

# Association of Accounting Technicians response to the IASB Exposure Draft on “Clarifications to IFRS 15”

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## 1. INTRODUCTION

- 1.1. The Association of Accounting Technicians (AAT) is pleased to have the opportunity to respond to the IASB Exposure Draft on “Clarifications to IFRS 15” published on July 2015.
- 1.2. AAT is submitting this response on behalf of our membership and for the wider public benefit.
- 1.3. AAT has added comment in order to add value or highlight aspects that need to be considered further.
- 1.4. AAT has focussed on the operational elements of the proposals and has provided opinion on the practicalities in implementing the measures outlined.
- 1.5. As the ED relates to clarification to IFRS 15, it is presumed by AAT that there is no intention to change the accounting treatment of the recognition of revenue but only to minimise the risks of misinterpretations or confusion which could arise in implementing the current IFRS 15. Consequently AAT has not attempted to question the underlying concepts of that IFRS other than with a view to minimising possible misinterpretations or confusion.

## 2. EXECUTIVE SUMMARY

- 2.1. AAT fully supports the objectives of the ED to provide clarification to IFRS 15 before entities introducing the new IFRS experience practical difficulties due to lack of clarity.
- 2.2. The identification of revenue and profits (or losses) earned are not an issue in clear cut situations but where there is uncertainty, AAT is of the opinion that prudence must be applied (3.1 and 4.1-4.4, below).
- 2.3. AAT suggests that transactions should only be treated as agency where the evidence of such is clear (3.2, below).
- 2.4. AAT believes that caution in the recognition of licensing revenue is necessary to ensure that it is matched to costs expected to be incurred over the period of the licence (3.5, below).
- 2.5. AAT believes it would be helpful to users for a default position to be established for uncertain situations so as to avoid any possible significant variance in the interpretation of the IFRS (4.2, below).

## 3. AAT RESPONSE TO THE IASB EXPOSURE DRAFT ON “CLARIFICATIONS TO IFRS 15”

### **Question 1 – Identifying performance obligations**

**IFRS 15 requires an entity to assess the goods or services promised in a contract to identify the performance obligations in that contract. An entity is required to identify performance obligations on the basis of promised goods or services that are distinct.**

**To clarify the application of the concept of ‘distinct’, the IASB is proposing to amend the Illustrative Examples accompanying IFRS 15. In order to achieve the same objective of clarifying when promised goods or services are distinct, the**

**FASB has proposed to clarify the requirements of the new revenue Standard and add illustrations regarding the identification of performance obligations. The FASB's proposals include amendments relating to promised goods or services that are immaterial in the context of a contract and an accounting policy election relating to shipping and handling activities that the IASB is not proposing to address. The reasons for the IASB's decisions are explained in paragraphs BC7-BC25.**

**Do you agree with the proposed amendments to the Illustrative Examples accompanying IFRS 15 relating to identifying performance obligations? Why or why not? If not, what alternative clarification, if any, would you propose and why?**

- 3.1. AAT agrees with the proposed amendments to the Illustrative Examples accompanying IFRS 15 relating to identifying performance obligations on the basis that it is helpful to those applying the IFRS 15 to be provided with guidance on the interpretation and identification of "distinct promised goods or services". This is not a problem in clear cut situations but it is difficult to set out clear authoritative definitions for less definite situations and examples assist the user to understand expectations in applying the Statement to more difficult situations. Even so examples cannot cover every possible marginal situation and the IFRS should make it clear that where any doubt exists a prudent approach should be adopted in not recognising income or profit as earned if it does not clearly fit the criteria set out in the IFRS.

**Question 2 – Principal versus agent considerations**

**When another party is involved in providing goods or services to a customer, IFRS 15 requires an entity to determine whether it is the principal in the transaction or the agent. To do so, an entity assesses whether it controls the specified goods or services before they are transferred to the customer.**

**To clarify the application of the control principle, the IASB is proposing to amend paragraphs B34-B38 of IFRS 15, amend Examples 45-48 accompanying IFRS 15 and add Examples 46A and 48A.**

**The FASB has reached the same decisions as the IASB regarding the application of the control principle when assessing whether an entity is a principal or an agent and is expected to propose amendments to Topic 606 that are the same as (or similar to) those included in this Exposure Draft in this respect.**

**The reasons for the Boards' decisions are explained in paragraphs BC26-BC56.**

**Do you agree with the proposed amendments to IFRS 15 regarding principal versus agent considerations? In particular, do you agree that the proposed amendments to each of the indicators in paragraph B37 are helpful and do not raise new implementation questions? Why or why not? If not, what alternative clarification, if any, would you propose and why?**

- 3.2. The proposed amendments to the IFRS regarding principal versus agent considerations are acceptable to AAT and the indicators set out in paragraph B37 are considered helpful and do not raise any new implementation questions. The ability to control and, indeed, to complete an intended sale of goods or services is a sound primary indicator of whether the transaction is carried out as an agent or principal although there are many situations where contracts are clearly entered into as a principal but are reliant on other parties not under the control of the contractor to be completed, for example manufactured goods which are reliant on the future availability of raw materials.
- 3.3. However, while the ED focuses on the identification of transactions as a principal, AAT considers that it should be made clear that, in the absence of evidence to the contrary, the default position to be adopted is that the entity acts as a principal. For agency transactions there should be an overriding requirement, firstly, that goods or services supplied to a customer are identical to those provided by the supplier and have not been

changed or processed in any way, secondly, that the terms of the contract between an entity and a supplier or customer specifically recognise the entity as acting as an agent, and thirdly that the entity does not have legal ownership rights to the goods or services concerned, otherwise the transaction must be regarded as carried out as a principal. AAT suggests that these characteristics should be added to those to be considered when identifying agency transactions in the absence of which the default position is that transactions are to be considered to be as a principal.

### **Question 3 – Licensing**

**When an entity grants a licence to a customer that is distinct from other promised goods or services, IFRS 15 requires the entity to determine whether the licence transfers to a customer either at a point in time (providing the right to use the entity's intellectual property) or over time (providing the right to access the entity's intellectual property). The determination largely depends on whether the contract requires, or the customer reasonably expects, the entity to undertake activities that significantly affect the intellectual property to which the customer has rights. IFRS 15 also includes requirements relating to sale-based or usage-based royalties promised in exchange for a licence (the royalties constraint).**

**To clarify when an entity's activities significantly affect the intellectual property to which the customer has rights, the IASB is proposing to add paragraph B59A and delete paragraph B57 of IFRS 15 and amend Examples 54 and 56-61 accompanying IFRS 15. The IASB is also proposing to add paragraphs B63A and B63B to clarify the application of the royalties constraint. The reasons for the IASB's decisions are explained in paragraphs BC57-BC86.**

**The FASB has proposed more extensive amendments to the licensing guidance and the accompanying Illustrations, including proposing an alternative approach for determining the nature of an entity's promise in granting a licence.**

**Do you agree with the propose amendments to IFRS 15 regarding licensing? Why or why not? If not, what alternative clarification, if any, would you propose and why?**

- 3.4. AAT agrees with the proposed amendments to IFRS 15 regarding licensing for the same reasons as set out in the response to question 1 (3.1, above) as regards providing more clarity to the users of the IFRS, particularly by the provisions of examples in respect of areas of uncertainty.
- 3.5. While the treatment of revenue generated from the granting of a licence by an entity for a period of time is addressed by IFRS 15, it should be recognised that guidance and clarification are required as regards accounting for costs incurred by the entity in support of the licence which may not arise evenly over the life of the licence and potentially fails to recognise the basic concept of matching costs to revenue earned and therefore the timing of recognition of profit, particularly where the licence activities have a seasonal bias or cover a long term (such as a number of years with support costs increasing towards the end of the period).

### **Question 4 – Practical expedients on transition**

**The IASB is proposing the following two additional practical expedients on transition to IFRS 15:**

**(a) to permit an entity to use hindsight in (i) identifying the satisfied and unsatisfied performance obligations in a contract that has been modified before the beginning of the earliest period presented; and (ii) determining the transaction price.**

**(b) to permit an entity electing to use the full retrospective method not to apply IFRS 15 retrospectively to completed contracts (as defined in paragraph C2) at the beginning of the earliest period presented.**

**The reasons for the IASB's decisions are explained in paragraphs BC109-BC115. The FASB is also expected to propose a practical expedient on transition for modified contracts.**

**Do you agree with the proposed amendments to the transition requirements of IFRS 15? Why or why not? If not, what alternative, if any, would you propose and why?**

- 3.6. Insofar as the two additional practical expedients to transition to IFRS 15 which are proposed are not mandatory and provide additional options to entities on their adoption of IFRS 15, AAT fully supports their inclusion in the clarification as they can only assist the transition process and do not need to be adopted by entities who have already undertaken the work required for transition.

#### **Question 5 – Other topics**

**The FASB is expected to propose amendments to the new revenue Standard with respect to collectability, measuring non-cash consideration and the presentation of sales taxes. The IASB decided not to propose amendments to IFRS 15 with respect to those topics. The reasons for the IASB's decisions are explained in paragraphs BC87-BC108.**

**Do you agree that amendments to IFRS 15 are not required on those topics? Why or why not? If not, what amendment would you propose and why? If you would propose to amend IFRS 15, please provide information to explain why the requirements of IFRS 15 are not clear.**

- 3.7. It is understood by AAT why the IASB has concluded that amendments to the IFRS are not required in respect of collectability, measuring non-cash consideration and the presentation of sales taxes.
- 3.8. While these topics do not have a direct impact on the recognition of revenue as compared to determining the nature of the underlying sales contract and when it has been completed, AAT considers that the clarification of IFRS 15 provides an opportunity to strengthen users understanding of these aspects as well.
- 3.9. Collectability could be an issue to consider where it is usual to expect that costs arise after the practical completion of a contract if the contract terms provide for a retention of a proportion of the consideration for a period of time until the customer is fully satisfied that the terms of the contract have been met (such as for rectification work under a construction contract). Until that time the retention monies may not prove collectable and should not be recognised as revenue at an earlier point of time.

## **4. CONCLUSION**

- 4.1. The recognition of revenue does not give rise to accounting problems after a contract has been completed and at that time it is likely to be reasonable to expect to be able to define the points of time when revenue and profits or losses earned should be recognised. However, reaching a conclusion that revenue and profit has been earned before the contract has been fully completed can necessitate reliance on subjective judgements which may not be borne out by subsequent events. Consequently, AAT believes it is important that a cautious approach should be adopted in any uncertain situations and that any statutory financial statements should require developments in the sales contract in the period after the date of the financial statements up to the date of formal approval to determine the timing of recognition of revenue even if otherwise the financial statements would comply with the other provisions of IFRS 15.
- 4.2. As a general principle in clarifying the application of the new IFRS 15, AAT considers that it would be helpful to users to set out default positions which should be adopted where there is uncertainty or a lack of clarity concerning recognition of revenue. For example, where there is uncertainty a prudent approach should be required to be

adopted and the legal position as regards the ability to enforce collection of the consideration deemed to represent revenue earned should be the ultimate test.

- 4.3. AAT also considers it is important that the ED should stress that the recognition of revenue should not be considered in isolation from the need to match costs so that the recognition of profits (or more especially losses) earned on contracts are recognised at the appropriate time on a prudent basis. Consequently, forecasting the likely outcome of incomplete contracts is vital to this evaluation and so should also be a key feature in determining when revenue should be recognised.
- 4.4. While it is to be expected that it is necessary for entities to exercise judgment in applying the IFRS in determining the recognition of revenue, particularly in cases of uncertainty, there should be no risk of materially different results arising if that judgment is exercised by different compilers and AAT believes that the IFRS should require a prudent approach is to be adopted in cases of doubt.
- 4.5. AAT does not consider that it is necessary to set an introductory date for the ED as it relates to clarification of the existing IFRS 15 which has an established timetable for introduction so that the clarification should be applied with immediate effect.

## **5. ABOUT AAT**

- 5.1. AAT is a professional accountancy body with over 49,500 full and fellow members and 82,400<sup>1</sup> student and affiliate members worldwide. Of the full and fellow members, there are 4,200 Members in Practice who provide accountancy and taxation services to individuals, not-for-profit organisations and the full range of business types.
- 5.2. AAT is a registered charity whose objects are to advance public education and promote the study of the practice, theory and techniques of accountancy and the prevention of crime and promotion of the sound administration of the law.

## **6. FURTHER INFORMATION**

If you have any questions or would like to discuss any of the points in more detail then please contact AAT at:

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<sup>1</sup> Figures correct at 30 Sept 2015