors in making decisions relating to providing resources to the entity.'

These users information about:

- The economic resources of the entity,
- Claims against the entity and
- changes in the entity's resources and claims

Information about the entity's economic resources and claims against it helps users to assess the reporting entity's liquidity and solvency, and its likely needs for additional financing.

Information about a reporting entity's financial performance helps users to understand the return that the entity has produced on its economic resources.

The conceptual Framework makes it clear that this information should be prepared on an accrual basis.

Information about a reporting entity's cash flows during a period also helps users to assess the entity's ability to generate future net cash inflows

Chapter 2—Qualitative characteristics of useful financial information

The Framework identifies types of information that are useful to the users of financial statements.

The Framework splits qualitative characteristics into categories

i) Fundamental qualitative characteristics

ii) Enhancing qualitative characteristics

Fundamental qualitative characteristics

The fundamental qualitative characteristics are relevance and faithful representation.

Relevance	Information must be relevant to the decision-making needs of users. Information is relevant if it can be used for predictive and/or confirmatory purposes. – It has predictive value if it helps users to predict what might happen in the future. – It has confirmatory value if it helps users to confirm the assessments and predictions they have made in the past. The relevance of information is affected by its materiality. Information is material if omitting it or misstating it could reasonably be expected to influence decisions of the users based on the financial statements. – Materiality is an entity-specific aspect of relevance based on the nature or magnitude (or both) of the items to which the information relates in the context of an individual entity's financial report. – Therefore, it is not possible for the IASB to specify a uniform quantitative threshold for materiality or predetermine what could be material in a particular situation.
Faithfully representation	• Information must **faithfully represent** the substance of what it purports to represent • A faithful representation is, to the maximum extent possible, complete, neutral and free from error – A complete depiction includes all information necessary for a user to understand the phenomenon being depicted, including all necessary descriptions and explanations. – A neutral depiction is without bias in the selection or presentation of financial information. – Free from error means there are no errors or omissions in the description of the phenomenon, and the process used to produce the reported information has been selected and applied with no errors in the process.

Enhancing qualitative characteristics

There are four enhancing qualitative characteristics

Comparability	• Comparability is the qualitative characteristic that enables users to identify and understand similarities in, and differences among, items. • Information about a reporting entity is more useful if it can be compared with similar information about other entities and with

	similar information about the same entity for another period or another date. • Consistency is related to comparability but is not the same. Consistency refers to the use of the same methods for the same items, either from period to period within a reporting entity or in a single period across entities. Consistency helps to achieve the goal of comparability.
Verifiability	• Verifiability helps assure users that information faithfully represents the economic phenomena it purports to represent. • Verifiability means that different knowledgeable and independent observers could reach consensus, although not necessarily complete agreement, that a particular depiction is a faithful representation.
Timeliness	• Timeliness means having information available to decision-makers in time to be capable of influencing their decisions. Generally, the older the information is the less useful it is. However, some information may continue to be timely long after the end of a reporting period because, for example, some users may need to identify and assess trends.
Understandability	• Classifying, characterising and presenting information clearly and concisely makes it understandable. • Financial reports are prepared for users who have a reasonable knowledge of business and economic activities and who review and analyse the information diligently. At times, even well-informed and diligent users may need to seek the aid of an adviser to understand information about complex economic phenomena.

The cost constraint

It is important that the costs incurred in reporting financial information are justified by the benefits that the information brings to its users.

Chapter 3—Financial statements and the reporting entity

The conceptual framework states that:

'The objective of financial statements is to provide financial information about the reporting entity's assets, liabilities, equity, income and expenses8 that is useful to users of financial statements in assessing the prospects for future net cash inflows to the reporting entity and in assessing management's stewardship of the entity's economic resources '

A complete set of financial statements includes:

(a) A statement of financial position,

(b) A statement of profit or loss and other comprehensive income

(c) A statement of changes in financial position

(d) Notes, other statements and explanatory material

A reporting entity is an entity that is required, or chooses, to prepare financial statements. A reporting entity can be a single entity or a portion of an entity or can comprise more than one entity. A reporting entity is not necessarily a legal entity.

Going concern assumption

Financial statements are normally prepared on the assumption that the reporting entity is a going concern and will continue in operation for the foreseeable future. Hence, it is assumed that the entity has neither the intention nor the need to enter liquidation or to cease trading. If such an intention or need exists, the financial statements may have to be prepared on a different basis. If so, the financial statements describe the basis used.

Chapter 4—The elements of financial statements

The elements of the financial statements as identified in the conceptual framework are summarized in the following table

Asset	• A present economic resource controlled by the entity as a result of past events. • An economic resource is a right that has the potential to produce economic benefits
Liability	• A present obligation of the entity to transfer an economic resource as a result of past events
Equity	• The residual interest in the assets of the entity after deducting all its liabilities.
Income	• Increases in assets, or decreases in liabilities, that result in increases in equity, other than those relating to contributions from holders of equity claims.
Expenses	• Decreases in assets, or increases in liabilities, that result in decreases in equity, other than those relating to distributions to holders of equity claims.

Chapter 5—Recognition and derecognition

Recognition

Per the conceptual Framework, recognition is the process of capturing for inclusion in the statement of financial position or the statement(s) of financial performance an item that meets the definition of one of the elements of financial statements—an asset, a liability, equity, income or expenses.
Only items that meet the definition of an asset, a liability or equity are recognised in the statement of financial position. Similarly, only items that meet the definition of income or expenses are recognised in the statement(s) of financial performance. However, not all items that meet the definition of one of those elements are recognised.
An asset or liability is recognised only if recognition of that asset or liability and of any resulting income, expenses or changes in equity provides users of financial statements with information that is useful, ie with:

(a) Relevant information about the asset or liability and about any resulting income, expenses or changes in equity ;and
(b) Faithful representation of the asset or liability and of any resulting income, expenses or changes in equity

Derecognition
Derecognition is the removal of all or part of a recognised asset or liability from an entity's statement of financial position. Derecognition normally occurs when that item no longer meets the definition of an asset or of a liability:
(a) for an asset, derecognition normally occurs when the entity loses control of all or part of the recognised asset; and
(b) for a liability, derecognition normally occurs when the entity no longer has a present obligation for all or part of the recognised liability.

Chapter 6—Measurement
The conceptual framework refers to a number of measurement bases, which can be used to different degrees and in varying combinations in the financial statements.

Historical cost	• The historical cost of an asset when it is acquired or created is the value of the costs incurred in acquiring or creating the asset, comprising the consideration paid to acquire or create the asset plus transaction costs. • The historical cost of a liability when it is incurred or taken on is the value of the consideration received to incur or take on the liability minus transaction costs.
Fair value	• Fair value is the price that would be received to sell an asset, or paid to transfer a liability, in an orderly transaction between market participants at the measurement date.
Value in use and fulfilment value	• Value in use is the present value of the cash flows, or other economic benefits, that an entity expects to derive from the use of an asset and from its ultimate disposal.

	• Fulfilment value is the present value of the cash, or other economic resources, that an entity expects to be obliged to transfer as it fulfils a liability.
Current cost	• The current cost of an asset is the cost of an equivalent asset at the measurement date, comprising the consideration that would be paid at the measurement date plus the transaction costs that would be incurred at that date. • The current cost of a liability is the consideration that would be received for an equivalent liability at the measurement date minus the transaction costs that would be incurred at that date.

The factors to be considered when selecting a measurement basis are **relevance** and **faithful representation**, because the aim is to provide information that is useful to investors, lenders and other creditors.

Chapter 7—Presentation and disclosure

The statement of profit or loss is the primary source of information about an entity's financial performance for the reporting period. Profit or loss could be a section of a single statement of financial performance or a separate statement. The statement(s) of financial performance include(s) a total (subtotal) for profit or loss

In principle, all income and expenses are classified and included in the statement of profit or loss

In exceptional circumstances, the Board may decide to exclude from the statement of profit or loss income or expenses arising from a change in current value of an asset or liability and include those income and expenses in other comprehensive income .The Board may make such a decision when doing so would result in the statement of profit or loss providing more relevant information or a more faithful representation

In principle, income and expenses included in other comprehensive income in one period are recycled to the statement of profit or loss in a future period when doing so results in the statement of profit or loss providing more relevant information or a more faithful representation

When recycling does not result in the statement of profit or loss providing more relevant information or a more faithful representation, the Board may decide income and expenses included in other comprehensive income are not to be subsequently recycled

Chapter 8—Concepts of capital and capital maintenance

Capital maintenance refers to the concept that profits can only be made when the capital of an organisation is restored to, or maintained at the level that it was at the start of an accounting period**.**

The concept is commonly separated into two types:

(a) **Financial capital maintenance.** Under this concept a profit is earned only if the financial (or money) amount of the net assets at the end of the period exceeds the financial (or money) amount of net assets at the beginning of the period, after excluding any distributions to, and contributions from, owners during the period. Financial capital maintenance can be measured in either nominal monetary units or units of constant purchasing power.

(b) **Physical capital maintenance**. Under this concept a profit is earned only if the physical productive capacity (or operating capability) of the entity (or the resources or funds needed to achieve that capacity) at the end of the period exceeds the physical productive capacity at the beginning of the period, after excluding any distributions to, and contributions from, owners during the period.

Question with answers

Question 1

The development of the ***IASB Conceptual Framework for Financial Reporting*** over the years has led to the IASB producing a body of accounting standards that have the advantages for those companies that adopt them. The Framework is also of value to auditors, and the users of financial statements, and more generally help interested parties to understand the IASB's approach to the formulation of an accounting standard.

Required:

Summarize the ***contents (scope)*** of the IASB's Conceptual Framework for Financial Reporting.

Question 2

Define '***equity',*** and explain why the conceptual framework does not prescribe any ***recognition criteria*** for equity.

Question 3

According to the ***IASB Conceptual Framework***, the concept of capital maintenance is concerned with how an entity defines the capital it seeks to maintain. The concept of capital gives rise to ***financial capital maintenance*** and ***physical capital maintenance***. The selection of the appropriate concept of capital by an entity should be based on the needs of the users of its financial statements**.**

Required:

Distinguish between ***financial capital maintenance*** and ***physical capital maintenance***.

Question 4

The Framework for the Preparation and Presentation of Financial Statements was originally issued in 1989. In 2004, the IASB and the FASB decided to review and revise the conceptual framework. However, this decision changed priorities and the slow progress in the project led to the project being abandoned in 2010. This was after only Phase A of the original joint project was finalised and introduced into the existing framework as Chapters 1 and 3 in September 2010.

The current form of the conceptual framework as at May 2018 provides a revised and complete version of the framework.

Required:

Explain **FOUR (4)** primary reasons why the IASB believed it was ***necessary to revise*** its conceptual framework.

Question 5

The qualitative characteristics of relevance, faithful representation and comparability which are identified in the IASB Conceptual Framework are some of the attributes that make financial information useful to the various users of financial statements.

Explain what is meant by relevance, faithful representation and comparability and how they make financial information useful.

Question 6

The Conceptual Framework states that an entity's choices of measurement bases and capital maintenance concept determine the accounting model used in the preparation of the financial statements.

(a) Explain the measurement bases identified in the Conceptual Framework.

(b) Explain the capital maintenance concepts identified in the Conceptual Framework.

Answers to question 1

Scope of the IASB Conceptual Framework for Financial Reporting

The Framework addresses:

(a) the objective of general purpose financial reporting qualitative characteristics of useful financial information financial statements and the reporting entity

(b) the elements of financial statements

(c) recognition and derecognition

(d) measurement

(e) presentation and disclosure

(f) concepts of capital and capital maintenance

Answers to question 2

The conceptual framework defines equity as **'the residual interest in the assets of the entity after deducting all its liabilities'.**

Equity cannot be identified independently of the other elements in the statement of financial position/balance sheet. The characteristics of equity are that equity is a residual, i.e. something left over after the entity has determined its assets and liabilities. In other words:

Equity = Assets –Liabilities.

There is no need for recognition criteria for equity **as it is a residual, determined after recognition criteria are applied to the other elements**. In other words, **the recognition of assets and liabilities will lead to recognition of equity**.

Answers to question 3

Financial capital maintenance: Under this concept, a profit is earned only if the financial (or money) amount of the net assets at the end of the period exceeds the financial (or money) amount of net assets at the beginning of the period, after excluding any distributions to, and contributions from owners during the period. Financial capital maintenance can be measured in either nominal monetary units or units of constraint purchasing power.

Physical capital maintenance: Under this concept, a profit is earned only if the physical productive capacity (or operating capability) of the entity (or the resources or funds needed to achieve that capacity) at the end of the period exceeds the physical productive capacity at the beginning of the period, after excluding any distributions to, and contributions from owners during the period**.**

Answers to question 4

The purpose of the project to revise the Framework was essentially:

(a) To update the Framework for changes in markets, business practices and economic environment since the original Framework was published in 1989

(b) To develop a common conceptual framework between US GAAP and IFRSs so that decisions are based on the same framework in the interests of harmonisation of future standards issued by both bodies.

(c) To provide a better foundation for developing principles-based and converged standards, including filling in some gaps (e.g. a lack of detail in the definition of the reporting entity).
(d) In addition, the IASB is interested in ensuring the conceptual framework is suitable for application to not-for-profit and other entities.

Answers to question 5

Relevance

To be useful, financial information must be relevant to the needs of users when they are making economic decisions. Financial information is relevant if it helps users to predict future events or if it helps them to confirm (or refute) previous predictions.

Information can have predictive value even though it does not take the form of an explicit forecast, since information on past events may be used as a basis for predictions about future events.

The relevance of information is affected by its level of materiality. Information is material if its omission or mis-statement could influence user decisions. Immaterial items are not relevant.

Faithful representation

To be useful, financial information must faithfully represent transactions and other events. The information must be complete, free of bias and free from material error. Financial information should also represent the substance of transactions and events rather than their legal form.

Comparability

Users should be able to compare financial information about an entity for a reporting period with similar information about the same entity for other periods and with similar information about other entities for the same period. Comparability is improved if consistent accounting treatments are adopted between periods and between entities.

Answers to question 6

(a) The measurement bases are historical cost, current cost, realisable value and present value.
(b) The capital maintenance concepts are financial capital maintenance (either in nominal units or in units of purchasing power) and physical capital maintenance.

IFRS- 16, LEASES

Introduction

International Financial Reporting Standard (IFRS) 16, *Leases* was issued in January 2016 and, in comparison to its predecessor International Accounting Standard (IAS) 17 makes significant changes to the way in which leasing transactions are reported in the financial statements of lessees (although not in the financial statements of lessors). The standard provides a single lessee accounting model, requiring lessees to recognise assets and liabilities for all leases unless the lease term is 12 months or less or the underlying asset has a low value. Lessors continue to classify leases as operating or finance, with IFRS 16's approach to lessor accounting substantially unchanged from its predecessor, IAS 17.

Objective of IFRS 16

IFRS 16 establishes principles for the recognition, measurement, presentation and disclosure of leases, with the objective of ensuring that lessees and lessors provide relevant information that faithfully represents those transactions.

Scope

IFRS 16 *Leases* applies to all leases, including subleases, except for:

(a) Leases to explore for or use minerals, oil, natural gas and similar non-regenerative resources;

(b) Leases of biological assets held by a lessee (see IAS 41 *Agriculture*);

(c) Licences of intellectual property granted by a lessor (see IFRS 15 *Revenue from Contracts with Customers*); and

(d) Rights held by a lessee under licensing agreements for items such as films, videos, plays, manuscripts, patents and copyrights within the scope of IAS 38 *Intangible Assets*

Definitions

IFRS 16 Leases provides the following definitions:

- **A lease** is a contract, or part of a contract, that conveys the right to use an underlying asset for a period of time in exchange for consideration.
- **The lessor** is the entity that provides the right-of-use asset and, in exchange, receives consideration.
- **The lessee** is the entity that obtains use of the right-of-use asset and, in exchange, transfers consideration.
- **A right-of-use asset** is the lessee's right to use an underlying asset over the lease term.

Identifying a lease

IFRS 16 Leases requires lessees to recognise an asset and a liability for all leases, unless they are short-term or of a minimal value. As such, it is very important to assess whether a contract contains a lease, or whether it is simply a contract for a service.

A contract contains a lease if it conveys 'the right to control the use of an identified asset for a period of time in exchange for consideration'.

For this to be the case, IFRS 16 says that the contract must give the customer:

- the right to substantially all of the identified asset's economic benefits, and
- the right to direct the identified asset's use.

The right to direct the use of the asset can still exist if the lessor puts restrictions on its use within a contract (such as by capping the maximum mileage of a vehicle, or limiting which countries an asset can be used in). These restrictions define the scope of a lessee's right of use, rather than preventing them from directing use. IFRS 16 says that a customer does not have the right to use an identified asset if the supplier has the practical ability to substitute the asset for an alternative and if it would be economically beneficial for them to do so.

Example 1

ABC Ltd enters into a contract with an airport operator to use some space in the airport to sell its goods from portable kiosks for a three-year period. ABC Ltd owns the portable kiosks. The contract stipulates the amount of space and states that the space may be located at any one of several departure areas within the airport. The airport operator can change the location of the space allocated to ABC Ltd at any time during the period of use, and the costs that the airport operator would incur to do this would be minimal. There are many areas in the airport that are suitable for the portable kiosks.

Required:

Does the contract contain a lease?

Answer1

The contract does not contain a lease because there is no identified asset. The contract is for space in the airport, and the airport operator has the practical right to substitute this during the period of use because:

- There are many areas available in the airport that would meet the contract terms, providing the operator with a practical ability to substitute
- The airport operator would benefit economically from substituting the space because there would be minimal cost associated with it. This would allow the operator to make the most effective use of its available space, thus maximising profits.

Example 2

XYZ enters into a contract with Sophia, the supplier, to use a specified ship for a five-year period. Sophia has no substitution rights. During the contract period, XYZ decides what cargo will be transported, when the ship will sail, and to which ports it will sail. However, there are some restrictions specified in the contract. Those restrictions prevent XYZ from carrying hazardous materials as cargo or from sailing the ship into waters where piracy is a risk. Sophia operates and maintains the ship and is responsible for the safe passage of the cargo on board the ship. XYZ is prohibited from hiring another operator for the ship, and from operating the ship itself during the term of the contract.

Required:

Does the contract contain a lease?

Answer2

XYZ has the right to use an identified asset (a specific ship) for a period of time (five years). Sophia cannot substitute the specified ship for an alternative.

XYZ has the right to control the use of the ship throughout the five-year period of use because: it has the right to obtain substantially all of the economic benefits from use of the ship over the five-year period due to its exclusive use of the ship throughout the period of use.

- it has the right to direct the use of the ship. Although contractual terms exist that limit where the ship can sail and what cargo can be transported, this acts to define the scope of XYZ's right to use the ship rather than restricting XYZ's ability to direct the use of the ship. Within the scope of its right of use, XYZ makes the relevant decisions about how and for what purpose the ship is used throughout the five-year period of use because it decides whether, where and when the ship sails, as well as the cargo it will transport.
- Sophia's operation and maintenance of the ship does not prevent XYZ from directing how, and for what purpose, the ship is used. Therefore, based on the above, the contract contains a lease.

Separating components of a contract

Each lease and non-lease component in a contract should be accounted for separately.

Separate lease components

The right to use an underlying asset is a separate lease component if both the following criteria are met

a. the lessee can benefit from use of the underlying asset either on its own or together with other resources that are readily available to the lessee; and

b. the underlying asset is neither highly dependent on, nor highly interrelated with, the other underlying assets in the contract.

Accounting by lessees

At the commencement date, a lessee (a customer) recognises a right-of-use ('RoU') asset and a lease liability. RoU is an asset representing lessee's right to use the leased asset during the lease term.

Initial measurement of the lease liability

The lease liability should be initially recognised and measured at the present value of the lease payments. Lease payments comprise:

a. fixed payments, less any lease incentives receivable,
b. variable lease payments that depend on an index or a rate,
c. amounts expected to be payable by the lessee under residual value guarantees,
d. the exercise price of a purchase option if the lessee is reasonably certain to exercise that option; and
e. payments of penalties for terminating the lease, if the lease term reflects the lessee exercising an option to terminate the lease.

The discount rate used to measure the present value of the minimum lease payments is the rate of interest implicit in the lease – essentially the rate of return earned by the lessor on the leased asset. [NB: If that rate cannot be readily determined, the lessee shall use their incremental borrowing rate.]

Incremental borrowing rate is the rate of interest that a lessee would have to pay to borrow over a similar term, and with a similar security, the funds necessary to obtain an asset of a similar value to the right-of-use asset in a similar economic environment.

Initial measurement of the right-of-use asset

The right-of-use ('RoU') asset is measured at cost at the commencement date. The cost of RoU comprises

a. the amount equal to the lease liability at its initial recognition,
b. lease payments made at or before the commencement of the lease (less any lease incentives received),
c. any initial direct costs incurred by the lessee; and
d. an estimate of costs to be incurred by the lessee in dismantling and removing the underlying asset, restoring the site on which it is located or restoring the underlying asset to the condition required by the terms and conditions of the lease, unless those costs are incurred to produce inventories (recognised under IAS 37).

Subsequent measurement of the lease liability

Lease liabilities are measured on an amortised cost basis using an effective interest method, similarly to other financial liabilities.

Interest is recognised in P/L unless it can be capitalised under IAS 23.

Subsequent measurement of the right-of-use asset

The right-of-use asset is measured subsequently at cost, unless the lessee applies the fair value model in IAS 40 or revaluation model in IAS 16.

The lease term

To calculate the initial value of the liability and right-of-use asset, the lessee must consider the length of the lease term. IFRS 16 says that the lease term comprises:

- Non-cancellable periods
- Periods covered by an option to extend the lease if reasonably certain to be exercised
- Periods covered by an option to terminate the lease if reasonably certain not to be exercised.

Example 3

On 1st January, 2019, Bahari entered into two year lease for machinery. The contract contains option to extend the lease term for a further year. Bahari believes that it is reasonably certain to exercise this option. Machineries have a useful life of ten years. Lease payments are TZS 10,000,0000 per annum for the initial term and TZS 15,000,000 per annum for the option period. All payments are due at the end of the year. To obtain the lease, Bahari incurs initial direct costs of TZS 3,000,000. The lessor immediately reimburses TZS 1,000,000 of these costs. The interest rate within the lease is not readily determinable. Bahari's incremental rate of borrowings is 5%.

Required:

(a) Calculate the initial carrying amount of the lease liability and the right to use asset and provide the double entries needed to record these amounts in Bahari's financial records.

(b) What figures will be shown in the financial statements for the year ended 31 December 2019

Answer 3

(a) The lease term is three years. This is because the option to extend the lease is reasonably certain to be exercised.

(i) Initial value of the lease liability calculated as the PV of lease payments as follows:

Date	Cash flow (TZS)	PV factor@ 5%	Present value
31/12/19	10,000,000	0.9524	9,524,000
31/12/20	10,000,000	0.9070	9,070,000
31/12/20	15,000,000	0.8638	12,957,000
			31,551,000

(ii) The initial value of the right-of-use asset is calculated at cost made of :-

	(TZS)
Initial liability value	31,551,000
Direct costs	3,000,000
Reimbursement	(1,000,000)
	33,551,000

Journal

Dr Right-of-use asset	TZS 33,551,000	
Cr Lease liability		TZS 31,551,000
Cr Cash (Direct costs less re-imbursement)		TZS 2,000,000

Subsequently

(i) The right-of-use asset is depreciated over the three year lease term, because it is shorter than the useful economic life. This gives a charge of TZS 11,183,667 (TZS 33,551,000/3 years).

For the year ended 31/12/2019

Dr Depreciation (P/L) TZS 11,183,667

Cr Right-of-use asset TZS 11,183,677

The carrying amount of the right-of-use asset will be reduced to TZS 22,367,333 at 31/12/2019 (TZS 33,551,000 – TZS 11,183,667).

(ii) Lease liability is subsequently measured at amortised cost, using the rate of interest implicit in the lease or incremental borrowing rate as the effective interest rate.

Lease liability table

YYear	Opening balance	Interest at 5%	Payments	Closing balance
	TZS	**TZS**	**TZS**	**TZS**
31/12/2019	31,551,000	1,577,550	(10,000,000)	23,128,550
31/12/2020	23,128,550	1,156,428	(10,000,000)	14,284,978

For the year ended 31 December 2019

Interest of TZS 1,577,550 is charged on the lease liability.

Dr Finance costs (P/L) TZS 1,577,550

Cr Lease liability TZS 1,577,550

The cash payment reduces the liability.

Dr Lease Liability TZS 10,000,000

Cr Cash TZS 10,000,000

Extract –Statement of profit or loss and OCI for the year ended 31 December 2019

- Finance costs (1,577,550)
- Depreciation (11,183,667)

Extract –Statement of financial position as at 31 December 2019

Assets

Non-current assets

Right of use assets (TZS 33,551,000 – TZS 11,183,667) 22,367,333

Non- current liability

Lease liability 14,284,978

Current liability

Lease liability (23,128,550-14,284,978) 8,843,572

Example 4

XYZ Limited entered into a four year lease on 1 January 2019 for a machine. Rentals are TZS 20,000,000 p.a payable in advance. XYZ Limited incurs initial direct costs of TZS 5,000,000. The rate of interest implicit in the lease is 10%. Machine has a useful life of five years.

Required:

Prepare extracts from financial statements for the year ended 31 December 2019

Answer 4

At inception XYZ Limited should recognizes right of use asset and lease liability.

(i) Initial value of the lease liability calculated as the PV of lease payments as follows:

Year	Lease payments	Discount factor at 10% (advance)	Present value
1	20,000,000	1	20,000,000
2	20,000,000	0.9091	18,182,000
3	20,000,000	0.8264	16,528,000
4	20,000,000	0.7513	15,026,000
			69,736,000

Initial value of the lease liability =TZS 69,736,000-TZS 20,000,000=TZS 49,736,000

(ii) Initial value of the right-of-use asset is calculated at cost made of :-

Initial liability value	49,736,000
Advance payments	20,000,000
Direct costs	5,000,000
	74,736,000

Journal

Dr Right-of-use asset TZS 74,736,000

Cr Lease liability TZS 49,736,000

Cr Cash (Advance) TZS 20,000,000

Cr Cash (Direct costs) TZS 5,000,000

(iii) The right-of-use asset is depreciated over the four years .This gives a charge of TZS 18,684,000 (TZS 74,736,000/4 years).

(iv) Lease liability is subsequently measured at amortised cost, using the rate of interest implicit in the lease or incremental borrowing rate as the effective interest rate.

Year	Opening balance	Lease payments	Capital	Interest at 10%	Closing balance
1	69,736,000	(20,000,000)	49,736,000	4,973,600	54,709,600
2	54,709,600	(20,000,000)	34,709,600	3,470,960	38,180,560

Extract –Statement of profit or loss and OCI for the year ended 31 December 2019

- Finance costs (4,973,600)
- Depreciation (3,470,960)

Extract –Statement of financial position as at 31 December 2019
Assets
Non-current assets

Right of use assets (TZS 74,736,000 – TZS 18,684,000)	56,052,000
Non- current liability	
Lease liability	34,709,600
Current liability	
Lease liability	20,000,000

Short-life and low value assets

If the lease is short-term (less than 12 months at the inception date) or of a low value then a simplified treatment is allowed.

IFRS 16 does not specify a particular monetary amount below which an asset would be considered 'low value' but instead gives the following examples of low value assets:

- Tablets
- Small personal computers
- Telephones
- Small items of furniture.

In these cases, the lessee can choose to recognise the lease payments in profit or loss on a straight line basis. No lease liability or right-of-use asset would therefore be recognised.

ACCOUNTING BY LESSORS

Lessors shall classify each lease as an operating lease or a finance lease.

A lease is classified as a finance lease if it transfers substantially all the risks and rewards incidental to ownership of an underlying asset. Otherwise a lease is classified as an operating lease.

Examples of situations that individually or in combination would normally lead to a lease being classified as a finance lease are:

(i) the lease transfers ownership of the asset to the lessee by the end of the lease term

(ii) the lessee has the option to purchase the asset at a price which is expected to be sufficiently lower than fair value at the date the option becomes exercisable that, at the inception of the lease, it is reasonably certain that the option will be exercised

(iii) the lease term is for the major part of the economic life of the asset, even if title is not transferred

(iv) at the inception of the lease, the present value of the minimum lease payments amounts to at least substantially all of the fair value of the leased asset

(v) the leased assets are of a specialised nature such that only the lessee can use them without major modifications being made

Accounting for finance leases by lessors
Initial accounting

Upon lease commencement, a lessor shall recognise assets held under a finance lease as a receivable at an amount equal to the net investment in the lease.

The net investment in the lease is the gross investment in the lease discounted at the interest rate implicit in the lease. The gross investment in the lease is the sum of (1) lease payments receivable by the lessor under a finance lease and,(2) any unguaranteed residual value accruing to the lessor.
The interest rate implicit in the lease is the rate of interest that causes the present value of (a) the lease payments ,and (b) the unguaranteed residual value to equal to the sum of (i) the fair value of the underlying asset, and (ii) initial direct costs of the lessor
IFRS 16 states that lease payments include the following:

- Fixed payments
- Variable payments that depend on an index or rate, initially valued using the index or rate at the lease commencement date
- Amounts expected to be payable under residual value guarantees
- Options to purchase the asset that are reasonably certain to be exercised
- Termination penalties, if the lease term reflects the expectation that these will be incurred.

Subsequent treatment

- The subsequent treatment of the finance lease is as follows:
- The carrying amount of the lease receivable is increased by finance income earned, which is also credited to the statement of profit or loss.
- The carrying amount of the lease receivable is reduced by cash receipts

Example 5
XYZ LTD leased medical equipment:

- Lease term: 2 years
- Inception of lease: 1 Jan 2019
- Annual instalments in advance: TZS 44,000,000
- Residual value as guaranteed by lessee: TZS 11,000,000
- Expected residual value at end of lease: TZS 13,200,000
- Initial direct costs by lessor
- Interest rate implicit in the lease: 10%

  Required:
  Show the net investment in the lease at 1 January 2019 and 31 December 2019 and 2020

Initial treatment

- At the inception of a lease, lessors present assets held under a finance lease as a receivable. The value of the receivable is calculated as the present value of lease payments receivable by the lessor under a finance lease and unguaranteed residual value accruing to the lessor.
- The present value is calculated as follows:-

Year	Payments	Amounts	PV factor @10%	Present value
1-2	Instalments	44,000,000	1.9090	83,996,000

2	Guaranteed residual value	11,000,000	0.8264	9,090,400
2	Unguaranteed residual value	2,200,000	0.8264	1,818,080
				94,904,480

Subsequently
Lease receivable is subsequently measured at amortised cost in which the carrying amount of the lease receivable is increased by finance income and reduced by cash receipts at each year end.

- In this case, the armotised cost at 31/12/2019
- Opening balance at 1 January 2019 94,904,480
- Cash received in advance (44,000,000
- _Subtotal 50,904,480
- Finance Income@10% 5,090,448
- Closing balance at 31 December 2019 55,994,928

Journal entries
The cash receipt reduces the lease receivable.

Dr Cash TZS 44,000,000
Cr Lease receivable TZS 44,000,000

Interest of TZS 5,090,448 is debited on the lease receivable.

- Dr Lease receivable TZS 5,090,448
- Cr Finance income (P&L) TZS 5,090,448

Accounting treatment of operating lease
A lessor recognises operating lease payments as income on a straight-line basis or, if more representative of the pattern in which benefit from use of the underlying asset is diminished, another systematic basis.

SALE AND LEASEBACK TRANSACTIONS
A sale and leaseback transaction occurs when one entity (seller) transfers an asset to another entity (buyer) who then leases the asset back to the original seller (lessee).
The companies are required to account for the transfer contract and the lease applying IFRS 16, however consideration is first given to whether the initial sale of the transferred asset is a performance obligation under IFRS 15.

(i) If the transfer of the asset is not a sale then the following rules apply:

- The seller-lessee continues to recognise the transferred asset and will recognise a financial liability equal to the transfer proceeds.
- The buyer-lessor will not recognise the transferred asset and will recognise a financial asset equal to the transfer proceeds.

(ii) If the transfer of the asset is a sale then the following rules apply:

Seller-Lessee

- Derecognise the asset
- Recognise the sale at fair value
- Recognise lease liability (PV of lease rentals •
- Recognise a right-of-use asset,as proportion of previous carrying value of underlying asset

Buyer-Lessor

- Recognise purchase of the asset
- Apply lessor accounting

Transactions not at fair value

(iii) If the sales proceeds are not at fair value, IFRS 16 requires that:

- Below market terms (e.g. when the sales proceeds are less than the asset's fair value) are treated as a prepayment of lease payments
- Above market terms (e.g. when the sales proceeds exceed the asset's fair value) are treated as additional financing.

Example 6

Dangote required funds to finance a new ambitious rebranding exercise. It's only possible way of raising finance is through the sale and leaseback of its head office building for a period of 10 years. The lease payments of TZS 100 million are to be made at the end of the lease period

The current fair value of the building is TZS1,000 million and the carrying value is TZS 840 million. The interest rate implicit in the lease is 5%.

Required:

Advise Dangote on how to account for the sale and leaseback in its financial statements

(a) If performance obligations are not satisfied;

(b) If the performance obligations are satisfied and the building is sold for the following:

(i) TZS 1,000 million

(ii) TZS 900 million;

(iii) TZS 1,100 million.

Answer

(a) If the transfer of the asset is not a sale then:-

Seller

- Continue to recognise the asset@TZS 840 million and depreciate
- Recognise a financial liability @transfer proceeds of TZS 1,000 million

Lessor

- Do not recognize the asset as it has not been sold to the buyer Recognise a financial asset @ transfer proceeds of TZS 1,000 million

(b) If the performance obligations are satisfied

(i) The transfer of asset is sale at fair value(ie TZS 1,000 million)

DR Bank TZS1,000 million
DR Right of use asset TZS 649million
CR Lease liability TZS 772million
CR PPE – Building TZS 840 million
CR Gain on transfer TZS 37 million

(ii) The transfer of asset is sale below fair value(ie TZS 900 million)

DR Bank TZS900 million
DR Prepayments TZS 100million
DR Right of use asset TZS 649million
CR Lease liability TZS 772million
CR PPE – Building TZS 840 million
CR Gain on transfer TZS 37 million

(iii) The transfer of asset is sale above fair value (ie TZS 1,100 million)

DR Bank TZS1,100 million
DR Right of use asset TZS 649million
CR Lease liability TZS 772million
CR Financial liability TZS 100million
CR PPE – Building TZS 840 million
CR Gain on transfer TZS 37 million

WORKINGS

Lease liability = PV of lease rentals at rate implicit in the lease = TZS 100 million x AF1-10@5% = 100 million x 7.722 = TZS 772 million

Right-of-use retained 772 - 77.22% -649
Rights transferred 228 -22.78% -191
Total 1,000 -100.0% - 840

Question 1

IFRS 16 - *Leases* was issued in January 2016 and is effective for accounting periods beginning on or after 1 January 2019. However, early adoption is permitted, provided IFRS 15 - *Revenue from Contracts with Customers* is implemented also. The IFRS brings significant changes to those leases formerly classified as operating leases under IAS 17 - *Leases*, the previous standard.

(i) On 1 August 2017, Maduhu Plc entered into an agreement to lease a building for a 10-year period. The lease terms stipulated that the annual lease rental would be TZS 100,000,000 per annum in arrears, with the first payment due on 31 July 2018. The interest rate implicit in the lease is 7%, and the present value of the minimum lease payments is TZS 702,358,154. Maduhu incurred costs of TZS 30,000,000 in entering the lease. The lease terms allow for the extension of the lease at market rental. However, it is not certain that Maduhu will take up this option.

(ii) On the same date, Maduhu Plc entered into an agreement to acquire a motor vehicle. The terms of the agreement were that the vehicle would be leased for 5 years from the date of inception, subject to a deposit of TZS 19,971,176 and 5 annual payments of TZS 6,500,000 in advance, commencing on

1 August 2017. The fair value of the vehicle and the present value of the lease payments were TZS 48,000,000 at inception. The interest rate implicit in the lease is 8%.

Required:

(a) Outline the key principles behind the accounting treatment for leases as required by IFRS 16.

(b) Show, with appropriate calculations, the accounting entries required to record each transaction above for the year ended 31 July 2018. Present the relevant extracts from the statement of profit or loss for the year ended 31 July 2018, and the statement of financial position as at that date.

Answer 1

(a) The approach to leases adopted by IFRS 16 requires the commitment to make annual payments to be recognised as a liability, provided the resulting benefit is an asset under the control of the entity for the term of the lease. The asset is recognised at present value of the minimum required lease payments, and is depreciated over the shorter of the lease term or the asset's useful economic life (unless it is highly likely that the asset will transfer to the lessee at the end of the least term, in which case the asset's useful economic life should be used). The liability is initially measured at the present value of minimum required lease payments, and is subsequently measured at amortised cost, with finance costs taken to profit or loss as incurred, using the effective rate implicit in the lease, or the entity's cost of capital if the implicit rate is not available.

(b)

(i) Initial recognition & measurement:

The lease obligation is initially recognised at TZS 702,358,154.

The asset is recognised at this amount plus costs (TZS 702,358,154 + 30,000,000), orTZS 732,358,154.

Journal:

Dr Leasehold buildings	TZS 732,358,154	
Cr Lease obligation		TZS 702,358,154
Cr Cash (costs)		TZS 30,000,000

Subsequent measurement:

Finance cost for year ended 31 July 2018 (702,358,154 * 7%) TZS 49,165,071

Payment made 31 July 2018 TZS 100,000,000

Depreciation of leased asset (732,358,154 / 10 years) TZS 73,235,815

Journal:

Dr Profit or loss (finance costs)	TZS 49,165,071	
Cr Lease obligation		TZS 49,165,071
Dr Lease obligation	TZS 100,000,000	
Cr Cash		TZS 100,000,000
Dr Profit or loss (depreciation)	TZS 73,235,815	
Cr Leasehold asset accumulated depreciation)		TZS 73,235,815

Closing balance on lease obligation (702,358,154 + 49,165,071– 100,000,000)TZS 651,523,225

Presented as current liability (100,000,000 – (651,523,225 * 7%))TZS 54,393,374

Presented as non-current liability TZS 597,129,850
Extracts from financial statements for year ended 31 July 2018:

Statement of Profit or Loss for year ended 31 July 2018:

Operating costs (depreciation)	73,235,815
Finance costs	49,165,071

Statement of Financial Position as at 31 July 2018:

Non-current assets:	
Leasehold building (732,358,154 – 73,235,815)	659,122,339
Non-current liabilities:	
Lease obligation	597,129,850
Current liabilities:	
Lease obligation	54,393,374

(ii) Initial recognition & measurement:
The asset is recognised at:TZS 48,000,000
The lease obligation is initially recognised at TZS 48,000,000 – 19,971,176 – 6,500,000) TZS 21,528,824

Journal:

Dr Vehicles	TZS 48,000,000	
Cr Lease obligation		TZS 21,528,824
Cr Cash (upfront payments: 19,971,176 + 6,500,000)		TZS 26,471,176

Subsequent measurement:
Finance cost for year ended 31 July 2018 (21,528,824 * 8%)TZS 1,722,306
Depreciation of leased asset (48,000 / 5 years)TZS 9,600,000

Journal:

Dr Profit or loss (finance costs) TZS 1,722,306
Cr Lease obligation TZS 1,722,306

Dr Profit or loss (depreciation) TZS 9,600,000
Cr Leasehold asset accumulated depreciation) TZS 9,600,000
Closing balance on lease obligation (21,528,824 + 1,722,306) TZS 23,251,130
Presented as current liability (full payment as it is in advance, due 1 August 2018)TZS 6,500,000
Presented as non-current liability TZS 16,751,130

Extracts from financial statements for year ended 31 July 2018:

Statement of Profit or Loss for year ended 31 July 2018:

Operating costs (depreciation)	9,600,000
Finance costs	1,722,306

Statement of Financial Position as at 31 July 2018:

Non-current assets:	
Leasehold building (48,000,000 – 9,600,000)	38,400,000
Non-current liabilities:	
Lease obligation	16,751,130
Current liabilities:	
Lease obligation	6,500,000

Question 2

On 1 December 2018, Siba sold a building at a price of TZ 5 million which was also the building's fair value at that date. The building had a carrying amount of TZS 3.2 million on that date. However, Siba immediately started leasing the building from the new owner under a 4 year lease. The building's remaining useful economic life at 1 January 2018 was 20 years. The leaserequires Siba to pay a rental of TZS 300,000 p.a on 31 December each year over the lease term. Siba's incremental borrowing rate is 15%.
The sale of the building has commercial substance in accordance with IFRS 15 Revenue From Contract with Customers.
The company is seeking advice on how to account for the sale and subsequent lease transactions.
Required:
Advise the directors on how the above transaction must be accounted for in Siba's financial statements for the year to 31 December 2018.
Answer 2
The sale and lease back will be accounted for in accordance with IFRS 16 Leases. The standard requires that in accounting for a sale and lease back, an entity must first establish whether a sale has taken place based on IFRS 15 requirements. The IFRS 16 requirements relating to accounting for sale and lease back will only apply where the sale is genuine in line with IFRS 15, which is the case here. Had the sale lacked commercial substance, the transaction would be accounted for as a mere security for loan finance. In this case, the IFRS 16 reqirements will apply as below.
Siba must recognise a liability in respect the lease in the usual way. In this case, the lease liability will be initially measured as the PV of the lessee's MLPs as follows:
Initial Lease Liability (1.15ˆ-1+1.15ˆ-2+1.15ˆ-3+1.15ˆ-4)X TZS 300,000 = TZS 856,494
Subsequently, the lease liability will be measured at amortised cost. This will be as follows for the current period:

Period	Bal b/d	Finance cost	Cash Paid	Bal c/d
(y/e 31.12)	TZS '000	@15%	TZS '000	TZS '000
2018	856	128	(300)	684
2019	684	103	(300)	487

The total lease liability at 31.12.2018 will therefore be TZS 684,000 of which TZS 487,000 will be presented within non- current liabilities and TZS 197,000 in current liabilities. A finance cost on the lease liability amounting to TZS 128,000 will be charged in P/L for the year to 31.12.2018.
Where a Right of Use Asset arises from a sale and lease back transaction, IFRS 16 require that the initial carrying amount of the asset if a proportion of the carrying amount of the disposed of asset, in this case computed as:
Initial lease liability/Fair value of asset X Carrying Amount of asset
This gives an initial carrying amount of the Right of Use Asset in this case of:
856494/5000000X3200000 = TZS 548,156.
Subsequently, the Right of Use Asset will be amortised over the shorter of the plant's useful economic life and the lease term. Amortisation charge in P/L will therefore amount to TZS 137,039 (ie 548156/4) for the year to 31.12.2018. The Right of use asset will have a carrying amount of TZS 411,117 (ie 548,156-137,039) at 31.12.2018.
A gain on sale and lease back of the building will arise computed as follows:

Disposal Account	TZS '000
Disposal Proceeds	5,000
Right of Use Asset Recognised	548
Lease liability recognised	(856)
Building Derecognised	(3,200)
Gain on sale and lease back of building	1,492

The whole gain will be reported in P/L for the year to 31.12.2018.

IFRS 15-REVENUE FROM CONTRACTS WITH CUSTOMERS

Introduction

IFRS 15 Revenue from Contracts with Customers was issued in May 2014. It is mandatory for all accounting periods beginning on or after 1 January 2018, with earlier adoption permitted. IFRS 15 replaces two standards, namely IAS 11 *Construction Contracts, and IAS 18 Revenue*

The IASB issued IFRS 15 because the existing criteria for revenue recognition outlined in IASs 11 and 18 were considered to be very subjective. Therefore it was difficult to verify the accuracy of the reported figures for revenue and associated costs.

The primary issue in accounting for revenue is determining when to recognise revenue. Revenue is recognised when an entity satisfies a performance obligation by transferring a promised good or service to a customer. However, a good or service is only considered transferred when the customer obtains control of that good or service.

Purpose and scope of IFRS15

The purpose of IFRS15 is to establish the principles that an entity should apply to report useful information in the financial statements concerning "the nature, amount, timing and uncertainty of revenue and cash flows arising from a contract with a customer".

Key definitions given in the standard are as follows:

- Revenue is "income arising in the course of an entity's ordinary activities".
- Income is "increases in economic benefits during the accounting period in the form of inflows or enhancements of assets or decreases of liabilities that result in an increase in equity, other than those relating to contributions from equity participants".
- A customer is "a party that has contracted with an entity to obtain goods or services that are an output of the entity's ordinary activities in exchange for consideration".

Scope

IFRS 15 Revenue from Contracts with Customers applies to all contracts with customers except for:

- Leases within the scope of IAS 17 Leases;
- Financial instruments and other contractual rights or obligations within the scope of IFRS 9 Financial Instruments, IFRS 10 Consolidated Financial Statements, IFRS 11 Joint Arrangements, IAS 27 Separate Financial Statements and IAS 28 Investments in Associates and Joint Ventures;
- Insurance contracts within the scope of IFRS 4 Insurance Contracts
- Non-monetary exchanges between entities in the same line of business to facilitate sales to customers or potential customers.

The five-step model

The core principle of IFRS15 is that an entity should recognise 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". This core principle is achieved by applying the following steps:

(a) **Step 1:** Identify a contract with a customer

(b) **Step 2:** Identify the performance obligations in the contract
(c) **Step 3:** Determine the transaction price
(d) **Step 4:** Allocate the transaction price to the performance obligations in the contract
(e) **Step 5:** Recognise revenue when or as the entity satisfies a performance obligation.

Each of these steps is explained below.

Step 1: Identify the contract with the customer
A contract with a customer will be within the scope of IFRS 15 if all the following conditions are met:

- the contract has been approved by the parties to the contract;
- each party's rights in relation to the goods or services to be transferred can be identified;
- the payment terms for the goods or services to be transferred can be identified;
- the contract has commercial substance; and
- it is probable that the consideration to which the entity is entitled to in exchange for the goods or services will be collected.

If a contract with a customer does not yet meet all of the above criteria, the entity will continue to re-assess the contract going forward to determine whether it subsequently meets the above criteria. From that point, the entity will apply IFRS 15 to the contract.
The standard provides detailed guidance on how to account for approved contract modifications. If certain conditions are met, a contract modification will be accounted for as a separate contract with the customer. If not, it will be accounted for by modifying the accounting for the current contract with the customer. Whether the latter type of modification is accounted for prospectively or retrospectively depends on whether the remaining goods or services to be delivered after the modification are distinct from those delivered prior to the modification.

Example 1

On 1st January 2019, Maua signed a contract with a customer to provide them with an asset on 31 December 2019. Control over the asset passed to the customer on 31 December 2019. The customer will pay TZS 100 million on 30 June 2020.
By 31 December 2019, as a result of changes in the economic climate, Maua did not believe it was probable that it would collect the consideration that it was entitled to.
Therefore, the contract cannot be accounted for and no revenue should be recognised.

Step 2: Identify the performance obligations in the contract

Some contracts contain more than one performance obligation, for example an entity may enter into a contract with a customer to provide text books and deliver a training course.
The distinct performance obligations within a contract must be identified. If goods or services are regularly sold separately then the supply of each is likely to form a distinct performance obligation if included within the same contract.
A good or service is distinct if both of the following criteria are met:

- the customer can benefit from the good or services on its own or in conjunction with other readily available resources; and
- the entity's promise to transfer the good or service to the customer is separately identifiable from other promises in the contract.

Example 2

A company enters into a contract to supply a customer with a computer system. The contract also provides the customer with technical support for the next 12 months. The computer is usable without the technical support and the company often sells computers and technical support services separately.

In this case it appears that the customer could benefit from use of the computer system without technical support. Furthermore, the computer system will become a "readily available resource" as soon as it is delivered and the customer could then benefit from acquiring technical support at a later date. Therefore the computer and the technical support are distinct and each represents a separate performance obligation.

Step 3: Determine the transaction price

The transaction price is the amount to which an entity expects to be entitled in exchange for the transfer of goods and services. IFRS 15 requires that the following are considered when determining transaction price.

(i) Variable consideration

Where a contract contains elements of variable consideration, the entity will estimate the amount of variable consideration to which it will be entitled under the contract. Variable consideration can arise, for example, as a result of discounts, rebates, refunds, credits, price concessions, incentives, performance bonuses, penalties or other similar items. Variable consideration is also present if an entity's right to consideration is contingent on the occurrence of a future event.

The standard deals with the uncertainty relating to variable consideration by limiting the amount of variable consideration that can be recognised. Specifically, variable consideration is only included in the transaction price if, and to the extent that, it is highly probable that its inclusion will not result in a significant revenue reversal in the future when the uncertainty has been subsequently resolved.

However, a different, more restrictive approach is applied in respect of sales or usage-based royalty revenue arising from licences of intellectual property. Such revenue is recognised only when the underlying sales or usage occur.

(ii) Financing

In determining the transaction price, an entity must consider if the timing of payments provides the customer or the entity with a financing benefit. A contract contains a significant financing component if the agreed date of payment by the customer is later than the date on which goods or services are transferred and the effects of the time value of money are significant. If there is a financing component, then the consideration receivable needs to be discounted to present value using the rate at which the customer borrows money

(iii) Non-cash consideration

Any non-cash consideration is measured at fair value. If the fair value of non-cash consideration cannot be estimated reliably then the transaction is measured using the stand-alone selling price of the good or services promised to the customer.

(iv) Consideration payable to a customer

If consideration is paid to a customer in exchange for a distinct good or service, then it should be accounted for as a purchase transaction. Assuming that the consideration paid to a customer is not in exchange for a distinct good or service, an entity should account for it as a reduction of the transaction price.

Step 4: Allocate the transaction price to the performance obligations in the contracts

Having determined the transaction price, the next step is to allocate that price between the performance obligations in the contract. The objective of this step is to determine the consideration to which the entity is entitled for each performance obligation. Note that:

- IFRS15 requires the transaction price to be allocated between performance obligations on the basis of the stand-alone selling price of each obligation. Standalone selling prices may be estimated, if necessary.
- If the total transaction price for the contract is less than the sum of the stand-alone selling prices of each performance obligation, the customer is effectively receiving a discount for purchasing a bundle of goods and services. Such a discount is usually allocated proportionately amongst performance obligations.
- If part of the transaction price is variable, the variable amount is allocated to a single performance obligation if it relates specifically to that obligation. Otherwise, the variable amount is allocated between performance obligations.
- If the transaction price changes after contract inception, the amount of the change is allocated amongst performance obligations on the same basis as the allocation of the original transaction price

(disregarding any changes to stand-alone selling prices in the meantime). Any amount allocated to a performance obligation that has already been satisfied is recognised as an increase or decrease in revenue for the period in which the change in transaction price occurs.

Example 3

A company enters into a contract to sell four distinct products to a customer. The promise to transfer each of these products is a separate performance obligation and the agreed contract price is TZS 14,400,000. Stand-alone selling prices are as follows: Product A TZS 4,800,000 Product B TZS 7,500,000 Product C TZS 2,700,000 Product D TZS 3,000,000. How should the transaction price be allocated to performance obligations?

Solution

The total of the stand-alone selling prices is TZS 18,000,000. Therefore the customer is receiving a discount of TZS 3,600,000 (TZS 18,000,000 – TZS 14,400,000) for purchasing a bundle of goods. This discount should be allocated proportionately, so the allocation of the transaction price is:

	TZS	
Product A	*3,840,000*	*(TZS 4,800,000 × (TZS 14,400,000 ÷ TZS 18,000,000))*
Product B	*6,000,000*	*(TZS 7,500,000 × (TZS 14,400,000 ÷ TZS 18,000,000))*
Product C	*2,160,000*	*(TZS 2,700,000 × (TZS 14,400,000 ÷ TZS 18,000,000))*
Product D	*2,400,000*	*(TZS 3,000,000 × (TZS 14,400,000 ÷ TZS 18,000,000))*
	14,400,000	

Step 5: Recognise revenue when (or as) the entity satisfies a performance obligation

The final step in the process is to recognise revenue when (or as) a performance obligation is satisfied by transferring a promised good or service to the customer. The amount of revenue recognised is the amount of the transaction price which was allocated to the satisfied performance obligation. IFRS15 states that goods and services are assets ("if only momentarily") and that an asset is transferred when (or as) the customer obtains control of that asset. Control refers to "the ability to direct the use of, and obtain substantially all of the remaining benefits from, the asset". These benefits may be obtained by:

(a) using the asset to produce goods or provide services
(b) selling the asset or using the asset to settle liabilities
(c) pledging the asset as security for a loan
(d) holding the asset.

For each performance obligation in a contract it is necessary for the entity to determine whether that obligation is satisfied over time or at a point in time. This distinction is very important since it governs the timing of revenue recognition.

(i) Performance obligations satisfied over time

An entity is regarded as transferring control of a good or service over time (and so satisfies a performance obligation over time) if any of the following conditions are satisfied:

(a) The customer simultaneously receives and consumes the benefits provided by the entity's performance whilst the entity performs its obligation (e.g. routine or recurrent cleaning services).
(b) The entity's performance creates an asset that the customer controls as it is created (e.g. a building contract where the customer has control over the work in progress).
(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 the performance that has been completed to date.

For each performance obligation that is satisfied over time, the entity should recognize revenue over time by measuring the progress made towards complete satisfaction of the obligation. IFRS15 suggests alternative methods for measuring progress. These include:

(a) **Output methods.** These methods measure progress on the basis of direct measurements of the goods and services transferred to date, relative to the goods and services that remain to be transferred. Such methods include surveys of the work done to date and appraisals of results achieved (e.g. units delivered, time elapsed).
(b) **Input methods.** These methods measure progress on the basis of the entity's efforts or inputs to date (e.g. hours expended, costs incurred) relative to the total expected inputs required in order to achieve the performance obligation.

The method chosen should faithfully depict the entity's progress.

No reasonable measure of progress

In certain circumstances (especially during the early stages of a contract) there may be no reasonable way in which to measure progress. In these circumstances, sufficient revenue may be recognised to cover the costs incurred to date, so long as the entity expects to recover the costs incurred in order to satisfy the performance obligation.

(ii) Performance obligations satisfied at a point in time

If a performance obligation is not satisfied over time then it must be satisfied at a point in time. In this case, revenue will be recognised when the customer obtains control of the promised asset (see above) and the obligation is satisfied. Indications of the transfer of control to the customer include (but are not limited to) the following:

(a) The entity is now entitled to payment for the goods or services provided.
(b) The customer has legal title to the asset concerned.
(c) The entity has transferred physical possession of the asset.
(d) The customer now has the significant risks and rewards that would normally be associated with ownership of the asset.
(e) The customer has accepted the asset.

Contract costs

IFRS 15 says that the following costs must be capitalised:

- The costs of obtaining a contract. This must exclude costs that would have been incurred regardless of whether the contract was obtained or not (such as some legal fees, or the costs of travelling to a tender).
- The costs of fulfilling a contract if they do not fall within the scope of another standard (such as IAS 2 Inventories) and the entity expects them to be recovered.

The capitalised costs of obtaining and fulfilling a contract will be amortised to the statement of profit or loss as revenue is recognised.

Example 4

Kabudi Ltd, a technology equipment supply company, entered into a contract with a customer on 1 December 2017 to supply, install and service a system of computers. The agreed price was TZS 200,000,000 to include a two-year service contract. Payment was made in total following installation in January 2018. At 31 December 2017, Kabudi had supplied all the machines, but had not yet installed any. Installation happened in January 2018. The directors of Kabudi estimated that the computers would be sold for TZS 150,000,000 on a stand-alone basis. Installation would cost TZS 20,000,000 and the two-year service contract would cost TZS 50,000,000 if purchased separately.

Required:

Advise, showing relevant journal entries, how the above transaction should be recognised in Kabudi's financial statements for years ended 31 December 2017 and 2018? (Apply the 5-step approach)

Solution:

Applying the 5-step approach:

Step1. *The contract is clear.*

Step2. *The performance obligations are three. Kabudi must deliver machines, install them and service them for 2 years.*

Step3. *The transaction price is clear. TZS 200,000,000.*

Step4. *The transaction price is allocated to each performance obligation in the ratio of their standalone fair values. The total of the individual deliverables would be TZS 220,000,000. Hence the transaction price is divided as follows:*

- *Machines 200,000,000 * (150/220) = TZS 136,363,636;*
- *Installation 200,000,000 * (20/220) = TZS18,181,818;*
- *Servicing 200,000 * (50/220) = TZS45,454,545.*

Step5. *Only the first performance obligation is satisfied during 2017. Hence Kabudi will recognise TZS 136,363,636 in revenue (and trade receivables) on that date. The installation is completed in January 2018. Hence TZS18,181,818 is recognised on that date. The servicing will happen over 2 years. Hence half the revenue related to the servicing (TZS 22,727,272) will be recognised in 2018. The balance will be carried forward as deferred revenue and recognised in 2019.*

Disclosure requirements

IFRS15 requires that entities disclose sufficient information to enable users of the financial statements to understand the "nature, amount, timing and uncertainty" of revenue and cash flows arising from contracts with customers. The main disclosure requirements are:

(a) Contracts with customers. The entity should disclose:

(i) the amount of revenue for the period arising from contracts with customers and an analysis of this revenue into appropriate categories

(ii) any impairment losses recognised during the period in relation to either contract assets or receivables arising from the entity's contracts with customers

(iii) the opening and closing balances of receivables, contract assets and contract liabilities rising from contracts with customers, together with an explanation of significant changes in the contract asset and liability balances during the period

(iv) descriptive information about the entity's performance obligations in contracts with customers, including when (typically) the entity satisfies its obligations and the entity's significant payment terms

(v) for performance obligations that remain unsatisfied at the end of the period, the total amount of the revenue allocated to these obligations.

(b) Significant judgements. The entity should explain the significant judgements made in applying the requirements of IFRS15. In particular, the entity should disclose:
   (i) for performance obligations that are satisfied over time, the methods used to measure the progress made towards satisfaction of those obligations
   (ii) for performance obligations that are satisfied at a point in time, the judgements made so as to determine when a customer obtains control of goods or services
   (iii) other significant judgements relating to matters such as determining transaction prices, estimating variable consideration, allocating transaction prices etc.

Guidance to the application of IFRS15

IFRS15 provides application guidance to help entities apply the standard's requirements in specific situations. Some of the main topics covered in this guidance are as follows:

(a) **Sales with a right of return.**
If customers are granted the right to return products and obtain a refund, the entity should estimate the expected returns (possibly using the expected value method) and recognise as revenue only the amount of consideration to which it expects to be entitled. If the customer pays more than this amount, the entity should also recognise a refund liability for the amount of consideration to which it expects not to be entitled. An asset should be recognised (and cost of sales should be adjusted) to represent the entity's right to recover inventory from customers.

(b) Warranties.
A contract with a customer may provide a warranty. If the customer has the option to purchase a warranty separately (perhaps because the warranty is priced separately) the warranty represents a distinct performance obligation and part of the transaction price should be allocated to it. However, if the warranty cannot be purchased separately, it should normally be accounted for in accordance with IAS37 Provisions, Contingent Liabilities and Contingent Assets.

(c) Repurchase agreements.
A repurchase agreement is a contract in which an entity sells an asset but is also obliged (or has the right) to repurchase the asset at a later date. The fact that the entity has an obligation or right to repurchase the asset means that the customer's ability to obtain substantially all of the remaining benefits from the asset is curtailed. Accordingly, if the repurchase price is less than the original selling price, the entity should account for the contract as a lease in accordance with IAS17 Leases or IFRS16 Leases. Otherwise the contract should be treated as a financing arrangement. This is an application of "substance over form" .

(d) Consignment arrangements.
If a product is shipped to a recipient who undertakes to sell those goods on behalf of the shipper, revenue should not be recognised by the shipper until the goods have been sold to a third party.

(e) Bill and hold arrangements.
These are contracts in which the entity invoices a customer for a product but retains physical possession of the product until such time as the customer requests delivery. For such contracts, the entity should determine whether or not the customer has yet obtained control of the product (see above) and should recognise revenue only if this is the case.

Question 1

The financial controller of Famau Ltd. has asked you, a trainee accountant, to research the implications for the company arising from the implementation of the new international financial reporting standard on Revenue i.e. IFRS 15 - *Revenue from contracts with customers.*

The core principle of IFRS 15 is that an entity recognises 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. This core principle is delivered in a five-step model framework.

REQUIRED:

Prepare a report for the financial controller in which you:

(a)

(i) Identify and briefly explain each of the five steps for revenue recognition.

(ii) Explain what is meant by the term 'performance obligations' in a contract?

(iii) Advise how a good or service can be defined as 'distinct'.

(b) Famau Ltd. enters a contract with a customer to supply a licence for a standard software product. The company will also install the software, provide updates to the software and technical support for a number of years. Famau Ltd. sells the licence and technical support separately, the software will continue to operate without the software updates and the installation of the software will be sub-contracted to a number of approvedinstallers throughout the country.

REQUIRED:

In light of your answer to part (a) above, identify the good/services which are distinct in the above contract.

(c) Famau Ltd. entered into a contract with a customer to sell its product for TZS 200,000 per unit for the 2017 calendar year. If the customer was to purchase more than 1,200 units in the year, the price would decrease to TZS 150,000 per unit. Famau Ltd. did not believe at the date of the contract being initiated that the customer would purchase more than 1,200 units from it due to previous trading patterns with this customer. However, on 1 October 2017, Famau Ltd. formed the view that the customer would meet or exceed the 1,200 units threshold based on its sales of 1,100 units by that date. The customer had purchased 500 units on that date and informed management of Famau Ltd. that it would be placing a further order of 200 units on 1 December 2017. This customer had purchased 600 units by 30 June 2017.

REQUIRED:

Using journal entries, show how Famau Ltd. accounts for its revenue to the customer in the period from 1 January 2017 to 30 June 2017 and in the period from 1 July 2017 to 31 December 2017.

Question 2

IFRS 15 - *Revenue from Contracts with Customers* was issued in May 2014, and is effective for accounting periods beginning on or after 1 January 2018. However, early adoption is permitted. The IFRS requires a 5-step approach to determining the amount of revenue to be recognised by an entity.

(i) On 31 March 2018, Dereva Plc signed a contract to supply 500 units of product at an agreed price of TZS 1,000,000 per unit. 300 units were delivered at that date, with the remainder to be delivered on 1 June 2018. It was agreed that the customer would have extended credit terms of 12 months from the date of delivery. Dereva Plc's cost of capital is 10%.

(ii) During the year ended 31 March 2018, Dereva Plc took payment in advance for the supply of 2,000 hotel room-nights to customers at TZS 100,000 per room per night. Only 400 of these had been occupied by 31 March 2018. The amounts paid by the customers are non-refundable unless the company fails to provide the agreed accommodation. Assume Dereva Plc has decided to adopt IFRS 15 for year ended 31 March 2018.

REQUIRED:

(a) Outline the general principles and the 5-step approach to recognising revenue as set out by IFRS 15 – *Revenue from Contracts with Customers.*

(b) In each scenario above, calculate the amount of revenue to be recognised in the financial statements of Dereva Plc for year ended 31 March 2018. Show the journal entries required to record each transaction. Justify your answer in each case.

Question 3

KTA Co. is a Company whose activities are in the field of major construction projects. During the year ended 30th September 2019, it entered into three separate construction contracts, each with a fixed contract price of TZS.1,000,000,000. The following information relates to these contracts at 30th September 2019. Figures are in TZS '000'.

	CONTRACT		
Details	A	B	C
Payments on account (including amounts receivable)	540,000	475,000	400,000
Costs incurred to date	500,000	550,000	320,000
Estimate costs to complete the contract	300,000	550,000	580,000
Estimate percentage of work completed	60%	50%	35%

REQUIRED:

(i) Show how each contract would be reflected in the statement of profit and loss and other comprehensive income of KTA Co. for the year ended 30th September 2019 under IFRS 15.

(ii) Show how each contract would be reflected in the Statement of Financial Position of KTA Co. at at 30th September 2019 under IFRS 15.

Answer 1

REPORT

To: Financial Controller – Famau Limited

From:Future Financial Accountant

Re: IFRS 15 – Revenue from contracts with customers

Date: April 2018

(a)

(i) An entity recognises revenue in accordance with that core principle by applying the following five steps.

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

(ii) A performance obligation is where there is a contract to transfer goods or services to a customer and the goods or services are distinct and can be accounted for separately.

(iii) A good or service is distinct if;

- The customer can benefit from the good or service on its own or together with other resources that are readily available to the customer; and
- The entity's promise to transfer the good or service to the customer is separately identifiable from other promises in the contract.

(b) Given the above information, the customer can benefit from each of the goods or services either on their own or altogether. The promises to transfer goods or services are separately identifiable. Consequently there are a number of distinct good or services identified i.e. software licence, installation service, software updates and technical support.

(c) **Period 01.01.17 – 30.06.17**

As Famau Limited does not believe that the customer will hit the target, it should account for the sales using a sales price per unit of TZS 200,000 i.e. sales of 600 units x TZS 200,000 per unit =TZS 120,000,000 as follows:

Dr. Trade Receivables TZS 120,000,000
Cr. Revenue TZS 120,000,000

Period 01.07.17 – 30.12.17

On the basis that Famau Limited believes that the customer will reach its target its accounts for its transactions with the customer as follows:

Order of 500 units xTZS150,000 =TZS75,000,000
Dr. Trade ReceivablesTZS75,000,000
Cr. Revenue TZS 75,000,000
Order of 200 units xTZS150 =TZS30,000,000
Dr. Trade ReceivablesTZS30,000,000
Cr. Revenue TZS 30,000,000.

Recalculating the sales value of the original 600 units sold in the first six months at TZS 150,000 per unit instead of TZS 200,000 per unit i.e.TZS 50,000 selling price per unit of a difference i.e. 600 units x TZS 50,000 per unit difference =TZS 12,000 as follows:

Dr. RevenueTZS12,000,000
Cr. Trade Receivables TZS 12,000,000.

If you have any further queries, please do not hesitate to contact me.
Yours sincerely,
Financial Accountant

Answer 2

(a) Revenue is recognised when an entity satisfies a performance obligation by transferring a promised good or service to a customer. However, a good or service is only considered transferred when the customer obtains control of that good or service.

This is an asset/liability-driven approach, consistent with the Conceptual Framework.

This approach has 5 steps:

(2) Identify the contract with the customer;

- Agreement between the parties;
- Each party's rights can be identified;

- Payment terms can be identified;
- The contract has commercial substance;
- It is probable the consideration will be collected.

(3) Identify the performance obligation(s);
May be single or multiple performance obligations; If multiple, each portion capable of being sold separately is identified.

(4) Determine transaction price;
- Agreed price;
- Probability weighted expected price if uncertain;
- Should be net of expected rebates and discounts;
- Should include the effect of the customer's credit rating and time value of money if relevant.

(5) Allocate transaction price to performance obligations;
- Only relevant if multiple deliverables exist in the contract;
- The transaction price is allocated to the deliverables in the ratio of the stand alone selling prices of each individual deliverable.

(6) Recognise revenue when performance obligation satisfied.
- This is normally when control is transferred to the customer;
- Control may be transferred at one point in time, or over a period of time;
- If a performance obligation is delivered over time, revenue is only recognised if ONE OF the following criteria is met:
- The customer consumes the service as it is supplied;
- The customer controls the asset as it is created in stages;
- The entity's performance does not create an asset with alternative uses to the entity, and the entity has an enforceable right to payment for work completed.
- The entity must be reasonably able to assess the outcome of the performance

Revenue shall be measured at the fair value of the consideration received or receivable. Fair value is the price that would be received to sell an asset or paid to transfer a liability in an orderly transaction between market participants at the measurement date (ie an exit price) (IFRS 13).

Further issues

- Selling costs directly incurred in earning a sales contract are capitalised and recognised over the period revenue from that contract is recognised. Example – sales commission for a 12 month phone service contract.
- Costs incurred in meeting the terms of a contract are capitalised and recognised against revenue provided they relate directly to an identifiable contract, help satisfy the obligations under the contract, and are expected to be recovered.
- Goods expected to be returned are not to be recognised as revenue. An estimate should be made of the amount expected to be returned.
- A warranty is often a separate deliverable in a sales contract. As such it is treated as a component of the deal. The revenue is separated, and the portion relating to the warranty is recognised over the warranty period. If the warranty is inseparable from the goods supplied (i.e. is not separately available, then a provision is made under IAS 37.
- If goods are sold as agent rather than as principal, only the commission receivable is recognised as revenue.
- If a sales contract grants the purchaser an option to purchase further goods / services at a discount, this is treated as a separate performance obligation. Example – air miles, discount coupons. The fair value is estimated and revenue recognised on delivery or expiry.

(b)

(i) The contract to supply is not sufficient to recognise revenue. It is necessary that control of the goods have actually transferred to the customer. This is the case for 300 units. The deferred payment does not prevent revenue from being recognised, but the consideration needs to be measured at the fair value, on the transaction date, of the amount receivable. The fair value needs to reflect a discount allowing for the time value of money, as a result of the extended credit period. The discount rate will be 10%, Derek's cost of capital. Hence revenue will be recognised as follows: 300 units * TZS 1,000,000 * 1/1.10 = TZS 2,727,272,727. The discount will be recognised as finance income as time passes, on a time-apportioned basis. As the sale took place on 31 March 2018, no time has yet passed to trigger the recognition of finance income.

Journal:

Dr trade receivables TZS 2,727,272,727

Cr Revenue TZS 2,727,272,727

(recognition of revenue and trade receivables at fair value of consideration receivable)

(ii) Again, the same principles apply. Revenue is recognised when control of the goods or services are transferred to the customer. Here, cash was received in advance. Nevertheless, revenue is only recognised when the service is delivered to the customer. Any excess cash retained is recognised as deferred income, a liability. If the cash is non-refundable, this does not change the timing of recognition of revenue. However, if the customer's right to the service expires, and the customer has no right to a refund, the revenue should then be recognised.

Total cash received in year ended 31 March 2018: 2000 *TZS 100,000 =TZS 200,000,000

Total room nights provided 400

Revenue recognised = 400 *TZS 100,000 =TZS 40,000,000

Deferred revenue = TZS 200,000,000 –TZS 40,000,000 = TZS 160,000,000

Journal:

Dr Cash	TZS 200,000,000	
Cr Revenue	TZS 40,000,000	
Cr Deferred revenue		TZS 160,000,000

(recognition of revenue, deferred revenue and cash received)

Answer 3

KTA Company

Statement of profits or losses

	TZS '000'	**TZS '000'**	**TZS '000'**
	A	**B**	**C**
Revenues	600,000	500,000	350,000
Costs	480,000	600,000	315,000
Profit/Loss	120,000	(100,000)	35,000

Statement of Financial Position as at 30th September 2019

	TZS '000'	**TZS '000'**	**TZS '000'**
	A	**B**	**C**
Current assets			
Gross amount due from customers	80,000	25,000	-

Current liabilities			
Gross amount to customers	-	-	45,000

Workings

Step 1-Determine whether the contract outcome is profit or loss

	CONTRACTS		
	A	**B**	**C**
	TZS'000'	TZS'000'	TZS'000'
Revenue	1,000,000	1,000,000	1,000,000
Costs(incurred to date +to complete)	(800,000)	(1,100,000)	(900,000)
Gross Profit/loss	**200,000**	**(100,000)**	**100,000**

Step 2-Determine the % of completion

	CONTRACTS		
CONTRACT	**A**	**B**	**C**
Estimate percentage of work completed	60%	50%	35%

Step 3-Recognise Revenue, Costs and Profit/loss

Contract A	**TZS '000'**
Revenues (60% x 1,000,000)	600,000
Expenses (60% x 800,000)	(480,000
Gross profit	**120,000**

2. Contract B	**TZS'000**
Statement of comprehensive income	
Revenue (50% x 1,000,000)	500,000
Expenses (50% x 1,100,000)	(550,000)
Expected losses	(50,000)
Gross profit	**(100,000)**

3. Contract CTZS'000	
Statement of comprehensive income	
Revenue (35% x 1,000,000)	350,000
Expenses (35% x 900,000)	(315,000)
Gross profit	**35,000**

Determination of contract asset/liabilities

	TZS '000'	**TZS '000'**	**TZS '000'**
	A	**B**	**C**
Cost incurred to date	500,000	550,000	320,000
Profit/Loss recognised	120,000	(50,000)	35,000
	620,000	500,000	355,000
Payment on account	(540,000)	(475,000)	(400,000)
	80,000	25,000	(45,000)

UPDATES ON TAX LAWS

TAX UPDATES-B4 –PUBLIC FINANCE AND TAXATION

Finance Acts from 2019 to 2022 have amended various laws relating to collection of Government Revenue with a view to impose and alter certain taxes, duties, levies, fees together with other written laws relating to the collection and management of public revenue.

Some of the amendments relevant to the B4 syllabus are highlighted below

S/N	TAX CHANGES	FINANCE ACT	BOOK PAGE	TOPIC
1	The Income Tax Act has been amended in the second schedule by deleting the words "fifty million shillings" appearing in subparagraph (1)(g)(iii) and substituting for them the words "one hundred million shillings"	Finance Act,2020	**Page 208**	**Introduction to Income taxation**
2	The Income Tax Act has been amended in paragraph 1(1) of the Second Schedule by adding immediately after paragraph (w) the following: "(x) interest derived by a person from government bonds of not less than three years issued and listed on the Dar es Salaam Stock Exchange from 1st July, 2021.	Finance Act,2021	**Page 208**	**Introduction to Income taxation**
3	The Income Tax Act has been amended in paragraph 1 of the Second Schedule by adding immediately after subparagraph (x) the following: "(y) amount derived from gain on realisation or transfer of mineral rights and mineral information to a partnership entity formed between the Government and an investor; (z) amount derived from gain on realisation or transfer of free carried interest shares from a partnership entity to the Government; (aa) amount derived from gain on realisation or transfer of shares to the Government through the Treasury Registrar."	Finance Act,2022	**Page 208**	**Introduction to Income taxation**
4	The Income Tax Act has been amended in section 4(1), by- adding immediately after paragraph (c) the following: "(d) who is a representative assessee from or through whom a non-resident person is in receipt of any income, whether directly or indirectly."	Finance Act,2020	**Page 209**	**Introduction to Income taxation**

5	The Income Tax Act has been amended in section 6(1),by adding immediately after paragraph (c) the following: "(d) in the case of a representative assessee, the income of a non-resident or beneficial owner from business or investment for the year of income deemed to accrue or arise in the United Republic.".	Finance Act,2020	**Page 209**	**Introduction to Income taxation**
4	The Income Tax Act has been amended in section 66(4) by adding the words "whether physically or through any electronic means" immediately after the words "United Republic" appearing in paragraph (b).	Finance Act,2022	**Page 212**	**Introduction to Income taxation**
5	The Income Tax Act has been amended by adding immediately after section 69 the following: 69A.-(1) Income accruing or arising in the United Republic, whether directly or indirectly through or from- (a) any business connection; (b) any property; (c) any asset or any source of income including the sources of payment referred to in section 69; or (d) transfer of an asset situated in the United Republic, shall be deemed to accrue or arise in the United Republic and shall be taxed through a representative assessee of a non-resident person or a beneficial owner.	Finance Act,2020	**Page 215**	**Introduction to Income taxation**
6	The Income Tax Act has been amended in section 69, by- (a) adding the words "including payment made for harnessing, generating or utilising land, air or water natural resources for generation of power or anything of value whether the respective natural resource is located alongside the border or within the country" immediately after the word "waters" appearing at the end of paragraph (c);and (b) adding immediately after paragraph (l) the following:	Finance Act,2022	**Page 215**	**Introduction to Income taxation**

	"(m) payments made by an individual other than payments made in conducting a business in respect of a service rendered by a nonresident through a digital market place".			
7	Section 12(5) of the Income Tax Act has been amended, by deleting the definition of the term "equity" and substituting for the new definition: "equity" means paid up share capital at the end of the year of income.	Finance Act,2022	**Page 227**	**Principles of Deduction**
8	Section 16(1), of the Income Tax Act has been amended by adding the following allowable contributions. - Contribution made to the AIDS Trust Fund established under the Tanzania Commission for AIDS Act; and - Contribution made to the Government in the fight against Coronavirus disease (COVID-19)."	Finance Act,2022	**Page 228**	**Principles of Deduction**
9	- Section 19(1), of the Income Tax Act has been amended in by adding "(2) Income of a person for the year of income having chargeable income and unrelieved losses for the four previous consecutive years of income may, subject to other limitations imposed by this section, be reduced by reason of use of the unrelieved losses which shall not be below thirty per centum of that income before any reduction for losses: Provided that, the requirement shall not apply to a corporation undertaking agricultural business or providing health or education services	Finance Act,2022	**Page 229**	**Principles of Deduction**
10	The Income Tax Act has been amended in section 3-(a) in the definition of the term "business", by-adding immediately after paragraph (a) the following:"(b) a transaction or activity carried out through the internet or an electronic means including an electronic service or transaction conducted in the digital market place regardless of the manner in which such transaction is carried out;";	Finance Act,2022	**Page 292**	**Computation of Individuals Business Income:**
11	The Income Tax Act has been amended- (a) in the First Schedule, by - (i) deleting the figure "20,000,000" appearing in paragraph 2(2) and substituting for it figure "100,000,000";	Finance Act,2019	**Page 296**	**Computation of Individuals Business Income**
12	The Income Tax Act has been amended in the First Schedule-(a) in paragraph 2, by-	Finance Act,2022	**Page 296**	**Computation of Individuals**

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<td></td>
<td>(i) adding the words “not including income derived by independent professionals and providers of,
technical, management, construction and training services” immediately after the word “business” appearing in subparagraph (1)(a);
(ii) deleting the table appearing in subparagraph (3) and substituting for it the following:
<table>
<tr><td>TAX PAYABLE WHERE SECTION 35 OF TAXADMINISTRATION ACT IS NOT COMPLIED WITH</td><td>TAX PAYABLE TAXADMINISTRA WITH</td></tr>
<tr><td>Where turnover does not exceed Tshs. 4,000,000/=</td><td>NIL</td></tr>
<tr><td>Where turnover exceeds Tshs. 4,000,000/= but does not exceed Tshs. 7,000,000/= Tshs.</td><td>100,000/=</td></tr>
<tr><td>Where turnover exceeds Tshs. 7,000,000/= but does not exceed Tshs. 11,000,000/=</td><td>250,000/=</td></tr>
<tr><td>Turnover of Tshs. 11,000,001/= but does not exceed Tshs. 100,000,000</td><td>3.5% of turnover</td></tr>
</table>
</td>
<td></td>
<td></td>
<td>Business Income</td>
</tr>
<tr>
<td>13</td>
<td>The Income Tax has been amended in section 83(1), by
deleting paragraph (d) and substituting for it the following:

“(d) pays-
(i) money transfer commission to a money transfer agent;
(ii) fee, commission or any other charge to a commercial bank agent; or
(iii) fee, commission or any other charge to a digital payment agent,”;</td>
<td>Finance Act,2020</td>
<td>Page 310</td>
<td>Procedures for Payment of Tax</td>
</tr>
<tr>
<td>14</td>
<td>The Value Added Act has been amended in Part I of the Schedule by adding immediately after sub item 4 of Item 13 the following:
5.Crop agricultural insurance</td>
<td>Finance Act,2020</td>
<td>Page 360</td>
<td>VAT Registration and Deregistrati on and</td>
</tr>
</table>

				Liability and VAT
15	The Value Added Act has been amended in Part I of the Schedule by adding immediately after sub item 5 of Item 13 the following: 6. Livestock farming insurance	**Finance Act,2021**	**Page 360**	**VAT Registration and Deregistration and Liability and VAT**
16	The Value Added Act has been amended in the Schedule- (a) in Part I- (i) in Item 6, by deleting sub-item 2 and substituting for it the following: 2. Aluminium and Stainless-Steel Milk Cans	**Finance Act,2021**	**Page 358**	**VAT Registration and Deregistration and Liability and VAT**
17	The Value Added Act has been amended in the Schedule- (a) in Part I- in item 15, by adding immediately after sub-item 10 the following: 11. Crude oil	**Finance Act,2021**	**Page 360**	**VAT Registration and Deregistration and Liability and VAT**
18	The Value Added Act has been amended in the Schedule- in item 21, by deleting the words "solar lights";	**Finance Act,2021**	**Page 360**	**VAT Registration and Deregistration and Liability and VAT**
19	The Value Added Act has been amended in the Schedule- by adding immediately after item 26 the following: "27. A supply or importation of smart phones, tablets and modems	**Finance Act,2021**	**Page 360**	**VAT Registration and Deregistration and Liability and VAT**
20	The Value Added Act has been amended in the Schedule in Part II, by adding immediately after item 24 the following- 25. An import of precious minerals, tin, tungsten, tantalum, mineral concentrates and loaded carbon by any person for processing, smelting, refining or sale in the Mineral and Gem Houses or buying stations designated by the Mining Commission.	**Finance Act,2021**	**Page 362**	**VAT Registration and Deregistration and Liability and VAT**

	26.An import of Contactless Smart Cards and Consumables 27.An import of cold rooms by a person engaged in horticulture. 28. An import of artificial grass for football pitches located in City or Municipal Council approved by the National Sports Council of Tanzania			
21	The Value Added Tax has been amended in the Schedule-(a) in Part I-(i) by adding immediately after sub item 23 appearing in item 1 the following: 24. Ear tag 25. Ear tag applicators 26. Automatic turning table 27. Stunning box 28. Lessor beam machines	**Finance Act,2022**	**Page 355**	**VAT Registration and Deregistration and Liability and VAT**
22	The Value Added Tax has been amended in the Schedule-(a) in Part I-(i) by adding immediately after sub item 8 appearing in item 2 the following: 9. Agro net	**Finance Act,2022**	**Page 356**	**VAT Registration and Deregistration and Liability and VAT**
23	The Value Added Tax has been amended in the Schedule-(a) in Part I-(i) adding immediately after item 42 appearing in item 3 the following the following: 43. Standing tree	**Finance Act,2022**	**Page 356**	**VAT Registration and Deregistration and Liability and VAT**
24	The Value Added Tax has been amended in the Schedule-(a) in Part I-(i) adding immediately after item 5 appearing in item 4 the following the following: 6. fishing hooks, reels and lines	**Finance Act,2022**	**Page 357**	**VAT Registration and Deregistration and Liability and VAT**
25	The Value Added Tax has been amended in the Schedule-(a) in Part I-(i) by adding immediately after item 10 appearing in item 6 the following the following: 11.Dairy packaging materials	**Finance Act,2022**	**Page 358**	**VAT Registration and Deregistration and**

				Liability and VAT
26	The Value Added Tax has been amended in the Schedule- (a) in Part I-(i) by deleting item 18 and substituting for it the following: "18. Importation of arms and ammunition, parts and accessories thereof, equipment and machineries for the official use of the armed forces as certified by the Ministry responsible for security and defence.";	**Finance Act,2022**	**Page 360**	**VAT Registration and Deregistrati on and Liability and VAT**
27	The Value Added Tax has been amended in the Schedule- (a) in Part I-(i) by deleting item 27 and substituting for it the following: 27. A supply of double refined edible oil from locally grown seeds by a local manufacturer for a period of one year from 1st July, 2022 to 30th June, 2023. 28. A supply of raw materials and packaging materials to be solely and directly used by a local manufacturer of double refine dedible oil from locally grown seeds for a period of one year from 1st July, 2022 to 30th June, 2023. 29. A supply of sisal ropes	**Finance Act,2022**	**Page 360**	**VAT Registration and Deregistrati on and Liability and VAT**
28	The Value Added Tax has been amended in the Schedule- (b) in Part II, by- (i) deleting item 20 and substituting for it the following: 20. An import of machinery by a local manufacturer of hides and skins; and a registered abattoir for exclusive use of skinning, dehiding and leather processing in Mainland Tanzania duly certified by the Ministry responsible for livestock or fishery.	**Finance Act,2022**	**Page 362**	**VAT Registration and Deregistrati on and Liability and VAT**
29	The Value Added Tax has been amended in the Schedule- (b) in Part II, by deleting item 20 and substituting for it the following: 20. An import of machinery by a local manufacturer of hides and skins; and a registered abattoir for exclusive use of skinning, dehiding and leather processing in Mainland Tanzania duly certified by the Ministry responsible for livestock or fishery.	**Finance Act,2022**	**Page 362**	**VAT Registration and Deregistrati on and Liability and VAT**

30	The Value Added Tax has been amended in the Schedule-(b) in Part II, by deleting item 27 and substituting for it the following: " 27. An import of cold rooms and refrigerated truck by a person engaged in livestock, fishery or agriculture duly certified by the Ministry responsible for livestock, fishery or agriculture.	**Finance Act,2022**	**Page 362**	**VAT Registration and Deregistrati on and Liability and VAT**
31	The Value Added Tax has been amended in the Schedule-(b) in Part II, by adding immediately after item 28 the following: 29. An import of raw materials of equipment and machineries of Chapters 84 and 85 to be solely and directly used in manufacturing of fertilizers duly certified by the Ministry responsible for industries. 30. An import of soil testing equipment as certified by the Ministry responsible for agriculture. 31. An import of moisture meter , rain gauge for weather stations, PH meters , tissue culture equipment and tension meters as certified by the Ministry responsible for agriculture. 32. An import of meteorological equipment and machinery by the Tanzania Meteorological Authority. 33. An import of raw materials by a manufacturer of gas cylinders upon signing a performance agreement with the Government of the United Republic.	**Finance Act,2022**	**Page 362**	**VAT Registration and Deregistrati on and Liability and VAT**

C4 –ADVANCED TAXATION UPDATES

Finance Acts from 2019 to 2022 have amended various laws relating to collection of Government Revenue with a view to impose and alter certain taxes, duties, levies, fees together with other written laws relating to the collection and management of public revenue.

Some of the amendments relevant to the C4 syllabus are highlighted below

S/N	TAX CHANGES	FINANCE ACT	BOOK PAGE	TOPIC
1	The Income Tax Act has been amended in section 3-(a) in the definition of the term "business", by-adding immediately after paragraph (a) the following:"(b) a transaction or activity carried out through the internet or an electronic means including an electronic service or transaction conducted in the digital market place regardless of the manner in which such transaction is carried out;";	Finance Act,2022	**Page 2**	**Income Taxation Rules applicable to particular type of persons /business**
2	Section 12(5) of the Income Tax Act has been amended, by deleting the definition of the term "equity" and substituting for the new definition: "equity" means paid up share capital at the end of the year of income.	Finance Act,2022	**Page 4**	**Income Taxation Rules applicable to particular type of persons /business**
3	Section 16(1), of the Income Tax Act has been amended by adding the following allowable contributions. - Contribution made to the AIDS Trust Fund established under the Tanzania Commission for AIDS Act; and - Contribution made to the Government in the fight against Coronavirus disease (COVID-19)."	Finance Act,2020	**Page 5**	**Income Taxation Rules applicable to particular type of persons /business**

4	- Section 19(1), of the Income Tax Act has been amended in by adding “(2) Income of a person for the year of income having chargeable income and unrelieved losses for the four previous consecutive years of income may, subject to other limitations imposed by this section, be reduced by reason of use of the unrelieved losses which shall not be below thirty per centum of that income before any reduction for losses: Provided that, the requirement shall not apply to a corporation undertaking agricultural business or providing health or education services	Finance Act,2020	**Page 6**	**Income Taxation Rules applicable to particular type of persons /business**
5	The Income Tax Act has been amended in section 52 by deleting subsection (2) and substituting for it the following: “(2) Distributions of a trust or unit trust shall be included in calculating the income of the trust’s beneficiary.”	Finance Act,2020	**Page 49**	**Taxation of trusts**
6	The Income Tax Act has been amended in section 3 in the definition of the term “permanent establishment” by adding a proviso immediately after paragraph (a) as follows: “Provided that, where an agent other than an independent	Finance Act,2021	**132**	**International taxation**

	agent is acting on behalf of another person, that other person shall be deemed to have a permanent establishment if- (i) the agent other than independent agent has and habitually exercises authority to (ii) conclude contracts or issues invoice on behalf of that other person, unless his activities are limited to the purchase of goods or merchandise for that other person; (iii) the agent other than independent agent has no authority to conclude contracts, but habitually maintains stock of goods or merchandise from which he regularly delivers goods or merchandise on behalf of that other person; or (iv) the agent other than independent agent habitually secures orders, wholly or almost wholly for that other person or for the enterprise and other enterprises controlling, controlled by, or subject to the same common control, as that of that other person."			
7	The Income Tax Act has been amended in section 65N(1), (a) adding immediately after paragraph (b) a proviso as follows:	Finance Act,2021	**115**	**Taxation of Petroleum operations**

	"Provided that, assets owned and employed by a person on international pipeline shall be treated as depreciable assets of class 6 pool of depreciable assets."; and			
8	The Tax Administration Act has been amended in section 51, by- (a) adding immediately after subsection (4) the following: "(5) An objection to a tax decision shall be accompanied by relevant document or information which the tax payer intends to rely upon to support his objection. (6) The information or document which the tax payer intends to rely upon shall be submitted at the time of lodging the notice of objection.";	Finance Act,2020	**354**	**Settlement of Tax Disputes**