Staff paper

Agenda reference: 30A

IASB® meeting

Date	**May 2024**
Project	**Second Comprehensive Review of the *IFRS for SMEs®* Accounting Standard**
Topic	**Proposed revised Section 23 *Revenue from Contracts with Customers*—Other matters raised in feedback**
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Introduction

1. The International Accounting Standards Board (IASB) proposed to revise Section 23 *Revenue* of the *IFRS for SMEs* Accounting Standard to align it with IFRS 15 *Revenue from Contracts with Customers* in the Exposure Draft *Third edition of the* IFRS for SMEs *Accounting Standard* (Exposure Draft). This paper discusses feedback on matters raised by one or two comment letter respondents.

2. The paper also discusses a suggestion to make the requirements in the proposed revised Section 23 easier to understand.

3. In this paper, the term SMEs refers to entities that are eligible to apply the *IFRS for SMEs* Accounting Standard.

Purpose of the paper

4. The purpose of this paper is to ask the IASB:

   (a) to consider feedback on matters raised by one or two respondents;

(b) to consider a suggestion to make the requirements in the proposed revised Section 23 easier to understand; and

(c) to decide whether to change the proposed requirements.

Summary of staff recommendations

5. The staff recommend that the IASB:

(a) change paragraph 23.14(a)(ii) of the Exposure Draft to match paragraph 21(a)(ii) of IFRS 15;

(b) make no change to include the first sentence of paragraph 19 of IFRS 15 in the revised Section 23;

(c) specify in the revised Section 23 that an SME accounts for a contract with renewal options based on the contract's expected term for only the purpose of allocating the transaction price;

(d) change paragraphs 23.11 and 23.42 of the Exposure Draft to match the final sentence of paragraph 11 and paragraph 49 of IFRS 15;

(e) change paragraph 23.110 of the Exposure Draft to match the first sentence of paragraph 99 of IFRS 15;

(f) require an SME to account for sales with a right of return by reducing the amount of consideration to the extent it is probable that products will be returned;

(g) change the proposed requirements for accounting for refund liabilities in the Exposure Draft so they are consistent with the requirements in the revised Section 23 for accounting for a sale with a right of return; and

(h) combine the proposed requirements in the revised Section 23 for accounting for a sale with a right of return and accounting for refund liabilities.

Structure of the paper

6. The paper is structured as follows:

   (a) background (paragraphs 8–11);

   (b) differences between the proposed revised Section 23 and IFRS 15 (paragraphs 12–18);

   (c) inconsistency within the proposed revised Section 23 (paragraphs 19–40); and

   (d) Appendix—Respondents' comments on differences between the proposed revised Section 23 and IFRS 15.

7. This paper includes two questions for the IASB which are included at end of the staff analysis on each matter raised by respondents.

Background

8. In the Exposure Draft, the IASB proposed amendments to the *IFRS for SMEs* Accounting Standard to align it with IFRS 15. To do so, the IASB proposed revising Section 23 of the *IFRS for SMEs* Accounting Standard to reflect the principles and language used in IFRS 15. The IASB also proposed simplifications to the requirements in IFRS 15 to reduce costs for SMEs of applying the revised Section 23.

9. The IASB decided to proceed with revising Section 23 to reflect the principles in IFRS 15 at its meeting in October 2023.[1] At subsequent meetings, the IASB has redeliberated proposals in the Section that respondents requested changes to or raised concerns about. The proposals the IASB redeliberated were based on an initial assessment of the feedback on the Section, which excluding matters raised by one or two respondents.

[1] See IASB *Update* from the October 2023 IASB meeting.

10. This paper discusses matters raised by one or two respondents about:

    (a) differences between the proposed revised Section 23 and IFRS 15; and

    (b) an inconsistency within the proposed revised Section 23.

11. The paper also discusses a suggestion to make the requirements in the revised Section 23 easier to understand and apply. The suggestion relates to the identified inconsistency within the proposed revised Section 23. Therefore, the suggestion is discussed in this paper, instead of Agenda Paper 30B *Proposed revised Section 23—Length and language* of this meeting.

Differences between proposed revised Section 23 and IFRS 15

12. The requirements of IFRS 15 were simplified in the proposed revised Section 23. Consequently, the Section includes requirements that are different from IFRS 15.

13. A few respondents suggested changing requirements in the Exposure Draft so they match IFRS 15.

Staff analysis

14. The objective of simplifying the requirements in IFRS 15 is to make the requirements easier for SMEs to understand and apply. However, outcomes might occur that differ from the outcomes of applying IFRS 15 because the requirements in IFRS 15 have been simplified in the revised Section 23.

15. A few respondents raised comments about differences between the proposed revised Section 23 and IFRS 15 that could make the Section more difficult to understand and apply than IFRS 15. In such instances, the staff recommend changing the proposed requirements to match IFRS 15.

16. A few respondents raised comments about differences between the proposed revised Section 23 and IFRS 15 that could result in different outcomes for SMEs compared

with entities applying IFRS 15. In considering whether to recommend removing these differences, the staff have considered the nature and extent of the differences and their effect on the information in SMEs' financial statements.

17. The appendix to this paper includes the staff analysis for each comment.

Staff recommendations and question for the IASB

18. The staff recommend the IASB:

(a) change paragraph 23.14(a)(ii) of the Exposure Draft to match paragraph 21(a)(ii) of IFRS 15;

(b) make no change to include the first sentence of paragraph 19 of IFRS 15 in the revised Section 23;

(c) specify in the revised Section 23 that an SME accounts for a contract with renewal options based on the contract's expected term for only the purpose of allocating the transaction price;

(d) change paragraphs 23.11 and 23.42 of the Exposure Draft to match the final sentence of paragraph 11 and paragraph 49 of IFRS 15; and

(e) change paragraph 23.110 of the Exposure Draft to match the first sentence of paragraph 99 of IFRS 15.

Question for the IASB
1. Does the IASB agree with the staff recommendations in paragraph 18 of this paper?

Inconsistency within the proposed revised Section 23

19. One respondent said the requirements for accounting for refund liabilities proposed in the revised Section 23 were inconsistent with the proposed requirements for accounting for a sale with a right of return in the Section. The respondent suggested

that the requirements for refund liabilities are consistent with the proposed requirements for a sale with a right of return.

Staff analysis

20. An entity may transfer:

    (a) a product to a customer and grant the customer a right to return the product if they are dissatisfied with the product.

    (b) a service to a customer and grant the customer a right to a refund if they are dissatisfied with the service.

21. The transactions described in paragraph 20 of this paper have a similar effect on an entity's income.

22. For the transaction described in paragraph 20(a) of this paper, the proposals in the Exposure Draft require SMEs to recognise revenue only to the extent it is highly probable that the products will not be returned. SMEs would recognise a refund liability for the amount of consideration received that is not recognised as revenue.[2] The proposed requirements incorporate the constraint on estimates of variable consideration proposed in the Exposure Draft.[3] This was done so SMEs could recognise revenue from sales with a right of return without having to estimate the expected revenue and then apply the constraint to that estimate (that is, follow a two-step process). The Exposure Draft proposed that SMEs follow this two-step process—of estimating expected revenue and then applying the constraint—when accounting for other forms of variable consideration.[4]

23. For the transaction described in paragraph 20(b) of this paper, the proposals in the Exposure Draft require SMEs to estimate the refund liability based on the amount of

[2] See paragraphs 23.53–23.54 of the Exposure Draft.

[33] See paragraph 23.46 of the Exposure Draft.

[4] See paragraphs 23.43–23.47 of the Exposure Draft.

consideration the SME reasonably expects to refund to the customer.[5] Unlike the proposed requirements for the transaction in paragraph 20(a), the requirements for the transaction in paragraph 20(b):

(a) do not incorporate the constraint on estimates of variable consideration; and

(b) focus on the consideration the SME expects to refund (instead of the consideration the SME does not expect to refund).

24. The differences described in paragraph 23 of this paper mean SMEs would recognise revenue from similar transactions differently. This is potentially confusing for both preparers and users of SMEs' financial statements. Therefore, the staff recommend aligning the requirements for accounting for refund liabilities with the requirements for accounting for a sale with a right of return.

Presentation of requirements

25. As a consequence of the staff recommendation in paragraph 24 of this paper, the requirements for contracts that grant a customer a right of return or a right to a refund would be similar. However, the Exposure Draft proposed that SMEs recognise their right to recover goods as an asset when accounting for sales with a right of return (that is, recognise both a refund asset and a refund liability).[6] This is necessary only when SMEs sell products with a right of return. Therefore, SMEs would be expected to easily identify those instances in which it would be required to recognise both a refund asset and a refund liability.

26. Because instances in which the accounting treatment differs would be easily identifiable, the staff recommend combining the requirements in the revised Section 23 for contracts that grant a customer a right of return or a right to a refund. Combining the requirements would emphasise that they are based on the same principles and reduce the length of the Section.

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[5] See paragraph 23.49 of the Exposure Draft.

[6] See paragraphs 23.53(c) and 23.55 of the Exposure Draft.

27. The SME Implementation Group (SMEIG) considered the staff recommendation in paragraph 26 of this paper when it met in December 2023. SMEIG members generally agreed with the recommendation.

Understandability of requirements

28. As explained in paragraph 22 of this paper, the proposed requirements for a sale with a right of return incorporate the constraint on estimates of variable consideration proposed in the Exposure Draft:

> An entity shall include in the transaction price some or all of an amount of variable consideration estimated in accordance with paragraph 23.44 only to the extent that it is highly probable that this amount will become due when the uncertainty associated with the variable consideration is subsequently resolved.

29. The constraint focuses on the consideration an SME will be entitled to. Therefore, the proposed requirements for a sale with a right of return focus on consideration an SME will be entitled to because the products will <u>not</u> be returned and is therefore expressed in the negative:

> … an entity shall recognise revenue only to the extent that it is highly probable that the product will <u>not</u> be returned [emphasis added].[7]

30. Positive sentences are more direct and easier to understand than negative sentences. Expressing the proposed requirements in the positive would change their focus from products that will <u>not</u> be returned, to products that will be returned. This means approaching the transaction from the perspective of the refund liability instead of revenue. The effect of this change is shown in Table 1:

[7] Paragraph 23.54 of the Exposure Draft.

Table 1—Requirements for a sale with a right of return expressed in the negative and positive

Expression	Focus	Requirements
Negative ⊖	Products that will not be returned	… an entity shall recognise revenue only to the extent that it is highly probable that the products will not be returned. The amount of consideration received (or receivable) that is not recognised as revenue shall be recognised as a refund liability … (per paragraph 23.54 of the Exposure Draft)
Positive ⊕	Products that will be returned	… an entity shall reduce the amount of consideration to the extent that it is highly probable that the products will be returned. The amount of consideration received (or receivable) that is not recognised as revenue shall be recognised as a refund liability … (discussed in paragraphs 31–37 of this paper)

31. The staff think expressing the requirements in the positive would make them easier to understand. It also reflects how entities typically monitor returns, which are measured in relation to goods that have been returned, not retained (for example, product return rates). This would make it easier for SMEs to estimate the refund liability. SMEs are also expected to account for returns by deducting expected returns from gross sales at the end of the reporting period. Therefore, focusing on the amount of consideration that will not be recognised as revenue is consistent with this approach and would make the requirements more intuitive to apply.

32. The negative expression of the requirements in Table 1 use a ‘highly probable’ confidence level. This is because the positive expression of the requirements in Table 1, and the constraint on estimates of variable consideration in the Exposure Draft, use this confidence level. However, using the same confidence level when the requirements approach the transaction from a different perspective would mean the threshold for recognising revenue applying the positive expression of the requirements

would be lower than if an SME applied the negative expression of the requirements. This is because the same confidence level is being applied to different amounts.

33. The confidence level used in the positive expression of the requirements would need to be inverted in order for SMEs applying the positive and negative expression of the requirements in Table 1 to recognise similar amounts of revenue. Inverting the 'highly probable' confidence level by using the expression 'not highly probable' would result in the requirements being expressed in the negative. This would be inconsistent with the original intention of making the requirements more understandable.

34. SMEs currently account for returns in accordance with Section 21 *Provisions and Contingencies* of the *IFRS for SMEs* Accounting Standard. The Section requires SMEs to approach sales with a right of return from the perspective of the refund liability, instead of revenue. SMEs recognise a provision for refunds if an outflow of resources is probable (that is, if it is probable that products will be returned).[8]

35. The staff think a 'probable' confidence level should be used in the revised Section 23 to recognise refund liabilities. Although this would not be a precise inversion of the 'highly probable' confidence level, it would be consistent with the requirements for recognising provisions in Section 21 of the Standard. It would also avoid introducing a new confidence level and new terminology into the *IFRS for SMEs* Accounting Standard.

36. The staff considered whether refund liabilities should continue to be accounted for in accordance with Section 21 of the *IFRS for SMEs* Accounting Standard. However, as refunds typically arise from contracts with customers, it is more logical for these liabilities to be accounted for in accordance with Section 23 of the Standard. Warranties also typically arise from contracts with customers. The revised Section 23 will require SMEs to account for warranties that customers do not have the option to

[8] See paragraph 21.4 of the *IFRS for SMEs* Accounting Standard.

purchase separately in accordance with Section 21 of the Standard.[9] However, the liabilities associated with such warranties do not affect revenue. This is different from refund liabilities, which do affect revenue. Therefore, the staff think requiring SMEs to account for refund liabilities in accordance with Section 21 of the Standard would not be appropriate.

37. Specifying a level of confidence for recognising refund liabilities is necessary so SMEs do not interpret the requirements in different ways. However, the staff expect the practical effect of changing the level of confidence to be minimal because SMEs are expected to estimate refund liabilities based on experience (for example, prior periods return rates).

38. Based on the analysis in paragraphs 31–37, the staff recommend requiring SMEs to accounting for sales with a right of return by reducing the amount of consideration to the extent that it is probable that products will be returned.

39. As a consequence of the staff recommendation in paragraph 24 of this paper, changing the requirements for a sale with a right of return would also change the requirements for a contracts that grant customers a right to a refund. For similar reasons, the staff think expressing these requirements in the positive would make them easier for SMEs to understand and apply.

Staff recommendations and question for the IASB

40. The staff recommend the IASB:

(a) require an SME to account for sales with a right of return by reducing the amount of consideration to the extent it is probable that products will be returned;

[9] At its March 2024 meeting, the IASB decided to require an SME to account for a warranty as a separate promise only if the customer has the option to purchase the warranty separately (see IASB *Update* from the March 2024 IASB meeting). As a consequence of this decision, warranties that a customer does not have the option to purchase separately will be accounted for in accordance with Section 21 *Provisions and Contingencies* of the *IFRS for SMEs* Accounting Standard.

(b) change the proposed requirements for accounting for refund liabilities in the Exposure Draft so they are consistent with the requirements in the revised Section 23 for accounting for a sale with a right of return; and

(c) combine the proposed requirements in the revised Section 23 for accounting for a sale with a right of return and accounting for refund liabilities.

Question for the IASB
2. Does the IASB agree with the staff recommendations in paragraph 40 of this paper?

Appendix—Respondents' comments on differences between proposed revised Section 23 and IFRS 15

<table>
<tr><th>Difference between the proposed revised Section 23 and IFRS 15</th><th>Staff analysis</th></tr>
<tr><td colspan="2">Contract modifications—Scope</td></tr>
<tr><td>The first sentence of paragraph 19 of IFRS 15 was not included in the proposed revised Section 23:

A contract modification may exist even though the parties to the contract have … approved a change in the scope of the contract but have not yet determined the corresponding change in price.</td><td rowspan="2">The scenario covered by the sentence was covered in IAS 11 Construction Contracts. The requirements in IAS 11 that cover this scenario were omitted from the current Section 23. Therefore, omitting the scenario from the revised Section 23 is consistent with the coverage of the current Section 23.

Omitting the scenario could result in an SME recognising contract modifications later than an entity applying IFRS 15. However, this would occur only if the SME approved the change in scope and price of a contract in different periods (that is, only in some instances).

Based on the above analysis, the staff recommend not including the sentence in the revised Section 23.</td></tr>
<tr><td>Reason for removing difference given by respondent(s):

The scenario covered by the sentence is common in some industries, for example construction.</td></tr>
<tr><td colspan="2">Contract modifications—Transaction price</td></tr>
<tr><td>'Any additional' is included at the start of paragraph 23.14(a)(ii) of the Exposure Draft:

any additional consideration promised as part of the contract modification.

The phrase is not included at the start of paragraph 21(a)(ii) of IFRS 15.</td><td rowspan="2">Omitting the phrase 'any additional' unnecessarily restricts the application of paragraph 23.14(a)(ii) of the Exposure Draft.

The staff recommend the paragraph is changed to match paragraph 21(a)(ii) of IFRS 15.</td></tr>
<tr><td>Reason for removing difference given by respondent(s):

Paragraph 23.14(a)(ii) of the Exposure Draft accommodates situations in which the price of a contract increases because of a contract modification, but not situations where the price decreases.</td></tr>
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continued…

Difference between the proposed revised Section 23 and IFRS 15	Staff analysis
Renewal options	
Paragraph B43 of IFRS 15 provides entities with a practical alternative to estimating the stand-alone selling price of renewal options. The alternative requires an entity to include the optional goods or services that it expects to provide (and corresponding expected consideration) in the initial measurement of the transaction price. Paragraph 23.36 of the Exposure Draft proposed mandating the alternative for SMEs. The paragraph requires an SME to account for the contract based on its expected term (that is, including expected renewal periods). Paragraph 23.11 of the Exposure Draft requires SMEs to apply the revised Section 23 to the duration of a contract in which the parties have present enforceable rights and obligations. No enforceable rights and obligations exist during expected renewal periods. Therefore, the paragraph specifies that accounting for a contract term based on its expected term is an exception to this requirement. Paragraph 23.42 of the Exposure Draft contains a similar exception. Similar exceptions are not included in paragraphs 11 and 49 of IFRS 15. **Reason for removing difference given by respondent(s):** Including expected renewal periods in the contract term could have unintended negative consequences for SMEs.	The Exposure Draft expresses the practical alternative in IFRS 15 differently by requiring SMEs to estimate the expected consideration by first estimating the expected contract term. This is because the contract term is expected to be the starting point for estimating this amount. Despite this difference, the methodology for estimating the amount is the same. Therefore, the staff would expect SMEs and entities applying the practical alternative in IFRS 15 to account for renewal options similarly. Including expected renewal periods in the contract term could mean SMEs determine the duration of a contract with renewal options differently from entities applying IFRS 15. Based on the IASB's tentative decisions on the revised Section 23, the only consequence of SMEs determining the duration of a contract differently would be if an SME chose to disclose revenue disaggregated into categories based on contract duration.[10] In such instances, SMEs and entities applying IFRS 15 may disclose different information about similar contracts. Although the identified disclosure difference is minor, the staff think it could be avoided without changing how the practical alternative in paragraph 23.36 of the Exposure Draft is expressed. To do so, the staff recommend: (a) specifying that SMEs account for a contract with renewal options based on the contract's expected term for only the purpose of allocating the transaction price; and (b) removing the references to contract renewal options in paragraphs 23.11 and 23.42 of the Exposure Draft to match the final sentence of paragraph 11 and paragraph 49 of IFRS 15.

continued…

[10] At its April 2024 meeting, the IASB decided to require SMEs to disclose revenue disaggregated into categories that depict its financial performance. The IASB also decided to include examples of disaggregation categories that might be appropriate for SMEs to use in the revised Section 23 (see IASB *Update* from the April 2024 IASB meeting). The categories are expected to be consistent with those in paragraph B89 of IFRS 15, which includes contract duration (for example, short-term and long-term contracts).

<table>
<tr><th>Difference between the proposed revised Section 23 and IFRS 15</th><th>Staff analysis</th></tr>
<tr><td colspan="2">Contract costs</td></tr>
<tr><td>Paragraph 99 of IFRS 15 requires an entity to amortise assets recognised from the costs of obtaining or fulfilling a contract on a systematic basis consistent with the transfer of goods or services to which the asset relates.

Paragraph 23.110 of the Exposure Draft requires these assets to be amortised in accordance with the pattern of transfer and revenue recognition of goods or services to which the asset relates.</td><td rowspan="2">At its February 2024 meeting, the IASB decided to require SMEs to recognise the costs of obtaining a contract as an expense when incurred.[11] As a consequence, the requirement will apply only to assets recognised from the costs of fulfilling a contract.

Requiring SMEs to amortise an asset using two different bases is confusing and potentially contradictory.

The staff recommend paragraph 23.110 of the Exposure Draft is changed to match the first sentence of paragraph 99 of IFRS 15.</td></tr>
<tr><td>Reason for removing difference given by respondent(s):

The pattern of transfer and pattern of revenue recognition can differ in instances in which the consideration in a contract is variable.</td></tr>
</table>

[11] See IASB *Update* from the February 2024 IASB meeting