

**Meeting:** International Public Sector Accounting  
Standards Board

**Meeting Location:** Santiago, Chile

**Meeting Date:** March 10–13, 2015

## Agenda Item 12

For:

Approval

Discussion

Information

### Education Session: IFRS 15, *Revenue from Contracts with Customers*

#### Objectives of Agenda Item

1. The objectives of this session are to:
  - (a) **Receive** an education session on the revenue model in IFRS 15; and
  - (b) **Discuss** any issues arising.

#### Materials Presented

Agenda Item 12.1      Background paper on IFRS 15

#### Action Requested

2. The IPSASB is asked to consider the information provided and identify any issues arising.

## **EDUCATION SESSION – IFRS 15, REVENUE FROM CONTRACTS WITH CUSTOMERS**

### **Objectives of this Paper**

1. This paper supports an education session on IFRS 15, *Revenue from Contracts with Customers*. It describes the background to the IASB's project, the core principle of IFRS 15, the 5 Step Revenue Model on which IFRS 15 is based, the impact of IFRS 15 and implementation issues.

### **Background**

2. Prior to IFRS 15 the IASB's two main revenue standards were:
  - (a) IAS 18, *Revenue* which was originally issued in 1982, and reissued in 1993. IPSAS 9, *Revenue from Exchange Transactions* is based on IAS 18; and
  - (b) IAS 11, *Construction Contracts* which was originally issued in 1979. IPSAS 11, *Construction Contracts* is based on IAS 11 (as at December 1993).
3. Both of these standards pre-date the IASB's original conceptual framework. The *Framework for the Preparation and Presentation of Financial Statements* was approved by the IASC Board in April 1989 for publication in July 1989, and adopted by the IASB in April 2001. Because they predate the IASB's Conceptual Framework they were not necessarily consistent with that framework. In particular, they focused more on profit and the earlier concept of matching than on the definitions of assets and liabilities. One of the reasons for undertaking the project was to establish revenue requirements consistent with the IASB's Conceptual Framework.
4. Other reasons for undertaking the project included:
  - (a) A desire to develop converged requirements with US GAAP. US GAAP had some broad revenue recognition concepts but it also had numerous requirements for particular industries or transactions that could result in different accounting for economically similar transactions;
  - (b) IAS 18 and IAS 11 could be difficult to understand and apply; and
  - (c) IAS 18 provided limited guidance on topics such as revenue recognition for multiple-element arrangements.
5. The project was conducted as a joint project between the IASB and the Financial Accounting Standards Board (FASB) and resulted in a converged standard. From the FASB's perspective, the main problem was that it had a number of pronouncements on revenue with specific guidance for various industries. There were issues both with the volume of guidance in the US and the lack of consistency between that guidance.
6. The review of these standards began in 2008 with a Discussion Paper entitled *Preliminary Views on Revenue Recognition in Contracts with Customers*. The first Exposure Draft ED/2010/6 *Revenue from Contracts with Customers* was published in 2010. The second Exposure Draft, ED/2011/6 *Revenue from Contracts with Customers* was published in 2011.

7. 1500 comment letters were received by the IASB and FASB in relation to these due process documents. 650 meetings were also held with various stakeholders. As all entities have revenue transactions there was a high level of interest in the project.
8. IFRS 15 was issued on 28 May 2014. IFRS 15 prescribes when an entity will recognize revenue and how much revenue an entity will recognize. It also requires entities to provide more relevant disclosures to users of financial statements. To assist with implementation issues, the IASB and FASB announced the creation of a Joint Transition Resource Group on Revenue when the Standard was released.

## Scope

9. IFRS 15 supersedes the following standards and interpretations:
  - (a) IAS 18, *Revenue*;
  - (b) IAS 11, *Construction Contracts*;
  - (c) IFRIC 13, *Customer Loyalty Programmes*;
  - (d) IFRIC 15, *Agreements for the Construction of Real Estate*;
  - (e) IFRIC 18, *Transfers of Assets from Customers*; and
  - (f) SIC 31, *Revenue-Barter Transactions involving Advertising Services*.<sup>1</sup>
10. IFRS 15 is a “residual” standard. This means that it applies when the following standards do not apply:
  - (a) IAS 17, *Leases*;
  - (b) IFRS 4, *Insurance Contracts*;
  - (c) IFRS 9, *Financial Instruments*; and
  - (d) The standards dealing with interests in other entities (IFRS 10, *Consolidated Financial Statements*, IFRS 11, *Joint Arrangements*, IAS 27, *Separate Financial Statements* and IAS 28, *Investments in Associates and Joint Ventures*).
11. However, a contract may be partly within the scope of IFRS 15, and partly within the scope of any of the other standards listed above. This means that some entities may need to split revenue into components and account for those components according to the relevant IFRS. If there is guidance in the other relevant standards on how to split the contract into components, that guidance is followed. If not, then IFRS 15 contains some guidance on how to split contracts into components.
12. IFRS 15 applies only to contracts with customers for goods and services in exchange for consideration. It does not apply to collaborative projects with another entity. Nor does it apply to non-monetary exchanges between entities in the same line of business to facilitate sales to customers. These non-monetary exchanges may occur due to geographical proximity to the resource and/or the customer.

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<sup>1</sup> None of the interpretations listed in this paragraph have been considered by the IPSASB. The guidance in these interpretations does not form part of IPSAS 9 or IPSAS 11.

13. The scope requirements in IFRS 15 mean that some entities will have to evaluate the nature of their contractual relationship with other entities in order to determine whether they have a vendor-customer relationship or some other relationship.

### **Core Principle of IFRS 15**

14. The core principle of IFRS 15 is that an entity will recognize revenue for the amount of consideration due to an entity in exchange for the goods and services provided to the customer.
15. This means that:
  - (a) Revenue should be recognized to reflect the transfer of control of the asset to the customer; and
  - (b) The amount of revenue recognized should be equal to the consideration that the entity is entitled to for satisfying the performance obligation.

### **5 Step Revenue Model**

16. The core principle in IFRS 15 is explained by means of a five-step model which is applied to all contracts with customers.
  - (a) Step 1: Identify the contract with the customer. This step involves consideration of whether to combine contracts and the impact of modifying contracts<sup>2</sup> [paras 9-21].
  - (b) Step 2: Identify the performance obligations in the contract. These are promises in a contract to transfer goods and services that are distinct<sup>3</sup> [paras 22-30].
  - (c) Step 3: Determine the transaction price. This step includes consideration of estimates which may be variable. Variable consideration<sup>4</sup> is included only to the extent that it is highly probable that a significant reversal in revenue recognized will not occur when the associated uncertainty is resolved [paras 46-72].
  - (d) Step 4: Allocate the transaction price to the performance obligations in the contract. This step includes consideration of discounts and variable consideration) [paras 73-90].
  - (e) Step 5: Recognize revenue when (or as) the entity satisfies a performance obligation by transferring control of an asset to a customer. This may be at a point in time (typically for goods), or over time (typically for services) [paras 31-45].
17. Step 5 requires that an entity form a judgment about when control of an asset is transferred to the customer. Indicators of the transfer of control at a point in time<sup>5</sup> include (but are not limited to) the following:
  - (a) The entity has a present right to payment for the asset;

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<sup>2</sup> A modification is a change in scope or the approved price, which may result in a new contract or an amendment to the existing contract.

<sup>3</sup> An entity needs to consider whether a customer can benefit from a good or service on its own, and whether it is separately identifiable from other promises in the contract.

<sup>4</sup> These can be based on the occurrence or non-occurrence of a future event, or be discounts, rebates and incentives.

<sup>5</sup> Para 38 of IFRS 15.

- (b) The customer has legal title; or
  - (c) The entity has transferred physical possession to the customer<sup>6</sup>; or
  - (d) The customer has significant risks and rewards of ownership of the asset; or
  - (e) The customer has accepted the asset.
18. Step 5 of the revenue model also requires that an entity assess whether it has satisfied performance obligations. Paragraph 35 of IFRS 15 outlines the criteria used to assess whether an entity has satisfied performance obligations over time and should therefore recognize revenue over time. Appropriate measures of progress include output methods (e.g. units produced or results achieved), and input methods (e.g. costs incurred or time elapsed).
19. Contract costs are dealt with in a separate section of the Standard [paras 91-104] and include costs of obtaining, and fulfilling a contract. The general rule is that contract costs are capitalized if the entity expects to recover the costs. However, the costs of obtaining a contract are expensed if the amortization period would be less than one year. Amortization and impairment rules will apply. There may be some judgment required about which costs may be capitalized.
20. Generally IFRS 15 applies to a single contract, but there is provision in the Standard for its application to a portfolio of contracts.

### Impact of IFRS 15 on Entities

21. As with any new standard, entities will need to reassess their existing accounting policies for various types of transactions and contracts to see if they comply with the provisions of the new standard. This, in itself, creates some work.
22. For many contracts, such as standard retail sales, IFRS 15 will have little, if any effect on the amount and timing of revenue recognition. However for contracts which extend over time, or have multiple elements, IFRS 15 could result in some changes to the amount or timing of revenue recognition. Consequently, although IFRS 15 will have little impact for many entities, in some industries there will be a significant impact to the timing of the recognition of revenue. For some industries distinct portion(s) of revenue will be recognized earlier than under the current standard. For other industries distinct portion(s) of revenue will be recognized later.
23. Particular situations where IFRS 15 is likely to require changes to existing practice include:
- (a) *Multiple element contracts: transaction price allocated on stand-alone selling price:* Current practice limits the consideration allocated to a “satisfied performance obligation” to that consideration which is not contingent on future performance obligations. An example of a multiple element contract is the bundling of the sale of mobile phones with the provision of future network services. Under IFRS 15 the transaction price (being the entry price plus any future monthly payments) is allocated based on the stand-alone selling prices of each item, so a “contingent revenue cap<sup>7</sup>” no longer exists.

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<sup>6</sup> Not applicable to some repurchase arrangements and consignment agreements.

<sup>7</sup> A charge for a mobile phone was based only on future services, and not on the mobile phone price, so no revenue was recognized on sale.

- (b) *Multiple element contracts: partially deferred revenue recognition:* Current practice is to recognize the entire transaction price as revenue even if there are some outstanding performance obligations. For example, a car dealer sells a new car, with free maintenance checks for a specified term, for example 3 years, or distance driven, for example 35,000 kilometers. Under IFRS 15 the sale of the vehicle and subsequent maintenance checks are treated as distinct transactions, and revenue is recognized when each distinct good or service is transferred to the customer.
  - (c) *No stand-alone selling prices: estimation required:* In some contracts, when there is no observable evidence of stand-alone selling prices, current practice is to defer revenue recognition. For example, in the software industry, the price of upgrades are not generally available as stand-alone selling prices. Under IFRS 15 the transaction price will be allocated based on estimated stand-alone selling prices for each distinct good or service.
  - (d) *Licences:* Current guidance for revenue recognition for licences of intellectual property is broad. IFRS 15 provides application guidance<sup>8</sup> for different types of intellectual property licences. The treatment of the three types of licences are:
    - (i) A distinct licence with a right to access intellectual property throughout the licence period – revenue is recognized over time;
    - (ii) A distinct licence with a right to use intellectual property at a point in time – revenue is recognized when the licence is granted; and
    - (iii) An indistinct licence (e.g. software) – revenue is recognized when the bundle of goods and services (including the licence) is transferred to the customer.
24. The new standard also provides a more robust framework to address what might be regarded as weaknesses in existing guidance and practice. Some areas where IFRS 15 provides more detailed or robust guidance include:
- (a) *Timing of Recognition:* Currently there is diversity in practice as to whether revenue is recognized at a point in time, or over time. IFRS 15 provides specified criteria for delayed revenue recognition; otherwise revenue is recognized when the customer obtains control of the good or service.
  - (b) *Variable Consideration:* There is currently no guidance for variable consideration. Under IFRS 15 the entity will estimate the amount of consideration to which it should be entitled only to the extent that it is highly probable that a significant reversal in the amount received will not occur when the uncertainty is resolved.
  - (c) *Financing Component:* When a customer pays in arrears, significant financing may not currently be accounted for by the entity. Under IFRS 15 significant financing components are considered when determining transaction price. However there is no adjustment for financing if the contract is for less than one year.
  - (d) *Disclosure:* Current requirements for disclosure were criticized as being inadequate and presenting revenue in isolation. IFRS 15 requires qualitative and quantitative disclosures about contracts with customers to help investors understand the nature, amount, timing and uncertainty associated with revenue.

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<sup>8</sup> IFRS 15 Application Guidance paragraphs B52-B63.

## Post Release of IFRS 15

25. Generally there has been little comment about IFRS 15 since its release in May 2014.
26. The Joint Transition Resource Group on Revenue has been jointly set up by the IASB and FASB and meets 3 monthly to discuss implementation issues. It will not issue guidance itself, but it may refer matters to IASB and FASB for attention. Forty issues have been submitted to the committee to date. This number of issues is probably not unexpected as a number of entities previously applying US GAAP were accustomed to detailed industry-specific guidance, and, faced with a single revenue standard they are looking for reassurance about how it will work.
27. US constituents consider that additional guidance on the following issues is needed before entities change their systems and processes to implement the standard:
  - (a) Licences of intellectual property;
  - (b) Identification of “distinct” performance obligations in a contract; and
  - (c) Gross versus net reporting.
28. In a joint meeting between the FASB and the IASB in February 2015 the FASB indicated that it wants to amend Topic 606, which is the FASB’s equivalent of IFRS 15. They are seeking more detailed guidance on distinguishing between royalties recognized over time, versus royalties recognized at a point in time. At this stage the IASB is not keen on making changes, unless the Joint Transition Resource Group identifies a fatal flaw.
29. A possible delay in the effective date of the revenue standard in the United States<sup>9</sup> is yet to be discussed by the FASB.

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<sup>9</sup> This effective date of Topic 606, the FASB Revenue standard, is different from the IASB date of 1 January 2017, and varies depending on whether an entity is a public or non-public entity.