IFRS Accounting

Staff paper

Agenda Reference: 4

IFRS Interpretations Committee meeting

Date	**29 November 2022**
Project	**Post-implementation Review (PIR) of IFRS 15 *Revenue from Contracts with Customers***
Topic	**Phase 1–Identifying matters to be examined**
Contacts	**Jelena Voilo (jvoilo@ifrs.org)** **Rashida Abdryashitova (rabdryashitova@ifrs.org)**

Purpose of this session

To share your views on the implementation and ongoing application of IFRS 15 *Revenue from Contracts with Customers*, including matters that you think the IASB should consider in the Post-implementation Review (PIR) of the Standard

Questions

- Slides 3–4 set out questions for discussion

Background information

- Slides 6–9 provide an overview of the PIR objective and process
- Slides 10–14 provide background to IFRS 15
- Slides 15–26 provide detailed information on changes introduced by IFRS 15 to support identification of application matters

IFRS Accounting

Questions

1

What is your **overall assessment** of IFRS 15?

- Does IFRS 15 achieve its objective of establishing the principles for reporting useful information to users of financial statements about the nature, amount, timing and uncertainty of revenue and cash flows arising from contracts with customers?
- Do you find the core principle of IFRS 15 and supporting five-step revenue recognition model clear and helpful in making revenue accounting decisions (see slide 12)?

2

What are the **application matters** that you think the IASB should examine during Phase 1 of the PIR and why? It would be most helpful if for each matter you could explain:

- How prevalent is the matter?
- What is the cause and what is the effect of the matter?
- Which companies are affected?
- Is this matter new, or did it exist under previous revenue requirements?
- What steps could the IASB take to resolve the matter?

IFRS Accounting

Questions

3

How challenging was the **transition** to IFRS 15 (see slide 24)?

- Which industries found the transition most challenging and why? Are their issues ongoing?
- In your experience, how often did companies use a modified transition method? Was it more prevalent in some industries than others? Were disclosures provided in the year of application sufficient to explain the transition?

4

Paragraphs BC454–BC493 of the Basis for Conclusions on IFRS 15 set out the IASB's analysis of the likely **benefits and costs** (effects) of implementing and applying the Standard (see high-level overview on slide 13)

- Have actual effects differed from the expected effects?
- Have you observed any other effects of IFRS 15 that were not identified in the effects analysis, for example, effects on the companies' internal controls or on the way the companies conduct their business?

Supporting material

PIR process

PIR – what is 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—how does the IASB respond to identified matters?

1 Consider whether to take action, based on the extent to which:

the **objective** of the new requirements is not being met;

benefits to users are significantly lower than expected

costs of application are significantly higher than expected

2 Determine the prioritisation of the matters based on the extent to which:

matter has **substantial consequences**

matter is **pervasive**

matter relates to an issue that **can be addressed** by the IASB or the Interpretations Committee (IC)

the benefits of any action would be expected to **outweigh** the costs

3 Determining the timing of taking action

High priority	to be addressed as soon as possible
Medium priority	to be added to the IASB or the IC research pipeline
Low priority	to be considered in the next agenda consultation
No action	require no further action

PIR—what is the process and where are we?

Phase 1
Identify matters to be examined

Phase 2
Consider feedback

Start when sufficient information is available

Publish public request for information

Report identified matters and next steps

September 2022

Q4 2022 – Q1 2023

H1 2023

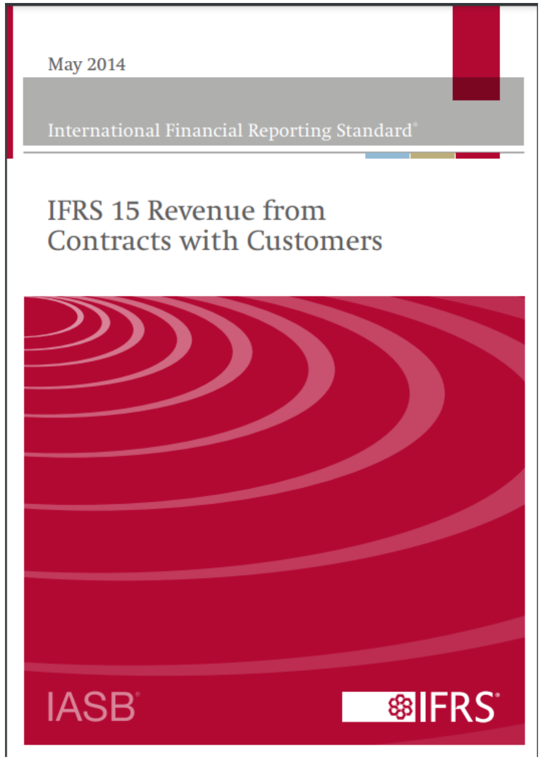
IASB decided to start PIR of IFRS 15

Phase 1 outreach and information gathering

Request for information to be published

Background to IFRS 15

IFRS 15 at a glance



Objective

To establish the principles for reporting 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

Substantially converged with US GAAP (Topic 606)

Effective from 1 January 2018

IFRS Accounting

Comprehensive principle-based framework

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

Five-step revenue recognition model

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 company satisfies a performance obligation

Application guidance for each step

Enhanced disclosure requirements

Expected overall improvement to financial reporting

Benefits:

- Enhanced comparability across companies, industries and capital markets, including with the US
- 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

Expected to be ongoing

Costs:

- compliance costs for preparers (for example, costs of changing or developing new systems, processes and controls; additional staff, audit and education costs)
- costs of analysis for users of financial statements (for example, costs of modifying processes and analyses; education costs)

Expected primarily during the transition

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

Detailed information to support outreach

IFRS 15—topic areas

1 Step 1: Identifying the contract(s) with a customer	2 Step 2: Identifying the performance obligations (POs) in the contract	3 Step 3: Determining the transaction price
4 Step 4: Allocating the transaction price to the POs	5 Step 5: Recognising revenue when (as) a PO is satisfied	6 Contract costs
7 Disclosures	8 Transition	9 Application guidance • principal vs agent • licencing

Note

- Slides 17–26 provide an overview of the requirements for each of these areas

1. Identifying the contract(s) with a customer

A **contract** is an agreement between two or more parties that creates enforceable rights and obligations*

Existence of a contract

Must meet specified criteria to apply the model:

- contract approved by parties who are committed to perform their obligations
- identifiable rights of each party
- identifiable payment terms
- commercial substance
- collection of consideration probable

Combination of contracts

Account for as a single contract if one or more criteria are met:

- negotiated as a package
- linked consideration
- goods or services form one performance obligation

Contract modifications

Account for:

- as a separate contract—if add distinct goods or services at standalone selling prices
- prospectively—if the remaining goods or services are distinct
- as part of the existing contract with cumulative catch-up—in remaining cases

* IFRS 15 does not apply to lease contracts, insurance contracts, financial instruments and non-monetary exchanges in the same line of business to facilitate sales to customers

2. Identifying the POs in the contract

A **performance obligation** (PO) is a promise in a contract with a customer to transfer a **distinct** good or service or a series of distinct goods or services

What makes a good or a service distinct?

Customer can **benefit** from the good or service	• on its own • together with other readily available resources (including goods or services previously acquired from the company)
+ Promised good or service is **separable** from other promises	• no significant service of integrating the good or service • the good or service does not significantly modify or customise another good or service in the contract • the good or service is not highly dependent on or interrelated with other goods or services

☑ Revenue information on each PO could help estimate individual margins in addition to contract-wide margins

3. Determining the transaction price

Transaction price is the amount of consideration to which the company **expects to be entitled** in exchange for transferring goods or services, excluding amounts collected on behalf of third parties

Variable consideration	Significant financing	Non-cash consideration	Consideration payable to customer
Estimate using: • expected value • most likely amount **Constraint**: estimate included in the transaction price only to the extent it ***is highly probable*** a significant reversal of revenue will not occur when uncertainty is resolved	Adjust consideration for the time value of money if timing provides customer or company with significant benefit of financing **Practical expedient**: no adjustment if the period between transfer of goods or services and payment is less than one year	• Measure at fair value • If fair value cannot be reasonably estimated, measure indirectly by reference to the stand-alone selling price of goods or services promised in exchange for the consideration (see slide 20)	Reduce the transaction price unless in exchange for a distinct good or service

☑ More discipline in measurement, better reflection of revenue over the duration of the period

4. Allocating the transaction price to the POs

Allocate to each PO the amount to which the company expects to be entitled in exchange for satisfying that PO – based on relative stand-alone selling prices (SSP)

How to determine SSP?

- Determined at contract inception
- Estimate SSP if not observable – methods include:
  - adjusted market assessment approach
  - expected cost plus a margin approach
  - residual estimation techniques if specified criteria are met

How to allocate the transaction price?

- Allocate to POs in proportion to SSP
- Discounts and contingent amounts allocated entirely to specific PO if specified criteria are met

☑ Better depiction of performance by recognising revenue when POs are satisfied
Greater consistency in the recognition of revenue across industries

5. Recognising revenue when (as) PO is satisfied

A performance obligation is satisfied by transferring good or service (when the customer obtains **control** of the good or service)

Is PO satisfied over time?

One of three criteria:

- benefits of the company's performance are simultaneously received and consumed by the customer
- the entity's performance creates or enhances the asset that the customer controls as the asset is created or enhanced
- no alternative use for the asset being created and the entity has an enforceable right to payment for performance to date

Yes

Select single measure of progress to depict performance of that PO

- units produced or delivered (output method) may be a reasonable proxy in some cases
- input methods may need to be adjusted (eg uninstalled materials)

No

PO satisfied at a point in time

To recognise revenue apply definition of control (ability to direct the use and obtain the benefits of the asset)

☑ Can result in change in timing of revenue compared to previous requirements

6. Contract costs

Specific requirements for accounting for some costs that are related to a contract with a customer

Costs of obtaining a contract

(*for example, selling commissions*)

Recognised as an asset if:

- incremental
- expected to be recovered

Costs of fulfilling a contract

(*for example, pre-contract setup costs*)

Recognised as an asset if:

- relate directly to a contract
- relate to satisfying POs in the future
- expected to be recovered

Onerous contracts

- Apply IAS 37 *Provisions, Contingent Liabilities and Contingent Assets*

7. Disclosures

Disclosure requirements to enable users to understand the nature, amount, timing and uncertainty of revenue and cash flows arising from contracts with customers

Revenue

- Disaggregation of revenue, including relationship with segment disclosure
- Amounts recognised relating to performance in previous periods

Contracts

- Information about contract balances and changes in those balances
- Information about POs
- Amounts allocated to remaining POs
- Information about assets recognised from costs to obtain or fulfil the contract

Significant judgements

- Timing of and methods for recognising revenue
- Determining the transaction price and amounts allocated to POs

☑ Enhanced information about a company's contracts with customers and revenue from those contracts

8. Transition

Choice of two methods – both provide some comparative information

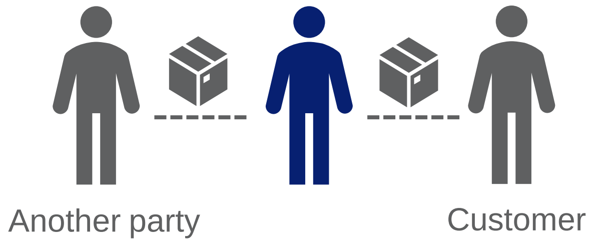
	Full retrospective	Modified retrospective
Revenue in the year of application	Applying IFRS 15	Applying IFRS 15
Revenue in comparative periods	Applying IFRS 15	Applying previous requirements
Adjustment to opening retained earnings to reflect transition	In the earliest comparative period	In the year of application
Disclosures	• Any practical expedients used	• How figures in the year of application would have looked • Explanation of significant changes

9. Application guidance: principal vs agent

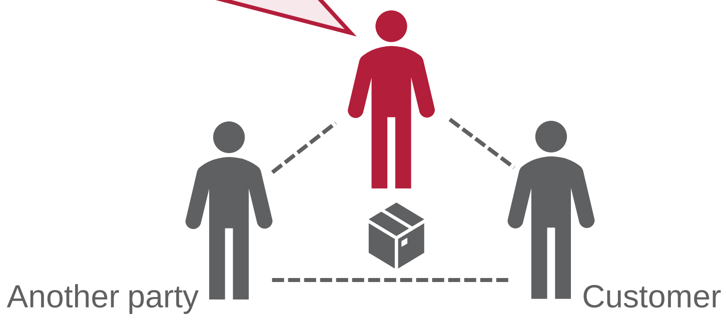
Guidance provided to align the nature of the PO and the amount of revenue recognised

- Identify specified good or service to be provided to a customer
- Assess whether the company **controls** that good or service before it is transferred to customer

Principal
- controls the good or service before the customer gets it
- PO is to *provide* the good or service



Agent
- does not control the good or service before the customer gets it
- PO is to *arrange* for the good or service to be provided



Indicators of control

The company:
- is primarily responsible for fulfilling the promise to provide the good or service
- has inventory risk before the good or service has been transferred to a customer or after transfer of control
- has discretion in establishing the price for the good or service

☑ Clear principle to help companies make judgements

9. Application guidance: licences

Guidance anchored in key steps of revenue recognition model and operationalised by differentiating between two types of licences of intellectual property (IP)

Step 2: Identify the POs

Is the licence distinct?

Yes

Apply criteria to determine whether **nature of licence** is to provide:

- a right to **access** the company's IP as it exists throughout the licence period → PO satisfied over time
- a right to **use** the company's IP as it exists at the point in time at which the licence is granted → PO satisfied at a point in time

For **sales-based or usage-based royalties** recognise revenue when (as) later of these occurs:

- the subsequent sale or usage
- the PO to which some or all of the royalty has been allocated has been (partially) satisfied

No

Account for bundle of goods and services

☑ Reduced diversity in practice

IFRS® Accounting

Thank you