هيئة الزكاة والضريبة والجمارك
Zakat, Tax and Customs Authority

Guideline

Manual of Transition to the International Financial Reporting Standards

and its impact on Calculating Zakat for Taxpayers Obligated to Maintain Statutory Accounts in the Kingdom of Saudi Arabia

International Financial Reporting Standard 15 "Revenue from Contracts with Customers"

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Introduction

Purpose of Manual:

This Manual aims to provide a summary of the most important effects that resulted from the transition to International Financial Reporting Standards (IFRSs) at the expense of Zakat. It should be noted here that the mentioned standards were adopted by the Saudi Organization for Chartered and Professional Accountants to become applicable by companies listed in the Saudi Financial Market effective from the Fiscal Year January 1st, 2017.

This Manual is intended to contribute to raising awareness on changes in the accounting handling contained in international standards, which may have changed the Zakat handling for some items. The Authority aims that the Manual will also contribute to narrowing the gap between the understanding of taxpayers and the Authority's expectations concerning the mechanisms for estimating and calculating Zakat in light of the transition to these standards. This Manual addresses the following standard, **which had an important impact on the financial statements upon transition:**

- International Financial Reporting Standard (15) "Revenue from Contracts with Customers"

The Manual has been prepared based on the International Financial Reporting Standards approved in the Kingdom of Saudi Arabia (issued in 2020 AD).

Overview of the transition to the approved International Financial Reporting Standards in the Kingdom of Saudi Arabia:

International Financial Reporting Standards have been endorsed by the Saudi Organization for Chartered Auditors and Accountants to become applicable by companies listed in the Saudi financial market effective from the fiscal year January 1st 2017.
In the interest of the Zakat, Tax and Customs Authority to keep pace with this fundamental transition, the Authority has listed and formulated the most prominent effects of the transition on the account of Zakat for private sector companies and institutions in the Kingdom of Saudi Arabia.

International Financial Reporting Standard 15 “Revenue from Contracts with Customers”

1.Overview IFRS No. 15

1.1.Standard Objective:

The objective of this Standard is to establish the principles that an entity should apply to provide useful information to users of financial statements about the nature, amount, timing and uncertainty of revenue and cash flows arising from a contract with a customer.

The main principle of this standard is that an entity shall recognize revenue to describe 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.

An entity shall consider the terms of the contract and all relevant facts and circumstances when applying this Standard, and the entity shall apply this Standard, including using any practical means, consistently to contracts that have similar characteristics and in similar circumstances.

This Standard specifies the accounting for an individual contract with a customer, however, as a practical mean, an entity may apply this Standard to a portfolio of contracts (or obligations with similar characteristics) if the entity reasonably expects that the effects on the financial statements of applying this Standard to a portfolio would not be materially different from the application of this Standard to the individual contracts (or individual obligations) within that portfolio. Upon accounting for a portfolio, an entity shall use estimates and assumptions that reflect the size and composition of the portfolio.

1.2.Scope Summary:

The Most Significant Exceptions to IFRS 15	Applicable Standard	Standard Name
Lease contracts	International Financial Reporting Standard 16	"International Financial Reporting Standard 16 Lease Contracts".
Insurance Contracts.	International Financial Reporting Standard 4	International Financial Reporting Standard 4 "Insurance Contracts".
Financial instruments and other contractual rights or obligations.	International Financial Reporting Standard 9 IFRS/ 10 IFRS/ 11 IAS 27/ IAS 28/	IFRS 9 "Financial Instruments". IFRS 10 "Consolidated Financial Statements" IFRS 11 "Joint Arrangements". IAS 27 "Independent Financial Statements" IAS 28 "Investments in Associates and Joint Ventures".

- An entity shall apply this standard to all contracts with customers except for non-monetary exchanges between entities in the same business activity to facilitate sales to customers or potential customers. For example, this standard does not apply to a contract between two oil companies that agree to exchange oil to meet the demand of their customers. at different specific places at the specified time.
- An entity shall apply this standard to any contract only if the counterparty to the contract is a customer (other than a contract that is included outside the scope). Further, the customer is a contracting party with the entity to obtain goods or services that are the result of the entity's normal activities in exchange for consideration, and the counterparty is not a customer. For example, if it has contracted with the entity to engage in an activity or operation in which the parties to the contract share the risks or benefits arising from the activity or operation (e.g., developing an asset in a co-operative arrangement) rather than obtaining the production of the entity's normal activities.
- A contract with a customer may fall partly within the scope of this Standard and partly within the scope of other Standards.
- This standard specifies the accounting for incremental costs of obtaining a contract with a customer and the accounting for costs incurred in fulfilling a contract with a customer if those costs are not within the scope of another standard. An entity shall apply those paragraphs only to costs incurred in connection with a contract with a customer (or part of that contract) that is within the scope of this Standard.

The Saudi standard that replaced it	The international standard that replaced	Effective Date
• Accounting Standard: Construction Contracts and Contracts. • Revenue standard 5.	• IAS 11: Construction Contracts. • IAS No. 18 "Revenues" • IFRIC13 Customer Loyalty Programs. • IFRIC15 • "Customer Loyalty Programs". • IFRIC 18 "Customer Loyalty Programs". • IFRIC 18 Customer Loyalty Programs.	January 1, 2017/2018, starting from the beginning of 2017 AD, for establishments listed in the Capital Market. As for other establishments, the application will be from the beginning of 2018 AD, with permission for those other establishments to start applying the standard starting from the beginning of 2017 AD.

2.Requirements of IFRS 15

2.1.Overview IFRS No. 15

From the beginning of the year 2017 AD, the establishments listed in the Capital Market, as for other establishments, the application will be from the beginning of the year 2018 AD, while allowing those other establishments to apply as of the beginning of the year 2017 AD

IFRS 15 specifies the principles that entities shall apply to provide information about the nature, amount, timing, and uncertainty of revenue and cash flows arising from contracts with customers.

Upon applying IFRS 15, entities shall recognize revenue to show the transfer of promised goods or services to a customer in an amount that reflects the consideration to which the entity expects to be entitled in exchange for those goods or services.

2.2.Five Step Model

The main principle of this standard is that an entity shall recognize revenue to describe 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 basic principle shall be executed under a typical five-step framework

1 Determining the contract(s) with a client

2 Determining the obligations contained in the contract

3 Determining the transaction price

4 The transaction price must be allocated to the obligations contained in the contract

5 Recognizing revenue when (or as soon as) an entity fulfills an obligation

Step 1: Determining the contract(s) with a client- Defining the Contract

1. The parties to the contract have agreed to the contract

2. The rights of each party with respect to the goods or services to be transferred can be determined.

3. Payment terms can be specified for the goods or services to be transferred.

4. The contract is a commercial contract.

5. It is possible for the establishment to obtain the consideration to which it will have a right in return for the goods or services that will be transferred to the customer.

Step 2: Determining the obligations contained in the contract

At the inception of the contract, the entity must evaluate the goods or services promised in the contract with the customer. Further, the entity shall identify each undertaking to transfer any of the following to the customer as a obligation.

1

A good or service (or bundle of goods or services) that can be self-recognizable.

2

Chain of self-recognizable goods or services that are substantially similar and have the same pattern of transfer to the customer.

A self-distinguishing series of goods or services has the same transfer pattern to the customer in case of fulfilling the following conditions:

1

Every single identifiable good or service in the chain that the entity undertakes to transfer to the customer is an obligation that is fulfilled over a period of time.

2

One method is used to measure an entity's progress toward full obligation by transferring each identifiable good or service in the chain to the customer.

Step 3: Determining the obligations contained in the contract (Cont'd)

Goods or services can be self-recognizable in case of fulfilling the following conditions:

1

If the customer can benefit from the goods or service by itself or with other resources that are immediately available to the customer.

2

It is possible to specify the entity's obligation to transfer the goods or services to the customer separately from other obligation in the contract.

Determining the goods and services contained in the contract

The Standard requires the entity to determine, from the beginning of the contract, the goods and services included in the contract, and provides manual about the goods or services that are specified in the contract, as follows:

1

Sale of goods classified by the entity (for example: Manufacturer inventory).

2

Resale of goods that are purchased by the entity (for example: retail establishment's goods).

3

Resale of goods or services purchased by the entity (for example: A ticket that has been resold by an establishment in its capacity as principal).

4

Standardization of service readiness to provide goods or services.

5

Providing a service to another party to transfer goods or provide services or make goods or services available to the customer for use when the customer decides.

6

Granting of rights in goods or services to be provided in the future that a customer can resell or provide to a customer of its own.

7

Constructing, manufacturing or developing on behalf of a client.

8

Granting licenses or purchase options for additional goods or services

Step 4: Determining the transaction price

The transaction price is the amount to which the entity expects to be entitled in exchange for the transfer of promised goods or services. In making this decision, the entity considers the course of normal business practices.
In determining the transaction price, the entity shall consider the effects of all of the following:
Variable compensation
Existence of a substantial financing component in the transaction
Non-cash compensation
The consideration is payable to the customer

Step 5: The transaction price must be allocated to the obligations contained in the contract

Once the separate obligations have been identified and the transaction price has been determined, the Standard requires the entity to allocate the transaction price to the obligations in proportion to the independent selling prices (i.e. on the basis of the relatively independent selling price). Upon allocating the transaction price to the obligations on the basis of the independent selling price, any discount in the contract is allocated pro rata to all of the obligations in the contract.

The following illustration details the methods for determining the independent transaction price:

When a contract has multiple obligations of the entity, usually, the transaction price on each obligation in the contract shall be determined on the basis of the independent selling prices for each country.

When the independent selling price is not directly observable, the entity must estimate it. IFRS 15 proposes several methods that can be used, including:

- Adjusted Assessment for the Market Approach
- Expected cost plus margin approach
- Remaining value approach (allowed only in limited circumstances)

Step 6: Recognizing revenue when (or as soon as) an entity fulfills an obligation

Revenue is recognized when control transfers, either over time or at a point in time

Control of an asset is defined as the power to direct and approximately obtain the use of the remaining benefits of the asset

Benefits from an asset are the potential cash flows that can be obtained directly or indirectly in several ways, such as:

- Using of the asset to produce goods or provide services
- Using the asset to enhance the value of other assets
- Using the asset to settle obligations or reduce expenses
- keeping the asset
- Mortgaging the asset for a loan
- Selling or exchanging the asset

The obligation shall be fulfilled over time

The obligation shall be fulfilled at a certain point in time

Revenue shall be recognized when control transfers at a point in time, including but not limited to factors that may indicate the point in time that control passes

The entity has a current entitlement to a payment in consideration of the asset

The client has a legal entitlement in the asset

The entity has transferred material possession of the asset

The customer has the significant risks and benefits of ownership of the asset

The customer has accepted the asset

Revenue shall be recognized over a period of time in case of fulfilling one of the following conditions:

1. The customer simultaneously receives and consumes the benefits provided by the entity's performance as soon as the entity fulfills its obligations.

2. Entity's performance establishes or enhances an asset that a customer controls when the asset is established or enhanced.

3. The entity's performance doesn't establish any asset that has an alternative use for the entity. The entity has an enforceable entitlement to payment for performance completed to date.

In case of failing to achieve any of the conditions provided hereinabove, revenue shall be recognized at a point in time.

When an entity determines that an obligation is satisfied over a period of time, the Standard requires the entity to choose one method for recognizing revenue for the related obligation:

Input Method	Output Method
Revenue shall be recognized on the basis of the entity's efforts or inputs to satisfy the obligation in relation to the total inputs expected to satisfy the obligation.	Revenue shall be recognized on the basis of direct measurements of the value of the goods or services transferred to the customer to date attributable to the remaining goods or services promised under the contract.

3. Impact of Transition to IFRS 15 on the Zakat Base

3.1.Introduction

There is no doubt that IFRS No. 15 introduced a different approach in the method of revenue recognition, which differs in some aspects from the method of recognition in the previous standard, whether IAS No. 18 or the standard applied before the adoption of international standards. The new standard is concerned with defining obligations in contracts with customers and developing some controls to determine the revenue recognition mechanism, including but not limited to: The right of return, determining the transaction price, determining contract costs, and recognizing them as an asset provided that to fulfill specific conditions. It is noted to have greatly affected in some sectors the revenue recognition mechanism at the date of the transition and the years following the transition.

In addition to the above, it is necessary to consider the nature and handling of the consolidated accounts in the international standards in terms of zakat, which will be explained in the following sections:

3.2. The Financial Impact of the Transition on the Zakat base

The transition to the dollar standard for financial reporting No. 15 resulted in creating of some new accounts related to the handling of accounting operations that fall within the scope of the international standard, including:

1. **Contract Assets:** Basically, it is receivables, but it is conditioned on the implementation of a specific obligation of a contract with a customer to be recognized as receivables from the zakat point of view. This item shall not be qualified to be deductible from the Zakat Base in accordance with the Executive Regulation of Zakat Levying. Noting zakat handling of this item and the item of accounts receivables doesn't differ from what has been prior to transition.

2. **Contract obligations:** This amount mainly represents amounts received in advance from customers until obligations are fulfilled to be reflected in revenues. Zakat handling of this item didn't differ from prior of transition, which was handled with within the second paragraph of Article 4, which requires adding the opening or final balance of the payments made by customers (whichever is less). In cases where this amount is considered due consideration and has not yet been received, the method of handling with this item may fall under the third paragraph of Article Four in the Executive Regulations for Levying Zakat.

3. **Contract Costs:** On the date of transition, some companies (according to the nature of their activities, its contracts with clients, and other factors) measure an asset against the additional costs of obtaining the contract, as the companies expected to recover those costs from future revenues. Recognition of these costs as an asset may result in consideration as deductions from Zakat base as capital expenditures in accordance with the paragraph (Six) of Article Five in the Regulations with the need to verify additional controls, for example, that these costs are recognized within non-current assets.

4. **Sale with right of return:** In the ordinary course after transition and in subsequent years, the accounts for the right of return shall be as follows:

- Right of Return Assets: Relates to inventory received by the customer and still within the right of return period. This item shall not be deducted for the purposes of zakat, since it is not included in the items that are deductible in Article Five.
- Refund Obligations: In general, this article relates to the price of the goods within the return period (see below in the theoretical applications section). It is handled with within the additions to the Zakat base if the additions controls apply according to what is stated in Article 4 of the Executive Regulations for Levying Zakat.
- It must be noted that in this case (sale with the right to return) and if the goods are still within the return period, the revenue shall not be recognized, and the cost of the goods sold shall not be recognized in the profits or losses. At the expiry of the right of return, the revenue shall be recognized by reversing the calculation of the obligation to return the amount, and the calculation of the original right of return shall be also reversed. Further, the recognition of the cost of the goods sold, i.e. the process in the outcome in general is to postpone the recognition of the revenue until the expiration of the right of return period. In all cases, this does not require an adjustment to the net profit for Zakat purposes as long as the revenue recognition policy falls within the requirements of international standards

3.3.Proposed Zakat Base Financial Implications Handling

As indicated earlier in this section, the method of recognizing revenue in accordance with the requirements of international standards differ to a varying extent from one sector to another. However, in the years following the original transition, the basic rule is that the activity shall not be amended by the revenue recognition method as long as it is within the framework of IFRS 15. In the context of reviewing the taxpayer's declarations, the Authority also reserves the right to ensure the correctness of revenue processing in the taxpayers' accounting books and its compliance with the requirements of international standards.

3.4.Theoretical Examples on the Effect of Transition on ZB

Example (1): Contract's Origin

A telecommunication has applied International Financial Reporting Standard No. 15 on the date of application on December 1, 2018. Accordingly, the impact on its financial statements was assessed according to the following information:

Contract details: The company sells internet line subscriptions for a commitment period of two years (24 months) in return for a monthly package subscription of SAR 1,250 per month and a free mobile device. The price for selling the device is SAR 10,000, and the internet service price is SAR 24,000. The company started providing this offer on June 1, 2017

Analysis:

According to the analysis of the nature of the gap between the previous practice and the required practice according to IFRS 15 for the company's revenues, the following is revealed:

- **Step 1 - Determining the Contract(s) with a client:**

The transaction is a commercial contract and the contract can be determined.

- **Step 2 - Determining the obligations contained in the contract:**

There are two obligations, the first is a mobile device and the second is the Internet service).

- **Step 3- Determining the transaction price**

Determining the transaction price on which the revenue recognition which will be based on accounting terms over the contract period according to the method used in the standard (SAR 30,000, the full value of the contract).

- **Step 4 - The transaction price shall be allocated to the obligations contained in the contract**

The transaction price shall be allocated proportionally to the two obligations using the independent price for each service

- **Step 5 - Recognizing revenue when (or as soon the company fulfills its obligation**

The company shall recognize revenue when fulfilling the obligation, either at a point or over a period of time.

3.5. Accounting Handling according to the previous standard as of December 31, 2017 (prior to the implementation of IFRS 15)

Dues	Debit (SAR)	Credit (SAR)	Statement
Cash	8,750*	-	Financial Position
Revenues	-	(8,750)*	Revenues

Monthly income from the package x number of months of service until the end of the year = revenue advance recognized at the end of the reporting period (prior to the application of IFRS 15) 1,250× 7 = SAR 8,750.

In accordance with the standard, the transaction price shall be determined and the price allocated to each obligation to recognize revenue either at a relevant point in time or over a period of time as shown below:

Dues	Saudi Riyals	Weighted Average
Mobile price only	10,000	29,4%
Internet service price Only	24,000	70,6%
Total	34,000	

The contract price as a whole is SAR 30,000 (SAR 1,250 monthly payments for 24 months). Accordingly, the appropriate allocation for each obligation is:

- Mobile Phone: SAR 8,824 (29,4% x 30,000)
- Internet: SAR 21,176 (70,6%×30,000)

According to IFRS 15, revenue from mobile devices shall be recognized at a point in time, while revenue from Internet service shall be recognized over time as indicated in the following entries:

(a) Recognition of revenue arising from mobile devices:

Dues	Debit (SAR)	Credit (SAR)	Statement
Contract's Origin	8,824	-	Financial Position
Mobile device revenue	-	(8,824)	profits and losses

(b) Recognition of revenue arising from the internet service:

Dues	Debit (SAR)	Credit (SAR)	Statement
Cash or Receivables	8,750		Financial Position
Amortization of the original contract	-	(2,574)*	Financial Position
Internet revenues	-	(6,176)	Profit or Loss
8,824+ 6,176 = SAR 15,000.		8,824/24* 7= SAR 2,574.	

Based on the calculations provided in the previous slides, the company shall adjust its opening balances by the difference between what should have been recognized according to IFRS 15 and what was recognized according to the previous standard (SAR 15,000 - SAR 8,750)

- **Entry of the opening balances adjustment as on January 1, 2018 AD (date of application of IFRS 15)**

Dues	Debit (SAR)	Credit (SAR)	Statement
Contract's Origin	6,250	-	Financial Position
Retained Earnings	-	(6,250)	Change in equity

* It should be amortized over 17 months (which represents the remaining period of the contract (24 months - 7 months))

After applying IFRS 15 - (Subsequent Period Accounting)

- Monthly Entry to Recognize the Revenues and Amortization of the Asset

Dues	Debit (SAR)	Credit (SAR)	Statement
Cash or Receivables	1,250		Financial Position
Contract's Origin	-	(368)*	Financial Position
Internet revenues		(882)**	Profit or Loss

6,250÷ 17 months = SAR 368.

** 21,176÷ 24 = SAR 882.

Zakat Handling:

It is noted that the method of distributing revenue according to IFRS 15 differ from what it was before the transition.

- Accordingly, and from the practical example, it is noted that the opening balance of the retained earnings as of January 1, 2018 was modified by SAR 6,250 with an increase (i.e. a higher amount of revenue was supposed to be recognized in the year of signing the contract with the customer)

- The aforementioned amendment is included in Zakat calculation for the year 2018 AD by adding the opening balance of the retained earnings after taking into account the financial impact of the applied standard as of January 1, 2018 AD.

- Contract's Origin: A new account has been recognized within the assets, which will be amortized over the course of the contract period. This item shall not be considered among the deductions from Zakat base due to its nature and the lack of a provision in the Regulations that permits its deduction.

Example 2: Costs of obtaining a contract

The same facts as in the first example (the original contract) apply to this example, but with the addition that the company incurred 3 riyals commission on each subscription that was sold through sales representatives (sales commission). On the date of launching the promotional campaign on June 1, 2017, 50,000 subscriptions were sold through sales representatives.

3.6. Accounting Handling according to the previous standard as of December 31, 2017 (prior to the implementation of IFRS 15)

Dues	Debit (SAR)	Credit (SAR)	Statement
Commission expenses *	150,000	-	profits and losses
Cash	-	(150,000)	Financial Position

*** The Company has calculated the expenses as follows:**
Number of subscriptions sold x commission for each subscription = commission expenses to be capitalized according to Standard 15
5,000× 3 = SAR 150,000.

The full amount of commissions (SAR 150,000) shall be capitalized and amortized over the contract period (24 months) as shown below:
150,000÷ 24 = SAR 6,250.

3.6.1. Requirements of IFRS 15

- An entity shall recognize the additional costs of obtaining a contract with a customer as an asset if the entity expects to recover those costs.
- Additional contract costs are those costs that the Company incurs in obtaining a contract with a customer which the Company wouldn't have had incurred if the contract wasn't obtained (for example "Sale Commission").

1. Calculating the total amount of commissions that have been amortized, as on January 1, 2018 (the date of application of IFRS 15).
   6,250× 7 = SAR 43,750.
2. The amount that shall be recognized as an adjustment to the opening balance of the financial statements is the difference between what is recognized as an expense (150,000) and what shall be recognized from the remaining period (43,750) as on January 1, 2018 (date of application of IFRS 15).
   150,000 - 43,750 = SAR 106,250.

Based on the calculations provided previously, the company shall adjust its opening balances by the difference between what should have been recognized according to IFRS 15 and what was recognized according to the previous standard (150,000 - 43,750)

- As on January 1, 2018 AD (date of application of IFRS 15)

Dues	Debit (SAR)	Credit (SAR)	Statement
Contract Costs (contract original price)	106,250	-	Financial Position
Retained Earnings	-	(106,250)	Change in equity

As for the subsequent periods, the company shall recognize the following entry:

- After applying IFRS 15 - (Subsequent Period Accounting)

Dues	Debit (SAR)	Credit (SAR)	Statement
Amortization of contract costs (commissions)*	75,000	-	profits and losses
Contract's Origin	-	(75,000)	Financial Position

*** The costs of obtaining the contract have not been calculated as follows:**
(Contract costs, commissions ÷ Contract duration). The time remaining until the end of the period = Commission expenses to be recognized.
(150,000÷ 24) × 12= SAR 75,000.

3.7. The resulting impact on the financial statements when applying IFRS 15:

	Balance per previous standard	Adjustments	By applying IFRS 15 - (as on 1 January 2018 AD)
Contract Costs	106,250	106,250	-
Retained Earnings (in respect of contract costs)	(106,250)	(106,250)	-

Note:

- An entity shall recognize the additional costs of obtaining a contract with a customer as an asset if the entity expects to recover those costs.
- Additional contract costs are those costs that the Company incurs in obtaining a contract with a customer which the Company wouldn't have had incurred if the contract wasn't obtained (for example "Sale Commission").

3.7.1. Zakat Handling:

- As a result of the capitalization of commission costs in accordance with the requirements of the standard, an increment on adjustment entry was made to the opening balance of retained earnings by SAR 106,250. The aforementioned amendment is included in Zakat calculation for the year 2018 AD by adding the opening balance of the retained earnings after taking into account the financial impact of the applied standard as of January 1, 2018 AD.
- It is noted that the method of distributing revenue according to IFRS 15 differ from what it was before the transition.
- Accordingly, and from the practical example, it is noted that the opening balance of the retained earnings as of January 1, 2018 was modified by SAR 106,250 with an increase (i.e., a higher amount of revenue was supposed to be recognized in the year of signing the contract with the customer)
- The aforementioned amendment is included in Zakat calculation for the year 2018 AD by adding the opening balance of the retained earnings after taking into account the financial impact of the applied standard as of January 1, 2018 AD.
- Contract Costs: A new account has been recognized within the assets, which will be amortized over the course of the contract period. This may result in adding the same to the item in the deductions of the Zakat base, due to its nature and its capitalization of assets in accordance with paragraph (6) of Article Five provided for in the Executive Regulations for Levying Zakat.

Example 3: Right of Return - Obligation to Refund

A company specialized in wholesale activity supplied 100 units of a specific product at a selling price of SAR 10 per unit, noting that the cost of one unit is SAR 6.5 on November 1, 2017, with the right given to the customer to return the goods that have not been sold and that have expired. The contract permits the customer to return the products within 90 days.

The Management recorded a provision for sales returns amounting to SAR 21. Under IFRS 15, the Company used the expected value method to estimate the goods to be returned.

The entity shall not recognize revenue when control of the product has passed to the customer in respect of sales expected to be returned by the customer. The reason for that is the existence of a right of return and the lack of relevant previous evidence means that the entity cannot conclude, i.e., it is highly probable that a significant reversal will not occur in the amount of cumulative revenue recognized in accordance with paragraphs 56 to 58 of IFRS 15. Thus, revenue shall be recognized three months after the expiration of the right of return.

3.7.2. The expected value of the goods to be returned based on Management estimates based on the best previous experience:

Number of Units	Probability
4	25%
6	50%
8	25%
Weighted Average	6 units

3.8.Accounting Handling according to prevailing practices as of December 31, 2017 (prior to the implementation of IFRS 15)

Dues	Debit (SAR)	Credit (SAR)	Statement
Sales Returns	21	-	profits and losses
Sales returns provision	-	(21)	Financial Position

Based on what was previously calculated, the Company shall adjust its opening balances by calculating the refund obligation provision at the expected value of SAR 60 (6 units x SAR 10) in addition to the original right to refund the amount of SAR 39 (6 units x SAR 6.5).

- **Recognizing the adjustment upon applying IFRS 15:**

Dues	Debit (SAR)	Credit (SAR)	Statement
Refund Obligation (Inventory)	39	-	Financial Position
Provision for Refund Obligation (Provision for Returns)	-	(39)*	Financial Position
Provision for impairment	39	-	Financial position (retained earnings)
Refund Obligation (Inventory)	-	(39)	Financial Position

* 60 - 21 = SAR 39, as SAR 21 was recognized as a provision for returns according to the previous standard

3.8.1. The resulting impact on the financial statements when applying IFRS 15:

	By applying IFRS 15 - (as on 1 January 2018 AD)	Re-measuring	Balance per previous standard
Obligation to Refund Provision	(39)	(39)	-
Refund Obligation	39	39	-
Provision for impairment (retained earnings)	39	39	-

- **First scenario - Assuming returns of 3 units:**

In the subsequent periods, the company shall recognize the following entry:

After applying IFRS 15 - (Subsequent Period Accounting)

Dues	Debit (SAR)	Credit (SAR)	Statement
Obligation to Refund Provision*	30	-	Financial Position
Accounts Receivable/ Cash	-	(30) *	Financial Position

* SAR 10 x 3 units = SAR 30

- **Second scenario - when the right of return period has expired (the products have not been returned):**

In the subsequent periods, the company shall recognize the following entry:
After applying IFRS 15 - (Subsequent Period Accounting)

Dues	Debit (SAR)	Credit (SAR)	Statement
Obligation to Refund Provision*	60	-	Financial Position
Revenues	-	(60)	profits and losses

* SAR 10 x 6 units = SAR 60

3.8.2. Zakat Handling:

- It is noted from the applied example, that the opening balance of retained earnings as of January 1, 2018 was adjusted as a result of the requirements of the standard after revenue recognition and after the return period expires.

- The aforementioned amendment is included in Zakat calculation for the year 2018 AD by adding the opening balance of the retained earnings after taking into account the financial impact of the applied standard as of January 1, 2018 AD.

- Right of Return Assets: A new account has been recognized within the assets, which will be amortized over the period of the contract. It shall not be considered as a deductible item from Zakat base.

- Obligation to Refund Provision: It is handled by adding it to Zakat base in accordance with the provisions of Article 4 by adding the balance of provisions at the beginning of the period less what is used from the same. This will offset the addition of retained earnings with a lower balance as a result of the adoption of the standard in accordance with Article 1 above. Noting that if the return period expires during such period, it will be reversed (reversal of the provision) to the revenues. Further, it shall be zakatable to compensate the effect of presenting the retained earnings by less balance as a result of adopting the Standard.

External document

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