IFRS® Accounting

Staff paper

Agenda Paper 5

Capital Markets Advisory Committee meeting

Date	**October 2022**
Project	**Post-implementation Review (PIR) of IFRS 15 *Revenue from Contracts with Customers***
Topic	**Phase 1–Identifying matters to be examined**
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Purpose of this session

Ask CMAC members to share their views on the application of IFRS 15 *Revenue from Contracts with Customers*, as well as matters that members think the IASB should consider for the Post-implementation Review (PIR) of the Standard

Questions for CMAC members

- Slide 3 sets out focus questions

Information for CMAC members

- Slides 4–9 provide PIR reminders
- Slides 10–12 provide background to IFRS 15
- Slides 13–27 provide supporting information on changes introduced by IFRS 15 and more detailed questions to consider in answering the focus questions on slide 3

Questions for CMAC members

1	**Effects on timing and amount of revenue** (slides 14–19)	• Do financial statements prepared applying IFRS 15 provide information useful for your analysis of the timing and amount of companies' revenue?
2	**Disclosures** (slides 20–22)	• Have you found disclosures provided under IFRS 15 more informative than under the previous revenue requirements?
3	**Comparability** (slides 23–24)	• Is revenue information comparable between different companies within an industry and between different industries?
4	**Transition** (slides 25–27)	• Did you find the information provided in the first set of IFRS 15 financial statements useful in understanding the changes in revenue recognition?

PIR reminders

PIR – the objective

OBJECTIVE	To **assess** whether the **effects** of applying new requirements on users of financial statements, preparers, auditors and regulators are **as intended** when the IASB developed those requirements
Overall, are the requirements working as intended?	**Fundamental questions** (ie 'fatal flaws') about the core objectives or principles—their clarity and suitability—would indicate that the new requirements are not working as intended
Are there specific application questions?	**Specific application questions** would not necessarily prevent the IASB from concluding that the new requirements are operating as intended but may nonetheless need to be addressed, if they meet the criteria for whether the IASB would take further action

PIR – what is the process?

Implementation → **Few years of application**

New Standard issued

Standard is effective

Post-implementation review

Phase 1
Identify matters to be examined

Phase 2
Consider feedback

Start when sufficient information is available

Publish public request for information (RFI)

Publish report summarising identified matters and next steps

Possible next steps

- Take no action
- Monitoring or further research
- Provide education
- Agenda decision
- Consider standard-setting

PIR – prioritising identified matters

To what extent are prioritisation characteristics present?

- **substantial consequences**
- **pervasiveness**
- financial reporting issue **can be addressed** by the IASB or IFRS Interpretations Committee
- the benefits of any action would be expected to **outweigh** the costs

most → **High priority** to be addressed as soon as possible

! *Relate to core objective or principles*

! *Solution needed urgently*

most → **Medium priority** to be added to the IASB research pipeline or the Interpretation Committee pipeline

some → **Low priority** to be considered in the next agenda consultation

few or none → **No action** not explored

IASB activities since IFRS 15 was issued

A solid foundation for the PIR

The IASB has put significant efforts into monitoring and supporting the implementation and application of IFRS 15

Established with the FASB a joint Transition Resource Group (TRG) to support implementation of IFRS 15

Provided educational materials such as articles and webcasts

Issued clarifications to IFRS 15 to address some of the matters discussed by the TRG

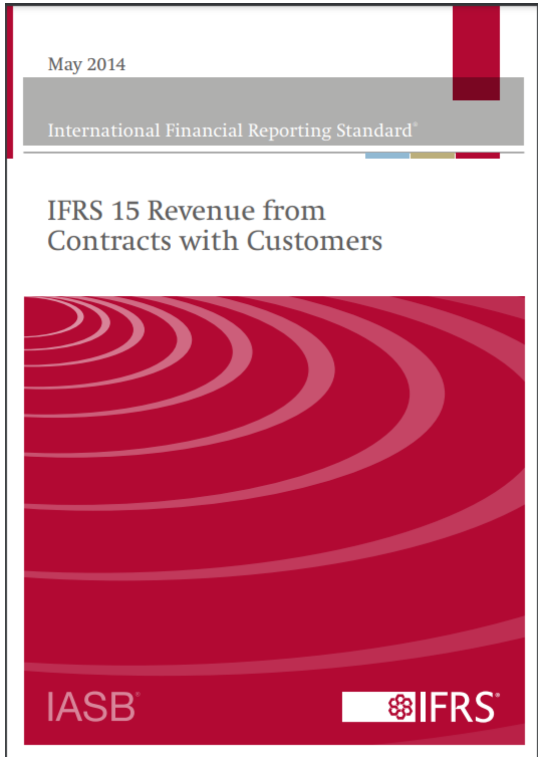
Analysed application questions at the IFRS Interpretations Committee

Where are we now?

September 2022	Q4 2022 – Q1 2023	H1 2023
IASB started PIR of IFRS 15	Phase 1 outreach and information gathering	Publish request for information

Background to IFRS 15

IFRS 15 at a glance



Comprehensive principle-based framework for the recognition, measurement and disclosure of revenue

- Greater rigour in revenue accounting
- More useful information through improved disclosure requirements
- Reduced need for interpretive guidance to be developed on a case-by-case basis
- Enhanced comparability across companies

Substantially converged with US GAAP (Topic 606)

Effective from 1 January 2018

Five-step revenue recognition model

Core principle

Recognise revenue to depict the transfer of promised goods or services to the customer in an amount that reflects the consideration to which the company expects to be entitled in exchange for those goods or services

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

Application guidance for each step

A **performance obligation** (PO) is a promise in a contract with a customer to transfer a good or service to the customer

Changes introduced by IFRS 15 and questions for CMAC members

1 Effects on timing and amount of revenue – who would be affected?

Changes to recognised revenue would broadly depend on starting point (previously applied judgements) and nature of contracts

More significant effect

Contracts

Straightforward:	Complex features:
• cash collected at point-of-sale and customer obtains immediate control	• multiple deliverables • variable consideration • long-term contracts • licensing transactions • principle vs agent • significant financing element
Retail, food and beverage, consumer products	Construction, airspace, defence, telcos, media, pharma, software

see slides 17–18 for more detail

1 Effects on timing and amount of revenue – main changes from previous requirements (1/2)

Change	Clarifications and added guidance	Expected effect
New concept of performance obligation	• Criteria and factors for identifying POs in multiple-element arrangements	✓ Information provided on individual margins for each PO not contract-wide margins *Example: revenue recognised separately for a handset and network service sold as a bundle* ✓ May affect pattern of revenue recognition
Timing of revenue recognition	• Specified criteria for recognising revenue over time • More guidance for using costs to measure progress on contracts • Control as the basis for recognising revenue	✓ More accurate reflection of the transfer of value to the customer *Example: a software development company recognises revenue:* • *over time – for unique software developed to meet specific customer specifications;* • *at a point in time (when control is transferred) – for software that could be sold to multiple clients* ✓ More discipline in amounts of revenue recognised over time

1 Effects on timing and amount of revenue – main changes from previous requirements (2/2)

Change	Clarifications and added guidance	Expected effect
Measurement	Guidance on: • allocation of the transaction price to POs based on relative stand-alone selling prices • variable consideration, including constraint on estimates • significant financing components • non-cash cash consideration • consideration payable to a customer	✓ Better reflection of revenue over the duration of the contract *For example, variable consideration such as performance bonuses would be recognised as revenue to the extent that it is highly probably that a significant reversal in the amount of cumulative revenue recognised will not occur*
Application guidance for some types of transactions	• Revenue recognition from licences, including licences of intellectual property • Agent vs principal—based on the control of the good or service before its transfer to a customer	✓ Economically similar contracts accounted for on a consistent basis

1 Effects on timing and amount of revenue – expected effects on key industries (1/2)

Industry	Expected effects
Construction/ Aerospace & Defence	• Revenue may be recognised over time but 'PO over time' criteria must be met • More discipline in cost-to-cost measures of performance • Costs capitalised if result in resources to be used in fulfilling contract, not to normalise margin
Telcos	• Revenue recognised for 'free' handset, as well as for airtime contract
Consumer products	• Revenue recognition deferred for some sales incentives and incidental obligations • Revenue recognition deferred for some implicit product warranties

1 Effects on timing and amount of revenue – expected effects on key industries (2/2)

Industry	Expected effects
Software	• VSOE (vendor-specific objective evidence) not used, so revenue can be recognised when license transferred • Revenue recognition for software development only if ‘PO over time’ criteria met
Media/ pharma	• Revenue may be recognised on transfer of licence, but will need to consider if licence is right to use or right to access • Sales-based royalties recognised as sales occur
Asset management	• Contingent fees based on index recognised only if highly probable will not be reversed

1 Effects – questions for CMAC

Main question	Do financial statements prepared applying IFRS 15 provide information useful for your analysis of the timing and amount of companies' revenue?

Detailed questions to consider

- Based on your observations, were the effects of IFRS 15 on key industries as expected (see slides 17–18)? Were there other industries that experienced significant changes in revenue recognition and measurement?
- Have you encountered any difficulties analysing information on revenue provided by companies? For example, have some of the new requirements (slides 15–16):
  - been applied by companies differently and so resulted in the lack of comparability of revenue information between companies; or
  - produced results that are seen as not reflecting the economics of a transaction?

2 Disclosures (1/2)

Enhanced disclosure requirements – information to help investors understand the nature, amount, timing and uncertainty of revenues and cash flows from contracts with customers

Disaggregation of revenue	• Categories that depict how revenue and cash flows are affected by economic factors • Explain relationship with segment disclosures (see illustration 1 on slide 29)
Performance obligations (POs)	• When POs are typically satisfied • Significant payment terms • The nature of the promised goods or services (see illustration 2 on slide 30) • Obligations for returns, refunds and similar obligations • Types or warranties and related obligations • Information about remaining POs (see illustration 3 on slide 31)
Contract balances	• Opening and closing balances of receivables, contract assets and contract liabilities (see illustration 4 on slide 32) • Revenue recognised from contract liabilities (see illustration 5 on slide 33) • Explanation of significant changes in contract balances

2 Disclosures (2/2)

Significant judgements	• Determining the timing of satisfaction of POs: ➢ for POs satisfied over time - methods used to recognise revenue and an explanation of why the methods used provide a faithful depiction ➢ for POs satisfied at a point in time – evaluating when a customer obtains control of promised goods or services • Methods, inputs and assumptions used for: ➢ determining the transaction price (see illustration 2 on slide 30) ➢ assessing whether estimates of variable consideration are constrained ➢ allocating the transaction price to POs ➢ measuring obligations for returns, refunds and similar
Assets recognised from costs to obtain or fulfil contracts with customers	• Closing balances by main category of asset (for example, costs to obtain contracts, pre-contract costs and setup costs) • Amount of amortisation and impairment losses in the reporting period

2 Disclosures – questions for CMAC

Main question	Have you found disclosures provided under IFRS 15 more informative than under the previous revenue requirements?

Detailed questions to consider

- Slides 20–21 provide an overview of disclosures required by IFRS 15 and slides 29–33 provide illustrations of how the IASB expected companies could provide specific disclosures. Which disclosures do you find most useful for your analysis and why? In contrast, are there disclosures that are less useful and why?
- Do you see significant variation in the quality of disclosures between various companies within the same industry or across industries? Where do you see most variation?
- Is there information you expected to see which is not being provided?

3 Comparability

Inconsistencies and weaknesses in IFRS Accounting Standards and US GAAP

- Economically similar transactions accounted for differently
- Diversity in practice between entities, industries and jurisdictions

After IFRS 15 – expected effects

Global comprehensive revenue recognition framework

- Economically similar transactions accounted for on a consistent basis
- Comparable revenue information in financial statements based on IFRS Standards and US GAAP

3 Comparability – questions for CMAC

Main question	Is revenue information comparable between different companies within an industry and between different industries?

Detailed questions to consider

Compared to pre-IFRS 15:

- Is it easier to compare revenue information between companies? Are there industries where comparisons are more difficult and why?
- Do you find that having converged standards makes it easier to compare revenue information between companies applying IFRS Standards and US GAAP?

4 Transition to IFRS 15 – available methods

Choice of two methods – both provide some comparative information

Full retrospective

- Revenue recognised and measured applying IFRS 15 from the beginning of the earliest comparative period provided
- Same basis for revenue figures in the current period and in the comparative periods
- Some optional practical expedients, for example, for completed contracts

Modified retrospective

- Revenue recognised and measured applying IFRS 15 from the date of initial application
- No restatement of comparative periods
- Cumulative adjustment to the opening balance of retained earnings
- Disclosures to illustrate the effect of IFRS 15 on the current period figures relative to previous revenue requirements

4 Transition to IFRS 15 – illustration

2016	2017	2018 (year of initial application)	2018 notes
Full retrospective			
• Revenue **restated** applying **IFRS 15** • Opening retained earnings adjusted to reflect transition	• Revenue **restated** applying **IFRS 15**	Revenue applying **IFRS 15**	
Modified retrospective			
• Revenue applying previous requirements	• Revenue applying previous requirements	• Revenue applying **IFRS 15** • Opening retained earnings adjusted to reflect transition	• How 2018 figures would have looked applying previous requirements • Explanation of significant changes

4 Transition – questions for CMAC

Main question	Did you find the information provided in the first set of IFRS 15 financial statements useful in understanding the changes in revenue recognition?

Detailed questions to consider

- Was it clear from the companies' financial statements which transition method they used?
- Did you see many companies use the modified retrospective transition method? Were related disclosures sufficient to help you understand revenue trends?
- On implementing IFRS 15, the IASB expected investors to incur educational costs as well as costs related to modifying their processes and analyses. Did you incur any unexpected costs related to implementation of IFRS 15? Are any of those costs ongoing? Have the benefits from IFRS 15, including a better depiction of companies' performance and improved disclosures, justified the costs related to implementing the Standard?

IFRS Accounting

Appendix – Illustrations of disclosures required by IFRS 15

Illustration 1: Linking disaggregated revenue to segments

Segments – primary geographical markets (CU mln)	Consumer products	Transport	Total
Asia	990	2,250	3,240
Europe	300	750	1,050
North America	700	260	960
Sub-total	**1,990**	**3,260**	**5,250**
Major goods/services			
Office supplies	1,000	-	1,000
Appliances	990	-	990
Automobiles	-	2,760	2,760
Support services	-	500	500
Sub-total	**1,990**	**3,260**	**5,250**
Timing of revenue recognition			
Goods transferred at a point in time	1,990	2,860	4,850
Services transferred over time	-	400	400
Sub-total	**1,990**	**3,260**	**5,250**

Illustration 2: Performance obligations and related judgements

Performance obligation (PO)	When PO is satisfied	Typical payment terms	How standalone selling price is typically estimated
Software and Product revenue			
Software licenses	When made available to the customer	Within 90 days of shipment	Residual approach
Appliances	When control of appliance passes to customer (typically on delivery)	Within 90 days of shipment	Observable price
Customer service revenue			
Support service	Over the course of the support contract term (over-time)	At the beginning of the contract period	Observable price from renewal transactions
Software updates	Over the course of the support contract term (over-time)	At the beginning of the contract period	Observable price from renewal transactions

Illustration 3: Remaining performance obligations

IFRS 15 requires companies to:

- disclose aggregate transaction price allocated to remaining performance obligations (ie. order book type or equivalent information that is audited)
- explain when this is expected to be recognised as revenue

Order book (CU mln)	Segment A	Segment B	Segment C
<1 year	30	45	12
1-3 years	180	90	210
>3 years	225	150	95

Illustration 4: Contract assets*

Improved insights into cash conversion

Contract assets	201X, CU mln
Balance, beginning of period	150
Net additions arising from operations	30
Amounts billed in period and thus reclassified to accounts receivable	(50)
Changes in impairment allowances	(1)
Balance, end of period	**129**

Reflects amounts for which the right to consideration depends on factors other than passage of time

Reflects amounts for which the right to consideration depends only on the passage of time

***Contract asset** – a company's right to consideration in exchange for goods or services that the company has transferred to a customer when that right is conditioned on something other than the passage of time (for example, on the company's future performance)

Illustration 5: Revenue recognised in the reporting period

Improved insights into revenue recognition

Illustration of disclosure	201X
Revenue recognised in the period from:	CU mln
Amounts included in the contract liabilities at the beginning of the period:	
Performance obligations satisfied	335
New activities in the period:	
Changes in the estimated transaction price allocated to performance obligations satisfied in prior periods	(25)
Performance obligations satisfied from new activities in the current period - contract revenue	85
Total revenue	**395**

Reflects revenue (satisfaction of POs) recognised in period that was included in opening contract liability

Reflects changes to revenues recognised in previous periods from changes in estimates

Thank you