

IFRS 15 PIR: EFRAG PREPARATORY WORK

PRELIMINARY FINDINGS

EFRAG FR TEG

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OVERVIEW

KEY MESSAGES

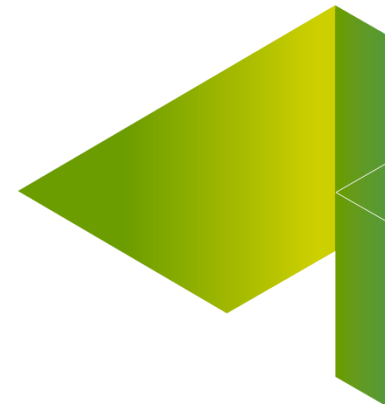
ISSUES FROM REVIEW OF ESMA, IFRS IC AND US GAAP

AUDITOR PERSPECTIVE

PREPARER PERSPECTIVE

USER PERSPECTIVE

APPENDIX - Issues addressed by IFRS IC





KEY MESSAGES

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- The overall assessment provided by most of the participants are that:
 - IFRS 15 is working well in practice although there is room for improvement (e.g. application guidance such as contract modification and interaction with other standards);
 - For some industries, there were initial implementation challenges and costs were significant;
 - IFRS 15 involves more judgement than other standards (or previous revenue standards);
 - Concerns were raised in instances where changes have arisen on previously converged requirements or on future changes to IFRS 15 or US GAAP that may reduce conversion; and
 - Suggested that the IASB consider the relevance of IFRS Standard against new digital business models that are becoming more prominent.

KEY MESSAGES

- So far, the following issues have been the most frequently raised by during the outreach:
 - Insufficiency of “Principal versus agent” requirements leads to diversity in practice
 - Difficulties in dealing with collaborative arrangements
 - Numerous accounting challenges arising from contract modifications
 - Interactions with other IFRS Standards (mostly raised by audit firms)



REVIEW OF ESMA, IFRS IC & US GAAP PIR

IFRS 15 APPLICATION ISSUES NOTED BY ESMA

- In the April 2021 ESMA report related to 2020 reporting ([see link](#)) it is noted that the main issues discussed related to the application of IFRS 15 in the European Enforcers coordination sessions (EECS) were:
 - The assessment of whether an entity acts as an agent or a principal;
 - The allocation of the transaction amount to multiple performance obligations;
 - The timing of recognition of revenue in specific circumstances;
 - The disaggregation of revenue;
 - The impact of certain types of taxes collected from a customer on the measurement of revenue; and
 - The presentation of (unbilled) revenue on the balance sheet and in the income statement.

FASB-PIR TOPIC 606

- Preliminary topics identified by FASB staff ([see link page 36 and 37](#)) which are under research:
 - **Principal vs agent** and related consideration payable to customer
 - **Licenses-** challenging to determine when a license is distinct from other services in the contract
 - **Variable consideration** – challenges in applying the guidance for contracts with sales or usage based royalties that are not licenses of IP
 - **Disclosures-** need for more specificity around disaggregated revenue and remaining performance obligation disclosures
 - Short-cycle contract manufacturing
 - **Standalone selling prices**, especially when the new performance obligation has never been sold on a standalone basis
 - **Identifying performance obligations**, assessing whether goods or services are distinct requires significant judgment
 - **Incremental costs of obtaining a contract-** difficulties in some situations in determining which costs should be capitalised and determining the amortisation period

IFRS 15 ISSUES ADDRESSED BY THE IFRS IC

- The IFRS Interpretation Committee received several submissions to clarify IFRS 15 issues. These submissions (details in Appendix) seek clarification on:
 - Recognition of revenue over time or at a point in time in specific real estate transactions.
 - The number of performance obligations identified in a specific contract.
 - Whether an upfront fee that a stock exchange charges to its customer give rise to an admission service that is distinct from the listing service.
 - Whether an airline accounts for its obligation to compensate customers for delays and cancelations either: (i) as variable consideration (part of the price) or ii) as a provision (applying IAS 37)
 - Whether costs incurred to construct a building and training costs incurred to fulfil a contract should be recognised as an asset or as an expense
 - Whether, in applying IFRS 15, a reseller of software licences should recognise its revenues net of related expenses or gross (principal or agent)



AUDITOR PERSPECTIVE

ISSUES IDENTIFIED FROM AUDIT FIRM INTERVIEWS

- **Principal versus agent consideration.** For companies that facilitate an arrangement between a supplier and a final customer and pay an incentive to the final customer (such as fintech companies) it is difficult to determine who the customer is as well as whether the entity is acting as a principal or as an agent.
- **Licenses** are affected by potential impacts arising from current changes in business models (e.g. online sales, digital sales in the metaverse, more platforms, more intermediaries...). It has a particular impact on licenses and principal versus agent. Therefore, additional guidance would be helpful.
- **Contract modifications.** Unclear whether the Licensing guidance of IFRS 15 requires Licensor to recognize revenue for the license renewal when the renewal is agreed to by the parties or when the renewal period begins. It also affects a broader range of industries like automotive or retail when the customer give something that had control back to an entity in exchange for a new contract.

ISSUES IDENTIFIED FROM AUDIT FIRM INTERVIEWS

- **Interactions between IFRS 10 and IFRS 15. Sale of a subsidiary to a customer.** Under IFRS the sale of a subsidiary that only contains inventory to a customer (the output is part of its ordinary activities) is recognised under IFRS 10. Under USGAAP, the FASB issued an exemption that allow entities to recognise these transactions as revenue as part of ASC 606.
- **Interactions between IFRS 15 and IAS 20.** BC 187 of IFRS 15 clarifies that the amounts to which the entity has rights can be paid by parties other than customers. Difficult to draw a line between government acting in its capacity as a customer or as a government, especially in energy renewable industry.
- **Interactions between IFRS 9 and IFRS 15** IFRS 9 requires entities to measure trade receivables without a significant financing component at their transaction price while IFRS 15 (paragraph 108) envisages scenarios in which entities could recognise a receivable for an amount different to its transaction price (for example if there is a future refund).

In addition, it is not clear which standard apply on gift cards to account for the liability arising from the potential obligation to deliver goods or services/cash.

ISSUES IDENTIFIED FROM AUDIT FIRM INTERVIEWS

- **Interactions between IFRS 16 and IFRS 15** especially in the sale and leaseback transactions.
- **Interactions between IFRS 15 and IFRS 3** In some cases, especially with brands and out-licensing arrangements, when determining the fair value of a contract liabilities there may be differences between the legal value, which may be zero, and the outstanding performance obligations.
- **Disclosures.** Lack from preparers to provide the disaggregation of revenue in a level of detail that may be most useful for all the users. The wording of the standard is such that preparers can provide more aggregated information and still comply with the requirements.
- **Collaborative arrangements.** Additional clarifications are needed to assess if these arrangements (e.g., in the aerospace industry), or only a part of them, are in scope of IFRS 15 or not.

ISSUES IDENTIFIED FROM AUDIT FIRM INTERVIEWS

- **Negative revenue** Some constituents questioned themselves what to do with the negative revenue. For example, a start-up may pay an incentive to attract customers higher than the consideration they will receive from the supplier. Some stakeholders regretted that the IFRS IC did not address the question on whether the reduction of revenue is limited to reducing the transaction price to nil (See September 2019 – compensations for delays and cancellations agenda decision).
- **EITF issue – modification from an on-premise software license to a hosted software solution.** Some contracts include a feature that allows such modifications. As there is usually a difference on the moment revenue is recognised, questions arise on how to account for the conversion of a point in time license to an over time service.
- Subsequent changing on time of delivery is an issue for **significant financing components**. It especially affects service concession arrangements and the construction industry.



PREPARERS PERSPECTIVE

ISSUES RAISED BY PHARMACEUTICAL ENTITIES

- **Generally satisfied** with IFRS 15, **although** it was **not a revolution** in the pharma industry as they already provided detailed disclosures.
- Not always easy to distinguish between **out-licensing arrangements** (i.e. licence transfer in IFRS 15) and the pure sale of an intangible asset.
- Diversity in practice on the presentation of **out-licensed arrangements** as some present them within 'net sales' while others present them within 'other operating income', depending on whether entities consider these arrangements as part of their core business. The IFRS IC agenda decision on 'player transfer payment' may reduce the diversity in practice
- Disclosures on **contract balances** were identified as difficult to prepare the implementation phase while investors showed low interest for this information (e.g., the reconciliation of contract asset and liability balances)
- Difficulties arise with **non-routine transactions** (e.g., business combinations - there is a need to reassess how revenue is recognised)
- **Principal versus agent considerations** and **collaboration arrangements** were identified as a challenge

ISSUES RAISED BY TELCO ENTITIES

- **Mixed views on the overall assessment.** One company satisfied while other not due mainly to higher costs.
- The **implementation of IFRS 15** had been a challenging and costly exercise.
- On an ongoing basis, IFRS 15 involves significant additional application costs and higher degree of judgement from management.
- IFRS 15 set a **lower level of prudence** on revenue recognition as a result of early recognition of revenue from sale of handsets
- Difficult to estimate the **contract period** as it may depend on the applicable laws in a jurisdiction
- The requirements on **contract costs** in IFRS 15 is an issue as it is difficult and judgmental to determine which costs are considered fulfilment or incremental costs that lead to the recognition of as an asset

ISSUES RAISED BY TELCO ENTITIES

- **Principal versus agent** leads to diversity in practice. Indicators included in B37 do not provide an evidence for prior control of goods or services.
- **Identifying performance obligations and the standalone selling price (SSP)**. A bundle of different components (TV stream + internet) with the same pattern of transfer exist and an add-on component (goods or services like a handheld) with a different PO pattern. The SSP of a bundle does better reflect the substance of the transaction than the SSP of each component of the bundle.
- A **customer contributes** (goods/services) to the delivery of goods or service provisions that he receives by supplier in exchange for a consideration at market value. Does it qualify for expense or revenue reduction?
- Difficult to estimate the **contract period** as it may depend on the applicable laws in the jurisdiction.
- Difficult to **identify separate performance obligations** when there is an activation fee. The entity has identified them as a separate performance obligation

ISSUES RAISED BY TELCO ENTITIES

- **Collaborative arrangements** Difficult to determine what transactions fall under the scope exemption of IFRS 15.5 d), as the guidance is limited.
- Unclear how to account for the provision of good or services to a **collaboration** partner (revenue or other operating income) when these goods/services are part of an entity's ordinary activities.
- **Principal versus agent consideration** Indicators included in IFRS 15 B37 do not provide an evidence for prior control of goods or services.

ISSUES RAISED BY SOFTWARE ENTITIES

- **Contract combinations** are frequent in the industry. It is common to define a temporal window during which multiple contracts must be closed and combined, if all the requirements are met. There may be some diversity in practice on determining the time of the window, though the preparer was not aware of that.
- **Principal vs agent consideration** may be tricky when it comes to combination of contracts (the customer may be different in the two contracts and therefore the combination may not be possible).
- **Difficult to estimate the standalone selling price** (SSP) as the marginal costs of providing the goods or services are low and the price charged varies considerably from customer to customer. The difficulty arises especially when the contract includes two products for which the residual approach is used, and the products are delivered at a different point in time.
- **Renewal of contracts is challenging** (whether they consider a new contract or a modification of a contract). The assessment is affected by the shift of many arrangements to cloud computer arrangements.

ISSUES RAISED BY SOFTWARE ENTITIES

- **Accounting of material rights** and its consideration as a separate performance obligation **had an impact on the entity's business.** The practice of granting incremental future discounts at the moment of a software sale ended as it delayed the recognition of revenue.
- **Principal vs agent (measurement uncertainty).** Issue arises due to the need for an entity to estimate the selling price of its resellers (agents) that can determine the price to the end customers. An affected software entity called for additional application guidance.
- **Challenges in determining point in time versus over time recognition.** Arises when the customer has the choice of either downloading the software or subscription. An affected software entity called for additional application guidance.
- **Increase use of APMs after the adoption of IFRS 15.** A software entity indicated increased APM reporting such as sales based on cash or annual recurring revenue corresponding to the increased level of required judgment under IFRS 15.



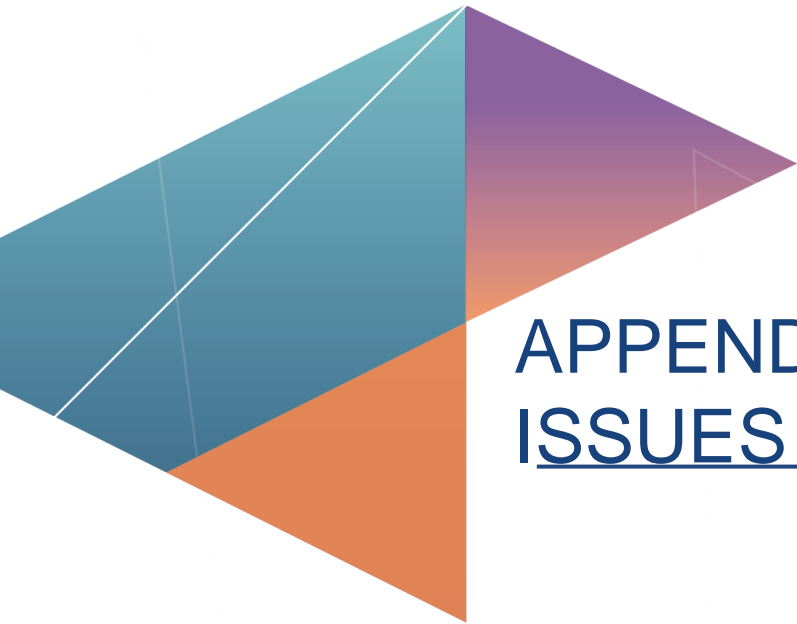
USER PERSPECTIVE

INTERVIEW WITH PHARMACEUTICAL SECTOR ANALYST

- The user corroborated the challenges mentioned by the pharmaceutical sector preparers
- **Divergence in practice** of the **accounting treatment of out-licensing arrangements** leading to revenues being recognised in different lines of the statement of financial performance (sales, other operating income...). For analysts it is very important to understand which transactions are included in each revenue line.
- **Principal versus agent.** The complexity of the accounting issue is strictly related to the complexity of the contracts
- **Disclosures** of drugs not fully owned by the entity need to be improved including, for example, information related to (i) who holds variable royalties, (ii) how the accounting works
- Useful for analyst to have further information on the total revenue for the main drugs detailed by revenue/other revenue, by country/region and by direct sales/collaboration revenue. Gross margin, which depends on cost recognition is important
- However, disclosures of the reconciliation of contract assets (liabilities) are not useful- corroborating the view expressed by a preparer

EFRAG FR TEG-USER PANEL KEY MESSAGES

- The information on revenue under IFRS 15 is useful to users to assess a company's financial performance and position and to compare with other companies
- Some areas of IFRS 15 present application challenges, largely in areas requiring judgement (e.g., whether a contract is under the scope of IFRS 15)
- The IASB should assess the interaction of IFRS 15 with other IFRS Standards and principal versus agent considerations



APPENDIX: ISSUES ADDRESSED BY IFRS IC

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- Since the issuance of the IFRS 15, the IFRS Interpretation Committee has received several submissions seeking clarification of various issues. Issues dealt by the Committee are summarised below.

Issue	Agenda decisions
Performance obligation satisfied over time or at a point in time	<ul style="list-style-type: none">- March 2018 – Right to payment for performance completed to date/ Revenue recognition in a real estate contract. Two request about whether to recognise revenue over time or at a point in time in relation to a contract for the sale of real estate unit in a residential multi-unit complex.- In both requests, the entity retains legal title to the real estate unit until the customer pay (after construction is complete). The customer pays a portion at the beginning and the remainder after construction. In one of the requests the customer has the right to cancel the contract paying the difference between the original purchase price and the resale price, if any, while in the other the customer can't cancel the contract but can resell or pledge its rights.

APPENDIX: ISSUES ADDRESSED BY IFRS IC

Issue	Agenda decisions
<p>Identification of performance obligations/ Performance obligation satisfied over time or at a point in time</p>	<ul style="list-style-type: none"> - March 2018 – Revenue recognition in a real estate contract that includes the transfer of land (and the construction of the building). The submission sought clarification on the number of performance obligations identified in the contract (one or two) and on whether the related revenue should be recognised over time or at a point in time.
<p>Identification of performance obligations</p>	<ul style="list-style-type: none"> - January 2019 – Assessment of promised good or services. Recognition of revenue by a stock exchange entity that provides a listing service to a customer. The request asked whether a non-refundable upfront fee that the entity charges to the customer give rise to an admission service that is distinct from the listing service.

APPENDIX: ISSUES ADDRESSED BY IFRS IC

Issue	Agenda decisions
Variable consideration	<ul style="list-style-type: none"><li data-bbox="498 429 1729 753">- September 2019 – Compensation for delays or cancellations. Request about an airline’s obligation to compensate customers for delayed or cancelled flights. Specifically, it referred to whether the entity accounts for its obligation to compensate customers either: (a) as variable consideration (part of the price) or b) applying IAS 37 separately from its performance obligation to transfer a flight service to the customer.<li data-bbox="498 811 1729 1039">- Some comment letters, while agreeing with the Committee’s conclusion that the compensation should be considered part of the price, regretted that they did not address the question on whether the reduction of revenue is limited to reducing the transaction price to nil.

APPENDIX: ISSUES ADDRESSED BY IFRS IC

Issue	Agenda decisions
Costs to fulfil a contract	<ul style="list-style-type: none"><li data-bbox="397 425 1727 654">- June 2019 – Costs to fulfil a contract. Request about the recognition of costs incurred to fulfil a contract (construction of a building) as an entity satisfies a performance obligation in the contract over time. The submitting entity asked whether those costs should be recognised as an asset or as an expense.<li data-bbox="397 711 1727 896">- March 2020 – Training costs to fulfil a contract. Request about training costs incurred to fulfil a contract for the supply of outsourced services with a customer (whether the entity recognises the training costs as an asset or an expense when incurred).<li data-bbox="397 953 1727 1139">- Some comment letters noted that capitalising training costs that are incurred to fulfil a specific contract and that the customer agreed to reimburse would be more relevant to users than the recognition of an expense.

APPENDIX: ISSUES ADDRESSED BY IFRS IC

Issue	Agenda decisions
Principal vs Agent	<ul style="list-style-type: none"><li data-bbox="401 439 1742 572">- Principal versus Agent: Software Reseller. Request asking whether, in applying IFRS 15, a reseller of software licences is a principal or agent - (tentative decision). <li data-bbox="401 629 1742 1001">- One comment letter pointed out that if the reseller was an agent, the software manufacturer would need to include the reseller's margin as part of its revenues and costs. In their view this accounting treatment would be impracticable as they may not know the price billed by the reseller to the end customer. One auditing firm notes in its accounting manual that there is not specific guidance for these cases and that entities should apply judgment and determine the transaction price based on the relevant facts.



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