

Mr Henry Rees
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25 September 2015

Dear Henry,

IASB Exposure Draft ED/2015/6 *Clarifications to IFRS 15*

This letter sets out the comments of the UK Financial Reporting Council (FRC) on the Exposure Draft ED/2015/6 *Clarifications to IFRS 15* (ED).

The FRC supports the IASB's decision to clarify the requirements of IFRS 15 *Revenue from Contracts with Customers* to reduce the potential for diversity in practice that may arise on adoption of the Standard. However, we also acknowledge that some preparers have begun the implementation process. We therefore agree with the IASB that (with the exception of additional practical expedients that will assist entities with implementation), at this stage, clarifications to IFRS 15 should be made only where this is necessary to ensure that the requirements of the Standard are interpreted consistently.

We recognise the benefits of convergence between IFRS 15 and Topic 606 *Revenue from Contracts with Customers* and strongly support the IASB's efforts to achieve this. We urge the IASB to reach consensus with the FASB wherever possible to minimise divergence between the Standards. However, we agree with the IASB's decision not to clarify or amend in IFRS 15 certain matters that the FASB has decided to clarify or amend in Topic 606. In our opinion, the IASB is right to prioritise the development of a high quality Standard that meets the needs of its stakeholders over convergence when agreement with the FASB on appropriate and consistent interpretation of the Standards cannot be reached. In our view, it would not be appropriate for the IASB to make amendments to IFRS 15 that change or override the underlying principles of IFRS 15, are unnecessary, are likely to result in further queries on implementation or are not relevant for its stakeholders.

We believe it is imperative that for each area where the wording of IFRS 15 and Topic 606 diverges, the Basis for Conclusions states the reasons for this. In each case, it should state explicitly whether the difference is simply semantic and is not expected to result in divergent practice, or that it could result in divergent practice and explain the circumstances in which this may occur. We also recommend the Basis for Conclusions to IFRS 15 specifically states

that IFRS reporters should not apply the requirements of Topic 606 in areas where FASB amendments result in more extensive or restrictive requirements.

We suggest that the IASB continues regular dialogue with the FASB to ensure that any further implementation issues raised are discussed jointly, enabling agreement to be reached on appropriate and consistent interpretation of the revenue Standards wherever possible. We also recommend that the TRG continues to examine emerging issues in relation to the implementation of IFRS 15 and Topic 606. TRG meetings provide a very useful forum where stakeholders can discuss implementation issues and interpretation of the Standard, resolving most matters without the need for further standard setting. They will also help to identify any more significant issues for consideration in the post-implementation review of IFRS 15.

Our detailed responses to the consultation questions are included in the Appendix to this letter.

If you would like to discuss these comments, please contact me or Rosalind Szentpéteri on 020 7492 2474.

Yours sincerely

A handwritten signature in blue ink that reads "M McLaren". The signature is written in a cursive style with a horizontal line underneath the name.

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Appendix – Responses to consultation questions

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?

Identifying a distinct good or service

We agree with the IASB's decision not to propose amendments to the Standard itself to clarify the concept of 'distinct'. In our view, the wording of paragraph 27 is clear. Further explanation is also provided in paragraph BC100.

However, given the concerns raised in TRG meetings over diversity in interpretation, we support the IASB's decision to propose additional Illustrative Examples and propose amendments to some of the existing Illustrative Examples. This will assist entities with making the assessment of whether a good or service is distinct in various circumstances and is likely to lead to more consistent application of the requirements.

We agree with the IASB that it is clear that the indicators in paragraph 29 are not an exhaustive list of factors because it states that indicators 'include, but are not limited to' the factors described. This is also emphasised in paragraph BC104. We therefore agree with the IASB that no clarification is needed in relation to this.

In our view Example 10 Case B (IE48A – IE48D) could be worded more clearly. The Example should explain clearly why the production of multiple units is considered to be a single performance obligation. It would also be helpful to state that the testing services are not distinct because they are a necessary step in producing the devices. This would clarify that the performance of integration services in respect of certain goods or services promised in a contract may not always be a sufficient basis to conclude that *all* of the goods and services promised in a contract constitute a single performance obligation.

The addition of Example 11 Case C (IE58A – IE58G) seems unnecessary because the rationale for accounting for an installation service as a separate performance obligation is explained already in Example 11 Case A (IE49 – IE58).

Identifying immaterial goods or services

We agree with the IASB's decision not to propose an amendment to clarify that an entity is not required to identify goods or services promised in the contract that are immaterial within the context of the contract, as proposed by the FASB. The application of materiality is required for all financial information prepared in accordance with IFRS so this does not need to be stated specifically in IFRS 15.

Shipping and handling activities

We agree with the IASB's decision not to propose a practical expedient permitting entities to make an accounting policy election in relation to the accounting for shipping and handling activities, as proposed by the FASB. As noted in paragraph BC24 of the ED, such an accounting policy election would be an exception from the principles of the revenue recognition model and would reduce comparability between entities.

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?

Principal versus agent considerations

Paragraphs BC39 and BC48 in the ED highlight the fact that the IASB is proposing more extensive amendments to the principal versus agent considerations in IFRS 15 than it deems to be strictly necessary, in order to align the wording in this area with the wording expected to be proposed by the FASB. While we acknowledge the importance of maintaining as much convergence as possible between the Standards, in our view the IASB should prioritise the development of high quality Standards over convergence.

We believe that some of the proposed amendments on this topic are unnecessary. Paragraph 22 of IFRS 15 makes clear that an entity must identify the promised goods or services in the contract. Paragraphs 26-29 provide guidance on how to identify distinct goods or services. Both of these steps precede the analysis of control. In our view, it is also self-evident that an entity needs to identify the nature of the specified good or service before it can assess whether it controls that good or service. Therefore, in our opinion the amendments to paragraphs B34 and B34A in respect of these matters are not warranted.

However, it is helpful to clarify how the control principle relates to intangible goods or services because this seems to have been causing significant confusion among some stakeholders. We therefore support the amendment proposed in paragraph B35A(b) and the additional Illustrative Examples that address this issue.

It is useful that the redrafting of paragraph B37 highlights how each indicator supports the control principle, given that similar indicators were used to support an analysis of risks and rewards under previous Standards. While we do not believe that it was essential for the indicators to be redrafted, we do not object to it. We also agree with the decision to remove the indicator relating to the form of the consideration because this is not directly related to the control principle.

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). That 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 sales-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 proposed amendments to IFRS 15 regarding licensing? Why or why not? If not, what alternative clarification, if any, would you propose and why?

The nature of an entity's promise in granting a licence of intellectual property

We acknowledge that the reference to form and functionality in the Standard, Illustrative Examples and Basis for Conclusions but not in paragraph B58 was causing confusion. We therefore support the IASB's decision to propose clarifications to paragraph B58 in the new paragraph B59A.

However, we believe that introducing the new concept of 'utility' in paragraph BC63 of the ED, which explains the purpose of paragraph B59A, is unhelpful and confusing. 'Utility' is not mentioned in the body of the Standard. If it is intended to refer to 'the ability of the intellectual property to provide benefits to the customer' it would be preferable to continue to use this terminology in the Basis for Conclusions for consistency with the rest of the Standard, rather than introduce a new term.

With regard to the FASB's proposal to classify intellectual property as either 'symbolic' or 'functional', it is unclear how an entity could determine whether intellectual property has significant stand-alone functionality *without* assessing whether the entity will undertake activities that significantly affect the intellectual property. Therefore, in most cases there may be no difference in accounting practice if the FASB adopts the approach it has proposed. We believe that a clarification of the existing principles is more appropriate and useful and therefore support the IASB's decision not to propose a similar amendment introducing the 'symbolic' and 'functional' classifications into IFRS 15.

The scope and applicability of the sales-based and usage based royalties exception

We agree that the application of the royalties constraint is unclear in circumstances when a licence constitutes only part of a performance obligation, or when a royalty relates to both a licence of intellectual property that is a separate performance obligation and to another good or service that is not a licence of intellectual property. We support the IASB's proposed clarifications to the requirements of paragraph B63 through the proposed new paragraphs B63A and B63B.

The effect of particular contractual restrictions in a licence on identifying the performance obligations in the contract

IFRS 15 is a principles-based Standard and we believe that it contains sufficient guidance on identifying the performance obligations in a contract. It should not include rules for how to account for every possible type of contractual clause. We support the IASB's decision not to make amendments to the Standard itself in relation to contractual restrictions.

However, we believe that a separate explanation in the Basis for Conclusions would be helpful; the Basis for Conclusions to the ED states that paragraphs B62 and BC411 provide guidance on the effect of contractual restrictions however, these paragraphs refer to whether contractual restrictions affect whether revenue is recognised at a point in time or over time rather than their impact on identifying the number of performance obligations in the contract, which is stakeholders' concern.

The application of the guidance on determining the nature of the entity's promise in granting a licence

In our view paragraphs B55 and BC407 are sufficiently clear that an entity should consider the nature of its promise in granting a licence when applying the general revenue recognition model to a combined performance obligation where the licence is the dominant component.

We believe that paragraph BC407 is explanatory in nature and it is therefore appropriate for it to be located in the Basis for Conclusions. We therefore agree with the IASB's decision not to propose any amendments in respect of this matter.

Illustrative examples

It would be helpful for Example 54 to explicitly state that, because the licence is distinct in accordance with paragraph 27, the entity should assess the nature of its promise in accordance with paragraph B56.

The drafting of Example 55 (IE278-IE280) could be improved. We believe it would be clearer if it explicitly stated that the licence is capable of being distinct in accordance with paragraph 27(a), but is not separately identifiable within the context of the contract in accordance with paragraph 27(b) because the licence and the updates are integrated and highly interdependent, and therefore constitute a combined performance obligation.

In our view, it would also be helpful for paragraph IE280 of Example 55 to explain that the entity should apply the general requirements on satisfying performance obligations in paragraphs 31-38 because the updates are essential to the licence and the licence is not the dominant component of the combined performance obligation, as described in paragraph BC407.

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?

Practical expedients on transition

We believe that the implementation of IFRS 15, particularly the requirements for accounting for contract modifications, will be challenging, complex and costly for some entities. We therefore support the IASB's efforts to provide practical expedients to assist entities with

implementation when this will not significantly impact on the usefulness of the information presented or disclosed.

We support the practical expedient proposed in paragraphs C5(c) and C7A in respect of contract modifications because we believe it will significantly reduce the cost and complexity of implementation for entities with large numbers of long-term contracts with frequent modifications, without a significant impact on the usefulness of the information presented or disclosed.

However, it is unclear how the practical expedient proposed in paragraph C5(a)(i) in respect of ‘completed contracts’ would operate in practice and we note that there were divergent views on this at the TRG meeting in July 2015. It is therefore difficult to judge whether the practical expedient would provide helpful relief or be a hindrance by increasing the complexity of the implementation process and creating potential for divergent practice.

In our opinion the IASB should consider this issue further with TRG members in November 2015, clarify how this practical expedient would operate in practice and include in IFRS 15 Illustrative Examples demonstrating how an entity applying this practical expedient would account for completed contracts following the adoption of IFRS 15.

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.

Collectability and contract termination

We support the IASB’s decision not to clarify this issue. Paragraph 9(e) is clear that an entity only assesses the consideration *to which it will be entitled* in exchange for the goods and services that *will be transferred* to the customer. This matter is also addressed in paragraph BC46 so in our view the FASB’s proposed amendment would simply relocate an explanatory paragraph that is rightly contained in the Basis for Conclusions to the body of the Standard.

In our view the meaning of ‘contract termination’ is also clear. There is no reason to presume a link between contract termination and ceasing to pursue the customer for outstanding payments. We do not believe that preparers will have difficulty identifying when a contract has been terminated.

Non-cash consideration

We support the IASB’s decision not to make amendments to IFRS 15 in respect of the measurement date for non-cash consideration or in relation to how to apply the constraint on

variable consideration in situations where the fair value of the non-cash consideration might vary due to both the form of the consideration and for reasons other than only the form of the consideration. We acknowledge that these issues interact with the requirements of other Standards such as IFRS 2 *Share-based Payment* and IAS 21 *The Effects of Changes in Foreign Exchange Rates*, as noted in paragraph BC100 of the ED. Accordingly, we agree that the IASB should address these issues in a separate project, if needed.

Presentation of sales taxes

We agree with the IASB's decision not to provide a practical expedient in respect of sales taxes that overrides the requirements of paragraph 47. We believe that this is a US specific issue and we agree with the analysis in paragraph BC108 of the ED. Overriding the requirements of IFRS 15 in this regard would reduce the comparability of revenue between entities under different tax regimes as well as entities in the same jurisdiction if they elect different approaches.