IFRS® Foundation

Second Comprehensive Review of the *IFRS for SMEs* Standard

Agenda Paper 3

Simplifications to IFRS 15 *Revenue from Contracts with Customers*

SME Implementation Group meeting

January 2022

IFRS®

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Project	**Second Comprehensive Review of the *IFRS for SMEs* Standard**	
Paper topic	Simplifications to IFRS 15 *Revenue from Contracts with Customers*	
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Purpose of this paper

The IASB met on 25 October 2021 to discuss whether and how to propose amendments to the *IFRS for SMEs* Standard to align with IFRS 15 *Revenue from Contracts with Customers*.

The IASB tentatively decided:

- to develop amendments to the *IFRS for SMEs* Standard to align it with IFRS 15 by rewriting Section 23 of the *IFRS for SMEs* Standard to reflect the principles and language used in IFRS 15; and
- to consider providing transition relief by permitting an entity to continue its current revenue recognition policy for any contracts already in progress at the transition date or scheduled to be completed within a set time after the transition date.

The IASB's approach to aligning Section 23 with IFRS 15 will require an assessment of what simplifications to the requirements of IFRS 15 are appropriate for SMEs. The IASB will consider a paper on possible simplifications to IFRS 15 to a future IASB meeting.

The purpose of this Agenda Paper is:

- to summarise the staff's approach to identifying the requirements in IFRS 15 that could be simplified when aligning Section 23 of the *IFRS for SMEs* Standard with IFRS 15; and
- to obtain SMEIG members' views on the staff's suggested simplifications to IFRS 15 to recommend to the IASB.

Contents

	Slides
Approach to alignment	5–7
Approach to simplifications	8–11
Suggested simplifications to IFRS 15	12–32
Questions for SMEIG members	33–34

Approach to alignment

Approach to alignment (1 of 2)

Rewrite Section 23 to reflect the principles and language used in IFRS 15, with simplifications

Determine whether and how to align by applying the three ‘alignment principles’

Alignment principles

Relevance to SMEs

Simplification

Faithful representation

Approach to alignment (2 of 2)

Comments from the October 2021 IASB meeting

Create a straightforward pathway for simple revenue contracts, explaining more complex features elsewhere

Use different words to get to a similar place as IFRS 15, accepting that this will not always give the same outcomes (alignment is a starting point, not the end point)

Simplifications should focus on judgements, rather than language or principles

Approach to simplifications

Approach to simplifications (1 of 3)

Modifications to full IFRS Standards to reflect:

- the needs of users of SMEs’ financial statements; and
- cost-benefit considerations.

Ways in which full IFRS Standards can be simplified in the *IFRS for SMEs* Standard (Paragraph BC16 of the *IFRS for SMEs* Standard)**:**

a) omitting some topics;

b) permitting only the simplest option when an IFRS Standard permits options;

c) simplifying recognition and measurement requirements;

d) reducing disclosures; and

e) simplifying language.

Approach to simplifications (2 of 3)

Approach taken to simplifying IFRS 15

1. Identify key features of the revenue recognition model in IFRS 15
2. Isolate areas of potential complexity
3. Consider whether and how the requirements of IFRS 15 could be simplified so they are easier and less costly for SMEs to apply
4. Assess whether the principle of faithful representation is met by these possible simplifications

Approach to simplifications (3 of 3)

Challenges

- Large and complex Standard
- Interdependency between each of the 5 steps
- IFRS 15 includes integral application guidance - no equivalent exists in *IFRS for SMEs* Standard
- IFRS 15 includes requirements that cover aspects relevant to more complex contracts

Suggested simplifications to IFRS 15

The 5-step model in IFRS 15

Recognise revenue to depict transfer of goods or services in an amount of consideration to which expected to be entitled

Step 1	**Identify the contract(s) with a customer**
Step 2	**Identify the performance obligations in the contract**
Step 3	**Determine the transaction price**
Step 4	**Allocate the transaction price to the performance obligations**
Step 5	**Recognise revenue when (as) a performance obligation is satisfied**

Step 1: Identify the contract

Existence of a contract	Must meet specified criteria to apply the model, including • It is probable that the entity will collect consideration If not: • Recognise revenue when the contract is either complete or cancelled; or • Reassess the contract to determine if specified criteria are met.
Combine contracts where necessary	Combine contracts if: • Negotiated as a package; • Linked consideration; or • Goods or services form one performance obligation
Contract modifications	Separate contract if add distinct goods/services at standalone selling price Prospective if remaining goods/services distinct Otherwise, cumulative catch-up

Step 1: Suggested simplifications

Requirements for contracts that do not meet the criteria to apply the model

IFRS 15 (Para. 15–16)	Specifies revenue recognition requirements for contracts that do not meet specified criteria to apply the 5-step model
***IFRS for SMEs* Standard**	• Simplify criteria so more contracts are likely to apply the model; or • Simplify recognition requirements for contracts that do not meet the criteria

Contract modifications

IFRS 15 (Para. 18–21)	Three different approaches dependent on conditions relating to whether a good or service is distinct
***IFRS for SMEs* Standard**	• Omit requirements • Preparers follow the concepts and principles in Section 2 consistent with current approach in the *IFRS for SMEs* Standard

Step 2: Identify the performance obligations

Performance obligation	A promise in a contract with a customer to transfer to the customer either: (a) good or service (or a bundle of goods or services) that is distinct; or (b) a series of distinct goods or services that are substantially the same and that have the same pattern of transfer to the customer.

Step 2: Identify the performance obligations

Criteria for a good or service to be distinct:

Customer can benefit from good or service	• On its own • Together with other readily available goods or services (including goods or services previously acquired from entity)
and	
Promised good or service is **separable identifiable** from other promises	Supporting factors: 1. No significant service of integrating the good or service 2. Good or service does not significantly modify or customise another good or service in the contract 3. Good or service is not highly dependent on or interrelated with other goods or services

Step 2: Suggested simplifications

‘Performance obligation’ terminology

IFRS 15 (Para. 22)	Defines a PO as a promise to transfer a distinct good or service or ‘a series of distinct goods or services …’
***IFRS for SMEs* Standard**	• Simplify language; replace PO with: ‘*a promise to transfer a distinct good or service*’ • Separately identify requirements for recognising revenue from ‘a series of distinct goods or services …’

Determining if a promised good or service is separately identifiable

IFRS 15 (Para. 29)	Includes three supporting factors that help determine if a promised good or service is separately identifiable
***IFRS for SMEs* Standard**	• Omit third factor • Simplify the language of the first and second factors

Step 3: Determine the transaction price

Amount of consideration to which an entity expects to be ***entitled*** in exchange for goods or services

Variable consideration	Significant financing component
Estimate using: • Expected value • Most likely amount but 'Constrained' (next slide)	Adjust consideration if timing provides customer or entity with significant benefit of financing (includes deferred and advanced payments)

Step 3: Constraining variable consideration

Include estimate of variable consideration in the transaction price only to extent it is highly probable a significant reversal of revenue will not occur when uncertainty is resolved

Entity’s expectations of revenue reversal assessed using indicators, for example:

- Factors outside entity’s influence (volatility in market, 3rd-party actions)
- Entity’s level of experience with similar types of contracts
- Length of time before uncertainty resolved

Step 3: Suggested simplifications

Variable consideration

IFRS 15 (Para. 50–58)	Two step process of estimating and constraining variable consideration
***IFRS for SMEs* Standard**	• Introduce a general principle for estimating consideration; or • Incorporate the requirement to constrain the consideration into the estimation principle

Significant financing component

IFRS 15 (Para. 60–65)	Determine if financing provides significant benefit to customer or entity and adjust for the time value of money
***IFRS for SMEs* Standard**	• Omit advance payments • Restrict adjustments for the time value of money to instances where payment is deferred beyond normal credit terms

Step 4: Allocate the transaction price

Allocate to each performance obligation the amount to which entity expects to be entitled in exchange for satisfying that performance obligation

Relative stand-alone selling price basis:
- Estimate selling prices if not observable
- Residual estimation techniques may be appropriate

Discounts Variable consideration	Allocated entirely to specific performance obligation if specified criteria met If not, allocated to all performance obligations

Step 4: Suggested simplifications

Allocation of a discount

IFRS 15 (Para. 82)	Allocate discount proportionally to all POs unless specific criteria met
***IFRS for SMEs* Standard**	• Omit criteria • Introduce a general principle to allocate discount proportionally to all POs if no better method is available

Allocation of a variable consideration

IFRS 15 (Para. 85)	Allocate variable consideration to the contract as a whole unless specific criteria met
***IFRS for SMEs* Standard**	• Omit criteria • Introduce a general principle to allocate variable consideration to the contract as a whole if no better method is available

Step 5: Recognise revenue when (as) a performance obligation is satisfied

Performance obligation is satisfied by transferring good or service

Performance obligation satisfied over time if 1 of 3 criteria met (next slide)	All other performance obligations satisfied at a point in time
Revenue is recognised by measuring progress towards complete satisfaction of the performance obligation: • Section of method for measuring progress requires judgement • Methods include output and input methods • Units produced or delivered may be a reasonable proxy in some cases	Revenue is recognised at the point in time when the customer obtains control of the promised asset. Indicators of control include: • Present right to payment • Legal title • Physical possession • Risks and rewards of ownership • Customer acceptance

Step 5: Criteria for POs satisfied over time

The customer receives and consumes the benefits of the entity's performance as the entity performs

- Routine or recurring services

or

The entity's performance creates or enhances an asset (eg WIP) that the customer controls as the asset is created or enhanced

- Building an asset on a customer's site

or

The entity's performance does not create an asset with an alternative use to the entity *and* the entity has an enforceable right to payment for performance completed to date

- Building a specialised asset that only the customer can use

Step 5: Suggested simplifications

Criteria for POs satisfied over time

IFRS 15 (Para. 35)	Assessment of 3 criteria supported by application guidance
***IFRS for SMEs* Standard**	Simplify the language of the criteria, eg: • *the entity's performance results in an expense for the customer;* • *the entity's performance results in an asset for the customer; or* • *the entity's performance does not result in an asset that could be readily redirect to a different customer and the customer is obliged to pay for work carried out to date.*

Step 5: Suggested simplifications

Selection of methods for measuring progress

IFRS 15 (Para. 41)	Requires judgement based on an underlying objective
***IFRS for SMEs* Standard**	• Preparer selects method, but Standard specifies when the simplest measurement methods may be used (eg passage of time)

Contract costs

Costs of obtaining a contract	Costs of fulfilling a contract	Onerous contracts
Recognised as an asset if: • Incremental • Expected to be recovered For example: *Selling commission*	If costs are not in scope of another Standard, recognised as an asset if: • Relate directly to a contract • Relate directly to future performance • Expected to be recovered For example: *Pre-contract or setup costs*	Apply IAS 37 *Provisions, Contingent Liabilities and Contingent Assets*

Contract costs: Suggested simplifications

Costs of obtaining a contract

IFRS 15 (Para. 91–94)	Requires costs to be analysed then capitalised
***IFRS for SMEs* Standard**	• Permit an accounting policy choice

Costs of fulfilling a contract

IFRS 15 (Para. 95)	Specifies capitalisation criteria when not in scope of another standard
***IFRS for SMEs* Standard**	• Omit criteria • Introduce specific requirements for those costs where the IFRS 15 capitalisation criteria typically applies

Application guidance

Topics covered		
Right of return		Warranties
Principle versus agent		Customer options for additional goods or services
Breakage (customers' unexercised rights)		Non-refundable upfront fees
Licensing		Repurchase agreements
Consignment arrangements	Bill-and-hold arrangements	Customer acceptance

Application guidance: Suggested simplifications

IFRS 15 (App. B)	Additional detail must be considered when applying the standard
***IFRS for SMEs* Standard**	Incorporate or omit based on topic's relevance to SMEs (next slide): • Relevant – *Incorporate as requirements and/or examples* • Less relevant – *Incorporate as examples* • Not relevant – *Omit*

Application guidance: Suggested simplifications

Relevant – Incorporate as requirements and/or examples		
Right of return	Warranties	Principle versus agent
Customer options for additional goods or services	Licensing	

Less relevant – Incorporate as examples	
Non-refundable upfront fees	Repurchase agreements
Bill-and-hold arrangements	Consignment arrangements

Not relevant – Omit	
Breakage (customers' unexercised rights)	Customer acceptance

Questions for SMEIG members

Questions for SMEIG members

- Do SMEIG members agree with the staff's suggested simplifications to IFRS 15 to recommend to the IASB?

- Do SMEIG members have any recommendations of other requirements of IFRS 15 that should be simplified when aligning Section 23 of the *IFRS for SMEs* Standard with IFRS 15?

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