

Amendments to HKFRS 15 – *Clarifications to HKFRS 15 Revenue from Contracts with Customers*

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MAIN FEATURES

- The amendments are issued with the aim to:
 - clarify when a promised good or service is separately identifiable from other promises in a contract (i.e. distinct within the context of the contract);
 - clarify how to apply the principal versus agent application;
 - clarify for a licence of intellectual property (“IP”) when an entity’s activities significantly affect the IP to which the customer has rights;
 - clarify the scope of exception for sale-based and usage-based royalties related to licences of IP; and
 - add two practical expedients to the transition requirements of HKFRS 15.
- The amendments are to be applied retrospectively.
- Effective for annual periods beginning on or after 1 January 2018, with earlier application permitted.

Background

After the issuance of International Financial Reporting Standard (“IFRS”) 15 *Revenue from Contracts with Customers* in May 2014, the International Accounting Standards Board (“IASB”) and Financial Accounting Standards Board (the national standard-setter of The United States of America) jointly formed a Transitional Resources Group for Revenue Recognition (“TRG”) to provide support on the implementation of IFRS 15. TRG has received queries from stakeholders in relation to certain topics on implementation of IFRS 15, including:

- i) Identification of performance obligations;
- ii) Principal versus agent considerations;
- iii) Licensing;
- iv) Scope of the exception for sales-based and usage-based royalties; and
- v) Practical expedients to the transition requirements of IFRS 15.

In order to tackle these issues, IASB has issued the amendments to IFRS 15 to clarify those implementation issues in April 2016.

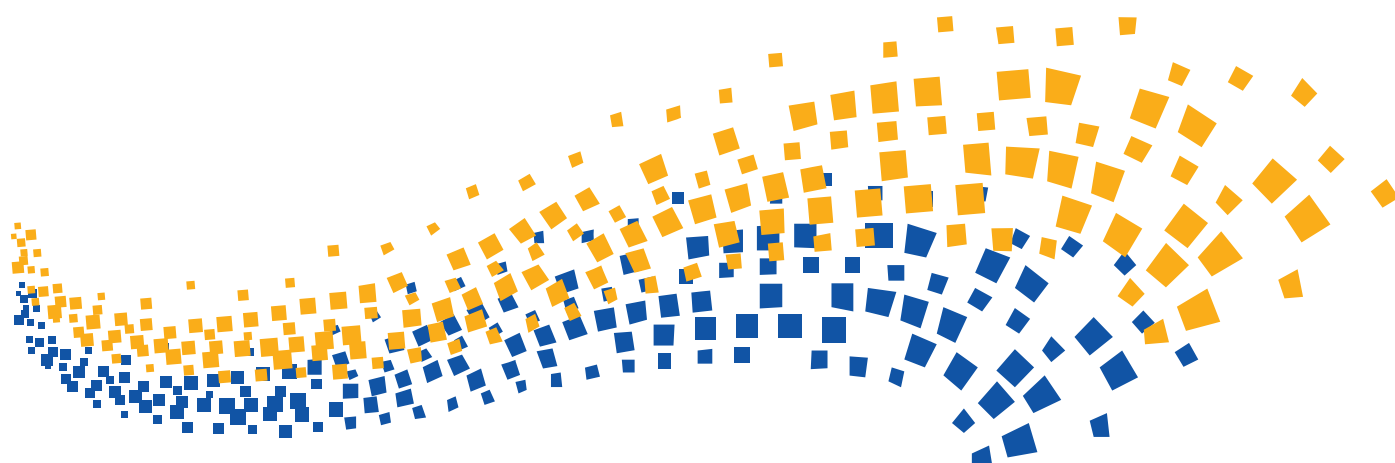
Subsequently in June 2016, the Hong Kong Institute of Certified Public Accountants also issued the same amendments, Amendments to Hong Kong Financial Reporting Standard (“HKFRS”) 15 – *Clarifications to HKFRS 15 Revenue from Contracts with Customers, so as to maintain the convergence with IFRSs.*

What are the major content of the amendments?

The following summarised the major amendments in Amendments to HKFRS 15:

Identification of performance obligations

- The amendments clarified when a promised good or service is separately identifiable from other promises in a contract (i.e. the promise to transfer the good or service is distinct the context of the contract), which is part of an entity’s assessment of whether a promised good or service is a performance obligation.
- In assessing whether an entity’s promises to transfer goods or services to the customer are separately identifiable, the objective is to determine whether the nature of the promise, within the context of the contract, is to transfer each of those goods or services individually or, instead, to transfer a combined item or items to which the promised goods or services are inputs.
- The amendments provide three indicators (including level of integration, modification or customisation, or interdependence among promises to transfer goods or services) in paragraph 29 of HKFRS 15 for clarifying two or more promises to transfer goods or services to a customer are not separately identifiable.



Principal versus agent considerations

- The amendments clarified how to apply the principal versus agent application guidance to determine whether the nature of an entity's promise is to provide promised good or service itself (i.e. the entity is a principal) or to arrange for goods or services to be provided by another party (i.e. the entity is an agent).
- Paragraph B34A of HKFRS 15 is newly added to clarify that to determine the nature of its promise, the entity should:
 - (a) identify the specified goods or services to be provided to the customer; and
 - (b) assess whether it controls each specified good or service before that good or service is transferred to the customer.
- An entity is a principal if it controls the specified good or service before that good or service is transferred to a customer while an entity is an agent if it does not control the specified good or service provided by another party before that good or service is transferred to the customer.
- An entity should determine whether it is a principal or an agent for each specified good or service promised to the customer. If a contract with a customer includes more than one specified good or service, an entity could be a principal for some specified goods or services and an agent for others.
- The amendments provide further indicators in paragraph B37 of HKFRS 15 for clarifying when an entity controls the specified good or service before it is transferred to the customer.

Licensing

- The amendments clarified when do an entity's activities significantly affect the intellectual property ("IP") to which the customer has rights. This is one of the three criteria that must be met to recognise revenue for a licence of IP over time.
- Paragraph B59A of HKFRS 15 is newly added to clarify that an entity's activities significantly affect the IP to which the customer has rights when either:
 - (a) those activities are expected to significantly change the form or functionality of the IP; or
 - (b) the ability of the customer to obtain benefit from the IP is substantially derived from, or dependent upon, those activities.

Scope of the exception for sales-based and usage-based royalties

- The amendments clarified the scope of the exception for sales-based and usage-based royalties related to licences of IP when there are other promised goods or services in the contract.
- Paragraph B63 of HKFRS 15 requires that an entity should recognise revenue for a sales-based or usage-based royalty promised in exchange for a licence of IP only when (or as) the later of the following events occurs:
 - (a) the subsequent sale or usage occurs; and
 - (b) the performance obligation to which some or all of the sales-based or usage-based royalty has been allocated has been satisfied (or partially satisfied).
- Paragraphs B63A and B63B of HKFRS 15 are newly added to clarify that when a royalty relates only to a licence of IP or when a licence of IP is the predominant items to which the royalty relates, revenue from a sales-based or usage-based royalty should be recognised wholly in accordance with paragraph B63. If not, the requirements on variable consideration in paragraphs 50-59 of HKFRS 15 apply to the sales-based or usage-based royalty.

Practical expedients to the transition requirements of HKFRS 15

- The amendments added two practical expedients to the transition requirements of HKFRS 15 for:
 - (a) completed contracts under the full retrospective transition approach; and
 - (b) contract modifications at transition.
- Paragraph C5(a) of HKFRS 15 explicitly stated that when applying HKFRS 15 retrospectively, an entity need not restate contract that are completed contracts at the beginning of the earliest period presented.
- Paragraph C5(c) of HKFRS 15 is newly added to allow entities exempted from retrospective restating the contracts that were modified before the beginning of the earliest period presented for contract modification in accordance with paragraphs 20 and 21 of HKFRS 15. Instead, an entity should reflect the aggregate effect of all of the modifications that occur before the beginning of the earliest period presented when:
 - (i) identifying the satisfied and unsatisfied performance obligations;
 - (ii) determining the transaction price; and
 - (iii) allocating the transaction price to the satisfied and unsatisfied performance obligation.
- Paragraph C3(b) of HKFRS 15 allows entities to apply HKFRS 15 retrospectively with the cumulative effect of initial application of HKFRS 15 to be recognised at the date of initial application in accordance with paragraphs C7 and C8 of HKFRS 15. C7 of HKFRS 15 is revised to allow entities to choose to apply HKFRS 15 retrospectively only to contracts that are not completed contracts at the date of initial application.
- Paragraph C7A of HKFRS 15 is newly added to allow entities which apply HKFRS 15 retrospectively in accordance with paragraph C3(b) of HKFRS 15 to use the practical expedient stated in paragraph C5(c) of HKFRS 15, either:
 - (a) for all contract modification that occur before the beginning of the earliest period presented; or
 - (b) for all contract modification that occur before the date of initial application.If an entity uses this practical expedient, the expedient should be applied consistently to all contracts.

The objective of these amendments is to clarify the standard setter's intention when developing the requirements in HKFRS 15 but not to change the underlying principles of HKFRS 15.

When will these amendments become effective?

The Amendments to HKFRS 15 will become effective for financial statements with annual periods beginning on or after 1 January 2018. Earlier application is permitted. If an entity applies these amendments for an earlier period, it should disclose that fact.

The Amendments to HKFRS 15 should be applied retrospectively in accordance with Hong Kong Accounting Standard 8 *Accounting Policies, Changes in Accounting Estimates and Errors*.

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