IASB redeliberates clarifications to IFRS 15

What you need to know

- The IASB redeliberated proposed amendments to clarify IFRS 15 at the December meeting.
- The IASB decided to proceed with amendments previously proposed on licences of intellectual property and transition.
- In a joint meeting, the IASB and FASB agreed to proceed with the converged amendments they proposed to the principal versus agent application guidance.
- The IASB will continue its redeliberations on identifying performance obligations in 2016.

Highlights

At its December 2015 meeting, the International Accounting Standards Board (IASB) decided to proceed with amendments it had previously proposed to the application guidance for licences of intellectual property (IP) and requirements for transition to IFRS 15 Revenue from Contracts with Customers. The IASB decided to consider whether amendments to the requirements for identifying performance obligations could be converged with those the US Financial Accounting Standards Board (FASB) decided to make.

At a joint session, the IASB and FASB (collectively, the Boards) agreed to proceed with their converged proposed amendments to the principal versus agent application guidance.

Background

In July 2015, the IASB issued an exposure draft (ED) proposing several clarifications to IFRS 15. The proposed amendments are intended to address implementation questions that were discussed by the Joint Transition Resource Group for Revenue Recognition (TRG) on licences of IP, identifying performance obligations, principal versus agent application guidance and transition. The proposed amendments are also intended to reduce diversity in practice when entities adopt the new revenue standard and decrease the cost and complexity of applying it.

The FASB issued three exposure drafts proposing similar amendments to its new revenue standard as well as some additional amendments not proposed by the IASB. While the proposed changes to their respective new revenue standards were similar, the Boards did not agree on the nature and extent of all of them. In October 2015, the FASB voted to proceed with its proposed amendments to the requirements for identifying performance obligations and licences of IP.

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1 Accounting Standards Update 2014-09, Revenue from Contracts with Customers (largely codified in Accounting Standards Codification (ASC) 606).
Key decisions

Licences of IP
The IASB reaffirmed its decisions to make the following amendments to its application guidance on accounting for licences of IP:

- To clarify that activities to be performed by the licensor significantly affect the IP if the activities (a) change the form or functionality of the IP to which the customer has rights, or (b) affect the ability of the customer to obtain benefit from the IP.

- To clarify that the sales-based or usage-based royalty exception would be applied to the overall royalty stream when the predominant item within the arrangement is the licence of IP. The proposed amendments would also clarify that a sales-based or usage-based royalty in these types of arrangements would not be partially in the scope of the sales-based or usage-based royalty exception and partially in the scope of the general variable consideration constraint requirements.

The IASB also reaffirmed its decisions not to follow the FASB’s alternative approaches to: require entities to classify IP as either functional or symbolic IP; and add further guidance and illustrative examples addressing the effect of contractual restrictions in a licence.

The IASB also decided that the issues raised on licence renewals and identifying attributes of a single licence versus identifying additional licences, which were discussed in the November 2015 TRG meeting, are outside the scope of the current project to clarify IFRS 15.

Identifying performance obligations
The IASB’s ED proposed to amend some of the existing illustrative examples that accompany IFRS 15 to clarify how an entity would determine when a promised good or service is ‘separately identifiable’ from other promises in the contract (i.e., distinct within the context of the contract). In evaluating whether a promise to transfer a good or service is separately identifiable from other promises in the contract, an entity considers the level of integration, interrelation or interdependence among promises to transfer goods or services.

The FASB previously proposed similar amendments to its new revenue standard. However, the FASB’s proposal included an amendment to the separately identifiable principle in the body of the standard itself, as opposed to the IASB’s proposal to only amend the illustrative examples. At its October 2015 meeting, the FASB decided to proceed with these amendments.

After considering feedback from constituents, the IASB decided to consider whether its amendments to these requirements could be aligned with the FASB’s anticipated amendments in order to maintain convergence on this aspect. The IASB is expected to discuss this further at its January 2016 meeting.

In addition, the IASB reaffirmed its decision not to proceed with two amendments that the FASB intends to make that would: allow entities to disregard promised goods or services that are immaterial in the context of the contract; and permit an accounting policy election to account for shipping and handling activities performed after control of the good has been transferred to the customer as a fulfilment cost (i.e., an expense).

Principal versus agent considerations
At a joint session during the December 2015 meeting, the Boards decided to finalise the following amendments to the principal versus agent application guidance:

- Reframe the indicators to focus on when an entity is a principal, rather than when an entity is an agent, including removing the commissions indicator.
Clarify that the unit of account for the principal versus agent evaluation would be at the level of a specified good or service, which is a distinct good or service (or a distinct bundle of goods or services) to be provided to the customer.

Clarify that the determining factor in the analysis would be whether the entity controls the specified good or service before transfer to the customer.

Clarify and explain the application of the control principle in relation to services.

Add two examples and amend some of the existing illustrative examples to align them with the amendments discussed above.

In a change to their proposed amendments, the Boards decided to remove the credit risk indicator because they determined that it is not useful in evaluating control.

The Boards also reaffirmed the decision not to propose application guidance on how an entity that is acting as a principal would determine its transaction price when it does not know (and does not expect to know) the price charged to its customer for its goods or services by an intermediary.

**Transition – practical expedients for contract modifications and completed contracts**

The IASB decided to finalise two proposed practical expedients to the transition requirements of IFRS 15:

- To allow an entity that uses the full retrospective approach to only apply the new standard to contracts that are not completed as at the beginning of the earliest period presented.
- To allow an entity to use hindsight to identify the satisfied and unsatisfied performance obligations and to determine the transaction price to allocate to those performance obligations in a contract that has been modified before the beginning of the earliest period presented.

In addition, to assist entities that have dual reporting requirements, the IASB decided to:

- Allow entities to apply the modified retrospective method either to all contracts at the date of initial application (as proposed by the FASB) or to contracts that are not complete at the date of initial application (as proposed by the IASB).
- Permit entities electing the modified retrospective method and applying the contract modifications practical expedient, the option to select the beginning of the earliest period presented (as proposed by the IASB) or the date of initial application of IFRS 15 (as proposed by the FASB), but not any other date.

IFRS 15 defines a completed contract as one “for which the entity has transferred all of the goods and services identified” in accordance with existing IFRSs. In contrast to the FASB’s proposal, the IASB reaffirmed its decision to retain this definition. The FASB’s proposal would amend the definition such that a completed contract is one in which all (or substantially all) of the revenue has been recognised under existing US GAAP.

**Topics for which the IASB did not propose any clarifications**

The IASB also considered the FASB’s proposed amendments on collectability, measurement of non-cash consideration, and presentation of sales taxes. It reaffirmed its decision not to amend IFRS 15 for these topics. The reasoning for, and implications of, any differences between IFRS 15 and ASC 606 for these topics will be explained in the Basis for Conclusion on IFRS 15.

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2 IFRS 15.C2
Constraining market price variability

In addition to redeliberating the amendments proposed in the ED, the IASB also considered whether the requirement in IFRS 15 to constrain estimates of variable consideration must be applied to variability arising solely from changes in market prices, such as a commodity price.

IFRS 15 requires an entity to include in the transaction price some, or all, of an amount of estimated variable consideration only to the extent that it is highly probable that a significant reversal in the amount of cumulative revenue recognised will not occur when the uncertainty associated with the variable consideration is subsequently resolved.3

The IASB agreed with the staff’s analysis in the agenda paper, which noted that changes in the market price of a commodity in the future would not affect the entity’s right to consideration, even though the amount that the entity receives is known only on the payment day. Therefore, the entity’s right to consideration is unconditional and the entity would recognise a receivable when it delivers the commodity.4 The receivable would be accounted for in accordance with IFRS 9 Financial Instruments and, therefore, the variable consideration constraint would not apply to the variability arising solely from changes in the market price. Instead, those changes would be measured in accordance with IFRS 9.

Next steps

The IASB will continue its redeliberations in 2016, in particular:

- Whether its amendments to identifying performance obligations could be aligned with the FASB’s in order to maintain convergence on this aspect
- Transition requirements and the effective date of the amendments

We believe the IASB’s proposed amendments, including adding and amending examples in the standard, should help to address many of the implementation issues raised about licences of IP, the principal versus agent application guidance and transition. Entities will still need to exercise judgement in these areas, as they do today.

We welcome the IASB’s decision to consider whether its amendments to the requirements for identifying performance obligations could be converged with the FASB’s. Having the same wording is important because identifying performance obligations is fundamental to the model and will have a significant impact when applying subsequent steps in the model.

3 IFRS 15.56
4 IFRS 15.108