Staff paper

Agenda reference: 30A

IASB® meeting

Date	**March 2024**
Project	**Second Comprehensive Review of the *IFRS for SMEs®* Accounting Standard**
Topic	**Proposed revised Section 23 *Revenue from Contracts with Customers*—Redeliberation topics**
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Introduction

1. The International Accounting Standards Board (IASB) proposed to revise Section 23 *Revenue* of the *IFRS for SMEs* Accounting Standard to align it with IFRS 15 *Revenue from Contracts with Customers* in the Exposure Draft *Third edition of the* IFRS for SMEs *Accounting Standard* (Exposure Draft). This paper discusses six topics where stakeholders requested changes to, or raised concerns about, the requirements proposed in the Exposure Draft.

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

Purpose of the paper

3. The purpose of this paper is to ask the IASB:

   (a) to consider feedback on six topics where stakeholders requested changes to, or raised concerns about, the requirements proposed in Section 23 *Revenue from Contracts with Customers* of the Exposure Draft; and

   (b) to decide whether to change the proposed requirements.

Staff recommendations

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

Table 1—Summary of recommended changes to Section 23 *Revenue from Contracts with Customers* of the Exposure Draft

Topic	Recommended change(s) to the requirements proposed in the Exposure Draft	Paragraph reference
Change the proposed requirements		
Warranties	• Remove the requirement for an SME to determine if a warranty—that a customer does not have the option to purchase separately—is significant to the contract (that is, remove the simplification proposed in the Exposure Draft) • Instead, require an SME to account for a warranty as a separate promise only if the customer has the option to purchase the warranty separately.	18–30
Principal versus agent considerations	• Remove the requirement for an SME to determine whether it is a principal or agent based on whether it meets the circumstances in paragraph 23.38 of the Exposure Draft (that is, remove the simplification proposed in the Exposure Draft) • Instead, require an SME to determine whether it is a principal or agent based on the principle and indicators of control in IFRS 15.	31–49
Repurchase agreements	Require an SME that is evaluating whether a customer obtains control of an asset to consider any agreement to repurchase the asset.	50–60

continued…

Topic	Recommended change(s) to the requirements proposed in the Exposure Draft	Paragraph reference
Withdraw the proposed requirements		
Customers' unexercised rights (breakage)		61–78
Retain the proposed requirements		
Contract balances		79–89
Retain the proposed requirements with changes		
Criteria for over time revenue recognition	Include the assumptions in paragraph B4(a)–(b) of IFRS 15.	90–112

Structure of the paper

5. This paper is structured as follows:
   (a) background (paragraphs 7–16);
   (b) redeliberation topics (paragraphs 17–112); and
   (c) next steps (paragraph 113); and
   (d) Appendix—Figures illustrating the recommended change to the proposed requirements for warranties.

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

Background

7. Section 23 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, 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 a good or service is transferred to a customer, determined as when the customer obtains control of the good or service.

9. In the Exposure Draft, 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 costs for SMEs of applying the revised Section 23.

10. Feedback was provided on Section 23 of the Exposure Draft through comment letters and outreach events. Fieldwork on the Section was also carried out with accounting practitioners involved in the preparation of SMEs' financial statements. The feedback generally agreed with the IASB's proposals to revise Section 23 to align it with IFRS 15. However, stakeholders had concerns about some of the proposals in the Exposure Draft.

11. Stakeholders identified topics on which they would like the proposed requirements to be:

    (a) simplified further; or

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

12. Some stakeholders had general concerns that the proposed revised Section 23 was too long and complex for SMEs. A few comment letter respondents (respondents) had concerns that the IASB was not considering insights from the IASB's post-implementation review (PIR) of IFRS 15 as it developed its proposals for the *IFRS for SMEs* Accounting Standard.

13. At its meeting in October 2023, the IASB considered feedback on the proposals to revise Section 23 to align it with IFRS 15. The IASB decided to proceed with revising Section 23 to reflect the principles in IFRS 15.[1] The IASB also discussed how to respond to stakeholder's concerns about the proposals.

14. To respond to concerns about specific requirements in the proposed revised Section 23, the staff suggested the IASB redeliberate topics on which stakeholders had requested changes to, or raised concerns about, the requirements.[2] At its February 2024 meeting, the IASB discussed eight of the 15 topics the staff suggested.[3] The IASB tentatively decided to make changes to the proposed requirements for these

[1] See IASB *Update* from the October 2023 IASB meeting.

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

[3] See IASB *Update* of the February 2024 IASB meeting.

topics. The changes are listed in the appendix to Agenda Paper 30 *Cover paper* for this meeting. This paper discusses six additional topics. The staff plan to bring a paper on the remaining topic—disclosure requirements—to the April 2024 IASB meeting.

15. To respond to concerns about the length and complexity of the proposed revised Section 23, the staff suggested exploring ways:

    (a) to reduce the length of the Section, and

    (b) to use plainer language to express the requirements in the Section.

16. To respond to concerns about the interaction between the project and the PIR of IFRS 15, the staff suggested drawing on relevant PIR feedback during the IASB's discussions on the revised Section 23. This paper references information gathered during the PIR of IFRS 15.

Redeliberation topics

17. For each topic, the paper provides:

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

    (b) a summary of the feedback received;

    (c) staff analysis of the feedback; and

    (d) a staff recommendation on whether and how to change the proposed requirements.

Determining whether to account for a warranty as a separate promise

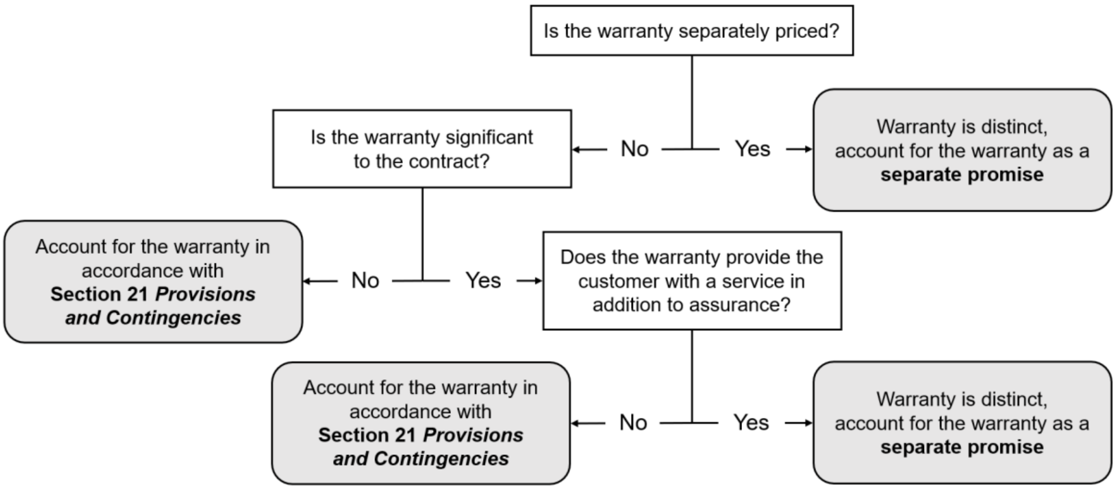
18. IFRS 15 requires an entity to account for a warranty as a separate performance obligation if a customer has the option to purchase the warranty separately.[4] If a customer does not have the option to purchase a warranty separately, an entity

[4] Paragraph B29 of IFRS 15 *Revenue with Contracts with Customers*.

accounts for the warranty 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.[5]

19. The IASB proposed requirements in the Exposure Draft similar to those described in paragraph 18 of this paper. However, the IASB proposed to require SMEs to 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 'proposed simplification').[6] The proposed requirements are illustrated in Figure 1 of this paper.

Figure 1—Summary of the requirements for warranties proposed in the Exposure Draft



Feedback received

20. Some respondents (mostly accounting firms and accounting bodies) who commented on Section 23 of the Exposure Draft said the proposed simplification would involve substantial judgement and add complexity to the *IFRS for SMEs* Accounting

[5] Paragraph B30 of IFRS 15.

[6] Paragraphs 23.25–23.28 of the Exposure Draft *Third edition of the* IFRS for SMEs *Accounting Standard* (Exposure Draft).

Standard. They asked for guidance and illustrative examples to help SMEs assess if a warranty is significant to a contract.

21. Most fieldwork participants who were unfamiliar with IFRS 15 were able to identify if a warranty should be accounted for as a separate promise or not. Some fieldwork participants described the nature of the warranties sold by SMEs (see paragraph 25 of this paper).

Staff analysis

22. When developing the Exposure Draft, the assessment of whether a warranty (or part of a warranty) provides a customer with a service in addition to the assurance that the product complies with agreed-upon specifications (the 'assessment') was identified as challenging for SMEs.

23. When a warranty (or part of a warranty) provides a customer with a service in addition to the assurance that the product complies with agreed-upon specifications, and the warranty is not separately priced, the assessment would ensure SMEs account for the warranty as a separate promise. If an SME did not account for the warranty as a separate promise, the SME would recognise revenue attributable to the service when the product is transferred to the customer. This would result in revenue attributable to the service being recognised prematurely. Therefore, the assessment prevents SMEs recognising revenue prematurely if:

    (a) SMEs sell warranties that are not separately priced (that is, they sell products with non-optional warranties); and

    (b) those warranties provide customers with a service in addition to the assurance that the product complies with agreed-upon specifications.

24. The proposed simplification would require SMEs to make the assessment only if the warranty is *significant to the contract*. The proposed simplification was intended to relieve SMEs from the challenge of making the assessment in instances where accounting for a warranty as a separate promise would not significantly change the

pattern of revenue recognition. However, feedback suggests the proposed simplification would add complexity to the *IFRS for SMEs* Accounting Standard by introducing a new judgement. Therefore, the staff recommend withdrawing the proposed simplification in the revised Section 23.

25. Feedback from fieldwork participants indicates that warranties sold by SMEs often provide customers with assurance that products comply with agreed-upon specifications and generally do not provide customers with additional services. Feedback from fieldwork participants also indicates that SMEs often have no further obligations in respect of the warranties they sell, because other parties provide the assurance or services associated with the warranties (for example, a third party or the manufacturer of the product sold). In contracts where a warranty provides a customer with an additional service, the service is usually incidental to the product sold. Consequently, revenue attributable to the service is not expected to be significant to the contract.

26. The feedback and analysis in paragraph 25 of this paper suggests that instances when SMEs sell warranties that provide customers with a service in addition to the assurance that the product complies with agreed-upon specifications are rare. Therefore, instances where the assessment would prevent SMEs recognising revenue attributable to the service prematurely are expected to be rare. Also, in instances where SMEs sell warranties that provide customers with an additional service, the assessment would be expected to have a limited effect on the timing of revenue recognised. For these reasons, the staff recommend SMEs are not required to make the assessment. As a consequence of this recommendation, SMEs would account for a warranty as a separate promise only if a customer has the option to purchase the warranty separately. This would mean SMEs account for warranties by applying a simple test based on a single observable factor, which would reduce the judgement required to apply the revised Section 23. The appendix to this paper illustrates the recommended change to the proposed requirements.

27. The SME Implementation Group (SMEIG) considered the staff recommendation in paragraph 26 of this paper when it met in December 2023. SMEIG members generally agreed with the recommendation. Two SMEIG members said not requiring SMEs to make the assessment could lead to SMEs recognising revenue prematurely in some instances. The staff analysis in paragraph 26 identifies such instances as rare. Also, in most of these instances, not accounting for the warranty as a separate promise is expected to have a limited effect on the timing of revenue recognised. Consequently, the staff think it is unnecessary to require SMEs to make the assessment.

Interaction with principal versus agent considerations

28. Feedback from fieldwork participants indicates that SMEs often sell warranties where the assurance or services associated with the warranties are provided by other parties (see paragraph 24 of this paper). In such instances, an SME might be acting as an agent with respect to the warranties it sells.

29. The requirements proposed in the Exposure Draft for principal versus agent would require an SME to assess whether it is acting as a principal or agent for promises to transfer distinct goods or services.[7] As a consequence of the recommendation in paragraph 26 of this paper, an SME would not assess whether it is acting as a principal or agent for a warranty transferred to a customer if that warranty is not separately priced and provides the customer with a service in addition to the assurance that the product complies with agreed-upon specifications. Instead, the SME would assess whether it is acting as a principal or agent for a warranty based on its promise to transfer the combined bundle of the product and warranty. If an entity sells a product with such a warranty, and concludes that it is a principal with respect to the product and an agent with respect to the warranty, the entity would be expected to recognise revenue it is entitled to in exchange for the warranty:

[7] Paragraph 23.37 of the Exposure Draft.

(a) at the net amount if applying IFRS 15; and

(b) at the gross amount if applying the requirement recommended in paragraph 26 of this paper.

30. The different outcomes described in paragraph 29 of this paper would occur only if an SME acted as both a principal and agent in the same contract. Although SMEs typically sell products with warranties that are provided by other parties, in most instances an SME purchases both the product and the right to the warranty in advance of selling them to customers. Consequently, the SME would control the right to the warranty prior to its sale and would be the principal with respect to both the product and the warranty. Therefore, the scenario described in paragraph 29 is expected to be rare. If the scenario occurs, revenue attributable to the service is not expected to be significant to the contract (see paragraph 24 of this paper) and the effect of accounting for revenue gross, instead of net, is not expected to be significant. For these reasons, the staff think it is unnecessary to specify requirements for this scenario in the revised Section 23.

Question for the IASB
1. Does the IASB agree to require an SME to account for a warranty as a separate promise only if the customer has the option to purchase the warranty separately?

Principal versus agent considerations

31. IFRS 15 includes a principle that determines whether an entity is acting as a principal or agent. The principle is based on the nature of the entity's promise and on whether the entity controls the good or service before it is transferred to the customer. Applying IFRS 15:

    (a) a principal controls the good or service before it is transferred to a customer; and

    (b) an agent does not control the good or service before it is transferred to a customer.[8]

32. To help an entity assess whether it controls a good or service before it is transferred to the customer, IFRS 15 provides a non-exhaustive list of three indicators of control.[9]

33. The Exposure Draft set out three circumstances that would result in an SME acting as a principal. If none of the circumstances were to apply, the SME would be an agent. The circumstances were based on the principle and one of the indicators of control in IFRS 15.[10] The Exposure Draft reframed the principle and indicator of control in IFRS 15 as circumstances so an SME would determine whether it is a principal or agent based on a limited number of factors. This was proposed to make determining whether an entity is a principal or agent more prescriptive compared with IFRS 15 and, thus, easier for SMEs to apply.

Feedback received

34. Among the comment letter feedback on Section 23 of the Exposure Draft, principal versus agent was the most common topic raised. Of the respondents who commented on the Section, many respondents (mostly accounting firms and accounting bodies)

[8] Paragraphs B34–B36 of IFRS 15.

[9] Paragraph B37 of IFRS 15

[10] Paragraph 23.38 of the Exposure Draft.

suggested changing the proposed requirements for principal versus agent to align with IFRS 15.

35. All fieldwork participants were able to determine if an SME is a principal or agent based on the requirements proposed in the Exposure Draft.

Staff analysis

Different outcome

36. The requirements for principal versus agent in IFRS 15 were reframed in the Exposure Draft to make the requirements easy for SMEs to apply. Fieldwork with accounting practitioners found that the requirements could be applied by SMEs, which indicates that this objective was met. However, the most common concern among respondents who suggested aligning the requirements in the revised Section 23 with IFRS 15 was that the proposed requirements in the Exposure Draft could result in outcomes that differ from the outcomes of applying IFRS 15. Respondents' concerns are similar to other areas of the proposed revised Section 23, where the IASB proposed simplifications to the requirements in IFRS 15 that could result in different outcomes.

37. The proposed requirements for principal versus agent reframed the principle and indicator of control in IFRS 15 so:

    (a) the principle of control in IFRS 15 would be 'downgraded' to a circumstance (or criterion);

    (b) the indicator of control in paragraph B37(a) of IFRS 15 ('the entity is primarily responsible for fulfilling the promise to provide the specified good or service') would be 'promoted' to a circumstance (or criterion); and

    (c) the indicators of control in paragraph B37(b)–(c) of IFRS 15 would not be included in the revised Section 23.

38. The simplifications described in paragraph 37 of this paper would result in different outcomes only if an entity is primarily responsible for fulfilling the promise to provide the specified good or service to a customer, but the entity does not control the good or service before it is transferred to the customer. In that scenario, the entity would conclude it is:

(a) a principal if applying the requirements proposed in the Exposure Draft; and

(b) an agent if applying IFRS 15.

39. Such a scenario was identified during outreach. In one jurisdiction, arrangements between online platforms and sellers often specify that the entity providing the platform has legal responsibility for fulfilling the promise to provide the specified good or service to a customer. In these arrangements, the SME that provides the platform would always meet the criterion in paragraph 23.38(a) of the Exposure Draft and therefore would be a principal. This would be the case even when the SME providing the platform does not control the goods or services before transferring them to the customer. In these instances, the entity would be an agent if applying IFRS 15 (as explained in paragraph 38 of this paper).

40. Comparability between SMEs and listed entities was not an important consideration when the *IFRS for SMEs* Accounting Standard was developed.[11] However, in the scenario described in paragraph 39 of this paper, the entity providing the platform would always recognise revenue on a gross basis if it applied the requirements proposed in the Exposure Draft. In instances where the SME providing the platform does not control the goods or services before transferring them to the customer, recognising revenue on a gross basis would not faithfully represent the entity's performance. This is because the SME facilitates the sale of the goods or services by arranging for another party to provide the goods or services to the customer. In such instances, recognising revenue on a net basis would more faithfully represent the entity's performance and provide more useful and relevant information to users.

[11] Paragraph BC187 of the *IFRS for SMEs* Accounting Standard.

41. The scenario described in paragraph 39 of this paper is specific to one jurisdiction. However, instances in which platform providers assume responsibility for fulfilling promises to customers may occur in other jurisdictions. SMEs commonly sell on online platforms, although it is less common for SMEs to provide such platforms. However, when an SME does so as its main business activity, the difference between revenue recognised by the SME if it applied IFRS 15 compared with revenue recognised if applying the proposed revised Section 23 would be substantial.

42. The SMEIG discussed the requirements for principal versus agent when it met in July 2023. SMEIG members had mixed views on whether the requirements in IFRS 15 and the revised Section 23 should be the same. One member said different outcomes in this area could result in SMEs and entities applying IFRS 15 coming to different conclusions in similar situations. In that member’s view, the consequence of different outcomes in this area is more substantial than in other areas of Section 23. This is because in other areas, different outcomes often result in differences in the timing of revenue recognised, which would be resolved once the contract is complete. For principal versus agent considerations, different outcomes result in an entity recognising revenue either gross or net of amounts payable to the supplier. This affects both the amount of revenue recognised as well as profit margins.

More difficult assessment

43. One SMEIG member said it would be difficult to assess whether an SME controls a good or service before it is transferred to a customer if any of the indicators of control in IFRS 15 are omitted from the revised Section 23. Similarly, most of the respondents that suggested changes to the proposed requirements for principal versus agent suggested including the indicators of control in IFRS 15 in the revised Section 23 to help SMEs make this assessment.

Different assessment

44. Section 23 of the *IFRS for SMEs* Accounting Standard includes no requirements on principal versus agent considerations. The IASB proposed requirements for principal

versus agent in the revised Section 23 because the topic was considered relevant to SMEs based on application of the IASB's alignment principles.[12] A few respondents said SMEs currently refer to IFRS 15 to determine whether they are a principal or agent. If the requirements for principal versus agent in IFRS 15 and the revised Section 23 were different, SMEs would be required to determine whether they are a principal or agent based on the requirements in the revised Section 23. As discussed in paragraph 38 of this paper, an SME might reach a different conclusion compared with its previous assessment if it had previously referred to IFRS 15.

45. The IASB's alignment approach requires that simplifications made to the requirements in full IFRS Accounting Standards:

(a) make the requirements in full IFRS Accounting Standards simpler for SMEs to apply (principle of simplicity);

(b) are supported by cost-benefit considerations; and

(c) result in financial statement that faithfully represent the substance of economic phenomena in words and numbers (principle of faithful representation).

46. The analysis in this paper:

(a) suggests that the indicators of control in IFRS 15 would make it easier for SMEs to determine if they control a good or service before it is transferred to a customer (see paragraph 43 of this paper). Therefore, the proposal to omit two of the indicators from the revised Section 23 could make the requirements for principal versus agent more complex for SMEs to apply.

(b) suggests that the proposed simplification could change the conclusions reached by SMEs that currently refer to IFRS 15 to determine whether they are a principal or agent (see paragraph 44 of this paper). Therefore, the proposed simplification would cause disruption for these SMEs, the cost of which is considered to outweigh the benefits of the proposed simplification.

[12] See Agenda Paper 30 *Cover paper* for this meeting and paragraphs BC29–BC32 of the Exposure Draft.

(c) identifies where the proposed simplification would result in an SME recognising revenue that does not faithfully represent the amount of consideration to which the SME is entitled (see paragraph 40 of this paper).

47. The staff considered whether it would be possible to overcome the difficulties identified with the proposed requirements for principal versus agent, while keeping the requirements more prescriptive compared with IFRS 15. However, a prescriptive approach could still result in scenarios where SMEs recognise revenue in a way that does not faithfully represent their performance, the effects of which could be significant. Consequently, the staff recommend withdrawing the proposed requirements for principal versus agent in the revised Section 23. Instead, the staff recommend requiring an SME to determine whether it is a principal or agent based on the principle and indicators of control in IFRS 15.

Potential challenges

48. Feedback on applying the principle and indicators of control in IFRS 15 was received as part of the PIR of IFRS 15. Many respondents to the Request for Information *Post-implementation Review of IFRS 15* Revenue from Contracts with Customers (Request for Information) reported challenges applying judgement to complex fact patterns using the principle and indicators of control.[13] The challenges identified were common in some industries and arrangements in which SMEs may be involved (for example, service industries and arrangements involving digital platforms). Therefore, SMEs that enter into complex transactions may encounter similar challenges applying the principle and indicators of control in IFRS 15.

49. The staff think it less likely that SMEs would encounter the challenges identified in the PIR of IFRS 15 compared with entities applying IFRS 15. This is because most SMEs are expected to have simpler contracts compared with entities applying IFRS 15. The challenges of applying the principle in IFRS 15 are a consequence of applying principle-based requirements. The IASB could make the requirements for

[13] Paragraph 10 of Agenda Paper 6B *Principal versus agent considerations* of the February 2024 IASB meeting.

principal versus agent in the *IFRS for SMEs* Accounting Standard less principle-based and more prescriptive to prevent SMEs encountering similar challenges. However, doing so could result in scenarios where SMEs recognise revenue in a way that does not faithfully represent their performance (as described in paragraph 47 of this paper). Finally, although the PIR of IFRS 15 found that entities encounter challenges applying the principle and indicators of control in IFRS 15, no respondents that suggested aligning the requirements for principal versus agent in the revised Section 23 with IFRS 15 had concerns that the principle and indicators of control in IFRS 15 would be too challenging for SMEs to apply.

Question for the IASB
2. Does the IASB agree to require an SME to determine whether it is a principal or agent based on the principle and indicators of control in IFRS 15?

Repurchase agreements

50. IFRS 15 includes requirements for repurchase agreements. Paragraph 34 of IFRS 15 requires entities to consider repurchase agreements when evaluating whether a customer has obtained control of an asset. Appendix B to IFRS 15 specifies how to account for repurchase agreements.[14]

51. Feedback received during the development of the Exposure Draft indicated that SMEs rarely enter into repurchase agreements. For this reason, requirements for repurchase agreements were not considered relevant to SMEs and not proposed in the Exposure Draft.

Feedback received

52. A few respondents suggested the IASB includes requirements for repurchase agreements in the revised Section 23.

[14] Paragraphs B64–B76 of IFRS 15.

Staff analysis

53. The SMEIG discussed repurchase agreements when it met in December 2023. Some SMEIG members said SMEs in their jurisdiction enter into repurchase agreements. Further discussions with these members indicated that instances of SMEs in their jurisdiction entering into repurchase agreements are rare. The repurchase agreements that SMEs enter into are typically with providers of finance, in which SMEs know the substance of the transaction.

54. All SMEIG members who said SMEs in their jurisdiction enter into repurchase agreements recommended that the IASB include requirements for such agreements in the revised Section 23. One member suggested requirements that are brief and focus on whether a customer has obtained control of the asset.

55. Repurchase agreements occur when an SME sells an asset and also enters into an agreement to repurchase the asset. If the SME does not consider both transactions, it might recognise revenue when the customer has not obtained control of the asset. This would not faithfully represent the substance of the transaction, which is typically to provide finance. Financing is often provided for substantial amounts. Therefore, significant differences in the amount of revenue recognised could arise if SMEs consider (or do not consider) repurchase agreements when accounting for contracts with customers.

56. Feedback from respondents and SMEIG members indicates that repurchase agreements are relevant to a small population of SMEs and in limited instances. However, the effect of not considering repurchase agreements when accounting for contracts with customers could be significant. For this reason, the staff recommend the revised Section 23 includes requirements for repurchase agreements.

57. IFRS 15 includes detailed requirements about how to account for repurchase agreements. Including similar requirements in the revised Section 23 would make the Section longer and more complex. Stakeholders said the proposed revised Section 23 was already too long and complex for SMEs (see paragraph 12 of this paper).

58. If the *IFRS for SMEs* Accounting Standard did not specify how to account for repurchase agreements, SMEs would need to determine an accounting policy for repurchase agreements. To do so, an SME first considers the requirements and guidance in the *IFRS for SMEs* Accounting Standard dealing with similar and related issues. If there are such no requirements or guidance, the SME must consider the definitions, recognition criteria, measurement concepts and pervasive principles in Section 2 *Concepts and Pervasive Principles* of the Standard. SMEs may (but are not required to) consider the requirements in full IFRS Accounting Standards.[15]

59. Section 11 *Basic Financial Instruments* of the *IFRS for SMEs* Accounting Standard includes requirements for accounting for agreements to repurchase financial assets. The staff think the outcome of accounting for repurchase agreements by applying the requirements in Section 11 would be broadly similar to the outcome of applying IFRS 15. Where the outcomes differ, the staff believe SMEs would still account for the transaction in way that faithfully represents the substance of the transaction. Consequently, SMEs would be able to reach an appropriate outcome by applying requirements in the *IFRS for SMEs* Accounting Standard that deal with similar and related issues.

60. Based on the analysis in paragraphs 58–59 of this paper, the staff think it is unnecessary to specify how to account for repurchase agreements in the revised Section 23. However, the staff think it is necessary for SMEs to consider repurchase agreements when evaluating whether a customer obtains control of an asset. This is because, without doing so, a SME might recognise revenue when a customer has not obtained control of the asset being sold. This would undermine a key principle of IFRS 15. Consequently, the staff recommend requiring SMEs that are evaluating whether a customer obtains control of an asset to consider any agreement to repurchase the asset.

[15] Paragraphs 10.4–10.6 of the *IFRS for SMEs* Accounting Standard.

Question for the IASB
3. Does the IASB agree: a. to require SMEs that are evaluating whether a customer obtains control of an asset to consider any agreement to repurchase the asset; and b. to include no requirements for how to account for repurchase agreements in the revised Section 23?

Customers' unexercised rights (breakage)

61. Entities may receive upfront non-refundable payments that give customers the right to receive goods or services in the future (for example, the purchase of gift cards). Under the proposals in the Exposure Draft, an SME would recognise a contract liability upon receipt of such payments.

62. Customers might not exercise all their rights to receive goods or services in the future. Customer's unexercised rights are referred to as breakage.

63. The Exposure Draft proposed requirements on how to account for breakage. Under the proposals, if an SME expects to be entitled to a breakage amount, the SME would estimate this amount. The SME would then recognise 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 would recognise breakage as revenue when the likelihood of the customer exercising its remaining rights becomes remote.[16]

64. The proposed requirements for breakage are aligned with the requirements for breakage in IFRS 15.[17]

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

[17] Paragraphs B44–B47 of IFRS 15.

Feedback received

65. Among fieldwork participants unfamiliar with IFRS 15, there were comparable numbers who were (and were not) able to make the judgements required to account for breakage. Many participants who were unable to make the judgements said the judgements were too difficult. Some participants thought that contracts for which breakage may occur are not significant to SMEs' activities.

Staff analysis

Significance of breakage amounts

66. Feedback from fieldwork participants indicates that revenue from contracts for which breakage is expected to occur is not expected to be significant to SMEs (for example, revenue from gift cards compared with total revenue). Consequently, the amount of breakage from these contracts is not expected to be significant.

67. An analysis of financial statements of entities that apply FASB's *Topic 606 Revenue from Contracts with Customers*[18] and disclose the amount of breakage recognised shows that, on average, the amount of breakage recognised as revenue was less than 1.6% of an entity's total revenue.[19] The analysis supports the expectation that the amounts of breakage recognised by SMEs are not significant.

68. Feedback from fieldwork participants also indicates that SMEs would find it difficult to make the judgements needed to account for breakage in accordance with the proposals in the Exposure Draft.

69. The analysis in paragraphs 66–68 of this paper indicates that the amounts of breakage to which SMEs are entitled are unlikely to be significant enough to influence the decisions of users of SMEs' financial statements. Consequently, the benefit of the

[18] 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 aligned with IFRS 15.

[19] 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 reporting period.

information provided to users from recognising breakage in accordance with the proposed requirements would not justify the complexities and costs of the requirements. For this reason, the staff recommend including no requirements for breakage in the revised Section 23.

70. The SMEIG considered the staff recommendation in paragraph 69 of this paper when it met in December 2023. Some SMEIG agreed with the recommendation. Other SMEIG members said because SMEs enter into contracts for which they are entitled to breakage amounts, the revised Section 23 should specify when SMEs recognise breakage amounts as revenue.

Accounting for topics not covered in the Standard

71. If the revised Section 23 includes no requirements for breakage, SMEs would need to determine an accounting policy for breakage if the effect of accounting for breakage is material to its financial statements. To do so, an SME first considers the requirements and guidance in the *IFRS for SMEs* Accounting Standard dealing with similar and related issues. If there are no such requirements or guidance, the SME must consider the definitions, recognition criteria, measurement concepts and pervasive principles in Section 2 of the Standard. SMEs may (but are not required to) consider the requirements in full IFRS Accounting Standards.[20]

72. The *IFRS for SMEs* Accounting Standard does not address breakage. Therefore, SMEs are currently required to determine an accounting policy for breakage. Feedback from fieldwork participants indicates that most SMEs account for breakage by:

(a) recognising breakage as revenue when a customer's rights expire; or

(b) recognising estimated breakage as revenue immediately on receipt of a prepayment from a customer.

[20] Paragraphs 10.4–10.6 of the *IFRS for SMEs* Accounting Standard.

73. Fieldwork participants said SMEs that recognise estimated breakage as revenue immediately on receipt of a prepayment from a customer also recognise the entire amount of the prepayment as revenue immediately on receipt (that is, the SMEs do not recognise prepayments from customers as contract liabilities). The proposed requirements for contract balances specify when SMEs must recognise payments from customers as contract liabilities.[21] SMEs applying the revised Section 23 would not be permitted to recognise payments that give customers the right to receive goods or services in the future as revenue immediately on receipt. Therefore, it would be less common for SMEs that apply the revised Section 23 to account for breakage as described in paragraph 72(b) of this paper.

74. The accounting policy for breakage described in paragraph 72(a) of this paper is consistent with the requirements in Section 11 of the *IFRS for SMEs* Accounting Standard for derecognising financial liabilities. It is also consistent with the requirements proposed in the Exposure Draft for recognising revenue allocated to material rights.[22]

75. Accounting for breakage by applying the accounting policy described in paragraph 72(a) of this paper would mean an SME would recognise breakage as revenue later than if the SME applied the proposed requirements. However, the staff believe that accounting for breakage by applying the accounting policy described in paragraph 72(a) would still faithfully represent an SME’s rights and obligations.

76. The feedback from fieldwork participants did not indicate how SMEs would account for breakage when customers’ rights do not expire. Such instances are expected to be uncommon. The requirements and guidance in the *IFRS for SMEs* Accounting Standard do not deal with similar or related issues. Therefore, SMEs would be expected to consider the recognition criteria in Section 2 of the *IFRS for SMEs* Accounting Standard. Based on the recognition criteria in the proposed revised Section 2 in the Exposure Draft, an SME would recognise breakage as revenue when

[21] Paragraph 23.115 of the Exposure Draft.

[22] Paragraph 23.34 of the Exposure Draft.

the probability of the customer exercising its remaining rights is low. Accounting for breakage in this way would mean the timing of revenue recognition would differ compared with if the SME applied the proposed requirements. However, the staff believe that accounting for breakage in this way would still faithfully represent an SME's rights and obligations.

77. Based on the analysis of how SMEs would be expected to account for breakage in paragraphs 71–76 of this paper, the staff think it is unnecessary to specify when SMEs should recognise breakage amounts as revenue in the revised Section 23. Including requirements for breakage would make the Section longer and more complex. In the absence of requirements for breakage, SMEs may recognise breakage as revenue at different times. However, as the amounts of breakage are likely to be small, such differences would not be expected to affect users' understanding of SMEs' revenue.

78. The conclusion in paragraph 77 of this paper differs from the conclusion in paragraph 60 in relation to repurchase agreements. This is because requirements for repurchase agreements are considered necessary for SMEs to faithfully represent the revenue arising from contracts with such agreements. Also, the difference between revenue recognised by SMEs that consider repurchase agreements, and those that do not, could be substantial.

Question for the IASB
4. Does the IASB agree to withdraw the proposed requirements for customers' unexercised rights in the revised Section 23?

Contract balances

79. The Exposure Draft proposed that SMEs present a contract in the statement of financial position as either a contract asset or contract liability.[23] Under the proposals, an SME would recognise a contract asset if it transfers a good or service to a customer before the customer pays consideration (or before consideration is due).

80. The proposed requirement in paragraph 23.116 of the Exposure Draft would require SMEs to exclude any amounts presented as a receivable from contract assets. A receivable is an SME's unconditional right to consideration. 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, where 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). The Exposure Draft proposed that SMEs present contract assets and receivables separately.[24]

81. The proposed requirements for contract balances are aligned with requirements for contract balances in IFRS 15.[25]

Feedback received

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

83. All fieldwork participants who commented on the judgement said 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.

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[23] Paragraph 23.114 of the Exposure Draft.

[24] Paragraph 23.118 of the Exposure Draft.

[25] Paragraphs 105–109 of IFRS 15.

Staff analysis

84. 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).

85. Users of financial statements are provided with more information about an entity's rights to consideration if contract assets and receivables are presented separately (that is, disaggregated). This information can help users better understand an entity's short-term cash flows. Feedback from users of SMEs' financial statements on the Request for Information *Comprehensive Review of the* IFRS for SMEs *Standard* indicated that users are particularly interested in SMEs' short-term cash flows and the disaggregation of amounts presented in financial statements.[26] For these reasons, the staff recommend the proposed requirement to present contract assets and receivables separately is retained in the revised Section 23.

86. The SMEIG considered the staff recommendation in paragraph 85 of this paper when it met in December 2023. SMEG members generally agreed with the recommendation. A SMEIG member disagreed with the recommendation and said SMEs should not be required to present contract assets and receivables separately for cost-benefit reasons. This view was also shared during an outreach meeting with a stakeholder from the same jurisdiction as the SMEIG member.

87. The jurisdiction discussed in paragraph 86 of this paper does not use the *IFRS for SMEs* Accounting Standard. Entities applying the local accounting standard in this jurisdiction often do not distinguish between balances that would be presented as contract assets and receivables in accordance with IFRS 15. Therefore, separately presenting these balances would change current practice for these entities. The *IFRS*

[26] Agenda Paper 5 *User survey and user interview feedback summary* of the February 2021 SME Implementation Group meeting.

for SMEs Accounting Standard requires SMEs to present accrued income and trade receivables separately.[27] Therefore, presenting contract assets and receivables separately would not significantly change current practice for SMEs.

Guidance on contract assets

88. 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 from a customer 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 is conditioned on the other goods or services being transferred to the customer.

89. The example described in paragraph 88 of this paper was 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 in which a right to consideration is conditional and gives rise to a contract asset. Focusing on this example is considered more helpful than including additional examples in the Standard that are unlikely to occur in practice.

Question for the IASB
5. Does the IASB agree to retain the proposed requirement for SMEs to present contract assets and receivables balances separately in the revised Section 23?

Criteria for over time revenue recognition

90. The Exposure Draft proposed requiring SMEs to recognise revenue when (or as) the SME transfers goods or services to a customer. A good or service is transferred when (or as) the customer obtains control of that good or service.

[27] Paragraph 4.11(b) of the *IFRS for SMEs* Accounting Standard.

91. Under the proposals, an SME would transfer control of a good or service over time and, hence, recognise revenue over time, if any of the criteria in paragraph 23.78 of the Exposure Draft were met:

(a) the customer receives and consumes the benefits of the entity's performance as the entity performs (paragraph 23.78(a) of the Exposure Draft);

(b) the entity's work carried out to date would not need to be substantially reperformed if another entity were to fulfil the remainder of the promise to the customer (paragraph 23.78(b) of the Exposure Draft);

(c) the entity's performance creates or enhances an asset that the customer obtains control of as the asset is created or enhanced (paragraph 23.78(c) of the Exposure Draft); and

(d) the entity's performance creates an asset that cannot be readily redirected to another customer and the customer is obliged to compensate the entity for work carried out to date (paragraph 23.78(d) of the Exposure Draft).

92. The proposed criteria for over time revenue recognition were based on the criteria in paragraphs 35 and B4 of IFRS 15 but expressed in simpler language.

Feedback received

93. Some respondents (mostly accounting firms and standard-setters) who commented on the Section 23 of the Exposure Draft said the criteria for over time recognition in the revised Section 23 should be the same as the criteria in IFRS 15 (that is, not simplified). Most of these respondents were concerned that the proposed criteria would lead to outcomes that differ from the outcomes of applying IFRS 15.

94. Some respondents (mostly accounting bodies) commented on the criterion in paragraph 23.78(b) of the Exposure Draft. All the respondents who commented on the criterion said it should be presented as an indicator of the criterion in paragraph 23.78(a) of the Exposure Draft instead of as a separate criterion. Two

respondents said the assumption in paragraph B4(b) of IFRS 15 should be included in the revised Section 23 so SMEs apply the criterion in paragraph 23.78(b) correctly.

95. One respondent commented on specific aspects of the language used in the proposed criteria, which the staff will consider in drafting.

96. Most fieldwork participants who were unfamiliar with IFRS 15 were able to apply the proposed criteria and determine if a promise is satisfied over time or at a point in time.

Staff analysis

Simplified language

97. The language used to express the criteria for over time recognition in IFRS 15 was simplified in the Exposure Draft to make the criteria easy for SMEs to understand and apply. It was also simplified to reduce the risk that SMEs look to guidance on the criteria in IFRS 15 when implementing the revised Section 23.

98. The SMEIG discussed the criteria when it met in July 2023. The number of SMEIG members who thought the language used to express the criteria should be simplified was comparable to the number who thought the language should not be simplified.

99. One SMEIG member said the language used to express the criteria in the Exposure Draft was more understandable for SMEs than the language in IFRS 15. This view was supported by the fieldwork, where most practitioners were able to apply the criteria.

100. One SMEIG member had concerns that simplifying the language in IFRS 15 would prevent practitioners from referring to guidance on the criteria in IFRS 15. This was one of the intentions of expressing the criteria in simplified language. Although referring to guidance on IFRS 15 may be helpful for SMEs, doing so should not be necessary for SMEs to understand the criteria in the revised Section 23. Creating an impression that referring to such guidance is necessary places an additional burden on SMEs to familiarise themselves with the guidance on IFRS 15. Additionally, guidance

on the criteria in the revised Section 23 will be available in separate educational material on the *IFRS for SMEs* Accounting Standard.

101. Respondents' concerns focused on whether using simpler language would lead to outcomes that differ from the outcomes of applying IFRS 15. Although the language used to express the criteria in the Exposure Draft and IFRS 15 is different, the principles remain the same. Consequently, instances where the simplified language would cause SMEs to interpret the principles differently from entities applying IFRS 15 would be expected to arise only infrequently.

102. Because any differences in outcomes are expected to occur infrequently, the staff think the effect of these differences is not significant enough to outweigh the benefits of using simpler language to express the criteria. Therefore, the staff recommend the criteria proposed in the Exposure Draft are retained in the revised Section 23.

Criterion in paragraph 23.78(b) of the Exposure Draft

103. Some respondents suggested the criterion in paragraph 23.78(b) of the Exposure Draft should be presented as an indicator of the criterion in paragraph 23.78(a). This is similar to the requirements in IFRS 15: paragraph B4 of IFRS 15 provides guidance on how to apply the criterion in paragraph 35(a) of IFRS 15 in instances when it is unclear whether the criterion is met.

104. The criterion in paragraph 23.78(b) is an alternative way to determine whether the criterion in paragraph 23.78(a) is met. However, presenting the criteria together would force SMEs to consider the relationship between the criteria. The staff think it is not necessary for SMEs to understand the relationship between the criteria to apply them. Requiring SMEs to do so adds complexity to the *IFRS for SMEs* Accounting Standard.

105. Two respondents said the assumption in paragraph B4(b) of IFRS 15 should be included in the revised Section 23 so SMEs apply the criterion in paragraph 23.78(b) of the Exposure Draft correctly. Paragraph B4(a)–(b) of IFRS 15 includes two

assumptions that entities make when applying the criterion in that paragraph. Entities must:

B4(a) disregard potential contractual restrictions or practical limitations that otherwise would prevent the entity from transferring the remaining performance obligation to another entity; and

B4(b) presume that another entity fulfilling the remainder of the performance obligation would not have the benefit of any asset that is presently controlled by the entity and that would remain controlled by the entity if the performance obligation were to transfer to another entity.

106. The criterion in paragraph B4 of IFRS 15 is based on a hypothetical assessment of what an entity would need to do if it were to take over the performance completed to date.[28] An entity would apply the criterion too narrowly if it did not make the assumption in paragraph B4(a) of IFRS 15.

107. If an entity presumed that another entity fulfilling the remainder of a performance obligation *did* have the benefit of any asset that is presently controlled by the entity (for example, work-in-progress), the criterion in paragraph B4 of IFRS 15 would typically be met. Another entity can benefit from these assets only if they are presently controlled by the customer. In such instances, the customer controls the work-in-progress as the asset is created or enhanced, and the criterion in paragraph 35(b) of IFRS 15 is met. Therefore, if an entity did not make the assumption in paragraph B4(b) of IFRS 15, it would recognise revenue over time for contracts that do not meet the criterion for over time revenue recognition in paragraph 35(b) of IFRS 15. This outcome would contradict the objective of the criterion.

108. Based on the analysis in paragraphs 105–107 of this paper, the staff think the assumptions in paragraph B4(a)–(b) of IFRS 15 are necessary so the criteria for over time recognition in the revised Section 23 are consistent with the principles in

[28] Paragraph BC127 of IFRS 15.

IFRS 15. Therefore, the staff recommend including in the revised Section 23 the assumptions in paragraph B4(a)–(b) of IFRS 15.

Criterion in paragraph 23.78(d) of the Exposure Draft

109. The criterion in paragraph 23.78(d) of the Exposure Draft requires an SME to assess if a customer is obliged to compensate the SME for work carried out to date. The assessment is similar to that in paragraph 35(c) IFRS 15, which requires an entity to assess whether it has an enforceable right to payment for performance completed to date.

110. Feedback from the PIR of IFRS 15 found that applying paragraph 35(c) of IFRS 15 can be challenging, notably in relation to the enforceability of an entity's right to payment.[29] A few respondents to the Request for Information said assessing whether a right to payment is enforceable can be complex and costly, particular for smaller entities.[30] Most of the difficulties arise from paragraph B12 of IFRS 15, which requires entities to consider laws, legal precedent and historical business practice when making the assessment.

111. The Exposure Draft does not specify the sources an SME must consider when it assesses whether a customer is obliged to compensate it for work carried out to date. The assessment is expected to be made by SMEs with long-term construction or manufacturing contracts, where payment is dependent on milestones reached or units produced. SMEs with these types of contracts are expected to know whether they have a right to payment. Therefore, it would not be expected to be unduly complex or costly for SMEs to make the assessment in instances where they are required to do so.

112. Based on the analysis in paragraph 111 of this paper, the staff think it is unnecessary to simplify the proposed requirement for SMEs to assess if a customer is obliged to compensate an SME for work carried out to date.

[29] Spotlight 4 of Request for Information *Post-implementation Review of IFRS 15* Revenue from Contracts with Customers.

[30] Paragraph 46(a)(i) of Agenda Paper 6A *Feedback summary—IFRS 15 requirements* of the January 2024 IASB meeting.

Question for the IASB
6. Does the IASB agree: a. to retain the criteria in the Exposure Draft for over time recognition in the revised Section 23; and b. to include in the revised Section 23 the assumptions in paragraph B4(a)–(b) of IFRS 15?

Next steps

113. The staff will bring papers to the IASB on:

(a) the remaining redeliberation topic—disclosure requirements; and

(b) changes to the structure and language of Section 23 of the Exposure Draft.

Appendix—Figures illustrating the recommended change to the proposed requirements for warranties

Figure 1—Summary of the requirements for warranties proposed in the Exposure Draft

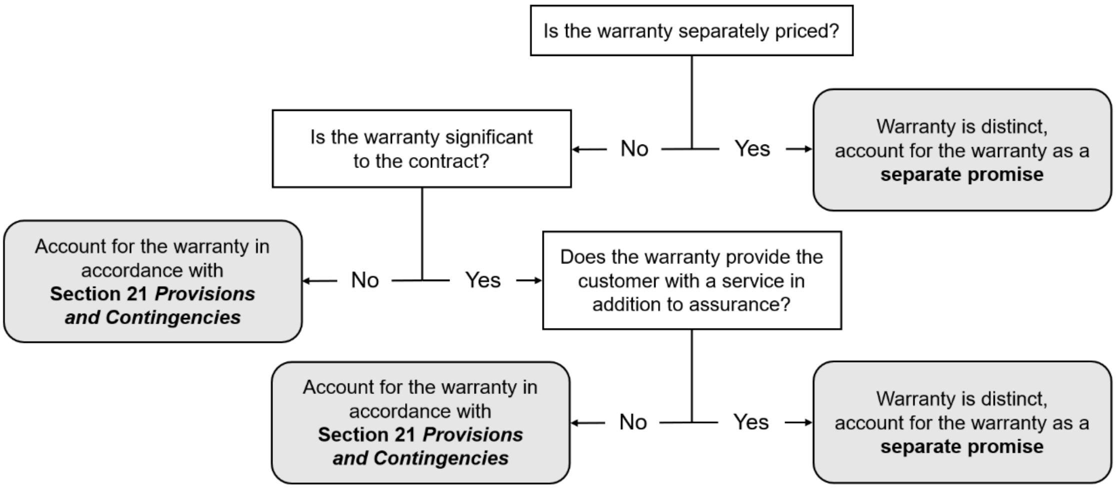

Figure 2—Summary of the requirements for warranties as a consequence of the staff recommendation