

## IFRS Developments

# IASB issues clarifications to IFRS 15

### What you need to know

- ▶ On 12 April 2016, the IASB amended its new revenue standard to address several implementation questions discussed by the TRG.
- ▶ The IASB has noted that different accounting outcomes may arise due to different decisions made by the IASB and FASB.
- ▶ The effective date of the amendments is 1 January 2018. Entities are required to apply these amendments retrospectively.

### Highlights

The International Accounting Standards Board (IASB) has issued amendments to its new revenue standard, IFRS 15 *Revenue from Contracts with Customers*. The amendments address implementation questions that were discussed by the Joint Transition Resource Group for Revenue Recognition on: identifying performance obligations; application guidance on principal versus agent and licences of intellectual property (IP); and transition. The amendments are also intended to help ensure a more consistent application when entities adopt IFRS 15 and decrease the cost and complexity of applying it.

The IASB's amendments:

- ▶ Clarify when a promised good or service is separately identifiable from other promises in a contract (i.e., distinct within the context of the contract), which is part of an entity's assessment of whether a promised good or service is a performance obligation
- ▶ Clarify how to apply the principal versus agent application guidance to determine whether the nature of an entity's promise is to provide a promised good or service itself (i.e., the entity is a principal) or to arrange for goods or services to be provided by another party (i.e., the entity is an agent)
- ▶ Clarify for a licence of IP when an entity's activities significantly affect the IP to which the customer has rights, which is a factor in determining whether the entity recognises revenue over time or at a point in time
- ▶ Clarify the scope of the exception for sales-based and usage-based royalties related to licences of IP (the royalty constraint) when there are other promised goods or services in the contract
- ▶ Add two practical expedients to the transition requirements of IFRS 15 for:  
(a) completed contracts under the full retrospective transition approach; and  
(b) contract modifications at transition

The IASB and the US Financial Accounting Standards Board (FASB) (collectively, the Boards) have not agreed on the nature and extent of all of the changes to their new revenue standards. In light of this, the IASB has noted in the Basis for Conclusions when different outcomes may arise as a consequence of the different decisions made by the Boards.

### **Identifying performance obligations - distinct within the context of a contract**

The amendments clarify when a promised good or service is 'separately identifiable' from other promises in a contract (i.e., distinct within the context of the contract). This is an important step in determining whether promised goods or services are separate performance obligations. The amendments: (1) reframe the principle for determining whether a promised good or service is separately identifiable to emphasise that the evaluation hinges on whether the multiple promised goods or services work together to deliver a combined output(s); (2) align the standard's three indicators for determining whether a promised good or service is separately identifiable with this principle; and (3) add new examples and amend some of the existing illustrative examples to help entities apply these concepts.

When evaluating one of the indicators that a promised good or service is separately identifiable, an entity considers the level of integration, interrelation or interdependence among promises to transfer goods or services. In the Basis for Conclusions, the IASB noted that an entity will not merely evaluate whether one item, by its nature, depends on the other (i.e., whether two items have a functional relationship), but rather will assess whether there is a transformative relationship between the two items in the process of fulfilling the contract.<sup>1</sup>

### **Principal versus agent considerations**

IFRS 15 requires an entity to determine whether it is a principal or an agent in a transaction in which another party is involved in providing goods or services to a customer by evaluating the nature of its promise to the customer. The amendments clarify that:

- ▶ The unit of account for the principal versus agent evaluation is the specified good or service, which is a distinct good or service (or a distinct bundle of goods or services). Depending on the circumstances, a specified good or service may be the underlying good or service (e.g., a flight, a meal) or a right to an underlying good or service to be provided by another party (e.g., a ticket, a voucher). The amendments are intended to help an entity properly identify the specified good or service and clarify that in a contract with multiple specified goods or services, an entity may be a principal for some specified goods or services and an agent for others.
- ▶ An entity is a principal (and, therefore, records revenue on a gross basis) if it controls the promised good or service before transferring it to the customer. An entity is an agent (and records as revenue the net amount that it retains for its agency services) if its role is to arrange for another entity to provide the good or service. The amendments also explain how to apply the control principle in relation to services (i.e., what is being controlled if an entity is the principal providing a service).
- ▶ The indicators are intended to help an entity make a control assessment, not replace that assessment. That is, the indicators do not override the assessment of control and are not intended to be considered in isolation or viewed as a checklist.<sup>2</sup> The amendments reframe the indicators to focus on evidence that an entity is acting as a principal rather than an agent.

The IASB has added new examples and amended some of the existing illustrative examples that accompany IFRS 15 to align them with these amendments.

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<sup>1</sup> IFRS15.BC116K.

<sup>2</sup> IFRS15.BC385H.

The IASB's amendments to clarify when a promised good or service is separately identifiable are expected to be converged with the FASB's amendments.

### How we see it

The amendments will help address many of the implementation issues raised about the principal versus agent application guidance in IFRS 15. However, entities will still need to exercise significant judgement to evaluate whether gross or net presentation of revenue is appropriate, as they do under current IFRS.

Entities may need to apply significant judgement to determine whether the specified good or service is the underlying good or service or a right to obtain that good or service. The IASB included language in the Basis for Conclusions<sup>3</sup> to help explain the distinction.

In March 2016, the FASB issued amendments to the principal versus agent application guidance in its revenue standard<sup>4</sup>, which are converged with the IASB's amendments.<sup>5</sup>

## Licences of IP

### Determining the nature of an entity's promise in granting a licence of IP

The amendments clarify how an entity will evaluate the nature of a promise to grant a licence of IP to determine whether the promise is satisfied (and revenue is recognised) over time or at a point in time. One of the three criteria that must be met to recognise revenue for a licence of IP over time requires an entity (the licensor) to assess its activities that do not otherwise transfer a good or service to the customer to determine if those activities significantly affect the IP to which the customer has rights. The amendments clarify that such activities significantly affect the IP if they: (a) change the form (e.g., design or content) or functionality of the IP; or (b) affect the ability of the customer to obtain benefit from the IP. If the IP has significant stand-alone functionality (i.e., the licensor's activities will not significantly affect the functionality of the IP to which the customer has rights), revenue will be recognised at a point in time.

### How we see it

We believe that the IASB's amendments will enhance the operability of IFRS 15 and result in greater consistency. However, entities will still need to apply judgement when accounting for licences of IP.

The FASB is expected to issue amendments that require entities to classify IP as either functional or symbolic IP, which will not be required under IFRS 15. The IASB acknowledged in its Basis for Conclusions that different outcomes are possible.<sup>6</sup>

### Sales-based and usage-based royalties

Stakeholders commented that it was unclear whether the sales-based or usage-based royalty exception (i.e., the royalty constraint) would apply if, for example, the arrangement had a distinct licence and another performance obligation, or if a licence was bundled together with another good or service into one performance obligation. As a result, the amendments clarify that the royalty constraint is applied to the overall royalty stream when the predominant item to which the royalty relates is a licence of IP. In addition, a sales-based or usage-based royalty in these types of arrangements would either be entirely in the scope of the royalty constraint or entirely in the scope of the general variable consideration constraint, but not both.

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<sup>3</sup> IFRS 15.BC385M-385W.

<sup>4</sup> Accounting Standards Update 2014-09, *Revenue from Contracts with Customers* (largely codified in Accounting Standards Codification (ASC) 606).

<sup>5</sup> Refer to the US publication, *To the point: FASB issues amendments to the principal versus agent guidance in its new revenue standard* (March 2016) for further details.

<sup>6</sup> IFRS 15.BC414K-BC414N.

## Transition - practical expedients for contract modifications and completed contracts

The amendments added two practical expedients to IFRS 15 to alleviate the transition burden of accounting for completed contracts and contracts that were modified prior to adoption under both transition approaches (i.e., full and modified retrospective). Without the practical expedients, the assessment of contracts to which IFRS 15 would be applied could be onerous for entities that have completed contracts for which revenue has not been fully recognised or multi-year contracts that have been modified many times prior to adoption of IFRS 15.

### Completed contracts

The new practical expedient will allow an entity that uses the full retrospective approach to only apply IFRS 15 to contracts that are not completed as at the beginning of the earliest period presented. Under IFRS 15, a contract is complete if the entity has transferred all of the goods and services identified under existing revenue standards and interpretations before the date of initial application. IFRS 15 already allows a similar accounting treatment for entities that choose to use the modified retrospective approach.

### Contract modifications

The new practical expedient for contract modifications will allow an entity, under either transition approach, to determine the aggregate effect of all of the modifications that occurred between contract inception and the earliest date presented, rather than accounting for the effects of each modification separately. However, entities applying the modified retrospective approach could apply this expedient to all modifications that occurred between contract inception and the date of initial application, instead of the earliest date presented.<sup>7</sup> An entity will be able to use hindsight to identify the satisfied and unsatisfied performance obligations and to determine the transaction price to allocate to those performance obligations. The beginning of the earliest period presented may vary for IFRS preparers depending on the number of years they present in their financial statements (e.g., 1 January 2017 for an entity that has a calendar year-end and includes only one comparative period in its financial statements). An entity that chooses to apply this practical expedient will be required to apply it to all contracts with similar characteristics.

## Transition and effective date

The amendments to IFRS 15 have an effective date of 1 January 2018, which is the effective date of IFRS 15. Entities are required to retrospectively apply the amendments in accordance with IAS 8 *Accounting Policies, Changes in Accounting Estimates and Errors*.<sup>8</sup> While retrospective application is required, the amendments are intended to clarify the requirements in IFRS 15, not to change the standard. Furthermore, retrospective application is expected to help users of financial statements understand trends in revenue.

## Next steps

The FASB is expected to issue final amendments to its new revenue standard shortly on licences of IP, identifying performance obligations, collectability, non-cash consideration, transition and presentation of sales and other similar taxes. The FASB has also voted to propose eight technical improvements related to its new revenue standard and to add a practical expedient that would allow an entity not to disclose variable consideration allocated to unsatisfied performance obligations in certain situations (i.e., in situations when an estimate of variable consideration would be made solely for disclosure purposes). Other than the final amendments on identifying performance obligations and accounting for licences of IP, the IASB is not expected to propose similar amendments.

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<sup>7</sup> IFRS 15.C7A.

<sup>8</sup> IFRS15.BC445S.