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International Accounting Standards Board
30 Cannon Street
London
EC4M 6XH

Grant Thornton International Ltd
Grant Thornton House
22 Melton Street
London NW1 2EP

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ED/2015/6 Clarifications to IFRS 15

Grant Thornton International Ltd is pleased to comment on the International Accounting Standards Board's (the Board) Exposure Draft ED/2015/6 *Clarifications to IFRS 15* (the ED). We have considered the ED, as well as the accompanying draft Basis for Conclusions.

We agree with the substance of each of these amendments, subject to some detailed comments set out as part of our responses to the specific questions. For reasons given in the proposed Basis for Conclusions we also agree with the IASB's decision not to include amendments relating to shipping and handling activities and promised goods or services that are immaterial in the context of a contract. Notwithstanding this view however, we are concerned about differences in wording between IFRS 15 and FASB ASC Topic 606 that will result if the FASB proceeds with its own amendments in these areas. We urge the Boards to continue their efforts to maintain convergence, to ensure that identical language is used in situations where similar results are intended, and to consider that wherever texts vary, divergence in practice may result.

Our responses to the ED's Invitation to Comment are set out in the Appendix.

If you have any questions on our response, or wish us to amplify our comments, please contact our Global Head of IFRS, Andrew Watchman (andrew.watchman@gti.gt.com or telephone + 44 207 391 9510).

Yours sincerely,

Kenneth C Sharp
Global Leader - Assurance Services
Grant Thornton International Ltd

Responses to Invitation to Comment 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?

We agree with the proposed amendments to the Illustrative Examples relating to the identification of performance obligations, with the exception of some specific concerns we have regarding Illustrative Example 10, Case B. In this regard, we believe it may be helpful to clarify:

- whether the references to "goods and services" appearing in the first two sentences of IFRS 15.IE48B are referring to the individual devices being manufactured, or to the materials, labour and other inputs that are integrated in producing those devices.
- whether the reference to "regularly sells many of these goods and services" appearing in IFRS 15.IE48B is referring to the devices, the inputs that are combined to make the devices, or the readily available resources needed to benefit from the devices.
- that references to "the full complement of devices (the combined output)" and "the entity's performance obligation" (singular) in IFRS 15.IE48C are not intended to preclude the possibility that each individual device may be a performance obligation in its own right. Referring instead to "the devices" and "performance obligation(s)" respectively would appear to reduce this risk.
- that the reference "including establishing a production process" in IFRS 15.IE48C is not intended to imply that this activity represents a separate performance obligation in its own right (rather than a set-up activity).
- that the opening sentence in IE48D is intended to read: "Because ~~the both~~ criteria in paragraph 27 of IFRS 15 are not both met, the goods and services (inputs) are not distinct". The existing wording may be read as stating that both criteria are not met, contradicting the fact that one criterion was met and one was not.

In addition, we note that notwithstanding the fact that Case B applies the paragraph 27 criteria at the level of individual promised goods or services (ie inputs), the conclusion reached in IE48D appears to go one step further and conclude that all devices must be combined into a single performance obligation. We suggest that the basis for this conclusion needs to be more fully explained and linked to the criteria in paragraph 29.

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?

While we believe that the existing guidance regarding principal versus agent considerations was already sufficiently clear for the majority of constituents, the proposed amendments to IFRS 15 should nevertheless help promote consistent application by further improving overall clarity, and therefore we support their inclusion in the Standard. Furthermore, we agree that the proposed amendments to each of the indicators in paragraph B37 are helpful and do not appear to raise new implementation questions.

Subject only to the following comments, we also agree with the proposed amendments to the Illustrative Examples regarding principal versus agent considerations.

- we observe that in Example 47, paragraph IE241, the entity "assists the customers in resolving complaints with the service provided by the airlines". In paragraph IE242A "the entity observes that no other promises are made to the customer". We believe clarity would be enhanced by including a brief description of the underlying analysis that led to the conclusion.
- while we agree with the conclusions reached in Illustrative Examples 47 and 48, we find that the second and third sentences in Example 48 paragraph IE247B(c), could also be used to describe the relationship between the airline ticket reseller and its customer in Example 47. As a result, we question whether highlighting these sentences as a principal consideration will help all constituents to understand the primary differentiating factors responsible for the conclusions reached in the two Examples.

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?

We support the Board's proposal to clarify the application of the licensing guidance in IFRS 15 by amending both the Standard itself and the accompanying Illustrative Examples while acknowledging our understanding that the US FASB is proposing further changes in this area. Without offering comment on any FASB proposals present or future, we are concerned that differences in wording between IFRS 15 and ASC Topic 606 will inevitably open the door to possible differences in interpretation. We urge the Boards to continue their efforts to maintain convergence, to ensure that identical language is used in situations where similar results are intended, and to consider that wherever texts vary, divergence in practice may result. Our specific comments and recommendations with regards to the Board's proposals follow.

- we note that the proposed wording of IFRS 15.B59A (specifically the two occurrences of the word "or" in paragraph B59A(a)) allows that a change in form alone could lead to a conclusion that an entity's activities significantly affect the intellectual property, regardless of whether the related impact is economically substantive. We believe that paragraph B59A(a) could be improved by stating that an entity's activities significantly affect the intellectual property ("IP") when they are expected to result in a change to either the form or functionality of the IP and this change is expected to have a more than inconsequential impact (positive or negative) on either the timing or quantum of expected future economic benefits available to the entity as a result of having obtained control of the IP.
- we recognise the practical merits of the proposed recommendation in IFRS 15.B63B that an entity should recognise revenue from a sales-based or usage-based royalty entirely in accordance with either the requirement in paragraph B63 or the requirements on variable consideration in paragraphs 50–59. Notwithstanding the practicality of the proposed recommendation, we have several suggestions in this regard:

- we are concerned that the inclusion of IFRS 15.B63B will result in an inconsistency in the timing of revenue recognition for some tangible goods depending on whether they are sold alone (apply the constraint guidance in IFRS 15.56-59) or together with an intellectual property licence where the licence is the predominant item to which the royalty relates (apply IFRS 15.B63). As IFRS 15.B63B will have no impact on an entity's need to allocate the variable consideration amongst the various performance obligations present in a contract, it is unclear whether any reduction of effort that might result is sufficient to justify this expansion of the scope of application of B63.
 - we also note that IFRS 15.IE185 (Illustrative Example 35, Case B) illustrates a situation where a sales-based royalty is allocated amongst performance obligations on a relative selling price basis. We believe this methodology would also be applied to contracts comprising one intellectual property licence and one tangible good (e.g. machinery). If proposed paragraph IFRS 15.B63B is incorporated into the revised Standard, we encourage the Board to expand Example 35 to include a Case C (based on Case B) where Licence X is replaced by a tangible good, and Licence Y is the predominant item to which the royalty relates. The explanation for Case C could explain that while the variable consideration (sales-based royalty) is still allocated amongst the performance obligations on a relative stand-alone selling price basis, any royalty-related revenue allocated to the tangible good is also subject to the restrictions of IFRS 15.B63. We believe this would be a helpful addition to the guidance being proposed in amended Illustrative Example 60. Whereas amended Example 60 assumes that the royalty is the only consideration present in the arrangement and that performance related to all non-IP elements is completed either in advance of or concurrent with performance on the IP, Example 35, Case C could include both fixed and variable consideration and illustrate the accounting for non-IP related performance obligations when performance occurs only after the IP element has been satisfied.
 - lastly, as a brief editorial note, we are unclear as to why proposed paragraph IFRS 15.B63B refers to paragraphs 50-59 instead of 56-59 as mentioned in existing paragraph IFRS 15.B63.
- we support the Board's decision not to propose further changes to IFRS 15 with regards to how contractual restrictions in a licence affect the identification of promises and are satisfied with the appropriateness of the proposed explanations provided in paragraph BC81 of the ED.
 - subject to our comments above, we support the Board's decision to modify Illustrative Example 60 to include non-intellectual property related promises, and to include guidance on when paragraph B63 might apply to such an arrangement. We welcome the inclusion of the word "predominant" in IFRS 15.IE308, and the related guidance in proposed paragraph IFRS 15.B63A.

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?

We agree with the proposed amendments to the transition requirements of IFRS 15 as we believe they balance the need for consistent application of the new model with the desire to alleviate some of the cost and complexity of applying the Standard for the first time. However, with regards to the proposed practical expedient allowing entities to ignore contracts that are complete as of the beginning of the earliest period presented, we are concerned that there may be some diversity in practice in how entities interpret the meaning of "completed". We are aware that this issue was discussed at the July 2015 meeting of the TRG and that mixed views were expressed by members at that time. We are also aware that this issue will be addressed by the FASB in the form of related amendments to ASC Topic 606. To avoid the occurrence of diversity in how the practical expedients are ultimately applied, we recommend that the meaning of "completed contract" be made explicit, and that every effort be made to reach agreement with the FASB concerning the exact language to be used to effect this clarification.

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.

With regards to collectability, we agree with the Board's decision not to clarify this issue. We note that existing paragraph IFRS 15.9(e) requires an assessment to be made only in connection with "*the goods or services that will be transferred to the customer*" (emphasis added) rather than the total of all goods or services promised in the contract. While this distinction might not be immediately apparent to all entities, we believe the Board's intent is adequately explained in paragraph IFRS 15.BC46 where it states that "*the entity would not consider the likelihood of payment for those goods or services that would not be transferred*".

With regards to the timing of measurement of non-cash consideration, we agree with the Board's decision not to clarify this issue. While we understand that the FASB has decided to proceed with an amendment requiring non-cash consideration to be measured at contract inception, we agree with the Board's view that this should not result in any additional diversity in practice. We also understand that consultations with some stakeholders suggest the practical impacts may be limited. In our opinion, the risks of unintended consequences are too great and we support the Board's intention to consider this issue more comprehensively in a separate project.

With regards to the presentation of sales taxes, we agree with the Board's decision not to propose a practical expedient similar to that being proposed by the FASB. As pointed out in the ED, previous IFRS revenue recognition standards contained requirements similar to those in IFRS 15 and therefore this is not a new requirement for IFRS preparers. In addition, we see few advantages that might justify the loss in comparability that would result when some but not all entities chose to adopt the expedient.