

# IFRS 15 PIR: *EFRAG PREPARATORY WORK- PRELIMINARY FINDINGS*

**EFRAG FRB**

21 DECEMBER 2022



# DISCLAIMER

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# OVERVIEW

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OBJECTIVE OF THE SESSION

OVERVIEW OF IFRS 15 PIR & EFRAG PREPARATORY WORK

WHAT WE HAVE LEARNT SO FAR

QUESTIONS FOR EFRAG FRB



# OBJECTIVE OF THE SESSION

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The objectives of this session are to:

- present an overview of the general messages and the preliminary issues identified during EFRAG Secretariat's preparatory work in anticipation of the IASB Post-Implementation Review of IFRS 15 *Revenue from Contracts with Customers* (IFRS 15 PIR);
- seek EFRAG FR Board members' views on the identified preliminary issues.



## OVERVIEW: IFRS 15 PIR & EFRAG PREPARATORY WORK

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# IFRS 15 PIR BACKGROUND INFORMATION

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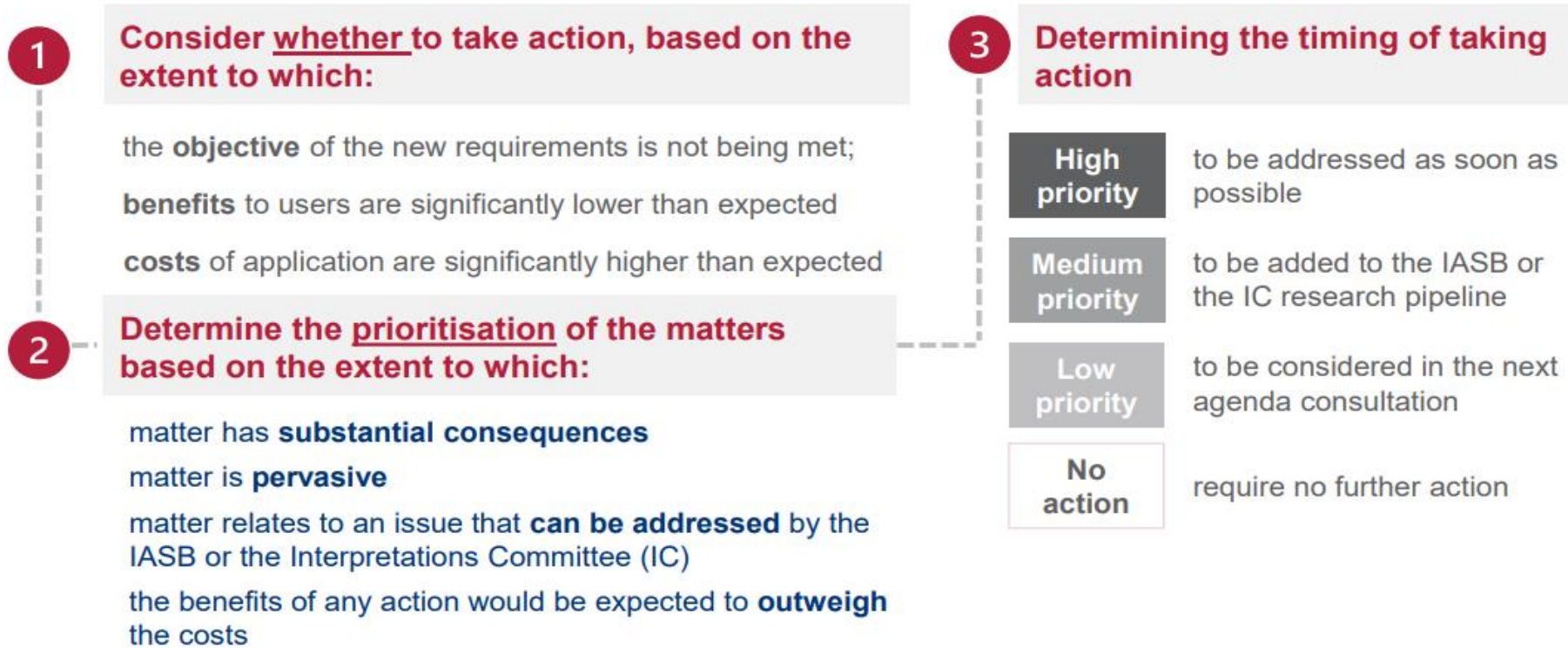
## IASB DUE PROCESS

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

# IFRS 15 PIR BACKGROUND INFORMATION

IASB DUE PROCESS (source: IASB's slide)

## PIR—how does the IASB respond to identified matters?



# EFRAG PREPARATORY WORK

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- EFRAG's preparatory work started in April 2022 and is expected to continue until the issuance of the RFI
- The EFRAG Secretariat has held several meetings with preparers and users from highly impacted sectors, audit firm subject matter experts and national standard setters including at the International Forum of Accounting Standard Setters (IFASS) and via a survey to CFSS members.
- The EFRAG Secretariat has discussed this topic with EFRAG FR TEG, EFRAG FR TEG CFSS and the various working groups (i.e., EFRAG User Panel, EFRAG FIWG and EFRAG Academic Panel).
- The EFRAG Secretariat has reviewed IFRS 15 issues raised before the IFRS Interpretation Committee (IFRS IC), related enforcement issues raised by ESMA, issues raised during the US GAAP PIR on Accounting Standards Update Revenue from Contracts with Customers (Topic 606) and academic papers.



# EFRAG PREPARATORY WORK

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## NEXT STEPS

- EFRAG Secretariat will continue its outreach to preparers and users in impacted sectors as well as to regulators.
- In future EFRAG FR TEG and FRB meetings, there will be a prioritisation of the identified issues (i.e., assessing if an issue is pervasive/material, and there is evidence of problem with the IFRS 15 requirements) and discussion on appropriate recommendations to be made to the IASB (e.g., educational material, agenda decisions, standard setting) in EFRAG's comment letter.

## EFRAG SUPPORT OF AN ACADEMIC STUDY

- EFRAG is supporting an academic study conducted via a survey to preparers and users to assess the effects and net benefits (costs) of IFRS 15 implementation/adoption. The study encompasses analysis of benefits for management in addition to implementation costs and benefits by users of reporting information. The results of this study will be included in EFRAG's comment letter to the IASB RFI.
- The link to the academic study-related survey is accessible [here](#). EFRAG invites you to distribute this survey to preparers and users in your network



## WHAT WE HAVE LEARNT SO FAR

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# OVERALL MESSAGES

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- In general, **IFRS 15 is working well in practice** although **there is room for targeted improvements** (e.g., need for additional guidance in some areas, clarification of interactions with several other IFRS Standards).
- The most affected sectors were telecommunications, software, and construction companies
- In many cases, the **effect on the amount and timing of revenue was minimal**
- Indications that **for some companies there were internal management benefits** due to IFRS 15 as it led to enhanced contract management/documentation and improvements in interdepartmental communication
- The **implementation challenges and transition costs were significant for some industries** (e.g., telcos). In many cases, ongoing incremental costs are minimal but in some cases these were significant
- No **significant concerns raised by users and no clear picture yet on whether the additional disclosures provided enhanced analytical benefits**
- **IFRS 15 involves significant estimates and increased use of management judgment relative to IAS 18** (e.g., separating performance obligations, estimation of stand-alone selling prices and estimation of variable consideration) (e.g., software/licensing industry)

## OVERALL MESSAGES- CONTINUED

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- Suggestions made that the IASB considers the **relevance of the IFRS 15 requirements towards new digital business models** that are becoming more prominent (e.g., increased use of cloud products, growth of digital assets related business models)
- Concurrently, concerns were voiced that any further significant changes to IFRS 15 **could disrupt established practice and impact IT systems**. Plus, there is a question from some on **whether it was all worth it from a cost-benefit perspective?**
- **Convergence with US GAAP**
  - There are **concerns that significant changes to either IFRS 15 or US GAAP ASC 606 may lead to reduced convergence** of revenue recognition requirements
  - But others have observed that, while convergence is desirable, **some level of divergence is inevitable** and they are comfortable with this situation

# APPLICATION CHALLENGES

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## RECOGNITION AND MEASUREMENT CHALLENGES

- Difficulties in determining whether a company is **a principal or an agent** (PA), leading to diversity in practice.
- PA challenges arise across a breadth of business models including Fintech online platforms, software resellers, construction companies
- The IFRS 15 indicators of control needed for entities to be deemed a principal (i.e., order fulfillment responsibility, pricing discretion, and bearing inventory risk) do not always suffice to inform preparer judgment on whether the entity is a principal or agent
  - For companies that facilitate an arrangement between a supplier and a final customer and pay an incentive to the final customer it is difficult to determine who the ultimate customer is as well as whether the entity is acting as a principal or as an agent.
  - The IFRS IC issued an agenda decision on PA considerations. The fact-pattern was about a software reseller that had a distribution agreement with a manufacturer to sell software licenses to customers. The reseller provided pre-sales advice and had ability to set the prices. The manufacturer provided the license directly to the customer via a software portal. The Agenda decision did not conclude whether the reseller was acting as a principal or as an agent. It highlighted that this consideration depends on the specific fact and circumstances and the terms and conditions of relevant contracts.
- Principal versus agent determination is a cross-cutting challenge applicable to other IFRS Standards,
- Users underscored the importance of the PA determination as it affects valuation of companies based on revenue-based valuations (e.g., enterprise value/gross revenue metrics)

# APPLICATION CHALLENGES

## RECOGNITION AND MEASUREMENT CHALLENGES-CONTINUED

- The **accounting for licenses** poses a number of challenges highlighted by software and pharma companies.
  - Determining whether the license grants right to access or right to use the IP poses challenges. For instance, when a software-entity customer has the choice of either downloading the software or having a cloud subscription (on-premise license revenues are recognised at a point in time while cloud subscription revenues are recognised overtime).
  - In the pharma industry, it is sometimes challenging to distinguish between an out-licensing arrangement (the entity allows a third-party to develop and/or commercialise a drug) and the pure sale of an intangible assets (drug). A user of this industry asked for more disclosures on out-licensing arrangements as there is diversity on how entities recognise these royalties (revenue, operating income...)
- **Contract modifications challenges have been highlighted by construction, pharma and software companies.** It is difficult to assess whether some arrangements/renewals represent a contract modification or a new/separate contract. In the software industry this assessment is affected by the shift of many arrangements to cloud computer arrangements.
- **Challenges in accounting for collaborative arrangements have been highlighted by pharma and telco companies** (e.g., It can be difficult to assess whether an arrangement, or only a part of it, is in scope of IFRS 15)

# APPLICATION CHALLENGES

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## RECOGNITION AND MEASUREMENT CHALLENGES CONTINUED

- **Measurement uncertainty/estimation challenges of variable consideration highlighted in media, construction companies.** The **assessment** of the “**high probability**” that the revenue will be no reversed in the future might be **very difficult**.
- **Cost recognition challenges highlighted for construction sectors, shipping companies:** Difficult to ascertain **which costs are considered fulfilment or incremental costs** that lead to the recognition of as an asset. Inconsistencies in practice in cost recognition are observable.

## PRESENTATION AND DISCLOSURES CHALLENGES

- Whether incentives/penalties to customers by intermediaries should be presented as **negative revenue or expense**. For example, a start-up may pay an incentive to attract customers higher than the consideration they will receive from the supplier. However, it has been noted that this issue was also at play under previous requirements (IAS 18)
- **Inconsistencies in classification and presentation of advance payments** from customers for long-term contracts (i.e., diversity in classification as either contract liability or separate liability)
- A pharma company indicated that the **reconciliation of contract assets and contract liabilities** was a **costly disclosure** and they questioned its usefulness.

# APPLICATION CHALLENGES

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## INTERACTIONS WITH OTHER IFRS STANDARDS

- **Interactions between IFRS 10 and IFRS 15. Sale of a subsidiary to a customer.** Under IFRS the sale of a subsidiary that only contains inventory to a customer (the output is part of its ordinary activities) is recognised under IFRS 10. Under USGAAP, the FASB issued an exemption that allow entities to recognise these transactions as revenue as part of ASC 606 (corporate wrappers).
- **Interactions between IFRS 15 and IFRS 3.** In some cases, there are inconsistencies in the recognition of contract assets and contract liabilities in the context of a business combination. In this regard, the FASB issued an amendment requiring that an entity recognises and measures contract assets and contract liabilities acquired in a business combination in accordance with the revenue standard. Generally, this should result in an acquirer recognizing and measuring the acquired contract assets and contract liabilities consistent with how they were being recognised by the acquiree.



# APPLICATION CHALLENGES

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## INTERACTIONS WITH OTHER IFRS STANDARDS

- **Interactions between IFRS 9 and IFRS 15** it is not always clear which standard apply on gift cards to account for the liability arising from the potential obligation to deliver goods or services. Prepaid gift cards that give rise to financial liabilities are within the scope of IFRS 9 but if the transaction does not give rise to a financial liability, it is likely to give rise to a contract liability recognised in accordance with IFRS 15. Depending on the transaction, such distinction (financial liability or contract liability) is not always straightforward.
- **Interactions between IFRS 15 and IAS 20.** IFRS 15 clarifies that the amounts to which the entity has rights can be paid by parties other than customers. Difficult to draw a line between government acting in its capacity as a customer or as a government, especially in energy renewable industry.
- **Interaction between IFRS 15 and IAS 37.** There might be difficulties in determining whether additional costs related to the completion of a service should be recognised as variable consideration or as a liability under IAS 37.
- **Interactions between IFRS 15 and other IFRS Standards.** Some constituents have flagged interaction difficulties with IFRIC 12 and IFRS 16 but at this stage we are in the process of identifying where these difficulties lay.

## QUESTIONS FOR EFRAG FRB

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**Q1:** Do you agree or disagree with the issues identified so far during the EFRAG Preparatory work ?

**Q2:** Do you any other comments or are there any other issues not raised that should be considered during the IFRS 15 PIR?



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