

**DRAFT ENDORSEMENT ADVICE AND EFFECTS STUDY REPORT
ON IFRS 15 *Revenue from Contracts with Customers*
INVITATION TO COMMENT ON EFRAG'S ASSESSMENTS**

Comments should be sent to commentletters@efrag.org by 15 December 2014

EFRAG has been asked by the European Commission to provide it with advice and supporting material on IFRS 15 *Revenue from Contracts with Customers* ('IFRS 15' or 'the Standard'). In order to do that, EFRAG has been carrying out an assessment of IFRS 15 against the technical criteria for endorsement set out in Regulation (EC) No 1606/2002 and has also been assessing the costs and benefits that would arise from its implementation in the European Union (the EU) and European Economic Area.

A summary of IFRS 15 is set out in Appendix 1.

Notes to constituents

The endorsement advice on IFRS 15 will be finalised by EFRAG Board which is expected to be in place by 31 October 2014. The EFRAG Board results from the recent and ongoing governance reform. It will be responsible for all EFRAG positions after considering the technical advice provided by the EFRAG Technical Expert Group and the outcome of EFRAG's due process. As a result, any dissenting views from the final endorsement advice would be the views of EFRAG Board members.

IFRS 15 includes consequential amendments to IFRS 9 *Financial Instruments* which has not been endorsed by the European Union. These consequential amendments are not addressed in this endorsement advice and will be considered as part of the endorsement process of IFRS 9 as a whole.

Before finalising its two assessments, EFRAG would welcome your views on the issues set out below. Please note that all responses received will be placed on the public record, unless the respondent requests confidentiality. In the interest of transparency EFRAG will wish to discuss the responses it receives in a public meeting, so we would prefer to be able to publish all the responses received.

EFRAG initial assessments summarised in this questionnaire will be amended to reflect EFRAG's decisions on Appendix 2 and 3.

- 1 Please provide the following details about yourself:
 - (a) Your name or, if you are responding on behalf of an organisation or company, its name:

Nicolas De Paillerets

Directeur des Normes Comptables Groupe Finance Groupe

Orange

(b) Are you a:

Preparer User Other (please specify)

(c) Please provide a short description of your activity:

Orange is a European mobile operator and telecommunications services provider. The Group has a total customer base of 240 million customers at 30 September 2014.

(d) Country where you are located:

France

(e) Contact details including e-mail address:

2 EFRAG’s initial assessment of IFRS 15 is that it meets the technical criteria for endorsement. In other words, it is not contrary to the principle of true and fair view and it meets the criteria of understandability, relevance, reliability and comparability. EFRAG’s reasoning is set out in Appendix 2.

(a) Do you agree with this assessment?

X Yes No

If you do not, please explain why you do not agree and what you believe the implications of this should be for EFRAG’s endorsement advice.

- (b) Are there any issues that are not mentioned in Appendix 2 that you believe EFRAG should take into account in its technical evaluation of IFRS 15? If there are, what are those issues and why do you believe they are relevant to the evaluation?

- 3 EFRAG is also assessing the costs that are likely to arise for preparers and for users on implementation of IFRS 15 in the EU, both in year one and in subsequent years. Some initial work has been carried out, and the responses to this Invitation to Comment will be used to complete the assessment.

The results of the initial assessment of costs are set out in paragraphs 3 - 37 of Appendix 3. To summarise, EFRAG’s initial assessment is that there may be significant one-off and ongoing cost for preparers to collect and process the information needed to apply IFRS 15. Users may incur one-off costs to update their models and restate the historical information into a comparable format.

Do you agree with this assessment?

X Yes No

If you do not, please explain why you do not and (if possible) explain broadly what you believe the costs involved will be?

- 4 When commenting on the Exposure Draft that resulted in IFRS 15, EFRAG expressed the view based on the results of its public consultation that a full three years was necessary to achieve proper implementation of the Standard. Publication of the final Standard in the spring of 2014 (instead of mid-2013 as expected) reduces the time available for implementation to less than three years. Having regard to the final transition requirements that are meant to ease implementation of the standard, do you assess it will be possible to apply IFRS 15 by 1 January 2017 (this question is only relevant if you are preparing financial statements under IFRS)?

Yes **X No**

If you do not, please explain why you do not think it would be possible.

The 1/1/2017 transition date represents a challenge in our industry (telecommunication) even for entities that can benefit from the relief of not providing comparatives mainly because of the underestimation of the time necessary to:

- (1) adapt the performance management; and
- (2) analyze the effects of the standard on b2b contracts.

Furthermore, the relief is uncertain to IFRS registrants in the US.

For these reasons, we assess the 01/01/2017 effective date as presenting too significant a risk.

In order not to lose any momentum in the implementation, should the deadline be postponed, companies that will be ready for 2017 should be allowed to apply IFRS 15 in 2017.

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- 5 In addition to considering the costs, EFRAG is assessing the benefits that are likely to be derived from IFRS 15. The results of the initial assessment of benefits are set out in paragraphs 38 - 41 of Appendix 3. To summarise, EFRAG’s initial assessment is that users will generally benefit from the Standard as it will result in relevant, reliable, comparable and understandable information. Preparers will also benefit from a robust and comprehensive framework applying to all contracts with customers, across industries. In addition, preparers may benefit from the guidance provided in IFRS 15 which is more comprehensive than in previous Standards on revenue.

Do you agree with this assessment?

X Yes No

If you do not agree with this assessment, please provide your arguments and indicate how this should affect EFRAG’s endorsement advice?

The standard will demonstrate its technical merits if its implementation pays respect to the criteria of relevant, reliable, comparable and understandable information.

Its approach puts pressure on the accounting for contracts with vendors, as preparers are left with no clear direction between keeping their current accounting, referring to ias37, or going for some analogy to ifrs15 .

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- 6 EFRAG’s initial assessment is that, for users and for most preparers, the benefits to be derived from implementing IFRS 15 in the EU as described in paragraph 5 above are likely to outweigh the costs involved as described in paragraph 3 above. It is however likely that for some entities or in some industries (particularly those with a large number of complex contracts) the benefits may not outweigh the costs, when considered in isolation. However, when taking into account the benefits of having one revenue recognition principle applying to all types of industries, EFRAG believes that, on balance, the benefits of adopting IFRS 15 will outweigh the costs.

Do you agree with this assessment?

Yes No

If you do not agree with this assessment, please provide your arguments and indicate how this should affect EFRAG’s endorsement advice?

The balance remains uncertain as of today as we lack distance for the actual benefits.

- 7 EFRAG is not aware of any reason to believe that it is not conducive to the European public good to adopt IFRS 15.

Are you aware of any reason to believe that it is not conducive to the European public good to adopt IFRS 15?

Yes No

If ‘yes’, please provide your reasons.

Such an assessment is difficult to make today : they are always risks associated to reshuffling standards applicable to such a significant line of the income statement

- 8 EFRAG is not aware of any other factors that should be taken into account in reaching a decision as to what endorsement advice it should give the European Commission on IFRS 15.

Do you agree that there are no other factors?

X Yes No

If you do not agree, please provide your arguments and indicate how this should affect EFRAG’s endorsement advice?

Appendix 1

A summary of IFRS 15

Background

- 1 Prior to the issuance of IFRS 15 *Revenue from Contracts with Customers* (‘IFRS 15’ or ‘the Standard’), the revenue recognition requirements in IFRS and US GAAP were different. IFRS included two different revenue Standards (IAS 11 *Construction Contracts* and IAS 18 *Revenue*). These previous revenue Standards had different principles and were sometimes difficult to understand and apply to complex transactions. The previous revenue Standards also lacked sufficient guidance on important topics such as revenue recognition for arrangements where a contract would include multiple goods and/or services (multiple-element arrangements) and the disclosure requirements would often not provide users of financial statements with information to enable them to sufficiently understand the revenue figure recognised.

How the issues have been addressed

- 2 IFRS 15 was developed jointly with the FASB and accordingly increases the likelihood that revenue figures and related disclosures will be comparable between entities reporting under IFRS and US GAAP. IFRS 15 applies one revenue recognition model to all contracts with customers and provides more detailed guidance on some of the issues where the previous revenue Standards lacked guidance. Finally IFRS 15 requires more disclosures about revenue than the previous revenue Standards.

What has changed?

- 3 According to IFRS 15, an entity shall generally recognise revenue when (or as) the entity transfers a promised good or service (i.e. an asset) to a customer. An asset is transferred when (or as) the customer obtains control of that asset.
- 4 Previously, the revenue model depended on whether a contract was covered by IAS 11 or IAS 18 and was based on the type of transaction or event (i.e. whether the entity was performing under a construction contract, sold a good, rendered a service or had income from interest, royalties and dividends).
- 5 Some of the other significant changes compared with the previous revenue Standards in IFRS address problems in relation to:
 - (a) How to account for multiple-element arrangements;
 - (b) When an entity shall recognise revenue over time;
 - (c) How to account for variable consideration;
 - (d) How to account for contract costs; and
 - (e) What disclosures to provide.

How to account for multiple-element arrangements

- 6 IFRS 15 includes guidance for multiple-element arrangements. The previous Standards only included very high-level guidance on such arrangements, except for the specific guidance provided for customer loyalty programmes (in IFRIC Interpretation 13 *Customer Loyalty Programmes*).

- 7 The guidance in IFRS 15 requires an entity to consider whether a good or a service covered by a contract is distinct.
- 8 As previous revenue Standards did not include detailed guidance on how to account for multiple-element arrangements, the requirements of IFRS 15 may result in different elements being identified in a contract compared with previous practice. This may affect when revenue from a contract is recognised in the financial statements. However, the effect may be different from contract to contract, and it is thus not possible to provide an assessment of whether revenue generally will be recognised sooner or later compared with previous revenue Standards.

When an entity shall recognise revenue over time

- 9 IFRS 15 includes different guidance than the previous revenue Standards on when an entity shall recognise revenue over time. In previous Standards, revenue should be recognised over time if the contract met the definition of a construction contract or if the transaction involved the rendering of services.
- 10 According to IFRS 15, an entity transfers control of a good or service over time, and therefore satisfies a performance obligation and recognises revenue over time, if one of the following criteria is met:
 - (a) The customer simultaneously receives and consumes the benefits provided by the entity’s performance as the entity performs;
 - (b) The entity’s performance creates or enhances an asset (for example, work in progress) that the customer controls as the asset is created or enhanced; or
 - (c) The entity’s performance does not create an asset with an alternative use to the entity and the entity has an enforceable right to payment for performance completed to date.
- 11 The new requirements may thus result in revenue being recognised over time for some contracts where revenue under the previous revenue Standards was recognised at a point in time and vice versa.

How to account for variable consideration

- 12 Both IAS 11 and IAS 18 required revenue to be measured at the fair value of the consideration received or receivable. In IFRS 15 the amount of revenue is based on the transaction price. The transaction price is the amount of consideration to which an entity expects to be entitled in exchange for transferring promised goods or services to a customer. IFRS 15 includes specific guidance in cases where the amount of consideration is (partly) variable. Such guidance was not included in either IAS 11 or IAS 18.
- 13 IFRS 15 states that an entity shall estimate an amount of variable consideration by using either the expected value or the most likely amount, depending on which method the entity expects to better predict the amount of consideration to which it will be entitled.
- 14 Unlike IAS 11 and IAS 18, IFRS 15 includes a constraint on the amount of variable consideration that can be recognised as revenue in a period. IFRS 15 requires that the transaction price only includes variable consideration where it is highly probable that a significant reversal in the cumulative amount of revenue recognised will not occur when the uncertainty associated with the variable consideration is resolved. For a sales-based or usage-based royalty promised in exchange for a licence of

intellectual property, IFRS 15 requires revenue recognition to be deferred until the later of the following events occurs:

- (a) The subsequent sale or usage occurs; and
- (b) The performance obligation to which some or all of the sales-based or usage-based royalties have been allocated has been satisfied (or partially satisfied).

How to account for contract costs

- 15 IAS 11 (but not IAS 18) included guidance on what costs could be capitalised as contract costs. These included the costs attributable to a contract for the period from the date of securing the contract to the final completion of the contract. However, costs that related directly to a contract and were incurred in securing the contract were also included as part of the contract costs if they could be separately identified and measured reliably and it was probable that the contract would be obtained.
- 16 IFRS 15 includes general requirements relating to contract costs that apply to all contracts within its scope. IFRS 15 includes both guidance on incremental costs of obtaining a contract and costs to fulfil a contract.
- 17 According to IFRS 15, an entity shall recognise the incremental costs of obtaining a contract with a customer as an asset if the entity expects to recover those costs.
- 18 In relation to costs to fulfil a contract, IFRS 15 requires that costs that relate directly to a contract should be capitalised. It also states that costs related to an anticipated contract that an entity can specifically identify should be capitalised. For both current and anticipated contracts, the costs that are capitalised should generate or enhance resources of the entity that will be used in satisfying (or continuing to satisfy) performance obligations in the future and the costs are expected to be recovered.

What disclosures to provide

- 19 IFRS 15 requires significantly more disclosures on revenue than IAS 11 and IAS 18. The objective of the disclosure requirements is for an entity to disclose sufficient information to enable users of financial statements to understand the nature, amount, timing and uncertainty of revenue and cash flows arising from contracts with customers. To achieve that objective, an entity shall disclose qualitative and quantitative information about all of the following:
 - (a) Its contracts with customers;
 - (b) The significant judgements, and changes in the judgements, made in applying the Standard to those contracts; and
 - (c) Any assets recognised from the costs to obtain or fulfil a contract with a customer.
- 20 IFRS 15 also specifies that an entity shall consider the level of detail necessary to satisfy the disclosure objective and how much emphasis to place on each of the various requirements.

When does IFRS 15 become effective?

- 21 An entity shall apply IFRS 15 for annual reporting periods beginning on or after 1 January 2017. Earlier application is permitted.
- 22 An entity shall apply IFRS 15 using one of the following two methods:

- (a) Retrospectively to each prior reporting period presented in accordance with IAS 8 *Accounting Policies, Changes in Accounting Estimates and Errors*. When applying IFRS 15 retrospectively, an entity may use one or more of the following practical expedients on a consistent basis:
 - (i) For completed contracts, an entity need not restate contracts that began and ended within the same annual reporting period;
 - (ii) For completed contracts that have variable consideration, an entity may use the transaction price at the date the contract was completed rather than estimating variable consideration amounts in the comparative reporting periods; and
 - (iii) For all reporting periods presented before the date of initial application, an entity need not disclose the amount of the transaction price allocated to the remaining performance obligations and an explanation of when the entity expects to recognise that amount as revenue.
- (b) Retrospectively with the cumulative effect of initially applying IFRS 15 recognised at the date of initial application as an adjustment to the opening balance of retained earnings (or other component of equity, as appropriate) of the annual reporting period that includes the date of initial application. Under this transition method, an entity shall apply IFRS 15 retrospectively only to contracts that are not completed contracts at the date of initial application. If this method is chosen, an entity shall provide the additional disclosures specified in the Standard.

Appendix 2

EFRAG’s Technical assessment of IFRS 15 against the endorsement criteria

This appendix sets out the basis for the conclusions reached, and for the recommendation made, by EFRAG on IFRS 15.

In its comment letters to the IASB, EFRAG points out that such letters are submitted in EFRAG’s capacity of contributing to the IASB’s due process. They do not necessarily indicate the conclusions that would be reached by EFRAG in its capacity of advising the European Commission on endorsement of the definitive IFRS in the European Union and European Economic Area.

In the latter capacity, EFRAG’s role is to make a recommendation about endorsement based on its assessment of the final IFRS or Interpretation against the technical criteria for the European endorsement, as currently defined. These are explicit criteria which have been designed specifically for application in the endorsement process, and therefore the conclusions reached on endorsement may be different from those arrived at by EFRAG in developing its comments on proposed IFRSs or Interpretations. Another reason for a difference is that EFRAG’s thinking may evolve.

Does the accounting that results from the application of IFRS 15 meet the technical criteria for EU endorsement?

- 1 EFRAG has considered whether IFRS 15 *Revenue from Contracts with Customers* (*‘IFRS 15’ or ‘the Standard’*) meets the technical requirements of the European Parliament and of the Council on the application of international accounting standards, as set out in Regulation (EC) No 1606/2002, in other words that IFRS 15:
 - (a) Is not contrary to the principle of ‘true and fair view’ set out in Article 4(3) of Council Directive 2013/34/EU; and
 - (b) Meets the criteria of understandability, relevance, reliability, and comparability required of the financial information needed for making economic decisions and assessing the stewardship of management.
- 2 EFRAG also considered, based only on evidence brought to its attention by constituents, whether it would be not conducive to the European public good to adopt IFRS 15.
- 3 EFRAG’s assessment on the whether the technical requirements are met are included in this appendix in the following paragraphs:
 - (a) Relevance: paragraphs 6 - 69;
 - (b) Reliability: paragraphs 70 - 105;
 - (c) Comparability: paragraphs 106 - 134;
 - (d) Understandability: paragraphs 135 - 146; and
 - (e) True and fair view: paragraph 147.
- 4 IFRS 15 includes consequential amendments to IFRS 9 *Financial Instruments*, which has not yet been endorsed in the European Union. These consequential amendments are not addressed in this endorsement advice and will be considered as part of the endorsement process of IFRS 9 as a whole.

Approach adopted for the technical evaluation of IFRS 15

- 5 In providing its assessment of whether IFRS 15 results in relevant, reliable, understandable and comparable information, EFRAG has considered all the requirements of IFRS 15. EFRAG has, however, focused its assessment on the requirements it considered most significant in relation to each of the criteria. EFRAG has accordingly focused on guidance that:
- (a) Is fundamental to revenue recognition and/or to IFRS 15;
 - (b) Has been subject to substantial debate (evidenced by the comments EFRAG has received from constituents including participants in EFRAG’s field-tests of the Exposure Draft); or
 - (c) May be problematic to apply (evidenced by the results of EFRAG’s field-tests).

Relevance

- 6 Information is relevant when it influences the economic decisions of users by helping them evaluate past, present or future events or by confirming or correcting their past evaluations.
- 7 EFRAG considered whether IFRS 15 would result in the provision of relevant information – in other words, information that has predictive value, confirmatory value or both – or whether it would result in the omission of relevant information.
- 8 Following the criteria set out in paragraph 5 above, EFRAG has focused its assessment on requirements related to:
- (a) Identifying the contract;
 - (b) Identifying performance obligations;
 - (c) Contract modifications;
 - (d) Satisfaction of performance obligations;
 - (e) Variable consideration;
 - (f) Existence of significant financing components;
 - (g) Allocating the transaction price to performance obligations and allocation of discounts;
 - (h) Incremental costs of obtaining a contract;
 - (i) Presentation;
 - (j) Disclosures;
 - (k) Licensing agreements;
 - (l) Effective date and transition; and
 - (m) Sales that are not an output of an entity’s ordinary activity (Amendments to IAS 16 *Property, Plant and Equipment*, IAS 38 *Intangible Assets* and IAS 40 *Investment Property*).

- 9 In performing its assessment, EFRAG has paid attention to the fact that both its own and the IASB’s observations during the development of IFRS 15 indicate that users of financial statements consider that revenue is more relevant if it is not expected to be subject to significant future reversals (i.e. downward adjustments) in a subsequent period (paragraph BC207 of the Basis for Conclusions accompanying IFRS 15).
- 10 As part of its assessment EFRAG has therefore assessed the extent to which the requirements of IFRS 15 limit the likelihood of reversals of revenue figures resulting from uncertainties that existed when the revenue was recognised.

Identifying the contract

- 11 When there is uncertainty about whether a contract establishes enforceable rights and obligations¹, IFRS 15 only allows (and requires) revenue to be recognised when:
- (a) The entity has no remaining obligations to transfer goods or services to the customer and all, or substantially all, of the consideration promised by the customer has been received by the entity and is non-refundable; or
 - (b) The contract has been terminated and the consideration received from the customer is non-refundable.
- 12 EFRAG assesses that uncertainty about the terms in a contract could result in revenue reversals when the uncertainty would be resolved in the future. EFRAG therefore assesses that in those circumstances, IFRS 15 takes an approach that limits revenue reversals and results in relevant information. EFRAG acknowledges that the requirements in paragraph 11 above are restrictive, but considers them appropriate in order to result in relevant information. EFRAG notes that when the terms in a contract are not clear, there would be a significant risk that an entity, without the requirements, would recognise revenue to which it would never be entitled.
- 13 The restrictions mentioned above in paragraph 11 also apply when at contract inception it is not probable (or at a later stage, because of significant changes in facts and circumstances, does not seem probable) that the entity will collect the consideration to which it will be entitled (see paragraphs 9(e) and 13 of IFRS 15). In these cases, EFRAG similarly assesses that the requirement results in relevant information for predicting future cash flows as it only permits the recognition of revenue that would be expected to result in future cash inflows.

Identifying performance obligations

Distinct goods and services

- 14 The requirements in IFRS 15 on how to identify performance obligations would generally result in revenue being recognised when an entity transfers a good or service to the customer and the customer, in principle, would have been able to purchase that good or service separately (if not from the entity then perhaps from another entity) because the good or service is distinct. EFRAG considers that it

¹ The requirements in IFRS 15 relate to circumstances where:

- (a) A contract (or contract modification) has not been approved;
- (b) Each party’s rights regarding the goods or services to be transferred cannot be identified;
- (c) The payment terms for the goods or services to be transferred cannot be identified;
- (d) The contract does not have commercial substance; or
- (e) It is not probable that the entity will collect the consideration to which it will be entitled.

results in relevant information to recognise revenue separately for distinct goods and services. As a result, the timing of revenue recognition becomes independent of whether a distinct good or service is included in a separate contract or in a contract with other distinct goods and/or services that are transferred at a different point in time. EFRAG assesses that this provides useful information when evaluating past, present or future events or when confirming or correcting past evaluations.

- 15 There are two circumstances when the requirements in IFRS 15 would not result in revenue being recognised when an entity transfers a good or service to the customer that the customer in principle could have been able to purchase separately.
- 16 The first circumstance is when an entity’s promise to transfer the good or service to the customer is not distinct within the context of the contract. This is, for example, the case when the customer has ordered a house and the entity has delivered some bricks (that the customer in principle could have purchased separately). Although EFRAG generally considers that it provides relevant information to recognise revenue from each performance obligation separately, EFRAG considers that it would not provide relevant information to recognise revenue separately in these cases for the distinct goods and services (e.g. for the bricks delivered). Doing so would not result in revenue being recognised when the entity performs in accordance with the particular contract (e.g. uses the bricks in the construction of the house, which is what the customer has ordered).
- 17 The second circumstance is when there is a series of distinct goods or services that are substantially the same and that have the same pattern of transfer to the customer. This is, for example, the case when a customer is entering into a contract to be on an electricity network for a year. In this case the distinct goods or services are considered one performance obligation although the customer could have chosen to buy 12 separate contracts each being for one month’s connection. If the price of being on the network were to be different in different months, the revenue reported in each period would be different depending on whether a contract for one year would be considered one performance obligation or 12 consecutive performance obligations. Although EFRAG generally considers that recognising revenue from each performance obligation separately provides relevant information, EFRAG assesses that the requirement to consider a 12 months contract as one contract would not affect the information’s ability to help users evaluate past, present or future events and confirm or correct past evaluations. Whether the contract would be considered as 12 performance obligations or as one performance obligation would not result in a different period over which revenue is recognised.

Marketing expenses

- 18 The requirements in IFRS 15 on how to identify performance obligations can result in what some consider to be ‘marketing expenses’ being accounted for as goods and services that an entity transfers to its customers in return for consideration. EFRAG is, for example, aware that analysts of financial statements of some telecommunication companies consider that if a customer receives a handset for ‘free’ or at a discount when signing a contract with a network operator, this handset (or the discount) is a marketing expense and should be accounted for as such. Under IFRS 15 such a handset should be considered as a good the entity transfers to the customer in return for consideration². Revenue should therefore be recognised when the handset is transferred.

² The amount of any revenue allocated to the handset may depend on the contract details and whether a portfolio approach is applied. For example, it may be that an entity will not expect a particular customer to perform its obligation (to pay). In

- 19 In some cases there can also be a relationship between the value of a ‘gift’ a customer receives for buying the entity’s ordinary goods and services and the value the customer attaches to those ordinary goods and services. The lower the customer values the entity’s ordinary goods and services, the more valuable the ‘gift’ may have to be in order for the entity to be able to sell its ordinary goods and services. Some therefore consider it to be counterintuitive that the revenue to be recognised when a customer enters into a contract and receives the ‘gift’ is higher under IFRS 15 when the entity is providing a valuable ‘gift’ compared with when a less valuable ‘gift’ is provided. They think that recognising a high amount of revenue signals that something beneficial for the entity has occurred. However, having to transfer an expensive ‘gift’ in order to having the customer purchasing the entity’s ordinary goods and services is not considered beneficial for the entity.
- 20 EFRAG acknowledges the arguments presented in both paragraphs 18 and 19 above. However, EFRAG notes that:
- (a) It seems impossible to develop requirements to distinguish between ordinary goods and services of an entity and marketing expenses that would meet all views on what are marketing expenses and what are not.
 - (b) If IFRS 15 did not include requirements on how to identify performance obligations, an entity might recognise all of the consideration in a contract as revenue even though the entity would continue to have remaining promises related to the contract with the customer. This would not be consistent with the principle that revenue should not be recognised until an entity has ‘performed’.
 - (c) Recognising a relatively high amount of revenue when a valuable ‘gift’ is transferred to a customer results in relatively little revenue being recognised when the entity transfers its ordinary goods and services. If a valuable ‘gift’ is necessary for having a customer buying the ordinary goods and services of an entity, the relatively low revenue figure (and corresponding lower profit margin) recognised when the ordinary goods and services are transferred, appears to be relevant for evaluating past, present or future events or for confirming or for correcting past evaluations.
- 21 In addition, EFRAG assesses that although it may take some time before an entity receives the consideration for the ‘gift’ in the form of the payments the customer is making for the ordinary goods or services, the requirements to recognise performance obligations do not result in information that is not relevant. As mentioned above, IFRS 15 includes restrictive revenue recognition requirements for situations where it is not probable that a customer would pay or in other ways fail to meet the conditions included in a contract.
- 22 EFRAG therefore assesses that the requirements included in IFRS 15 on identifying performance obligations generally result in relevant information.

Contract modifications

- 23 EFRAG assesses that the requirements in IFRS 15 related to contract modifications are generally consistent with how performance obligations are identified in the

those cases, that contract may not be included within the scope of the Standard, and the entity can only recognise revenue in accordance with paragraph 15 of IFRS 15 when the entity receives consideration from the customer (and the entity has performed or the contract has been terminated). However, if a portfolio approach is applied, an ‘average approach’ to all contracts is applied.

Standard. For example, if an entity is modifying a contract, but there would be no economic difference if the entity had entered into a separate contract for additional goods or services, the modification is accounted for as a separate contract. For similar reasons as presented above in paragraph 14, EFRAG considers that this results in relevant information.

Satisfaction of performance obligations

Right to consideration

- 24 In the view of EFRAG (and consistent with the feedback EFRAG has received from users), the revenue figure that could best provide information with predictive value and confirmatory value is linked to an entity’s entitlement to consideration under a contract with a customer. Without this link, revenue could be recognised to which the entity would never become entitled and from which the entity would therefore never receive any benefits³. Presenting revenue figures that would not be linked to the cash flows an entity could be expected to be (or become) entitled to would not provide information useful for predicting future cash flows and hence for confirming or correcting expectations of performance.
- 25 IFRS 15 bases revenue recognition on the transfer of goods and services from the entity to the customer under a contract. In many cases, if an entity has agreed with a customer to transfer a good or service, the entity would have a right to consideration when it has transferred that good or the service. It would be stated implicitly or explicitly in the contract with the customer that the customer would have to pay when the entity has performed its part of the contract by delivering a good or a service. The overall revenue recognition principle in IFRS 15 therefore results in relevant information. However, this may not be the case when the entity’s right to consideration depends on the occurrence or non-occurrence of future events other than the transfer of a single good or service. Such situations could, for example, happen when the entity delivers additional goods and services before it is entitled to any consideration or completes the transfer of a distinct good or service within a given time period (when a performance obligation is satisfied over time).
- 26 IFRS 15 includes some modifications to the overall revenue recognition principle that address these situations. These requirements result in very limited circumstances where IFRS 15 could result in revenue being recognised for which an entity will never be entitled to consideration. These circumstances arise when both of the following circumstances exist:
- (a) The entity satisfies a performance obligation at a point in time or over time because:
 - (i) the customer simultaneously receives and consumes the benefits provided by the entity’s performance as the entity performs; or
 - (ii) the entity’s performance creates or enhances an asset that the customer controls as the asset is created or enhanced.
 - (b) Although the entity initially assesses that it is highly probable that it will be entitled to consideration, the circumstances and assumptions on which this

³ In this regard a receivable is considered a benefit even if the debtor may default.

assessment was based cease to exist and the entity will not be entitled to any consideration.

- 27 EFRAG accordingly assesses that although IFRS 15 could result in revenue being recognised for which an entity will never be entitled to consideration, such an outcome will be rare. It will only happen when an entity assesses that it is highly probable that it will be entitled to consideration and it turns out that it will not be entitled to this consideration. EFRAG considers that requiring higher certainty for a transfer to result in a right to consideration could reduce the relevance of the information about the activities (transfers) that result in the right to consideration. The reason is that requiring higher certainty would result in revenue being reported too late for the information to be useful in evaluating past events or for confirming or correcting past evaluations. For example, if revenue would generally not be recognised until the entity would receive a (non-refundable) consideration from the customer, revenue reported in one period could be related to activities the entity performed in much earlier periods and for which it was certain to receive consideration.

Reversal of revenue

- 28 IFRS 15 includes criteria for when a performance obligation is considered satisfied over time versus when it is satisfied at a point in time. In addition to these criteria, IFRS 15 requires that an entity shall recognise revenue for a performance obligation satisfied over time only if the entity can reasonably measure its progress towards complete satisfaction of the performance obligation.
- 29 Consistent with the arguments presented in paragraphs 9 - 10, EFRAG considers that this requirement results in relevant information as an entity that cannot measure its progress reasonably may end up in a situation where it is recognising ‘too much’ revenue in a period.
- 30 EFRAG also assesses that the requirement reflects an appropriate balance between permitting revenue to be recognised too early and delaying the provision of information. The requirements (by referring to ‘reasonably’) require less certainty than the requirements applying when there is uncertainty about the terms in the contract or the consideration is variable (where entitlement to an amount of consideration must be ‘highly probable’). However, in the cases of variable consideration and uncertainty about the terms of the contract, the worst case scenario is that an entity recognises revenue to which it will never be entitled. When the only issue is that an entity cannot measure its progress towards complete satisfaction of a performance obligation, the worst case is that the entity has allocated too much revenue to the past periods and accordingly will have to recognise less revenue in future periods (i.e. no direct reversal of recognised revenue). In these circumstances it therefore seems appropriate that IFRS 15 requires revenue to be recognised if the entity can reasonably measure its progress towards complete satisfaction.

Variable consideration

Estimate of variable consideration

- 31 As noted above in paragraph 24, EFRAG considers that the revenue figure could best provide information that has predictive value and confirmatory value if it is linked to an entity’s entitlement to consideration under a contract with a customer. EFRAG therefore assesses that the requirement of IFRS 15, that an entity shall estimate the amount of consideration to which it expects to be entitled in exchange for transferring the promised goods or services to a customer, will result in relevant information.

Similarly, EFRAG considers that the requirement to estimate the amount of variable consideration based either on the most likely amount or the expected value results in relevant information as the choice of the method is based on which one better predicts the amount of consideration an entity is entitled to.

Constraining estimates of variable consideration

- 32 When the consideration is variable, EFRAG considers that a requirement to determine the transaction price on the basis of an estimate of the amount of consideration to which the entity would be entitled could often result in revenue reversals as the estimates change. Consistent with the arguments provided in paragraphs 9 - 10, EFRAG therefore assesses that the requirements to limit such reversals by constraining estimates of variable consideration results in relevant information.
- 33 IFRS 15 requires a high level of certainty⁴ when the consideration is variable. EFRAG assesses this to be appropriate, not least because variable consideration in IFRS 15 is a broad term and encompasses situations where an entity may be entitled to a fixed consideration, but only upon the occurrence or non-occurrence of a future event.
- 34 While EFRAG thus generally considers that there is balance between the certainty required for recognising revenue and the decrease in the usefulness of the information caused by revenue reversals, there is an exception when the consideration has the form of royalties from a sales-based or usage-based licence of intellectual property. In those cases, revenue cannot be recognised even when the entity believes that there is a high certainty about an amount to which it will be entitled. Revenue can be recognised only when the uncertainty has been resolved following the customer’s subsequent sale or usage. EFRAG assesses that there are no underlying differences between those royalty-based contracts and some other types of contracts that would necessitate a different level of certainty before recognising revenue. Accounting differently for these contracts could impair comparability (see paragraphs 121 - 122 below), but might also indicate that the requirements may not result in relevant information.
- 35 Following its assessment, EFRAG is, however, not concerned that the special requirement for the aforementioned royalty-based contracts would result in revenue being recognised too late and thus not result in relevant information that reflects the entity’s performance in the appropriate reporting period. EFRAG assesses that information is relevant when revenue for a sales-based or usage-based royalty is recognised when the subsequent sale or usage occurs (and the performance obligation has been satisfied (or partially satisfied)). If the general requirements on constraining estimates of variable consideration had been applied for revenue recognised in these cases, the pattern by which revenue would be recognised could primarily reflect the changes in the entity’s estimates of the amount of revenue that it is highly probable would not reverse. Such a revenue figure could be less useful for evaluating past, present or future events or for confirming or correcting past evaluations than the requirements of IFRS 15 as they would not be related to an entity’s actual performance in a given period (only to changes in the entity’s estimates).
- 36 EFRAG therefore assesses that the requirements of IFRS 15 result in revenue figures that are not likely to reverse as a result of changes in estimates of outcomes of

⁴ IFRS 15 uses the phrase: ‘highly probable that a significant reversal in the amount of cumulative revenue recognised will not occur’.

conditions that existed when the revenue was recognised and at the same time does not defer revenue recognition to such an extent that the performance of the entity (the transfer or the creation of a right to consideration) would not be reflected in the appropriate reporting period.

Existence of significant financing components

- 37 EFRAG assesses that adjusting the transaction price to reflect the time value of money for contracts that include a significant financing component provides relevant information. EFRAG considers that it enhances the predictive value and the confirmatory value of information about sales to a customer if revenue is reported as the ‘cash selling price’ of the underlying good or service at the time that the good or service is transferred and any financing component included in a contract is reported as such. This allows users to assess separately both of these elements.
- 38 EFRAG therefore also assesses that the relevance of the information provided is limited in that IFRS 15 allows entities, as a practical expedient, not to adjust for the effects of a significant financing component when the period between the transfer of a good or a service and the payment from the customer is one year or less. EFRAG notes that the financing component of a contract can be significant even for contracts of less than one year. This will be the case, for instance, when an entity has operations in a high interest rate environment or if the amount of consideration in the contract (principal of the financing component) is substantial.

Allocating the transaction price to performance obligations and allocation of discounts

- 39 EFRAG assesses that the objective included in IFRS 15 on allocation of the transaction price results in relevant information. The objective states that the transaction price should be allocated to each performance obligation in an amount that depicts the amount of consideration to which the entity expects to be entitled in exchange for transferring the promised goods or services to the customer. EFRAG considers that this objective reflects the basic requirements regarding the identification of performance obligations and determination of the transaction price. EFRAG’s evaluation of the objective thus follows from the assessments referred to in paragraphs 14 and 31.
- 40 IFRS 15 operationalises the objective of allocating the transaction price by requiring that by default the transaction price should be allocated in proportion to the stand-alone selling prices. When the sum of the stand-alone selling prices for each performance obligation equals the transaction price, this operationalisation corresponds to how EFRAG would apply the objective (assessed in paragraph 39 above). It therefore follows that EFRAG considers the operationalisation to result in relevant information in those circumstances as the revenue figure will reflect the revenue that would have been recognised if each performance obligation had been included in separate contracts.
- 41 When the sum of the stand-alone selling prices for each performance obligation does not equal the transaction price, the difference could, however, be allocated to the various performance obligations by means other than in proportion to the stand-alone selling prices in order to meet the objective related to allocating the transaction price. Similarly, if the transaction price is not fixed, the variability could be attributed in different ways to the performance obligation in a contract.
- 42 If a discount or a variable consideration relates to specific performance obligations within a contract, EFRAG assesses the information that would be most useful for evaluating past, present or future events or for confirming or correcting past

evaluations would be information that reflects this relationship. This would result in the revenue associated with a performance obligation being recognised when that performance obligation is fulfilled. EFRAG also assesses that IFRS 15 results in information that reflects this relationship and hence results in relevant information when the relationship between a discount or variable consideration and the specific performance obligations to which these relate is clear.

- 43 If a discount does not relate to specific performance obligations within a contract, IFRS 15 requires the discount to be allocated to the performance obligations based on relative stand-alone selling prices. This could result in a loss on part of a contract being reported when, for example, low margin items are transferred to a customer even when the overall contract is profitable. Some could argue that this would reduce the predictive value of the information depicted in the financial statements.
- 44 To avoid such a situation some would argue that discounts could, for example, be allocated based on the margins related to each performance obligation (based on their stand-alone selling prices). Although allocating the transaction price based on margins may reduce any ‘noise’ included in the financial statements by applying a mechanical method for allocation, the discounts can only be allocated arbitrarily when they do not relate to specific performance obligations. Any method would thus inevitably reduce the relevance of the information, and EFRAG therefore assesses that requiring the allocation to be based on stand-alone selling prices introduces some consistency with the general requirements on how to allocate the transaction price.
- 45 Generally, EFRAG therefore assesses that the requirements included in IFRS 15 on how to allocate the transaction price to performance obligations result in relevant information.

Incremental costs of obtaining a contract

- 46 EFRAG assesses that capitalising incremental costs incurred in obtaining a contract (i.e., those costs that an entity incurs to obtain a contract with a customer that it would not have incurred if the contract had not been obtained) provides relevant information.
- 47 When an entity enters into a contract with a customer, paragraph BC18 of the Basis for Conclusions accompanying IFRS 15 explains that the entity obtains rights to receive consideration from the customer and assumes obligations to transfer goods or services to the customer (performance obligations). The combination of those rights and performance obligations gives rise to a net asset or a net liability depending on the relationship between the remaining rights and the performance obligations. As IFRS 15 implicitly requires that the right is measured at the same amount as the performance obligation neither an asset nor a liability is recognised at contract inception. However, when an entity has incurred incremental costs of obtaining a contract, IFRS 15 requires these costs to be capitalised and recognised as a separate asset.
- 48 EFRAG considers that measuring the right to receive consideration and the performance obligation at the same amount when an entity enters into a contract generally results in relevant information. An alternative approach where the contract asset and the performance obligation are measured independently could result in revenue being recognised when an entity enters into a contract and not result in revenue being linked with an entity’s entitlement to consideration (see paragraphs 24 - 27 above). However, when costs have been incurred in acquiring a contract, measuring the net contract asset at this amount would not result in revenue being

recognised when a contract is entered into. It would just result in those costs not being recognised until the revenue from the contract is recognised (unless the asset is impaired).

- 49 In EFRAG’s view, recognising the existence of an asset by capitalising the costs of obtaining a contract provides information that has a predictive value of the entity’s overall performance because these costs result in a right that meets the definition of an asset (see paragraph 47 above).

Presentation

- 50 IFRS 15 is not overly prescriptive as to presentation and includes only a limited number of requirements. The following sections examine the three requirements that EFRAG considers relevant for its technical assessment.

Presentation of contract receivables separately from other contract assets

- 51 EFRAG 15 requires that contract receivables are presented separately from other contract assets. EFRAG assesses that this results in relevant information as the risks associated with contract receivables (resulting from an unconditional right to payments) are different from those of other contract assets (representing the fact that an entity has satisfied a performance obligation but does not have an unconditional right to consideration). Both assets are subject to credit risk, but the contract asset is also subject to other risks, for example, performance risk.

Presentation of remaining rights and obligations on a net basis

- 52 EFRAG assesses that it would generally provide relevant information to present the remaining rights and performance obligations in a contract on a net basis, as either a contract asset or a contract liability, as required by IFRS 15. The net presentation reflects the interdependence between the right to receive consideration and the entity’s performance (the entity performs only as long as the customer continues to pay and vice versa).
- 53 However, in a limited set of circumstances where an entity has no legal right to offset advances received from a customer against any assets recognised a result of a transfer of goods or services (for instance when these advances have the nature of security deposits and are refundable), the requirement to always present contract assets and liabilities on a net basis may not provide the most relevant information for users.
- 54 EFRAG notes, in that respect, that IFRS 15 includes no specific requirements to disclose the gross amount of contract assets and liabilities although some entities may, voluntarily, provide that information. This is in contrast to IAS 11 which requires an entity to separately disclose advances received from other contract assets or liabilities (IAS 18 does not include a similar requirement and IFRS 15 will accordingly only result in a loss of information for contracts within the scope of IAS 11).

Customer’s credit risk

- 55 IFRS 15 requires that revenue is measured without adjustments for the effects of the customer’s credit risk unless the contract includes a significant financing component. Impairment losses shall be presented as an expense. This is consistent with the definition that revenue is the amount of consideration to which an entity ‘expects to be entitled’ in exchange for transferring goods or services. Feedback received by EFRAG from its user panel has confirmed that presenting revenue gross provides the most relevant information as impairment losses are considered to reflect how an

entity manages its credit risk and collects its receivables and not how the entity is performing under contracts with customers.

Disclosures

- 56 EFRAG considers that IFRS 15 includes the disclosure requirements that generally would provide users with relevant information. EFRAG assesses that the objective of disclosures (as stated in paragraph 110 of IFRS 15) that disclosures should help ‘understand the nature, amount, timing and uncertainty of revenue and cash flows arising from contracts with customers’ would result in relevant information.
- 57 In particular, EFRAG assesses that the disclosure requirements about changes in contract balances, transaction prices allocated to remaining performance obligations and significant assumptions will help better relate the information on revenue to the entity’s financial position (the entity’s contract assets and liabilities) and enhance the predictive value of the financial information.
- 58 Disclosures may be relevant for some entities or industries but may be irrelevant for others. EFRAG observes, in this respect, that the Standard clarifies that an entity:
- (a) Need not disclose information that is immaterial; and
 - (b) Shall consider the level of detail necessary to satisfy the disclosure objective and how much emphasis to place on each of the various requirements.
- 59 EFRAG’s overall assessment is that the disclosure requirements would result in the provision of relevant information.

Licensing agreements

- 60 IFRS 15 contains detailed application guidance for licensing agreements. In the following paragraphs EFRAG has included its assessment on determining the nature of the promise in a licensing agreement. The requirements related to sales-based and usage-based royalties promised in exchange for a licence of intellectual property are considered in paragraphs 34 - 35 above.
- 61 EFRAG observes that when the promise to grant a licence represents a distinct promise and is not part of an obligation to provide other goods or services, the entity must determine whether the performance obligation arising from this promise is satisfied at a point in time or over a period of time.
- 62 EFRAG assesses that the distinction provides relevant information as it is based on assessing whether the promise gives the licensee the right to access intellectual property as it existed at the time the license was granted (i.e. the license gives no rights to updates of the intellectual property); or the right to access intellectual property over a period of time (e.g. the intellectual property is maintained and enhanced over the period of the licence by the licensor).

Effective date and transition

Transition provisions

- 63 EFRAG observes that when first applying IFRS 15, entities can choose either to apply a full retrospective approach to all periods presented (with some optional practical expedients) or to retain prior period figures as reported under the previous Standards and recognising the cumulative effect of applying IFRS 15 as an adjustment to the opening balance of equity as at the date of initial application.

64 EFRAG assesses that under this latter approach, users may not be provided with the most useful information for confirming or correcting their past evaluations as some transfers of goods and services may never be recognised in revenue and other transfers may be recognised twice.

65 However, EFRAG notes that the loss of information on trends will be compensated by the additional disclosures required if the standard is not applied retrospectively: an entity shall present for the reporting periods that include the date of initial application, the amount by which each financial statement line item is affected by the application of IFRS 15.

Sales that are not an output of an entity’s ordinary activity (Amendments to IAS 16, IAS 38 and IAS 40)

66 As described above, EFRAG assesses that the principles contained in IFRS 15 on recognising revenue when an entity satisfies its performance obligations as a result of the customer obtaining control of those goods or services, results in relevant information. EFRAG considers that this would be the case regardless of whether a transaction is considered to form part of an entity’s ordinary activities or not.

67 The main effects of applying IFRS 15 to sales that are not an output of an entity’s ordinary activities are that:

- (a) The asset is derecognised when control is lost (rather than for instance upon transfer of risks and rewards); and
- (b) Consideration is measured based on the amount an entity expects to be entitled to (including constraining variable consideration).

68 In both cases, it is believed that the requirements lead to relevant information.

Conclusion on relevance

69 Based on EFRAG’s assessment of the above mentioned requirements, EFRAG’s overall initial assessment is that IFRS 15 would result in the provision of relevant information; and therefore it satisfies the relevance criterion.

Reliability

70 EFRAG also considered the reliability of the information that will be provided by applying IFRS 15. Information has the quality of reliability when it is free from material error and bias and can be depended upon by users to represent faithfully what it either purports to represent or could reasonably be expected to represent, and is complete within the bounds of materiality and cost.

71 There are a number of aspects to the notion of reliability: freedom from material error and bias, faithful representation and completeness.

72 Following the criteria set out in paragraph 5 above, EFRAG has focused its assessment on the requirements related to:

- (a) Satisfaction of performance obligations;
- (b) Measuring progress towards complete satisfaction of a performance obligation;
- (c) Measuring variable consideration;
- (d) Existence of significant financing components;

- (e) Allocating the transaction price to performance obligations;
- (f) Presentation;
- (g) Licensing agreements;
- (h) Effective date and transition; and
- (i) Sales that are not an output of an entity’s ordinary activity (Amendments to IAS 16, IAS 38 and IAS 40).

These requirements are assessed separately below.

Satisfaction of performance obligations

- 73 EFRAG believes that, for contracts that transfer control of goods or services over time, recognising revenue as the entity progresses towards performance obligation fulfilment, rather than just on fulfilment, provides reliable information about the activity (transfer/creation of a right to consideration) carried out and the entity’s performance.
- 74 IFRS 15 is basing revenue recognition on the transfer of goods and services from the entity to the customer under a contract. EFRAG assesses that the indicators for when a performance obligation is satisfied at a point in time and the first two criteria for when a performance obligation is satisfied over time reflect this basis. The third criterion for when an entity satisfies a performance obligation over time (the entity’s performance does not create an asset with an alternative use to the entity and the entity has an enforceable right to payment for performance completed to date) will, however, not necessarily reflect this basis. For example, an entity could have transferred an asset without having an enforceable right to payment and the entity could have created an asset with no alternative use but would still have control of the asset (even if it would have a right to consideration for work performed if the contract would be cancelled). However, in many cases the third criterion would be a good indicator of goods and services having been transferred. EFRAG therefore assesses that the requirement generally results in reliable information.

Measuring progress towards complete satisfaction of a performance obligation

- 75 There are various methods that an entity might use to measure its progress towards complete satisfaction of a performance obligation and EFRAG observes that IFRS 15 neither prescribes one specific method nor offers a ‘free choice’. Rather, IFRS 15 requires an entity to use, and apply consistently, input or output methods which better depict the entity’s performance in transferring control of goods or services promised to a customer (i.e. the satisfaction of an entity’s performance obligation). This is consistent with the overall revenue model and EFRAG therefore assesses that this requirement results in faithful representation.
- 76 In some cases an output measure will provide the most faithful depiction of an entity’s performance because it directly measures the value of the goods or services transferred to the customer. However, progress in the output may not always be directly observable (for example, through surveys of performance completed to date, appraisals of results achieved, or milestones reached) or may not be available to the entity without undue cost. In such circumstances, even though an input method only indirectly measures progress on the basis of an entity’s efforts or inputs towards satisfying a performance obligation (for example, resources consumed, labour hours expended or costs incurred), IFRS 15 notes that it may be necessary to use an input

method⁵. EFRAG assesses that this requirement generally helps to ensure that information is reliable because it reduces subjectivity in the absence of observable data.

- 77 IFRS 15 requires that an entity should not recognise revenue over time if it cannot reasonably measure its progress towards complete satisfaction of the performance obligation. However, if costs incurred are expected to be recovered, revenue should be recognised to the extent of the costs incurred. EFRAG accordingly assesses that the requirements on measuring progress result in reliable information as, in the case of too much uncertainty, no revenue is recognised or revenue is only recognised to cover the costs (zero profit is reported from the partially completed contract). It may be considered that ‘reasonably’ is a low threshold. However, the threshold is considered to be sufficiently high considering the effects of a too optimistic estimation of progress. When the progress estimation is too optimistic, revenue recognition is accelerated, but the entity would only recognise revenue to which it would become entitled.
- 78 In addition, IFRS 15 introduces guidance when an input method is used to measure progress on how to identify and adjust costs incurred that do not contribute to an entity’s progress in satisfying the performance obligation. For example, the guidance explains that the costs incurred that are attributable to inefficiencies in the entity’s performance that was not reflected in the price of the contract do not contribute to an entity’s progress and that delivered but uninstalled material does not reflect progress in excess of the cost incurred. This contributes to a faithful representation of the entity’s progress in satisfying a performance obligation.

Measuring variable consideration

- 79 EFRAG assesses that it results in a faithful representation to estimate the transaction price using either an expected value or the most likely amount depending on which method the entity expects to better predict the amount of consideration to which it will be entitled, as required by IFRS 15.
- 80 The requirements in IFRS 15 on constraining estimates of variable consideration might result in revenue being reported at an amount that is less than the amount to which an entity expects to be entitled. It could thus be argued that the requirement would result in the information not being a faithful representation (as the Standard specifies that the transaction price is the amount of consideration to which an entity expects to be entitled). However, as further explained in paragraphs 9 - 10, users seem to consider revenue to be more relevant if it is not expected to be subject to significant future reversals. Accordingly, if users expect that revenue represents a figure that with some degree of certainty will not reverse (and accordingly may be lower than the amount to which an entity expects to be entitled), the figures resulting from IFRS 15 will result in a faithful representation.
- 81 The requirements in IFRS 15 on constraining estimates of variable consideration also reduces the uncertainty inherent in the information being reported. Providing an estimate of the amount of variable consideration to which an entity will ultimately be entitled will require the use of information that may be uncertain in nature. The requirements on constraining estimates of variable consideration reduce this uncertainty as the information reported has to be ‘highly probable’. The ‘highly probable’ threshold that is used in the requirement is assessed to be sufficiently high

⁵ This is identified in paragraph B17 of IFRS 15.

and EFRAG notes that the threshold is even higher for revenue for sales-based and usage-based royalties promised in exchange for a licence of intellectual property.

- 82 In addition to the information about the judgements made by management, IFRS 15 requires disclosure about:
- (a) The methods, inputs and assumptions used for determining the transaction price, which includes, but is not limited to, estimating variable consideration;
 - (b) Whether the consideration in contracts with customers is variable and whether the estimate of variable consideration is typically constrained;
 - (c) Whether any consideration from contracts with customers is not included in transaction price;
 - (d) The methods, inputs and assumptions used for assessing whether an estimate of variable consideration is constrained; and
 - (e) Changes in the contract asset and the contract liability during the reporting period resulting from cumulative catch-up adjustments to revenue that affect the corresponding contract asset or contract liability, including adjustments arising from a change in an estimate of the transaction price (including any changes in the assessment of whether an estimate of variable consideration).
- 83 EFRAG assesses that these disclosures will generally provide users with sufficient information to understand how variable consideration affects the entity’s financial statements.

Existence of significant financing components

- 84 EFRAG assesses that the requirement to adjust the promised amount of consideration for the effects of financing components results in a faithful representation of the substance of the transaction. A contract that has a significant financing component includes, conceptually, two transactions: one for the sale and one for the financing. Identifying a significant financing component acknowledges an important economic feature of the contract, and not recognising it could misrepresent the revenue of the contract. By adjusting the promised amount of consideration for the time value of money, the ‘cash selling price’ of the underlying good or service at the time that the good or service is transferred is reflected in the financial statements.
- 85 Accordingly, EFRAG also considers that the only benefits of the practical expedient whereby an entity does not need to adjust for the effects of a significant financing component if the entity expects that the financing period will be one year or less is that it can reduce costs for preparers.
- 86 When an entity has to determine any financing component, the quality of data that could be used to estimate the cash selling price of the goods and/or services transferred may be poor. Accordingly, there is a risk that an error will occur. EFRAG, however, considers that data would seldom be so poor that the financing component cannot be determined within a reasonable range. In addition, errors would not affect the total contract income, but how income and expenses are presented in the financial statements and, to some extent, the timing of these.
- 87 EFRAG also observes that IFRS 15 requires disclosures that provide information about any uncertainty related to determining the financing component and the effects of these. IFRS 15 thus requires disclosures about:

- (a) Methods, inputs and assumptions used for adjusting the consideration for the effects of the time value of money;
- (b) Significant payment terms in contracts with customers, including whether the contract has a significant financing component; and
- (c) How the timing of satisfaction of the entity’s performance obligations relates to the typical timing of payment and the effect that those factors have on the contract asset and the contract liability balances.

Allocating the transaction price to performance obligations

- 88 EFRAG assesses that the objective of allocating the transaction price to each performance obligation in an amount that depicts the amount of consideration to which the entity expects to be entitled in exchange for transferring the promised goods or services to the customer results in a faithful representation as this reflects how a good or service could have been priced had it been sold separately.
- 89 When the sum of the stand-alone selling prices for each performance obligation in a contract equals the transaction price, the guidance included in IFRS 15 to meet this objective would similarly result in a faithful representation as EFRAG assesses that the operationalisation included by this guidance reflects the objective.
- 90 When a discount does not relate to specific performance obligations within a contract, and accordingly is allocated to the performance obligations in the contract based on a relative stand-alone selling price basis, the margins of the different performance obligations are altered. This could result in a loss being reported when low margin items are transferred to a customer even when the contract is profitable. However, as there is no conceptually ‘right’ way of allocating a discount to performance obligations, EFRAG assesses that allocation based on stand-alone selling prices in accordance with IFRS 15 is not in conflict with a faithful representation and introduces a general level of discipline in performing this exercise that reduces subjectivity.
- 91 In most cases, EFRAG assesses that there would only be limited uncertainty around finding or estimating stand-alone selling prices based on the guidance included in IFRS 15. However, there may be significant uncertainty related to estimating the stand-alone selling prices in cases where all of the following conditions exist:
- (a) The price charged for the good or service varies considerably from customer to customer.
 - (b) Some elements of the arrangement are unique and customer-specific in nature.
 - (c) There is lack of historical sales information about new products or specified upgrade rights.
 - (d) The marginal cost of providing a good or service is close to nil.
 - (e) The contract includes several goods and services with the characteristics mentioned above.
- 92 EFRAG acknowledges that these conditions would exist in some circumstances (e.g. in relation to some software contracts). However, generally the occurrence is assessed to be infrequent.

Presentation

- 93 IFRS 15 contains a limited number of requirements on presentation.

Presentation of contract receivables separately from other contract assets

- 94 EFRAG believes that the separate presentation (and testing for impairment) of contract receivables from other contract assets enhances the completeness of the information provided by including additional information on the various risks associated with those assets as only receivables include an unconditional right to consideration that is subject to credit risk.
- 95 Therefore EFRAG believes that a separate presentation provides reliable information about the actual rights and obligations.

Presentation of remaining rights and obligations on a net basis

- 96 IFRS 15 requires that the residual rights and obligations in a contract are presented on a net basis. EFRAG believes that, in most instances, presenting the remaining rights and obligations on a net basis (that is without ‘grossing up’ the amounts in the statement of financial position) would provide the most faithful depiction of the interdependencies between the rights and obligations. The financial statements thus reflect that the right to receive consideration from a customer depends on the entity’s performance and the entity performs only as long as the customer continues to pay.
- 97 However, in a limited number of cases in which an entity has no legal rights to net settle the advances received from a customer with contract assets, a net presentation would not always provide a faithful representation of an entity’s rights and obligations. EFRAG also notes that, in such situations, there are no specific requirements to disclose the contract gross amounts.

Customer’s credit risk

- 98 IFRS 15 requires that revenue should not be adjusted for the effects of the customer’s credit risk unless the contract includes a significant financing component. Impairment losses shall be presented as an expense. This is consistent with the definition that revenue is the amount of consideration to which an entity expects to be entitled to (and not the amount expected to be recovered) in exchange for transferring goods or services. EFRAG therefore considers that this requirement results in a faithful representation.

Licensing agreements

- 99 The special requirements for royalties from sales-based and usage-based licences of intellectual properties introduce an exception to the principles of IFRS 15 for constraining estimates of variable consideration. Under the exception, no revenue is recognised until the customer’s sales or usage have occurred, even when an entity is capable of estimating with a high certainty a minimum amount of revenue. EFRAG acknowledges that this may reduce the faithful representation of some transactions.
- 100 However, sales-based or usage-based revenue from licences of intellectual property is generally uncertain and difficult to assess. Applying the general constraints on variable consideration to those types of contracts may lead to an overstatement of revenue with successive downwards adjustments recognised over the licence periods. That would not provide reliable information about the entity’s past performance.

Effective date and transition

- 101 EFRAG acknowledges that applying a full retrospective approach as allowed by IFRS 15 may not always result in a faithful representation. This is because, under a full retrospective approach, an entity would have to prepare all estimates based on information known at inception of the contract or during the course of the contract. It may not always be possible to recreate the circumstances that applied historically without the undue use of hindsight.
- 102 However, the alternative approach to full retrospective application allowed under IFRS 15 could also affect reliability as it would not necessarily result in complete information. The revenue from some transfers of goods and services may never be reported as revenue when this alternative is used.

Sales that are not an output of an entity’s ordinary activity (Amendments to IAS 16, IAS 38 and IAS 40)

- 103 EFRAG assesses that the application of certain of the principles contained in IFRS 15 to sales of assets that are not an output of an entity’s ordinary activity will result in a faithful representation for the same reasons as for the output of an entity’s ordinary activity (see the assessment above).
- 104 EFRAG notes that, in some circumstances, the application of the provisions on variable consideration in IFRS 15 (including the constraint) may lead to recognition of losses upon derecognition of assets that are disposed of, although the disposed of assets were not previously identified as impaired. This may also occur for assets that were previously carried at fair value (or fair value less cost to sell under IFRS 5 *Non-current Assets Held for Sale and Discontinued Operations*) when the assets are sold for a price that includes a variable amount that is not ‘highly probable’ to be received.

Conclusion on reliability

- 105 The assessment in paragraphs 73 - 104 showed that IFRS 15 generally results in reliable information. Only a few requirements, that EFRAG does not consider would affect its overall assessment, could limit the reliability of the information. These requirements were:
- (a) The practical expedient by which an entity would not need to consider a significant financing component when determining the transaction price (see paragraph 85 above);
 - (b) The requirement to always present remaining contract rights and obligations on a net basis (see paragraph 88 above); and
 - (c) The transition requirements (see paragraphs 101 - 102 above).

Comparability

- 106 The notion of comparability requires that:
- (a) Like items and events are accounted for in a consistent way through time and by different entities; and
 - (b) Unlike items and events should be accounted for differently.
- 107 EFRAG has considered whether IFRS 15 results in transactions that are:

- (a) Economically similar being accounted for differently; or
- (b) Transactions that are economically different being accounted for as if they are similar.

108 EFRAG considers that the main factors to be assessed in relation to IFRS 15, as far as comparability is concerned, regard:

- (a) Whether the requirements of the Standard will be interpreted in a consistent manner;
- (b) Whether the Standard adequately provide guidance on all significant matters within its scope and does not result in a loss of guidance compared to the guidance it is replacing;
- (c) Whether the Standard requires economically similar items to be accounted for similarly; and
- (d) The transition requirements (for comparability around the transition).

Consistent interpretation

109 IFRS 15 provides one set of requirements for recognising revenue that applies to all contracts covered by the Standard. EFRAG assesses that the general requirements of recognising revenue when control is transferred would in many cases be straight forward and hence not result in any issues that would reduce comparability.

110 However, based on the field-tests EFRAG conducted on the 2011 Exposure Draft on revenue from contracts with customers, EFRAG learned that some of the requirements of the 2011 Exposure Draft could be interpreted differently by different people. Most notably different interpretations were identified in relation to the requirements on how to identify distinct goods and services and in relation to the requirements on when a performance obligation is satisfied over time. EFRAG, however, assesses that the changes from the 2011 Exposure Draft to the final Standard (IFRS 15) have resulted in clearer guidance for many of the issues identified in the field-tests. Although there are some areas where further guidance might have been beneficial, EFRAG acknowledges that a principles based standard cannot and should not provide guidance for all possible situations and circumstances.

111 It could be argued that the judgements required by IFRS 15 in some areas could limit comparability. This could particularly be the case when the evaluation requires various factors to be considered and those factors might contain uncertainty or the information to support them might be difficult to obtain. Some of the judgements that have to be made under IFRS 15 are:

- (a) Determining whether a contract meets the criteria to be considered to be within the scope of IFRS 15 (i.e. whether the contract is with a ‘customer’ and meets the identification and recognition criteria);
- (b) Determining the number of performance obligations included in a contract and their respective stand-alone selling prices;
- (c) Determining the amount of revenue that is ‘highly probable’ in the case of variable consideration;
- (d) Determining whether a contract includes a significant ‘benefit of financing’ for one of the parties; and

- (e) Distinguishing between licences that convey a right of use and licences that convey an access to intellectual property.

112 EFRAG notes that making judgements is inherent in a principles-based environment and that the level of judgement required by IFRS 15 is not so exceptional in nature that it would be impracticable to apply the requirements. Principles based standards may increase the risk of diversity in practice developing, at least over the first years of application before practices settle. Some consider that this is an unavoidable price to pay for high quality principles-based standards. EFRAG believes that the extensive application guidance included in IFRS 15 provides the relevant framework to exercise judgement, and illustrates the principles included in the Standard. In that respect, EFRAG also observes that IFRS 15 provides guidance in a lot of areas on which previous revenue Standards provided little or no guidance.

Adequacy of guidance provided

113 IFRS 15 replaces the previous revenue Standards (IAS 18 and IAS 11), and the related Interpretations. EFRAG assesses that IFRS 15 provides guidance on all of the most important issues in relation to revenue recognition that were covered in the previous revenue Standards and in addition provides guidance on multiple-element arrangements which was considered to be the missing element in previous revenue Standards.

114 EFRAG acknowledges that, as IFRS 15 only deals with revenue arising from contracts with customers, there will be types of revenue that will not be covered by IFRS 15 for instance:

- (a) Contracts with counterparties that do not meet the definition of ‘customers’ (including transactions among partners in collaboration arrangements);
- (b) Non-exchange transactions (such as donations or contributions received);
- (c) Sales of financial instruments (including investments in affiliates); and
- (d) Dividends received.

115 EFRAG observes that, although the revenue guidance in IAS 18 is often applied by analogy to the transactions (a) to (c) above (although they are generally not an output of the entity’s ordinary activities), there is no specific guidance in IAS 18. EFRAG also observes that the guidance on dividends received is moved, unchanged, into IFRS 9.

116 Overall, EFRAG believes that the implementation of IFRS 15 will not result in a loss of material guidance regarding revenue as compared to the standards and interpretations it supersedes.

Similar accounting for similar items

117 Except for the transition requirements, IFRS 15 does not introduce accounting options. However, it includes a limited number of exceptions and practical expedients. It also includes requirements that apply in some circumstances, but not in others. The paragraphs below consider the practical expedients included in IFRS 15 and some specific requirements for some types of contracts (including exceptions);

Practical expedients

- 118 IFRS 15 includes practical expedients so that an entity does not need to:
- (a) Account for the effects of a significant financing component if the entity expects, at contract inception, that the period between when the entity transfers a promised good or service to a customer and when the customer pays for that good or service will be one year or less.
 - (b) Recognise the incremental costs of obtaining a contract as an asset if the amortisation period of the asset would be one year or less.
- 119 EFRAG considers that there is no difference between significant financing components that are settled within one year and financing components that are settled after more than one year. Because IFRS 15 does not limit the use of this practical expedient to situations where the impact would not be material, it may limit comparability.
- 120 For similar reasons, EFRAG considers that the practical expedient not to recognise the incremental costs of obtaining a contract if the amortisation period would be one year or less, regardless of materiality, could also limit comparability.

Specific requirements for some types of contracts

Exception for sales-based or usage-based royalties promised in exchange for a licence of intellectual property

- 121 EFRAG assesses that sales-based and usage-based royalties promised in exchange for a licence of intellectual property have similar economic characteristics and similar degrees of uncertainty, as many other types of contracts with variable consideration that are based on the customer’s sales or usage (e.g. usage-based royalties promised in exchange for a licence of an intangible right that is not intellectual property).
- 122 Accordingly, EFRAG considers that it could limit comparability that IFRS 15 requires these contracts to be accounted for differently from those transactions with similar economic characteristics.

Restrictive revenue recognition requirements for contracts that do not meet certain criteria

- 123 IFRS 15 includes (in paragraph 15) special restrictive revenue recognition requirements for contracts where one or more of the following conditions are met (see paragraph 9 of IFRS 15):
- (a) The parties to the contract have not approved the contract.
 - (b) The entity cannot identify each party’s rights regarding the goods or services to be transferred.
 - (c) The entity cannot identify the payment terms for the goods or services to be transferred.
 - (d) The contract has no commercial substance.
 - (e) It is not probable that the entity will collect the consideration to which it will be entitled.

- 124 EFRAG assesses that introducing more restrictive requirements for the circumstances listed in (a) – (d) of paragraph 123 may not necessarily be considered as alternative accounting treatments from the normal revenue recognition requirements. Under the circumstances mentioned in (a) – (d), the uncertainty regarding whether to recognise revenue, when to recognise revenue or at what amount revenue should be recognised seems significant. EFRAG accordingly assesses that the alternative accounting treatments would not necessarily depart from how revenue would be recognised under the normal model for revenue recognition in IFRS 15. Accordingly, EFRAG does not consider that these requirements result in information that is not comparable.
- 125 Similarly, although it could seem as if IFRS 15 introduces different requirements for contracts for which it is not probable that the entity will collect the consideration to which it will be entitled, EFRAG thinks that IFRS 15 simply states that, for all contracts, revenue cannot be recognised if it is not probable that an entity will collect the consideration to which it will be entitled. The special requirements on when revenue can be recognised if it is not probable that the entity will collect the consideration to which it will be entitled do not allow an entity to recognise revenue until it has received the consideration from the customer (because at that point in time it is certain that the entity will collect the consideration).
- 126 EFRAG therefore assesses that the special restrictive revenue recognition requirements result in consistent outcomes and do not affect the comparability of revenue figures.

Incremental costs of obtaining a contract

- 127 EFRAG notes that some constituents argue that applying the guidance in IFRS 15 on capitalising the incremental costs of obtaining a contract would limit the comparability of information. These constituents argue that the application of the requirements in the Standard would result in differences between entities that are using their own sales channels (remunerated at a fixed amount) and entities using third party distribution networks (remunerated based on the number of contracts obtained).
- 128 However, EFRAG assesses that it would lead to comparable information because there is a difference between an entity incurring variable costs when obtaining a contract and an entity where the costs related to obtaining contracts are fixed. Therefore, transactions that are economically different will be accounted for differently and transactions that are similar will be accounted for similarly.

Transition requirements

- 129 EFRAG has assessed whether IFRS 15 will result in comparable information in the transition period. In this regard EFRAG notes that the transition requirements included in IFRS 15 allow for early adoption. This could limit comparability between entities that will be significantly affected by the new requirements.
- 130 Comparability, both between entities and over time for a particular entity, could also be limited by allowing an alternative to full retrospective application (‘the cumulative catch-up transition method’).
- 131 However, EFRAG notes that all ongoing contracts as of the effective date of the Standard would need to be accounted for similarly. In addition, the cumulative catch-up transition method results in consistent presentation of contracts under previous IFRS in the comparative years and in consistent presentation of any contracts not yet completed at the date of initial application under IFRS 15 in the current year. EFRAG

also notes that, when the cumulative catch-up transition method is used, additional disclosures are required to help users of financial statements understand the effect on trend information.

- 132 EFRAG assesses that, in many instances, reported revenue will not be significantly affected by the introduction of IFRS 15, when compared with current practice. However, for those entities that will be affected, there will be a time period where comparability could be impaired by the prospective application of IFRS 15. For long-term contracts, that period could extend over a long period of time.

Conclusion on comparability

- 133 On balance, EFRAG’s overall assessment is that the requirements in IFRS 15 will result in comparable information although the comparability could be limited in the transition period and although differing interpretations of the requirements may also reduce comparability.
- 134 In relation to the latter, EFRAG, however, notes that judgements are unavoidable in principles-based standards. Judgement may also be necessary in order to achieve comparability rather than uniformity (without regard to the substance of a transaction or event). Finally, EFRAG considers that the level of judgement required by IFRS 15 is not so exceptional that it would generally result in information that is not comparable.

Understandability

- 135 The notion of understandability requires that the financial information provided should be readily understandable by users with a reasonable knowledge of business and economic activity and accounting and the willingness to study the information with reasonable diligence.
- 136 Although there are a number of aspects to the notion of ‘understandability’, EFRAG considers that most of the aspects are covered by the discussion above about relevance, reliability and comparability. For example, in paragraphs 18 - 21 EFRAG assessed whether the requirements for identification of performance obligations would result in relevant information in cases where it would result in what some consider marketing expenses being considered as deliverables under a contract. In paragraphs 24 - 30 EFRAG similarly assessed whether the revenue recognition criteria included in IFRS 15 would result in relevant information.
- 137 As a result, EFRAG assesses that the main additional issue it needs to consider, in assessing whether the information resulting from the application of IFRS 15 and in particular whether the information about the areas mentioned in paragraph 5 above is understandable, is whether that information will be unduly complex.
- 138 EFRAG considers that principles-based standards generally enhance understandability by users when the principles are clearly articulated. Complexity often arises when standards tend to become rules-based because many specific transactions are dealt with in great detail and/or in different manners that could reflect different underlying principles. Exceptions, including practical expedients, may also cause complexity in understanding the figures reported in the financial statements. IFRS 15 includes both a few exceptions and a few practical expedients.

Exception for royalties from sales- and usage-based licences

- 139 The special requirement for the recognition of royalties from sales- and usage-based licences of intellectual properties is one of the exceptions. When an exception is

introduced it is usually because it reduces costs or enhances relevance. As explained in paragraph 35 above, EFRAG assesses that this exception enhances the relevance of the information provided. In addition, EFRAG considers that the exception does not introduce something completely different for royalties from sales- and usage-based licences of intellectual property compared with the general constraint on variable consideration. The exception can thus be said only to raise the threshold for variable consideration to be included in the transaction price from ‘highly probable’ to ‘certain’. EFRAG also considers that the exception will benefit users as it will reduce spurious estimates. Accordingly, EFRAG believes that the benefits resulting from the introduction of the requirement outweigh the complexity created by the introduction of the exception.

Exceptions when terms are uncertain or the consideration is variable

- 140 The restrictive requirements on when to recognise revenue from contracts where some of the terms or conditions are uncertain (paragraphs 9 and 15 of IFRS 15) could be considered as an exception to the general requirement that an entity shall recognise revenue when it satisfies a performance obligation by transferring a promised good or service to a customer (paragraph 31 of IFRS 15). Similarly the requirements that constrain estimates of variable consideration (paragraphs 56 – 58 of IFRS 15) could be considered to be an exception to the general requirement that the transaction price is the amount of consideration to which an entity expects to be entitled in exchange for transferring promised goods or services to a customer.
- 141 In both cases, these potential exceptions will, however, only be difficult to understand if they are considered as exceptions to what users would generally expect the revenue figure to reflect. As it was noted in paragraph 9 above, users do not consider that revenue figures that are subject to reversals provide useful information. Accordingly, if users consider that revenue represents a figure that will likely not reverse, the figures resulting from the requirements that constrain estimates of variable consideration will correspond to that understanding.
- 142 This argument also applies to the restrictive requirements on when to recognise revenue where some of the terms or conditions are uncertain, however, with the modification that revenue should not only represent a figure that will likely not reverse, but also an amount that is likely to be collected by the entity.
- 143 EFRAG assesses that such a depiction of what revenue represents will be relatively easy to understand and the two potential exceptions will accordingly not result in inappropriate complexity.

Other exceptions and disclosures

- 144 EFRAG assesses that other exceptions (including practical expedients) are limited and are not expected to introduce undue complexity.
- 145 EFRAG also observes that IFRS 15 requires useful disclosures. In particular, disclosures on assumptions and judgements used are likely to enhance the understandability by users. Although the application guidance and disclosures might not be helpful in all cases, IFRS 15 is assessed to provide users of financial statements with sufficient information to understand revenue arising from contracts with customers.

Conclusion on understandability

- 146 It follows from the previous sections that EFRAG generally considers IFRS 15 to result in relevant and reliable information. In EFRAG’s view, IFRS 15 does not

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introduce complexities that may impair understandability. Therefore, EFRAG’s overall initial assessment is that IFRS 15 satisfies the understandability criterion in all material respects.

True and Fair

147 EFRAG’s initial assessment is that the information resulting from the application of IFRS 15 would not be contrary to the true and fair view principle.

European public good

148 EFRAG is not aware of any reason to believe that it is not conducive to the European public good to adopt IFRS 15.

Conclusion

149 For the reasons set out above, EFRAG’s initial assessment is that IFRS 15 satisfies the technical criteria for EU endorsement and EFRAG should therefore recommend its endorsement.

Appendix 3

EFRAG’s evaluation of the costs and benefits of IFRS 15

- 1 EFRAG has also considered whether, and if so, to what extent, implementing IFRS 15 in the EU might result in incremental costs for preparers and/or users, and whether those costs are likely to be exceeded by the benefits to be derived from adoption of IFRS 15.
- 2 IFRS 15 includes consequential amendments to IFRS 9 *Financial Instruments*, which has not yet been endorsed in the European Union. Costs and benefits relevant to IFRS 9 will be considered in any endorsement advice on IFRS 9.

Cost for preparers

- 3 EFRAG has carried out an initial assessment of the cost implications for preparers resulting from IFRS 15.

One-off costs

Reading and understanding IFRS 15

- 4 Preparers will incur one-off costs to familiarise themselves with the new requirements and for training. Those costs could also include consultations with other parties (e.g. peers and auditors).
- 5 For many transactions IFRS 15 is relatively easy to understand and will not change current practice. However, for other types of transactions – for instance for multiple-element arrangements – the changes resulting from IFRS 15 will have a significant impact. In these cases preparers may need additional resources to understand and apply the requirements of IFRS 15.

Compliance cost

- 6 EFRAG believes that a majority of preparers may incur the following type of costs:
 - (a) Costs to implement changes in, or develop new, systems, processes and controls used to gather contract data, make required estimates and provide required disclosures; and
 - (b) Incremental fees paid to independent auditors to audit the financial statements in the period of initial application.
- 7 The new requirements will make it necessary for some companies to gather information that existing accounting systems are not designed to track and capture or information that is aggregated or disaggregated differently (e.g. implementing accounting systems to determine stand-alone selling prices in each contract and allocate the transaction price to the performance obligations in the contract (see paragraph 14 below)). Preparers will need to consider the system modifications, the relating processes and internal controls that will be necessary to ensure that the information is complete and accurate.
- 8 EFRAG believes that the magnitude of the one-off costs will vary from preparer to preparer and is likely to affect some entities (e.g. those that have a large number of contracts with complex features) more than others.

Effective date and transition

- 9 The transition requirements include an alternative to a full retrospective application that aims to reduce the costs for preparers. In particular, entities may opt for a

modified form of retrospective application whereby the new standard would only apply as of the beginning of the first year of application and, therefore, all contracts with customers completed prior to that date would not need to be reassessed. For entities that opt for a full retrospective approach, practical expedients are also available (e.g. in estimating variable consideration for contracts completed over prior periods). The combination of the modified retrospective application and the practical expedients are expected to reduce one-off costs for preparers.

- 10 EFRAG’s initial assessment is that, despite the transitional relief, one-off costs of modifying systems and collecting and processing required information about ongoing contracts can be significant for entities:
 - (a) With a high number of contracts; or
 - (b) With complex multiple-element arrangements.
- 11 Some of these entities may, however, be able to reduce the costs by applying a ‘portfolio approach’.

Identifying performance obligations

- 12 EFRAG’s field-tests of the 2011 Exposure Draft showed that the new requirements for accounting for multiple-element arrangements by identifying performance obligations will for some entities (e.g. some construction companies) require that more information is collected. The additional information will be needed to assess whether, and if so how, a contract should be unbundled into performance obligations. The collection and processing of the additional information may require modifications to information systems.

Satisfaction of performance obligations

- 13 The criteria for when a performance obligation is satisfied and whether it is satisfied over time or at a point in time are different from current requirements. An entity may therefore have to modify its accounting systems if, for example, it only has contracts that are satisfied at a point in time according to the current requirements, but under IFRS 15 will have contracts that are satisfied over time.

Allocating the transaction price to performance obligations and allocation of discounts

- 14 Some entities may need to develop processes for estimating stand-alone selling prices of goods or services that are typically not sold separately and for complying with the specific requirements to allocate discounts. These costs will be higher for those entities that have many such contracts or that enter into multiple-element arrangements that contain several performance obligations. However, other entities may already have processes for determining stand-alone selling prices on the basis of reasonably available data or may already have been performing such allocations for internal reporting purposes in order to measure contracts’ profitability. These entities will not incur significant additional costs related to the allocation of the transaction price.

Incremental costs of obtaining a contract

- 15 The proposed model would require companies that currently expense incremental costs of obtaining a contract as incurred to capitalise these costs. Entities would need to evaluate the terms of their contracts with dealers and service providers to determine how much of those payments represent eligible costs. The cost associated

with establishing the data collection and processes may be significant for certain mass product industries.

Disclosures

- 16 The disclosure requirements will make it necessary for companies to gather more information than was historically required for financial reporting purposes on contracts that are ongoing at the date of first application of the Standard. Some of the information needed may not be readily available (for instance when this information has not been customarily used by management) and therefore might be costly to provide. In addition, companies will need to consider the internal controls that will be necessary to ensure that the process to collect the information is complete and accurate.

Ongoing costs

Aggregation and processing of data on an ongoing basis

- 17 EFRAG acknowledges that, in some industries, aggregating and processing contract data (e.g. stand-alone prices) in a meaningful and understandable way may be a costly task. The overall difficulty will depend on the number of contracts under consideration, the complexity of the agreements and whether they have similar characteristics.

Identifying performance obligations

- 18 EFRAG’s field-tests of the 2011 Exposure Draft showed that some entities would have to consider more information than considered at present in order to determine whether, and if so how, a contract should be unbundled into multiple performance obligations. Collecting and considering this additional information will increase costs.
- 19 EFRAG’s field-tests of the 2011 Exposure Draft also showed that some entities would have to account for more parts of a contract separately (as a performance obligation). It was considered by participants in EFRAG’s field-tests that costs would increase with the number of different parts of a contract that should be accounted for separately.

Satisfaction of performance obligations

- 20 EFRAG’s field-tests showed that it could be costly to assess whether the entity has a right to payment for performance completed to date. According to IFRS 15, an entity shall not only consider the contract but also any legislation or legal precedent that could supplement or override those contractual terms. An entity operating in multiple jurisdictions would therefore have to assess the criterion for each type of contract in each jurisdiction.

Variable consideration (including the constraint)

- 21 The requirements to measure variable consideration either by a most likely amount or an expected value approaches can be costly. However, EFRAG believes that information that an entity uses to estimate the amount of variable consideration would typically be similar to the information that the entity’s management uses during the bid-and-proposal process and in establishing prices for promised goods or services.
- 22 Furthermore the Standard clarifies that an entity shall ‘consider all the information (historical, current and forecast) that is *reasonably available*’ (emphasis added) ‘to the entity and shall identify a reasonable number of possible consideration amounts’ (paragraph 54 of IFRS 15). Therefore, in many cases, a limited number of discrete

outcomes and probabilities can often provide a reasonable estimate of the distribution of possible outcomes.

- 23 Regarding the constraint on variable consideration, the analysis an entity will undertake to determine if its estimates meet the required level of confidence (the ‘highly probable’ criterion) will be largely qualitative. It is not expected that an entity will need to prepare a quantitative analysis each time it assesses the likelihood of a significant revenue reversal. However, it is assessed that there will be some ongoing costs associated with this requirement.

Existence of a significant financing component

- 24 Participants in EFRAG’s field-tests of the 2011 Exposure Draft noted that it would be costly to account for the effect of the time value of money for all contracts.
- 25 IFRS 15 specifies that the time value of money shall only be considered when a contract provides a significant benefit of financing to one of the parties. This reduces the costs of the requirement compared with a situation where the time value of money should always be considered. Similarly, the practical expedient which provides an entity with an option not to adjust for the effects of a significant financing component if the period between the transfer of a good or service and the payment is one year or less will reduce the costs. However, in some industries and for some entities the cost of identifying and separately accounting for the financing component for all affected contracts might be significant.

Allocating the transaction price to performance obligations and allocation of discounts

- 26 As noted above some entities (e.g. software developers) may have difficulties in determining the stand-alone selling prices related to some performance obligations. However, EFRAG believes that in most cases stand-alone selling prices ought to be readily available and the allocation method ought to be relatively simple to apply in most circumstances. Therefore, situations such as those described above are likely to be very limited and the guidance in IFRS 15 will be helpful in most cases.
- 27 On the other hand, the requirements will increase costs for preparers when a discount should be allocated to separate performance obligations. While preparers would incur certain costs in allocating discounts to each separate performance obligation, it is expected that these costs will decrease over time as preparers develop internal guidelines to collect information that is necessary for the allocation.

Incremental costs of obtaining a contract

- 28 Recognising an asset from incremental acquisition costs will require more recording than immediate recognition of those costs as expenses. However, for this reason, the Standard includes a practical expedient allowing an entity to recognise incremental costs as expenses when the amortisation period is one year or less. EFRAG believes that the ongoing costs to implement this requirement are generally unlikely to be significant.

Disclosure

- 29 The qualitative and quantitative information required by IFRS 15 will make it necessary for some companies to gather more information on contracts than previously, on a recurring basis (e.g. disaggregation of revenue, analysis of the changes in the contract balances, and transaction price allocated to remaining performance). Some of the information needed may not be readily available in the required format and therefore costly to provide on an ongoing basis.

- 30 EFRAG’s field-tests of the 2011 Exposure Draft showed that preparers considered it costly to comply with the disclosure requirements. In accordance with EFRAG’s recommendations, the IASB held meetings with users and preparers simultaneously when finalising IFRS 15 to find the right level for the disclosure requirements. As a result, the disclosure requirements in IFRS 15 were significantly reduced (compared with the 2011 Exposure Draft) and the most costly requirements were removed (such as the tabular reconciliations of opening and closing balances of contract assets and liabilities or the additional disclosures in interim financial reporting).
- 31 EFRAG also observes that IFRS 15 clarifies that disclosures should be provided only to the extent that they are material and that the requirements should not be seen as a checklist of minimum requirements. Materiality will play an important role for preparers in determining which disclosures need to be presented in the financial statements and should reduce the burden related to disclosures.

Conclusion

- 32 Overall, EFRAG’s assessment is that all preparers will incur additional costs to implement the requirements in IFRS 15. For the majority of entities, the additional costs will be low. However for some (particularly entities with a high number of complex contracts), the initial costs of implementation and conducting the required analysis will be significant. In those cases the ongoing costs may be less significant and may decrease over time.

Costs for users

One-off costs

- 33 EFRAG’s initial assessment is that users may have to incur one-off costs to read and understand IFRS 15 and to restate or update their analyses to bring the information into a ‘comparable format’ and restate information on ‘trends’. The latter seems particularly relevant in relation to the entities that do not opt for a full retrospective application of IFRS 15 but use either the alternative ‘cumulative catch up method’ as of the first year of application (with no restatement of comparative years) or use some of the practical expedients provided by IFRS 15.
- 34 Users will need to understand why the numbers in the financial statements are different and what this means. In that respect, EFRAG notes that IFRS 15 requires specific disclosures if the ‘cumulative-effect transition approach’ is applied so as to make up for the loss of information on trends.
- 35 EFRAG therefore assesses that one-off costs for users may be significant in those cases where entities do not opt for a full retrospective application of the Standard.

Ongoing costs

- 36 EFRAG believes that ongoing costs for users are generally unlikely to be significant since the requirements will lead to relevant and understandable information and it is not expected that users will have to restate financial statements.

Conclusion

- 37 Overall, EFRAG’s assessment is that ongoing costs are unlikely to be significant for most users. One-off costs for users may be significant in those cases where entities do not opt for a full retrospective application of the Standard.

Benefits for preparers and users

- 38 EFRAG has carried out an initial assessment of the benefits for users and preparers resulting from IFRS 15.
- 39 In EFRAG’s view, users will generally⁶ benefit from the Standard as it will generally result in:
- (a) Relevant information (see paragraphs 6 - 69 in Appendix 2).
 - (b) Reliable information (see paragraphs 70 - 105 in Appendix 2).
 - (c) Comparable information, as it provides guidance on the most important issues of revenue recognition (including issues that were not covered by previous revenue Standards), provides one model for revenue recognition across industries and corresponds to the requirements on revenue recognition in US GAAP.
 - (d) Understandable information (see paragraphs 135 - 146 in Appendix 2).
- 40 IFRS 15 also requires relevant information (and more information than currently) about revenue in the notes to the financial statements.
- 41 The benefits for users of IFRS 15 may reduce entities’ costs of capital and hence benefit preparers. Preparers may also benefit from:
- (a) The additional guidance provided in the Standard (this guidance addresses most of the inconsistencies and weaknesses in previous revenue guidance);
 - (b) A principle-based framework that can be applied to complex transactions and that provides timely guidance for evolving revenue transactions; and
 - (c) A standard on revenue that is substantially converged with US GAAP thus potentially allowing cost reductions for preparers with worldwide operations.

Conclusion

- 42 EFRAG’s overall initial assessment is that the benefits that are expected to arise from the implementation of IFRS 15 are likely to outweigh the associated costs for users and for most preparers. EFRAG acknowledges that for some entities or industries, the benefits may not necessarily outweigh the associated costs. However, when taking into account the benefits of having one revenue recognition model applicable across entities, industries and jurisdictions, EFRAG believes that the benefits of adopting IFRS 15 will outweigh its associated costs.

⁶ As explained in paragraph 18 of Appendix 2, users of financial statements from telecommunication companies have noted that they do not find the information useful.