

ANNEX B

Understanding the public sector landscape: initial impact assessment of IFRS 15 *Revenue from Contracts with Customers*

1. IFRS 15 *Revenue from Contracts with Customers*⁷ supersedes IAS 18 *Revenue*, IAS 11 *Construction Contracts* and related IFRIC and SIC interpretations. IFRS 15 introduces a single 5 step process for the recognition and measurement of revenue:
 - Step 1: Identifying a contract with a customer;
 - Step 2: Identifying performance obligations;
 - Step 3: Identifying the transaction price;
 - Step 4: Allocating transaction prices to performance obligations; and
 - Step 5: Satisfaction of performance obligations.
2. The technical working group has identified that:
 - a. Views from the private sector are still evolving regarding implementation of IFRS 15 and concerns and issues are still being identified with guidance being sought from the IASB. IASB have issued a clarification to IFRS 15 exposure draft in July 2015, with consultation responses due October 2015.
 - a. Preparers should follow the output from IASB/FASB Joint Transition Resource Group for Revenue Recognition (TRG)⁸ about potential implementation issues that could arise.
 - b. There was greater scope for judgement under IAS 18, whereas IFRS 15 is a significantly larger standard with detailed criteria and application guidance. As a result, the level of implementation required by entities is likely to be extensive.
 - c. Under IAS 18, revenue is recognised when the risks and rewards are transferred whereas under IFRS 15, it is at the point of control passing. Furthermore, IFRS 15 requires this assessment to be undertaken for each performance obligation within the contract. This may impact on the timing of revenue recognition.

Step 1: Identifying a contract with a customer

⁷ See the CIPFA November 2014 paper to the FRAB on the requirements of IFRS 15:
https://www.gov.uk/government/uploads/system/uploads/attachment_data/file/389078/FRAB__122__04_-_IFRS_15.pdf

⁸ <http://www.ifrs.org/About-us/IASB/Advisory-bodies/Joint-Revenue-Transition-Resource-Group/Pages/Home.aspx>

3. IFRS 15 applies to all contracts with customers except for those that are within the scope of other IFRSs, for example, leases (IAS 17 *Leases*); insurance contracts (IFRS 4 *Insurance Contracts*); and financial instruments (IFRS 9 *Financial Instruments*).
4. In order for a contract to be within the scope of IFRS 15, all of the following criteria must be met:
 - b. The parties have approved the contract (in writing, orally or in accordance with their customary business practices) and are committed to perform their respective obligations;
 - c. The entity can identify each party's rights regarding the goods and services to be transferred;
 - d. The entity can identify the payment terms;
 - e. The contract has commercial substance (i.e. the risk, timing or amount of the entity's future cash flows is expected to change as a result of the contract; and
 - f. It is probable the entity will collect the consideration to which it will be entitled to.
5. IFRS 15 offers criteria to recognise revenue where there are no contracts with customers but consideration is received. The standard requires there to be a) no further performance obligations to transfer goods or services or b) the contract is terminated. Under both (a) and (b) above the consideration is non-refundable.
6. The technical working group has identified:
 - a. In some cases it may be difficult to identify if there is a customer or a contract in the public sector context.
 - b. There are significant levels of exchange and non-exchange transactions between departments and other public bodies and all should consider the extent to which IFRS 15 will apply in these situations.
 - c. The concern around the extent to which the receipt of revenue is due to a willing agreement by the customer versus being mandated to pay through statutory means and how IFRS 15 may apply in these situations.
 - d. Some concerns around the interaction of the requirements of Managing Public Money (MPM) for the setting of fees and charges and with IFRS 15.
 - e. There may be audit implications for any contracts that are not formal or written but based on verbal or customary practices and so departments should begin engaging with the NAO early enough to mitigate issues during the year end audit process.

7. Do you have any examples of where consideration is received for where there are no performance obligations? If so, how material are they to your department? How many can be considered to be as a result of statutory obligations?
8. Do you foresee there being an impact on fees and charges requirements per MPM and the introduction of IFRS 15? If so, why and how material is the impact to your department? What alternative do you propose? If not, why not?

Step 2: Identifying performance obligations

9. IFRS 15 introduces a concept of identifying performance obligations which are promises in a contract to transfer goods or services that are distinct. In determining whether a good or service is distinct, an entity needs to consider if the customer can benefit from the good or service on its own or together with other resources that are readily available to the customer. An entity also needs to consider whether the promise to transfer the good or service is separately identifiable from other promises. If a promised good or service is not distinct, an entity is to combine that good or service with other promised goods or services until it identifies a bundle of goods or services that is distinct. The recognition of revenue will be based on the satisfaction of these individual performance obligations.
10. Do you foresee any difficulties in identifying distinct performance obligations in your contracts with customers? If so, why? If not, why not?

Step 3: Identifying the transaction price

11. The transaction price is the amount of consideration to which an entity expects to be entitled in exchange for transferring promised goods or services to a customer. The transaction price is determined under the terms of the contract and the entity's customary business practices.
12. The transaction price may be a fixed amount of consideration or include estimates of consideration that is variable or consideration in a form other than cash. Some or all of the estimated amount of variable consideration is included in the transaction price only to the extent that it is highly probable that a significant reversal in the amount of cumulative revenue recognised will not occur when the uncertainty associated with the variable consideration is subsequently resolved. Adjustments to the transaction price are also made for the effects of financing (if significant to the contract) and for any consideration payable to the customer.
13. Do you foresee any difficulties in identifying the transaction price for your contracts? If so, why? If not, why not?

Step 4: Allocating transaction prices to performance obligations

14. IFRS 15 requires the transaction price to be allocated to each performance obligation (or distinct good or service) in an amount that depicts the amount of

consideration to which the entity expects to be entitled in exchange for transferring the promised goods or services to the customer

15. An entity is required to allocate the transaction price to each performance obligation on the basis of the relative stand-alone selling prices of each distinct good or service. If a stand-alone selling price is not observable, the entity is required to estimate it. IFRS 15 details examples of methodologies an entity could use to determine the stand-alone price.
16. The transaction price may include a discount or a variable amount of consideration that relates entirely to a specific part of the contract. The requirements specify when an entity should allocate the discount or variable consideration to a specific part of the contract rather than to all performance obligations in the contract.
17. The technical working group has identified:
 - a. There are likely to be more contracts within the public sector where the department is the sole market provider compared with private sector organisations. This may cause difficulties in establishing a stand-alone price for each distinct good or service.
 - b. There may be difficulties in applying the transaction price particularly to complex projects and Private Finance Initiatives (PFIs) as the public sector usually incurs expenditure and not income.
18. Do you foresee any difficulty in allocating transaction prices to performance obligations within your department? If so, why? If not, why not?
19. Do you foresee any difficulty in producing auditable evidence to support the transaction price allocation? If so, why? If not, why not?

Step 5: Satisfaction of performance obligations

20. IFRS 15 requires revenue to be recognised when (or as) it satisfies a performance obligation by transferring a promised good or service to a customer (which is when the customer obtains control of that good or service).
21. For satisfaction over time, IFRS 15 specifies 1 of the following criteria needs to be met:
 - a. The customer simultaneously receives and consumes the benefits provided;
 - b. The entity's performance creates or enhances an asset that the customer controls as it is being created or enhanced; or
 - c. The entity's performance does not create an asset with an alternative use to the entity and the entity has an enforceable right to payment for performance completed to date.

22. If an entity does not satisfy a performance obligation over time, the performance obligation is satisfied at a point in time. For a performance obligation satisfied over time, an entity is required to select an appropriate single method of measuring of progress to determine how much revenue should be recognised as the performance obligation is satisfied.
23. Does step 5 above significantly alter the revenue profile of your department? If so, how material will this change be to your department?
24. Do you foresee there being any significant impact on the accounting for intra-group and/or intra-government transactions (particularly with the WGA consolidation in mind)? If so why, if not why not?

Disclosures

25. IFRS 15 requires disclosures to understand the nature, amount, timing and uncertainty of revenue and cash flows arising from contracts with customers. Entities will be required to disclose:
- a. Revenue recognised from contracts with customers, including the disaggregation of revenue into appropriate categories;
 - b. Contract balances, including the opening and closing balances of receivables, contract assets and contract liabilities;
 - c. Performance obligations, including when the entity typically satisfies its performance obligations and the amount of the transaction price that is allocated to the remaining performance obligations in a contract;
 - d. Significant judgements, and changes in judgements, made in applying the requirements; and
 - e. Assets recognised from the costs to obtain or fulfil a contract with a customer.
26. These disclosures are similar to those already required under IAS 11.
27. The technical working group has noted that the standard as a whole adds to the quantum and detail of disclosures required for revenue recognition. However, section 1.2 of the FReM states "In accordance with IAS 1 *Presentation of Financial Statements*, applying the concept of materiality means that a specific disclosure requirement in a Standard or in an Interpretation need not be satisfied if the information is not material (disclosures should be limited to those necessary for an understanding of the entity's circumstances)".
28. Are there any disclosure requirements in the standard which you believe are not applicable to the public sector? If so why, and what alternatives do you propose? If not why not?

29. Do you have any comments on the disclosure requirements from a departmental perspective but also considering implications across the public sector for reporting entities and for facilitating the WGA consolidation?

Transition Arrangements

30. IFRS 15 is to be applied retrospectively, subject to some transitional reliefs in particular circumstances. There are 2 high level options for transition to IFRS 15⁹:

Option 1: Retrospection application with restatement

31. Prior periods may be restated if it is possible to do so without the use of hindsight. If an entity restates prior periods, the restated financial statements must exhibit all the requirements of IFRS 15. The standard does allow the use of some practical expedients for contracts that are completed under IAS 11 or IAS 18 at the point of transition and some disclosure exemptions.
32. Disclosures will be required in accordance with IAS 8 *Accounting Policies, Changes in Accounting Estimates and Errors*. If any practical expedients are used, entities will be required to disclose which practical expedients have been used and, to the extent reasonably possible, a qualitative assessment of the estimated effect of applying each of the practical expedients.

Option 2: Retrospective application with no restatement

33. If an entity elects not to restate comparative periods, quantification of adjustments is still necessary in order to determine the transition adjustments in the opening balances in reserves/other components of equity, as appropriate; the difference between the previous carrying amounts and the new carrying amounts is recorded in the opening balances of the annual period including the initial application date.
34. Additional disclosures are required with this option and consist of:
- a. The amount by which each financial statement line is affected in the current reporting period by the application of the standard as compared to IAS 11, IAS 18 and related interpretations that were in effect before the change; and
 - b. An explanation of the reasons for significant changes identified in the above.
35. It should be noted that entities will be required to calculate the restated amounts for the prior period comparatives regardless of which method of transition is adopted.

⁹ See HM Treasury's June 2015 paper to the FRAB on the transition arrangements and considerations of IFRS 9:
https://www.gov.uk/government/uploads/system/uploads/attachment_data/file/448936/FRAB_124__05__IFRS_9_-_transition_arrangements.pdf

36. In order to improve consistency across the public sector and to better facilitate the consolidation of public sector entities within the Whole of Government Accounts (WGA), HM Treasury propose the following 'blanket' approach to be applied across the public sector in relation to transition: **Option 2 - Retrospective application with no restatement.**
37. The technical working group has identified:
- a. There may be difficulties in fully restating where public sector bodies have complex long term contracts.
 - b. For departments the difference between restated and non-restated figures may not be material and therefore the additional work required to prepare restated financial statements may not be necessary. Furthermore, not restating may be more efficient to implement at a group level where there are a significant levels of components to be consolidated.
 - c. Preparers should be considering the cost and time implications of introducing IFRS 15 as well as considering the level of preparatory work, systems and processes required.
38. Do you agree with the proposed transition approach above, and applying in across the public sector, and what impact will it have on your department? If you agree, why? If not, why not, and what alternatives do you propose?

Budgets and Estimates

39. The new standard may affect the timing of revenue reported in budgets and Estimates. Dependent on the performance obligations identified and the satisfaction criteria adopted, departments may see revenue being recognised earlier or over multiple periods causing an impact to DEL. The technical working group highlighted this may be particularly noticeable for revenue arising from work in progress.
40. Do you foresee a significant impact on your department's budget and Estimate from applying the satisfaction of performance obligations' criteria to recognise revenue over time or at a point in time? If so, why? If not, why not?
41. Does your department undertake work in progress which is material to your budget and resource accounts? Do you foresee there being a significant issue in applying IFRS 15 for revenue arising from work in progress?
42. Do you have any other comments relating to the resulting impact on budgets and Estimates following implementation of IFRS 15?

Current guidance within the FReM

43. The FReM does not provide adaptations or interpretations for IAS 18. The FReM currently provides guidance for revenue (and some associated expenditure) collected by entities on behalf of the Consolidated Fund, either by statute or convention, and where the entity undertaking the collection is consequently acting as agent rather than as principal:
- a. Taxes and duties: to recognise taxes 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; and
 - b. Fines and penalties: to recognise fines and penalties at the time that the fine or penalty is imposed and becomes receivable by the entity. Where on appeal or for legal reasons the penalty is cancelled, the amount receivable is derecognised at the date of 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. 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.
44. HM Treasury proposes to retain the above guidance when implementing IFRS 15.
45. Do you agree the above guidance remains appropriate due to the nature of this type of revenue within the public sector context? If so why, if not why not and what alternative do you propose?
46. Does your department have any revenue from contracts with customers that are classed as taxes by the ONS? How material are they to your department?
47. Are there any other interpretations and/or adaptations you believe are required to be included in the FReM due to the introduction of IFRS 15 in the public sector?

Implementation timetable

48. HM Treasury is proposing and working to the following timetable for implementation of IFRS 15¹⁰:

November 2015	Update paper to be presented to the FRAB on the progress of the technical working group and feedback from the initial public sector consultation exercise.
2016	Exposure Draft for wider consultation on the impact of IFRS 15.

¹⁰ See the relevant authorities' March 2015 paper to the FRAB on the work plan for implementation of IFRS 15:
https://www.gov.uk/government/uploads/system/uploads/attachment_data/file/427697/FRAB_123_03_IFRS_15_Revenue_from_contracts_with_customers.pdf

Spring 2017	Further opportunity to consider any adaptations, interpretations or guidance.
June 2017	FRAB meeting for further consideration if needed. Consider FReM (2017-18 and 2018-19).
Summer 2017	Opportunity to amend FReM extract if needed.
November 2017	FRAB meeting to approve FReM (2017-18 and 2018-19).
December 2017	Final 2017-18 FReM published. Initial publication of 2018-19 FReM.
January 2018	IFRS 9 implementation date.
2018-20	UK public sector implementation of IFRS 15.
December 2018	Final 2018-19 FReM published.

49. Do you agree with the proposed implementation timetable and effective date for IFRS 15 in the public sector? If so, why? If not, why not and what alternative do you propose?

50. IFRS 9 and IFRS 15 are both currently timetabled to be implemented in 2018-19. How significant will the implementation of both standards at the same time be to your department and why?

51. Do you consider that there will be any other particular application issues not raised in any questions above?