Hong Kong Institute of
Certified Public Accountants
香港會計師公會

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Sent electronically through the IASB Website (www.ifrs.org)

26 October 2023

Dr Andreas Barckow
International Accounting Standards Board
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Canary Wharf
London E14 4HD
United Kingdom

Dear Andreas,

IASB Request for Information
Post-implementation Review of IFRS 15 Revenue from Contracts with Customers

The Hong Kong Institute of Certified Public Accountants (HKICPA) is the only body authorised by law to set and promulgate standards relating to financial reporting, auditing, ethics and sustainability disclosures for professional accountants in Hong Kong. We are grateful for the opportunity to provide our comments on this Request for Information (RFI).

Overall, we consider that IFRS 15 has achieved its objectives. It provides a logical model for applying accounting principles to transactions and assists entities in determining accounting treatments in a comprehensive and systematic manner. Nevertheless, we have identified application issues relating to certain aspects of the requirements that warrant the IASB's further consideration. We provide detailed comments in the Appendix, and summarize our primary comments and recommendations below.

<u>Principal versus agent assessment</u>
Our respondents noted that entities often assess whether they are a principal or an agent based solely on the indicators in IFRS 15.B37 and overlook the concept of control. They also commented that assessing whether an entity controls the specified good or service before that good or service is transferred to the customer can be judgmental and challenging in practice, especially for transactions involving intangible or non-physical items, "flash title" contracts or provision of services. They considered that the indicators in IFRS 15.B37 are more applicable to physical goods.

Considering that the assessment of principal versus agent has been a long-standing issue, and that new forms of operation, such as digital platforms, have introduced additional challenges, we recommend that the IASB incorporate the key messages in BC385H into the body of the Standard to emphasize that the indicators were included to support an entity's assessment of whether it controls a specified good or service before transfer but they should not override the assessment of control. Furthermore, we recommend the IASB add indicators in IFRS 15.B37 to assist entities in performing the control assessment for intangible or service-based transactions and provide examples to illustrate the application of the concept of control.

<u>Non-cash consideration</u>
Non-cash considerations (including in some cases consideration payable to a customer), such as shares and warrants, have become increasingly common after IFRS 15 became effective and their impact could be significant, particularly in light of the current volatile

market. However, there is a lack of guidance on the following areas:

(a) Measurement date
Entities currently adopt different approaches regarding the measurement date of non-cash consideration. They measure it either at contract inception, when the non-cash consideration is received, or when the related performance obligation is satisfied. The timing difference between these dates may have a significant impact on the measurement of non-cash consideration. We consider that the requirement of Topic 606 in US GAAP, which requires entities to measure non-cash consideration at contract inception, is consistent with other requirements in IFRS 15 for determining the transaction price and for allocating the transaction price to performance obligations, and is less complex to apply in practice. Accordingly, we recommend the IASB reference Topic 606 to address this issue which would have the added benefit of enhancing convergence with US GAAP.

(b) Subsequent changes in measurement of non-cash consideration
There is diversity in practice in the accounting for subsequent changes in measurement of non-cash consideration. Specifically, it is unclear whether it should be accounted for as variable consideration under IFRS 15 or under other applicable IFRS Accounting Standards, such as IFRS 9 *Financial Instruments*. Questions arise as to whether the variable consideration requirements in IFRS 15 apply in circumstances where the changes in the fair value of non-cash consideration relate to both the form of consideration and other reasons. We acknowledge that determining how to allocate fair value changes between those due to the form of the consideration and changes for other reasons could be challenging in practice. In this regard, we recommend the IASB provide guidance on how to account for the changes in the fair value of non-cash consideration that relate to both the form of consideration and other reasons, and expand the existing Example 31 on non-cash consideration to illustrate the relevant requirements.

Determining the transaction price
We noted several application issues regarding the determination of transaction price and recommend the IASB clarify how the relevant requirements in IFRS 15 should be applied. These issues include:
- How should an agent account for marketing incentives paid to end customers in three-way arrangements?
- How should consideration payable to a customer be accounted for if it exceeds the amount of consideration expected to be received from the customer? and
- How would an entity that is a principal estimate the amount of revenue to recognize if it were not aware of the amounts being charged to end customers by the agent?

If you have any questions regarding the matters raised in this letter, please contact Katherine Leung (katherineleung@hkicpa.org.hk), Associate Director or Sam Chan (samkcchan@hkicpa.org.hk), Manager of the Standard Setting Department.

Sincerely,

Cecilia Kwei

Cecilia Kwei
Director of Standard Setting

Work undertaken by the HKICPA in forming its views:

The HKICPA:

(a) issued an Invitation to Comment on the RFI on 30 June 2023 to its members and other stakeholders;

(b) sought input from its Revenue Recognition Advisory Panel, Small and Medium Practices Committee and its Technical Issues Support Group, which mainly comprise technical and industry experts from large as well as small and medium accounting firms (collectively, Practitioners);

(c) held a public roundtable discussion for local stakeholders, including Practitioners and preparers on 13 September 2023;

(d) reviewed the findings from regulators' reports focusing on the requirements in IFRS 15; and

(e) developed its views through its Financial Reporting Standards Committee, having reflected on its respondents' views. The Committee comprises preparer representatives from various industry sectors, regulators, as well as technical and industry experts from small, medium and large accounting firms.

Detailed comments on the IASB RFI

Question 1 - Overall assessment of IFRS 15

1. We considered that IFRS 15 is an improvement on legacy IFRS and has achieved its objectives. The core principle of IFRS 15 and the five-step model are helpful in making revenue accounting decisions. However, there are certain aspects of the requirements that remain unclear, and additional guidance would be helpful in enhancing consistent application of the requirements. Please refer to our responses below for areas where additional guidance is needed.

Question 3 - Determining the transaction price

A. Marketing incentives to end customers

2. Our respondents shared the same comments as stated in spotlight 3 of the RFI that there is a lack of guidance in identifying an entity's customers when applying the requirements for consideration payable to a customer (CPC). Specifically, in three-way arrangements where an entity, acting as an agent, pays a marketing incentive to the principal's end customers, there are mixed views as to whether the reporting entity's (agent) customers include the principal's end customers outside the distribution chain, and therefore whether such marketing incentive would fall within the scope of CPC and be accounted for as a reduction of revenue.

3. On the one hand, the guidance in IFRS 15.70 seems to imply that CPC refers to payments to customers in the distribution chain only. On the other hand, BC255 mentions the concept of "customer's customer" and provides *an example* where an entity may sell a product to a dealer or distributor and subsequently pay a customer of that dealer or distributor. Some respondents considered that payments to customers of a distributor are only *an example* of a "customer's customer" and that the term "customer's customer" could be interpreted more broadly.

4. It is very common for an agent to provide incentives (e.g. coupons, cash rebates) to the principal's customers who are not purchasing the agent's goods or services (i.e. not in the distribution chain), e.g. a digital platform offers incentives to end customers who order food or taxi services through the platform. In many cases,

these incentives are neither part of the contract with the principal nor a promise made explicitly or implicitly to the principal, although the principal may be aware of these incentives. It is not clear whether such incentives which are intended to increase the volume of transactions on which the agent earns its agency fee should be accounted for as CPC (i.e. reductions of revenue) or as marketing expense.

5. We noted that the Transition Resource Group (TRG) had made relevant discussions on this matter. In particular, TRG Agenda No. 44 paragraphs 14-15 discussed that an entity's customers include those in the distribution chain and may include a customer's customer outside the distribution chain. In light of the above, we recommend that the IASB further explore the TRG discussions to provide guidance on the factors to consider in identifying an entity's customers in relation to the requirements for CPC.

B. "Negative" revenue

6. Our respondents (most notably the banking industry) noted that there is a lack of guidance on how to account for CPC if it exceeds the amount of consideration expected to be received from the customer. For example, in the credit card business, it is common for banks to offer marketing incentives to cardholders, who are considered as customers by most banks. The amount of marketing incentives offered to the cardholders in one promotion campaign could exceed the revenue generated by the specific transactions in the campaign. Some entities present it as "negative" revenue while others reclassify that excess as an expense. Some entities also questioned whether "negative revenue" should be assessed on a customer basis instead of on a transaction basis given the business rationale for the incentives is to promote the cardholders' spending for the whole period of the credit card contract.

7. We noted that a similar question was previously raised in the IFRS Interpretations Committee (IC) Agenda Decision on *Compensation for Delays or Cancellations* regarding whether the amount of compensation recognized as a reduction of revenue is limited to reducing the transaction price to nil. However, the IC did not address this question. In this regard, we recommend the IASB clarify:
   i. how to determine the unit of account for assessing whether there is negative revenue, for example, whether it is assessed on a transaction basis, customer basis or other basis; and
   ii. how should entities present the excess amount, whether as negative revenue or as an expense.

C. Determining amount of consideration to be recognized as a principal

8. Several respondents commented that it is challenging for the principal to estimate the amount being charged to end customers by an intermediary (i.e. agent) in determining the amount of consideration it recognizes. As a result, some entities have included an estimated amount in the consideration based on market observations (e.g. prices charged and discounts offered by platform operators in the market), while others have not done so due to practical difficulties, particularly in cases where discounts or rebates provided by the intermediaries are discretionary and dependent on negotiations with individual end customers, or the principal is dealing with multiple agents in different regions.

9. In addition, some entities consider that the intermediary acts as the agent of the end customer, and argue that the intermediary and the end customer are of "one customer group". Consequently, they only recognize the amount received directly

from the intermediary as revenue and do not estimate the amount received from end customers by the intermediary. This results in diversity in practice.

10. To address this issue, some respondents suggested the IASB consider:
    i. providing a practical expedient for entities to exclude the amount that is not expected to be ultimately resolved (i.e. the difference between the amount to which the entity is entitled from the intermediary and the amount charged by the intermediary to the end customer) from the transaction price with reference to Topic 606[1]; and
    ii. clarifying whether the argument of "customer group" justifies the accounting treatment.

11. We noted that this issue was considered by the IASB when it developed IFRS 15 (refer to BC385X-BC385Z). At that time, the IASB concluded that this issue was expected to affect a limited number of entities and contracts and so did not require any clarifications or additional guidance. Nevertheless, we noted that this issue is increasingly prevalent among the advertising and gaming industries where the advertising agencies or platform operators (i.e. the intermediaries) choose not to disclose to the principal how much they have received from end customers for commercial reasons. Therefore, the principal could only recognize the amount it expects to receive from the intermediary because it is difficult to estimate the amount paid by the end customers. In view of the practical challenges, we recommend the IASB consider our respondents' suggestions in paragraph 10 to address this issue.

D. Non-cash consideration

12. Several respondents commented that non-cash considerations (including in some cases consideration payable to a customer), such as shares and warrants, are pervasive nowadays but there is a lack of guidance on the following areas:

Measurement date of non-cash consideration

13. Entities currently adopt different approaches regarding the measurement date of non-cash consideration. They measure it either at contract inception, when the non-cash consideration is received, or when the related performance obligation is satisfied. The timing difference between these dates may have a significant impact on the measurement of non-cash consideration.

14. We noted from BC254E that the IASB had considered this issue when it developed IFRS 15. The IASB acknowledged that IFRS 15 does not contain any specific requirements about the measurement date for non-cash consideration for revenue transactions. However, the IASB did not address this issue at that time considering that any practical effect of different measurement dates would arise in only limited circumstances.

15. Nevertheless, as noted from our outreach activities, non-cash considerations have become increasingly common after IFRS 15 became effective and their impact could be significant, particularly in light of the current volatile economic landscape. We consider that the requirement of Topic 606, which requires entities to measure non-cash consideration at contract inception, is consistent with the requirements in

[1] BC38(c) of Accounting Standards Update No.2016-08 states that when the uncertainty in the transaction price is not expected to be ultimately resolved, the difference between the amount to which the entity is entitled from the intermediary and the amount charged by the intermediary to the end customer is not variable consideration and, therefore, is not part of the entity's transaction price.

IFRS 15 for determining the significant financing component in the transaction price (IFRS 15.64) and for allocating the transaction price to performance obligations based on stand-alone selling prices (IFRS 15.76), and is less complex to apply in practice. Therefore, we recommend the IASB provide guidance on this matter with reference to Topic 606 which would also enhance convergence therewith.

Subsequent changes in measurement of non-cash consideration

16. There is diversity in practice in the accounting for subsequent changes in measurement of non-cash consideration, specifically whether it should be accounted for as variable consideration under IFRS 15, or under other applicable IFRS Accounting Standards, such as IFRS 9 *Financial Instruments*.

17. IFRS 15.68 states that the variable consideration requirements in IFRS15.56-58 are applied if the fair value of the non-cash consideration varies for reasons other than only the form of the consideration. It is well understood that changes in the fair value of non-cash consideration that are due to the form of the consideration are not subject to the constraint on variable consideration. Non-cash consideration that is variable for reasons other than the form of the consideration is included in the transaction price and is subject to the constraint on variable consideration. However, it is not clear whether the variable consideration requirements apply in circumstances where the change relates to both the form of consideration and other reasons.

18. We noted that the TRG (TRG Agenda No.25 Topic 4 paragraphs 25-28) had discussed this issue and Topic 606 specifies that the constraint on variable consideration applies only to variability in the fair value of the non-cash consideration that arises after contract inception for reasons other than the form of the consideration.

19. We acknowledge that determining how to allocate fair value changes between those due to the form of the consideration and changes for other reasons could be challenging in practice. In this regard, we recommend the IASB provide guidance on how to account for the change relates to both the form of consideration and other reasons, with reference to the materials in paragraph 18 above, and expand its existing Example 31 on non-cash consideration in IFRS 15 to illustrate the relevant requirements.

Question 4 - Determining when to recognize revenue

20. We considered that there is a lack of guidance in determining the timing of revenue recognition for an agent when the end customer has an unconditional right to return the goods or services facilitated by the agent. If the end customer exercises the right of return, the agent would not be entitled to any commission. It is not clear whether the agent can apply IFRS 15.B21 to treat the contingent commission as variable consideration or it should recognize the commission revenue only when the right of return expires. Accordingly, we recommend the IASB provide clarification on the timing of revenue recognition by an agent when the end customer has a right of return.

Question 5 - Principal versus agent considerations

21. Our respondents noted that entities often assess whether they are a principal or an agent based solely on the indicators in IFRS 15.B37 and overlook the concept of control. They also commented that it is judgmental and challenging in applying IFRS

15.B34A in assessing whether an entity controls the specified good or service before that good or service is transferred to the customer in the following cases:

i. transactions involving intangibles or non-physical items in which the entity does not have physical possession of the goods, e.g. online games, mobile applications and digital e-books are sold to end customers through online retailers.
ii. "flash title" contracts, e.g. the reporting entity contracts with a supplier to provide goods or services through the reporting entity's sales channels to its customers; or where the legal title/ownership of the goods vests in a trading company for a very short time (such as a few hours or a day) before the goods are transferred to the end customers; and
iii. provision of services, e.g. online car hailing platform where the entity does not bear any front-end inventory risk (i.e. no commitment to buy, no advance payment or no prepaid deposit before a customer places an order).

22. We agree that transactions involving intangibles or non-physical items, as well as provision of services, are widespread. We also acknowledge that the indicators in IFRS 15.B37 are more applicable to physical goods. Considering that the assessment of principal versus agent has been a long-standing issue, and that new forms of operation, such as digital platforms, have introduced additional challenges, we strongly recommend the IASB:

i. incorporate the key messages in BC385H into the body of the Standard to emphasize that the indicators in IFRS 15.B37 were included to support an entity's assessment of whether it controls a specified good or service before transfer but they should not override the assessment of control.
ii. add other indicators in IFRS 15.B37 to help entities perform the assessment. These indicators include the discretion of an entity in supplier selection or the involvement of the entity in the determination of product or service specifications. We consider that these indicators are helpful in explaining further the existing indicator of "primarily responsible for fulfilling the promise" in IFRS 15.B37(a). For transactions involving non-physical goods or services, the commitment of an entity to pay for certain services or non-refundable advance payments made to the suppliers may also indicate that the entity is exposed to certain risks before the specified service or good is transferred to a customer.
iii. provide illustrative examples on the fact patterns in paragraph 21 above in assessing the concept of control. In particular, in relation to "flash title" contracts, IFRS 15.B35 states that an entity does not necessarily control a specified good if the entity obtains legal title to that good only momentarily before legal title is transferred to a customer. We suggest the IASB incorporate this guidance when it develops illustrative examples on "flash title" contracts.

Question 6 - Licensing

A. Accounting for licence renewals

23. We noted that there is diversity in practice in the timing of revenue recognition for licence renewals. Some entities recognize revenue when the renewal period starts, while others recognize revenue when the renewal is agreed upon based on the justification that the customer already controls the license, and renewing it merely changes an attribute of the license that has already been transferred to the customer previously. So entities recognize revenue for the licence renewals when the renewal is agreed upon.

24. Though the issue of licence renewals are not common in Hong Kong and Mainland China, we suggest the IASB consider providing guidance on the timing of revenue recognition for licence renewals by making reference to Topic 606, which requires entities to recognize revenue no earlier than the beginning of the renewal period, to address the diversity in practice and enhance convergence with Topic 606.

B. Sales-based or usage-based royalty exception

25. We noted that IFRS 15.B63 does not specify whether the sales-or usage-based royalty exception is applicable to the principal only or to both the principal and the agent. Accordingly, we recommend the IASB clarify whether an agent can apply the sales-or usage-based royalty exception in IFRS 15.B63 in recognizing its sales- or usage-based commission, and if so, under what circumstances an agent can apply the exception.

Question 11 – Other matters

26. In our outreach activities, our respondents also shared the following application challenges in IFRS 15. We noted that the IASB or the TRG had discussed these issues. We consider that these discussions provide valuable insights and support for the application of the judgmental aspects of the Standard. To facilitate the consistent application of IFRS 15, we recommend the IASB revisit these topics in this PIR and incorporate the relevant discussions in the Basis for Conclusions or the TRG meeting summaries into the body of the Standard.

A. Identifying performance obligations in a contract

27. BC116K discussed the notions of "separable risks" and "transformative relationship" when identifying performance obligations. As stated in that paragraph, the IASB had considered the notion of "separable risks" as an alternative basis for assessing whether an entity's promise to transfer a good or service is separately identifiable from other promises in the contract but decided not to use this terminology in IFRS 15. Nevertheless, the notion of "separable risks" continues to influence the principle of separately identifiable in IFRS 15.27(b) when the IASB developed the standard. In addition, the IC has applied the concepts of "separable risks" and "transformative relationship" in assessing the criteria in IFRS 15.27(b) in its Agenda Decision *Revenue recognition in a real estate contract that includes the transfer of land*.

28. We consider that the discussions about "separable risks" and "transformative relationship" in BC105 and BC116K would assist entities in determining whether a good or service is separately identifiable from other promises in the contract. Therefore, we recommend the IASB incorporate the guidance in these paragraphs into the body of the Standard.

B. Series of distinct goods or services

29. A respondent from the banking industry commented that it is challenging in determining whether a series of distinct goods or services should be treated as a single performance obligation, and whether such a series constitutes a promise of providing a service of standing ready to provide goods or services. Specifically, questions arise as to how entities should consider whether the performance obligation consists of distinct goods or services that are substantially the same when applying the series provision in IFRS15.22(b).

30. We noted that the IASB has provided examples, in its Basis for Conclusions and Illustrative Examples accompanying IFRS 15, regarding the consideration of a series of distinct goods or services. For instance, Example 7 and Example 13 illustrate a series of distinct service in cleaning services and payroll processing services respectively. BC285 discusses a series of distinct days of hotel management service and BC160 illustrates the nature of promise of a health club contract is to stand ready for a period of time. However, these examples and discussions do not provide detailed analysis on why the series of goods or services are substantially the same.

31. We noted that TRG Agenda No.39 (Issue 1) and TRG Agenda No. 44 (Topic 5) discussed this matter. In particular, paragraph 33 of TRG Agenda No. 44 provides clear guidance on how to apply the series provision practically. We consider that it would be beneficial if the IASB provides guidance and illustrative examples by making reference to these TRG discussions. Additionally, the IASB could consider Example 12A-Series of Distinct Goods or Services of Topic 606-10-55-157B to 157E which provides an example to illustrate the application of the series provision.

C. Consideration payable to a customer

32. Some respondents noted that it is common for entities, such as the Technology, Media and Telecommunication industry and membership associations, to offer different types of coupons (e.g. cash coupons, discount coupons, coupons for free goods or services) to end customers after the sale transactions. Judgement is often required in determining whether the coupons should be accounted for as CPC, variable consideration, or customer options for additional goods or services. Different conclusions on the assessment could have a material impact in the determination of the transaction price and the timing of recognition.

33. We noted that there are various types of coupons in the market and each of these coupons could represent a different nature. We agree that judgement is required in accounting for coupons and that further guidance could be provided with reference to the relevant TRG discussions. Specifically, TRG Agenda No.14 paragraphs 7-21 and TRG Agenda No.44 paragraphs 16-17 discussed an illustrative example (cash coupons granted after sale transaction) and provided guidance on the interaction of the requirements of CPC and variable consideration. In addition, we recommend the IASB provide illustrative examples to demonstrate how to determine whether a coupon is accounted for as CPC, variable consideration or customer option for additional goods or services.

~ End ~