INSTITUTE OF SINGAPORE CHARTERED ACCOUNTANTS

INSTITUTE OF SINGAPORE
CHARTERED ACCOUNTANTS
60 Cecil Street, ISCA House
Singapore 049709
Tel: 65 6749 8060
isca.org.sg

27 October 2023

International Accounting Standards Board
7 Westferry Circus
Canary Wharf
London E14 4HD
United Kingdom

Dear Board Members,

RESPONSE TO REQUEST FOR INFORMATION – POST-IMPLEMENTATION REVIEW: IFRS 15 *REVENUE FROM CONTRACTS WITH CUSTOMERS* ("RFI")

ISCA welcomes and supports the IASB's initiative in subjecting various IFRSs to Post-Implementation Reviews (PIRs) and subsequently improving the Standards in response to feedback gathered during the PIRs.

ISCA sought views from its members through a two-month public consultation and from the ISCA Financial Reporting Committee which comprises experienced technical professionals from audit firms, preparers of financial statements and other stakeholders.

Overall assessment of IFRS 15 and application challenges

We understand from our outreach that the principles set out in IFRS 15 are fundamentally sound and the five-step revenue recognition model has enabled entities to apply a consistent approach in recognising revenue. This has helped improve comparability of revenue information among entities with economically similar transactions. IFRS 15 has also enhanced transparency by requiring entities to disclose quantitative and qualitative information about their contracts with customers to help stakeholders better understand the nature, amount, timing and uncertainty of their revenue.

However, the application of IFRS 15 involves significant estimates and use of judgement leading to challenges in areas such as determining performance obligations in a contract, determining transaction price, determining principal vs agent, and applying IFRS 15 with other IFRS accounting standards. When addressing the above application challenges, we urge the IASB to refrain from making any significant changes to IFRS 15 as the underlying principles are fundamentally sound and entities have already gone through significant efforts and costs in transitioning to IFRS 15.

Convergence between IFRS 15 and US GAAP Topic 606 Revenue from Contracts with Customers

IFRS 15 was substantially aligned with Topic 606 when it was first issued in 2014. However, subsequent discussions by the joint Transition Resource Group, prompted by stakeholder concerns, led to amendments in both standards. With Topic 606 undergoing more extensive changes than IFRS 15, this resulted in further differences between the two standards.

Given the significance of the revenue figure as a key financial metric for entities, and in light of global developments such as Pillar Two Model Rules that depend on the revenue figure as the threshold, it is crucial to maintain alignment in revenue accounting standards. This will help improve consistency in the determination of revenue figure across jurisdictions. Hence, we urge the IASB to work closely with the FASB to continue alignment between IFRS 15 and Topic 606.

Other matters for the IASB's consideration

We suggest the IASB considers (i) providing a practical expedient for short-term service contracts for which revenue is recognised over time to alleviate the burden of extensive disclosures required for such contracts; and (ii) introducing the 'predominant' concept (similar to that in US GAAP) in determining the appropriate accounting standard to be applied to a transaction to simplify the accounting treatment.

Our detailed comments to specific questions in the RFI are set out below.

Question 1—Overall assessment of IFRS 15

(a) In your view, has IFRS 15 achieved its objective? Why or why not?

Please explain whether the core principles and the supporting five-step revenue recognition model provide a clear and suitable basis for revenue accounting decisions that result in useful information about an entity's revenue from contracts with customers.

If not, please explain what you think are the fundamental questions (fatal flaws) about the clarity and suitability of the core principle or the five-step revenue recognition model.

We understand from our outreach that the principles set out in IFRS 15 are fundamentally sound and the five-step revenue recognition model has enabled entities to apply a consistent approach in recognising revenue. This has helped improve comparability of revenue information among entities with economically similar transactions. IFRS 15 has also enhanced transparency by requiring entities to disclose quantitative and qualitative information about their contracts with customers to help stakeholders better understand the nature, amount, timing and uncertainty of their revenue.

However, the application of IFRS 15 involves significant estimates and use of judgement and this has led to application challenges in the following areas which we request the IASB to address:

- determination of performance obligations in a contract;
- determination of transaction price;
- determination of principal vs agent; and
- application of IFRS 15 with other IFRS accounting standards

The above are covered in further detail in our responses to Questions 2, 3, 5 and 9.

When addressing the above application challenges, we urge the IASB not to make any significant changes to IFRS 15 as the underlying principles are fundamentally sound and entities have already gone through significant efforts and costs in transitioning to IFRS 15.

Question 2—Identifying performance obligations in a contract
(a) Does IFRS 15 provide a clear and sufficient basis to identify performance obligations in a contract? If not, why not? Please describe fact patterns in which the requirements: (i) are unclear or are applied inconsistently; (ii) lead to outcomes that in your view do not reflect the underlying economic substance of the contract; or (iii) lead to significant ongoing costs. If diversity in application exists, please explain and provide supporting evidence about how pervasive the diversity is and explain what causes it. Please also explain how the diversity affects entities' financial statements and the usefulness of the resulting information to users of financial statements. **(b) Do you have any suggestions for resolving the matters you have identified?**

We noted challenges in identifying performance obligations in a contract in the following situation:

Difficult for technology entities offering system integration services to identify distinct performance obligations

Many technology entities offer products and/or services bundled together in a single contract, such as those involved in the provision of system integration services. Identification of performance obligations can be challenging for these entities as the promised goods and services often include a mix of hardware, software components and installation services to customise and integrate the components into the customer's information technology environment. This makes it difficult to assess whether a good or service is distinct. In addition to the factors set out in paragraph 29 of IFRS 15, we urge the IASB to consider providing industry-specific guidance on factors that could indicate whether two or more promises to transfer goods or services are separately identifiable, with a focus on such technology-driven products and offerings.

Question 3—Determining the transaction price
(a) Does IFRS 15 provide a clear and sufficient basis to determine the transaction price in a contract—in particular, in relation to accounting for consideration payable to a customer? If not, why not? Please describe fact patterns in which the requirements on how to account for incentives paid by an agent to the end customer or for negative net consideration from a contract (see Spotlight 3) are unclear or are applied inconsistently. If diversity in application exists, please explain and provide supporting evidence about how pervasive the diversity is and explain what causes it. Please also explain how the diversity affects entities' financial statements and the usefulness of the resulting information to users of financial statements. **(b) Do you have any suggestions for resolving the matters you have identified?**

We noted challenges in determining the transaction price in the following situations:

(i) Difficulties in the accounting of marketing incentives given to customers by entities selling goods or services on digital platforms

As noted in the initial feedback to the IASB, there is diversity in the accounting for incentives offered in three-way arrangements when a party pays a marketing incentive to indirect end customers – for example, when an e-commerce platform offers incentives to end customers who buy goods or services through the platform. This is common in the marketplace these days with the prevalence of digital platform businesses.

Another common situation is when the digital platform entity issues ‘points’ under customer loyalty programmes to customers who purchase goods or services through the platform, and the customer is then able to use the points earned to acquire/redeem goods or services from the other entities on the digital platform.

<u>Illustration</u>
The digital platform entity (Platform) issues points to the customer (Mr Jones) who purchased an oven from Merchant A, and Mr Jones subsequently uses the points earned to offset the purchase price of a rice cooker from Merchant B. In this situation, is Mr Jones considered a customer of Platform, Merchant A or Merchant B when accounting for the points?

Platform is likely an agent in the arrangement and should recognise revenue for the net fee or commission retained in the exchange. For Merchant A and Merchant B, as the points are issued by Platform, it is uncertain whether the points are to be accounted for as ‘consideration payable to customer’ (paragraphs 70 to 72 of IFRS 15) and if so, the appropriate party to account for it.

The obligations relating to such customer loyalty programmes can be significant even if though the value of each individual incentive is insignificant. Hence, we urge the IASB to provide guidance for situations where the consideration may be payable to an indirect customer, including whether such consideration is to be accounted for as ‘consideration payable to customer’.

(ii) Difficulties in applying the notion of ‘highly probable’ for reversal of revenue in respect of liquidated damages or penalties by entities in the construction industry

In the construction industry it is common for liquidated damages or penalties to be claimed against the entity. Such penalties are included in determining the transaction price at contract inception unless the likelihood of the payment is remote. However, it is challenging to determine the amount of such penalties and some entities may not account for these penalties until near the end of the construction phase. This has led to diversity in practice for the accounting for similar transactions. We urge the IASB to consider providing industry-specific guidance on how to apply the estimation constraint on variable consideration.

Question 5—Principal versus agent considerations
(a) Does IFRS 15 provide a clear and sufficient basis to determine whether an entity is a principal or an agent? If not, why not? Please describe fact patterns in which the requirements are unclear or are applied inconsistently—in particular, in relation to the concept of control and related indicators (see Spotlight 5). If diversity in application exists, please explain and provide supporting evidence about how pervasive the diversity is and explain what causes it. Please also explain how the diversity affects entities’ financial statements and the usefulness of the resulting information to users of financial statements. **(b) Do you have any suggestions for resolving the matters you have identified?**

We noted challenges in identifying the principal / agent in the following situations:

(i) Diversity in views on whether certain indicators should be weighted more heavily and whether emphasis should be placed on legal form or substance of the arrangement or customary market practice

For arrangements involving two or more unrelated parties that contribute to providing a specified good or service to a customer, entities need to evaluate whether it has promised to provide the specified good or service itself (acting as principal) or to facilitate the provision of the specified good or service by another party (acting as agent). This assessment often requires significant judgement to be exercised and the amount and timing of revenue recognition can be significantly impacted depending on the conclusion.

Paragraph B37 of IFRS 15 provides some indicators that an entity is a principal in the arrangement. But the Standard does not provide for a single indicator that is determinative or whether certain indicators should be weighted more heavily than others. This has led to diversity in views on whether (i) certain indicators should be accorded more importance and (ii) emphasis should be placed on the legal contractual terms, customary practices of the marketplace in which the transaction is taking place in, or the substance of the arrangement.

Commodity trading entities typically face challenges in this area as the arrangements typically involve (i) back-to-back arrangements between the end buyer of the commodity, the commodity trading entity and the seller of the commodity; and (ii) customary practice of one party raising the invoice(s) on behalf of another entity. Because of (ii) and without having a complete understanding of the agreed arrangement(s), it may appear that the party raising the invoice has the discretion in establishing the price of the commodity and is the primary obligor to the customer (i.e. meeting the indicator that it is a principal).

We urge the IASB to consider providing more guidance in this area such as further illustrative examples to clarify the evaluation of whether a party has control over the goods / services before transferring to the customer, especially when goods are shipped direct from supplier to end customer, and how to assess the relative importance of the indicators under paragraph B37, given varying sets of facts and circumstances which are common for certain industries.

(ii) Diversity in practice when accounting for sale of 'right' to the specified good or service

We understand that there are situations where the specified good or service to be transferred to a customer may be a right to an underlying good or service that is provided by another entity. For instance, a digital platform business (Platform) selling rights (e.g. vouchers) that give the end customers the right to a merchant's products. Such rights may be purchased in advance or involve back-to-back arrangements or a combination of both.

In these situations, the Platform will need to assess whose performance obligation is it to deliver the specified good or service to the end customer, i.e. whether it is the Platform or the merchant. We note that the application of the requirements in the accounting for such rights can be challenging and may lead to different accounting conclusion for very similar transactions in the entity and between entities with very similar business models.

In view of the above, we urge the IASB to consider providing more guidance in this area, such as further illustrative examples to clarify the evaluation of which party is principal or agent.

Question 8—Transition requirements
(a) Did the transition requirements work as the IASB intended? Why or why not? Please explain: (i) whether entities applied the modified retrospective method or the practical expedients and why; and (ii) whether the transition requirements in IFRS 15 achieved an appropriate balance between reducing costs for preparers of financial statements and providing useful information to users of financial statements.

Under IFRS 15, there are two transition methods (full retrospective and modified retrospective) and we observed that both methods are being applied by entities in Singapore.

We also note that the practical expedients and option to use the modified retrospective approach have helped to reduce the complexity, cost and burden of transition for preparers of financial statements.

Question 9—Applying IFRS 15 with other IFRS Accounting Standards
(a) Is it clear how to apply the requirements in IFRS 15 with the requirements in other IFRS Accounting Standards? If not, why not? Please describe and provide supporting evidence about fact patterns in which it is unclear how to apply IFRS 15 with the requirements of other IFRS Accounting Standards, how pervasive the fact patterns are, what causes the ambiguity and how that ambiguity affects entities' financial statements and the usefulness of the resulting information to users of financial statements. The IASB is particularly interested in your experience with the matters described in Spotlights 9.1–9.3. **(b) Do you have any suggestions for resolving the matters you have identified?**

We noted the following challenges stemming from the interaction between IFRS 15 and other Standards:

(i) IFRS 15 & IFRS 16 – Challenges in the determination of transaction price for contracts with variable payments due to inconsistency in measurement requirements

For a contract that is, or contains a lease, the entity is required to account for lease and non-lease components separately, and to allocate the transaction price to each component. However, we note that the determination of the transaction price can be challenging for contracts containing variable payments due to inconsistency in the measurement requirements in IFRS 15 and IFRS 16.

Under IFRS 16 only variable lease payments that depend on an index or a rate are included in the computation of the lease liability. However IFRS 15 requires the total amount of variable consideration (subject to the constraint) to be estimated and included in the transaction price at contract inception. This inconsistency in measurement requirements in the two standards could result in significant difference in the amount to be allocated. We urge the IASB to consider providing guidance to address this issue in the Standard.

(ii) IFRS 15 & IFRS 10 – Diversity in the accounting of sales of assets via corporate wrappers

We note that there is diversity in the accounting of sales of assets via corporate wrappers as entities apply different Standards to transactions with similar commercial substance.

<u>Illustration</u>
An entity, as part of its ordinary activities, enters into a contract with a customer to sell an asset by selling the entity's equity interest in the legal entity that holds the said asset (i.e. the corporate wrapper). The entity has concluded that the corporate wrapper is its subsidiary in accordance with IFRS 10.

IFRS 10 requires a parent to consolidate a subsidiary from the date of obtaining control of the subsidiary until the date of losing control. In the above situation, the entity should apply the deconsolidation requirements in IFRS 10 to account for the disposal of the subsidiary. However, if the entity were to sell a similar asset which is not held in a corporate wrapper, the entity would apply other Standards, e.g. IFRS 15 to account for the sale. We consider both transactions to have similar commercial substance (albeit different legal forms) and are concerned that different Standards are applied when accounting for them thereby resulting in diversity in practice.

Although the IASB has shared in Spotlight 9.4 its reasons for deciding to defer the assessment of this matter till the next agenda consultation, we wish to highlight that this is a common issue faced by entities, particularly in the real estate industry and would urge the IASB to consider this issue to be of high priority.

(iii) IFRS 15 & IFRS 9 or IFRS 2 – Difficulties in accounting for equity incentive payments to customers

We understand that some entities provide non-cash consideration payable to a customer in the form of equity instruments (e.g. shares, share options or other equity instruments) as incentives for purchasing from the entity i.e. not in exchange for distinct goods or services from the customer. This is common among start-ups which are typically cash-strapped.

IFRS 15 does not provide guidance on whether such share-based payments are consideration payable to customer, and how they should be accounted for and measured initially and subsequently. We understand that under US GAAP such obligations could be accounted for using a classification and measurement model similar to Topic 718 Compensation-stock compensation, with the debit as a reduction in transaction price. Given that IFRS 2 applies only to share-based payments in exchange for goods or services, it would appear that IFRS 2 cannot be applied to the above situation as there are no distinct goods or services received from the customer. As a result, a IFRS reporter has to apply judgement to determine an appropriate accounting policy for such an arrangement and this could result in diversity in practice.

We suggest the IASB provides clarification and guidance for the above situation, considering the potential differing accounting outcome between IFRS and US GAAP.

(iv) IFRS 15 & IFRS 3 – Challenges in accounting for contract assets and liabilities acquired in a business combination due to inconsistencies in measurement principles

We note that entities face challenges in the accounting for contract assets and contract liabilities acquired in a business combination due to inconsistencies in the measurement principles between IFRS 3 and IFRS 15.

Under IFRS 3 assets acquired and liabilities assumed in a business combination generally should be recognised and measured at fair value on acquisition date. This requirement applies to contract assets and liabilities acquired in a business combination and may result in different amounts from what the acquiree previously recognised in its books under IFRS 15 based on transaction price. The difference can affect the amount of goodwill recognised on acquisition and the amounts of revenue recognised in the future.

Under US GAAP, we note that the FASB revised Topic 805 *Business Combinations* to require an acquirer to apply the revenue standard Topic 606 when measuring contract assets and liabilities acquired in a business combination at the acquisition date. The effect of this would be that contract assets and liabilities acquired in a business combination will be recognised and measured largely based on their contractual terms as if the acquirer entered into the original contract on the same date with the same terms.

The above amendments by the FASB have created another difference between IFRS 15 and Topic 606. In our view it is important to ensure continued alignment between the two standards given the significance of the revenue figure as a key financial metric for many entities and in light of global developments such as Pillar Two Model Rules that depend on the revenue figure as the threshold. Hence, we urge the IASB to work closely with the FASB to ensure continued alignment between IFRS 15 and Topic 606. Please see our response to Q10 for further discussion on this topic.

In addition to the above, we would like to share our views on the following matter highlighted in Spotlight 9.2 on *Price concession versus impairment losses*:

As detailed in Spotlight 9.2, some stakeholders are unsure whether to apply the requirements in IFRS 15 or IFRS 9 when accounting for the reduction in consideration from the customer whose financial position has deteriorated over the course of the relationship. However, in our view it is clear that the lower consideration should be accounted for as (i) an impairment of receivables or contract assets in accordance with IFRS 9 if the entity had already completed its performance obligations and recognised the associated revenue; and (ii) a contract modification in accordance with IFRS 15 if the lower consideration is for uncompleted performance obligations. Hence, we do not consider this issue to be of high priority.

Question 10—Convergence with US GAAP Topic 606
(a) How important is retaining the current level of convergence between IFRS 15 and Topic 606 to you and why?

In our view continued convergence between IFRS 15 and US GAAP Topic 606 is important, particularly in light of global developments such as the Pillar Two Model Rules. When determining the applicability of the Pillar Two Model Rules, the key determinant is the consolidated revenue figure of the multi-national entity (i.e. above EUR 750 million). Hence, there is a need for continued convergence of the revenue accounting standard requirements across jurisdictions to ensure consistent application of the Pillar Two Model Rules.

We note that the term ‘revenue’ is not defined in the Conceptual Framework nor under IAS 1. Instead, it is defined under IFRS 15 as “income arising in the course of an entity’s ordinary activities” but the term “ordinary activities” is not defined in the current IFRSs. This may result in varied terminology and presentation of income/revenue figures in the Statement of Comprehensive Income, which in turn, could result in confusion in assessing the appropriate revenue figure to use in establishing the cut-off threshold of EUR 750 million.

We also note that the definition of a customer in IFRS 15 refers to an entity’s ordinary activities. Paragraph BC 53 of the Basis of Conclusions for IFRS 15 explains that the IASB and the FASB have decided not to provide additional requirements as the notion of ordinary activities is derived from the definitions of revenue in the IASB’s and FASB’s (then) respective conceptual frameworks. That is, the (then) IASB’s Conceptual Framework’s description of revenue refers specifically to the ‘ordinary activities of an entity’ and the definition of revenue in FASB’s Concepts Statement No. 6 refers to the notion of an entity’s ‘ongoing major or central operations’. In view that the current Conceptual Framework no longer has this description of revenue, we suggest for the IASB to reconsider providing more clarity on what constitutes ‘ordinary activities’ and revenue vis-à-vis other income / gain.

Question 11—Other matters
(a) Are there any further matters that you think the IASB should examine as part of the post-implementation review of IFRS 15? If yes, what are those matters and why should they be examined? Please explain why those matters should be considered in the context of this post-implementation review and the pervasiveness of any matter raised. Please provide examples and supporting evidence.

(i) To consider providing a practical expedient for short-term service contracts

Revenue from short-term service contracts (e.g. contracts which are completed within a day or a month) could be recognised at a point in time or overtime (i.e. meeting the criterion in paragraph 35(a) of IFRS 15). The difference in the timing of revenue recognition would typically not result in significant financial impact due to the short-term nature of the contracts. However, we note concerns on the extensive disclosure requirements particularly if the revenue is recognised overtime. Hence, we suggest for the IASB to consider providing practical expedients for such short-term service contracts similar to that in IFRS 16 which has a practical expedient for leases with a lease term of 12 months or less – short-term leases, to alleviate the burden of extensive disclosures required for such contracts.

(ii) To consider introducing the 'predominant' concept in determining the appropriate accounting standard to be applied to a transaction

We note that US GAAP has the 'predominant' concept in determining the appropriate accounting standard to be applied to a transaction. For instance, when the non-lease component is the predominant component in the contract, both the lease and non-lease components are accounted for together in accordance with Topic 606. In our view, such practical expedients will greatly help reduce the complexity in accounting for such transactions. Hence, we suggest the IASB considers introducing this concept in IFRSs to simplify the accounting treatment.

Should you require any further clarification, please feel free to contact Ms Felicia Tay at felicia.tay@isca.org.sg or Ms Jezz Chew at jezz.chew@isca.org.sg.

Kang

Yours faithfully,
Mr Wai Geat, KANG
Divisional Director
Professional Standards Division