IFRS Accounting

Staff paper

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Introduction

1. This paper summarises the feedback on applying IFRS 15 *Revenue from Contracts with Customers* with other IFRS Accounting Standards received in response to Request for Information *Post-implementation Review of IFRS 15* Revenue from Contracts with Customers (the RFI).

Summary of feedback

IFRS 15 requirements

IFRS 15 requires an entity to apply the requirements in the Standard to all contracts with customers, except:

(a) lease contracts within the scope of IFRS 16 *Leases*.

(b) contracts within the scope of IFRS 17 *Insurance Contracts*. However, an entity may choose to apply IFRS 15 to insurance contracts that have as their primary purpose the provision of services for a fixed fee.

IFRS 15 requirements
(c) 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*. (d) non-monetary exchanges between entities in the same line of business to facilitate sales to customers or potential customers. IFRS 15 also sets out requirements for contracts that are partially within the scope of IFRS 15 and partially within the scope of the other specified IFRS Accounting Standards. If the other Standards: (a) specify how to separate and/or initially measure one or more parts of the contract, then an entity should first apply the separation and/or measurement requirements in those Standards; (b) do not specify how to separate and/or initially measure one or more parts of the contract, then the entity should apply IFRS 15 to separate and/or initially measure the part (or parts) of the contract.[1]

2. In the RFI the IASB asked stakeholders to provide information about challenges in applying IFRS 15 with other Standards, in particular with IFRS 3 *Business Combinations*, IFRS 9 and IFRS 16. In addition, respondents commented on the application of IFRS 15 with:

   (a) IFRS 10;

   (b) IFRS 11;

   (c) IFRIC 12 *Service Concession Arrangements*; and

   (d) other Standards.

[1] See paragraphs 5–7 of IFRS 15.

3. A few respondents suggested that in developing a new Standard, the IASB devote more time to considering the interaction between that Standard and other Standards including the scope of the new requirements.

Interaction with IFRS 3

IFRS 3 and IFRS 15 requirements
Under IFRS 3, assets and liabilities acquired in a business combination are generally measured at fair value.[2] Under IFRS 15, contract assets and contract liabilities are measured based on the transaction price. The difference in the measurement principles may result in fair value adjustments when contract assets and contract liabilities are acquired as part of a business combination.

4. Many respondents commented on matters related to the interaction between IFRS 15 and IFRS 3. A few respondents (mostly standard-setters) identified ‘applying IFRS 15 with IFRS 3’ as a major application matter. In addition, we received feedback on this topic from users of financial statements in outreach meetings.

5. Most stakeholders commenting on this topic reported challenges related to the difference in the measurement principles in IFRS 3 and in IFRS 15. Specifically:

   (a) some respondents (mostly standard-setters) and a few users in outreach said that fair value measurement of contract liabilities can result in a downward adjustment which in their view distorts the depiction of an entity’s post-acquisition performance.[3] A few respondents said these adjustments are pervasive in the software industry.

   (b) some respondents (mostly standard-setters) raised questions about initial measurement and subsequent accounting (especially presentation) of contract assets and contract liabilities—for example, in contracts with variable consideration or with favourable or unfavourable terms.

[2] See paragraph 18 of IFRS 3.

[3] In outreach meeting, users often used the term ‘deferred revenue’ rather than ‘contract liabilities’.

(c) some users said that challenges related to fair value adjustments on acquisition relate not only to contract assets and contract liabilities, but also to other assets and liabilities, for example, inventory. A few users said that fair value adjustments on acquisition are difficult to understand because entities do not provide sufficient information to explain the reasons for those adjustments.

6. Stakeholders expressed mixed views on resolving the matters:

(a) most of them (mostly standard-setters) suggested the IASB consider the changes the FASB made to its ASC Topic 805, Business Combinations, which require an entity to apply FASB ASC Topic 606, Revenue from Contracts with Customers, to measure contract assets and contract liabilities acquired in a business combination.

(b) other stakeholders suggested retaining the fair value measurement principle on acquisition for all assets and liabilities:

(i) some of these stakeholders, including some users, said that fair value is the most appropriate basis for accounting for a business combination, and they see no difference between contract assets and liabilities and other asset or liability acquired in a business combination.

(ii) a few users said that entities usually provide additional information and non-GAAP measures to help users adjust their valuation models for the effects of a business combination, including the effects of fair value adjustments.

Interaction with IFRS 9

IFRS 9 and IFRS 15 requirements

Price concession or impairment loss

Under IFRS 15, a change in the price of a contract approved by the parties to the contract—either in writing, by oral agreement or implied in customary business practices—is accounted for as a contract modification.[4]

[4] See paragraphs 18–21 of IFRS 15.

IFRS 9 and IFRS 15 requirements

Under IFRS 9, the amount of expected credit losses is recognised as an impairment loss in profit or loss.[5]

Liabilities arising from IFRS 15

IFRS 15:

(a) sets out requirements for accounting for some liability types, for example, contract liabilities and refund liabilities relating to a sale with a right of return;[6] and

(b) specifies two cases (both relate to repurchase agreements) in which entities account for liabilities arising from IFRS 15 in accordance with IFRS 9.[7]

7. Many respondents commented on matters related to the application of IFRS 15 with IFRS 9. A few respondents identified this as a major application matter.

8. Some respondents (mostly standard-setters and accounting firms) reported diversity in practice in cases when an entity accepts lower consideration from a customer—for example, because the customer's financial position has deteriorated over the course of their relationship or because the entity wishes to enhance a customer relationship. In such cases:

   (a) some entities apply IFRS 15 and account for the reduction as a price concession which reduces revenue; and

   (b) others apply IFRS 9 and account for the reduction as an expected credit loss.

9. A few respondents (mostly standard-setters) said there is diversity in practice because IFRS 15 does not specify whether to classify some of the liabilities arising from IFRS 15 as non-financial (contract) liabilities or as financial liabilities applying IFRS 9, for example:

[5] See paragraph 5.5.8 of IFRS 9.

[6] See paragraphs 55, 106 and B20–B27 of IFRS 15.

[7] See paragraphs B66, B68 and B70 of IFRS 15.

(a) liabilities relating to points under loyalty programmes or gift cards which a customer can exchange for the entity's goods or services (the entity has a performance obligation) or a third party's goods or services (the entity has an obligation to pay cash to the third party) at the customer's discretion;

(b) refund liabilities; and

(c) prepayments refundable at the customer's request.

10. The respondents suggested adding guidance and/or illustrative examples to clarify accounting for the matters described in paragraphs 8–9.

Interaction with IFRS 16

IFRS 15 and IFRS 16 requirements

Under IFRS 16, the lease term includes the non-cancellable period and periods covered by an option to extend and an option to terminate when specified conditions are met.[8] Variable payments are included in lease payments only when those payments depend on an index or a rate.[9]

IFRS 15 applies to the duration of the contract in which the parties have present enforceable rights and obligations.[10] Estimated variable consideration is included in the transaction price subject to the constraint.[11]

IFRS 16 requires an entity to apply the requirements in IFRS 15 to determine whether the transfer of an asset is accounted for as a sale in sale and leaseback transactions.[12]

11. Many respondents (mostly standard-setters and accounting firms) commented on the interaction between IFRS 15 and IFRS 16. A few respondents identified 'applying IFRS 15 alongside IFRS 16' as a major application issue.

[8] See paragraph 18 of IFRS 16.
[9] See paragraphs 70, 81 and the definition of lease payments in Appendix A of IFRS 16.
[10] See paragraph 11 of IFRS 15.
[11] See paragraphs 50–59 of IFRS 15.
[12] See paragraph 99 of IFRS 16.

12. Most of these respondents said that it is unclear how an entity should apply the requirements in IFRS 15 with the requirements in IFRS 16 in some situations. Most commonly reported challenges were:

    (a) how to separate lease and non-lease components, determine lease term and contract duration and measure variable consideration in contracts that include both a lease and non-lease components given that the requirements for determining lease term, contract duration and for measuring variable consideration differ between IFRS 15 and IFRS 16; and

    (b) how to assess whether the transfer of an asset in a sale and leaseback transaction is a sale in accordance with IFRS 15, for example in contracts with renewal options.

13. Some respondents and a user of financial statements in outreach said that difficulties in applying the requirements in IFRS 15 with those in IFRS 16 result in diversity in practice. Respondents asked for additional guidance and/or illustrative examples on the identified matters, with a few respondents saying that the issues should be addressed in the forthcoming post-implementation review of IFRS 16.

Interaction with IFRS 10

14. The IASB decided against including in the RFI a question about accounting for transactions in which an entity—as part of its ordinary activities—sells an asset by selling an equity interest in a single-asset entity that is a subsidiary (a so called 'corporate wrapper'). Given its previous work on this matter, the IASB decided to assess the demand for resolving the matter in the next agenda consultation.

15. Some respondents (mostly regulators, standard-setters and accounting firms) asked the IASB to clarify whether an entity should account for a sale of a corporate wrapper applying IFRS 10 or IFRS 15, with many of them highlighting the matter as a high priority.

16. Many of those commenting on the matter reported diversity in practice, in particular in the real estate, pharmaceutical and utilities sectors, although a few said common practice has generally developed, especially in jurisdictions where such transactions are common. A few respondents suggested the IASB should reconsider the priority of this matter because:

    (a) corporate wrapper transactions are widespread and uncertainty about their accounting treatment has not been resolved by either the IASB or the IFRS Interpretations Committee; and

    (b) stakeholders are unsure whether, and if so how, the amendments to the definition of a business in IFRS 3 affect accounting for a sale of a corporate wrapper.

17. Most of those commenting on the interaction with IFRS 10 suggested that accounting for corporate wrappers should reflect the substance of the transaction, which in their view would mean accounting for them applying IFRS 15. A few respondents noted that such treatment would lead to closer alignment with US GAAP under which the sale of a corporate wrapper to a customer would generally be in the scope of Topic 606.

Interaction with IFRS 11

18. A few respondents (mostly standard-setters and accounting firms) reported challenges related to the interaction between IFRS 15 and IFRS 11, including:

    (a) how to determine whether a collaborative arrangement is in the scope of IFRS 15, IFRS 11 and/or another Standard;

    (b) how to account for arrangements that contain both a supplier-customer and joint control components; and

    (c) how to account for arrangements when no joint control is established and when neither party is seen as a customer.

19. The respondents asked for more guidance (for example, educational materials, illustrative examples and flowcharts) on these questions.

20. Some of those commenting on the topic said that the challenges related to accounting for collaborative arrangements are common, in particular in the pharmaceutical, biotechnology, oil and gas, healthcare, media, telecommunications and real estate industries. An accounting firm suggested collaborative arrangements are becoming more common—for example, to enter new markets—and that there is diversity in understanding how to analyse such transactions. In addition, a few respondents noted that the FASB provided guidance on collaborative arrangements in FASB ASC Topic 808, Collaborative arrangements.

Interaction with IFRIC 12

21. A few respondents (mostly standard-setters and accounting firms) provided comments on the application of IFRS 15 alongside IFRIC 12. The respondents raised the following main issues:

    (a) paragraph BC62 of the Basis for Conclusions on IFRIC 12 says that an operator's asset arising during development of an infrastructure asset in a concession arrangement is classified as a financial asset when it represents cash or another financial asset due from or at the direction of the grantor. In the respondents' view, this contradicts the requirements of IFRIC 12 to account for construction or upgrade services in accordance with IFRS 15, which would lead to the recognition of contract assets that are non-financial assets;[13]

    (b) unlike IFRS 15, IFRIC 12 does not provide guidance on significant financing component or discounting, although concession contracts are typically long-term contracts; and

    (c) IFRIC 12 requires an entity to apply IAS 37 *Provisions, Contingent Liabilities and Contingent Assets* to recognise an operator's contractual obligation to

[13] See paragraph 14 of IFRIC 12.

restore or maintain the infrastructure.[14] In the respondents' views, such obligation should be accounted for applying IFRS 15 as a contract liability relating to a separate performance obligation.

22. The respondents suggested amending IFRIC 12 to align it with IFRS 15, IFRS 9 and other applicable Standards for all stages of a concession arrangement.

Interaction with other Standards

23. A few respondents (mainly accounting bodies and standard-setters) raised some issues related to the interaction between IFRS 15 and IFRS 17 *Insurance Contracts*, including how to determine whether some contracts—such as a warranty contract with alternative cash settlement features—meet the criteria for the scope exemption from IFRS 17. They asked the IASB to clarify these issues or to consider them in the post-implementation review of IFRS 17.

24. A few respondents asked the IASB to clarify some narrow points related to applying IFRS 15 with other Standards—for example, IAS 37, IFRS 8 *Operating Segments*, the forthcoming IFRS 18 *Presentation and Disclosure in Financial Statements*, IAS 20 *Accounting for Government Grants and Disclosure of Government Assistance* and IFRS 2 *Share-based Payment*.

25. The staff will provide analysis of the reported issues in future papers.

[14] See paragraph 21 of IFRIC 12.