

EAA-EFRAG-IASB FINANCIAL REPORTING STANDARDS WORKSHOP ON POST IMPLEMENTATION REVIEW IFRS 15

4 October 2023



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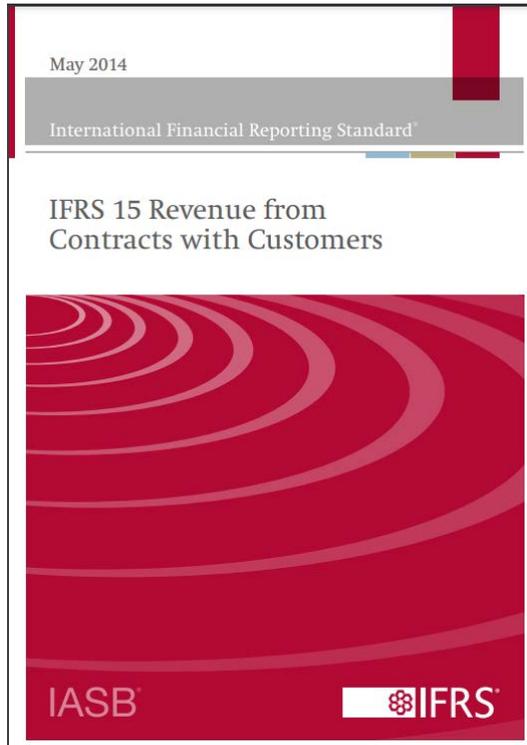
4 October 2023

Agenda:

- Introduction
- Overall assessment of IFRS 15
- Disclosure requirements
- Other Matters Covered in the Request for Information



IFRS 15 at a glance



Objective

To establish the principles for reporting useful information to users of financial statements about the **nature, amount, timing and uncertainty of revenue and cash flows** arising from a contract with a customer



Substantially converged with
US GAAP (Topic 606)



Effective from 1 January 2018

IASB activities since IFRS 15 was issued

A solid foundation for the PIR

The IASB has put significant efforts into monitoring and supporting the implementation and application of IFRS 15



Established with the FASB a joint Transition Resource Group (TRG) to support implementation of IFRS 15



Provided educational materials such as articles and webcasts



Issued clarifications to IFRS 15 to address some of the matters discussed by the TRG



Analysed application questions at the IFRS Interpretations Committee

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





Overall Assessment of IFRS 15

Expected overall improvement to financial reporting

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

Benefits

- Greater rigour in revenue accounting
- Enhanced comparability across companies, industries and capital markets, including with the US
- More useful information through improved disclosure requirements
- Reduced need for interpretive guidance

Expected to be ongoing

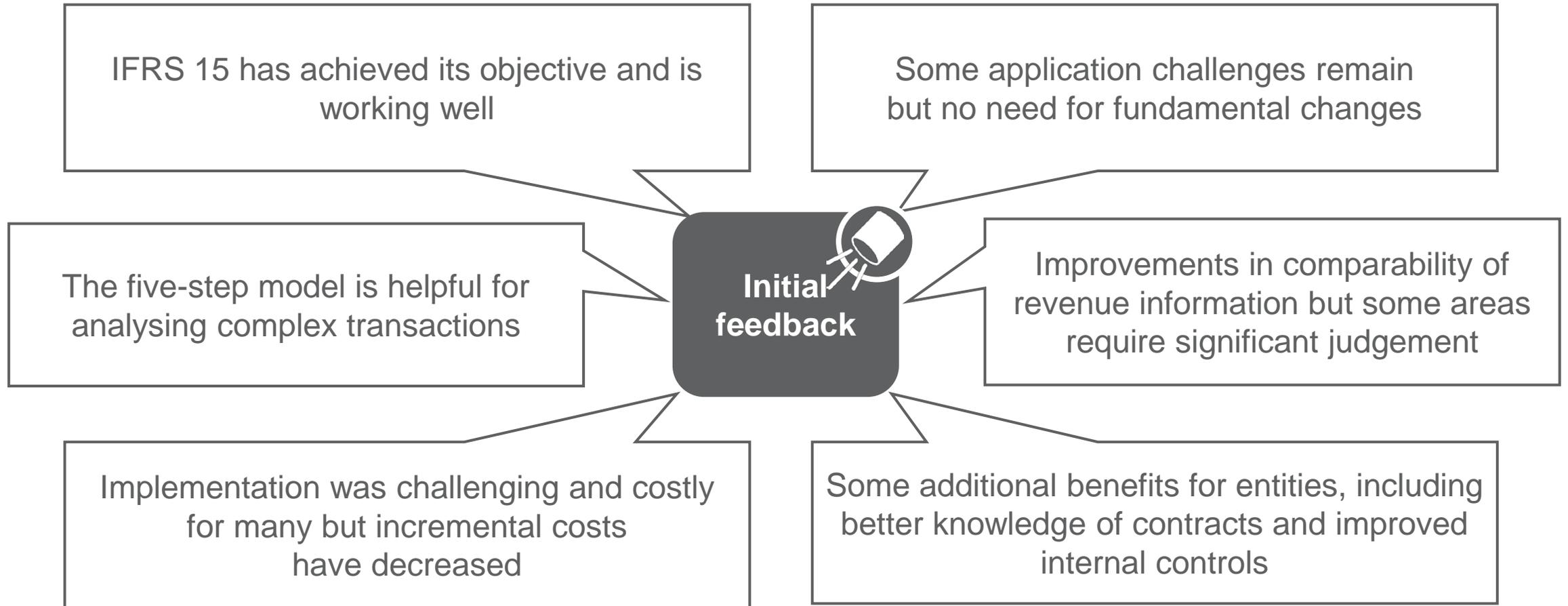


Costs

- Compliance costs for preparers (for example, costs of changing or developing new systems, processes and controls; additional staff, audit and education costs)
- Costs of analysis for users of financial statements (for example, costs of modifying processes and analyses; education costs)

Expected primarily during the transition

Phase 1 feedback



Overall assessment of IFRS 15

Questions

Can you share academic evidence that could help the IASB assess:

- whether IFRS 15 has achieved its objective; and
- whether the costs and benefits of implementing and applying the requirements in IFRS 15 are those the IASB intended when it developed the Standard?

OVERALL SUITABILITY

- Working well in practice,
- Five-step model is a robust model for revenue recognition
- Welcome replacement of previous fragmentary requirements
- Initial acclimatization (preparers had to navigate through initial challenges faced on some topics)
- Some call for convergence on some aspects (e.g., acquiree contract assets and contract liabilities)

UNDERSTANDABILITY

- Well-structured and understandable standard with plenty of illustrative examples
- Some fact patterns may call for further illustrative examples (accounting for contracts with licences)



COST-BENEFIT ASSESSMENT

- Some companies had/have significant transition/ongoing costs
- In many cases there were limited impacts on amount and timing of revenue
- User perspective: Improvements in relevance (estimating future cash flows, assessing revenue margins, and assessing stewardship) and comparability of information
- Improved internal benefits for some preparers (e.g., better management of business, cross-departmental co-ordination)



Summary of the academic evidence the IASB has considered

Implementation



- cost of implementation varied across entities (Davern et al, 2019)
- revenue recognition cycle decreased (Topic 606) (Ali and Tseng, 2022)

Usefulness of revenue information



- the predictive ability of revenue for future earnings and the comparability of revenue information increased after the implementation of the revenue recognition model (Chen et al, 2022)
- mixed evidence on the effects of the new revenue recognition model on analyst revenue forecast accuracy and dispersion (Topic 606) (Ferreira et al, 2022; Goldman et al, 2022; Billings et al, 2022)
- earnings-returns association increased (Castro et al, 2022)
- cost of debt increased but the increased cost dissipated over time (Sadka et al, 2022)

Revenue management



- managers used judgement on application of the revenue recognition model opportunistically (Hubbard, 2022)
-

Summary of the academic evidence the IASB has considered *continued*

Transition to IFRS 15



- the effects of transition to IFRS 15 on reported numbers varied across entities (Krupova and Partac, 2022)
- around half of the examined entities disclosed immaterial impact from the implementation of IFRS 15 (Napier and Stadler, 2019)
- choice between the retrospective and modified retrospective method varied by entity, industry and cost of compliance (Chau, 2022)

Real effects



- Topic 606 led to higher innovation by entities in the life sciences industry through an increase in investment resulting from (Cetin, 2022):
 - increased transparency of revenue recognition, and
 - lower information asymmetry between managers and investors.
-

IFRS 15 (ASC 606) Academic Literature

- There are studies on the standards, however potentially relevant empirical studies are still working papers (unpublished)
- Research topics limited to those where appropriate data available, mainly:
 - capital market effects
 - disclosures
 - transition
 - some real effects
- Some innovative methodology approaches to examine selected topics:
 - time-varying industry shocks (exogenous to companies) to encapsulate overlapping revenue cycles and assess the changes in timing of revenue recognition (Ali and Tseng, 2023wp)
 - textual analysis of disclosures to identify Principal vs. Agent Exposure (Du, Louis and Wang, 2023wp)

Classification of the IFRS 15 Effects

Accounting Effects
*(Recognition, Measurement,
Presentation, Disclosure)*

Benefits and costs

Information Effects:

- Information understanding and communication
- Information processing costs
- Information asymmetry

Capital Market Effects:

- Value relevance
- Analysts' forecasts
- Bid-ask spread
- Trading volumes

Real Effects:

- Implementation costs
- Contracting
- Behavioural effects
- Regulatory implications
- Taxation

Adapted from Napier & Stadler (2020)

Overall assessment of IFRS 15 (Q1)

IFRS 15 is *decision-useful* for many stakeholders

Accounting effects include:

- Relatively little impact on recognition and measurement of revenue (Napier and Stadler, 2020; Ali and Tseng, 2023wp)
- Increase in financial statement comparability (Choi, Kim, and Wang, 2023)
- Increase (Decrease) in revenue comparability for firms in different industries with similar revenue-generating transactions (firms in the same industry with similar revenue-generating economic transactions) [Tillet, 2023]
- Better mapping of revenue into cash flows (Choi, Kim, and Wang, 2023wp)
- Increase in future cash flow predictability that comes from the guidance on contract revenue (ASC 606) and the guidance on contract costs (ASC 340-40) [He, 2023]

Overall assessment of IFRS 15 (Q1)

Information and capital market effects include:

- Decrease in information asymmetry between managers and investors (Cetin, 2022)
- Decrease in bid-ask spread, price impact of trades, and return volatility (Choi, Kim, and Wang, 2023wp)
- Increase in the quoted depth, trading volume, and price efficiency (Chung and Chuwonganant, 2019wp)
- Increase in liquidity (Ferreira, 2021):
 - Through the precision channel (the change in the accounting report's ability to reflect economic events)
 - Through the comparability channel (the increase in comparability across reporting entities)

Overall assessment of IFRS 15 (Q1)

Information and capital market effects include:

- Increase in the combined information content of financial statements and the capital market efficiency (He, 2023)
- Increase in value relevance of earnings (revenue) [Choi, Kim, and Wang, 2023wp]
- Analyst forecast accuracy and consensus:
 - Higher error and dispersion (Hao and Pham, 2023), (Lee, Lee, and Sadka, 2022wp)
 - Negative impact on the cost of debt (Lee, Lee, and Sadka, 2022wp)
 - The effect dissipates over time (learning curve of a new standard)
 - Full retrospective method leads to lower error
 - Positive effect of disaggregation disclosures

Overall assessment of IFRS 15 (Q1)

Implementation costs:

- IFRS 15 has a complex impact on business models; there are significant implementation costs and proprietary costs.
- IFRS 15 is a driver to justify large investments, including MCS, ERP, etc. (Davern, 2019; Osma García, Gomez Conde and Mora, 2023wp) & implementation costs directly related to IFRS 15 cannot be easily identified
- High costs but also additional benefits (see Q7 & Q11)

Related Matters

- **Q8 Transition requirements**

- Most entities opted for modified (cumulative) approach (Kabir and Su, 2022; Onie et al., 2023; Krupová and Partac, 2023wp; Hao and Pham, 2023)
- A stronger reaction to revenue surprises & lower analysts' forecast errors for those firms choosing the full retrospective method; the effect diminishes over time (Hao and Pham, 2023wp)
- Extending effective dates for new standards is questionable as entities do not utilise the additional time to proceed with the implementation properly (Davern et al., 2019)

Related Matters

- **Q11 Other matters (real effects)**
 - **Behavioural effects:**
 - Extension of contract horizon to offset accelerated revenue by firms with a longer revenue cycle (Ali and Tseng, 2023wp)
 - Restructure of R&D alliances of drug development firms, as a consequence of reduce information asymmetry and increased investments (Cetin, 2022)
 - **Contracting:**
 - Reassessment of credit policies from a strict to a loosen one and vice versa (Lessis and Karampinis, 2023wp)
 - Increasing use of ASC 606 jargons in sales contracts post-adoption (Ali and Tseng, 2023wp)

Related Matters

- **Q11 Other matters (real effects)**
 - **Organisational effects:**
 - Effects on the whole organization, across multiple functional areas beyond accounting (Davern et al., 2019)
 - Preparers were reluctant to acknowledge the potential benefits of changes in MCS and IT systems, but they note benefits such as more detailed and timely information, integrated procedures, internal communication → positive impact on output efficiency (García Osma, Gomez Conde & Mora, 2023wp)
 - **Potential implications for the PIR:**
 - High implementation costs → additional large investments into internal systems are highly unlikely
 - Any amendments rather a fine-tuning with reasonable and not burdensome disclosure requirements



IFRS 15 Disclosure Requirements

Enhanced disclosure requirements



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.

Phase 1 feedback



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
 - remaining performance obligations
 - some companies not providing the information required

IFRS 15 disclosure requirements

Questions

Can you share academic evidence that could help the IASB assess:

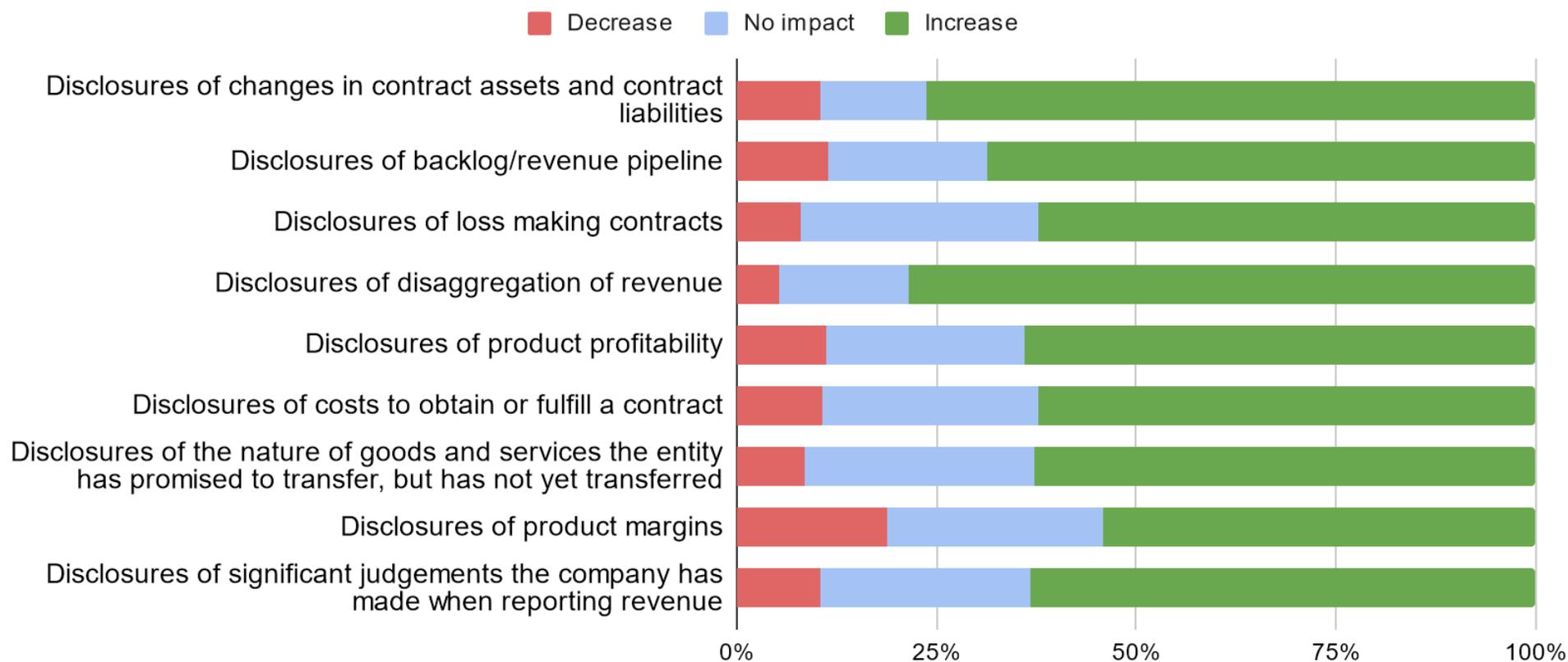
- whether the disclosure requirements in IFRS 15 result in entities providing useful information to users of financial statements;
- whether any disclosure requirements in IFRS 15 give rise to significant ongoing costs; and
- whether there is significant variation in the quality of disclosed revenue information and what could cause such variation?

PREPARERS AND STANDARD SETTERS VOICED CONCERNS AND SUGGESTIONS FOR IMPROVEMENTS

- Reconciliation of contract assets and liabilities. Some preparers questioned the usefulness of this disclosure. Assertions of prohibitive costs and disclosure not being used for internal management purposes
- Disaggregation of revenue was not presented at the right level. It was also suggested that it should only be required for entities in the scope of IFRS 8 and that it would be helpful that entities disclose the risk factors on each revenue stream;
- Remaining performance obligations. View that backlog information is more useful than the remaining performance obligation disclosure
- A reconciliation of the transaction price allocated to remaining performance obligations should be required.

USER SUPPORT FOR DISCLOSURES

- Reconciliation of contract assets and liabilities. Users pointed at its importance for certain industries and to have transparency (e.g., to unwind FV adjustments associated with acquisition accounting)
- Disaggregation of revenue Critical to understanding business model risk



Summary of the academic evidence the IASB has considered

Length of disclosure



- the length of revenue-related disclosures increased post - IFRS 15 implementation (Napier and Stadler, 2020)

Proprietary costs and increased scrutiny



- preparers' concerns about disclosing sensitive information and about increased scrutiny from external stakeholders (Davern et al, 2019)

Disaggregation



- increased decision-usefulness of revenue information when:
 - disaggregation accompanied by detailed qualitative disclosures
 - disaggregation categories comparable to those of other entities in the industry (Hinson et al, 2022)
-

Disclosure requirements (Q7)

Do they result in entities providing useful information or variation in the quality of disclosed revenue information?

Survey and interviews of descriptive evidence on 48 users' perception (García Osma, Gomez Conde and Mora, 2023wp)

- Disclosures increase decision-usefulness by enhancing the ability to make estimates of future cash flows
- Most relevant disclosures:
 - disaggregation of revenue
 - changes in contract assets and contract liabilities
- These disclosures have also positive impact on comparability

Disclosure requirements (Q7)

Do they result in entities providing useful information or variation in the quality of disclosed revenue information?

Empirical evidence with archival data

- Disaggregation requirements increases predictive value (analysts' revenue forecast accuracy and dispersion)
- Benefits are primarily present when disaggregation is accompanied by detailed qualitative disclosures, when disaggregated revenues are comparable, and when the granularity of segment information was low before adoption (Pundrick and Zakota, 2022wp)
- New disclosures more comparability, in general, although it depends on the proxy used to measure comparability as well as industry-specific situation before adoption (Choi, Kim and Wang, 2022)
- For example, removal of industry-specific guidance (referred to US) decreases revenue comparability among firms that previously had industry guidance (relative to those that did not have guidance) (no direct inferences when considering IFRS 15) [Tillet, 2023wp]

Disclosure requirements (Q7)

Do any disclosure requirements in IFRS 15 give rise to significant ongoing costs?

Survey and interviews of descriptive evidence on 196 preparers' perception (García Osma, Gomez Conde and Mora, 2023wp)

- Disclosure requirements is perceived as the main driver of implementation costs
- Significant and costly effects/changes on the Management Control Systems and IT compared to other standards, with differences among industries
- Training the staff are the main ongoing costs indicated by the preparers

Disclosure requirements (Q7)

Do any disclosure requirements in IFRS 15 give rise to significant ongoing costs?

- Some preparers (around slightly more than half of the responders in Davern et al. (2019), have the potential to have reputational or competitive costs and the entity would be subject to greater scrutiny from external stakeholders but this perception has not been empirically evidenced till date
- There are effects on the whole organization, and cross multiple functional areas beyond accounting, so this additional cost burden of IFRS 15 compared to other standards needs to be carefully interpreted ⇔ additional costs driven more by the need to update and enhance the business rather than implement the new accounting standard (Davern, Giles, Potes and Yang, 2019; García Osma, Gomez Conde and Mora, 2023wp)
- Preparers expectation's costs overweight the particularly during implementation, are more likely to overstate costs (which are real and present) and underestimate benefits (which are expectations of the future) as predicted by the notion of temporal discounting in behavioral economics (Frederick et al., 2002) and with construal level theory (Weisner, 2015)



Other Matters Covered in the Request for Information

Other matters being examined

1 Identifying performance obligations

2 Determining the transaction price

3 Determining when to recognise revenue

4 Principal versus agent

5 Licensing

6 Applying IFRS 15 with other Standards

7 Convergence with Topic 606

8 Other matters

What evidence is the IASB seeking?

Clarity and sufficiency of specific requirements

Fact patterns

in which requirements are unclear or applied inconsistently

Diversity in practice

- how pervasive is it?
 - what causes it?
- how does it affect financial statements and usefulness of the information to users?

Suggestions

for resolving identified matters

Other matters

Question

- Can you share academic evidence that could help the IASB assess whether the requirements related to other matters being examined in the RFI are working as intended?

- Principal versus agent considerations (assessment of transfer of control)- issue arises across a variety of business models
- Accounting for contracts involving licences (fact patterns where it is challenging to know whether in scope of licensing application guidance)
- Variable consideration estimation constraint (diversity in practice in both initial and subsequent measurement)
- Identifying distinct performance obligations (pre-production services, front-end fees)
- Interaction with other IFRS Accounting Standards (IFRS 3, 10, 16)

Summary of the academic evidence the IASB has considered

Principal
vs
agent



- after the implementation of Topic 606 (Du et al, 2022):
 - the compliance and audit risk of entities with principal agent considerations decreased, and
 - the higher analyst forecast errors associated with entities with principal or agent considerations remained unchanged.
-

Other Matters

- **Q4 Determining when to recognise revenue**
 - More entities with immaterial impact of the new standard around its adoption (Napier and Stadler, 2020; Kabir and Su, 2022), however with cross-industry variance
 - Immaterial impact on firms with a short revenue cycle; acceleration of revenue for firms with a longer cycle (Ali and Tseng, 2023wp)
 - Changes in revenue recognised at a point of time driven by the shift from the „risk & reward“ model to the „transfer of control“ concept & for revenue over time most changes due to updates in the methods to estimate PoC
 - Increased within-industry comparability of revenue for US firms and, hence, higher value relevance (Choi, Kim and Wang, 2023wp)
 - Improved quality of sales-related accruals (He, 2023)

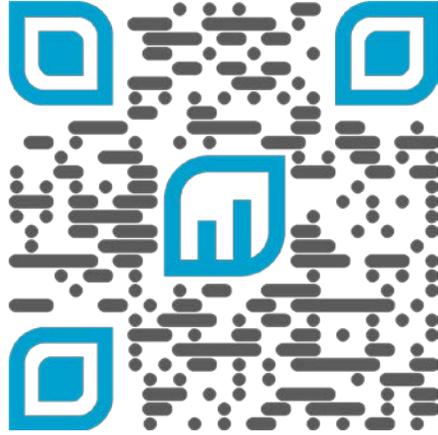
Thank you for your attention!

Suggestions are welcome and can be sent to the team members

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