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## **PIR IFRS 15 Revenue from Contracts with Customers - Prioritisation of application challenges Issues Paper**

### **Objective**

- 1 The IASB Request for Information (RFI) of the PIR of IFRS 15 *Revenue from Contracts with Customers* is expected to be published by the end of June 2023. As part of the preparatory work for the PIR and to obtain input for EFRAG's comment letter response to the RFI, since April 2022, EFRAG has conducted outreach to European stakeholders. In April 2023, EFRAG FR TEG discussed EFRAG's initial categorisation, prioritisation of application challenges and preliminary recommendations based on the issues identified during EFRAG's preparatory work.
- 2 The objective of this session is to update and obtain the views of the EFRAG FRB on the overall messages and prioritisation of IFRS 15 application challenges agreed upon by EFRAG FR TEG.
- 3 The rest of the paper is structured as follows:
  - (a) Overview of IFRS 15 and EFRAG's preparatory work;
  - (b) Overall messages from stakeholders during the outreach;
  - (c) IASB discussion and decisions;
  - (d) Criteria for assessment of the priority of IFRS 15 PIR issues;
  - (e) Summary of prioritisation of application challenges with IFRS 15 and its interaction with other IFRS Standards;
  - (f) Detailed assessment of IFRS 15 application challenges (nine issues); and
  - (g) Detailed assessment of issues related to the interaction between IFRS 15 and other IFRS standards (four issues).
- 4 Furthermore, the Appendix includes a summary of other six identified issues that have been categorised as being of low prevalence and priority as application challenges. It is proposed that these issues should not be included in EFRAG's comment letter response to the forthcoming RFI.

## Overview of IFRS 15 and EFRAG Preparatory work

### Overview of IFRS 15

- 5 In May 2014, the IASB issued IFRS 15 which replaced IAS 11 *Construction Contracts*, IAS 18 *Revenue*, IFRIC 13 *Customer Loyalty Programmes*, IFRIC 15 *Agreements for the Construction of Real Estate*, IFRIC 18 *Transfers of Assets from Customers* and SIC-31 *Revenue—Barter Transactions Involving Advertising Services*. IFRS 15 became effective for annual periods beginning on or after 1 January 2018.
- 6 At the same time, the US Financial Accounting Standards Board (FASB) introduced into its Accounting Standards Codification® Topic 606 *Revenue from Contracts with Customers* substantially converged with IFRS 15.
- 7 In April 2016, the IASB issued *Clarifications to IFRS 15 Revenue from Contracts with Customers* which resulted in a number of clarifications mainly around the identification of performance obligations, the principal versus agent consideration and the accounting of licenses. In addition to the topics clarified by the IASB, the FASB clarified other topics around collectability, measuring non-cash consideration and timing of revenue recognition, for which the IASB decided not to issue clarifications concluding that IFRS 15 provides sufficient guidance.

### EFRAG preparatory work

- 8 EFRAG has conducted outreach to different constituents (preparers, users, auditors, national standard setters, and academics) to get their overall assessment of how IFRS has worked and to identify issues for the PIR. EFRAG has:
  - (a) Held meetings with seventeen preparers from the pharmaceutical, telecommunications, construction, aerospace, media and software industries (some of these preparers were also involved in the EFRAG field test held prior to the adoption of IFRS 15) and with a preparer organisation;
  - (b) Held three meetings with experts from three different audit firms;
  - (c) Had a meeting with a sell-side analyst from the pharmaceutical sector;
  - (d) Got input during the September 2022 International Forum of Standard-setters (IFASS) meeting (see [meeting](#) report-Page 6), EFRAG FR TEG-CFSS and participated at the IASB Accounting Standards Advisory Forum (ASAF) meeting where the topic was discussed (see [December 2022 ASAF meeting](#) report); and
  - (e) Held meetings with the EFRAG FRB, EFRAG FR TEG and the various working groups (i.e., EFRAG User Panel, EFRAG FIWG, EFRAG IAWG and EFRAG Academic panel).
- 9 Furthermore, EFRAG sent a questionnaire-based survey to European national standard setters to identify issues in the implementation of IFRS 15 that have arisen in their jurisdictions. EFRAG received eight completed survey responses (for detailed results see [the survey with National Standard Setters](#) presentation). EFRAG is also sponsoring an academic survey for users and preparers on the implementation costs and benefits. The findings of this survey are not available at this date. However, we anticipate that some of the findings (i.e., high-level

descriptive statistics for users<sup>1</sup>) will be available at the time of issuance of the RFI and can be reflected in EFRAG's draft comment letter.

- 10 In addition, EFRAG has reviewed IFRS 15 issues raised before the IFRS Interpretation Committee (IFRS IC), ESMA enforcement issues, the FASB PIR<sup>2</sup> on Accounting Standards Update Revenue from Contracts with Customers (Topic 606), and academic literature.

### **Overall messages from stakeholders during the outreach**

- 11 The general feedback from **EFRAG's outreach is that IFRS 15 is working well in practice. As a result, stakeholders have little appetite for any significant, disruptive changes** but they acknowledge there is room for targeted improvements.
- 12 Despite requiring an increased use of significant estimates and management judgment, the Standard is an improvement from the previous IFRS revenue recognition requirements and is an exemplar of an understandable Standard including through its extensive use of illustrative examples.
- 13 The implementation challenges and transition costs were significant for some industries (e.g., telco, software and construction). In many cases, ongoing incremental costs are minimal but in some cases these are significant. In many cases, the effect on the amount and timing of revenue was minimal.
- 14 No significant concerns have been raised by users and no clear picture yet on whether the additional disclosures provided enhanced analytical benefits.
- 15 There are indications that, for some companies, there were internal management benefits due to IFRS 15 as it led to enhanced contract management/documentation and improvements in interdepartmental communication.
- 16 Stakeholders have suggested that the IASB considers the relevance of the IFRS 15 requirements towards new digital business models that are becoming more prominent (e.g., increased use of cloud products, growth of digital assets related business models). Concurrently, concerns were voiced that any further significant changes to IFRS 15 could disrupt established practice and impact IT systems (i.e., cost-benefit trade-off). Plus, there is a question from some on whether it was all worth it from a cost-benefit perspective.
- 17 Convergence (i.e., enhancing or retaining converged requirements) between IFRS 15 and US GAAP requirements is a desirable outcome but some European stakeholders have also noted and expressed comfort that a level of divergence may inevitably occur.

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<sup>1</sup> The academic survey to users is expected to close in early June 2023 and the descriptive statistics are expected to be available to EFRAG. However, to obtain further data and generalisable findings, the survey to preparers will remain open and the results will be made available to EFRAG at a later date.

<sup>2</sup> The FASB PIR occurred from 2018 to 2022. The review of US GAAP PIR was considered because IFRS 15 and Topic 606 are largely converged requirements.

## IASB discussion and decisions

- 18 In March 2023, the IASB discussed the questions to be included in the RFI based on the feedback received during its outreach<sup>3</sup> on phase 1 of the project (see [IASB Agenda Papers](#)).
- 19 According to the IASB Agenda Papers, IASB's stakeholders noted that IFRS 15 had achieved its overall objective and was working well although some application challenges remained. They also indicated that the five-step revenue recognition model was generally seen as helpful—in particular as a robust basis for analysing complex transactions. In addition, some stakeholders said that the supporting application guidance and illustrative examples help entities in making judgements. Lastly, many stakeholders highlighted that IFRS 15 is an improvement on the previous revenue requirements
- 20 Generally, stakeholders suggested the IASB should resolve the identified application matters by providing targeted clarifications or additional application guidance or illustrative examples.
- 21 On the convergence with Topic 606, many stakeholders emphasised the importance between IFRS 15 and Topic 606 while some stakeholders said that convergence was important but should not be an aim or priority in itself. Having converged standards was particularly important for stakeholders from the US and Canada, for entities operating worldwide and for entities operating in fields with many US competitors. In addition, many stakeholders called for cooperation between the IASB and the FASB if either board decides to make significant changes to their respective standards.
- 22 The application challenges identified by the IASB generally overlap with those identified by EFRAG. As such, EFRAG has gathered feedback on many of the specific issues that will be included in the IASB's RFI. Hence, for each application challenge raised in this paper, there is also a summary of the IASB staff paper/IASB meeting perspective on the matter.
- 23 We however note the IASB will raise questions on the following issues for which EFRAG did not get relevant feedback and therefore need to be further investigated:
  - (a) Determining the timing of revenue recognition (Step 5 of revenue recognition model): stakeholders asked for additional guidance on applying IFRS 15 requirements for over time revenue recognition, which could require a significant judgment and lead to a revenue recognition that does not reflect the economics of the transactions.
  - (b) Transition requirements: the IASB decided to ask for more feedback on stakeholders' transition experience to assess whether the transition requirements worked as intended. In addition, further feedback, including respondents' suggestions for improving transition requirements, can be useful input for developing transition requirements for future IFRS Standards.

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<sup>3</sup> Of note, EFRAG and IASB staff conducted several joint outreach meetings to European preparers.

### Criteria for the assessment of the priority of IFRS 15 PIR issues

- 24 When considering the priority of issues, EFRAG has taken into account the IASB criteria (see [agenda paper PIR IFRS 15 project plan](#)) and considered the following:
- (a) whether the IASB’s requirements are **working as intended**:
    - (i) whether there are fundamental questions (i.e., ‘fatal flaws’) about the **clarity and suitability of the core principle** and the five-step revenue recognition model in IFRS 15
  - (b) whether the IASB’s requirements can be **applied consistently**:
    - (i) how the application challenges affect the consistent application of IFRS 15 and whether there is **diversity in practice**
    - (ii) whether there is a deficiency in the way particular types of transactions or activities are reported in financial reports;
    - (iii) whether there were any **unexpected effects of, or challenges**;
    - (iv) the **types of entities** likely to be affected by any proposals (industry, jurisdiction, etc); and
    - (v) how pervasive the financial reporting issue is for entities.
  - (c) whether the resulting **information is useful to users**:
    - (i) whether the benefits to users of financial statements of the information arising from applying the IFRS 15 requirements are broadly as expected; and
    - (ii) the level of importance of the issues identified for those who use financial reports.
  - (d) whether the **costs of applying** some or all of the IFRS 15 requirements and auditing and enforcing their application are broadly as expected.

### Summary of prioritisation of application challenges with IFRS 15 and its interaction with other Standards

25 Tables 1 and 2 summarise the prioritisation of application challenges with IFRS requirements and its interactions with other Standards. Only issues identified as a high and medium priority are included in the Tables. EFRAG has identified 19 application challenges of which 13 are included in the two tables below. The remaining 6 issues are included in the Appendix as they are considered to be of low prevalence and priority for EU stakeholders.

Table 1 Application challenges- IFRS 15 requirements

#	Issue	Type of issue	Industries affected	Prevalence & Priority for EU stakeholders	EFRAG's preliminary view on priority for IASB action	EFRAG's preliminary recommendation for IASB action
1	Determining whether an entity is a Principal or Agent (Application guidance)	Application challenges and lack of consistent application in: Applying the transfer of control principle and the related indicators	Across industries	Prevalent	High	Strengthen the principle that transfer of control should be the primary assessment in principal versus agent situations by elevating BC385H to the main body guidance
		Estimating revenue when acting as a principal	Software	Not prevalent	Not high	N/A
		Identifying the customer	E-commerce	Not prevalent	Not high	N/A

#	Issue	Type of issue	Industries affected	Prevalence & Priority for EU stakeholders	EFRAG's preliminary view on priority for IASB action	EFRAG's preliminary recommendation for IASB action
2	Identification of performance obligations (Step 2)	Application challenges in identifying performance obligations	Across industries	Prevalent	High	Additional guidance (updated illustrative examples) and improved disclosures
3	Determining the transaction price (Step 3)	Application challenges in: - determining variable consideration - Significant financing component	Software, Telco, Construction	Prevalent	High	Additional guidance and clarification of the issue
4	Consideration payable to customers and negative revenue	Lack of guidance is leading to diversity in practice	Across industries	Medium prevalence	High	Clarify the issue
5	Collaborative arrangements (Scope)	Application difficulties and lack of consistent application	Telecommunication, aerospace, pharmaceutical, Oil, Gas & Mining	Some prevalence	High	Clarify what collaborative arrangements are outside the scope of IFRS 15

#	Issue	Type of issue	Industries affected	Prevalence & Priority for EU stakeholders	EFRAG's preliminary view on priority for IASB action	EFRAG's preliminary recommendation for IASB action
6	Disclosures	Information is not always useful to users and costly to apply	Across industries	Some prevalence	High as a means of assessing benefits (medium priority as an application challenge)	Include in PIR, feedback should inform any amendments
7	Licences (Application guidance)	Royalty constraint / Others	Pharmaceutical, Software	Prevalent	High	Extend the scope of the royalty constraints and additional illustrative examples.
8	Contract modification (Steps 1 and 2)	Application difficulties and lack of consistent application	Pharmaceutical, Software	Prevalent for affected entities	Medium	Monitor for issues that may arise (e.g. with IFRIC) Check illustrative example for consistency with requirements
9	Recognition of costs (costs considered fulfilment or incremental costs)	Application difficulties and lack of consistent application	Construction / Long-term contracts	Some prevalence	Medium	No action  Clarification of the issue



#	Issue	Type of issue	Industries affected	Prevalence & Priority for EU stakeholders	EFRAG's preliminary view on priority for IASB action	EFRAG's preliminary recommendation for IASB action
		Lack of guidance is leading to diversity in practice (presentation in P&L)				

Table 2: Application challenges - Interactions with other IFRS Standards

#	Issue	Type of issue	Industries affected	Prevalence & Priority for EU stakeholders	EFRAG's preliminary view on priority for IASB action	EFRAG's preliminary recommendation for IASB action
10	Interaction between IFRS 15 and IFRS 3 - inconsistency in the recognition of contract assets and contract liabilities in the context of a business combination	Lack of consistent application	Across industries	Prevalent	High	Discussing to add a narrow-scope project
11	Interaction between IFRS 15 and IFRS 10 - Sale of a single-asset entity (e.g., corporate wrappers)	Lack of consistent application	Across industries	Prevalent	High	Discussing to add a narrow-scope project
12	Interaction between IFRS 15 and IFRS 16 (Sale and leaseback	Application difficulties and lack of consistent application	Real estate and retail	Some prevalence	High	Additional guidance (e.g., sale and leaseback transaction)

#	Issue	Type of issue	Industries affected	Prevalence & Priority for EU stakeholders	EFRAG's preliminary view on priority for IASB action	EFRAG's preliminary recommendation for IASB action
	transaction and scoping issue)					
13	Interaction between IFRS 15 and IFRS 9 (Commodities, credit risk and gift cards)	Commodities: diversity in practice	Across industries	Some prevalence	Medium	Clarification and monitoring of the issue
		credit risk: Inconsistency across standards			Medium	Clarification of the issue
		Gift Card: application difficulties and diversity in practice			Low	No action

## Detailed assessment of IFRS 15 requirements application challenges

26 Three categories are applied in the assessment of priority namely: high, medium and low. The below section only consists of EFRAG's high and medium-priority issues in respect of IFRS 15 requirements. Low-priority issues are included in the Appendix. For each issue, where applicable, we have indicated either the related step in the five-step model<sup>4</sup> or the related aspect of IFRS 15 requirements (i.e., application guidance, scope).

### IFRS 15 issues categorised by the EFRAG as being of high priority

#### **Issue 1: Determining whether an entity is a principal or agent (related to Application Guidance)**

27 EFRAG has received feedback from most stakeholders and in relation to a wide range of industries on the challenges arising from the IFRS 15 requirements on principal versus agent (PA) considerations. The concerns have arisen across a variety of business models including those with multi-layers of intermediaries, fintech companies, and construction companies with subcontractors. However, we have also found out that the application guidance works well in other sectors. In many cases, respondents are asking for more application guidance while in some cases the concerns are on specific aspects of the IFRS 15 requirements. The challenges identified stem from the following specific issues:

- (a) Applying the transfer of control principle and the related indicators in identifying whether an entity is a principal or an agent;
- (b) Estimating revenue when acting as a principal; and
- (c) Identification of a customer.

#### Applying the transfer of control principle and the related indicators in identifying whether an entity is a principal or an agent

28 Several constituents have indicated difficulties in applying the transfer of control indicators in IFRS15.B37. In their view, these indicators do not always provide evidence of an entity's prior control of goods or services before their transfer. Below is an elaboration of concerns related to the insufficiency of the three criteria:

- (a) Primarily responsibility for fulfilment (IFRS 15.B37(a)): there is no link between prior control as defined in IFRS 15.B35 and the question of whether the entity or the supplier is primarily responsible towards the customer. The fact that an entity is primarily responsible for fulfilling the contract, including providing customer support, resolving customer complaints, and accepting responsibility for the quality or suitability of the product or service does not always provide evidence that it controls the good or service before is transferred to a customer.

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<sup>4</sup> Step 1-Identify the contract with a customer;

Step 2-Identify the performance obligations in the contract;

Step 3-Determine transaction price;

Step 4-Allocate the transaction price to the performance obligations in the contract;

Step 5- Recognise revenue when, or as, the entity satisfies a performance obligation

- (b) Inventory risk (IFRS 15.B37(b)): the standard refers to risk “after transfer of control to the customer (for example, if the customer has a right of return)”. Having the inventory risk does not provide any evidence as to whether an entity controls the goods or services before they are transferred to the customer.
  - (c) Price discretion (IFRS 15.B37I): whether or not an entity has discretion in determining the selling price does not technically indicate prior control.
- 29 Therefore, an entity that is primarily responsible for fulfilling the promise to provide the specified good or service to the customer, has inventory risk (especially after the transfer of control to the customer) and has the discretion to establish the price will likely have to assess whether it controls the underlying goods or services before they are transferred to the customer.
- 30 It is worth mentioning that the indicators included in IFRS 15.B37 were carried forward from IAS 18 Revenue. IAS 18 had a principle for this assessment (based on risks and rewards) that was different from the control principle in IFRS 15. In the *Clarifications to IFRS 15 Revenue from Contracts with Customers* issued in April 2016, the IASB added application guidance to explain how each indicator supports the assessment of control as defined in IFRS 15.33 and clarified that the indicators are not an exhaustive list and they merely support the assessment of control and do not replace or override that assessment.
- 31 During the EFRAG outreach, an audit firm expert opined that there is no disconnection between the risk and reward indicators of IFRS 15.B37 and the concept of control but it may be useful to consider the supplier choice power as an additional indicator.

#### Estimating revenue when acting as a principal

- 32 When an entity acts as a principal and sells a product or service to the end client through a reseller that has discretion in establishing the price for the specified good or service, it might not know the selling price. Therefore, it needs to estimate a portion of its revenue (and the costs of revenue).
- 33 IFRS 15.BC385X states that some TRG participants asked how an entity that is a principal would estimate the amount of revenue to recognise if it was not aware of the amounts being charged to end customers by an intermediary that is an agent. The IASB noted that this issue did not require any clarification or additional guidance because the issue was expected to affect a limited number of entities and contracts. They also noted that an entity would generally be expected to be able to apply judgement and determine the consideration to which it is entitled using all relevant facts and circumstances available to it.
- 34 On 30 May 2022, the IFRS IC published the agenda decision *Principal versus Agent: Software Reseller - IFRS 15* a request asking the IC whether, in applying IFRS 15, a reseller of software licences is acting as a principal or as an agent. In the fact pattern, the reseller has discretion in determining the price sale of the software licenses. However, the IFRC IC agenda decision does not assess the revenue estimation of the software manufacturer because the fact pattern is analysed from the reseller’s point of view.

#### Identification of a customer

- 35 EFRAG has received feedback from large audit firms and national standard setters that it is sometimes challenging to identify the customer and this particularly affects the e-commerce business and the fintech transactions (i.e., from the

fintech company perspective whether the customer is the provider of the good or service or the end customer). This specific issue also arose in the PIR of the US GAAP topic ASC 606.

Prevalence and priority for EU stakeholders

- 36 For the following reasons, EFRAG considers that the principal versus agent consideration is prevalent and of high priority for EU stakeholders:
- (a) The PA issue has been raised in most of the outreach events held by EFRAG. It has been brought up by preparers in the telco, software, pharma and construction industry as well as by experts from audit firms.
  - (b) It has also been identified as prevalent and a priority area by National Standard Setters, who represent the views of a broad spectrum of constituents. In the CFSS survey, it was ranked as the most prevalent issue (90%). It was also raised as a matter of concern at the September 2022 IFASS meeting (78% of respondents to a polling question, and it was ranked as the most prevalent issue) and at the December 2022 ASAF meeting (flagged by most meeting participants)
  - (c) The issue related to estimating revenue when acting as a principal was raised and dealt with by the IFRS IC Committee – see the [Principal versus Agent: Software Reseller–IFRS 15](#) agenda decision published in May 2022). However, the issue was about a specific fact pattern and even though the agenda decision went through the different indicators included in IFRS15.B37, it did not conclude whether the reseller was acting as a principal or as an agent. It highlighted that this consideration depends on the specific facts and circumstances and the terms and conditions of relevant contracts.
  - (d) Similarly, it was identified as a challenging and judgmental area by many US practitioners in the context of the Post-Implementation Review of Topic 606, Review of Topic 606, Revenue from Contracts with Customers (see [here](#) the FASB meeting handout published in September 2022). The US situation does not imply applicability for EU entities. However, as the Standard is converged, EFRAG considers the findings under the US GAAP could be indicative of similar challenges faced by EU entities.
- 37 From the feedback gotten, EFRAG considers the challenge related to applying the indicators of transfer of control to be prevalent, resulting in diversity in practice and is of high priority for EU stakeholders for the PIR.
- 38 However, the issue of estimation of revenue when acting as a principal is a less pervasive issue as far as we are aware and as stated in IFRS 15.BC 385X. During our outreach, the latter issue was raised by an entity in the software industry but another entity in the same industry did not have this issue because they were involved in the discussions between their resellers and the end clients. The issue around the identification of customers is also less pervasive. This issue was raised by two audit firms as part of issues identified while applying the principal versus agent guidance but was not identified by preparers. Moreover, EFRAG FR TEG confirmed that these two issues are less pervasive than the challenge of applying the transfer of control principle and the related indicators.

IASB preliminary recommendation

- 39 The IASB's feedback gathered in this area and included in agenda paper 6D of the March 2023 IASB meeting highlighted matters that require the application of

judgement. However, while some of the issues arose from the need to apply judgement in cases involving complex arrangements, the feedback also suggested that some of the guidance on determining whether an entity is a principal or an agent may be unclear or insufficient, for example, the guidance on the indicators of control.

- 40 Therefore, **the IASB decided to include a question on applying the principal-agent guidance in the RFI** focusing on identifying fact patterns in which the guidance is unclear or is applied inconsistently and asking for suggestions on clarifying the guidance.

*EFRAG preliminary recommendation for IASB action*

- 41 EFRAG acknowledges that the role reporting entities fulfil (i.e., whether they are a principal or agent) can vary and, in some cases, entities can fulfil both roles for different transactions they engage in. We also acknowledge that as indicated by constituents, for some fact patterns, the indicators included in IFRS 15.B37 may not be sufficient for reporting entities to ascertain that the transfer of control for goods and services has occurred or may not even be relevant at all. However, this is not indicative of a fatal flaw in the Standard since as indicated in paragraph BC385H the indicators merely support an entity's assessment of whether it controls a specified good or service before transfer in scenarios for which that assessment might be difficult. Therefore, depending on the facts and circumstances, individual indicators will be more or less relevant or persuasive to the assessment of control.
- 42 Furthermore, while acknowledging the suggestion made by an audit firm expert that having supplier choice could be an additional indicator, EFRAG considers that with evolving business models and contractual arrangements, there can be no set of indicators that will be exhaustive and encompass all the fact patterns faced by preparers. There will always be a judgement-based aspect to the PA determination. In other words, we consider that it is unlikely that any change in guidance within the framework of Principles-based requirements will resolve the difficulties that preparers face in the PA determination. Furthermore, BC37 and BC37A enable entities to use different indicators. Of note, the PA determination challenges are not limited to IFRS 15.
- 43 EFRAG's preliminary recommendation is to enhance the message that the assessment of transfer of control is the primary assessment and proposes that the IASB should elevate paragraph BC385H to the application guidance. This way, the application guidance would indicate that the indicators (1) do not override the assessment of control; (2) should not be viewed in isolation; (3) do not constitute a separate or additional evaluation; and (4) should not be considered a checklist of criteria to be met, or factors to be considered, in all scenarios.

***Issue 2: Identification of performance obligations (related to Step 2 of the five-step model)***

- 44 EFRAG received feedback that complexities arise when identifying performance obligations in an arrangement, particularly on whether the promise is distinct in the context of the contract. The IFRS Interpretations Committee has also received requests on whether a good or service is distinct in the context of the contract.
- 45 This issue often occurs in the telecommunication, construction, and software industries and contracts containing licenses, particularly when considering post-contract customer services (updates, bug fixes, etc) and new business models focused on cloud products (hosting arrangements). Another example is the

charge to the customer of a non-refundable upfront fee which can affect the telecommunication, pharmaceutical and retail industries. In the telecommunication industry, preparers have mentioned that it is difficult to identify separate performance obligations when there is, for example, an activation fee (i.e. whether the payments relate to the transfer of a promised good or service and if so, whether these promises represented separate performance obligations). Also, the existence of a non-refundable upfront fee may indicate that the contract includes a renewal option for future goods or services at a reduced price. In such circumstances, a preparer may need to assess whether the option is a material right. There are other examples such as:

- (a) A franchisor which charges a separate non-refundable fee from a franchisee to enter the franchise network; and
- (b) a drug manufacturer that sells its products in other countries by signing an agreement with a local third party, under which that party receives an exclusive right to distribute the products on that local market. There is a non-refundable upfront payment for a 'licence' for a sole right to distribute the product and then variable payments based on price and quantity of products delivered.

*Prevalence and priority for EU stakeholders*

- 46 During EFRAG outreach activities, preparers and national standard setters have often mentioned this issue, particularly preparers from the software and telecommunication industry. In addition, the IFRS Interpretations Committee received requests on whether a good or service is distinct in the context of the contract. Finally, in response to the EFRAG survey sent to CFSS members, one respondent indicated that the identification of performance obligations is a challenging issue. Therefore, EFRAG assesses that this issue is of high prevalence and high priority to EU stakeholders.

*IASB preliminary recommendation*

- 47 The IASB noted that many stakeholders of all types commented on application matters related to identifying the performance obligations in a contract. The comments related to:
- (a) challenges applying specific requirements for Step 2 (e.g., identifying a good or service specified in a contract, applying the concept of 'distinct'; and
  - (b) cases when applying the requirements may result in outcomes that do not reflect the economics of a transaction or lead to significant costs.
- 48 The diversity in practice mentioned by these stakeholders could be due to either the specifics of the contracts or unclear or insufficient guidance. The IASB suggested that gathering further information about circumstances in which entities are unclear on how to apply the requirements on identifying performance obligations and in which they observe diversity in practice, would help them assess whether the effects of the requirements are as expected and whether requirements are capable of being applied consistently. This information would also provide evidence on the cause of any diversity in practice, the prevalence of any diversity, and the effects of any diversity.
- 49 Therefore, **the IASB decided to include a question related to the guidance on identifying the performance obligations in the contract in the RFI**, focusing on identifying fact patterns in which the requirements are applied inconsistently,



leading to either reporting outcomes not reflecting the underlying economic substance or significant ongoing costs.

EFRAG preliminary recommendation for IASB action

- 50 Given the importance of identifying performance obligations for multiple-element arrangements including those involving licenses (as outlined in issue 7 below), EFRAG recommends the following potential improvements to current requirements:
- (a) Updating the examples in IFRS 15 to reflect new business models, such as the prevalence of cloud products and hybrid models (i.e. companies that have both the 'right to use a licence' and 'right to access a licence') and introducing an illustrative example where a non-refundable upfront fee would be linked to a performance obligation.
  - (b) Reviewing the disclosures on significant judgements and assumptions to ensure completeness. Some of the significant judgements are explicitly required by IFRS 15 (e.g. disclosures on the timing of satisfaction of performance obligations and the transaction price and the amounts allocated to performance obligations). However, other common significant judgements might need to be disclosed such as judgements on the identification of separate performance obligations (e.g., significant judgements on warranty or maintenance phases in the retail industry and treatment of upfront fees and pre-production costs in the construction or outsourcing industries).

**Issue 3: Application challenges in determining the transaction price (related to Step 3 of the five-step model)**

- 51 EFRAG received feedback that, for affected entities, determining the transaction price can be complex and judgemental but without sufficient application guidance. Challenges were highlighted in respect of:
- (a) Variable consideration; and
  - (b) Significant financing component.

Variable consideration

- 52 IFRS 15.56-57 requires an entity to include a variable consideration in the transaction price only to the extent that it is highly probable that a significant reversal in the amount of cumulative revenue recognised will not occur when the uncertainty associated with the variable consideration is subsequently resolved. This assessment requires an entity to consider both the likelihood and the magnitude of the revenue reversal.
- 53 EFRAG received feedback that it can be challenging to estimate variable consideration including price concessions, rebates and returns. For example, it is difficult to estimate the variable consideration of products like gene therapies or vaccine therapies that are sold and there is a need to track the success of those products over a long period of time. In addition, it is often a judgement that is significantly debated with the auditors.
- 54 Furthermore, preparers highlighted that the assessment of the "high probability" threshold that the revenue will not be reversed in the future is challenging and that they involved internal and external legal/technical advisors to assess such probability. Such an assessment, especially in the construction industry, could be particularly challenging when related to some "optional/extra-works" or contract

modifications in scope and/or price, usually subject to dispute between the parties (both in terms of merit and pricing). In this context, the concept of highly probable could be interpreted in different ways across entities leading to diversity in practice. Diversity in practice occurs during both initial measurement and subsequent measurement. Even though an entity might not recognise revenue initially because the 'highly likely' threshold is not clearly met, it could recognise it overtime as the uncertainty diminishes, being judgmental when this moment takes place.

- 55 Besides application challenges, EFRAG also received feedback on the appropriateness of the IFRS 15 requirements on variable consideration. Specifically, it was noted that the high probability threshold requirement conflicts with the overarching accounting principles of neutrality because it is overly prudent or conservative. Despite the standard being built towards conservatism, there were not many changes in practice compared to the previous revenue recognition requirements. For example, in the construction industry, variable consideration arrangements (i.e., penalties) are frequent and they should reduce the total price unless the likelihood of these penalties is remote. In practice, many contractors do not account for these penalties until agreed upon with the client (and this is usually done together with other modifications in scope and takes place towards the end of the construction phase).
- 56 Nonetheless, based on past feedback, EFRAG's understanding is that users expect prudence in the recognition of variable consideration due to its uncertainty and to avoid overstating revenue or recording potentially reversible revenue. Furthermore, the purpose of the PIR is not to resurrect discussions on the appropriateness of the Standard's recognition and measurement requirements.

#### Significant financing components

- 57 EFRAG has received feedback from some EFRAG FR TEG members of the widespread tendency to not recognise a financing component even in the long-term contracts industries (e.g., construction, aerospace and life sciences sectors). The issue has increasing relevance in light of the rising interest rates. Specifically, they noted that the concept of IFRS 15.62 c)<sup>5</sup> (a factor whereby a contract with a client does not include a significant financing component) is imprecise and may lead to an entity not recognising the time value of money.
- 58 Furthermore, ESMA published an enforcement decision on the significant financing component ([EECS/0122-05](#) 26<sup>th</sup> Extract from the EECS's Database of enforcement). The enforcement decision was about the lack of recognition of the significant financing component in a long-term construction contract where revenue was recognised over time and the major part of the contract price was paid upon delivery. Given the length of time between when the entity transfers the promised goods and services to the customer and when the customer pays

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<sup>5</sup> Paragraph 62 c) of IFRS 15 states that a contract with a customer would not have a significant financing component if "the difference between the promised consideration and the cash selling price of the good or service (as described in paragraph 61) arises for reasons other than the provision of finance to either the customer or the entity, and the difference between those amounts is proportional to the reason for the difference. For example, the payment terms might provide the entity or the customer with protection from the other party failing to adequately complete some or all of its obligations under the contract."

for those goods and services the issuer should have assessed the existence of a significant financing component.

Prevalence and priority for EU stakeholders

Variable consideration

- 59 The challenges of determining variable consideration, raised during EFRAG outreach, came from:
- (a) preparers, particularly in the software, construction, pharmaceutical and telecommunication industries;
  - (b) regulators, particularly on the allocation of the transaction price to multiple performance obligations; and
  - (c) CFSS respondents to the EFRAG survey identified variable consideration (62.5% of respondents) as among the most prevalent application challenges in their jurisdictions.
- 60 Therefore, EFRAG assesses that variable consideration is of high prevalence and priority for affected EU entities. As these issues affect the amount, timing, and uncertainty of revenue, the IASB needs to explore potential improvements to the existing guidance.

Significant financing components

- 61 This issue was raised by:
- (a) one large audit firm;
  - (b) ESMA enforcement issue report in paragraph 58;
  - (c) a CFSS respondent to the EFRAG survey identified significant financing components as among the most prevalent application challenges in its jurisdiction and was also raised at the December 2022 ASAF session; and
  - (d) some EFRAG FR TEG members who outlined the pervasiveness and importance of this issue especially in industries where entities are involved in long-term contracts. It is common for customers in these industries (for example aircraft manufacturers) to make down payments years in advance.
- 62 Therefore, EFRAG considers this issue to be of high prevalence, especially in industries involving long-term contracts, and of high priority issue for EU stakeholders.

IASB preliminary recommendation

Variable consideration

- 63 The IASB noted that:
- (a) The feedback received suggests that despite initial challenges entities have developed accounting policies for estimating variable consideration and there is no evidence of significant diversity in practice; and
  - (b) the 'highly probable' threshold used in IFRS 15 had already been used in other IFRS Accounting Standards such as IFRS 5.
- 64 Therefore, the **IASB decided to not include a specific question on variable consideration in the RFI.**

Significant financing components

- 65 The IASB received little feedback in this respect which came mainly from stakeholders from Latin America. Therefore, **the IASB decided to not include a specific question on the significant financing component in the RFI.**

EFrag preliminary recommendation for IASB action

- 66 Based on the above assessments that these issues on significant financing components and applying the variable consideration constraint are of high prevalence and priority for EU stakeholders, EFRAG recommends the following potential improvements to current requirements:
- (a) providing additional guidance on how to apply the constraint on variable consideration, including when variable consideration is negative; and
  - (b) clarify the extent to which reasons other than the provision of finance could be met when applying paragraph 62 c) of IFRS 15.

**Issue 4: Consideration payable to customers and lack of guidance on the treatment of negative revenue<sup>6</sup>**

- 67 There is currently a lack of clear IFRS requirements for accounting for the consideration payable to a customer and a lack of guidance on the treatment of negative revenue.
- 68 The IFRS Interpretations Committee has received requests to address the lack of guidance on the treatment of negative revenue. In addition, preparers, auditors, regulators and national standard setters have highlighted this issue in the outreach activities.
- 69 During EFRAG outreach, the lack of clear IFRS requirements related to the treatment of negative revenue (also referred to as contra revenue) and the resulting diversity in practice was raised by a representative of the audit firms. We got more colour on the issue in our analysis of a related IFRS Interpretations Committee request and the FASB PIR on US GAAP revenue recognition requirements. This issue has been raised in respect of
- (a) incentives from agents to end consumers; and
  - (b) obligation to compensate customers.

Consideration payable to customers

- 70 EFRAG has been informed by preparers of the telco and the software industry business about transactions where a customer contributes to the delivery of goods or service provisions by providing raw materials or services in exchange for consideration at market value. An example could be an entity in the software industry that sells a cloud service to the end customer but get from the same customer infrastructure hosting technical management services that are used as an input to the cloud service.
- 71 Entities apply IFRS 15.70 to assess whether the consideration payable to a customer in exchange for a distinct good or service that the customer transfers to the entity. Overall, an entity concludes that the customer does not provide a

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<sup>6</sup> EFRAG has decided to present the consideration payable to customers issue together with the lack on guidance on the treatment of negative revenue to be consistent with how the IASB presented the issue in agenda paper 6C of the IASB meeting held on March 2023.

distinct good or service when it cannot realistically use such goods or services for any other purpose than for fulfilling its performance obligation to the customers.

- 72 However, a software preparer expressed concerns about the fact that non-cash considerations paid to a customer under IFRS 15.69 and considerations payable to a customer under IFRS 15.70 are assessed using different concepts despite being similar in substance. Specifically, under IFRS 15.69, an entity would apply the concept of control to assess whether it controls the goods or services provided by the customer. However, under IFRS 15.70, an entity would apply the concept of a 'distinct good or service' to assess whether the good or service received by the client is distinct.

#### *Lack of guidance on the treatment of negative revenue*

##### Incentives from agents to the end consumer

- 73 EFRAG received feedback that there is a lack of guidance on whether incentives/penalties to customers by intermediaries should be presented as negative revenue or expense. For example, a start-up may pay an incentive to attract customers higher than the consideration they will receive from the supplier. However, it has been noted that this issue was also at play under previous requirements.
- 74 Similarly, in an agenda paper for the FASB July 2021 meeting, the FASB Staff highlighted, that auditors raised concerns on the accounting for consideration payable to a customer. When companies that are acting as an agent provide a marketing incentive to the end consumer, they must determine whether to present these incentives as a contra-revenue or as a marketing expense.
- 75 Many companies acting as an agent do not want to net incentives against revenue because the payments are not payments to a customer, but rather payments to their customer's customer. However, auditors noted that there is no framework in the guidance for determining when incentives should be treated as consideration payable to a customer (and thus a decrease in revenue) when the end user is not technically a customer and the contracts are not contractually linked. More than one audit firm indicated that the FASB Board could issue authoritative or interpretative guidance on how companies look at those arrangements, noting that the TRG had discussed this topic but did not fully resolve the issue.
- 76 Several auditors also noted issues related to a large amount of marketing incentives netting against gross revenues such that total net revenue is negative. Those auditors noted that there is diversity in practice on how to present negative revenue.

##### Obligation to compensate customers

- 77 The IFRS Interpretations Committee received a request about an airline's obligation to compensate customers for delayed or cancelled flights. The request asked whether the entity accounts for its obligation to compensate customers as variable consideration applying paragraphs 50-65 of IFRS 15, or applying IAS 37 *Provisions, Contingent Liabilities and Contingent Assets*, separately from its performance obligation to transfer a flight service to the customer.
- 78 The Committee concluded that compensation for delays or cancellations, as described in the request, is variable consideration in the contract. Accordingly, the entity applies the requirements in paragraphs 50-59 of IFRS 15 in accounting for its obligation to compensate customers for delays or cancellations.

79 The Committee however did not consider the question of whether the amount of compensation recognised as a reduction of revenue is limited to reducing the transaction price to nil. In particular, whether any compensation payment beyond the ticket price should be recognised as an expense or as negative revenue.

80 This issue was also raised by EFRAG TEG members. However, we note that an EFRAG FRB member also stated that this challenge of negative or contra revenue predates IFRS 15.

*Prevalence and priority for EU stakeholders*

81 As mentioned above, the IFRS Interpretations Committee has received requests to address this issue. In addition, preparers, auditors, regulators and national standard setters have highlighted this issue in the outreach activities.

82 Therefore, EFRAG assesses that this issue has some prevalence leading to diversity in practice and is a high priority as it affects the presented revenue amount.

*IASB preliminary recommendation*

83 The IASB has identified the same issues outlined by EFRAG in paragraph 69 above. In their view, the “consideration payable to customers” issue relates to applying the concept of ‘distinct’ in identifying performance obligations, which already has its own specific question. However, feedback related to “incentives from agents to end consumer” and “obligation to compensate customers” indicates there may be a lack of clarity on the presentation of revenue amounts. Stakeholders asked the IASB to clarify the requirements to improve consistency in presentation.

84 Given the rising popularity of digital platforms, the materiality of amounts involved and the fact that there may be diversity in practice, the IASB considers that it would be helpful to gather further evidence on the aforementioned matters. Therefore, **the IASB decided to include a specific question on accounting for consideration payable to a customer in the RFI.**

*EFRAG preliminary recommendation for IASB action*

85 Based on the above analysis that this is a high priority, EFRAG considers that the IASB could clarify how to account for the obligation to compensate customers and/or incentives from agents to the end consumer, including whether they should be presented as negative revenue or expense and how the allocation of penalties and incentives should be done (by customer, by transaction, by contract, etc.,).

86 EFRAG does not have a view on the pervasiveness and practical implications of the noted inconsistency between the accounting treatment of non-cash considerations payable to a customer and considerations payable to a customer yet (see paragraph 72 above).

***Issue 5: Whether collaborative arrangements are in scope***

87 EFRAG received feedback that it could be difficult to determine whether a contract (or only a part of it) falls under the scope exception of the Standard. As specified in paragraph 5 of IFRS15, the Standard is not applicable for some contracts and it is only applicable to a contract if the counterparty to the contract is a customer. As stated in paragraph 6 of IFRS 15, there could be circumstances where the counterparty to the contract would not be a customer. For example, if, rather than to obtain the output of the entity’s ordinary activities the counterparty



has contracted with the reporting entity to participate in an activity or process as part of a risk-sharing arrangement.

- 88 Collaborative arrangements are frequent in the pharmaceutical, automotive, oil & gas and telecommunication industries and are mainly related to the development of an asset (e.g., a new technology) and these can also be related to providing goods or services as part of an entity's ordinary activities.
- 89 However, constituents including preparers from different sectors (pharma, software, telco) and audit firm experts have pointed to the limitations of IFRS 15.6 in identifying whether a collaborative arrangement contract is within the scope of IFRS 15. However, it has not been elaborated under what specific circumstances, the challenges with determining whether collaborative arrangements are in scope arise.

Prevalence and priority for EU stakeholders

- 90 During EFRAG's outreach, auditors and preparers often mentioned this issue, in relation to the pharmaceutical and telecommunication sectors. However, only one CFSS respondent to the EFRAG survey indicated that determining the applicable standard to account for the collaborative arrangements is a challenging issue. Therefore, EFRAG assesses that there is only a medium prevalence of this issue but it is of a high priority to EU stakeholders as it reflects an area where there is an identified gap in the IFRS requirements.

IASB preliminary recommendation

- 91 The IASB noted that a question about accounting for collaborative arrangements that are outside the scope of IFRS 11 came up in the PIR of IFRS 10, IFRS 11 and IFRS 12 (here the [Feedback Statement](#)).
- 92 **The IASB considered that this is a cross-cutting issue and concluded that this matter could be considered in the next Agenda Consultation rather than in the PIR of IFRS 15.**

EFRAG preliminary recommendation for IASB action

- 93 As noted, EFRAG outreach has not substantiated under what specific circumstances or fact patterns, the challenges with determining whether collaborative arrangements are in scope arise. EFRAG also acknowledges the cross-cutting nature of collaborative arrangements. Nonetheless, based on the assessment that this issue is of a high priority to affected EU stakeholders given the importance and prevalence of these arrangements, EFRAG recommends the IASB should clarify which collaborative arrangements are considered to be outside of the scope of IFRS 15 (i.e. which arrangements meet the requirements included in IFRS 15.5(d)).

**Issue 6: Disclosures**

- 94 To enable investors to understand the nature, amount, timing and uncertainty of revenue and cash flows arising from revenue with contracts with customers, IFRS 15 has disclosure requirements detailed in paragraphs 110-129 of IFRS 15.
- 95 EFRAG has received feedback mainly from NSS, preparers and auditors on the required disclosures. Even though we have presented the topic to the EFRAG user panel, we have not gotten detailed specific feedback from users on the disclosures. EFRAG expects that some insights will be drawn from the academic survey to users and we will consider whether to send a tailored survey on disclosures before the issuance of the RFI.

- 96 The feedback from NSS, preparers and auditors has been about the complexity, the high level of judgement required, some questions on the usefulness and suggestions for improvement of the following required disclosures:
- (a) disaggregation of revenue for the period;
  - (b) reconciliation of the contract balances;
  - (c) the transaction price allocated to the remaining performance obligations; and
  - (d) significant judgements/estimates used in the application of the standard.
- 97 Regarding the disaggregation of revenue, some NSS and auditors noted:
- (a) Lack to provide disaggregated information at a useful level for users and too standardised disclosures, which could not represent the entity-specific circumstances (e.g., split between direct sales vs collaboration revenue in the pharmaceutical industry); and
  - (b) Undue complexity for small-medium entities. Some disclosure requirements (e.g., IFRS 15.114 and IFRS15.B87-89) seem to better suit those entities that are in the scope of IFRS 8 *Operating Segments* (e.g., listed entities). Therefore, such a disclosure requirement should be differentiated based on the type or size of the entity that has to provide for it.
- 98 Regarding the reconciliation of the contract assets and liabilities, some preparers noted costs for preparers could outweigh benefits for users, especially in the pharmaceutical industry.
- 99 Regarding the disclosure of the aggregate amount of the transaction price allocated to the performance obligations that are unsatisfied (or partially unsatisfied) as of the end of the reporting period, some preparers and NSS noted:
- (a) Additional explanation on how to calculate the required amount could be useful (e.g., how to reconcile it from the amount of backlog provided in the management report);
  - (b) It is not always clear how this information could provide useful information to users as they usually did not ask for additional clarification from preparers; users seem more interested in the backlog information instead of in the remaining performance obligations.
- 100 An auditor FR TEG member suggested adding a reconciliation requirement on the transaction price allocated to the performance obligations that are unsatisfied as of the end of the reporting period as it would enable users to identify unusual movements such as changes in the scope of consolidation.
- 101 A few preparers noted that some of the required disclosures refer to information that is not needed by management in running the business and, therefore, they questioned the benefit to investors.

*Prevalence and priority for EU stakeholders*

- 102 As stated above, during EFRAG's outreach, some preparers, auditors, and national standard setters mentioned the challenges and questioned the usefulness of providing some of the required disclosures. Many CFSS respondents (50%) to the EFRAG's survey indicated providing the required disclosures was one of the most prevalent application matters (e.g., challenging because it requires judgement to achieve the disclosure objective).



IASB preliminary recommendation

- 103 The IASB noted that Phase 1 feedback had indicated that the main concerns about disclosure requirements related to whether:
- (a) the costs of meeting some requirements exceeded the usefulness of the resulting information to users of financial statements: and
  - (a) the specificity of disclosure requirements was sufficient.
- 104 Therefore, **the IASB decided to include a question on these matters in the RFI.**

EFRAG preliminary recommendation for IASB action

- 105 EFRAG assesses that there is some prevalence and a medium priority of disclosures as an application challenge for EU stakeholders. However, as stated in paragraph 24(c) above, another of the objectives of the PIR is to ascertain whether the Standard delivered the intended benefits to users. In other words, disclosures should not only be assessed on whether they present application challenges. In that regard, EFRAG notes IFRS 15 significantly increased the disclosure requirements intending to benefit users. So far, though there is an indication of application challenges, we have not received any positive confirmation or specific feedback from users on the benefits of these disclosures. Hence, disclosures should be a high priority for inclusion in the PIR so as to evaluate the benefits of the Standard relative to the related cost and complexity. We note that EFRAG has sponsored an academic survey of preparers and users, and we anticipate benefits expressed by user respondents will be informed by their views on the disclosures.
- 106 As stated above, an objective of the PIR is to assess whether the Standard delivered its intended benefits. Hence, EFRAG recommends the IASB include the disclosures where there has been an indication of application challenges (see paragraph 98 above) as a PIR issue. Based on the feedback to the PIR, the IASB can consider the appropriate amendments (if any) to the current disclosure requirements.

**Issue 7: Licenses (relates to application guidance)**

- 107 EFRAG has received extensive feedback that accounting for licenses is challenging. An entity has to determine whether the promise to grant a license is distinct from other goods or services promised in a contract. If the license is distinct, an entity has to determine in accordance with the application guidance on accounting for licenses<sup>7</sup> whether the license is transferred to a customer either at a point in time or over time. This depends on whether an entity's promise is to provide a right to access the entity's intellectual property (IP) as it exists throughout the licence period or if it provides a right to use the IP as it exists at the point in time the licence is granted<sup>8</sup>. In addition, paragraph B63 establishes that sales-based or usage-based royalties linked to a license are recognised when the sale or usage occurs (i.e., they do not follow the variable consideration requirements included in paragraphs 50 to 59 of IFRS 15).

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<sup>7</sup> See paragraphs B52 to B63B of IFRS 15.

<sup>8</sup> If the promise to grant a license is not distinct from other promised good or services, an entity accounts for the license in a bundle together with the other goods or services and follows the general requirements (paragraphs 31 to 38) to determine whether the unique performance obligation is satisfied overtime or at a point in time.

- 108 EFRAG has received feedback that there are circumstances where determining if the promise to grant a license to a customer is distinct from other promised goods or services in the contract is very challenging. For example, in the case of a drug manufacturer who licenses to a customer its rights to the distribution of the drug and also promises to manufacture the drug for the customer, determining whether the right to sell the product is distinct or not requires careful analysis of the contract and the product. For example, whether the drug is generic or not or whether there is a minimum level of purchases could be relevant aspects to consider.
- 109 EFRAG has also learnt that determining if the licensing of intellectual property is the predominant transaction is sometimes very judgemental and challenging. According to B63B the "royalty constraint" applies when the royalty relates only to a licence of intellectual property or when a licence of intellectual property is the predominant item to which the royalty relates. For example, the licence of IP may be the predominant item to which the royalty relates when the entity has a reasonable expectation that the customer would ascribe significantly more value to the licence than to the other goods or services to which the royalty relates.
- 110 We have also obtained feedback that, in the pharmaceutical industry, it is sometimes challenging to distinguish between out-licensing arrangements, which are the usual license agreements in this industry, and the pure sale of the drug (intangible). Some contracts refer to licensing but in substance, the arrangement may be a sale of IP. Some entities follow the legal form of the contract and some account for the arrangement based on its substance, leading to diversity in practice. It is common for transactions of this type to include sales-based royalties that are paid to the entity if the drug is successfully developed. In such situations, the judgment applied by entities to determine the nature of the transaction is critical. If the transaction is an out-licensing arrangement, the royalties constraint will apply and the royalties will not normally be recognised until the sale occurs (IFRS15.B63). However, if the nature of the transaction is a sale, an entity recognises an estimate of these royalties as part of the consideration to be received in accordance with the variable consideration principles of IFRS 15 (IAS38.116).

*Prevalence and priority for EU stakeholders*

- 111 EFRAG considers the application challenges in accounting for licenses to be of high prevalence and a high priority for EU stakeholders for the following reasons:
- (a) The application challenges were outlined by several preparers from the pharma and software industries.
  - (b) CFSS respondents (50%) to the EFRAG survey identified the issue as a prevalent issue. One of them highlighted as a challenge the accounting for bundles of licenses and renewal of licenses in the software industry. At the September 2022 IFASS meeting, it was identified as the second most prevalent issue after PA considerations and was also raised at the December 2022 ASAF session.
  - (c) Accounting for licenses has also been identified as challenging by several US practitioners in the context of the Post-Implementation Review of Topic 606 Revenue from Contracts with Customers (see [here](#) related FASB document). The challenges faced by US preparers related to contract modifications as well as the shift from over time to a mix of upfront and over time recognition. However, there are some differences between IFRS 15

and Topic 606 in the accounting for licenses and it cannot be inferred that similar issues will arise for EU entities.

IASB preliminary recommendation

- 112 The IASB noted that some of the challenges highlighted related to other guidance in IFRS 15, for which the IASB already recommended including questions in the RFI (i.e., Step 2 – Identifying the performance obligations in the contract) rather than to applying the guidance on licensing.
- 113 Stakeholders’ feedback specific to licensing indicates that there may be diversity in practice, for example in accounting for out-licensing or licence renewals. Any such diversity could reduce the usefulness of information to users of financial statements. Any lack of clarity on the date of accounting for renewals may also create scope for revenue manipulation.
- 114 The IASB thought it would be helpful to gather further information on the circumstances in which entities face challenges in applying the guidance for licensing and their suggestions for improving the guidance. This could help the IASB in assessing whether the requirements in IFRS 15 are sufficient and capable of being applied consistently. It could also help in assessing the prevalence of any diversity in practice and the effects of any diversity on financial statements. Therefore, **the IASB decided to include a question on applying the guidance on licensing in the RFI, focusing on identifying fact patterns in which the guidance is unclear or is applied inconsistently and asking for suggestions on clarifying the guidance.**

EFRAG preliminary recommendation for IASB action

- 115 To deal with the challenges outlined in paragraphs 108 and 109 above, EFRAG considers that the IASB could provide further illustrative examples for more complex fact patterns. For example, there could be an example that enables entities to identify whether a license is the predominant promise in a more complex scenario than the one depicted in the illustrative example 60 of IFRS 15. Alternatively, additional guidance or definitions on what being the predominant item means could enable entities to better apply judgment.
- 116 To deal with the challenge outlined in paragraph 110 above and avoid diversity in practice, EFRAG considers that the IASB could extend the royalty constraint to other fact patterns like the pure sale of intellectual property.
- 117 We have gotten feedback on some other aspects of the accounting of licenses including the identification of performance obligations in cloud contracts, challenges around the identification of stand-alone selling prices of software subscriptions or the renewal of licenses in the software industry. These aspects are analysed in this issues paper within the corresponding issue. (e.g., the renewal of licenses in the software industry is part of the broader issue of contract modification- issue).

**IFRS 15 issues categorised by the EFRAG as being of medium priority**

**Issue 8: Contract modification (Primarily related to steps 1 and 2, but could be interdependent with steps 3, and 4)**

- 118 EFRAG received feedback that it could be difficult to assess whether a customer contract modification as defined in paragraphs 18 to 21 of IFRS 15 has occurred. In a nutshell, under IFRS 15 requirements, a contract modification occurs when there is a change in the scope or price (or both) of a contract, which is approved

by the parties. In essence, a modification creates new enforceable rights and obligations in a contract or changes the existing ones. The modification is regarded as a separate contract if the modified goods and services are distinct from the goods and services before modification and the consideration relating to the modification reflects the stand-alone selling price.

- 119 Hence, to determine the appropriate accounting (i.e., whether or not the contract modification is deemed to be a separate PO and, thereafter, whether to apply the prospective or cumulative catch-up method), an entity needs to evaluate whether the modification adds distinct goods or services and, if so, whether the prices of those distinct goods or services reflect their stand-alone selling prices. This assessment will depend on the specific facts and circumstances of the contract and the modification and may require significant judgement.
- 120 Such an assessment could impact both the timing and the method of the revenue recognition at the time of the modification as detailed in paragraph 21 of IFRS 15 (e.g., prospective base or cumulative catch-up basis).

*Prevalence and priority for EU stakeholders*

- 121 During EFRAG's outreach, auditors and preparers often mentioned this issue, particularly regarding the software industry and it was mentioned that the ongoing application challenges are expected to increase with the development of new business models (e.g., cloud computing arrangements).
- 122 The feedback on challenges with contract modification requirements primarily related to the software and pharmaceutical sectors, especially in the accounting for:
- (a) the extension of the existing contract terms: the renewal of a license agreement is agreed upon before the start of the renewal period leading to concerns about when to recognise revenue for the renewal (when the renewal is agreed upon or when the renewal period starts); or
  - (b) the conversion of a licence contract with revenue recognised at a point in time to a service contract with services provided over time (e.g., from an on-premises software license to a hosted software solution, such as a Software-as-a-Service arrangement). In this context, it is not always clear whether such a conversion option should be considered as a variable consideration for which a return reserve has to be accounted for, should result in a (partial) revenue reversal for the revoked rights or should not impact revenue already recognized.
- 123 A software company preparer also highlighted the inconsistency between paragraph 21(a) and the Illustrative example 5 - Case B (paragraphs IE22-IE24). In particular, it was noted that in the example, a reversal of revenue related to a partially satisfied performance obligation occurred at the date of the modification, even if not attributable to an amount of variable consideration in the original contract. This accounting treatment does not seem to be consistent with the requirements included in paragraph 21(a) when the remaining goods or services are distinct from those transferred on or before the contract modification.
- 124 In addition, many CFSS respondents (50%) to the EFRAG survey indicated that accounting for contract modifications is a prevalent application challenge. Therefore, EFRAG assesses that the issue is of high priority for affected EU entities (e.g., those with dynamic, changing business models and multi-period contracts with customers).

IASB preliminary recommendation

- 125 The IASB received relatively little feedback on the requirements and guidance related to Step 1, including the accounting for contract modifications. However, the IASB noted that:
- (a) the feedback suggested that most issues related to contract modifications have now been resolved;
  - (b) the remaining challenges and suggested diversity in practice seem to relate mostly to determining whether the goods or services promised by a contract modification are distinct, and so relate to the guidance on identifying the performance obligations in a contract (i.e., Step 2); and
  - (b) stakeholders did not provide specific suggestions for improving the guidance on Step 1 of the revenue recognition process, including the accounting for contract modifications.
- 126 Therefore, **the IASB decided not to include a specific question on the requirements for Step 1, including contract modifications in the RFI.**

EFRAG preliminary recommendation for IASB action

- 127 EFRAG acknowledges the challenges faced by some preparers in applying the existing IFRS 15 requirements for contract modifications. However, we are unable to recommend any change in the IFRS requirements as there hasn't been a sufficient articulation of what aspects of related requirements (i.e., IFRS 15. 18-21) need further clarification or amendment. Hence, though the issue is a high priority for affected entities, we consider it a medium priority for standard-setting action. We consider this to be an issue the IASB should be aware of and keep monitoring including if it will arise through the IFRS IC and enforcement actions.
- 128 That said, as expressed by a software company preparer, it could be useful to refine the Illustrative Example 5 - Case B in order to ensure its consistency with the requirements of IFRS 15. 21(a).

**Issue 9: Recognition and presentation of costs**

- 129 EFRAG has gathered feedback from preparers in the telco and construction industry and from a national standard setter that it is sometimes difficult and judgmental to ascertain which costs are considered to be incremental costs or costs necessary to fulfil a contract, leading therefore to the recognition of an asset. Paragraphs 91 to 94 of IFRS 15 include the requirements on incremental costs of obtaining a contract while paragraphs 95 to 98 include the requirements on costs to fulfil a contract.
- 130 EFRAG has also heard that IFRS requirements (IFRS15.99 and IE193) do not provide information on where in the income statement an entity should present the amortisation expense. According to a national standard setter, this has led to diverse practices as some entities present the amortisation expenses as an operating expense and others as depreciation or amortisation.

Prevalence and priority for EU stakeholders

- 131 EFRAG considers this issue to be of medium prevalence and priority for EU stakeholders for the following reasons:
- (a) The issue was raised by preparers of the telco industry and construction industries;

- (b) CFSS respondents (40%) to the EFRAG survey highlighted this issue as prevalent. One national standard-setter specifically pointed to the presentation issue;
- (c) An EFRAG FRB member (both an auditor and National Standard Setter) also indicated that diversity in practice in cost recognition arises in his jurisdiction;
- (d) An IAWG member highlighted questions faced in his jurisdiction related to pure investment contracts such as unit link contracts, which typically have significant acquisition costs (e.g., commissions to brokers). The member noted that these costs are accounted for under IFRS 15 while the rest of the contract is accounted for under the scope of IFRS 9. He suggested that the IASB should clarify whether part of these contracts should be under the scope of IFRS 15 and it should provide an illustrative example of how these types of contracts should be split between IFRS 9 and IFRS 15. However, another member considered the standard to be clear and did not consider that adding an example should be a PIR priority;
- (e) The issue has been dealt with by the IFRS IC Committee - see the agenda decision Training Costs to Fulfil a Contract published in March 2020 (here) and the agenda decision Costs to fulfil a contract published in June 2019 (here); and
- (f) The issue around the incremental costs of obtaining a contract has been raised in the context of the Post-Implementation Review of Topic 606, Review of Topic 606, Revenue from Contracts with Customers (see here the FASB meeting handout published in September 2022).

IASB preliminary recommendation

- 132 The IASB noted that the cost accounting is a cross-cutting issue and requirements on accounting for costs are included in many IFRS Accounting Standards.
- 133 During phase 1 outreach, the IASB received relatively little feedback on accounting for contract costs. Therefore, **the IASB decided to not include a specific question on contract costs in the RFI.**

EFRAG preliminary recommendation for IASB action

- 134 While assessing the issue to be a medium priority for EU stakeholders, EFRAG considers that this issue should be a low/medium priority for the PIR because we are neither aware of the specific fact patterns where there is diversity in practice nor has there been a sufficient articulation of the what aspects of the IFRS requirements are leading to diversity in practice. Hence, we recommend the IASB monitors this issue to ascertain the extent and root causes of any diversity in practice without including it as a PIR issue.
- 135 With regard to the fact that IFRS 15 does not provide information on where in the income statement an entity should present the amortisation expense, there might be diversity in practice as some entities present the amortisation as an operating expense and others as a depreciation and amortisation expense. This issue could affect the comparability of financial statements as two similar businesses could present the amortisation expense above or below EBITDA. Accordingly, it could affect the valuations of users who consider EBITDA as the benchmark indicator. Therefore, EFRAG recommends that the IASB clarifies how this expense should be presented.

**Questions for EFRAG FR Board**

- 136 Do you agree or disagree with the categorisation, and prioritisation of IFRS 15 application challenges (PA considerations, determining the transaction price and allocating to the performance obligations, consideration payable to customers and negative revenue, collaboration arrangements, accounting for licenses and disclosures) as being a high priority? Do you agree with the EFRAG's recommended IASB action on these identified issues?
- 137 Do you agree or disagree with the categorisation, and prioritisation of IFRS 15 application challenges (contract modifications and recognition of costs) as being a medium priority? Do you agree with the EFRAG's recommended IASB action on only monitoring these identified issues?

## Detailed assessment of identified issues related to the interactions between IFRS 15 and other IFRS Standards

138 Interaction between IFRS 15 and other standards is an area that has also been identified as a priority area. The below section of the paper only consists of EFRAG's high and medium-priority issues in respect of IFRS 15 requirements. The low-priority issues relating to interaction with other standards are included in the Appendix.

### IFRS 15 interaction with other Standards categorised by EFRAG as high-priority

#### **Issue 10: Interaction between IFRS 15 and IFRS 3**

139 EFRAG received feedback (mainly from auditors and national standard setters) about the inconsistency in the recognition of contract assets and liabilities from revenue contracts in the context of a business combination. In particular, the accounting for such assets and liabilities related to acquired revenue contracts could differ from those related to revenue contracts originated by the acquirer, even when the contracts are similar.

140 Under IFRS, the contract assets and liabilities arising from a business combination are accounted for at their fair value in accordance with IFRS 3 *Business Combinations*. This accounting treatment could consequently differ from that the acquirer would use as if it had entered into the original contract at the same date and on the same terms as the acquiree (i.e., application of different accounting standards, usage of different assessments or estimates etc.). Therefore, the revenue recorded by the acquirer post-acquisition could differ from the revenue recognition of the acquiree prior to the acquisition.

141 It was also noted that the FASB, in October 2021, issued the Accounting Standards Update (ASU) No. 2021-08 - *Business Combinations (Topic 805) Accounting for Contract Assets and Contract Liabilities from Contracts with Customers*. The amendment clarified that an acquirer of a business shall recognize and measure contract assets and contract liabilities in a business combination in accordance with Topic 606 - *Revenue from Contracts with Customers*. It aligns the accounting for the acquiree contracts to the accounting for revenue contracts originated by the acquirer and will provide more comparable information to investors and other financial statement users seeking to better understand the financial impact of these acquisitions.

#### Prevalence and priority for EU stakeholders

142 The accounting for contract assets and liabilities arising from acquired contracts could differ from those related to similar contracts originated by the acquiree, leading to diversity in practice.

143 In its outreach activities, auditors have mentioned this issue as relevant due to the inconsistent accounting treatment for transactions that are similar in substance. In addition, in the EFRAG survey sent to CFSS, only one respondent indicated that the interaction between IFRS 15 and IFRS 3 is a prevalent application issue. Therefore, based on the feedback from National Standard Setters, EFRAG assesses that though raised by auditors, there is likely only a medium prevalence of this issue for EU stakeholders.

#### IASB preliminary recommendation

144 In the IASB Agenda Paper was noted that:



- (a) in the Report and Feedback Statement on the PIR of IFRS 3, published in 2015, the IASB acknowledged respondent's concerns related to fair value adjustments made to contract assets acquired and contract liabilities assumed in a business combination but concluded that fair value remains the best approach for measuring the assets acquired and the liabilities assumed in a business combination;
  - (b) few respondents to the IASB Discussion Paper Business Combinations–Disclosures, Goodwill and Impairment suggested that the IASB should reconsider the requirement in IFRS 3 to measure all contract assets acquired and contract liabilities assumed in a business combination at their acquisition date fair values. The IASB discussed the issue in December 2022 (see Agenda Paper 18D Goodwill and Impairment–Other topics). The IASB decided not to consider this issue in the Goodwill and Impairment project.
- 145 The phase 1 feedback did not indicate that this matter was pervasive or that the difference in requirements between IFRS 15 and IFRS 3 created significant issues for users of financial statements. Given this and the IASB's earlier decisions on this matter, in its Agenda Paper, it was preliminarily suggested to not recommend including in the RFI a specific question on this matter.
- 146 However, during the IASB's meeting held on 20-23 March, **the IASB decided to include a specific question in the RFI** because of the importance of this matter, the inconsistency with USGAAP and the fact that affects all business combinations.

EFRAG preliminary recommendation for IASB action

- 147 As noted, based on the feedback from National Standard Setters, EFRAG concludes that there is likely only a medium prevalence of this issue for EU stakeholders. However, after taking into account the arguments<sup>9</sup> presented by EFRAG FR TEG and EFRAG FRB members on this matter and considering it was raised by several auditors who also have insight on reporting entities' accounting challenges, and assessing the issue could be pervasive for business models with long-term contracts that are likely to have contract assets and contract liabilities, and viewing this as an area where, if addressed, convergence with US GAAP could be attained, EFRAG assesses the matter as a high priority for the PIR.
- 148 Therefore, we would recommend that the IASB considers raising this as a PIR issue and, based on the feedback received, align the accounting for the acquirer and acquiree contract assets and contract liabilities.

**Issue 11: Interaction between IFRS 15 and IFRS 10**

- 149 EFRAG received feedback about the interaction between IFRS 15 and IFRS 10 *Consolidated Financial Statements* in case of a sale of a single asset (that could be part of its ordinary activities) through a corporate wrapper.
- 150 Constituents (i.e. mainly auditors and national standard setters) have highlighted that applying different standards to similar transactions with only differing legal forms will result in the inconsistent treatment of transactions with the same

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<sup>9</sup> At the July 2022 TEG meeting, some of the complexities were highlighted. For example, it was noted that *If the expected consideration subsequent to business combination is expected above market, the difference between the remaining unfulfilled PO and the amount paid is generally recognised as intangible asset amortised on a straight-line basis (below EBITDA). Otherwise (below market price), a contract liability is recognised which will be reverse as additional revenue in the next year.*

commercial substance. And this affects the timing of recognition, measurement, presentation and disclosure of these transactions.

- 151 Under IFRS Standards, the sale of a subsidiary that only contains an asset (e.g., inventory) to a customer is accounted for in accordance with IFRS 10. Applying the deconsolidation rules under IFRS 10 for the disposal of a subsidiary where the underlying does not constitute a business when compared to the disposal of the same underlying assets without a corporate wrapper following other relevant standards (e.g., IFRS 15 or IFRS 16) might lead to different accounting.
- 152 The IFRS IC concluded that IFRS 15 scopes out contracts with customers that fall within the scope of IFRS 9 or IFRS 10 and as such the entity shall account for the transaction under IFRS 10. However, diversity in practice was noted, especially in the real estate industry.
- 153 Therefore, clarifications on the applicable treatment under IFRS 15 or IFRS 10 (or other standards) would promote more consistency, also with regards to the net or gross presentation of the sale of subsidiaries which are single asset entities through selling their equity interest and with regards to the timing of revenue recognition.
- 154 In the [Project report and feedback statement](#) related to the PIR of IFRS 10, IFRS 11 *Joint Arrangements* and IFRS 12 *Disclosure of Interests in Other Entities*, the IASB assessed this matter to be of low priority and decided no further action was required. However, this matter could be explored if identified as a priority in the next agenda consultation.
- 155 Appendix C of the IASB feedback statement states, *“The IASB was concerned it might not be able to successfully resolve this matter within the scope of IFRS 10, particularly as the matter extends beyond the scope of this Post-implementation Review. For example, the matter might also affect IFRS 15 Revenue from Contracts with Customers or IFRS 16 Leases. The structure of ‘corporate wrappers’ also depends on jurisdictional laws and/or regulations. Therefore, identifying matters to be addressed by the IASB could require substantial resources for both the IASB and its stakeholders. If identified as a priority in the next agenda consultation, the IASB could either:*
- (a) *research whether it is appropriate and, if so, whether it is possible to develop a principle for transactions that involve ‘corporate wrappers’; or*
  - (b) *focus only on particular transactions that involve ‘corporate wrappers’.*”

- 156 Of note, the deconsolidation guidance under US GAAP (*Topic 810 – Consolidation*) provides for an exception for those transactions that are in substance addressed by *Topic 606 – Revenue from Contracts with Customers*.

*Prevalence and priority for EU stakeholders*

- 157 During EFRAG outreach activities, all auditors mentioned this issue (i.e., accounting treatment of corporate wrapper) as a concern, particularly regarding the real estate industry. In addition, as noted above, the IFRS IC received a request about the accounting of these transactions. And, in the EFRAG survey sent to CFSS members, almost all respondents (75%) indicated that the interaction between IFRS 15 and IFRS 10 is a prevalent application issue. It was also highlighted as a concern at both the September 2022 IFASS and December 2022 ASAF meetings. Therefore, EFRAG assesses this issue to be of high prevalence and a high priority for EU stakeholders.

IASB preliminary recommendation

- 158 In the IASB Agenda Paper, it was noted that this matter was commonly raised in the PIR of IFRS 15 with some stakeholders highlighting the difference in how the matter is treated under IFRS Standards and US GAAP. Given that this matter continues to cause challenges for preparers, the IASB staff preliminary considered that it could be helpful to gather further information on the prevalence of the matter, especially from users of financial statements to understand whether the matter creates difficulties for their analysis. Therefore, the IASB staff recommended including in the RFI a question on this matter.
- 159 However, the **IASB decided to not include a specific question in the RFI but to provide an explanation for such exclusion**. The IASB considered it to be a cross-cutting issue that, consequently, should be addressed through a specific project.

EFRAG preliminary recommendation for IASB action

- 160 After considering the issue to be of high prevalence and a high priority for EU stakeholders, and considering this as being an area where convergence with US GAAP could be attained, EFRAG would recommend that the IASB considers adding a narrow-scope project that will require an entity to apply IFRS 15 instead of IFRS 10 for the sale of a single-asset subsidiary to a customer.

**Issue 12: Interaction between IFRS 15 and IFRS 16**

- 161 EFRAG received feedback, mainly from an auditor and some national standard setters, about the interaction between IFRS 15 and IFRS 16. The feedback point to:
- (a) Difficulty in assessing whether, in a sale and leaseback transaction, the initial transfer of the underlying asset from the seller-lessee to the buyer-lessor is a sale. They noted the lack of specific or additional guidance in IFRS 16 about how to make this assessment. Instead, for determining when a performance obligation is satisfied (i.e., when the control of an asset is transferred to the customer) the parties apply the IFRS 15 (paragraphs 31-34 and 38). In some cases (e.g., a sale contract which includes a call option), it is clear that the transfer leg does not meet IFRS 15 requirements, and therefore the transaction should be accounted for as a financing transaction (i.e., the seller-lessee does not derecognise the asset and recognises a financial liability under IFRS 9 for any amount received from the buyer-lessor; the buyer-lessor recognises a financial asset under IFRS 9 for amounts transferred to or receivable from the seller-lessee). Furthermore, there could be circumstances where some contractual conditions or options (e.g., lessee's renewal option extending the lease term substantially to all remaining economic life of the underlying asset) could impact the substance of a lease transaction. There could also be circumstances where determining the unit of account is challenging (e.g., a sale of a four-floor building being one of them leased back).
  - (b) Difficulty in assessing whether the contract (or a part of it) is in the scope of IFRS 15 or/and IFRS 16 (e.g., the split of operating income due to leasing under IFRS 16 and arrangement of operating services under IFRS 15). Based on the feedback received from respondents from the real estate industry, such an assessment could require judgment leading to diversity in practice across entities operating in the same industry. A similar issue was also

addressed by an enforcement decision issued by the ESMA in 2020 ([decision ref EECS/0120-08 - Identifying components in lease contracts](#)).

*Prevalence and priority for EU stakeholders*

- 162 During EFRAG outreaches, some auditors and national standard setters mentioned this issue as challenging, especially in the real estate and retail industry, noting some diversity in practice.
- 163 The CFSS respondents (50%) to the EFRAG survey indicated that the interaction between IFRS 15 and IFRS 16 is a prevalent application issue, but only one of them specified that the issue was related to sales and leaseback transactions as mentioned above.
- 164 Based on the feedback received, EFRAG considers that this issue is of high prevalence and of high priority for EU stakeholders.

*IASB preliminary recommendation*

- 165 The IASB noted that it would be helpful to gather further information on the circumstances in which entities are unclear about applying the requirements in IFRS 15 together with IFRS 16 to help the IASB in assessing whether the requirements are working as intended. Therefore, **the IASB decided to include a question on the interaction between IFRS 15 and IFRS 16 in the RFI.**

*EFRAG preliminary recommendation for IASB action*

- 166 Based on the above analysis EFRAG recommends the IASB to provide additional guidance in order to address the identified sale and leaseback transaction issues and reduce the existing diversity in practice.

**IFRS 15 interaction with other Standards categorised by EFRAG as medium priority**

**Issue 13: Interactions between IFRS 15 and IFRS 9**

167 EFRAG has received feedback on concerns related to the interaction between IFRS 9 and IFRS 15. The issues raised by constituents are the following:

- (a) Commodities;
- (b) Credit risk;
- (c) Gift cards; and
- (d) Other issues.

Commodities<sup>10</sup>

168 This refers to an issue of the settlement of a contract to buy or sell a non-financial item that does not meet the own-use scope exception and is measured at FVTPL. We have heard from a national standard setter that there is diversity in how entities present these transactions when there is a physical settlement<sup>11</sup>.

169 Upon physical settlement, one approach is that the contract continues to be accounted for as a derivative financial instrument within the scope of IFRS 9 (or IAS 39) and not within the scope of IFRS 15 and so it does not give rise to 'revenue from contracts with customers' or related cost of sales. Another approach is that this is a contract with a customer to sell physical commodities that are an output of the entity's ordinary activities. Under this view, the gross proceeds that result from the contract give rise to revenue under IFRS 15 that should be presented within the line item 'revenue from contracts with customers'.

170 EFRAG's constituent asked for clarifications on whether IFRS 15 applies to revenue obtained from the customer upon physical delivery of commodities under such contracts.

Credit risk

171 A meeting with several preparers from the telco industry highlighted a challenge related to the significant financing component. According to IFRS 15.64 relating to adjustment of the promised amount of consideration for a significant financing component, an entity shall use a discount rate that reflects the credit characteristics of the party receiving financing. As such, revenue will be deducted by a financing component that takes into account the credit risk. The financing component is presented as financial income. At the same time, IFRS 9 requires a provision for expected credit losses which generally will be booked as an

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<sup>10</sup> An example of this issue is included in PwC manual of accounting FAQ 4.114.4 – How should an entity present fair value changes and sales proceeds from commodity contracts that are accounted for as a derivative financial instruments under IFRS 9?

<sup>11</sup> The IFRS IC concluded in the agenda decision *Physical Settlement of Contracts to Buy or Sell a Non-Financial Item (IFRS 9)* issued on March 2019 that IFRS 9 neither permits nor requires an entity to make the additional journal entry described in the request (a journal entry that would reverse the accumulated gain or loss previously recognised in the profit or loss on the derivative and adjust either inventory – in the case of a purchase contract – or revenue – in the case of the sale contract – upon the completion of the contract). However, the IFRS IC did not address whether an entity can present the gross proceed that result from the physical settlement as revenue under the scope of IFRS 15 because this matter was beyond the question submitted to the IFRS IC.

operating expense. This results in credit losses being deducted from operating profit twice. We propose to clarify this issue to avoid a double charge on operating profit.

Gift cards

- 172 EFRAG received feedback from an audit firm that it is unclear which standard applies to gift cards when a gift card provides a customer with the right to redeem the card in the future for goods or services from third parties. Entities may need to use judgment to determine whether the prepaid gift card is within the scope of IFRS 15 or another standard. Prepaid cards that give rise to a financial liability are within the scope of IFRS 9. If a prepaid card does not give rise to a financial liability it is likely to be within the scope of IFRS 15.
- 173 An example of a prepaid card that is within the scope of IFRS 9 was discussed by the IFRS Interpretation Committee at its March 2016 meeting. However, the issue was limited to prepaid cards that have the specific features described in the request to the IFRS Interpretations Committee. Entities need to apply judgment to determine which standard applies depending upon the specific facts and circumstances for scenarios other than the one discussed by the IFRS IC. We have learned that it is not always clear to determine which standard applies.

Other issues

- 174 EFRAG has identified an inconsistency between IFRS 9 and IFRS 15. According to IFRS 9.5.1.3, *an entity shall measure trade receivables at their transaction price (as defined in IFRS 15) if the trade receivables do not contain a significant financing component in accordance with IFRS 15*. Therefore, IFRS 9 does not seem to envisage scenarios in which the amount of a receivable may differ from the transaction price. In contrast, paragraph 108 of IFRS 15 envisages scenarios in which the amount of the receivable may differ from the transaction price (for instance an entity may recognise a receivable for an amount lower than the transaction price if it expects to be subject to a refund in the future) This is illustrated in Example 40 in IFRS 15.
- 175 There were no concerns raised on this matter in our meeting with FIWG and during the outreach. Therefore, EFRAG views this as a minor inconsistency with limited practical implications.

Prevalence and priority for EU stakeholders

- 176 For the following reasons, EFRAG assesses that taken together, the different issues that arise related to the interaction between IFRS 15 and IFRS 9 have a medium prevalence and a medium priority for EU stakeholders:
- (a) Most respondents (85%) to the EFRAG survey sent to CFSS members considered the interaction between IFRS 9 and IFRS 15 to be one of the most prevalent application challenges. While this feedback could be interpreted as indicative of the high prevalence of this issue for EU stakeholders, the feedback did not substantiate the circumstances and fact patterns where inconsistencies arise ;
  - (b) The issue on commodities has been identified by a large audit firm's manual of accounting and this is indicative of some prevalence;
  - (c) The credit risk issue was raised in a meeting with several preparers from the telco industry;



- (d) The interaction between IFRS 9 and IFRS 15 was discussed at EFRAG FIWG. Regarding the gift card issue, FIWG members noted that the new marketing models (e.g., multi-suppliers gift card/platform models) could lead to an additional issue beyond that already addressed by the May 2016 IFRS IC agenda decision;
- (e) The gift card issue was raised mainly by one large audit firm; and
- (f) The gift card issue has been dealt with by the IFRS IC Committee - see [Classification of liability for a prepaid card in the issuer's financial statements \(IAS 32\)](#) agenda decision published in March 2022).

IASB preliminary recommendation

Commodities

- 177 The IASB did not receive any feedback on this issue.

Credit risk

- 178 The IASB concluded that the discount rate determined in applying paragraph 64 of IFRS 15 does not consider expected credit losses measured in accordance with IFRS 9. Therefore, **the IASB would not expect the requirements in IFRS 15 and IFRS 9 to lead to double counting** for the effect of credit risk for receivables with a significant financing component.

Gift card

- 179 The IASB received feedback that in some cases it may be unclear how to account for some liabilities arising from IFRS 15 (including those related to gift cards), especially if those liabilities resemble financial liabilities in substance.
- 180 The IASB suggested that it would be helpful to gather further information about circumstances in which entities are unclear about the requirements that should be applied to liabilities arising from IFRS 15. This could help the IASB in assessing how prevalent the issues are, whether there is any diversity in practice, and the effects of any diversity. Therefore, **the IASB decided to include a question related to accounting for liabilities arising from IFRS 15 in the RFI.**

Others

- 181 In addition, the IASB received feedback that it may be difficult to determine whether the entity has implicitly offered a price concession or whether the entity has chosen to accept the risk of default by the customer (so-called "Price concession versus impairment losses" issue in the IASB's agenda paper). The feedback received suggests that some entities struggle with applying judgement and there may be diversity in practice which could affect revenue included in financial statements.
- 182 Gathering further information on circumstances in which entities struggle to apply the requirements would help the IASB in assessing whether the requirements are working as intended. In particular, further information could help in assessing the cause of any diversity, the prevalence of any diversity, and the effects of any diversity on the entities' financial statements. Therefore, **the IASB decided to include a question on this matter in the RFI.**

EFRAG preliminary recommendation for IASB action

Commodities

183 EFRAG considers that the commodities issue should be a medium priority for the PIR as it reflects a gap in the IFRS guidance and was raised by a national standard setter and the manual of accounting of (at least) one large audit firm allows entities to have an accounting policy choice and this implies that there might be some diversity in practice for the same type of transaction. The medium assessment reflects that no concerns related to this matter arose in the meeting with the FIWG and during our outreach to preparers. Hence, we suggest further monitoring of this issue by the IASB to ascertain whether its current requirements are leading to diversity in practice and whether clarifying guidance on this issue should be developed.

Credit risk

184 EFRAG considers that the credit risk issue should be a medium priority for the IFRS 15 PIR for the following reasons:

- (a) It seems to be an unintended consequence that, under current IFRS requirements, an entity might have to recognise the credit risk of a contract asset twice (firstly when recognising the significant financing component under IFRS 15 and secondly when recognising expected credit losses under IFRS 9).
- (b) There might be some diversity in practice if some entities recognise the credit risk of a contract asset twice while others avoid the double charge.
- (c) As a consequence of the recent rise in interest rates, the issue is likely to be more relevant now than in the past.

185 Therefore, EFRAG suggests that the IASB should clarify this issue to avoid a double charge on the operating profit. However, we acknowledge that this issue might need to be better dealt with under IFRS 9 rather than by IFRS 15.

Gift card

186 EFRAG considers that the gift card issue should be a low priority for the PIR for the following reasons:

- (a) We are not aware of fundamental questions around the clarity and suitability of the related IFRS 15 requirements; and
- (b) We are not aware of widespread inconsistencies (or evidence of diversity in practice) when applying the Standard.

187 Therefore, EFRAG recommends no further action from the IASB on this issue.

**Questions for EFRAG FR Board**

188 Do you agree or disagree with the categorisation and prioritisation of the interaction between IFRS 15 and Other IFRS Standards as detailed in paragraphs 139 to 187? Do you agree with the EFRAG's recommendations for IASB actions on interaction with IFRS 3, IFRS 10 and IFRS 16, and limited action on the interaction with IFRS 9?

189 Do you agree or disagree with the categorisation and low prioritisation of the other identified issues listed in the Appendix?



## Appendix: Other issues that are of low prevalence and priority for EU stakeholders

- 1 This appendix includes other six issues identified by EFRAG that are of low prevalence and low priority for EU stakeholders for the following reasons:
  - (a) EFRAG received limited feedback;
  - (b) The issue is not pervasive and only affects specific industries;
  - (c) No specific fact patterns and/or limited articulation of the problem with IFRS 15 requirements have been provided, and
  - (d) The issue may go beyond the scope of IFRS 15.

### **Estimating stand-alone selling prices**

- 2 EFRAG has received feedback from preparers and to a lesser extent from NSS that the estimation of stand-alone selling prices can be challenging when there is no observable selling price (e.g., a performance obligation has never been sold on a standalone basis) or an undeterminable cost basis. This regularly occurs in the software industry when observable prices are not available for upgrades, post-contract customer support and additional functionality for computer software.
- 3 The estimation of standalone selling prices can also be challenging in contract modifications as the commercial structure and economics of the contract are typically more complex when compared with the initial transaction with the customer.
- 4 **The IASB received little feedback on this matter.** Even though some preparers said that it was challenging to estimate stand-alone selling prices for some performance obligations, they also acknowledged that practice had now been developed. **As the IASB did not identify pervasive matters on this topic, it decided not to include a specific question in the RFI.**

### **Inconsistency of clarification and presentation of advance payments**

- 5 An academic Working Paper<sup>12</sup> presented at the 2022 IASB-FASB AAA research conference reflecting reviewed the implementation of IFRS 15 by 68 construction companies (mainly from the EU). The paper found that some entities recognise the advanced payments received from a customer as a separate liability while some others recognise it as part of contract liabilities.
- 6 Even though the main body of IFRS 15 does not mention how these payments should be accounted for, Illustrative example 29 Advance payments and assessments of discount rates seems to imply that advance payments should be accounted for as part of a contract liability. However, the IFRS 15 Illustrative Examples are not part of IFRS 15 and are not intended to provide interpretative guidance.
- 7 Even if there is some diversity in practice on whether the advance payments are presented as contract liabilities or as something else (for instance, advance payments) it should not have a major impact on the usefulness of the information for the users of financial statements.

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<sup>12</sup> Krupova. L., Partac.M., 2022, Impact of IFRS 15 Revenue for Contracts with Customers on Construction Industry

### **Insufficient information to assess margins at different stages of a contract**

- 8 EFRAG has received feedback from an academic TEG member that when products or services are integrated into complex products (as it could be the construction of an oil refinery where there are normally engineering, procurement and construction services), it is difficult assessing the margins at the different stages of the contract. A change in the weight of the different products or services could have a relevant impact. IFRS 15.114 requires an entity to disaggregate revenue from contracts with customers into categories that depict how the nature, amount, timing and uncertainty of revenue and cash flows are affected by economic factors. Paragraphs B87 to B89 provide some guidance on how an entity disaggregates revenue based on its facts and circumstances.
- 9 However, EFRAG considers that even if an entity provided more disaggregated revenue disclosures (for example the split of engineering, procurement and construction services in the aforementioned example) it could be difficult for users to assess the operating margin without having the corresponding split in of operating expenses. The EFRAG's preliminary view is that requesting the IASB a disclosure requirement that mandates entities to disclose the margins at the different stages of a contract goes beyond IFRS 15. IFR 8 requires an entity to disaggregate total revenue by products or services and geographical areas if the entity's operating segments are not based on those factors. Disaggregating the costs of sales by products or services and geographical areas is something that the IASB could do as part of its operating segment project if the project is added to the IASB's workplan (it is currently in the reserve list of the IASB's workplan for the 2022-2026 period).

### **Interaction between IFRS 15 and IAS 37**

- 10 EFRAG has received feedback (albeit limited) related to the interaction between IFRS 15 and IAS 37.
- 11 At the September 2022 IFASS meeting, a national standard setter indicated that construction industry entities found IFRS 15 challenging in terms of the interaction with other standards, e.g., on the treatment of onerous contracts (IAS 37 is used to determine whether a contract in the scope of IFRS 15 is onerous). A similar picture was portrayed in the academic Working Paper<sup>13</sup> that reviewed the accounting of 68 construction companies and observed that although IAS 37.68A addresses the accounting for onerous contracts, further guidance is needed. The paper found that there were inconsistent accounting practices in recognition patterns for onerous contracts, i.e., whether, in these situations, a separate liability (provision) should be recognised or whether a loss should be recognised as a part of contract accounting.
- 12 **The IASB received very little feedback on this topic and, therefore, decided not to include in the RFI a specific question on this matter.**

### **Interaction between IFRS 15 and IFRIC 12**

- 13 EFRAG has received feedback from a large audit firm and some national standard setters that the interaction between IFRS 15 and IFRIC 12 raises application challenges, especially with regard to the intangible asset model. However, this

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<sup>13</sup> Krupova. L., Partac.M., 2022, Impact of IFRS 15 Revenue for Contracts with Customers on Construction Industry presented at the AAA IASB-FASB research conference.

feedback received has not highlighted the specific areas of interaction that are of concern.

- 14 In addition, EFRAG is aware that there might be a fine line in some circumstances between an operation and maintenance arrangement with a public entity that falls in the scope of IFRIC 12 and a service contract that should be recognised under IFRS 15. However, we are yet to identify where the difficulties arise in practice.
- 15 **The IASB received very little feedback on this topic and, therefore, decided not to include a specific question on this matter in the RFI. In addition, they noted that IFRIC 12 affects a relatively narrow population of entities.**

***Interaction between IFRS 15 and IAS 20***

- 16 EFRAG has received feedback (mainly from auditors) that in some circumstances it is challenging to determine whether Governments are acting as a customer or as a government. Entities need to carefully assess the contract to determine the Government's role. An entity shall apply IFRS 15 to a contract, other than those listed in paragraph 5 of IFRS 15, if the counterparty to the contract is a customer. IFRS 15 defines a customer as a party that has contracted with an entity to obtain goods or services that are an output of the entity's ordinary activities in exchange for consideration.
- 17 Furthermore, BC 187 clarifies that the amounts to which the entity has rights under a contract can be paid by any party (i.e., not only by the customer). For example, in the healthcare industry, an entity may determine the transaction price based on amounts to which it will be entitled to payment from the patient, insurance companies and/or governmental organisations. Even though there seems to be little debate on whether these amounts are recognised as revenue in the healthcare industry, we learned that there are other industries in which the distinction is unclear. Specifically, entities in the renewable energy industry obtain proceeds as part of alternative revenue programs which ensure some minimum revenue to the entities. There are discussions on whether those proceeds should be considered revenue or government grants.
- 18 **The IASB received very little feedback on this topic and, therefore, decided not to include a specific question on this matter in the RFI.**