IFRS NEWSLETTER

REVENUE

Issue 13, March 2015

KPMG

cutting through complexity

> Once again, the FASB has shown a greater appetite to make detailed changes to the new revenue standard than the IASB.

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KPMG's global IFRS revenue recognition leader

Problems with principals

This edition of *IFRS Newsletter: Revenue* examines the latest developments on the new standard, and what the decisions could mean for you.

The principal-agent guidance in the new revenue standard was the main focus of the March meeting between the IASB and the FASB. The Boards discussed proposed improvements, but decided that further research was needed before firm decisions could be taken.

However, in other areas – for the second time in two months – the Boards agreed to propose changes to the new standard. The changes are intended to address implementation issues discussed by the Boards' joint Transition Resource Group for Revenue Recognition.

As in their February meeting, the FASB has proposed more extensive and more detailed changes than the IASB.

Highlights

- *Principal-agent considerations* – The Boards requested further research, with the aim of clarifying how to apply the control principle.
- *Presentation of sales taxes* – The FASB agreed a new practical expedient permitting a company to present sales taxes net.
- *Collectibility considerations* – The FASB agreed to clarify how the collectibility criterion applies when assessing contract existence, and the meaning of contract termination.
- *Non-cash consideration* – The FASB agreed to clarify that non-cash consideration is measured on contract inception, and how to apply the constraint.
- *Transition to the new standard* – The Boards proposed adding further practical expedients to the transition options.

CURRENT STATUS OF THE REVENUE PROJECT

The story so far …

In May 2014, the IASB and the FASB (the Boards) published their new joint standard on revenue recognition – IFRS 15/ASC Topic 606 *Revenue from Contracts with Customers* (the new standard). This replaces most of the guidance on revenue recognition that currently exists under IFRS and US GAAP.

At the same time, the Boards formed the joint Transition Resource Group for Revenue Recognition (TRG). Its primary purposes are to:

- solicit, analyse and discuss stakeholder issues arising from implementation of the new standard;
- inform the Boards about those implementation issues, which will help them determine what, if any, action will be needed to address those issues; and
- provide a forum for stakeholders to learn about the new standard from others involved with implementation.

The TRG advises the Boards and does not have standard-setting authority. Its members include auditors, financial statement preparers and users with knowledge and experience of revenue recognition under US GAAP and/or IFRS from various industries and geographies. Two KPMG partners are members.

Since its formation, the TRG has met three times – in July 2014, October 2014 and January 2015. It is expected to meet approximately four times annually until 2017 or 2018.

The agenda and papers of the TRG are publicly available and all meetings are held in public. A summary of the issues discussed to date by the TRG is included at the back of this newsletter.

The TRG discussion on most issues considered to date has indicated that stakeholders should be able to understand and apply the new standard. However, in some cases the discussion has identified the potential for diversity in practice to arise.

Following the previous TRG discussion, the IASB and FASB decided in February to propose amendments to the new standard regarding:

- licences; and
- identifying separate performance obligations.

There are a number of differences between the amendments to be proposed by the IASB and the FASB respectively, as explained in our February newsletter.

What happened in March 2015?

In March, the Boards met to consider how to address issues that have been referred to them by the TRG in the areas of:

- assessing whether a company is acting as a principal or as an agent – i.e. whether it should recognise revenue gross or net;
- how a company that acts as a principal should measure revenue when it does not know the amount of consideration paid by the end customer;
- whether a company should present sales taxes gross or net;
- the measurement of non-cash consideration; and
- whether to add practical expedients to the new standard to provide further transition relief, particularly for companies that enter into long-term contracts that are modified frequently.

A number of these issues arise under currently effective revenue recognition requirements. In the case of principal-agent considerations, the FASB may also amend current US GAAP requirements and not just the new standard.

Each Board will issue its proposed changes for public comment in separate exposure drafts (EDs). The Boards have not confirmed the precise timings of their EDs, but it is likely that the FASB ED will be issued shortly with a 45-day comment period.

In addition, the Boards are undertaking outreach with stakeholders over whether to defer the effective date, which is currently 2017 under IFRS and for public business entities under US GAAP. They plan to discuss the results of this outreach in Q2 2015.

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MARCH DECISIONS AT A GLANCE

The Boards agreed to propose amendments in a number of areas.

What's the issue?	IASB decisions	FASB decisions
	Principal-agent considerations	
How should a company assess whether it is a principal or an agent?	Conduct further research into principal-agent issues, with a view to clarifying how to apply the control principle.	
	Presentation of sales taxes	
How should a company present sales taxes?	No action to be taken.	Add a practical expedient under which a company can elect an accounting policy to present sales taxes net.
	Collectibility considerations	
How should a company assess collectibility when determining whether a contract exists?	Conduct further research.	Amend the new standard to clarify how to assess collectibility and the meaning of contract termination.
	Non-cash consideration	
What is the measurement date for non-cash consideration?	No action to be taken.	Clarify that the fair value of non-cash consideration is measured at the contract inception date.
How is the variable consideration guidance applied to contracts that include non-cash consideration?	No action to be taken.	Clarify that the variable consideration guidance only applies to variability resulting from factors other than the form of the consideration.
	Transition to the new standard	
Should further practical expedients be added to the transition options?	Add a practical expedient for contracts that are modified before the date of initial application.	
	Permit companies not to apply the new standard to contracts completed under legacy GAAP when applying the new standard retrospectively.	No action to be taken.
	No action to be taken – exemption already exists under IFRS.	Exempt companies from certain disclosures in the year of adoption of the new standard.

PRINCIPAL-AGENT CONSIDERATIONS

The Boards requested further research into principal-agent considerations, with the aim of clarifying how to apply the control principle.

What's the issue?

How should a company assess whether it is a principal or an agent?

Under the new standard, if more than one party is involved in providing goods or services to a customer, then the company assesses whether it is:

- the principal in the transaction, in which case it presents the gross amount of consideration for the goods and services as revenue; or
- an agent, in which case it presents only its fee or commission as revenue.

The new standard's guidance on how to make this assessment includes an overall principle, indicators and illustrative examples. The overall requirement to assess whether a company is a principal or an agent also exists in current revenue recognition guidance under IFRS and US GAAP, broadly within a 'risk-and-reward' framework rather than the 'control' framework of the new standard.

Stakeholders have expressed concerns about consistency of application of the principal-agent guidance under both the new standard and the currently effective revenue recognition requirements. Under the new standard, specific areas of concern include whether all of the indicators and examples are consistent with the control principle, and how to weight the indicators in cases when they contradict each other. Stakeholders have also noted that the guidance can be particularly difficult to apply to 'new economy' transactions involving virtual or intangible goods.

At the TRG meeting in July 2014, concern was expressed that the guidance in the new standard could be interpreted in various ways that could potentially result in diversity in practice. Therefore, the Boards instructed their staff to perform additional research to understand whether specific improvements are needed.

How should a principal assess gross revenue?

Stakeholders also noted that in some cases the company may not know the amount that an intermediary charges the end customer – e.g. if the intermediary has discretion over setting prices. In such cases, the company may find it difficult to estimate the transaction price and so measure revenue. This is a practice issue under currently effective revenue recognition requirements, on which there is no specific guidance in the new standard.

At the TRG meeting in July 2014, there were differing views about whether, in such cases, the company should recognise as revenue:

- only the cash received from the intermediary; or
- an estimate of the amount charged by the intermediary to the end customer.

What did the Boards decide?

Further research required on principal-agent considerations

The Boards were not asked to vote on specific proposals regarding the overall principal-agent guidance at this meeting. However, they acknowledged the significance of the issues, and instructed the staff to conduct further research.

In the course of the discussion, many IASB and FASB members expressed initial support for targeted improvements to amend the principal-agent guidance to clarify that the control principle is always the determining factor when making the principal-agent assessment. These improvements could include revisions to the indicators, designed to ensure that each indicator links to the control principle. There was less support for an alternative approach that was tabled for consideration, which would have involved a more fundamental re-articulation of the guidance.

What are the implications?

Increased clarity on principal-agent guidance in the works

It appears likely that the Boards will continue to work towards improving the principal-agent guidance. This will respond to concerns expressed by TRG members that the current guidance could result in diversity in practice, with reasonable people reaching different conclusions for the same fact patterns. It may also pave the way for changes to currently effective US GAAP. However, this is a broad, complex issue and the timelines and precise changes that may be made to the new standard have not been confirmed.

PRESENTATION OF SALES TAXES

The FASB agreed a new practical expedient permitting a company to present sales taxes net.

What's the issue?

How should a company present sales taxes?

Under the new standard, the transaction price – and therefore revenue – excludes amounts collected on behalf of third parties – e.g. some sales taxes. A company assesses sales taxes on a case-by-case basis to determine whether it should present them:

- gross – i.e. include them in revenue and cost of sales; or
- net – i.e. exclude them from revenue.

The requirement to assess each tax collected from a customer and remitted to a governmental body is similar to current IFRS. However, it differs from current US GAAP, which permits a company to make an accounting policy election to present these sales either gross or net. The US GAAP election covers sales taxes, use taxes, value-added taxes and some excise taxes.

Following a TRG discussion of the issue, some US stakeholders asked the Boards to add a practical expedient to the new standard to lessen the complexity and practical difficulties in assessing whether a tax is collected on behalf of a third party.

What did the Boards decide?

FASB supports but IASB rejects a new practical expedient

The IASB decided that no standard-setting is needed on this issue because the new standard is clear that sales taxes are excluded from the transaction price if collected on behalf of the tax authorities. Judgement will be required to determine the appropriate presentation of each sales tax.

By contrast, the FASB decided to propose amendments to the new standard to introduce a new practical expedient. This would permit, but not require, a company to present sales taxes that are in the scope of the expedient on a net basis. Alternatively, the company could apply the current requirements of the new standard. Either way, the company would disclose the approach taken.

What are the implications?

Reinstating an existing GAAP difference

The FASB proposal would reinstate an existing IFRS/US GAAP difference that the new standard sought to eliminate. This would reduce the comparability of financial statements under IFRS and US GAAP, and within US GAAP to the extent that different companies adopt different approaches. Users would have to rely on additional disclosures to make meaningful comparisons between affected companies.

The FASB staff noted that under current US GAAP, companies within a given sector tend to select the same approach, so it is possible that current sector-by-sector preferences would be carried forward. This would be contrary to one of the key aims of the new standard, which was to reduce sector-specific accounting.

COLLECTIBILITY CONSIDERATIONS

The FASB agreed to clarify how the collectibility criterion applies when assessing contract existence, and the meaning of contract termination.

What's the issue?

How should a company assess collectibility when determining whether a contract exists?

The new standard's revenue recognition model applies only to contracts that pass the 'contract existence' criteria in Step 1 of the model. These criteria include assessing whether it is probable that the customer will pay the consideration to which the company expects to be entitled – i.e. the 'collectibility criterion'.

If a contract fails any of the contract existence criteria – including the collectibility criterion – then the company recognises any consideration received from the customer as revenue only when:

- the contract existence criteria are met subsequently and application of the model would result in revenue recognition;
- the company has no remaining obligations and all, or substantially all, of the consideration has been received and is non-refundable; or
- the contract has been terminated and the consideration received is non-refundable.

The TRG discussed a number of issues relating to collectibility at its meeting in January 2015. Following this discussion, the Boards agreed to do more research on:

- how to apply the collectibility criterion and how to determine when the contract has been terminated; and
- whether the accounting required when a contract fails the contract existence criteria is a faithful depiction of the economics.

What did the Boards decide?

FASB to clarify how to assess collectibility and the meaning of contract termination

The FASB agreed to propose amendments to the new standard, which are intended to clarify:

- how to apply the collectibility criterion; and
- for contracts that fail the contract existence test, how to assess when a contract has been terminated.

Specifically, the FASB proposes to clarify that:

- when assessing collectibility, a company considers the consideration "to which it will be entitled in exchange for the goods or services that will be transferred to the customer" rather than all consideration – i.e. collectibility is a forward-looking assessment that considers the company's exposure to credit risk and the tools available to the company to manage that exposure to credit risk throughout the contract; and
- contract termination means that the company has the ability to stop transferring goods and services under the contract, and has done so.

The IASB does not plan to make corresponding clarifications to the IFRS version of the new standard at this time.

What are the implications?

Only a clarification …

The FASB regards the proposals on assessing collectibility and the meaning of contract termination purely as clarifications. The aim of the proposals would be to ensure that the new standard is applied in the manner originally intended by the Boards. The IASB considers that no clarification is necessary.

… at this stage

By contrast, a change in the accounting for contracts that fail the contract existence criteria would represent a more significant change. Although some may consider the accounting required in these circumstances to be punitive – notably, it is more prudent than cash accounting – the Boards did not expect it to be applied frequently in practice. A key focus of the staff work in this area will be to assess the extent of contracts to which the guidance would apply following the clarifications agreed at this meeting.

NON-CASH CONSIDERATION

The FASB agreed to clarify that non-cash consideration is measured on contract inception, and how to apply the constraint.

What's the issue?

What is the measurement date for, and how is the constraint applied to, contracts that include non-cash consideration?

Under the new standard, non-cash consideration is included in the transaction price and is measured at fair value, unless this cannot be reliably measured. If the fair value of non-cash consideration varies only because of the form of the consideration, then it is not variable consideration.

Stakeholders have raised questions about the date at which the fair value of non-cash consideration should be determined. They have also questioned how the variable consideration guidance should be applied to contracts that include non-cash consideration, specifically when the fair value of non-cash consideration varies due to its form and also for other reasons.

At the TRG meeting in January 2015, TRG members expressed mixed views on both questions.

What did the Boards decide?

IASB decides that no action is required

The IASB decided not to address these issues at this stage. It highlighted that this would allow the issue to be considered more comprehensively, and also avoid potential unintended consequences arising from the interaction with other standards.

FASB proposes to introduce specific guidance on both issues

By contrast, the FASB decided to propose amendments to the new standard to specify that:

- the measurement date for non-cash consideration is the contract inception date; and
- the variable consideration guidance does not apply to variations in the fair value of the non-cash consideration that arise because of its form.

What are the implications?

The FASB proposals on the measurement date would increase consistent application of the new standard under US GAAP.

The FASB proposals on variable consideration would also promote consistent application under US GAAP. However, the FASB's chosen approach may be difficult to apply in some cases, as it requires a company to split movements in the fair value of non-cash consideration between those related to the form of the consideration and those arising for other reasons. The IASB's decision not to provide guidance leaves open the possibility that companies following IFRS may seek to follow the FASB's approach, but they may instead prefer a simpler approach that avoids the allocation of changes in fair value to different causes than the FASB's approach requires.

TRANSITION TO THE NEW STANDARD

The Boards proposed adding further practical expedients to the transition options.

What's the issue?

Should further practical expedients be added to the transition options?

Companies can transition to the new standard using one of two methods.

Retrospective approach	A company may adopt the new standard retrospectively
Cumulative effect approach	A company may choose not to restate comparatives, and instead adopt the new standard with effect from the date of initial application, adjusting retained earnings at that date

The new standard also features optional practical expedients intended to provide transition relief under the retrospective approach.

Stakeholders have expressed concerns that transition to the new standard may be especially burdensome for companies that enter into long-term contracts that have been frequently modified before the date of initial application.

At the TRG meeting in January 2015, there was general support for investigating whether further practical expedients could be identified that would provide additional relief in such cases.

What did the Boards decide?

A new practical expedient for contract modifications

The Boards agreed to propose adding a practical expedient to the new standard for contracts that are modified before the date of initial application. Under this proposal, a company would:

- identify all satisfied and unsatisfied performance obligations from contract inception to the contract modification adjustment date (CMAD[1]);
- determine the transaction price based on information available at the CMAD; and
- allocate the transaction price to those performance obligations using the historical stand-alone selling prices of the goods or services.

IASB to simplify transition for completed contracts

The IASB also agreed to propose an additional practical expedient that would apply under the retrospective approach, allowing companies to not apply the new standard to contracts that completed under previous GAAP on or before the date of initial application.

FASB to simplify disclosures on transition

In addition, the FASB decided to propose amendments to the new standard, so that a company applying the retrospective approach would not be required to disclose for the current period:

- the effect of adoption of the new standard on financial statement line items; and
- any affected per share amounts.

However, a company would still apply the remaining accounting change disclosure requirements in its year of transition.

The IFRS version of the new standard already includes such an exemption.

1. Under IFRS, the CMAD would be the beginning of the earliest period presented. Under US GAAP, the CMAD would be the beginning of the earliest period for companies applying the retrospective approach, and the date of initial application for companies applying the cumulative effect approach.

What are the implications?

A trade-off between cost and comparability

The practical expedient for modified contracts would provide welcome relief for companies with large numbers of contracts that are frequently modified, and for those with complex long-term contracts. However, it would not provide full relief because companies would still be required to:

- identify all of the performance obligations in the contract, whether satisfied or unsatisfied, at the CMAD; and
- obtain historical data to allocate the transaction price at that date.

The relief afforded by the IASB's additional practical expedient for completed contracts when a company applies the retrospective approach would extend beyond merely contracts that include modifications before the transition date. In particular, it would provide relief for companies that may be required to identify goods or services as a performance obligation under the new standard that were previously treated as expense items – e.g. after-sales services provided to a customer's customer.

While the additional practical expedients would provide relief on transition, they would also reduce comparability – e.g. between similar contracts entered into by the same company before and after the date of initial application. This could affect trend data until all contracts that were open at the date of initial application are completed, which may be many years away for some companies. Therefore, companies would need to carefully weigh the benefit of reduced costs on transition against the down-side of reduced comparability.

ISSUES DISCUSSED BY THE TRG

Date	TRG Ref	Topic discussed	Outcome
18 July 2014	**1**	Gross vs net revenue: agency indicators	FASB staff to perform additional research and outreach
	2	Gross vs net revenue: amounts billed to customers	FASB staff to perform additional research and outreach
	3	Sales-based or usage-based royalties in contracts with licences and goods or services other than licences	Discussed at joint Board meeting in February
	4	Impairment testing of capitalised contract costs	No further action expected
31 October 2014	**5**	July 2014 meeting summary of issues discussed and next steps	N/A
	6	Customer options for additional goods and services and non-refundable up-front fees	No further action expected
	7	Presentation of a contract as a contract asset or a contract liability	No further action expected
	8	Determining the nature of a licence of intellectual property	Discussed at joint Board meeting in February
	9	Distinct within the context of a contract	Discussed at joint Board meeting in February
	10	Contract enforceability and termination clauses	No further action expected
26 January 2015	**11**	October 2014 meeting summary of issues discussed and next steps	N/A
	12	Identifying promised goods or services in a contract with a customer	Discussed at joint Board meeting in February
	13	Collectibility	Discussed at joint Board meeting in March*
	14	Variable consideration	No further action expected
	15	Non-cash consideration	Discussed at joint Board meeting in March
	16	Stand-ready performance obligations	No further action expected
	17	Islamic financing transactions	Discussions will continue with the IASB Advisory Group
	18	Material rights	To be discussed further at the March TRG meeting
	19	Consideration payable to a customer	To be discussed further at the March TRG meeting
	20	Significant financing component	To be discussed further at the March TRG meeting
	21, 22	Research project update (licences of intellectual property and identifying performance obligations)	Discussed at joint Board meeting in February
	23	Incremental costs to obtain a contract	No further action expected
	24	Transition: contract modifications	Discussed at joint Board meeting in March

* Potential further action is limited to concerns raised about the accounting in circumstances where performance obligations have been satisfied and some, but not substantially all, of the consideration has been received.

A more detailed summary of the issues discussed, the views expressed by TRG members and the FASB/IASB staff's views about those issues, and the Boards' planned next steps, if any, for each of these issues can be found in agenda paper 5, agenda paper 11 and agenda paper 25[2].

2. The agenda and papers for the TRG meeting on 30 March 2015 will be posted on the TRG's meetings web page.

YOU MAY ALSO BE INTERESTED TO READ …

Visit KPMG's *Global IFRS Institute* at kpmg.com/ifrs to access KPMG's most recent publications on the IASB's major projects and other activities.

Revenue

Our IFRS – revenue hot topics page brings together our materials on the new revenue standard, including *Issues In-Depth*, which provides our detailed analysis and observations.

Financial instruments

Our IFRS – financial instruments hot topics page brings together our materials on the complete version of IFRS 9 published in July 2014.

Our *IFRS Newsletter: Financial Instruments* examines the latest developments on the financial instruments project – including the IASB's ongoing discussions on macro hedge accounting.

Leases

Our IFRS – leases hot topics page brings together our materials on the leases project, including our *IFRS Newsletter: Leases* and our suite of publications on the IASB's re-exposure draft on lease accounting published in May 2013.

Insurance

Our IFRS – insurance hot topics page brings together our materials on the insurance project, including our *IFRS Newsletter: Insurance* and our suite of publications on the IASB's re-exposure draft on insurance contracts published in June 2013.

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IFRS Newsletter: Revenue **is KPMG's update on the IASB's and the FASB's new revenue standard.**

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