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## IASB<sup>®</sup> meeting

Date	<b>May 2024</b>
Project	<b>Second Comprehensive Review of the <i>IFRS for SMEs</i><sup>®</sup> Accounting Standard</b>
Topic	<b>Proposed revised Section 23 <i>Revenue from Contracts with Customers</i>—Length and language</b>
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This paper has been prepared for discussion at a public meeting of the International Accounting Standards Board (IASB). This paper does not represent the views of the IASB or any individual IASB member. Any comments in the paper do not purport to set out what would be an acceptable or unacceptable application of IFRS<sup>®</sup> Accounting Standards or the *IFRS for SMEs*<sup>®</sup> Accounting Standard. The IASB's technical decisions are made in public and are reported in the IASB<sup>®</sup> *Update*.

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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 the length of, and language used in, the proposed revised Section 23 *Revenue from Contracts with Customers*.
2. In this paper, the term SMEs refers to entities that are eligible to apply the *IFRS for SMEs* Accounting Standard.

## Purpose of the paper

3. The purpose of this paper is to ask the IASB:
  - (a) to consider feedback on the length of, and language used in, the proposed revised Section 23; and
  - (b) to consider the staff approach to responding to this feedback.

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## Summary of staff recommendations

4. The staff recommend the IASB:
  - (a) consider changes to the revised Section 23 to reduce its length and improve its structure; and
  - (b) include in the revised Section 23 the notion of a transformative relationship as explained in the Basis for Conclusions on IFRS 15.

## Structure of the paper

5. The paper is structured as follows:
  - (a) background (paragraphs 7–9);
  - (b) length and structure (paragraphs 10–20);
  - (c) language and clarity of requirements (paragraphs 21–35); and
  - (d) next steps (paragraph 36).
6. The paper includes two questions for the IASB which are included at end of the discussions about the length of, and language used in, the proposed revised Section 23.

## Background

7. 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. These included simplifying the structure of, and language used in, IFRS 15.

8. The IASB decided to proceed with revising Section 23 to reflect the principles in IFRS 15 at its meeting in October 2023.<sup>1</sup> This decision differs from the IASB's original proposal to revise the Section to reflect the principles *and language* used in IFRS 15. This was because the IASB might use different language to express the principles in IFRS 15 in response to feedback on the Exposure Draft.
9. Stakeholders provided feedback on the length of, and language used in, the revised Section 23. Stakeholders had concerns that the language used in the Section was complex and the Section was too long. This paper discusses how to respond to this feedback.

## Length and structure

10. IFRS 15 is substantially longer than the standards it replaced (IAS 11 *Construction Contracts* and IAS 18 *Revenue*). The requirements in IFRS 15 are split between the Standard and application guidance. The application guidance is included in an appendix to the Standard that has the same authority as the Standard.
11. Section 23 of the Exposure Draft proposed a new recognition model for revenue. The structure of the Section was based on the five steps of this model and reflected the order in which SMEs are expected to apply the requirements. The model is more comprehensive than the current model for revenue recognition applied by SMEs. Consequently, the Section was substantially longer than the current Section 23.

### ***Feedback received***

12. Some comment letter respondents had concerns that the proposed revised Section 23 was too long and difficult for SMEs to follow. A few respondents said the Section would make accounting for straightforward revenue transactions more complex.

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<sup>1</sup> See [IASB Update](#) from the October 2023 IASB meeting.

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13. Participants in the fieldwork carried out on the Section said its length was problematic because readers:
- (a) would find it difficult to find information;
  - (b) would have to read many requirements that are not applicable to them; and
  - (c) would be intimidated by the Section.

***Approach to reducing the length of the Section***

14. As explained in paragraph 11 of this paper, the proposed revised Section 23 is substantially longer than the current Section 23. This is because the revised Section incorporates the comprehensive framework for recognising revenue in IFRS 15. This was one of the benefits of IFRS 15 that was considered relevant to SMEs when the IASB proposed aligning the *IFRS for SMEs* Accounting Standard with IFRS 15. Therefore, shortening the revised Section could reduce this benefit.
15. The length of the revised Section 23 will be reduced as a consequence of the IASB's tentative decisions:
- (a) to withdraw some requirements proposed in the Exposure Draft;
  - (b) to combine some requirements in the Section; and
  - (c) to include guidance in educational material on the Section, instead of in the Section.<sup>2</sup>
16. The IASB plans to provide educational material on the revised Section 23 which includes non-mandatory guidance that explains and illustrates the requirements in the Section. Agenda Paper 30 *Cover paper* of this meeting describes factors the staff suggests to consider when determining whether guidance belongs in the Standard or in educational material. These factors will be used by staff to identify guidance in the proposed revised Section 23 that could be included in educational material.

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<sup>2</sup> The IASB's tentative decisions to date on redeliberating the proposals in the Exposure Draft are set out the appendix to Agenda Paper 30 *Cover paper* of this meeting.

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***Approach to improving the structure of the Section***

17. The staff think respondents' concerns about the length and complexity of the proposed revised Section 23 could be addressed by improving the structure of the Section. Changes to the structure of the Section could:
- (a) provide SMEs with a clear pathway for accounting for straightforward revenue transactions; and
  - (b) make it easier for SMEs to locate requirements relevant to contracts with their customers.
18. Therefore, the staff intend to restructure the revised Section 23 by:
- (a) including requirements that apply only to particular contracts with customers in an appendix to Section 23 which has the same authority as the Section (for example, requirements that apply only if an SME grants a licence of intellectual property); and
  - (b) presenting requirements together if they are expected to apply to similar contracts (for example, presenting the requirements for recognising sales-based and usage-based royalties together with the requirements for accounting for licences, instead of the requirements for measuring variable consideration).
19. A few sections of the current *IFRS for SMEs* Accounting Standard are accompanied by an appendix which includes application guidance or illustrative examples. However, none of these appendices include requirements and have the same authority as the Section it accompanies. Therefore, restructuring Section 23 as described in paragraph 18(a) of this paper would be a departure from the structure of the current Standard. However, the staff think this is necessary to address stakeholders' concerns. Also, although restructuring the Section would be a departure from the current Standard, it would be similar to the proposed structure of Section 19 *Business Combinations and Goodwill* of the Exposure Draft. Section 19 was accompanied by Appendix A *Application Guidance* which included proposed guidance that would be

integral, and therefore have the same authority as Section 19. At its February 2024 meeting, the IASB tentatively decided to proceed with the proposed amendments to Section 19, which included this appendix.<sup>3</sup>

20. At its meeting in December 2023, the SME Implementation Group (SMEIG) discussed the structure of the proposed revised Section 23. SMEIG members generally agreed with restructuring the Section as described in paragraph 18(a) of this paper.

#### Question for the IASB

1. Does the IASB have any comments on the staff approach to reducing the length, and improving the structure, of the revised Section 23 set out in paragraphs 16–18 of this paper?

## Language and clarity of requirements

21. One way the IASB aims to simplify the *IFRS for SMEs* Accounting Standard is to consider whether the language used in full IFRS Accounting Standards can be simplified and expressed more clearly for SMEs. Consequently, the proposed revised Section 23 expressed the requirements in IFRS 15 in simpler, more concise language when possible.

### **Feedback received**

22. Both comment letter respondents and fieldwork participants said the requirements in the proposed revised Section 23 should be expressed in simpler language. A few stakeholders suggested ways of simplifying the language used in the Section.

### **Approach to simplifying the language in the Section**

23. At its April 2024 meeting, the IASB tentatively decided to consider whether plainer language can be used in the new and revised sections of the Third edition of the *IFRS*

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<sup>3</sup> See [IASB Update](#) from the February 2024 IASB meeting.

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for SMEs Accounting Standard.<sup>4</sup> This includes the revised Section 23. The staff approach to using plainer language in the new and revised sections of the Standard is set out in [Agenda Paper 30B Proposed new Section 12 Fair Value Measurement—use of plainer language](#) of the April 2024 IASB meeting.

24. The staff will consider stakeholders' suggestions to simplify the language used in the Section as part of the drafting process.

### ***Improving clarity***

25. When considering how the proposed revised Section 23 could be redrafted using plainer language, the staff identified requirements in the Section that could be expressed more clearly. This includes the proposed requirements in paragraph 23.23 of the Exposure Draft.

### ***Distinct goods or services—Paragraph 23.23***

26. Paragraph 23.23 of the Exposure Draft describes three factors that indicate whether an obligation to transfer a good or service is separate from other obligations in a contract. SMEs would consider these factors when determining whether a good or service is distinct. Determining whether a good or service is distinct is an essential part of the proposed revenue recognition model and is necessary for all contracts with customers.
27. The description of each factor in paragraph 23.23 of the Exposure Draft uses the word 'significant'. The word is used to describe the level of integration, interrelation and interdependence among obligations in a contract that indicates whether an obligation is not separate (and a good or service is not distinct).
28. The meaning of the word 'significant' is often unclear without further explanation. Consequently, the staff think paragraph 23.23 of the Exposure Draft would be more

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<sup>4</sup> See [IASB Update](#) from the April 2024 IASB meeting.

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understandable if an alternative word was used, or the Standard explained what ‘significant’ means each time it is used.

29. Paragraph 23.23 of the Exposure Draft is based on paragraph 29 of IFRS 15. Both paragraphs use the word ‘significant’ in the same way. The Basis for Conclusions on IFRS 15 explains the level of integration, interrelation and interdependence in comparison to the relationship between items in a contract (that is, if they have a functional or transformative relationship):

... an entity should consider the level of integration, interrelation or interdependence among the promises to transfer goods or services. The boards observed that rather than considering whether one item, by its nature, depends on the other (ie whether two items have a functional relationship), an entity evaluates whether there is a transformative relationship between the two items in the process of fulfilling the contract.<sup>5</sup>

30. The staff think the notion of a transformative relationship helps explain the level of integration, interrelation and interdependence that indicates whether a good or service is not distinct. That is, whether the level of integration, interrelation or interdependence between goods or services is significant enough to transform them into a combined (and different) output in the process of fulfilling the contract. Respondents to the [Request for Information Post-implementation Review of IFRS 15 Revenue from Contracts with Customers](#) (Request for Information) said the explanation of a transformative relationship helps entities applying IFRS 15 to determine whether a good or service is distinct.<sup>6</sup>
31. The staff think including the notion of a transformative relationship in paragraph 23.23 of the Exposure Draft would help explain the word ‘significant’. Incorporating this notion into the description of the factors in the paragraph would make it easier for SMEs to understand and apply these factors.

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<sup>5</sup> Paragraph BC116K of IFRS 15 *Revenue from Contracts with Customers*.

<sup>6</sup> Paragraphs 21(d) of [Agenda Paper 6A. Identifying performance obligations in a contract](#) of the February 2024 IASB meeting



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**Location**

32. The staff considered whether the notion of a transformative relationship could be discussed in educational material, or in the Basis for Conclusions on the *IFRS for SMEs* Accounting Standard (as in IFRS 15), instead of being included in the Standard. However, the purpose of including this material in the Standard would be to make the words used in the Standard more understandable. The most effective way to do this would be to include the material in the Standard, not outside it. Also, compared to entities applying full IFRS Accounting Standards, SMEs may be less likely to read the Basis for Conclusions alongside the Standard. Therefore, there would be a risk that SMEs would not read the material if it was not included in the Standard.

**Post-implementation Review of IFRS 15**

33. At its February 2024 meeting, the IASB discussed the explanation of a transformative relationship in the Basis for Conclusions on IFRS 15 when it discussed the feedback on the Request for Information. The IASB tentatively decided to discuss at a later date whether to add the explanation to IFRS 15 (that is, whether to add the explanation to the Standard from the Basis for Conclusions).<sup>7</sup>
34. Including the notion of a transformative relationship in the revised Section 23 would change requirements that SMEs have no experience of applying. This is different to IFRS 15, which is applied by entities and for which practice has already developed.

**Staff recommendation and question for the IASB**

35. The staff recommend including in the revised Section 23 the notion of a transformative relationship as explained in the Basis for Conclusions on IFRS 15.

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<sup>7</sup> See [IASB Update](#) from the February 2024 IASB meeting.

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**Question for the IASB**

2. Does the IASB agree to include in the revised Section 23 the notion of a transformative relationship as explained in the Basis for Conclusions on IFRS 15?

**Next steps**

36. The staff will apply the approaches set out in paragraphs 16–18 and 23–24 of this paper when drafting the revised Section 23. IASB members will be able to comment on the drafting during the balloting process.