



Clarifications to HKFRS 15 Revenue from Contracts with Customers

HKICPA Standard Setting Department Staff Summary (June 2016)

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Introduction

1. *Clarifications to HKFRS 15* is the equivalent of *Clarifications to IFRS 15 Revenue from Contracts with Customers* issued by the International Accounting Standards Board (IASB).
2. *Clarifications to HKFRS 15* addresses implementation issues that were discussed by the Joint Transition Resource Group (TRG) for Revenue Recognition created by the IASB and US Financial Accounting Standards Board (FASB). The objective of these amendments is to clarify the IASB's intentions when developing the requirements in IFRS 15 but not to change the underlying principles of IFRS 15.
3. The amendments do not change the effective date of HKFRS 15 and therefore are effective for annual reporting periods beginning on or after 1 January 2018. Early application continues to be permitted.

Reasons for issuing *Clarifications to HKFRS 15*

4. The IASB and the FASB formed the TRG to support the implementation of the new revenue standard. The substantial majority of the issues discussed by the TRG were resolved without the need for standard-setting activity. However, the TRG's discussions on five topics indicated potential differences of views on how to implement the requirements and, therefore, were considered by the boards. Those topics were:
 - identifying performance obligations;
 - principal versus agent considerations;
 - licensing;
 - collectability; and
 - measuring non-cash consideration.



5. The boards also received requests from some stakeholders for practical expedients in respect of the following:
 - (a) accounting for contract modifications that occurred before transition to IFRS 15;
 - (b) for entities electing to use the full retrospective transition method, accounting for a contract completed under previous revenue standards before transition to IFRS 15; and
 - (c) assessing whether a sales tax (or similar tax) is collected on behalf of a third party.
6. The boards discussed the five topics and the possible practical expedients, and each board decided to make amendments to clarify the requirements in its own new revenue standard. As a result, the IASB issued *Clarifications to IFRS 15* in April 2016 making targeted amendments to IFRS 15 with respect to three of the five topics considered—identifying performance obligations, principal versus agent considerations and licensing. The IASB concluded that it was not necessary to amend IFRS 15 with respect to the other two topics—collectively and measuring non-cash consideration. In respect of the practical expedients, the IASB provided transition relief for modified contracts and completed contracts.
7. The IASB and the FASB have not agreed on the nature and extent of all of the changes to their respective revenue standard. In light of this, 'Appendix A: Comparison of IFRS 15 and Topic 606'¹ of the Basis for Conclusions to IFRS 15/HKFRS 15 outlines when different outcomes may arise as a consequence of the different decisions made by the boards.

Main features of *Clarifications to HKFRS 15*

Identifying performance obligation

8. HKFRS 15 requires an entity to identify performance obligations on the basis of distinct promised goods or services. The amendments clarify the principle and the factors that indicate when two or more promises to transfer goods or services are not separately identifiable within the context of a contract.
9. The amendments are intended to convey that an entity should evaluate whether its promise, within the context of the contract, is to transfer each good or service individually or a combined item (or items) that comprises the individual goods or services promised in the contract. Therefore, entities should evaluate whether the promised goods or services in the contract are outputs or, instead, are inputs to a combined item (or items).

Principal versus agent considerations

10. HKFRS 15 requires an entity to determine whether it is a principal or an agent in a transaction in which another party is involved in providing goods or services to a customer by evaluating the nature of its promise to the customer.

¹ The new revenue standard issued by the FASB is Topic 606 introduced by Accounting Standards Update 2014-09 *Revenue from Contracts with Customers*.

11. The amendments clarify that:
- the unit of account for the principal versus agent evaluation is the specified good or service, which is a distinct good or service (or a distinct bundle of goods or services). Depending on the circumstances, a specified good or service may be the underlying good or service (e.g. a flight, a meal) or a right to an underlying good or service to be provided by another party (e.g. a ticket, a voucher);
 - an entity is a principal if it controls the promised good or service before transferring it to the customer. An entity is an agent if its role is to arrange for another entity to provide the good or service. The amendments also explain how to apply the control principal in relation to services; and
 - the indicators are not an exhaustive list and merely support the assessment of control—they do not replace or override that assessment. The amendments reframe the indicators to focus on evidence that an entity is acting as a principal rather than an agent.

Licensing

12. HKFRS 15 requires that when an entity grants a licence to a customer that is distinct from other promised goods or services, the entity has to determine whether the licence is transferred at a point in time or over time on the basis of whether the contract requires the entity to undertake activities that significantly affect the intellectual property to which the customer has rights.
13. The amendments clarify that the activities significantly affect the intellectual property if they:
- (a) change the form or the functionality of the intellectual property; or
 - (b) affect the ability of the customer to obtain benefit from the intellectual property.
14. The amendments also clarify that the sales-based or usage-based royalty exception (i.e. the royalty constraint) is applied to the overall royalty stream when the predominant item to which the royalty relates is a licence of intellectual property.

Transition relief

15. The amendments added two practical expedients to HKFRS 15 to alleviate the transition burden of accounting for completed contracts and contracts that were modified prior to adoption under both transition approaches (i.e. full and modified retrospective).
16. Completed contracts: The new practical expedient will allow an entity that uses the full retrospective approach to only apply HKFRS 15 to contracts that are not completed as at the beginning of the earliest period presented. HKFRS 15 already allowed a similar accounting treatment for entities that choose to use the modified retrospective approach.
17. Contract modifications: The new practical expedient will allow an entity, under either transition approach, 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. However, entities applying



the modified retrospective approach could apply this expedient to all modifications that occurred between contract inception and the date of initial application, instead of the earliest date presented. An entity will be able to use hindsight to identify the satisfied and unsatisfied performance obligations and to determine the transaction price to allocate to those performance obligations. An entity that chooses to apply this practical expedient will be required to apply it to all contracts with similar characteristics.

Other references

1. Deloitte IFRS in Focus
<http://www.iasplus.com/en/publications/global/ifrs-in-focus/2016/ifrs-15-clarifications>
2. EY IFRS Developments: IASB issues clarifications to IFRS 15
[http://www.ey.com/Publication/vwLUAssets/IFRS_Developments_Issue_119:_IASB_issues_clarifications_to_IFRS_15/\\$File/Devel119-Rev-Apr2016.pdf](http://www.ey.com/Publication/vwLUAssets/IFRS_Developments_Issue_119:_IASB_issues_clarifications_to_IFRS_15/$File/Devel119-Rev-Apr2016.pdf)
3. KPMG – First Impressions: IFRS 15 (2016 edition)
<https://home.kpmg.com/content/dam/kpmg/pdf/2016/04/first-impressions-revenue-IFRS15-apr16.pdf>
4. IASB project page – Clarifications to IFRS 15
<http://www.ifrs.org/Current-Projects/IASB-Projects/Clarifications-IFRS-15-Issues-from-TRG-discussions/Pages/default.aspx>
5. PricewaterhouseCoopers – In Brief: IASB issues amendment to IFRS 15
<https://inform.pwc.com/inform2/content?action=resource&id=0000018662990430.pdf>

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