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IASB introduced clarifications to IFRS 15

Why has this amendment been issued?

The amendments are issued in response to feedback received by the IASB|FASB Joint Transition Resource Group for Revenue Recognition (TRG), which was formed to address potential issues associated with the implementation of IFRS 15 and the US GAAP equivalent, ASU topic 606. The TRG discussed the following topics: (a) identifying performance obligations; (b) principal versus agent considerations; (c) licensing; (d) collectability; and (e) measuring non-cash considerations.

Observations

In deciding which of the issues raised by the TRG required amendments to IFRS 15, the IASB decided to apply a high hurdle to minimise changes to the extent possible and, therefore, to avoid disrupting the implementation process of IFRS 15. The FASB decided to make more extensive amendments to Topic 606.

What are the changes introduced by the amendment?

Identifying performance obligations

The amendments provide some illustrative factors that an entity might consider in making the assessment as to whether promised goods or services are distinct. Those factors are: (i) whether the goods or services are inputs to produce or deliver a combined output (ii) whether the goods or services promised in the contract modify or customise or are significantly modified or customised by one or more of the other goods or services; and (ii) whether the goods or services are highly interdependent or interrelated.

The amendments include new illustrative examples, and the modification of some of the existing illustrative examples to demonstrate the application of the guidance to several different industries and fact patterns.

Principal versus agent considerations

IFRS 15 requires an entity to evaluate whether it is a principal or an agent on the basis of whether it controlsa promised good or service before it is transferred to the customer. Although IFRS 15 provides a list of indicatorsto determine whether the entity is a customer or an agent, constituents raised concerns on how to (i) determine the unit of account (i.e. whether it should be at the contract level or performance obligation level) and (ii) the interaction of the indicators in relation to the general control principle.

The amendments clarify that an entity should assess whether it is a principal or agent on each specified good or service promised to the customer. Accordingly, an entity is required to identify each good or service to be provided to the customer and assess whether it controls each good or service before that good or service is transferred to the customer.

The indicators to assess whether an entity is a principal or agent are amended as follows:

There is additional guidance to explain how each indicator supports the assessment of control.

The indicators are reframed to indicate when an entity is a principal rather than when an entity is an agent.For example an entity is a principal if it is primarily responsible for fulfilling the promise to provide the specifiedgood or service, the entity has inventory risk and the entity has discretion in establishing the prices for the specified good or service.

The indicator relating to the form of the consideration is removed as this indicator would not be helpfulin assessing whether an entity is a principal.

Observations

The indicators above were included to support the entity's assessment of whether it controls a specified goodor service before transfer in scenarios for which the assessment might be difficult. The indicators do not override the application of the general control principle in IFRS 15 and should not be viewed in isolation.

An entity is required to assess the relevance of those indicators depending on the specific facts and circumstances of the contract.

The amendments also add two examples and revise some of the existing illustrative examples in IFRS 15 to better illustrate the application of the principal versus agent guidance.

Observations

An area that will require significant judgement is to determine whether the entity is a principal or agentin a contract in which the entity directs another party to provide the services to the customer on the entity's behalf. The amendments include an illustrative example in which the entity obtains the right to the servicesof the subcontractor and then directs the subcontractor to provide the services to the customer on the entity's behalf. This scenario is equivalent to the entity fulfilling the contract using its own resources rather than engaging another party to do so. In other scenarios in which the specified services provided to the customer are provided by another party and the entity does not have the ability to direct those services, the entity would typically bean agent.

Licensing application guidance

Determining the nature of the entity's promise in granting a licence of intellectual property

IFRS 15 contains application guidance on an entity's promise to grant a licence of its intellectual property ("IP") and requires entities to determine whether the licence grants customers a right to use the underlying IP (which would result in point in time revenue recognition) or a right to access the IP (which would result in revenue recognition over time). This determination is based on whether the licensor's ongoing activities are expected to significantly affect the underlying IP.

The amendments clarify that in making this assessment, an entity is required to determine whether (i) those activities are expected to significantly change the form or the functionality of the IP and (ii) the ability of the customer to obtain benefit from the IP is substantially derived from or dependent upon those activities.

If the IP has significant stand-alone functionality (i.e. the entity's activities do not significantly affect the functionality of the IP), the licence would be a right to use IP, and revenue would be recognised at a point in time.

Observations

The term 'significant stand-alone functionality' is not defined in IFRS 15; however, the amendments made to the Illustrative Examples aim to explain when the intellectual property to which the customer has rights might have significant stand-alone functionality.

Sales-Based and Usage-Based Royalties

IFRS 15 contains specific guidance on sales-based and usage-based royalties promised in exchange for licencesof IP, often referred to as the "royalties constraint". In such arrangements, entities must recognise revenue at the later of when (1) the subsequent sale or usage occurs or (2) the related performance obligation has been fully or partially satisfied.

In response to questions raised by stakeholders regarding the application of the royalties constraint when a licence is bundled with other goods or services in a contract, the amendments add guidance to clarify that the royalties constraint guidance is applied either (1) when the royalty relates only to a licence of IP or (2) when a licence of IPis the predominant item to which the royalty relates.

Practical expedients upon transition

Completed contracts

The amendments give entities the option to apply another practical expedient when using the full retrospective transition approach. Under this expedient, entities are permitted to exclude the evaluation of any contract that was completed at the beginning of the earliest period presented. The purpose of this practical expedient is to reduce the population of contracts to which an entity will need to apply IFRS 15, in order to reduce the effort and cost of initial application.

Contracts modifications

In addition, an entity will not be required to apply the requirements for contracts modifications retrospectively for those contracts that were modified before the beginning of the earliest period presented. Instead, an entity is required to reflect the aggregate effect of those modifications when: (i) identifying the satisfied and unsatisfied performance obligations (ii) determining the transaction price; and (iii) allocating the transaction price to the satisfied and unsatisfied performance obligations.

When do the new requirements apply?

The amendments are effective for annual reporting periods beginning on or after 1 January 2018 and earlier application is permitted.

The amendments are to be applied retrospectively, so entities will apply the amendments as if they had been included in IFRS 15 at the date of initial application of the Standard.