



# HM TREASURY

## Financial Reporting Advisory Board Paper

### *IFRS 15 Revenue from Contracts with Customers – Progress Update*

<b>Issue:</b>	This paper provides a progress update on the introduction of IFRS 15 including details of the IASB update to the standard, discussions of interpretations/adaptations, analysis of disclosure requirements and implementation matters for the public sector.
<b>Impact on guidance:</b>	None proposed at this stage. The FReM will need to be updated in due course.
<b>IAS/IFRS adaptation?</b>	None proposed. To be considered further in a paper to the Board before issuing an Exposure Draft in 2016
<b>Impact on WGA?</b>	None at this stage, but transition, intra group balances and disclosure requirements will affect how IFRS 15 is applied in WGA
<b>IPSAS compliant?</b>	Prior to IFRS 15, IPSAS and IFRS were broadly consistent. IPSASB are considering the impacts of IFRS 15 through its revenue project.
<b>Interpretation for the public sector context?</b>	None proposed. To be considered further in a paper to the Board before issuing an Exposure Draft in 2016
<b>Impact on budgetary regime?</b>	IFRS 15 does not impact the budgetary regime beyond changing the timing of recognition points of certain revenue streams
<b>Alignment with National Accounts</b>	Initial discussions with the ONS indicate IFRS 15 is broadly aligned with the National Accounts treatment.
<b>Impact on Estimates?</b>	IFRS 15 does not impact Estimates beyond changing the timing of recognition points of certain revenue streams
<b>Recommendation:</b>	That the Board note the IASB clarification to IFRS 15, note the progress made and seek comments and views from the Board on the issues discussed and questions raised.
<b>Timing:</b>	No changes are expected to be made to the FReM until the 2018-19 financial year.

## DETAIL

### Background

1. The International Accounting Standards Board (IASB) has issued 'IFRS 15 *Revenue from Contracts with Customers*' which replaces IAS 18 *Revenue*, IAS 11 *Construction Contracts* and related interpretations. IFRS 15 has an effective date of 1st January 2018 and is due for implementation within the public sector in 2018-19.
2. HM Treasury's paper of November 2015 (FRAB 125) provided the Board with a progress update against the work plan and the results of the initial public sector consultation. The Board requested further work to be carried out on potential interpretations and adaptations in advance of the Exposure Draft.
3. This paper provides a progress update, including IASB clarifications to IFRS 15 and the work of the technical working group's consideration of the matters raised by the Board. It also highlights some initial views on the WGA implications of the standard.

### IASB amendments made to IFRS 15

4. IASB will issue a revised version of IFRS 15 in March 2016 to address implementation questions that were discussed by the Joint Transition Resource Group for Revenue Recognition. The amendments also intended to reduce diversity in practice when entities adopt the new revenue standard and decrease the cost and complexity of applying it. As the amendments made were clarifications, IASB decided not to re-exposure the standard.
5. The clarifications relate to:
  - a) When an entity's activities significantly affect the intellectual property to which the customer has rights, which is a factor in determining whether the entity recognises revenue over time or at a point in time;
  - b) How entities would apply the exception for sales- and usage-based royalties related to licences of intellectual property and recognise revenue when the related licences are not separate performance obligations;
  - c) When a promised good or service is distinct within the context of the contract by amending related illustrative examples to IFRS 15;
  - d) Reframing the principal versus agent indicators, clarifying how to apply the control principle to services provided by another party, amending related illustrative examples, and adding two examples to clarify how to apply the principal versus agent application guidance;
  - e) Adding two practical expedients to the transition requirements of IFRS 15 for:
    - i. Completed contracts under the full retrospective transition approach; and
    - ii. Contract modifications at transition

6. The clarifications do not significantly affect the discussions within the public sector on the adoption of IFRS 15. Where it is likely to add value is through the addition of a practical expedient to be used under either transition approach allowing the use of hindsight to identify satisfied and unsatisfied performance obligations and to determine the transaction price to allocate to those performance obligations. This will enable entities to determine the aggregate effect of all of the modifications that occurred between contract inception and the earliest date presented, rather than accounting for the effects of each modification separately.

## IPSASB Considerations

7. IPSASB approved the project brief for a revenue project in March 2015. The primary goal of the revenue project was to update the requirements and guidance currently set out in IPSAS 9 *revenue from exchange transactions*; IPSAS 11 *construction contracts* and IPSAS 23 *revenue from non-exchange transactions (taxes and transfers)*.

8. Subsequent meetings have suggested that two revenue standards are likely to be needed; one for revenue with performance obligations, using the ideas in IFRS 15 as a starting point but with modifications likely and the other with the remaining revenue transactions most of which are currently dealt with in IPSAS 23. Consideration has also been given to the characteristics of non-exchange transactions and the interactions between the non-exchange expenses project with the revenue project.

9. IPSASB have identified three categories of revenue which may be applicable to the public sector:

- Cat A – exchange transactions such as those currently falling within the scope of IPSAS 9 and IPSAS 11 and some non-exchange transactions where performance obligations could be identified. IFRS 15 could be applied to these transactions with some modifications
- Cat B – revenue which may give rise to performance obligations but where the recognition model would require significant modification before it could be applied. For example capital grants and research agreements.
- Cat C – revenue from non-exchange transactions, along the lines of IPSAS 23.

10. IPSASB agreed at their December 2015 meeting to develop one consultation paper for both revenue and non-exchange expenses that would set out the two alternative approaches that it has been considering – that is, an exchange/non-exchange classification approach and a performance obligation/no performance obligation approach.

11. The March 2016 meeting will explore some of the issues that would need to be considered if IPSASB were to propose extending the performance obligation approach in IFRS 15 to a wider range of transactions than envisaged by IFRS 15.

## Issues raised for interpretations/adaptations for the Public Sector

12. IFRS 15 is a residual standard; i.e. it is applied when there is no requirements from other standards. As well as revenue from leases, insurance contracts and financial instruments, IFRS 15 does not apply to non exchange transactions.

13. The public sector however receives revenue from non-exchange transactions namely some fees, charges and levies, grants/donations, taxes and duties and fines and penalties. Discussions at previous FRAB meetings, the initial impact consultation and technical working groups have highlighted potential issues in these transactions where interpretation and/or adaptations could be introduced. Details of existing FReM requirements can be found in Annex A.

## ***Grants/Donations***

14. IAS 20 *Accounting for Government Grants and Disclosure of Government Assistance* provides the standard for recording grants and donations from government (to both the public and private sectors). The grant is recognised in profit or loss on a systematic basis over the periods in which the entity recognises as expenses the related costs for which the grants are intended to compensate.

15. The FReM has withdrawn the option to offset a grant for acquisitions of an asset against the cost of the asset. Where assets are funded by grants/donations the option to defer grant income is restricted to where the funder imposes a condition. The funding is to be recognised as income and taken through the Statement of Comprehensive Net Expenditure.

16. The FReM states that where grants or grant in aid is provided from controlling parties, this is considered to give rise to a financial interest in the residual interest of the body, and hence ALBs should account for grants and grant in aid as financing rather than reserves, i.e. by crediting them to the income and expenditure reserve.

17. There has been no amendments to IAS 20 following the introduction of IFRS 15. As a result, no reason has been found to change existing interpretations to IAS 20.

## ***Taxes and Duties***

18. There are no IFRS' for the recognition of revenue by government from taxes and duties. Whilst currently based on the principals of IAS 18, IPSAS 23 provides a framework which the current FReM is broadly aligned with.

19. The FReM (*para 8.2.4*) currently requires revenue recognition for taxes and duties as *"when a taxable event has occurred, the revenue can be measured reliably and it is probable that the economic benefits from the taxable event will flow to the collecting entity. All these elements are required to be satisfied."*

20. The wording refers to the terminology used in IAS 18, in particular with flow of economic benefits. The IASB have removed the reference to "gross inflow of economic benefits" from its conceptual framework and aligned revenue with the IFRS 15 definition of satisfaction of performance obligations, as they had concerns that some might have misread that reference as implying that an entity should recognise as revenue a prepayment from a customer for goods or services (*IFRS 15, BC29*).

21. Analysing the current accounting requirements to the principals of IFRS 15:

- A taxable event is considered to be the activity which requires the customer to pay the tax
- Measured reliably is considered to be with regard to the identification of the transaction price
- Economic benefits will flow to the collecting entity (*as an agent rather than principal*) – the entity is expected to receive the consideration with the underlying legislation providing the entity with the ability to collect the tax.
- There are no performance obligations the entity has to perform to receive the revenue.

22. Where by law these taxes and duties are required to be paid into the Consolidated Fund, rather than record in resource accounts, entities are required to prepare Trust Statements to record the revenue as the entity is acting as agent rather than principal for the revenue.

### ***Fines and Penalties***

23. Fines and penalties are economic benefits payable to government for breaches of laws or regulations where there is a statutory obligation to pay. These are paid into the Consolidated Fund as collecting entities act as an agent rather than a principal and recorded in Trust Statements.

24. The FReM (*para 8.2.9*) currently required revenue recognition for fines and penalties "*at the time that the fine or penalty is imposed and becomes receivable by the entity*"

25. The analysis under IFRS 15 would be similar to that for taxes and duties. There are no performance obligations the entity has to perform to receive the revenue. The underlying legislation providing:

- the ability for the fine or penalty being imposed on the customer; and
- the enforceable obligation for the customer to pay consideration.

### ***Fees, Charges and Levies***

26. Concern was raised on whether all the criteria of IFRS 15 could be applied where entities imposed fees, levies and charges (shortened to charges); in particular with regard to whether there was a contract and performance obligations.

27. A small sample of entities who impose these charges has been consulted to better understand the nature of "contracts" and "obligations" present. It was found that:

- a) The "contract" was considered to be the legislation or regulations providing the ability for the entity to impose a charge on the customer and the requirement for the customer undertaking the relevant activities to be liable to pay the charge. The legislation would also provide the enforceability of the obligations on both parties.
- b) Entities could identify performance obligations they were required to undertake in exchange for the charges they impose. These included provision of a licence for a determined period of time, a report or certificate of competence following an investigation etc.

- c) There was sufficient information held by the entities to identify separate transaction prices for the obligations. For example staff time on investigations and published prices for licences.
- d) The charges were more often than not for a period of one year and therefore recognised at a point in time. In addition the revenue was unlikely to give rise to any significant assets or liabilities in the entities.
- e) From the “customer’s” perspective, IFRIC 21 *Levies* provides the interpretation on when to recognise a liability to pay a levy that whose timing and amount is certain or where it is not in accordance with IAS 37 *Provisions, Contingent Liabilities and Contingent Assets*. The interpretation states that the obligating event that gives rise to a liability to pay a levy is the activity that triggers the payment of the levy, as identified by the legislation.

28. One example was identified where the entity described difficulties in identifying performance obligations and determining the transaction price. For the same charge, obligations could vary significantly and was determined by individual customer needs. It was considered applying IFRS 15 to individual customers would result in a significant overhaul of existing processes and systems. Whilst only one example has been identified so far and given the limited responses to the initial impact consultation, the Exposure Draft may highlight further organisations that may be significantly impacted by the new standards.

29. IFRS 15 does allow a practical expedient, in that entities may apply the standard to a portfolio of contracts (or performance obligations) with similar characteristics if the entity reasonably expects that the effects on the financial statements of applying this Standard to the portfolio would not differ materially from applying this Standard to the individual contracts (or performance obligations) within that portfolio (*IFRS 15. 4*).

30. Applying the portfolio approach therefore may be more cost effective than applying the standard to individual customers especially for those entities which impose charges to a significant level of customers. Entities will need to ensure they evaluate what characteristics constitute a portfolio and develop the controls and processes needed to account for the portfolio.

31. There are some charges where there are no clear obligations present, for example some environmental levies. The FReM currently requires for WGA in paragraph 10.3.2 that “*levies reported as income in the financial statements of consolidated entities but which are classified as taxes by the Office for National Statistics shall be reported as taxes in WGA*”. This is in recognition that in substance the charges are akin to taxation.

32. It is proposed that where no performance obligations are present, the criteria used to record taxes and duties should be used to record revenue.

**33. Do the Board agree the existing accounting principles for grants, donations, taxes and duties and fines and penalties should remain?**

**34. Do the board agree that IFRS 15 can be applied to entities that impose fees, charges and levies where performance obligations can be identified without adaptation or interpretation?**

**35. Do the Board agree that where fees, levies and charges are classified as taxes by the Office of National Statistics that entities should follow the accounting principles for taxes and duties?**

## Allocating transaction price to performance obligations

36. IFRS 15 requires entities to identify a stand-alone selling price. The best evidence of a stand-alone selling price is the observable price of a good or service when the entity sells that good or service separately in similar circumstances and to similar customers. However it has been noted in the technical working group and initial impact consultation that for some public sector transactions, there may not be an observable price as there may not be any comparable circumstances

37. The standard goes on to say if a stand-alone selling price is not directly observable, an entity shall estimate the stand alone selling price at an amount that would result in the allocation of the transaction price meeting the allocation objective. The standards does suggest but do not prescribe suitable methods for estimate. These included adjusted market assessment; cost plus margin or residual approach.

38. Given the vast array of revenue transactions, the technical working group agreed it was not considered appropriate for the FReM to mandate estimation techniques but for entities to adopt suitable methods relating to the individual circumstances of their revenue streams and the markets in which they operate.

**39. Do the Board agree that the standards provide sufficient guidance to determine the stand alone transaction price in the public sector?**

## Disclosure Requirements

40. Under the new standard, entities disclose more information about its contract with customers than currently required under IAS 18 and IAS 11, including more disaggregate information about revenue and more information about its performance obligations remaining at the reporting period.

41. The preferred option for transition is retrospective application without restatement. IFRS 15 requires modified transition disclosures instead of the restatement of comparative financial statements within this transition approach. The standard includes modified transition disclosure requirements that focus on changes in the statement of financial position at the date of initial application of IFRS 15 and also focus on the effect on the key financial statement line items for the current period.

42. The FRAB and the technical working group have highlighted the burden of the increased disclosure requirements and whether these are aligned to the objectives of the Simplification and Streamlining agenda. Similar comments on the burden of the disclosures has been highlighted by the private sector.

43. In the Basis for Conclusions (BC327-329), the IASB/FASB found that users of financial statements supported the proposed disclosure requirements because those requirements would have been a significant improvement over previous requirements. In contrast, other respondents (primarily preparers) noted that, when viewed as a whole, the proposed disclosure requirements would have resulted in voluminous disclosures and they questioned whether the proposed disclosures were justifiable on a cost-benefit basis. IASB/ FASB observed that, to some extent,

concerns about the increased volume were the inevitable consequence of addressing the shortcoming in the previous disclosure requirements.

44. When reviewing the disclosure requirements, the technical working group identified:

- Disaggregation of revenue is a new requirement however it was in the spirit of enhanced information on revenue which was the objective of IFRS 15. Some entities already provide additional information on disaggregation. For example the Home Office provide breakdowns of regional analysis of overseas income generated.<sup>1</sup>
- The FReM does already require enhanced disclosures for some revenue streams through Managing Public Money requirements for fees and charges disclosures. Though it should be noted that from 2015-16 fees and charges disclosures will be situated in the Accountability Report rather than in the notes to the Financial Statements.
- Disclosures on performance obligations and timing of revenue recognition were seen to be appropriate in light of the new requirements of the standards and could be linked to some of the existing disclosures on the revenue accounting policies.
- Some members considered disclosures of contract balances as less relevant for the public sector. For short term contracts, there was a rationale to not disclose, however if these were on the grounds of materiality, there should not be a need for the FReM to provide any exemptions. The disclosures may be more relevant to those with long term revenue contracts. The Nuclear Decommissioning Authority provides some narrative on their revenue contracts in their annual report and accounts<sup>2</sup>.
- Disclosing significant judgements is not a new requirement as it has always been required under IAS 1 Presentation of Financial Statements. IFRS 15 highlights particular areas of the standard where judgements are present that may be relevant to users of the accounts.

45. IFRS 15 states that an entity need not disclose information in accordance with this Standard if it has provided the information in accordance with another Standard. The technical working group continued to highlight that care should be taken to not reduce the understandability of the financial statements by obscuring material information with immaterial information or by aggregating material items that have different natures and functions.

**46. Do the Board agree that there is no need to adapt the disclosure requirements for IFRS 15?**

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1 Home Office Annual Report and Accounts 2014-15 -  
[https://www.gov.uk/government/uploads/system/uploads/attachment\\_data/file/441282/HO-AR15\\_web.pdf](https://www.gov.uk/government/uploads/system/uploads/attachment_data/file/441282/HO-AR15_web.pdf)

2 <https://www.gov.uk/government/publications/nda-annual-report-and-accounts-2014-to-2015>



## Transition and implementation

47. The transitional requirements of IFRS 15 were discussed again, jointly with the IFRS 9 technical working group. It is expected, subject to the Exposure Draft processes, that both standards will be applied retrospectively without restatement. The transition approach chosen for IFRS 15 will reduce the number of expedients available on initial adoption and the calculation of adjustments is still necessary in order to determine the transition adjustment in the opening balances in reserves.

48. Whilst IFRS 15 was considered to be conceptually simpler than IFRS 9, the consensus was that a significant amount of work will be required when transitioning to the new standards.

49. Entities will also need to assess whether their current systems and processes are capable of tracking, aggregating and reporting information to meet disclosure requirements of the new standard.

## Impact on WGA

50. A representative from the WGA team provided the technical working groups with some early thoughts on the likely impacts of both standards on its consolidation process and resulting publication. From a WGA perspective consistency of disclosure requirements is desirable for both IFRS 9 and IFRS 15; one way of reporting is preferable but if this cannot be mandated then it would need to be achieved through the data collection tool.

51. WGA will need to ensure the right data is collected from public sector entities to facilitate the consolidation and this will need to be considered in advance of the data collection tool being issued. The concept of materiality from a WGA perspective will be important when assessing the impact of the standards across government and the relevant sectors.

52. From a presentational perspective, WGA will need to explain the movements to opening balances and the impacts on profit or loss (and other comprehensive income) as a result of transitioning to the new standards. Understanding the movements will be key to forming the narrative for the publication.

53. The introduction of IFRS 9 and IFRS 15 further complicates the elimination of intra-government balances. The timing of revenue recognition may affect balances and revenue and expenditure may be recognised at different points by the bodies consolidated into WGA

## Next steps

54. As it stands no compelling case for adaptations or interpretations of IFRS 15 have been identified and existing accounting principles for non-exchange transactions remain appropriate. Further technical working group meetings will be held as necessary. A draft Exposure Draft will be circulated to the Board as an 'out of meeting' paper in advance of the June 2016 FRAB meeting. This will allow time for comments and views of members before a final Exposure Draft is put to the Board in June; enabling formal consultation over the summer of 2016 in line with the original timetable.

55. The communication strategy for the Exposure Draft (as recommended by the Board in November 2015) will be presented at the June 2016 meeting.

## Timing

56. No changes are expected to be made to the FReM until the 2018-19 financial year.

## Recommendation

57. HM Treasury ask that the Board note the amendments on IFRS 15, note the progress made and seek comments and views on the issues discussed and questions raised.

HM Treasury  
17 March 2016

## Annex A – FReM Extracts

### IAS 20 Accounting for Government Grants and Disclosure of Government Assistance Interpretations

(1) The option provided in IAS 20 to offset a grant for acquisitions of an asset against the cost of the asset has been withdrawn.

(2) The option provided in IAS 20 to defer grant income relating to an asset is restricted to income where the funder imposes a condition. Where assets are financed by government grant (not a grant from a sponsoring department to an NDPB) or donation (including lottery funding), the funding element is recognised as income and taken through the Statement of Comprehensive Net Expenditure. To defer this income, a condition imposed by the funder must be: a requirement that the future economic benefits embodied in the grant/donation are consumed as specified by the grantor/donor or must be returned to them, e.g. a grant that is conditional on the construction of an asset. Trading Funds, where they have the consent of the Relevant Authority, need not apply this interpretation.

(3) A grant, contribution or donated asset may be received subject to a condition that it be returned to the transferor if a specified future event does or does not occur (for example, a grant may need to be returned if the authority ceases to use the asset purchased with that grant for a purpose specified by the transferor). In these cases, a return obligation does not arise until such time as it is expected that the condition will be breached and a liability is not recognised until that time. Such conditions do not prevent the grant, contribution or donated asset being recognised as income in the Statement of Comprehensive Net Expenditure.

Chapter 8 provides application guidance on distinguishing between income and financing, the treatment of Supply, grants from UK government entities and the European Union, transactions with the Consolidated Fund

### **8.2 Consolidated Fund revenue**

8.2.1 This section deals with revenue (and some associated expenditure) collected by entities on behalf of the Consolidated Fund which by statute or convention are due to the Consolidated Fund and where the entity undertaking the collection is consequently acting as agent rather than principal.

#### **Taxes and duties**

8.2.2 Taxes and duties are economic benefits compulsorily payable to public sector entities, in accordance with laws and regulations established to provide revenue to the government, excluding fines or other penalties imposed for breaches of laws or regulations.

8.2.3 In preparing their financial statements, entities will not recognise or measure the “tax gap”. The “tax gap” is defined as the difference between the hypothetical amounts of revenues due, based on data on economic activity, and revenues receivable. Revenues receivable include both the tax yield from compliant taxpayers and estimates of amounts due from non-compliant, but known, taxpayers. Where taxes and duties are material, a statement should be included in the accounting policies note that the “tax gap” is not recognised in the financial statements.

8.2.4 Where taxes and duties are recognised on an accrual basis, they will be measured at the fair value of the consideration received or receivable, net of repayments. Revenue is recognised when a taxable event has occurred, the revenue can be measured reliably and it is probable that the economic benefits from the taxable event will flow to the collecting entity. All these elements are required to be satisfied.

8.2.5 Tax revenues are deemed to accrue equally over the period for which they are due. No revenue is recognised if there are significant uncertainties regarding recovery of the taxes due. The term "probable" means that the flow of revenue should be more likely than not to occur. Revenue should be accrued net of amounts not expected to be collected, which might be determined by reference to past trends in write-offs and remissions, the emerging position in-year, historical debt collection performance or by other appropriate means.

8.2.6 Where, exceptionally and with the consent of HM Treasury, taxes and duties are recognised on a cash basis, they will be recognised in the accounting period in which the tax is received by the entity and are measured at the cash amount received.

8.2.7 In the UK the main form of tax expense is personal tax credits. Tax credits are recognised in the Statement of Comprehensive Net Expenditure of the department which has responsibility for their payment. Where the financing required to fund tax credits may be deducted by statute from tax revenues collected before those revenues are remitted to the Consolidated Fund, the deduction and payment of these amounts is recorded in the trust statement as an appropriation of the revenue received.

#### **Fines and penalties**

8.2.8 Fines and penalties are economic benefits payable to government for breaches of laws or regulations where there is a statutory obligation to pay.

8.2.9 Fines and penalties are recognised at the time that the fine or penalty is imposed and becomes receivable by the entity. Where, on appeal, or for other legal reasons, the penalty is cancelled, the amount receivable is derecognised at the date of the successful appeal. Where a financial penalty is imposed, but with an alternative of a non-financial penalty, the financial penalty is recognised initially, but is derecognised if the option of the non-financial penalty is taken up.

8.2.10 Where fines and penalties are uncollectible or, for policy reasons, (other than the imposition of an alternative penalty), the entity decides that it is inappropriate to pursue collection, the amounts not collected are recorded as an expense. The amounts not collectible are estimated from the most appropriate data available to the entity