IFRS Accounting

Staff paper

Agenda reference: 1

SME Implementation Group meeting

Date	**December 2023**
Project	**Second Comprehensive Review of the *IFRS for SMEs*® Accounting Standard**
Topic	**Proposed revised Section 23 *Revenue from Contracts with Customers***
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Introduction

1. This paper provides a summary of the feedback on the requirements for revenue proposed by the International Accounting Standards Board (IASB) in its Exposure Draft *Third edition of the* IFRS for SMEs *Accounting Standard* (Exposure Draft). The paper then provides:

   (a) staff analysis of the feedback; and

   (b) staff suggestions for revising, retaining or removing the proposed requirements in the Exposure Draft.

2. In this paper, the term SMEs refers to small and medium-sized entities that are eligible to apply the *IFRS for SMEs* Accounting Standard.

Purpose of the paper

3. This paper seeks views from the SME Implementation Group (SMEIG) members on the staff suggestions for changing the proposed requirements in the Exposure Draft.

Summary of staff suggestions

4. The staff suggestions are summarised in Table 1 of this paper.

Table 1—Summary of suggested changes to the proposed revised Section 23 of the Exposure Draft

Topic	Summary of staff suggestion(s)	Paragraph reference
Revise the proposed simplification		
Contract modifications	Revise by: • removing the option for an SME to account for a contract modification as a separate contract if the modification meets specified criteria (that is, remove the proposed simplification); and • requiring an SME to account for a contract modification as a separate contract if the modification meets specified criteria.	13–17
Warranties	Revise by: • removing the requirement for an SME to determine if a warranty is significant to the contract (that is, remove the proposed simplification); and • requiring an SME to account for a warranty as a separate promise only if the customer has the option to purchase the warranty separately.	18–27
Customer options for additional goods or services	Revise by: • removing the requirement for an SME to determine if the effect of accounting for an option as a separate promise is significant to the individual contract (that is, remove the proposed simplification); and • requiring an SME to account for an option that provides a material right to a customer as a separate promise unless doing so involves undue cost or effort. Do not make the undue cost or effort exemption available to SMEs accounting for customer renewal options.	28–38
Disclosures	Revise by requiring SMEs to disaggregate revenue using one of the following categories: a) type of good or service (for example, major product lines); b) geographical region (for example, country or region); c) market or type of customer (for example, government and non-government customers); d) type of contract; (for example, fixed-priced and time-and-material contracts); e) contract duration (for example, short-term and long-term contracts);	39–45

Topic	Summary of staff suggestion(s)	Paragraph reference
	f) timing of transfer of goods or services (for example, revenue from goods or services transferred to customers at a point in time and revenue from goods or services transferred over time); and g) sales channels (for example, goods sold directly to consumers and goods sold through intermediaries).	
Retain the proposed requirements		
Variable consideration	Retain the proposed requirements	46–61
Contract balances	Retain the proposed requirements	62–70
Repurchase agreements	Continue not to include requirements for accounting for repurchase agreements	71–75
Retain the proposed requirements, with drafting improvements		
Non-cash consideration	• Include the term ‘barter’ in the description of non-cash consideration; and • Present the requirement for an SME to measure the non-cash consideration indirectly by reference to the stand-alone selling price of the goods or services promised to the customer separately from the requirement to measure the non-cash consideration (directly) at fair value.	76–84
Allocating variable consideration	Present the requirements for allocating variable consideration and discounts together.	85–92
Remove the proposed requirements		
Customers’ unexercised rights (breakage)	Remove the proposed requirements	93–99
Section length and structure		
Length and structure	Restructure the Section so that: a) mandatory requirements are split between the Section and an appendix to the Section; and b) non-mandatory guidance is included in educational material on the Section.	100–110

Structure

5. This paper is structured as follows:
   (a) background (paragraphs 7–11);
   (b) redeliberation topics (paragraphs 12–99);
   (c) length and structure of the revised Section 23 (paragraphs 100–110);
   (d) next steps (paragraph 111);
   (e) Appendix A—Structure of the proposed revised Section 23; and
   (f) Appendix B—Suggested restructure of the proposed revised Section 23.

6. This paper includes 11 questions for the SMEIG; questions for the SMEIG are included at the end of the staff analysis for each topic.

Background

7. Section 23 *Revenue* of the *IFRS for SMEs* Accounting Standard sets out the requirements for accounting for revenue and is based on IAS 11 *Construction Contracts* and IAS 18 *Revenue*. The Section requires revenue to be recognised for goods when risks and rewards are transferred and, for services, as the service is performed.

8. In 2014, the IASB issued IFRS 15 *Revenue from Contracts with Customers*, which replaced IAS 11 and IAS 18. IFRS 15 introduced a single framework for recognising revenue for both goods and services. IFRS 15 requires revenue to be recognised when the customer obtains control of the good or service.

9. The IASB proposed amendments to the *IFRS for SMEs* Accounting Standard to align it with IFRS 15. To do so, the IASB proposed revising Section 23 of the *IFRS for SMEs* Accounting Standard to reflect the principles and language used in IFRS 15. The IASB also proposed simplifications to the requirements in IFRS 15 to reduce the

costs for SMEs of applying the revised Section 23 *Revenue from Contracts with Customers*.

10. Feedback on the proposed revised Section 23 was provided through comment letters and fieldwork. Accounting practitioners involved in the preparation of SMEs' financial statements participated in the fieldwork.[1] The feedback generally supported the IASB's proposals to revise Section 23 of the *IFRS for SMEs* Accounting Standard to align it with IFRS 15. Comment letter respondents and fieldwork participants identified topics where they would like the proposed requirements to be:

    (a) simplified further; or

    (b) the same as IFRS 15 (that is, not simplified).

    Concerns were also raised about the Section's length and its complexity for SMEs.

11. The IASB decided to proceed with revising Section 23 of the *IFRS for SMEs* Standard to reflect the principles used in IFRS 15 at its October 2023 meeting.[2] The IASB also agreed to redeliberate topics where respondents requested changes or raised concerns about the application of the proposed requirements.[3] This paper discusses topics that the IASB will redeliberate and the length and structure of the proposed revised Section 23.

Redeliberation topics

12. For each topic, this paper provides:

    (a) a description of the proposed requirements in the Exposure Draft;

    (b) a summary of the feedback received;

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[1] The fieldwork was discussed by the SMEIG at its July 2023 meeting. The fieldwork methodology and findings are included in Agenda Paper 5 *Proposed revised Section 23—Fieldwork methodology* and Agenda Paper 6 *Proposed revised Section 23—Findings from fieldwork*.

[2] See IASB *Update* of the October 2023 IASB meeting.

[3] The topics the IASB will redeliberate are summarised in the appendix to Agenda Paper 30A *Proposed revised Section 23 Revenue from Contracts with Customers* of the October 2023 IASB meeting.

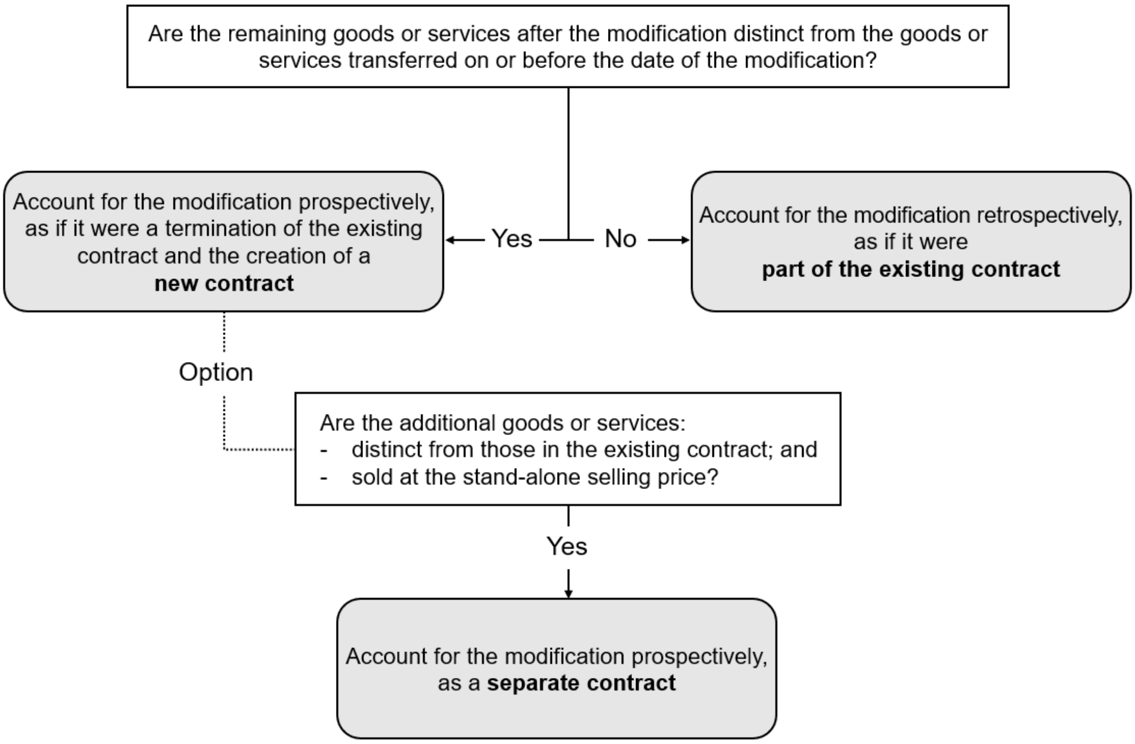
(c) the staff analysis of the feedback and staff suggestion; and

(d) a question for the SMEIG.

Contract modifications

13. The IASB proposed three different approaches for accounting for contract modifications in the Exposure Draft.[4] Each approach was subject to criteria. If a modification can be accounted for by terminating the contract and creating a new contract, SMEs are given the option to account for the modification as an additional, separate contract if specified criteria are met. The requirements in the Exposure Draft are illustrated in Figure 1 of this paper.

Figure 1—Summary of the requirements for contract modifications in the Exposure Draft



[4] Paragraphs 23.14–23.15 of the Exposure Draft.

14. The option to account for a contract modification as a separate contact was considered a simplification compared to the requirements for accounting for contract modifications in IFRS 15. No such option exists in IFRS 15 and an entity must accounting for a contract modification as a separate contract if it meets the specified criteria.[5]

Feedback received

15. Among fieldwork participants unfamiliar with IFRS 15, there were comparable numbers who were able to identify how to account for contract modifications and who were not. Many participants who were unable to identify how to account for a contract modification said the requirements were unclear and difficult to understand.

Staff analysis

16. The IASB considered whether the number of approaches and conditions that SMEs must consider when accounting for contract modifications could be reduced by removing the requirement to account for a contract modification as a separate contract. However, this was rejected because accounting for a contract modification as a separate contract can often be the easiest way for an entity to account for a contract modification. Consequently, all three approaches for accounting for contract modifications were proposed in the Exposure Draft. However, the IASB decided to make the requirement to account for a contract modification as a separate contract an option to make the process of identifying which approach to use easier for SMEs.

17. The *IFRS for SMEs* Accounting Standard generally does not include accounting policy options because they make the Standard complex for users and preparers. The staff believe the option to account for a contract modification as a separate contract has made the proposed requirements difficult for SMEs to understand. Consequently, the staff suggest all three approaches for accounting for contract modifications are

[5] Paragraph 20 of IFRS 15.

included in the revised Section 23. SMEs will be *required* to account for a contract modification as a separate contract if the modification meets the specified criteria, instead of having the *option* to do so (that is, the approach will be mandatory instead of optional).

Question for the SMEIG
1. What are your views on the staff suggestion to remove the proposed simplification that gives SMEs the option to account for a contract modification as a separate contract?

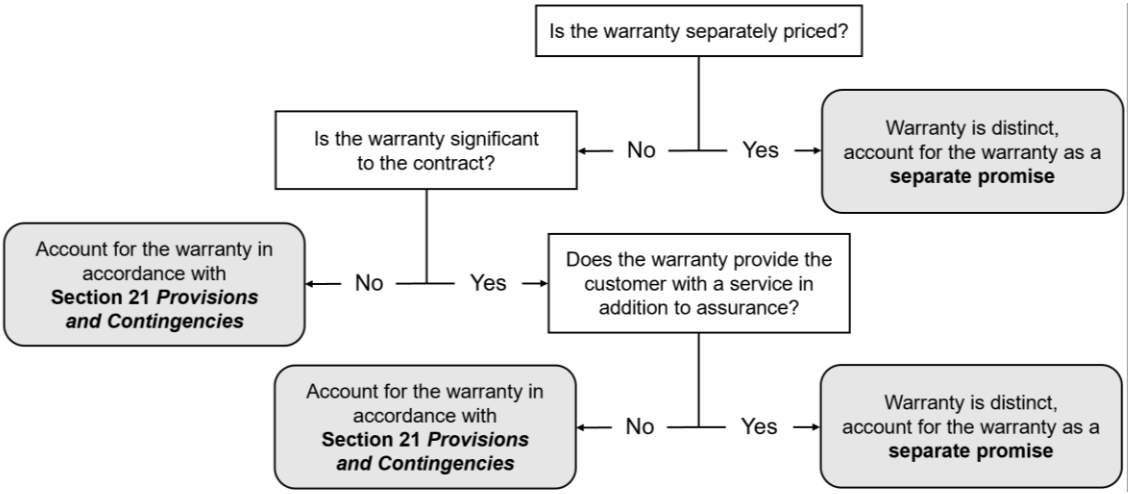
Determining whether a warranty should be accounted for as a separate promise

18. IFRS 15 requires a warranty to be accounted for as a separate performance obligation if a customer has the option to purchase the warranty separately.[6] If a customer does not have the option to purchase a warranty separately, IFRS 15 requires the warranty to be accounted for in accordance with IAS 37 *Provisions, Contingent Liabilities and Contingent Assets*, unless the warranty (or part of the warranty) provides the customer with a service in addition to the assurance that the product complies with agreed-upon specifications.[7]

19. The IASB proposed requirements in the Exposure Draft similar to those described in paragraph 18 of this paper.[8] However, the IASB proposed that SMEs would assess whether a warranty (or part of a warranty) provides the customer with a service in addition to the assurance that the product complies with agreed-upon specifications only if the warranty is *significant to the contract*. The requirements in the Exposure Draft are illustrated in Figure 2 of this paper.

[6] Paragraph B29 of IFRS 15.
[7] Paragraph B30 of IFRS 15.
[8] Paragraphs 23.25–23.28 of the Exposure Draft.

Figure 2—Summary of the requirements for warranties in the Exposure Draft



Feedback received

20. Many respondents who commented on the proposed requirements felt that requiring SMEs to assess if a warranty is significant to a contract would involve substantial judgement and introduce complexity into the Standard. The respondents asked for guidance and illustrative examples to help SMEs make this assessment.

21. The SMEIG discussed the respondents' comments on the proposed requirements at its meeting in July 2023. SMEIG members generally supported the IASB retaining the requirement for SME to assess if a warranty is significant to a contract in the revised Section 23. Some SMEIG members recommended that the IASB provide guidance to help SMEs make this assessment. SMEIG members had different views about how the significance of a warranty should be assessed for the purposes of applying the proposed requirement.

Staff analysis

22. When developing the Exposure Draft, the assessment of whether a warranty provides a customer with an additional service was considered to be challenging for SMEs. To limit the instances of when SMEs would have to make the assessment, the IASB restricted the assessment to when the warranty is significant to the contract.

Consequently, SMEs would only have to make the assessment if accounting for an additional service as a separate promise would significantly change the revenue recognition pattern of a contract.

23. The feedback suggests the proposed simplification described in paragraph 22 of this paper adds complexity to the Standard by introducing a new judgement. Guidance on how to assess significance could make the judgement easier for SMEs. However, additional guidance would increase volume of material that preparers would need to refer when applying the revised Section 23. For these reasons, the staff think the overall benefit of the proposed simplification is limited.

24. Assessing whether a warranty (or part of a warranty) provides a customer with a service is necessary if entities sell products with non-optional warranties that provide customers with a service in addition to the assurance that the product complies with agreed-upon specifications. Without the assessment, an entity would recognise the revenue attributable to the service at the time the product is transferred to the customer, instead of when the service is transferred. Consequently, if an entity does not account for the service element of these types of warranties as a separate promise, the entity may not faithfully represent the nature of the entity's promise to the customer.

25. Feedback from fieldwork participants indicated that warranties provided by SMEs often only provide customers with assurance that a product complies with agreed upon specifications (that is, the warranties do not provide customers with a service). Consequently, instances when SMEs sell products with non-optional warranties that provide customers with a service in addition to the assurance that the product complies with agreed-upon specifications are expected to be limited. In such instances, the revenue typically attributable to the service is not expected to be significant to the contract. This is because the services provided by the SME are usually incidental to the products sold. Therefore, recognising the revenue attributable to the service at the time the product is transferred to the customer is not expected to impede on faithful representation.

26. For the reasons in paragraphs 23–25 of this paper, the staff suggest that:

    (a) SMEs are not required to assess if a warranty is significant to the contract (that is, the proposed simplification is removed); and

    (b) SMEs are not required to assess if a warranty (or part of the warranty) provides the customer with a service in addition to the assurance that the product complies with agreed-upon specifications.

27. Instead, the staff suggest that SMEs are required to account for a warranty as a separate promise only if the customer has the option to purchase the warranty separately. This would mean SMEs determine how to account for warranties by applying a simple test based on a single observable factor. The test would reduce the judgement required to be applied by SMEs when applying the revised Section 23.

Question for the SMEIG
2. What are your views on the staff suggestion to require SMEs to account for a warranty as a separate promise only if the customer has the option to purchase the warranty separately?

Customer options for additional goods or services

28. An entity may grant a customer an option to acquire additional goods or services for free or at a discount (for example sales incentives, customer award credits or other discounts on future goods or services). Applying IFRS 15, an entity shall account for the option as a separate performance obligation if the option provides a material right to the customer that it would not receive without entering into that contract (referred to as a material right).[9] To account for a material right, IFRS 15 requires an entity to estimate the stand-alone selling price of the option, allocate the transaction price based on this amount and recognise revenue when those future goods or services are transferred or when the option expires.[10]

[9] Paragraph B40 of IFRS 15.

[10] Paragraphs B40 and B42 of IFRS 15.

29. The IASB proposed requirements in the Exposure Draft similar to those described in paragraph 28 of this paper. However, the IASB proposed that an SME would account for an option that provides a material right as a separate promise only if the effect of doing so is significant to the accounting for the individual contract.[11]

Feedback received

30. Many respondents who commented on the proposed requirements felt that requiring SMEs to assess if the effect of accounting for a material right as a separate promise are significant to the contract would involve substantial judgement and introduce complexity into the Standard. The respondents asked for guidance and illustrative examples to help SMEs make this assessment.

31. The SMEIG discussed the respondents' comments on the proposed requirements at its meeting in July 2023. SMEIG members generally supported the IASB retaining the requirement for SME to assess if the effect of accounting for a material right as a separate promise are significant in the revised Section 23. Some SMEIG members recommended that the IASB provide guidance to help SMEs make this assessment.

Staff analysis

Proposed simplification

32. The proposed requirement to assess if the effect of accounting for a material right as a separate promise is significant was intended to limit the situations when SMEs must separately account for material rights. This was to avoid SMEs incurring substantial costs to account for options that are not material to their financial statements. Therefore, the requirement was introduced for cost-benefit reasons.

33. The feedback indicates that the proposed requirement adds complexity to the Standard. Part of the complexity is because the proposal requires SMEs to

[11] Paragraph 23.35 of the Exposure Draft.

differentiate between the concepts of significance and materiality to assess two related items. The staff do not think that the complexity of these judgements could be overcome through addition guidance or illustrative examples. Consequently, the staff suggest the proposed requirement is removed.

Cost benefit considerations

34. It can be costly for entities to separately account for material rights because of the systems needed to capture information about customer options. Feedback from fieldwork participants indicated that typically SMEs do not have systems that capture information about customer options if:

    (a) customers are not expected to return and exercise the options for additional goods or services; or

    (b) the options for additional goods or services are immaterial and relate to a large volume of contracts.

35. If an entity does not separately account for material rights, the entity recognises revenue attributed to the additional goods and services associated with the option when the other promises in the contract are satisfied, instead of when the additional goods or services are transferred or when the option expires. Separately accounting for material rights in the instances described in paragraph 34(a)–(b) of this paper would depict the amount of consideration to which an entity is entitled to more faithfully than not doing so. However, if an SME did not have a system that captured the information to separately account for material rights, the incremental costs and additional effort of doing so would be unlikely to substantially exceed the benefits of this information to users of the SME’s financial statements. Consequently, the intention of the proposed simplification could be better achieved by having an undue cost or effort exemption. Therefore, the staff suggest that SMEs are required to account for a material right as a separate promise unless doing so involves undue cost or effort. SMEs that use the undue cost of effort exemption would disclose that fact and the reasons why accounting for a material right as a separate promise would

involve undue cost or effort (consistent with paragraph 2.14D of the *IFRS for SMEs* Accounting Standard).

Renewal options

36. An entity may grant a customer the option to renew a contract on similar terms (a renewal option). The Exposure Draft distinguishes renewal options from other options to acquire goods or services because the requirements for measuring renewal options are simplified compared to other options.[12]

37. Renewal options are typically offered in subscription-based or membership-based business models, where customers are offered substantial incentives to their loyalty. Customer renewals are fundamental to entities with these business models. Therefore, these entities would be expected to have systems that capture information about renewal options. Consequently, if a renewal option provides a customer with a material right, it is likely that:

    (a) the effect of accounting for the renewal option as a promise will be significant to the accounting for the contract; and

    (b) the incremental costs and additional effort of accounting for the renewal option as a promise will not exceed the benefits of this information to users of the entity's financial statements.

38. Consequently, accounting for a renewal option as a promise would not be expected to involve undue cost or effort because of the circumstances in which renewal options arise. Therefore, the staff suggest that the undue cost or effort exemption is not available to SMEs accounting for customer renewal options.

[12] Paragraph 23.36 of the Exposure Draft.

Question for the SMEIG
3. What are your views on the staff suggestions: a. to require SMEs to account for a material right as a separate promise, unless doing so involves undue cost or effort; and b. not to extend the scope of the suggested undue cost or effort exemption to customer renewal options?

Disclosures

39. Paragraph 23.121 of the Exposure Draft proposes that SMEs disaggregate revenue into categories, showing separately, as a minimum, revenue arising from:

(a) the sale of goods;

(b) the rendering of services;

(c) royalties;

(d) commissions; and

(e) any other significant types of revenue from contracts with customers.

40. The proposed categories are similar to the categories that SMEs disaggregate revenue into when applying the current Section 23 *Revenue* of the *IFRS for SMEs* Accounting Standard.[13] The IASB decided to retain the categories in the proposed revised Section 23 to ensure a level of consistency for users of SMEs' financial statements.

Feedback received

41. A comment letter respondent suggested the requirement for disclosing disaggregated revenue should be aligned with the objective of the proposed revised Section 23. The respondent suggested that SMEs disaggregate revenue into categories based on whether the goods of services are transferred to customers at a point in time or over

[13] Paragraph 23.30(b) of the *IFRS for SMEs* Accounting Standard.

time. The respondent thought disaggregating revenue into the categories would provide more useful information to users of SMEs' financial statements.

Staff analysis

42. The recognition requirements in the proposed revised Section 23 do not distinguish between revenue from the sale of goods and the rendering of services. Consequently, requiring SMEs to disaggregate revenue into categories based on goods and services is inconsistent with objective of the Section.

43. Requiring SMEs to disaggregate revenue into categories based on the timing of the transfer of goods or services, as suggested by the respondent, would be consistent with the proposed revised Section 23. However, whether disaggregating revenue based on these categories provides useful information for users of financial statements will depend on the composition of an SME's revenue. For example, if an SME satisfies all its promises with customers at a point in time, the categories will result in disaggregation that is too aggregated and not useful to users. Consequently, prescribing specific categories will mean SMEs will not report useful information in all circumstances.

44. IFRS 15 does not prescribe specific categories for disaggregating revenue. Instead, entities are required to disaggregate revenue into categories that depict how the nature, amount, timing and uncertainty of revenue and cash flows are affected by economic factors.[14] The staff think that an objective-based requirement for disaggregating revenue would introduce too much judgement into the *IFRS for SMEs* Accounting Standard. However, the judgement involved in determining the categories to use to disaggregate revenue could be reduced by requiring SMEs to choose categories from a list in the Standard. Therefore, the staff suggest SMEs are required to disaggregate revenue using one of the following categories:

[14] Paragraph 114 of IFRS 15.

(a) type of good or service (for example, major product lines);

(b) geographical region (for example, country or region);

(c) market or type of customer (for example, government and non-government customers);

(d) type of contract (for example, fixed-price and time-and-materials contracts);

(e) contract duration (for example, short-term and long-term contracts);

(f) timing of transfer of goods or services (for example, revenue from goods or services transferred to customers at a point in time and revenue from goods or services transferred over time); and

(g) sales channels (for example, goods sold directly to consumers and goods sold through intermediaries).

45. The suggested categories in paragraph 44 of this paper are based on the list of example categories in paragraph B89 of IFRS 15. The list was compiled to apply to many different entities, industries and contracts.[15] Therefore, the staff think an SME will be able to choose a category that is appropriate to its circumstances.

Question for the SMEIG
4. What are your views on the staff suggestion to require SMEs to disaggregate revenue using one of the categories in paragraph 44 of this paper?

Measuring variable consideration

46. IFRS 15 includes requirements for determining the transaction price in a contract if the consideration includes a variable amount. An amount of consideration can vary

[15] Paragraph BC337 of IFRS 15.

because of discounts, penalties, performance bonuses and other similar items. Entities determine the amount of variable consideration to include in the transaction price by:

(a) estimating the amount of consideration that the entity expects to be entitled to; and

(b) constraining the estimate of variable consideration in (a).[16]

47. The IASB proposed requirements in the Exposure Draft similar to those described in paragraph 46 of this paper.[17] However, the expression of the requirement to constrain estimates of variable consideration was simplified.[18]

Feedback received

48. Some comment letter respondents said the requirement to constrain estimates of variable consideration should not be simplified (that is, be the same as IFRS 15). Most of these respondents were concerned that the amount of variable consideration recognised by an SME would be different to the amount of variable consideration recognised by an entity applying IFRS 15.

49. The SMEIG discussed the respondents' comments on the proposed requirement to constrain estimates of variable consideration at its meeting in July 2023. SMEIG members generally supported the IASB retaining the simplified expression of the requirement in the revised Section 23.

50. Most fieldwork participants who were unfamiliar with IFRS 15 were unable to make the judgements required to determine the amount of variable consideration. Some of these participants said determining the amount of variable consideration is difficult because it involves significant judgement and complex calculations. A few

[16] Paragraphs 50 and 56 of IFRS 15.

[17] Paragraph 23.43–23.47 of the Exposure Draft.

[18] Paragraph 56 of IFRS 15 requires estimates of variable consideration to be included in the transaction price '*only to the extent that it is highly probable that a significant reversal in the amount of cumulative revenue recognised will not occur when the uncertainty associated with the variable consideration is subsequently resolved*'. Paragraph 23.46 of the Exposure Draft requires estimates of variable consideration to be included in the transaction price '*only to the extent that it is highly probable that this amount will become due when the uncertainty associated with the variable consideration is subsequently resolved*'.

participants said SMEs should determine the amount of variable consideration based on the actual amount of consideration received (or receivable), instead of an estimate.

Staff analysis

Use of hindsight

51. The staff considered the fieldwork participants' suggestion that SMEs should determine the amount of variable consideration based on the actual amount of consideration received (or receivable).

52. IFRS 15 requires entities to determine the amount of variable consideration to include in the transaction price based on the circumstances present at the end of the reporting period.[19] The amount of consideration that an entity is entitled to will be known once the uncertainty associated with the variable consideration is resolved. The uncertainty may be resolved between the reporting date and the date the financial statements are authorised for issue. In such circumstances, the entity is still required to determine the amount of variable consideration based on the on the circumstances present at the end of the reporting period. The entity would not determine the amount of variable consideration based on the transaction price at the date the uncertainty is resolved (that is, the entity would not determine the amount of variable consideration using hindsight).

53. Permitting SMEs to determine amounts of variable consideration using hindsight would reduce the judgement required to apply the proposed requirements. It would also reduce instances of SMEs having to adjust revenue recognised in previous periods when uncertainties associated with variable consideration are resolved. This would provide users of financial statements with more reliable information about SMEs' revenue.

[19] Paragraph 59 of IFRS 15.

54. Other requirements in the proposed revised Section 23 require SMEs to determine amounts based on circumstances present at the end of the reporting period. These include the requirements for measuring the progress of promises to transfer goods or services that are satisfied over time. The revised Section 23 identifies two methods for measuring progress that an SME may use. The methods require SMEs to determine either:

    (a) the total goods or services to be transferred under the contract; or

    (b) the expected inputs needed to satisfy the promise.

55. In contracts where the consideration includes a variable amount, the amounts in paragraph 54(a)–(b) of this paper also may vary because of the same uncertainty associated with variable consideration. For example:

    (a) a contract that includes a volume discount incentive, where the price per good is reduced if a customer purchases more than a specific number of goods. The total number of goods to be transferred will be greater if the customer purchases over the specific number compared with the total number of goods to be transferred if the customer does not.

    (b) a construction contract that includes a penalty if the construction is not completed by a specific date. The inputs needed to complete the construction by the specific date may be greater than the inputs needed to complete the construction after the specific date.

56. If an SME was permitted to use hindsight to determine amounts of variable consideration in a contract when the consideration and methods being used to measure progress vary because of the same uncertainty, the SME would:

    (a) be permitted to determine the variable consideration based on conditions that arose after the end of the reporting period (that is, after the uncertainty was resolved); and

(b) be required to measure an entity's progress towards complete satisfaction of a promise based on the circumstances present at the end of the reporting period (that is, before the uncertainty was resolved).

Therefore, to account for the contract, the SME would estimate two amounts that vary because of the same uncertainty. However, the SMEs would use hindsight to estimate one amount, but not the other.

57. The inconsistency described in paragraph 56 of this paper could be overcome by permitting SMEs to use hindsight when measuring progress towards satisfaction of a promise, if:

(a) the consideration for the promise includes a variable amount; and

(b) the consideration and the amounts used to measure progress vary because of the same uncertainty.

58. Permitting SMEs to use hindsight would create exceptions to the general requirements in the revised Section 23. The staff think the exceptions would add complexity to the Standard which would outweigh the benefit of reducing the judgement needed to apply the proposed requirements for variable consideration. Consequently, the staff suggest the proposed requirements in the Exposure Draft for measuring variable consideration are retained in the revised Section 23.

Constraining estimates of variable consideration

59. The expression of the requirement to constrain estimates of variable consideration in IFRS 15 was simplified in the Exposure Draft to make the requirement easier for SMEs to understand and apply. By using different language to express the requirement, SMEs may not get to the same outcome as entities applying IFRS 15. If the outcome is different, SMEs are still expected to determine an amount of variable consideration that faithfully depicts the amount of consideration to which the SME is entitled. Consequently, the staff think that making the requirement easier to understand and apply should be prioritised ahead of making the outcome the same as

IFRS 15. Therefore, the staff suggest the simplified expression of the requirement is retained in the revised Section 23.

Educational material

60. Fieldwork participants said prompt payment discounts are a common type of variable consideration that exists in contracts between SMEs and their customers. The judgement and calculations needed to determine the amount of variable consideration for contracts that include prompt payment discounts is simpler compared with other forms of variable consideration. The feedback suggests that most SMEs will not have contracts with complex variable consideration arrangements.

61. The IASB will provide educational material on the revised Section 23. The material will include guidance on the judgements and calculations needed apply the proposed requirements for variable consideration. The guidance will be available to SMEs with contracts with complex variable consideration arrangements. Providing educational material is considered a more appropriate way to help SMEs apply the proposed requirements compared with making further simplifications to the requirements.

Question for the SMEIG
5. What are your views on the staff suggestion to retain the proposed requirements in the Exposure Draft for measuring variable consideration in the revised Section 23?

Contract balances

62. The proposed revised Section 23 requires SMEs to present a contract in the statement of financial position as either a contract asset or a contract liability.[20] An SME recognises a contract asset if it transfers a good or service to a customer before the customer pays consideration (or before consideration is due). The term ‘accrued income’ is often used to describe contract assets.

[20] Paragraph 23.114 of the Exposure Draft.

63. Paragraph 23.116 of the Exposure Draft requires SMEs to exclude any amounts presented as a receivable from contract assets. A receivable is an SME's right to consideration that is unconditional. A right to consideration is unconditional if only the passage of time is required before payment of that consideration is due. This is different to a contract asset, when an SME's right to consideration is conditional on something other than the passage of time (for example, the SME transferring other goods or services promised in the contract). Paragraph 23.118 of the Exposure Draft requires SMEs to present contract assets and receivables separately.

64. The proposed requirements for contract balances in the Exposure Draft are aligned with the presentation requirements in IFRS 15.[21]

Feedback received

65. Among fieldwork participants unfamiliar with IFRS 15, there were comparable numbers who were able to able to distinguish between a contract asset and a receivable and who were not.

66. All participants who commented on the judgement said that the requirements for distinguishing between a contract asset and a receivable should be clearer. Most participants said more guidance is needed on identifying circumstances when a right to consideration is conditional and gives rise to a contract asset.

Staff analysis

67. Contract assets and receivables arise in similar circumstances; however, they are different from each other because:

    (a) receivables are subject to credit risk; and

    (b) contract assets are subject to other risks in addition to credit risk (for example, performance risk).

[21] Paragraphs 105–109 of IFRS 15.

68. Users of financial statements are provided with more information about an entity's rights to consideration if contract assets and receivables are presented separately. This information can help users better understand an entity's short-term cash flows. Users of SME's financial statements are considered to be particularly interested in SME's short-term cash flows. For this reason, the staff suggest that the proposed requirement in the Exposure Draft to distinguish between contract assets and receivables is retained in the revised Section 23.

Guidance on contract assets

69. Contract assets are most likely to arise when an entity's right to consideration is conditional on its performance. For example, consideration might be due only after the entity has transferred all the goods and services in a contract to the customer. Therefore, until the entity has transferred all the goods and services, any right to consideration that the entity has will be conditioned on the other goods or services being transferred to the customer.

70. The example described in paragraph 69 of this paper is included in paragraph 23.116 of the Exposure Draft. The staff think that expanding the example in educational material would help SMEs to identify circumstances when a right to consideration is conditional and gives rise to a contract asset. This is considered more helpful than including an additional example in the revised Section 23 that is unlikely to occur in practice.

Question for the SMEIG
6. What are your views on the staff suggestion to retain the proposed requirements in the Exposure Draft for contract balances in the revised Section 23?

Repurchase agreements

71. IFRS 15 includes requirements for accounting for repurchase agreements.[22] The IASB did not propose requirements for accounting for repurchase agreements in the Exposure Draft. This was because the requirements were not considered relevant to SMEs (that is, the requirements did not meet the relevance principle when the IASB applied its alignment principles[23]).

Feedback received

72. A few comment letter respondents suggested the IASB include requirements for accounting for repurchase agreements in the revised Section 23.

Staff analysis

73. The current Section 23 of the *IFRS for SMEs* Accounting Standard covers accounting for repurchase agreements in:

    (a) paragraph 23.8. The paragraph requires SMEs to apply the revenue recognition criteria in Section 23 to two or more transaction together when they are linked in such a way that the commercial effect cannot be understood without reference to the series of transactions as a whole. A repurchase agreement is used to illustrate the requirement.

    (b) the Appendix to Section 23 *Examples of revenue recognition under the principles in Section 23*. The Appendix includes an example of a repurchase agreement.[24] The accounting treatment for the agreement is based on whether an SME retains the risks and rewards of ownership of the goods sold. If an SME retains the risks and rewards of ownership, the agreement is a financing arrangement.

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[22] Paragraphs B64–B76 of IFRS 15.
[23] See paragraphs BC29–BC32 of the Exposure Draft.
[24] Paragraph 23A.10 of the *IFRS for SMEs* Accounting Standard.

74. Feedback received during the development of the Exposure Draft indicated that repurchase agreements occur rarely among SMEs and the current requirements for accounting for repurchase agreements in Section 23 are rarely applied.

75. The feedback from comment letter respondents does not include any evidence about the relevance of the requirements for accounting for repurchase agreements. Consequently, the staff continue to think the requirements do not meet the relevance principle and suggest not to include requirements for accounting for repurchase agreements in the revised Section 23.

Question for the SMEIG
7. What are your views on the staff suggestion not to include requirements for accounting for repurchase agreements in the revised Section 23?

Measuring non-cash consideration

76. The IASB proposed requirements in the Exposure Draft for determining the transaction price for contracts in which a customer promises consideration in a form other than cash (that is, non-cash consideration). Paragraph 23.60 of the Exposure Draft requires SMEs to measure non-cash consideration at fair value. However, if an SME cannot reasonably estimate the fair value of the non-cash consideration, the consideration is measured indirectly by reference to the stand-alone selling price of the goods or services promised to the customer in exchange for the consideration.

77. The proposed requirements for non-cash consideration in the Exposure Draft are aligned with the requirements for non-cash consideration in IFRS 15.[25]

[25] Paragraphs 66–69 of IFRS 15.

Feedback received

78. Among fieldwork participants unfamiliar with IFRS 15, there were comparable numbers who were able to measure non-cash consideration and who were not. Of the participants who were unable to measure non-cash consideration, there were equal numbers who:

(a) were unsure of what transactions are in scope of the proposed requirements for non-cash consideration; and

(b) were unable to measure non-cash consideration because it involves significant judgement.

79. Transactions that fieldwork participants thought were in scope of the proposed requirements were:

(a) transactions covered by other requirements in the proposed revised Section 23 (for example, non-monetary exchanges between entities in the same line of business to facilitate sales to customers or potential customers, which is covered by paragraph 23.1(d) of the Exposure Draft); and

(b) transactions when an SME receives cash (for example, cash received via an electronic transfer system).

Staff analysis

Transactions in the scope of the proposed requirements

80. The fieldwork participants' responses were based on an initial study of the proposed revised Section 23. Additionally, only a few participants said their clients commonly receive non-cash consideration. Therefore, participants were commenting on requirements that they had not applied and will not typically use. For these reasons, the staff think that any initial difficulties of understanding the scope of the requirements for non-cash consideration will be overcome as SMEs gain a better understanding of the revised Section.

81. Entities typically receive non-cash consideration when they enter into barter transactions (that is, exchanges of dissimilar goods or services). To help SMEs identify transactions that may be in scope of the requirement for non-cash consideration, the staff suggest the description of non-cash consideration in the revised Section 23 includes the term 'barter'.

Level of judgement

82. The fieldwork participants' comments on the judgement involved in measuring non-cash consideration related to requirement to estimate the fair value of the consideration (the inbound asset). The proposed requirements allow SMEs to measure the inbound asset by reference to the stand-alone selling price of the goods or services being transferred to the customer (the outbound asset) if the SMEs cannot reasonably estimate the fair value of the inbound asset.

83. The feedback suggests that the exemption from measuring the fair value of the inbound asset directly has been overlooked by participants unfamiliar with IFRS 15. This may be because exemptions from measuring items at fair value are typically included as undue cost or effort exemptions in the *IFRS for SMEs* Accounting Standard. So preparers do not overlook the exemption, the staff suggest the exemption is presented separately from the requirement to measure the fair value of the inbound asset.

84. The staff think it is unnecessary to simplify the proposed requirements for non-cash consideration. This is because the feedback on the proposed requirements did not identify that SMEs would find it difficult to:

(a) demonstrate that they cannot reasonably estimate the fair value of the inbound asset (that is, qualify for the exemption); or

(b) estimate the stand-alone selling price of the outbound asset (that is, apply the exemption).

Question for the SMEIG
8. What are your views on the staff suggestions: a. to retain the proposed requirements in the Exposure Draft for measuring non-cash consideration in the revised Section 23; and b. to make the drafting improvements described in paragraphs 81 and 83 of this paper?

Allocating variable consideration

85. IFRS 15 includes criteria that specify circumstances when an entity is required to allocate variable consideration entirely to one or more, but not all, performance obligations in a contract.[26] Only in these circumstances is the entity required to depart from allocating the transaction price on a relative stand-alone selling price basis (the default method).

86. The IASB proposed requirements in the Exposure Draft to allow SMEs to use an alternative method to allocate variable consideration to promises in a contract. SMEs are allowed to use an alternative method if the default method does not depict the amount of consideration to which the SME expects to be entitled in exchange for transferring the goods or services.[27] The proposed requirements for allocating variable consideration in the Exposure Draft are the same as the proposed requirements for allocating discounts.[28]

Feedback received

87. Most fieldwork participants who were unfamiliar with IFRS 15 were unable to allocate variable consideration to the promises in a contract. Some participants said the information needed to make the judgement would be difficult to obtain. This was

[26] Paragraph 85 of IFRS 15.

[27] Paragraph 23.70 of the Exposure Draft.

[28] Paragraphs 23.68–23.69 of the Exposure Draft

because the terms for variable consideration are often approved by oral agreement and not documented. One participant said that SMEs typically negotiate different terms for different customers.

88. Some fieldwork participants said it would be difficult to decide whether:

(a) the contract includes variable consideration (and the proposed requirements for allocating variable consideration apply); or

(b) a customer has received a discount (and the proposed requirements for allocating a discount apply).

This is because variable consideration can arise because of a discount offered by the SME (for example a cumulative quantity discount).

Staff analysis

Information needed to make the judgement

89. The proposed requirements in the Exposure Draft require an SME to determine if allocating variable consideration using the default method depicts the amount of consideration to which the SME expects to be entitled in exchange for transferring the goods or services. To do so, the SME must consider whether the variable consideration is attributable to the entire contract, or to specific parts of the contract.

90. Feedback from fieldwork participants indicates that SMEs commonly negotiate and agree variable consideration terms with their customers verbally. As a result, terms might not be documented and differ between contracts. The staff think it is more likely that the amount of variable consideration will differ between contracts, than the goods or services that the variable consideration is attributable to. For example, it is more likely that the terms of a volume discount are negotiated for an entire contract, instead of for specific parts of the contract. If the terms of the variable consideration are negotiated for the entire contract, the method used to allocate the variable consideration to the promises in a contract basis will not change regardless of the terms agreed.

91. For the reason in paragraph 90 of this paper, the staff think that if variable consideration terms differ between contracts, the proportion of variable consideration attributable to each part of the contract is unlikely to change. Consequently, SMEs are expected to be able to determine whether allocating variable consideration using the default method is appropriate without having to refer to the terms of each contract.

Differentiating between variable consideration and discounts

92. When allocating variable consideration and discounts to promises in a contract, it is unnecessary for SMEs to differentiate between these amounts because the proposed requirements for allocating these amounts are the same. To avoid SMEs doing so, the staff suggest that the requirements for allocating variable consideration and discounts are presented together in the revised Section 23.

Question for the SMEIG
9. What are your views on the staff suggestions: a. to retain the proposed requirements in the Exposure Draft for allocating variable consideration in the revised Section 23; and b. to present the requirements for allocating variable consideration and discounts together in the revised Section 23?

Customers' unexercised rights (breakage)

93. Entities may receive an upfront non-refundable payment that gives a customer the right to receive goods or services in the future (for example, a gift card). Upon receipt of the non-refundable payment, an SME would recognise the amount as a contract liability in accordance with paragraph 23.115 of the Exposure Draft.

94. Customers may not exercise all their rights to receive goods or services in the future. Unexercised rights are referred to as breakage.

95. The IASB proposed requirements in the Exposure Draft for how to account for breakage.[29] If an SME expects to be entitled to a breakage amount, the SME is required to estimate this amount. The SME then recognises the estimated breakage amount as revenue in proportion to the pattern of rights exercised by the customer when those future goods or services are transferred. If an SME does not expect to be entitled to a breakage amount, the SME shall recognise the breakage as revenue when the likelihood of the customer exercising its remaining rights becomes remote.

96. The proposed requirements for breakage in the Exposure Draft are aligned with the requirements for breakage in IFRS 15.[30]

Feedback received

97. Among fieldwork participants unfamiliar with IFRS 15, there were comparable numbers who were able to make the judgements required to account for breakage and who were not. Many participants who were unable to make the judgements said the judgements were too difficult. Some participants thought that contracts where breakage may occur are not significant to their clients' businesses.

Staff analysis

98. Feedback from fieldwork participants indicates that revenue from contracts when breakage is expected to occur is not expected to be significant to SMEs (for example, revenue from gift cards compared with revenue from other sources). Consequently, the amount of breakage from these contracts would not be expected to be significant. Analysis of a sample of financial statements of entities applying FASB's *Topic 606 Revenue from Contracts with Customers*[31] shows that on average, the

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[29] Paragraphs 23.119–23.120 of the Exposure Draft.

[30] Paragraphs B44–B47 of IFRS 15.

[31] The IASB and the FASB jointly developed IFRS 15 and Topic 606 *Revenue from Contracts with Customers* (Topic 606). The requirements for accounting for breakage in Topic 606 are consistent with IFRS 15.

amount of breakage recognised as revenue was less than 1.5% of entities' total revenue.[32]

99. The evidence in paragraph 98 of this paper indicates that amounts of breakage are unlikely to be significant enough to make a difference in the decisions of users of SME's financial statements. Therefore, requirements for breakage are not considered to meet the relevance principle when applying the IASB's principles for determining if the *IFRS for SMEs* Accounting Standard should be aligned with full IFRS Accounting Standards.[33] Consequently, the staff suggest the proposed requirements are not included in the revised Section 23.

Question for the SMEIG
10. What are your views on the staff suggestion not to include requirements for accounting for breakage in the revised Section 23?

Length and structure of the proposed revised Section 23

100. The IASB proposed a new revenue recognition model for SMEs in the Exposure Draft. The requirements in the proposed revised Section 23 are structured based on the five steps of this model. The Section's structure reflects the order in which SMEs are expected to apply the requirements.

101. The requirements in IFRS 15 are split between the Standard and application guidance. The application guidance is included in an appendix to the Standard that has the same authority as the Standard.

[32] Based on a sample of 17 entities who filed their 2022 or 2023 financial statements with the Securities and Exchange Commission and disclosed the amount of breakage recognised as revenue during the year.

[33] See paragraphs BC29–BC32 of the Exposure Draft.

Feedback received

102. Both comment letter respondents and fieldwork participants had concerns that the proposed revised Section 23 was too long and difficult to follow. Fieldwork participants said the Section's length was problematic for readers because:

(a) they would find it difficult to find information;

(b) they would have to read many requirements that are not applicable to them; and

(c) they would be intimidated by number of requirements they have to understand and apply.

103. A few comment letter respondents said the proposed revenue recognition model would make accounting for straightforward revenue transactions more complex.

Staff analysis

Appendix to the revised Section 23

104. The revenue recognition model proposed by the IASB in the Exposure Draft is more comprehensive than the current model applied by SMEs. As a result, the proposed revised Section 23 is longer than the current Section 23 *Revenue*.

105. The proposed revised Section 23 includes requirements that are considered to be relevant to SMEs based on the application of the IASB's alignment principles.[34] However, some of the requirements only apply to contracts that contain specific features and will not apply to all contracts. Contracts with simple terms and conditions are less likely to contain these features.

106. Most SMEs are expected to enter into revenue contracts with simple terms and conditions. SMEs with contracts with simple terms and conditions would find the

[34] See paragraphs BC29–BC32 of the Exposure Draft.

revised Section 23 easier to navigate if requirements that only apply to contracts that contain specific features are included in an appendix to the Section. Structuring the Section in this way would provide SMEs with a clear pathway for accounting for straightforward contracts.

Educational material

107. The IASB will provide separate educational material on the revised Section 23. The educational material will contain non-mandatory guidance that explains and illustrates the requirements in the Section. The Section's length could be reduced by including non-mandatory guidance in the educational material rather than the Section itself.

108. The SMEIG discussed what factors the IASB should consider when deciding whether guidance belongs in the *IFRS for SMEs* Accounting Standard or in educational material at its meeting in July 2023. Consistent with SMEIG member's suggestions, the staff think:

(a) in general, guidance should be included in the Standard if it meets both of the following factors:

(i) it is relevant to many SMEs; and

(ii) it is necessary to operationalise principles in Standard; and

(b) in general, guidance should be included in educational material if it is:

(i) non-mandatory;

(ii) about specific fact patterns; or

(iii) is not relevant to many SMEs.

109. Consequently, the staff the suggest the requirements and guidance in the revised Section 23 is structured so that:

(a) mandatory requirements are split between the Section and an appendix to the Section; and

(b) non-mandatory guidance is included in educational material on the Section.

110. Appendix A of this paper shows the structure of the proposed revised Section 23. Appendix B of this paper shows the suggested location of the requirements and guidance in the revised Section 23 based on the staff suggestion in paragraph 109 of this paper.

Question for the SMEIG
11. What are your views on the staff suggestion to restructure the proposed revised Section 23 as shown in Appendix B of this paper?

Next steps

111. The feedback from SMEIG members on the staff suggestions will be considered by the IASB during its redeliberation of the proposed revised Section 23.

Appendix A—Structure of the proposed revised Section 23 *Revenue from Contracts with Customers*

Step 1—Identify the contract(s) with a customer

- Criteria for the model
- Combination of contracts
- Contract modifications

Step 2—Identify the promises in the contract

- Distinct goods or services
- Warranties
- Non-refundable upfront fees
- Customer options for additional goods or services
- Principal versus agent considerations

Step 3—Determine the transaction price

- Variable consideration
  - *Sales-based or usage-based royalties*
  - *Refund liabilities*
  - *Sale with a right of return*
- Time value of money
- Non-cash consideration

Step 4—Allocate the transaction price to the promises in the contract

- Allocation based on stand-alone selling prices
- Allocation of a discount
- Allocation of variable consideration
- Changes in the transaction price

Step 5—Recognise revenue when (or as) the entity satisfies a promise

- Promises satisfied over time
- Promises satisfied at a point in time
  - *Customer acceptance*
- Measuring progress towards complete satisfaction of a promise
- Licensing

Appendix B—Suggested restructure of the proposed revised Section 23 *Revenue from Contracts with Customers*

Step 1—Identify the contract(s) with a customer

- Criteria for the model
- Combination of contracts

Step 2—Identify the promises in the contract

- Distinct goods or services
- Customer options for additional goods or services

Step 3—Determine the transaction price

- Variable consideration
- Time value of money

Step 4—Allocate the transaction price to the promises in the contract

- Allocation based on stand-alone selling prices
- Allocation of discounts and variable consideration **[COMBINED]**
- Changes in the transaction price

Step 5—Recognise revenue when (or as) the entity satisfies a promise

- Promises satisfied over time
- Promises satisfied at a point in time
  - *Customer acceptance*
- Measuring progress towards complete satisfaction of a promise

Appendix to the revised Section 23 *Additional guidance*

- Contract modifications
- Warranties
- Principal versus agent considerations
- Non-cash consideration
- Refund liabilities (incorporating Sale with a right of return) **[COMBINED]**
- Licensing
  - *Sales-based or usage-based royalties*

Educational material

- Non-refundable upfront fees
- Examples of factors that indicate a good or service is not distinct
- Methods for estimating stand-alone selling prices