

PIR of IFRS 15: *EFRAG's preparatory work and preliminary findings*

EFRAG FR TEG-CFSS

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OVERVIEW

OBJECTIVE OF THE SESSION

OVERVIEW OF IFRS 15 PIR & EFRAG PRELIMINARY WORK

WHAT WE HAVE LEARNT SO FAR

QUESTIONS FOR EFRAG TEG-CFSS PANEL

APPENDIX – DETAILED OUTREACH FINDINGS & OTHER
APPLICATION REVIEWS

OBJECTIVE OF THE SESSION

The objectives of this session are to:

- present an overview of the general messages and the preliminary issues identified during EFRAG Secretariat's preparatory work in anticipation of the IASB Post-Implementation Review of IFRS 15 *Revenue from Contracts with Customers* (IFRS 15 PIR);
- seek EFRAG FR TEG-CFSS members' views on the questions raised by the IASB staff on the agenda paper 07-02 that will be discussed during the December ASAF meeting.



OVERVIEW: IFRS 15 PIR & EFRAG PRELIMINARY WORK

IFRS 15 PIR BACKGROUND INFORMATION

- **IFRS 15 *Revenue from Contracts with Customers*** was issued in May 2014 and applied to annual reporting periods beginning on or after 1 January 2018
- During the IFRS 15 PIR, the IASB will assess the effect of IFRS 15 on users, preparers and auditors. Each PIR has two phases where the IASB:
 - **Phase 1:** identifies matters to be examined (Request for Information)
 - **Phase 2:** considers the information gathered from the public consultation and publishes a Report and Feedback Statement, including a summary of the finding and outline of next steps (i.e. develop educational material, standard-setting activities, agenda decisions).
- In September 2022, the IASB discussed the project plan. **The issuing of the Request for Information (RFI) is expected in 1H 2023** with a comment period of 120 days.

EFRAG PRELIMINARY WORK

EFRAG Preparatory work status

- EFRAG's preparatory work started in April 2022 and is expected to continue until the issuance of the RFI (e.g., outreach to construction industry and users of financial statements)
- The EFRAG Secretariat has held several meetings with preparers and users from highly impacted sectors, and audit firm subject matter experts. In addition, the EFRAG Secretariat has discussed this topic with EFRAG Financial Reporting TEG, EFRAG User Panel, the International Forum of Accounting Standard Setters (IFASS) and attended the AAA IASB-FASB academic conference. The issues identified so far from different stakeholders are in the slides that follow.
- In its next steps and ongoing outreach, EFRAG will also be assessing if (i.e., is it a pervasive issue, is it a problem with the standard?) and what further action from the IASB is needed for the identified issues (e.g., educational material, agenda decisions, standard setting)

EFRAG Support of an academic study on implementation of IFRS 15

- EFRAG is supporting an academic study on the implementation of IFRS 15. The results of this study will be one of the inputs for EFRAG's work related to IFRS 15 PIR
- The academic study aims to assess the net benefits (costs) of IFRS 15 implementation/adoption and collect information on the effects of IFRS 15 implementation.



WHAT WE HAVE LEARNT SO FAR

PRELIMINARY KEY FINDINGS

IFRS 15 IS WORKING WELL IN PRACTICE BUT THERE IS ROOM FOR IMPROVEMENT

- In general, **IFRS 15 is working well in practice** although **there is room for targeted improvements** (e.g., need for additional guidance in some areas such as the interaction of IFRS 15 with other IFRS Standards).
- For some industries, the **implementation of IFRS 15 was challenging** and the related costs were significant (e.g., IT systems, training of employees across different departments and review of contracts)
- **IFRS 15 involves significant estimates and use of management judgment** (e.g., separating performance obligations, estimation of stand-alone selling prices and estimation of variable consideration), **raising some concerns on comparability** (e.g., software/licensing industry)
- Questions on the usefulness of the disclosures on contract assets and contract liabilities for some industries
- There were **concerns about significant changes to IFRS 15 as they may lead to reduced convergence with US GAAP** requirements on revenue recognition **and disrupt established practice** and IT systems
- Suggested that the IASB considers the relevance of the requirements in IFRS 15 against new digital business models that are becoming more prominent (e.g., more use of cloud products, proof-of-work mining for crypto-assets)

PRELIMINARY KEY FINDINGS

CERTAIN TOPICS ARE STILL CHALLENGING TO ACCOUNT FOR

So far, the most frequent challenges raised in the outreaches were:

- Difficulties in determining whether a company is **a principal or an agent**, leading to diversity in practice
- The **accounting for licenses** still raises a number of questions and challenges
- Difficulties in dealing with **collaborative arrangements** (e.g., assess whether an arrangement, or only a part of it, is in scope of IFRS 15)
- Numerous accounting challenges arising from accounting **contract modifications** (e.g., difficult to assess whether some arrangements/renewals represent a contract modification or a new/separate contract)
- Interactions with a number of other IFRS Standards (mostly raised by audit firms) not always clear
- When incentives/penalties should be treated as **contra-revenue or expense**

DIFFERENT PERSPECTIVES (1/2)

ISSUES RAISED BY PREPARERS

- **Implementation of IFRS 15 was challenging and costly**
- **IFRS 15 involves high degree of judgement from management (e.g., estimation of SSP, variable consideration and contract period; and identification of SPO)**
- **Principal versus agent considerations**
- **Collaborative arrangements**
- **Accounting for out-licensing arrangements**
- **Disclosures on contract balances**
- **Negative revenue**
- **Combination of contracts**

ISSUES RAISED BY AUDITORS

- **Principal versus agent considerations**
- **Accounting for licenses of intellectual property**
- **Contract modifications**
- **Interaction with other IFRS Standards such as IAS 20, IFRS 3, IFRS 9, IFRS 10 and IFRS 16**
- **Adequacy of disclosures**
- **Collaborative arrangements**
- **Negative revenue**

DIFFERENT PERSPECTIVES (2/2)

The information on revenue under IFRS 15 is useful to users to assess a company's financial performance and position and to compare with other companies

ISSUES RAISED BY USERS

- **Some areas of IFRS 15 present application challenges, largely in areas requiring judgement (e.g., whether a contract is under the scope of IFRS 15)**
- **Divergence in practice of the accounting treatment of out-licensing arrangements (particularly pharmaceutical industry) with revenues being recognised in different lines of the income statement**
- **Principal versus agent considerations**
- **Disclosures of the reconciliation of contract assets (liabilities) are not always useful**
- **Would welcome further disaggregation of revenue, particularly when related to out-licensing arrangements**

ASSESSMENT OF CHALLENGING TOPICS

- IFRS 15 requires **extensive use of judgment** and therefore it may lead to some diversity in practice. However, that does not imply the need of requiring standard setting activity.
- Some constituents were calling for **additional application guidance**, mainly related to principal versus agent consideration and contract modification issues.
- Some others emphasized the principle-based nature of the IFRS framework, meaning that different approaches may be acceptable as long as the underlying reasons are supported by IFRS standards and are disclosed in the financial statements.
- Some constituents have indicated that the issues identified are of a cross-cutting nature (e.g., principal versus agent) and solutions on these should not exclusively be focused on IFRS 15
- On the alignment with US GAAP, some constituents acknowledged that the full **convergence** is likely not feasible, but they are comfortable with this situation.
- EFRAG will assess the main issues identified by constituents to find out what should be the appropriate way forward (e.g., educational material, agenda decisions, standard setting)

IFASS MEETING 27-09 - KEY TAKEAWAYS

Polling question results

- For 83% of IFASS participants, IFRS 15 is working well in practice although there is room for improvement.
- According to IFASS participants, the most challenging industries to implement IFRS 15 were telecommunications (71%), construction (66%) and software industries (60%). A lower proportion considered it to be an ongoing challenge; software industries (50%), telecommunications (34%) and construction (28%).
- For IFASS participants, these are the most prevalent application issues: principal versus agent (78%), accounting for licenses (47%) and interaction with other standards (41%).

Qualitative comments

- Feedback relating to judgmental areas does not necessarily trigger standard-setting activities.
- Software and telecommunications companies' complexity may be affected by the link between revenue recognition and intangible assets.
- Interaction with other standards is an issue for construction entities (i.e., IFRS 10 “corporate wrappers issue” or IAS 37 “treatment of onerous contracts”).
- For Scandinavian telecommunications entities, the transition to IFRS 15 was very expensive but had little effect on their financial statements.

QUESTIONS FOR EFRAG TEG CFSS

Q1: What is the overall assessment of IFRS 15 in your jurisdiction? Does IFRS 15 achieve its objective of establishing the principles for reporting useful information to users of financial statements about the nature, amount, timing and uncertainty of revenue and cash flows arising from contracts with customers? Do your stakeholders find the core principle of IFRS 15 and supporting five-step revenue recognition model clear and helpful in making revenue accounting decisions (see slide 12 of paper 07-02)?

Q2: What are the application matters that you think the IASB should examine during Phase 1 of the PIR and why? It would be helpful if you could explain:

- How prevalent the matter is.
- What the cause and the effect of the matter are
- Which companies are affected?
- Is this matter new, or did it exist under previous revenue requirements?
- What steps could the IASB take to resolve the matter?

QUESTIONS FOR EFRAG TEG CFSS

Q3: How challenging was the transition to IFRS 15? Which industries found the transition most challenging and why? Are their issues ongoing? In your experience, how often did companies use a modified transition method? Was it more prevalent in some industries than others? Were disclosures provided in the year of application sufficient to explain the transition?

Q4: Paragraphs BC454–BC493 of the Basis for Conclusions on IFRS 15 set out the IASB’s analysis of the likely benefits and costs (effects) of implementing and applying the Standard (see high-level overview on slide 13 of paper 07-02)

- Have actual effects differed from the expected effects?
- Have you observed any other effects of IFRS 15 that were not identified in the effects analysis, for example, effects on companies’ internal controls or on the way companies conduct their business?
- How important is it to your stakeholders to have revenue requirements substantially converged with the US GAAP?

APPENDIX A – DETAILED OUTREACH FINDINGS & OTHER APPLICATION REVIEWS

- **PREPARER OUTREACH**
- **USER OUTREACH**
- **AUDITOR OUTREACH**
- **OTHER REVIEWS OF IFRS 15 IMPLEMENTATION**



PREPARER OUTREACH

ISSUES RAISED BY TELCO ENTITIES

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

ISSUES RAISED BY TELCO ENTITIES

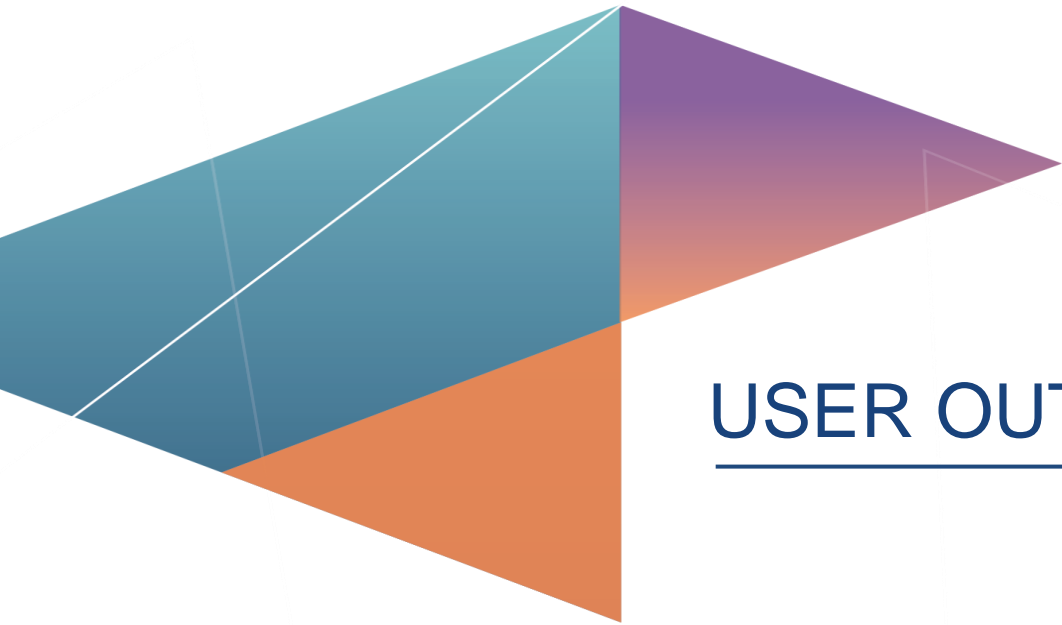
- **Principal versus agent** leads to diversity in practice. Indicators included in paragraph B37 of IFRS 15 do not provide an evidence for prior control of goods or services
- **Identifying performance obligations and the standalone selling price (SSP)**. A bundle of different components (TV stream + internet) with the same pattern of transfer exist and an add-on component (goods or services like a handheld) with a different PO pattern. The SSP of a bundle does better reflect the substance of the transaction than the SSP of each component of the bundle.
- A **customer contributes** (goods/services) to the delivery of goods or service provisions that he receives by supplier in exchange for a consideration at market value. Does it qualify for expense or revenue reduction?
- Difficult to **identify separate performance obligations** when there is an activation fee. The entity has identified them as a separate performance obligation

ISSUES RAISED BY TELCO ENTITIES

- **Collaborative arrangements** Difficult to determine what transactions fall under the scope exemption of IFRS 15.5 d), as the guidance is limited.
- Unclear how to account for the provision of good or services to a **collaboration** partner (revenue or other operating income) when these goods/services are part of an entity's ordinary activities.

ISSUES RAISED BY SOFTWARE ENTITIES

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



USER OUTREACH

INTERVIEW WITH PHARMACEUTICAL SECTOR ANALYST (USER)

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

EFRAG FR TEG-USER PANEL KEY MESSAGES

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



AUDITOR OUTREACH

ISSUES IDENTIFIED FROM AUDIT FIRM INTERVIEWS

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

ISSUES IDENTIFIED FROM AUDIT FIRM INTERVIEWS

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

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

ISSUES IDENTIFIED FROM AUDIT FIRM INTERVIEWS

- **Negative revenue** Some constituents questioned themselves what to do with the negative revenue. For example, a start-up may pay an incentive to attract customers higher than the consideration they will receive from the supplier. Some stakeholders regretted that the IFRS IC did not address the question on whether the reduction of revenue is limited to reducing the transaction price to nil (See September 2019 – compensations for delays and cancellations agenda decision)
- Subsequent changing on time of delivery is an issue for **significant financing components**. It especially affects service concession arrangements and the construction industry



OTHER REVIEWS OF IFRS 15 IMPLEMENTATION

IFRS 15 ISSUES ADDRESSED BY THE IFRS IC

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

IFRS 15 APPLICATION ISSUES NOTED BY ESMA

- In the April 2021 ESMA report related to 2020 reporting ([see link](#)) and in the March 2022 ESMA report related to 2021 reporting ([see link](#)) it is noted that the main issues discussed related to the application of IFRS 15 in the European Enforcers coordination sessions (EECS) were:
 - The assessment of whether an entity acts as an agent or a principal;
 - The allocation of the transaction amount to multiple performance obligations;
 - The timing of recognition of revenue in specific circumstances;
 - The disaggregation of revenue;
 - The impact of certain types of taxes collected from a customer on the measurement of revenue; and
 - The presentation of (unbilled) revenue on the balance sheet and in the income statement.

FASB-PIR TOPIC 606

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

FASB-PIR TOPIC 606

- **Identifying performance obligations**, assessing whether goods or services are distinct requires significant judgment
- **Incremental costs of obtaining a contract**- difficulties in some situations in determining which costs should be capitalised and determining the amortisation period
- **EITF issue – modification from an on-premise software license to a hosted software solution.** Some contracts include a feature that allows such modifications. As there is usually a difference on the moment revenue is recognised, questions arise on how to account for the conversion of a point in time license to an over time service

IASB-FASB AAA CONFERENCE NOVEMBER 2022 - KEY TAKEAWAYS

Some academic working papers related to revenue recognition (IFRS 15 / ASC 606) were discussed at the November 2022 IASB-FASB AAA conference. The content and key conclusions were the following:

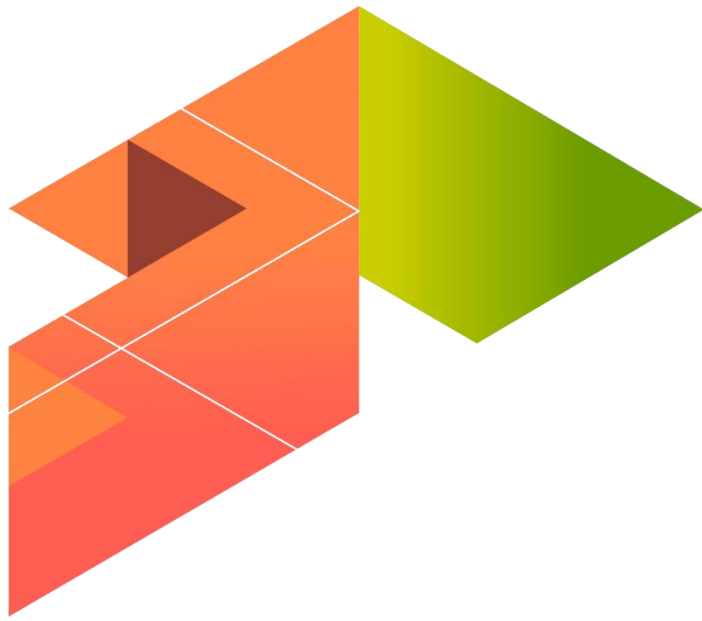
- The impact of IFRS 15 on construction entities. The impact of IFRS 15 adoption was heterogenous: from zero impact to major changes in equity. The study also shows that inconsistent accounting practices persist even after IFRS 15 adoption.
- The consequences of the principal versus agent (PA) consideration and the new revenue standard (ASC 606). The study shows that its adoption reduces compliance risk and audit fees for firms with PA considerations. It also alleviates the disparity in investors' processing of revenue.
- The benefits of retrospective application (ASC 606). The study shows that analysts' revenue forecasts of firms that retrospectively adopt the standard exhibit greater accuracy and that stock price liquidity of these firms is higher.
- Assessment of the increased usefulness of additional disaggregation requirements (ASC 606). The study shows that there are benefits especially when disaggregation is accompanied by detailed qualitative disclosures, when disaggregated revenues are comparable and when the granularity of segment information is low.



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