

EFRAG STAFF PAPER FOR PUBLIC MEETING

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IFRS 15 *Revenue from Contracts with Customers*

Objectives

- 1 The objectives of the session are to:
 - (a) provide the EFRAG Board with an outline of the main provisions contained in IFRS 15 *Revenue from Contracts with Customers* (further detail is included in paper 11.02 – the IASB’s Project Summary and Feedback Statement);
 - (b) present the views expressed by EFRAG in its draft endorsement advice issued on 15 October 2014; and
 - (c) seek the advice of EFRAG Board as to whether the Board:
 - (i) supports EFRAG’s current position as expressed in the draft endorsement advice; and
 - (ii) considers that further work should be undertaken in relation to the endorsement of IFRS 15.

Background

- 2 The IASB issued IFRS 15 on 28 May 2015. It will replace the previous revenue Standards IAS 18 *Revenue* and IAS 11 *Construction Contracts*, and their related Interpretations. IFRS 15 was developed as a joint project with the FASB and is substantially converged with the equivalent US GAAP standard.
- 3 On 15 October 2014, EFRAG issued an Invitation to Comment relating to the endorsement of IFRS 15 that contained its assessment of the Standard against the technical criteria for endorsement in the EU and its initial assessment of the costs and benefits that would arise from the implementation and application of the Standard. The request for endorsement advice from the EC is attached as paper 11.03 and the Invitation to Comment is attached as paper 11.04.
- 4 IFRS 15 addressed many of the recommendations made by EFRAG. Where the recommendations have not been fully followed, EFRAG assessed that the outcome was still acceptable. Comments on the draft endorsement advice were requested by 15 December.

IFRS 15

- 5 The key features of IFRS 15 are summarised below. Further details are in the Appendix to this paper.

Objective and scope

- 6 The objective of IFRS 15 is to provide a single, comprehensive revenue recognition model for all contracts with customers. In doing so, IFRS 15 will replace the existing literature (which will be much more significant for entities applying US GAAP than entities applying IFRS).
- 7 IFRS 15 is designed to remove inconsistencies and weaknesses identified in the current revenue recognition guidance, provide a more robust framework for addressing complex transactions, improve comparability of revenue recognition practices across industries and provide more useful information to users through new disclosures.

Core principle

- 8 The core principle of IFRS 15 is that an entity should recognise revenue:
- (a) when (or as) the entity fulfil its performance obligations by transferring a promised good or service to a customer; and
 - (b) in an amount that reflects the consideration to which the company expects to be entitled in exchange for those goods or services.

Revenue recognition

- 9 The recognition of revenue requires the entity to complete five steps:
- (a) Identify the contract(s) with the customer;
 - (b) Identify the performance obligations in the contract;
 - (c) Determine the transaction price;
 - (d) Allocate the transaction price and
 - (e) Recognise revenue when a performance obligation is satisfied.
- 10 A *performance obligation* is a promise to transfer a distinct good or service (or a series of distinct goods or services that are substantially the same and have the same pattern of transfer) to a customer.
- 11 An entity satisfies a performance obligation by transferring *control* of a promised good or service to the customer, which could occur over time or at a point in time. *Control* is defined as the ability to direct the use of, and obtain substantially all of the remaining benefits of, a good or service. Under IAS 18, revenue recognition is based on the transfer of risks and reward. This now forms one of a number of criteria that are assessed in determining whether control has been transferred.
- 12 IFRS 15 includes a *collectability* criterion as an entity is required to evaluate at contract inception (and when significant facts and circumstances change) whether it is probable that it will collect the consideration it expects to be entitled to receive in exchange for transferring goods or services to a customer. This requirement maintains and strengthens the existing requirements.

EFRAG's initial position

Draft endorsement advice

- 13 EFRAG's initial assessment was that IFRS 15 satisfies the technical criteria for EU endorsement and EFRAG should recommend its endorsement. In other words, IFRS 15 is not contrary to the principle of true and fair view and it meets the criteria of understandability, relevance, reliability and comparability. EFRAG's preliminary assessment is that, for most users and preparers, the benefits to be derived from implementing IFRS 15 in the EU are likely to outweigh the costs involved. In summary, EFRAG TEG is of the view that IFRS 15 provides appropriate guidance for the recognition of revenue.
- 14 The invitation to comment also includes a specific question regarding the application date of IFRS 15 of 1 January 2017. When commenting on the Exposure Draft that led to IFRS 15, EFRAG expressed the view, based on the results of its public consultation, that a full three year period was necessary to achieve proper implementation of the Standard. EFRAG noted that the delayed publication of the Standard in May 2014 (instead of mid-2013 as initially planned), would not allow such an implementation period. Therefore EFRAG specifically asked constituents if they foresaw any difficulties to apply IFRS 15 by 1 January 2017.

Field tests

- 15 During the development of IFRS 15, EFRAG undertook a number of field tests with entities in industries that were likely to be significantly affected by the proposed standard. The concerns raised by entities in these industries included:
- (a) The recognition of revenue over time in the case of real estate construction contracts;
 - (b) The separation of contracts into components in the case of long term contracts;
 - (c) The unbundling of contracts that provided equipment and services in the case of telecommunications companies; and
 - (d) The application to specific scenarios by all entities involved in the field tests, including entities in the pharmaceutical, utilities and software industries.
- 16 The issues raised in the field tests have been reviewed against the requirements of IFRS 15. Many of the issues appear to have been fully or partly resolved. Participants in the field tests have been asked whether they agree with the assessment of the extent to which the issues raised have been addressed. Eleven responses have been received so far and are being analysed.

Other issues that could be considered in the final endorsement advice

- 17 Based on the issues raised request for endorsement advice on IFRS 9 *Financial Instruments* from the European Commission, the Board may wish to include additional material in the final endorsement advice.

Convergence

- 18 IFRS 15 is a converged standard that was developed jointly by the IASB and the FASB. In order to ensure that interpretations of the standard do not diverge, the IASB and the FASB have established a Joint Transition Resource Group for Revenue Recognition. Some very specific issues have already been raised with this Group, but the extent to which further guidance will need to be developed is unclear.

Prudence

- 19 The draft endorsement advice does not make any specific reference to prudence. The early draft of the endorsement advice considered by EFRAG TEG made explicit references to prudence. This early draft took the view that, overall, IFRS 15 meets the concept of prudence. For example, the collectability criterion discussed in paragraph 12 of this paper is a clear example of prudent recognition of revenue.
- 20 However, the draft endorsement advice issued for comment did not include any explicit reference to prudence as it was not clear whether the approach to endorsement should change before the new EFRAG Board was in place.
- 21 The definition of prudence is scheduled for discussion during the Board's discussion of IFRS 9. If the Board considers that a consideration of prudence should be included in the final advice on IFRS 15, the results of the Board's earlier discussion will be used as the basis for such consideration.

EFRAG secretariat recommendations

- 22 EFRAG secretariat recommends that the Board:
- (a) Supports the EFRAG preliminary view that IFRS 15 meets the criteria for endorsement in the EC; and
 - (b) Addresses convergence in its final advice to the EC.

Questions for EFRAG Board members

- 23 Do you support EFRAG's current position as expressed in the draft endorsement advice?
- 24 Do you consider that the only additional work that should be undertaken in relation to the endorsement of IFRS 15 is to consider convergence with US GAAP?
- 25 Based on the discussions about IFRS 9, do you consider that the endorsement advice on IFRS 15 should make explicit reference to the concept of prudence?

Agenda Papers

- 26 In addition to this paper, the agenda papers for this session are:
- (a) Agenda paper 11.02 – IASB Project Summary and Feedback Statement *IFRS 15 Revenue from Contracts with Customers*
 - (b) Agenda paper 11.03 – EC request for endorsement advice
 - (c) Agenda paper 11.04 – EFRAG draft endorsement advice