STAFF PAPER

July 2019

IASB® Meeting

Project	**Comprehensive review of the *IFRS for SMEs®* Standard**		
Paper topic	New IFRS Standards—IFRS 15 *Revenue from Contracts with Customers*		
CONTACT(S)	Michelle Sansom & Helen Lloyd	msansom@ifrs.org	+44 (0) 20 7246 6963

Purpose

1. At this meeting we are asking Board members if the Request for Information, that will be issued as part of the 2019 Comprehensive Review of the *IFRS for SMEs* Standard (2019 Review), should seek views on whether and how the requirements of the *IFRS for SMEs* Standard could be aligned with IFRS 15 *Revenue from Contracts with Customers*.
2. The objective of the Request for Information is to obtain evidence that will assist the Board in deciding whether and how to develop an Exposure Draft of amendments to the *IFRS for SMEs* Standard.

Summary of staff recommendations

3. The staff recommends that the Board seek views in the Request for Information on whether and how Section 23 *Revenue* of the *IFRS for SMEs* Standard could be aligned with IFRS 15 and, in particular, on the following three alternatives:
   (a) Alternative 1—modifying Section 23 to remove the clear differences in outcomes between Section 23 and IFRS 15 without a wholesale reworking of Section 23;

(b) Alternative 2—fully reworking Section 23 to reflect all IFRS 15 principles and language; and

(c) Alternative 3—not amending Section 23 as part of the 2019 Review.

4. The staff recommends that the Board identifies, in the Request for Information, alternative 1 as its preferred approach to aligning the *IFRS for SMEs* Standard with IFRS 15.

5. The staff also recommends that the Board seek views on whether, if it proceeds to an Exposure Draft using either alternative 1 or alternative 2, to provide transition relief by permitting an entity to continue its current revenue accounting treatment for any contracts already in progress at the transition date or scheduled to be completed within a set period of the transition date.

Structure of this paper

6. This paper is structured as follows:

   (a) background (paragraphs 7–21):

      (i) overview of IFRS 15 (paragraphs 7–14);

      (ii) overview of Section 23 (paragraphs 15–21);

   (b) applying the alignment principles (paragraphs 22–48);

      (i) principle 1—relevance (paragraphs 24–39);

      (ii) principle 2—simplicity (paragraphs 40–46);

      (iii) principle 3—faithful representation (paragraphs 47–48);

   (c) stakeholder views (paragraphs 49–55); and

   (d) question for the Board.

Background

Overview of IFRS 15

7. IFRS 15 became effective on 1 January 2018 and introduced a single comprehensive model for recognising revenue that applies consistently to all contracts for goods or services, including construction contracts.

8. IFRS 15 replaces the previous revenue Standards, IAS 18 *Revenue* and IAS 11 *Construction Contracts*, and the related Interpretations on revenue recognition, namely IFRIC 13 *Customer Loyalty Programmes*, IFRIC 15 *Agreements for the Construction of Real Estate*, IFRIC 18 *Transfers of Assets from Customers* and SIC-31 *Revenue—Barter Transactions Involving Advertising Services*.

9. IFRS 15 was issued after the 2012 Comprehensive Review of the *IFRS for SMEs* Standard was completed. The Board has not previously considered whether to align the *IFRS for SMEs* Standard with IFRS 15.

10. IFRS 15 addressed significant diversity in revenue recognition practices that arose because previous revenue Standards contained limited guidance on important topics, including accounting for arrangements with multiple elements. Also, the limited guidance that was provided was often difficult to apply to complex transactions.

11. The move to a single, consistent model represented a significant change from applying the previous IFRS Standards and IFRIC Interpretations, which focused on specific types of revenue transactions and were used as the basis for Section 23.

12. However, IFRS 15 was expected to have little, if any, effect on the amount and timing of revenue recognition for many straightforward contracts. The most notable areas where changes were anticipated were contracts with multiple elements (such as mobile phone contracts) and construction contracts. Construction contracts had been addressed separately in IAS 11 and were reasonably likely to be analysed differently under IFRS 15, sometimes resulting in a fundamental change to the pattern of revenue recognition, and sometimes with more subtle changes in detail.

13. Even where there is or will be little impact on values of reported revenue, there is a more clearly defined framework in IFRS 15 and the move from the core distinction

being between goods and services to the core distinction being between performance over time and performance at a point in time requires effort for preparers implementing IFRS 15.

14. IFRS 15 also added disclosure requirements.

Overview of Section 23

15. Section 23 (and the examples in the Appendix to Section 23) of the *IFRS for SMEs* Standard is largely based on the principles of IAS 11 and IAS 18.

16. The objective of Section 23 is to prescribe how much revenue should be recognised, when it should be recognised and what to disclose about revenue. In addition, it prescribes how costs arising on construction contracts should be recognised.

17. One of the primary issues in accounting for revenue is determining when it should be recognised. The staff believes that underlying Section 23 are two criteria that must be satisfied before an item is recognised in the financial statements, which, when applied to revenue, specify that it is recognised when:

    (a) it is probable that any future economic benefit associated with the item of revenue will flow to the entity; and

    (b) the amount of revenue can be measured with reliability.

18. Revenue is measured at the fair value of the consideration received or receivable considering the amount of any trade discounts, prompt settlement discounts and volume rebates the entity offers.[1] When the inflow of cash or cash equivalents is deferred, and the arrangement constitutes, in effect, a financing transaction, the fair value of the consideration is the present value of all future receipts determined using an imputed rate of interest (using the effective interest method).

19. Section 23 provides additional guidance on accounting for specific categories of revenue and includes additional requirements that must be met before revenue can be recognised. The categories identified are:

[1] *IFRS for SMEs* Standard paragraph 23.3.

(a) the sale of goods;

(b) the rendering of services;

(c) construction contracts in which the entity is the contractor; and

(d) the receipt of interest, royalties or dividends arising from the use by others of entity assets.

20. The recognition criteria in Section 23 are usually applied separately to each transaction. However, in some circumstances, it is necessary to apply the recognition criteria to the separately identifiable components of a single transaction to reflect the substance of the transaction.[2] Conversely, an entity applies the recognition criteria to two or more transactions together when they are linked in such a way that the commercial effect cannot be understood without reference to the series of transactions as a whole.

21. Section 23 includes 26 examples of the application of its principles, almost all taken from IAS 18. Given that these have such a broad coverage, many SME preparers are likely to be able to decide how to recognise revenue without needing to perform a detailed analysis based on the principles in the Standard.

Applying the alignment principles

22. At its May 2019 meeting (Agenda Paper 30A), the Board decided that to determine whether and how to align the *IFRS for SMEs* Standard with new and amended IFRS Standards, it would apply three principles:

(a) relevance;

(b) simplicity; and

(c) faithful representation.

23. The following paragraphs apply the alignment principles to assist the Board in determining whether and how to align the *IFRS for SMEs* Standard with IFRS 15.

[2] *IFRS for SMEs* Standard paragraph 23.8.

Principle 1—Relevance

24. The recognition, measurement and disclosure of revenue are areas on which most, if not all, SMEs need guidance. In considering the relevance of information reported applying IFRS 15, an important question is whether applying the principles in IFRS 15 gives rise to information that is more relevant than that obtained by applying the current wording of Section 23 of the *IFRS for SMEs* Standard.

25. IFRS 15 provides a clear rationale for the recognition of revenue by an entity and takes a principle-based (rather than transaction-based) approach to recognising revenue. An early impression from informal feedback is that for many entities, the timing and amount of revenue recognised did not change significantly on implementing IFRS 15. This impression, however, cannot be confirmed until the Board conducts a Post-implementation Review of the Standard. There is, however, no reason to suppose this result would be radically different if the *IFRS for SMEs* Standard were aligned with IFRS 15.

26. For some complex transactions or arrangements with multiple elements, a principle-based approach aligned with IFRS 15 may have an impact on the amount and timing of revenue recognition. This could particularly affect entities applying the *IFRS for SMEs* Standard that are involved in the construction of real estate and other long-term service contracts, and also those engaged in software development and other technology-based offerings.

27. Considering the principle of relevance, although revenue is of interest to users of financial statements prepared applying the *IFRS for SMEs* Standard, the problems solved by IFRS 15 are quite limited in scope in relation to simpler transactions undertaken by SMEs. However, there are indubitable differences in outcome in some specific areas.

28. The staff has identified three alternatives on which the Board could seek views in the Request for Information:

Alternative 1—modifying Section 23 to remove the clear differences in outcomes without a wholesale reworking of Section 23

29. Alternative 1 would involve making at least the following changes to Section 23:

(a) adding a ‘principles’ heading and subsection near the beginning of the Section providing new guidance defining performance obligations and distinguishing between performance over time and performance at a point in time. This subsection would include a requirement for preparers to consider the examples in the Appendix to Section 23 and if a suitable example is not available to follow an entity applies the principles.

(b) rewording some of the current guidance so it relates to the timing of satisfaction of performance obligations and the distinction between performance over time and at a point in time.

(c) removing the guidance that relates specifically to construction contracts.

(d) elevating the status of the examples in the Appendix to Section 23 by describing them as forming an integral part of the Section.

(e) amending the examples addressing construction contracts and any other observed areas where there would otherwise be clear differences in outcome if IFRS 15 were applied.

(f) adding new examples in areas where it appears necessary (for instance on the agent/principal distinction, which at present is addressed in the examples to Section 23).

30. The guidance to preparers applying the *IFRS for SMEs* Standard would be amended such that if they cannot find their transaction among the listed examples at the end of Section 23, they would apply the principles in Section 23 in order to devise a suitable accounting policy (see paragraph 29(a) above) .

31. As proposed for the classification of financial assets if the Board aligns the *IFRS for SMEs* Standard with IFRS 9 *Financial Instruments*, entities would place more emphasis on examples than principles. This is in contrast to the approach in full IFRS Standards but reflects an approach that is practical for preparers of SMEs’financial reports, who often have less resources available.

32. Applying alternative 1 may cause some discomfort as it attempts to resolve the conceptual differences between two frameworks for revenue by bridging those two approaches. In particular:

(a) some staff members believe alternative 1 could achieve the goal of relevance while not breaching the simplicity principle. They believe this alternative is less likely to impose significant workloads on entities by requiring them to apply a revised version of Section 23 which in practice provides few or no adjustments.

(b) other staff members hold the view that the principles of IFRS 15 could not be incorporated into Section 23 as it currently stands. They believe there is too much tension between the principles of IAS 18 and IFRS 15 for a Section based on IAS 18 to be used, with modifications, to give measurement and timing outcomes sufficiently similar to those provided by IFRS 15.

33. Feedback from the Request for Information will help the Board determine whether this pragmatic, rather than principle-led, approach will be welcome and workable in practice.

Alternative 2—fully reworking Section 23 to reflect all IFRS 15 principles and language

34. An alternative approach, which would be less simple, is to acknowledge the differences in structure and principles between IFRS 15 and Section 23 and to respond to these by making significant changes to the structure of Section 23, as follows:

(a) Section 23 differentiates between goods and services and specifies accounting requirements for each. IFRS 15 differentiates between the performance obligations in a contract (which might correspond to individual components in a multiple element sale in Section 23) that are satisfied at a point in time or over time. Most of the wording in Section 23 would, therefore, need to be replaced with summary guidance from IFRS 15.

(b) IFRS 15 generally contains more guidance, including on multiple element sales and variable consideration, than Section 23; more guidance may need to be added to Section 23 on these areas, so it is comparable to IFRS 15 in this regard.

(c) contracts that meet the definition of a construction contract under Section 23 would not be accounted for on a percentage of completion basis unless the enforceable contractual rights and obligations they include satisfy specified criteria in IFRS 15. In practical terms, the guidance on construction contracts would need to be removed, and explicit guidance would need to be introduced elsewhere in the new structure.

(d) IFRS 15 contains more comprehensive disclosure requirements than does Section 23.

35. Alternative 2 would require that Section 23 be rewritten so it is in line with the five steps for recognising revenue applying IFRS 15, namely:

(a) identifying the contract(s) with a customer;

(b) identifying the performance obligations in the contract;

(c) determining the transaction price;

(d) allocating the transaction price to each performance obligation on the basis of the relative stand-alone selling prices of each distinct good or service promised in the contract; and

(e) recognising revenue when a performance obligation is satisfied by transferring a promised good or service to a customer (which is when the customer obtains control of that good or service).

36. The staff carried out an initial review considering aligning the examples in Section 23 with the IFRS 15 principles. This review suggested the amount and timing of revenue reported would not be affected in the case of many of the examples. Given this expectation of limited impact on the reporting of revenue by most entities applying the *IFRS for SMEs* Standard, the staff does not believe at this time, that the benefits of aligning the *IFRS for SMEs* Standard with IFRS 15 justify the cost to preparers applying the *IFRS for SMEs* Standard. On this point, feedback from the Request for Information will be crucial for determining how well the examples address the most common revenue sources for SMEs, and whether preparers and users believe changes would arise in practice were the principles aligned with IFRS 15.

Alternative 3—not amending Section 23 as part of the 2019 Review

37. A third alternative would be to note: (a) the limited effect that aligning the *IFRS for SMEs* Standard with IFRS 15 principles may have; and (b) early informal feedback that some preparers found IFRS 15 required considerable implementation work, only to illustrate that their current accounting could continue as before. In view of this the Board could seek views in the Request for Information that it will not consider aligning the *IFRS for SMEs* with IFRS 15 until the next review of the Standard.

38. A decision not to align the *IFRS for SMEs* Standard with IFRS 15 could be revisited in future reviews of the Standard once a post-implementation review of IFRS 15 has been performed and more feedback about implementation is available; if this further feedback indicates that changes from aligning IFRS 15 are more significant than they have initially appeared to be

39. The staff notes that in June 2019, the Board agreed to consult on aligning for IFRS 16 as part of the Request for Information. Arguably this puts pressure to consult on IFRS 15, since entities applying full IFRS Standards have not been permitted to adopt IFRS 16 early, unless they are also applying IFRS 15.

Principle 2—Simplicity

40. Should the Board agree with the staff about aligning the *IFRS for SMEs* Standards with IFRS 15 applying alternative (1) or (2) above, the next principle to consider is that of simplicity.

41. A new version of Section 23 updated for full or partial alignment with IFRS 15 would be unlikely to include any accounting options, so unlike with some other standards, simplification through the removal of options is not available in this case.

42. Areas in which IFRS 15 specifies more detailed requirements than Section 23 at present include principal/agent decisions, contingent or uncertain revenues and costs to obtain a contract. The staff proposes maintaining the current simplicity of the Section by only adding further requirements in any of these areas if there is a clear indication in the feedback on the Request for Information that doing so would be valuable. This proposal would apply whether alternative (1) or (2) is preferred. It

would not be relevant if the Board preferred alternative (3), namely, making no changes to the *IFRS for SMEs* Standard in relation to IFRS 15 at this stage.

43. The staff believes that any simplifications will be to the language and depth of guidance provided and to disclosures, and not to the underlying principles.

Transition relief

44. Some of the informal feedback to the implementation of IFRS 15 has highlighted that the implementation costs are high due to the need to review existing contracts with customers. The staff thinks that if the Board decides to seek views on aligning the *IFRS for SMEs* Standard with IFRS 15 using alternative (1) or alternative (2), it should consider easing transition.

45. On first-time implementation of an updated *IFRS for SMEs* Standard, preparers could be permitted (without being required) to continue with their current revenue accounting treatment for any contracts already in progress at the transition date or those that will be completed before a certain specified period after transition. This election could be made on a contract-by-contract basis with entities only being required to apply the updated Section 23 to new contracts.

46. The staff takes the view that simplifying transitional relief would bring significant cost relief and that given the limited changes that appear likely, would not significantly reduce the benefits to preparers or users.

Principle 3—Faithful representation

47. The staff does not foresee substantive issues relating to faithful representation arising from alternatives (1) or (2), as both of these potential proposals would bring the *IFRS for SMEs* Standard in line with IFRS 15.

48. If no changes at all were proposed to Section 23 for alignment with IFRS 15, users would not benefit from the new approach which the Board has concluded results in better information that more faithfully represents a reporting entity's performance.

Stakeholder views

49. In February 2019, responses were received from the Small and Medium-sized Entities Implementation Group (SMEIG) about possible alignment with IFRS 15.

50. Responses from the SMEIG were inconclusive. Several members argued that there is insufficient implementation experience for making an informed decision on alignment with IFRS 15. This view supports adopting alternative 3. Other members stated that IFRS 15 would be too complex for SMEs to apply, which also supports adopting alternative 3.

51. Other members, however, supported introducing IFRS 15 principles, arguing that they bring much-needed clarity and standardisation. One respondent suggested that applying IFRS 15 principles might result in more prudent revenue recognition (and that this was valuable).

52. In its triennial review, the UK Financial Reporting Council (FRC) sought indicative stakeholder views about incorporating IFRS 15 into FRS 102 *The Financial Reporting Standard Applicable in the UK and Republic of Ireland*. All respondents agreed (in 2017) that it was too early and that there was insufficient implementation experience from IFRS 15 preparers. This was an unsurprising outcome as the consultation took place before the effective date of IFRS 15.

53. Respondents to the FRC also observed that entities that are part of a group applying IFRS Standards have an option in the UK to use FRS 101 (applying principles from IFRS Standards but with reduced disclosures) rather than FRS 102. To some extent, this reduces the urgency of considering changes for consistency with IFRS Standards because preparers, unlike those using the *IFRS for SMEs* Standard, have an option that is less demanding than full IFRS Standards.

54. A 2018 survey of the Asian-Oceanian Standard-Setter Group (AOSSG) on the *IFRS for SMEs* Standard found that:

    (a) Three jurisdictions (Cambodia, Nepal and Syria) were in favour of aligning the *IFRS for SMEs* Standard with IFRS 15 because revenue is an important consideration for users. Note that these same three jurisdictions were in favour of aligning the *IFRS for SMEs* Standard with IFRS 16.

(b) Seven jurisdictions (China, Korea, Malaysia, Pakistan, the Philippines, Sri Lanka and Thailand) do not support aligning the *IFRS for SMEs* Standard with IFRS 15 because of insufficient implementation experience. One respondent observed that entities will find it less appealing to adopt the *IFRS for SMEs* Standard if it is seen to be regularly changing.

(c) One jurisdiction (India) suggested a compromise of incorporating IFRS 15 measurement principles based on price.

55. Feedback from the AOSSG relating to IFRS 15 seems focused on theoretical support or reservations that would apply to any new Standard at this stage in its life, rather than on specific implementation issues or reporting outcomes relating to the content of IFRS 15. This suggests that even if a decision were taken not to seek views on aligning IFRS 15 at this point, there may still be a need to consider this again in the next review, when more standard-specific feedback is available.

Question for the Board

Board members are asked whether they agree with the recommendation to seek views in the Request for Information on aligning the *IFRS for SMEs* Standard with IFRS 15, including on:

1. presenting alternatives (1), (2) and (3) in the Request for Information in order to seek stakeholder views;
2. identifying alternative (1) as its preferred approach to aligning Section 23 with IFRS 15; and
3. whether, if the Board proceeds to an Exposure Draft using alternative (1) or alternative (2), to consider providing transition relief by permitting an entity to continue its current revenue accounting treatment for any contracts already in progress at the transition date or scheduled to be completed within a set period of the transition date.