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To all
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Circular No. 48/2023

Bolzano, 11 December 2023

Subject: Accounting standard OIC No. 34 in force from 1 January 2024

With the 2024 financial year, the new accounting standard OIC 34, which is intended to govern the recognition of revenue in the accounts, enters into force. The new standard was definitively approved by the OIC in April 2023 and becomes binding for the first time for the 2024 financial year. It is essential that „separate performance obligations“ arising from contracts with customers (e.g. supply of a device with a future maintenance obligation) be identified separately, recognised in income and allocated to the correct accounting periods. The corresponding rules were previously scattered across OIC 15 and OIC 23. The accounting standard OIC 34 applies to all revenue from the sale of goods and services, irrespective of how it is presented in the profit and loss account (item A1 – revenue from sales and services, and A5 – other operating income).
Important: no changes arise with regard to the accounting treatment of work in progress, since the accounting standard OIC 23 continues to apply in these cases. Likewise, the new OIC 34 does not apply to revenue from the disposal of businesses, to rental income, to profit allocations and to other legal transactions, provided that these are not aimed at a sale of goods and services.

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The new principles will have to be observed for the first time for the annual financial statements as at 31.12.2024; in many cases, however, it will be necessary to adapt business practices, general terms and conditions and templates for commercial contracts to the new guidelines as from 1 January 2024. Following the international standard IFRS 15, the standard is based on a „5-step model“. Here are the details:

Step 1: combination of contracts:

A group of contracts is treated as a single contract if they are negotiated at the same time with the same customer and pursue a single commercial purpose, or if the price of one contract depends on the prices or the performance of the others. Where these conditions are met, the group of contracts must be treated as a single contract.

Step 2: determination of the total transaction price:

If the price contains variable components, it is necessary to measure these variable components, namely:

- additional revenue (variable mark-ups) is included in the total price only if it is sufficiently certain;
- components reducing revenue, such as price reductions, cash discounts for immediate payment, rebates, contractual penalties, bonuses and return obligations, must always be recognised as a reduction of revenue on the basis of the company’s past experience.

Important: where payment terms of more than 12 months are granted without an interest agreement or with interest which differs significantly from the market rate, the total price must be determined taking into account the discounting of the cash flows at the market interest rate. Incidentally: whereas in recent years so-called cash discounts have been shown in the profit and loss account as financing expenses, in future they will once again have to be recorded as a reduction of income under A.1 of the profit and loss account.

Step 3: identification and determination of separate performance obligations:

A supply or service contract may contain several separate performance obligations which must be recognised separately. This concerns in particular maintenance services, repair commitments, return obligations, etc.; a split into the individual components may, on the other hand, be dispensed with if:

- the individual goods or services are interdependent (in other words, if the individual goods or services cannot be used separately by the customer);

- one or more services which are the subject of the contract do not form part of the company's characteristic activities and are provided free of charge (premium transactions);
- the transaction is a sale including a statutory warranty, where the latter cannot be separated from the goods sold. In the case of the sale of goods with a statutory warranty, revenue must therefore be recognised at the moment when the risks and rewards are substantially transferred to the customer. At the same time, a warranty provision must be set up in the amount of the estimated costs of any replacement and/or repair. All other warranties granted, by contrast, must be accounted for separately and recognised as separate revenue.

Example: if a machine is sold with a maintenance contract or with a training obligation, these performance obligations must be recognised separately. Only the warranty services required by law are not to be treated as separate obligations in this respect.

Step 4: allocation of the transaction price to the performance obligations:

If, under step 3, a split into separate performance obligations is made, the total price must then be allocated proportionately to the individual performance obligations. The selling prices are to be taken into account net of the customarily applied discounts which have been contractually agreed.

In plain terms: if a machine is sold with a maintenance contract at a single price and a discount of 10% is granted on it, the sale price and the consideration for the (possibly multi-year) maintenance contract must each be reduced separately by 10%.

Step 5: allocation to the correct accounting periods:

In step 5, the price thus allocated to the performance obligations must be assigned to the correct accounting periods, whereby considerable differences naturally arise between supplies of goods and services.

Example: the following example, which is presented in this way in OIC 34 itself, is intended to illustrate the effects.

A machine is sold for 110 together with a 2-year „free“ maintenance contract. The list price for the machine is normally 100 and that for the 2-year maintenance 20.

There are clearly 2 separate performance obligations: the supply of the machine and the maintenance service, which must be recognised separately. The total price (110) is to be allocated proportionately to the separate performance obligations, namely 91,67 for the machine and 18,33 for the 2-year maintenance. This results in the revenue being recognised at different times: for the machine, the handover is decisive, whereas the revenue for the maintenance must be allocated to the two following years on an accrual basis. The proportionate revenue for the maintenance must be deferred as deferred income and postponed accordingly.

Effects:
In practice, the greatest differences compared with the current rules arise in the following cases:
- in the case of supplies with warranty services going beyond the statutory warranties, these must be recognised and deferred separately;
- in the case of supplies with return obligations;
- in the case of premium transactions;
- in the case of disposals of licence rights;
- in the case of supplies of goods and services in the name of and/or on behalf of third parties and
- in the case of supplies with deferred handover.

Simplifications for small enterprises:
Small enterprises which are permitted to prepare their annual financial statements in abridged form or in the form of the so-called micro-entity financial statements may claim the following simplifications:

1. waiver of the discounting of receivables and revenue where payment terms exceed 12 months without payment of interest or applying interest rates which differ significantly from market rates;
2. waiver of the allocation of the total price to performance obligations, provided that such a separation would have only an immaterial effect;
3. simplified recognition of sales with a right of return, thereby avoiding the need for the goods sold which are expected to be returned to be reinstated in inventory.

Important: if these reliefs are claimed, this must be stated in the notes to the annual financial statements.

Recommendation: where the reliefs are not available on account of the size of the company, it will have to be examined whether, as from 1 January 2024, the general terms and conditions or the contracts customarily used need to be adapted in order to be able to comply with the separations set out here.

Yours sincerely

Josef Vieider