Staff paper

Agenda reference: 2

Capital Markets Advisory Committee meeting

Date	**October 2023**
Project	**Post-implementation Review (PIR) of IFRS 15 *Revenue from Contracts with Customers***
Topic	**Request for Information**
Contacts	**Jelena Voilo (jvoilo@ifrs.org)** **Rashida Abdryashitova (rabdryashitova@ifrs.org)**

Purpose of this session

To share your views on the matters raised in Request for Information (RFI) as part of the Post-implementation Review (PIR) of IFRS 15 *Revenue from Contracts with Customers*

Focus of this session

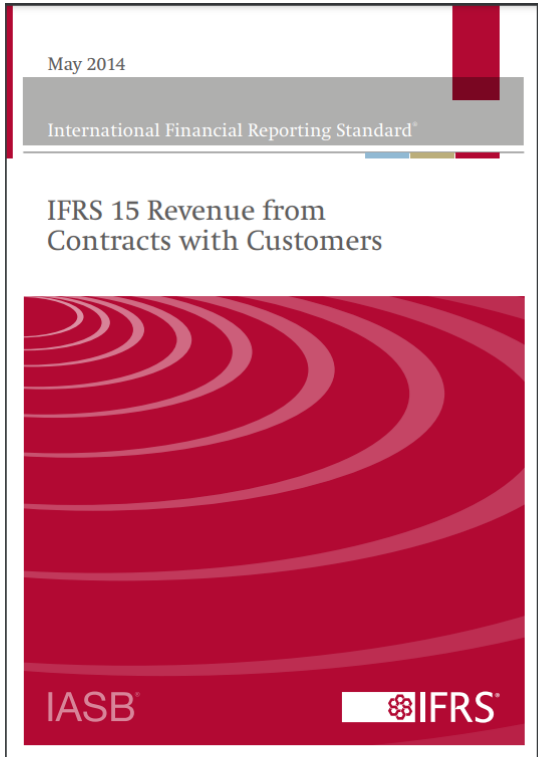
- In October 2022 we heard your initial views on the implementation and application of IFRS 15
- Slides 8–10 set out focus questions for this session

Information for participants

- Slides 4–6 provide background on the project
- Slides 11–37 provide supporting information to consider in answering the focus questions on slides 8–10

Background

IFRS 15 at a glance



Comprehensive principle-based framework for the recognition, measurement and disclosure of revenue

- Greater rigour in revenue accounting
- More useful information through improved disclosure requirements
- Reduced need for interpretive guidance to be developed on a case-by-case basis
- Enhanced comparability across companies, industries and capital markets

Substantially converged with US GAAP (Topic 606)

Effective from 1 January 2018

PIR—objective and process

Assess whether the **effects** of applying the new requirements on users of financial statements, preparers, auditors and regulators are those the IASB **intended** when it developed the requirements

PIR—how does the IASB respond to identified matters?

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

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

benefits to users are significantly lower than expected

costs of application are significantly greater than expected

2 Determine prioritisation based on whether:

matter has **substantial consequences**

matter is **pervasive**

matter **can be addressed** by the IASB or the IFRS Interpretations Committee (IC)

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

3 Determine the timing of any action

High priority	address as soon as possible
Medium priority	add to the IASB or the IC research pipeline
Low priority	consider in the next agenda consultation
No action	no further action

Questions for the session

Questions for CMAC members

1	**Disclosures** (slides 11–18)	• Do the disclosure requirements in IFRS 15 result in companies providing information useful for your analyses? • Have you observed significant variation in the quality of disclosed revenue information?
2	**Principal vs agent** (slides 19–21)	• Do companies provide disclosures sufficient for you to understand their judgement on whether they are a principal or an agent? • Do you observe unexpected diversity in reporting revenue net/gross among similar companies?
3	**Consideration payable to a customer** (slides 22–24)	• Do companies provide disclosures sufficient for you to understand their judgement on the nature of consideration payable to a customer? • Do you observe diversity in how consideration payable to customers is presented in the financial statements you analyse?

Questions for CMAC members

4	**Timing of revenue recognition** (slides 25–27)	• Do companies provide sufficient information for you to understand when they recognise revenue (over time vs. at a point-in-time)? • Do you observe unexpected diversity in judgements on the timing of revenue recognition made by similar companies?
5	**Licensing** (slides 28–30)	• Do companies provide sufficient information for you to understand when they recognise revenue from licences? • Do you observe unexpected diversity in judgements on the timing of revenue recognition made by similar companies?

Questions for CMAC members

6	**Application with IFRS 3 *Business Combinations*** (slides 31–34)	• Have you come across significant fair value adjustments to contract assets or contract liabilities on business acquisitions? • Did the adjustments affect the usefulness of information when you analysed the company's financial statements?
7	**Identifying performance obligations** (slides 35–37)	• Do you find the split of revenue made by companies useful? Do you base your analysis on the separate performance obligations identified by preparers? • Do you see unexpected diversity in the performance obligations identified by similar companies?

1 Disclosures

Background

Disclosure requirements enhanced to improve the usefulness of information about the **nature, amount, timing and uncertainty of revenue**.

Required disclosures include:

a. revenue from contracts with customers, including disaggregation of revenue;

b. contract balances, including reasons for significant changes in contract assets and contract liabilities;

c. impairment losses on receivables or contract assets;

d. performance obligations, including transaction price allocated to remaining performance obligations and expected timing of revenue recognition;

e. significant judgements and changes in judgements;

f. assets recognised from contract costs;

g. practical expedients used, if any.

1 Disclosures

Initial feedback

- Improvement seen in the usefulness of disclosed information.
- Some concerns relate to:
  - costs of providing some disclosures potentially exceeding their usefulness. For example, preparers raised concerns about disclosures relating to:
    - contract assets and contract liabilities (see slides 15–17)
    - remaining performance obligations (see slide 18)
  - some companies not providing the information required

IFRS Accounting

1 Disclosures

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Questions

a. **Do the disclosure requirements in IFRS 15 result in companies providing information useful for your analyses?**
- Which IFRS 15 disclosures are particularly useful and why?
- What type of disaggregation do you find most useful and why? (see slide 14)
- Do you find disclosures about contract assets, contract liabilities and remaining performance obligations useful (see slides 15–18)? If so, how do you use this information in your analyses?
- Are there any disclosures that do not provide useful information?

b. **Have you observed significant variation in the quality of disclosed revenue information?**
- If so, what in your view causes such variation and what steps could the IASB take to improve the quality of information provided?

1 Illustration 1: Disaggregation of revenue

Segments – primary geographical markets	Consumer products	Transport	Total
Asia	990	2,250	3,240
Europe	300	750	1,050
North America	700	260	960
Sub-total	**1,990**	**3,260**	**5,250**
Major goods/services			
Office supplies	1,000	-	1,000
Appliances	990	-	990
Automobiles	-	2,760	2,760
Support services	-	500	500
Sub-total	**1,990**	**3,260**	**5,250**
Timing of revenue recognition			
Goods transferred at a point in time	1,990	2,760	4,750
Services transferred over time	-	500	500
Sub-total	**1,990**	**3,260**	**5,250**

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IFRS 15 gives examples of categories that might be used for disaggregation:

- type of good or service
- geographical region
- market or type of customer
- type of contract
- contract duration
- timing of transfer of goods or services
- sales channels

1 Illustration 2: Contract balances

Statement of financial position (Balance Sheet) – 31 December 2022

	2022	2021
Non-current assets		
Goodwill	1,000	1,000
…	…	…
Contract assets (note 1)	60	70
Contract costs	120	100
…	…	…
	2,000	**1,900**
Current assets		
Contract assets (note 1)	150	120
Contract costs	180	150
Trade receivables	900	800
…	…	…
	3,000	**2,500**
Total assets	**5,000**	**4,400**

	2022	2021
Equity	**600**	**500**
Non-current liabilities		
Loans	2,000	2,200
Contract liabilities (note 2)	70	50
…	…	…
	2,200	**2,300**
Current liabilities		
Loans	500	400
Contract liabilities (note 2)	130	50
…	…	…
Trade payables	1,000	1,100
	2,200	**1,600**
Total equity and liabilities	**5,000**	**4,400**

1 Illustration 2: Contract balances (cont.)

Note 1 – Contract assets

Contract assets (unbilled revenue) usually arise when revenue is recognised over time for milestone payments conditional on customer acceptance. The increase in contract assets during the year is attributable to the progress of construction projects ahead of billings.

	31 December 2022	31 December 2021
Contract assets		
Current	150	120
Non-current	60	70
	210	**190**

IFRS 15
requires companies:
- to disclose opening and closing balances of contract assets
- to provide explanation of the significant changes in contract assets during the reporting period

1 Illustration 2: Contract balances (cont.)

Note 2 – Contract liabilities

Contract liabilities (advance payments from customers) relate to amounts received prior to transferring goods or services to a customer. The increase in contract liabilities during the year is mainly attributable to the launch of the new apartment construction site in City A. Of the amount of contract liabilities at 31 December 2021, 50 has been recognised in revenue during the year ended 31 December 2022.

	31 December 2022	31 December 2021
Contract liabilities		
Current	130	50
Non-current	70	50
	200	**100**

IFRS 15 requires companies to disclose:

- opening and closing balances of contract liabilities
- significant changes in contract liabilities during the reporting period
- revenue recognised in the reporting period that was included in the contract liability balance at the beginning of the period

1 Illustration 3: Remaining performance obligations

Company 1: The amount of the company's revenue allocated to performance obligations not satisfied at 31 December 2022 is 20,000, of which 12,000 is expected to be recognised within the next year and the majority of the remaining amount in the following 12 months.

Company 2: Unfulfilled performance obligations and when they are expected to be satisfied:

	31 December 2022
Less than one year	15,000
1 to 2 years	5,000
2 to 3 years	1,000
3 to 4 years	1,500
4 to 5 years	500
More than 5 years	2,000
Total remaining performance obligations	**25,000**

2 Principal vs agent

Background

- A company's judgement on whether it acts as a principal or an agent determines whether revenue is presented gross or net.
- A company determines whether it is a principal or an agent based on who controls the good or service before it is transferred to the customer.

Initial feedback

- Subjectivity of judgements may lead to diversity in accounting for similar fact patterns (see slide 20).
- This diversity may affect users applying revenue-based valuation models.

2 Illustration 4: Principal vs agent – Income Statement

Year to 31 December	Principal (gross revenue) 2022	Principal (gross revenue) 2021	Agent (net revenue) 2022	Agent (net revenue) 2021
Revenue	**12,200**	**10,600**	**10,000**	**9,500**
Cost of revenue	(6,200)	(5,000)	(4,000)	(3,900)
Sales and marketing	(500)	(400)	(500)	(400)
General and administrative	(1,850)	(1,900)	(1,850)	(1,900)
…	…	…	…	…
Operating profit	**2,400**	**2,000**	**2,400**	**2,000**
Financing costs	(300)	(250)	(300)	(250)
Profit before tax	**2,100**	**1,750**	**2,100**	**1,750**
Income tax	(420)	(350)	(420)	(350)
Profit for the year	**1,680**	**1,400**	**1,680**	**1,400**

Both revenue and cost reduced by 2,200

Both revenue and cost reduced by 1,100

2 Principal vs agent

Questions

a. **Do companies provide disclosures sufficient for you to understand their judgement on whether they are a principal or an agent?**
   - If not, what information is missing?

b. **Do you observe unexpected diversity in reporting revenue net/gross among similar companies?**

3 Consideration payable to a customer

Background

- If a company pays its customer for distinct goods or services received from the customer, the payment is recognised as the company's **expense**; otherwise – as a **reduction of revenue** from the customer.

Initial feedback

- Subjectivity of judgements may lead to diversity in accounting for similar fact patterns. For example:
  - incentives to end customers in a multi-party arrangement are presented either as a reduction of revenue or as marketing expenses
  - when large one-off expenses to attract customers exceed consideration receivable from a customer, the excess is presented as 'negative' revenue or as an expense
- This diversity may affect users applying revenue-based valuation models.

3 Illustration 5: Consideration payable to a customer – P&L

A food delivery company offers incentives to end customers who order food delivery through its digital platform

	Consideration payable presented as an expense		Consideration payable presented as a revenue reduction	
Year to 31 December	**2022**	**2021**	**2022**	**2021**
Revenue	**11,200**	**10,500**	**10,000**	**9,500**
Cost of revenue	(5,250)	(5,200)	(5,250)	(5,200)
Sales and marketing	(1,700)	(1,400)	(500)	(400)
General and administrative	(1,850)	(1,900)	(1,850)	(1,900)
…	…	…	…	…
Operating profit	**1,400**	**1,000**	**1,400**	**1,000**
Financing costs	(300)	(250)	(300)	(250)
Profit before tax	**1,100**	**750**	**1,100**	**750**
Income tax	(220)	(150)	(220)	(150)
Profit for the year	**880**	**600**	**880**	**600**

Both revenue and expense reduced by 1,200

Both revenue and expense reduced by 1,000

3 Consideration payable to a customer

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Questions

a. **Do companies provide disclosures sufficient for you to understand their judgement on the nature of consideration payable to a customer?**
   - If not, what information is missing?

b. **Do you observe diversity in how consideration payable to customers—in particular, customer incentives and 'negative revenue'—is presented in the financial statements you analyse?**
   - Does the diversity, if any, significantly affect your analysis of revenue?

4 Timing of revenue recognition

Background

- A company recognises revenue when (or as) the company transfers a good or a service to a customer, which is when (or as) the customer obtains control of that good or service.

Initial feedback

- Some companies found it challenging to assess whether to recognise revenue over time or at a point in time.

4 Illustration 6: Timing of revenue recognition

Examples of accounting policies disclosures

Construction company A (at a point in time and overtime revenue recognition)

For the majority of contracts, there is a single performance obligation for which revenue is recognised **at a point in time**, when construction has been completed and control is transferred to the customer. The company recognises revenue **over time** in relation to certain contracts only in circumstances in which control of the associated land is transferred to the customer before or during construction.

Construction company B (at a point in time and overtime revenue recognition)

Revenue from condominiums sold off-plan* with land is recognised at the time the construction is complete and real estate is delivered to the customer.

Custom-built houses are constructed on the customer's land. The customer controls the asset as the performance obligation is satisfied. Accordingly, revenue is recognised over the term of the contract with the customer based on the percentage of completion calculated considering cost incurred to date.

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* After a construction plan is prepared, but before construction is complete

4 Timing of revenue recognition

Questions

a. **Do companies provide sufficient information for you to understand when they recognise revenue?**

b. **Do you observe unexpected diversity in judgements on the timing of revenue recognition made by similar companies?**
   - If so, what types of companies are affected and are their disclosures sufficient to understand the differences in companies' judgements?

5 Licensing

Background

- A company determines whether the promise to grant a licence is distinct from other goods or services promised in a contract
- A company considers the nature of the licence to determine whether the licence transfers to a customer either at a point in time or over time

Initial feedback

- Some application questions and diversity in practice relating to:
  - determining whether an arrangement is a licensing arrangement
  - identifying performance obligations in arrangements including goods or services and a licence
  - accounting for licence renewals

5 Illustration 7: Licensing

Example of accounting policies – software service company

We derive our revenue from fees charged to our customers for the use of our cloud offerings, for licences to our on-premise software products*, and for support services, consulting, customer-specific software developments, training and other services. Typically, these products and services qualify as separate performance obligations in a contract. Judgment is required, however, in determining whether a good or service is considered a separate performance obligation depending on whether such services significantly integrate, customize, or modify the on-premise software or cloud service to which they relate.

Revenue from **cloud-based** solutions, where a customer has the right to access a software solution over a specified time period, is spread evenly **over the period** that the service is available.

Revenue from **standard on-premise** software licences is recognised at **the point in time** when we grant the license rights to the customer and the customer has access to and control over the software. For **customer-specific on-premise** software, we recognise revenue **over time** as the software development progresses.

* Software that is installed on computers in the customer's premises

5 Licensing

Questions

a. **Do companies provide sufficient information for you to understand when they recognise revenue from licences?**

b. **Do you observe unexpected diversity in judgements on the timing of revenue recognition made by similar companies?**
   - If so, what types of companies are affected and are their disclosures sufficient to understand the differences in companies' judgements?

6 Application with IFRS 3 *Business Combinations*

Background

- IFRS 3: when a company acquires contract assets or contract liabilities in a business combination, it recognises them at fair value as of the date of acquisition. Fair value may differ from the IFRS 15 measurement which is based on transaction price.
- Fair value adjustments could affect subsequent revenue recognition and goodwill.

Initial feedback

- Some stakeholders suggested that contract balances continue to be measured at their previous transaction prices after the business combination. They noted that the FASB amended its standard to require a company to recognise contract assets and contract liabilities based on transaction price rather than fair value[1].

[1] Amendments to Topic 805 *Business Combinations* effective from 1 January 2023.

6 Illustration 8: Contract liabilities – licence

- **Acquirer acquires Target (TC) in a business combination on 1 January 20X1.**
- **A year before the acquisition, TC granted a customer a 5-year character images licence in exchange for an upfront payment of 10,000.**
- **The licence is a right to access the IP, so revenue is recognised over the term of the contract.**

Before acquisition (IFRS 15)

1 January 20X1	
Contract liabilities	8,000

If there were no acquisition (IFRS 15)

Jan 20X1 to Dec 20X4	
Revenue per year	2,000

Vs.

At acquisition (IFRS 3)

1 January 20X1	
Contract liabilities	100

Fair value of contract liabilities

- ✓ Fair value is estimated as post-acquisition period costs + profit
- ✓ For the character images licence post-acquisition period costs are minimal after providing the licence

After acquisition (IFRS 15)

Jan 20X1 to Dec 20X4	
Revenue per year	25

6 Illustration 9: Contract liabilities – software as a service (SaaS)

- **Acquirer (AC) acquires Target (TC) in a business combination on 1 January 20X1.**
- **A year before the acquisition, TC entered into a 3-year contract with a customer for a SaaS solution, including maintenance and unspecified upgrades in exchange for an upfront payment of 12,000.**

Before acquisition (IFRS 15)

1 January 20X1	
Contract liabilities	8,000

If there were no acquisition (IFRS 15)

Jan 20X1 to Dec 20X2	
Revenue per year	4,000

Vs.

At acquisition (IFRS 3)

1 January 20X1	
Contract liabilities	4,000

After acquisition (IFRS 15)

Jan 20X1 to December 20X2	
Revenue per year	2,000

Fair value of contract liabilities

- ✓ Fair value is estimated as post-acquisition period costs + profit
- ✓ AC determines the FV based on AC's analysis of costs to provide the SaaS in the post-acquisition period

6 Application with IFRS 3 *Business Combinations*

Questions

a. **Have you come across significant fair value adjustments to contract assets or contract liabilities on business acquisitions?**
   - If so, what did those adjustments relate to?

b. **Did the adjustments affect the usefulness of information when you analysed the company's financial statements?**

7 Identifying performance obligations

Background

- Identifying performance obligations in a contract affects the pattern of revenue recognition in the company's financial statements.
- Basis for identification—is a good or service being transferred distinct?

Initial feedback

- Some challenges identifying performance obligations for arrangements involving:
  - internally developed or digital products
  - contract modifications
  - licensing
  - principal-agent

7 Illustration 10: Examples of performance obligations in various industries

Telecoms			
Bundle 1	**Bundle 2**	**Bundle 3**	**Bundle 4**
Handset	Router	Tablet	Dongle
Communication service (tariff plan)	Communication service (tariff plan)	Communication service (tariff plan)	Communication service (tariff plan)

Pharma
Instruments
Reagents
Services

IT
Software licence (including upgrades)
Support services
Consulting services
Customer-specific software developments
Training services

7 Identifying performance obligations

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Questions

a. Do you find the split of revenue made by companies useful? Do you base your analysis on the separate performance obligations identified by preparers?

b. Do you see unexpected diversity in the performance obligations identified by similar companies?

IFRS Accounting

Thank you