

CLARIFICATIONS TO IFRS 15 *REVENUE FROM CONTRACTS WITH CUSTOMERS*

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Summary

In April 2016, the International Accounting Standards Board (the Board) issued amendments to IFRS 15 *Revenue from Contracts with Customers*, clarifying some requirements and providing additional transitional relief for companies that are implementing the new Standard.

The amendments to IFRS 15 *Revenue from Contracts with Customers* clarify the existing guidance for:

- *Identification of performance obligations*
Performance obligations are identified on the basis of distinct goods or services. To further clarify the concept, additional illustrative examples have been added with others being amended.
- *Principal vs. agent considerations*
IFRS 15 requires an entity to determine whether it is a principal or an agent based on whether it controls the underlying goods or services before the transaction. In order to clarify the approach the application guidance in Appendix B has been amended and additional illustrative examples have been added.
- *Licensing agreements*
Revenue from a licensing agreement is either recognised over time or at a point in time. The pattern of revenue recognition is based on whether the entity is required to undertake activities that significantly affect the functionality of the intellectual property. The amendments include additional application guidance and examples to determine when an entity's activities significantly affect intellectual property, together with clarification for arrangements involving sales- or usage-based royalties.
- *Transitional reliefs*
Completed contracts: there is no requirement to apply IFRS 15 retrospectively to completed contracts at the beginning of the earliest period presented

Modified contracts: an entity is allowed to use hindsight when determining the effects of contract modifications on transition.

The IASB's *Clarifications to IFRS 15* differ in certain respects from the amendments to *Topic 606* issued by the FASB, and those expected to be issued in future by the FASB based on its decisions up to March 2016.

The effective date of the amendments in *Clarifications to IFRS 15* is annual reporting periods beginning on or after 1 January 2018. The endorsement of the amendments for its use in the European Union is not expected before the first quarter of 2017.

STATUS

Final

EFFECTIVE DATE

1 January 2018

ACCOUNTING IMPACT

Very significant

Background

Following the issuance of IFRS 15 and the equivalent US GAAP guidance (Topic 606), the IASB and the Financial Accounting Standards Board (FASB) formed the Transition Resource Group for Revenue Recognition (TRG) in order to support the implementation of the new standard.

As a result of the discussions at the TRG meetings five implementation issues were identified for further consideration by the IASB and the FASB, out of which the IASB decided to propose amendments with regard to the identification of performance obligations, principal vs. agent considerations, licensing, and limited transitional reliefs for completed and modified contracts.

The FASB decided to issue more extensive amendments to Topic 606. In addition to the above issues, the FASB addressed collectability, the measurement of non-cash considerations, presentation of sales taxes (determining the transaction price) and the definition of a completed contract. However, no transitional relief was proposed under US GAAP for completed contracts.

After completing its redeliberations during January 2016, the IASB issued *Clarifications to IFRS 15* in April 2016 making targeted amendments to IFRS 15 in respect of three of the five issues considered: identifying performance obligations, principal versus agent considerations and licensing. It was concluded that it was not necessary to make amendments for collectability and measuring non-cash consideration. In respect of the practical expedients, the IASB provided transition relief for modified contracts and completed contracts.

When considering whether to amend the Standard or not the IASB considered the following:

- the need to balance being responsive to issues raised but, at the same time, not creating a level of uncertainty about IFRS 15;
- when new Standards are issued there are always initial questions that arise but those questions are generally resolved working through them over time; and
- the effect of any differences between its decisions and those made by the FASB.

On this basis, the IASB made clarifying amendments to IFRS 15 only when:

- it considered those amendments to be essential to clarifying the IASB's intentions when developing the requirements in IFRS 15; or
- it viewed the benefits of retaining converged requirements as greater than any potential costs of amending the requirements.

Although some of the changes made by the IASB and the FASB are in relation to the same topics, for some of them the wording is not the same. Consequently, in certain cases the proposed amendments may result in IFRS/US GAAP differences.

Changes to IFRS 15

Identification of performance obligations

The guidance in IFRS 15 requires the identification of performance obligations based on distinct goods or services. The amendments to the illustrative examples enhance the guidance for when goods or services should be accounted for as a single performance obligation (bundle) or as separate performance obligations. For this purpose the IASB included additional examples in relation to installation services, multiple items, and equipment/consumables.

Principal vs. agent

In a transaction involving more than one counterparty, an entity is required to determine whether it acts as a principal or agent. The assessment is based on whether an entity controls the underlying goods or services before the transaction (principal) or not (agent).

Because the assessment of the transfer of control for items purchased online is more complex in comparison with tangible assets, the IASB included additional examples that specifically address this point.

Licensing agreements

Revenue from a licensing agreement is recognised either over time or at a point in time on the basis of whether the contract requires the entity to undertake activities that significantly affect the functionality of the intellectual property.

For example, the functionality of a license to broadcast a movie or use a standard-software exists upon the transfer of control, and requires a point in time revenue recognition. On the other hand the functionality of a brand constantly changes over time and is affected by various factors (e.g. constant advertising), which requires revenue recognition over time.

In order to illustrate more clearly when an entity's activities significantly affect intellectual property, additional application guidance and examples were included in the Standard.

Transitional reliefs

The transitional reliefs are intended to reduce the complexity of first-time application of IFRS 15.

Contracts that are already completed do not need to be restated when an entity applies IFRS 15 retrospectively.

In addition, contracts modified before the beginning of the earliest period presented require no retrospective restatement for the modifications made. Instead, hindsight can be used with the aggregate effect of all modifications to be reflected when:

- identifying the satisfied and unsatisfied performance obligations;
- determining the transaction price; and
- allocating the transaction price to the satisfied and unsatisfied performance obligations.

In practice, the amendments result in IFRS 15 being applied to fewer existing contracts. As mentioned below, it should be noted that the FASB did not propose the practical expedient for completed contracts.

Effective date:

The effective date of *Clarifications to IFRS 15 Revenue from Contracts with Customers* is annual reporting periods beginning on or after 1 January 2018. Earlier application is permitted. If the amendments are applied for an earlier period, this is required to be disclosed.

Comparison of IFRS 15 and Topic 606:

In IFRS 15 and Topic 606, issued in May 2014, the boards achieved their goal of reaching the same conclusions on all requirements for the accounting for revenue from contracts with customers. However, there are some minor differences in the standards as issued in May 2014:

- collectability threshold;
- interim disclosure requirements;
- early application and effective date;
- impairment loss reversal; and
- non-public entity requirements.

In addition, the IASB's Clarifications to IFRS 15 differ in certain respects from the amendments to Topic 606 issued by the FASB, and those expected to be issued by the FASB based on its decisions up to March 2016. Some differences arise from the FASB addressing US specific issues, including where guidance is included in existing US GAAP. The differences are as follows:

(a) Collectability criterion:

The amendments made by the FASB clarify that an entity should assess the collectability of the consideration promised in a contract for the goods or services that will be transferred to the customer rather than assessing the collectability of the consideration promised in the contract for all of the promised goods or services. The IASB did not make similar amendments.

(b) Revenue recognition for contracts with customers that do not meet the Step 1 criteria:

The FASB decided to amend Topic 606 to add an event in which an entity recognises any consideration received as revenue when: (i) the entity has transferred control of the goods or services to which the consideration received relates; (ii) the entity has stopped transferring additional goods or services and has no obligation to transfer additional goods or services; and (iii) the consideration received from the customer is non-refundable. The IASB did not make a similar amendment.

(c) Promised goods or services that are immaterial within the context of the contract:

The FASB decided to amend the Standard to clarify that an entity is not required to assess whether promised goods or services are performance obligations if they are immaterial within the context of the contract with the customer. The IASB did not make a similar amendment.

(d) Shipping and handling activities:

In accordance with amendment made to Topic 606, an entity is permitted (as an accounting policy choice) to account for shipping and handling activities that occur after the customer has obtained control of a good as fulfilment activities. The IASB did not make a similar amendment.

(e) Presentation of sales taxes:

FASB decided to permit entities an accounting policy choice to exclude from the measurement of the transaction price all taxes assessed by a governmental authority that are both imposed on and concurrent with a specific revenue-producing transaction and collected from customers (for example: sales taxes, use taxes, VAT etc.). The IASB decided not to provide a similar accounting policy choice in IFRS 15.

(f) Non-cash consideration:

The FASB decided to amend the Standard to require non-cash consideration to be measured at its fair value at contract inception. It was also specified that the constraint on variable consideration applies only to variability in the fair value of the non-cash

consideration that arises for reasons other than the form of the consideration. The IASB did not make similar amendments.

(g) Licensing:

- Determining the nature of the entity's promise in granting a licence of intellectual property:

The FASB decided to amend the criteria to determine the nature of a licence by requiring an entity to classify the intellectual property underlying the licence as functional or symbolic based on whether the intellectual property has significant stand-alone functionality. A licence to functional intellectual property is considered a right to use, while a licence to symbolic intellectual property is considered a right to access the underlying intellectual property. The IASB did not amend the criteria in IFRS 15 to determine the nature of the licence.

- Contractual restrictions in a licence and the identification of performance obligations:

Topic 606 was amended to clarify that the requirements about contractual restrictions of the nature described in paragraph B62 do not replace the requirement for the entity to identify the number of licences promised in the contract. The IASB did not make similar amendments to IFRS 15.

- Renewals of licences of intellectual property:

The FASB included an additional example in the Standard to specify that an entity would not generally recognise revenue from the transfer of a licence renewal until the beginning of the licence renewal period. The IASB did not make similar amendments.

- When to consider the nature of an entity's promise in granting a licence:

Unlike the IASB, the FASB decided to make amendments that explicitly state that an entity considers the nature of its promise in granting a licence when applying the general revenue recognition model to a single performance obligation that includes a licence and other goods or services.

(h) Completed contracts:

The definition of a completed contract in Topic 606 was amended. A completed contract is a contract for which all (or substantially all) of the revenue was recognised in accordance with the previous revenue Standards. The IASB did not make a similar amendment.

On the other hand, the IASB added a practical expedient to allow an entity applying IFRS 15 in accordance with paragraph C3(a) not to restate contracts that are completed contracts at the beginning of the earliest period presented. The FASB did not provide this practical expedient.

- (i) Date of application of the contract modifications practical expedient:

For entities applying Topic 606, for the equivalent guidance to paragraph C3(b) of IFRS 15, the FASB decided that the entity should apply the practical expedient at the date of initial application. However, the IASB decided that an entity may apply the practical expedient either (a) at the beginning of the earliest period presented; or (b) at the date of initial application.



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