

Regulation Impact Statement

Australian Accounting Standard *AASB 15 Revenue from Contracts with Customers*

December 2014



Australian Government

**Australian Accounting
Standards Board**

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Introduction

Why Accounting Standards Exist

- 1 Accounting standards exist to facilitate the preparation of high-quality and consistent general purpose financial statements that convey useful information about the financial position and performance of reporting entities, for example, companies, not-for-profit entities and governments. General purpose financial statements are used by investors, securities analysts and other members of the public interested in resource allocation.
- 2 Without standards, investors and other users of financial statements could be expected to incur additional costs associated with obtaining, understanding and verifying the relevance of financial information. With standards, these costs to users are reduced, but the costs of preparing financial statements are generally borne by the reporting entities, and include costs of understanding possibly complex standards, keeping up to date with changing standards, and developing and maintaining information systems capable of producing the relevant information. The extent to which this results in a more efficient allocation of resources, and therefore provides for a net benefit, depends on a range of assumptions, including those around the costs of capital.
- 3 Australia has mandated a single set of accounting standards to be applied by reporting entities¹ on the basis that the net benefit of mandated standards is considered to lead to better financial reporting and better overall economic outcomes than would emerge in the market in the absence of standards. This is accepted wisdom in all developed economies, but is dependent on there being a sound and thorough standard-setting process.²
- 4 Although Australia has had a robust standard-setting process since the 1980s, the AASB has also had a long association with accounting standard-setting at an international level, and from 2000 the international standard setting process underwent a complete reform and professionalisation, which prepared the way for jurisdictions to adopt International Financial Reporting Standards (IFRS).³

Why Australia adopted international standards

- 5 Australia adopted IFRS in 2005, as directed by the Financial Reporting Council in its 2002 directive to the AASB.⁴ The main benefits of international adoption were identified at the time to include:
 - (a) removing barriers to international capital flows by reducing differences in financial reporting requirements for participants in international capital markets and by increasing the understanding by foreign investors of Australian financial reports;

¹ This would include entities that are required to report under the *Corporations Act 2001*.

² For example, see Financial Accounting Foundation, *Overview: Accounting & Standards*, USA – accessed in December 2014 at:

³ <http://www.accountingfoundation.org/jsp/Foundation/Page/FAFSectionPage&cid=1351027541272>

⁴ For more background on this development, see, for example:

<http://www.iasplus.com/en/resources/ifrsf/history/resource25>, accessed in December 2014.

⁴ Financial Reporting Council Bulletin 2002/4 – 3 July 2002 *Adoption of International Accounting Standards by 2005*.

- (b) reducing financial reporting costs for Australian multinational companies and foreign companies operating in Australia and reporting elsewhere;
- (c) facilitating more meaningful comparisons of the financial performance and financial position of Australian and foreign public sector reporting entities; and
- (d) improving the quality of financial reporting in Australia to best international practice.⁵

6 The European Union countries also adopted IFRS in 2005. In the years since, more than 100 jurisdictions have elected to apply IFRS.⁶ Consequently, the benefits noted above have been enhanced as more jurisdictions have adopted IFRS.

⁵ Source: AASB Policy Statement PS 4 *International Convergence and Harmonisation Policy*, April 2002, available at http://www.aasb.gov.au/admin/file/content102/c3/ACCPS4_4-02.pdf, accessed 2 December 2014

⁶ For further information, see: <http://www.ifrs.org/Use-around-the-world/Pages/Jurisdiction-profiles.aspx> -- accessed in December 2014.

What this Regulation Impact Statement is about

- 7 This Regulation Impact Statement assesses policy options that are available to address inconsistencies and weaknesses that have been identified in existing Australian accounting standards on revenue recognition.

What is revenue recognition and why is it important?

- 8 An entity recognises revenue when it sells goods or provides services to its customers in the ordinary course of business. The amount of revenue that an entity recognises is based on the consideration (typically cash) that the customer promises in exchange for those good or services.
- 9 Information about revenue is critical to any assessment of the financial performance of an entity. Investors and other users of financial statements need to know the amount of revenue an entity earns in each period and information on the nature of that revenue to make decisions about the entity's performance. They also want to be able to compare the revenues earned by different entities in each period.

The problem with existing revenue standards

- 10 The existing Australian standards on revenue recognition adopt the same requirements as the international accounting standards on revenue recognition that are issued by the International Accounting Standards Board (IASB). These existing revenue standards have led to inconsistencies between entities' reported revenues, principally in relation to when an entity recognises revenue under long term contracts (e.g. construction contracts) and contracts that bundle together goods and services (e.g. contracts that bundle a telephone handset with network services). Users of financial statements have also asked for more information on revenue to help facilitate analysis of entities' performance. The problem is discussed in more detail in RIS Section 1 below.

Why regulatory action is needed?

- 11 The inconsistent reporting of revenues by different entities under existing Australian standards are valid applications of those standards, and more or better enforcement of the standards would not solve this inconsistency. Although some entities voluntarily report useful information about their revenues, that information is generally not comparable across entities. Accordingly, a revised standard is needed to remedy inconsistent revenue recognition and the lack of consistently useful information about revenues. The need for regulatory action is discussed in more detail in RIS Section 2 below, including discussion of the action taken by the IASB to recently issue IFRS 15 *Revenue from Contracts with Customers* as a replacement for its existing revenue standards that were adopted for use in Australia from 2005. The IASB issued IFRS 15 to address the same inconsistencies and weaknesses identified in paragraph 10 above.

What policy options are available?

- 12 This Regulation Impact Statement assesses the following three actions available to the Australian Accounting Standards Board (AASB) to resolve the identified problems:
- (a) Option 1—to replace the existing revenue standards with the requirements of IFRS 15, which contains comprehensive revenue recognition requirements that

will lead to the amount and timing of revenue being recognised on a basis that is consistent and that represents an economically realistic reporting of revenue, particularly for long-term contracts and bundled contracts. Option 1 would be implemented by the AASB adopting IFRS 15 as Australian accounting standard AASB 15 *Revenue from Contracts with Customers*.⁷

- (b) Option 2—to revise the existing revenue standards to ‘harmonise’ with the requirements in IFRS 15 that apply to bundled contracts, which is the aspect of existing revenue standards that is in most need of improvement.
 - (c) Option 3—to retain the existing revenue standards and allow entities to refer to the requirements of IFRS 15 when developing accounting policies for transactions that are not specifically addressed in existing standards.
- 13 Each option is described in detail in RIS Section 3 and the costs and benefits of those options are assessed in RIS Section 4.

Outcomes from consultation

- 14 Extensive consultation was conducted on proposals to address the inconsistencies and weaknesses in existing standards on revenue recognition. This consultation was undertaken internationally by the IASB and domestically by the AASB. The feedback indicated overall support for the proposals that the IASB ultimately issued as IFRS 15 on the basis that IFRS 15 represents a single and comprehensive revenue recognition model that applies equally across industries and transactions. The AASB also specifically invited comment on whether the proposals that became IFRS 15 were in the best interests of the Australian economy and no comments were received to suggest that the adoption of IFRS 15 in Australia would not be in the economy’s best interests. The outcomes from consultation are discussed in more detail in RIS Section 5.

The AASB’s preferred option

- 15 Option 1 (that is, adopting IFRS 15 in Australia as AASB 15) is the AASB’s preferred option because it is expected to yield the greatest net benefit to the Australian economy. Issuing AASB 15 is considered to be the preferred means for addressing the deficiencies that have been identified in the existing revenue standards. Issuing AASB 15 will also ensure that Australian entities can continue to obtain the benefits of preparing financial statements that are in compliance with IFRS. This discussed in more detail in RIS Section 6.

⁷ As part of making AASB 15, the AASB issued the related consequential amendments to other standards in AASB 2014-5 *Amendments to Australian Accounting Standards arising from AASB 15*.

Background on AASB 15

- 16 The project that has led to AASB 15 *Revenue from Contracts with Customers* was a joint project of the IASB and the Financial Accounting Standards Board (FASB) in the United States of America to develop a high quality global accounting standard for revenue recognition. On 28 May 2014, the IASB and the FASB jointly issued their new—and converged—standards on revenue recognition, entitled IFRS 15 *Revenue from Contracts with Customers* and Accounting Standards Update 2014-09 *Revenue from Contracts with Customers* respectively.
- 17 AASB 15 incorporates IFRS 15 issued by IASB. Accordingly, the issuance of AASB 15 forms part of the AASB’s ongoing adoption of IFRS in Australia so that Australian businesses—and the Australian economy more generally—can continue to obtain the benefits of preparing financial statements that comply with IFRS.
- 18 AASB 15 replaces the previous revenue Standards: AASB 118 *Revenue* and AASB 111 *Construction Contracts*. AASB 15 also replaces the related Interpretations on revenue recognition: AASB Interpretation 13 *Customer Loyalty Programmes*, AASB Interpretation 15 *Agreements for the Construction of Real Estate*, AASB Interpretation 18 *Transfers of Assets from Customers*, AASB Interpretation 131 *Revenue—Barter Transactions Involving Advertising Services* and AASB Interpretation 1042 *Subscriber Acquisition Costs in the Telecommunications Industry*. With the exception of Interpretation 1042, which was developed to address a specific interpretative issue in Australia,⁸ each of the standards and interpretations being replaced by AASB 15 correspond to IASB standards and interpretations being replaced by IFRS 15.
- 19 The requirements in AASB 15 were developed and refined through extensive consultation undertaken internationally by the IASB and the FASB and domestically by the AASB. The AASB published the following consultation documents for public comment (which were based on similar consultation documents issued internationally by the IASB and the FASB):
- (a) Invitation to Comment 18 ‘Request for Comment on IASB Discussion Paper *Preliminary Views on Revenue Recognition in Contracts with Customers*’;
 - (b) Exposure Draft 198 *Revenue from Contracts with Customers*, which incorporates IASB ED/2010/6 *Revenue from Contracts with Customers*; and
 - (c) Exposure Draft 222 *Revenue from Contracts with Customers*, which incorporates the IASB ED/2011/6 *Revenue from Contracts with Customers*.
- 20 A draft Regulation Impact Statement was not prepared to accompany any of these draft proposal documents. However, the Exposure Drafts were each accompanied by a Basis for Conclusions that included an outline of the potential benefits and costs of the respective proposals in qualitative terms. Accordingly, constituents were provided with ample opportunity to comment on the costs and benefits of the proposals.

⁸ AASB Interpretation 1042 will not be required once AASB 15 is applicable because the requirements of AASB 15 address the accounting for contract acquisition costs in the telecommunications industry.

RIS Section 1: Assessing the problem

Key points:

- Revenue is an important number to users of financial statements in assessing an entity's financial performance and position.
- However, limited guidance in existing revenue standards has led to diversity in the amount and timing of revenue reported by entities in their financial statements. Consequently, the diversity in the application of existing revenue standards has a detrimental effect on the usefulness of the revenue information reported by entities.
- The disclosure requirements in existing revenue standards often result in entities disclosing information that is inadequate for investors to understand an entity's revenue.

- 21 Revenue is an important number to users of financial statements in assessing an entity's financial performance and position. However, a problem is that inconsistencies and weaknesses in revenue recognition requirements have made it difficult for investors and other users of financial statements to understand and compare an entity's revenue. These existing revenue standards have led to inconsistencies between entities' reported revenues, principally in relation to when an entity recognises revenue under long term contracts (e.g. construction contracts) and contracts that bundle together goods and services (e.g. contracts that bundle a telephone handset with network services). Consequently, there was general acknowledgement that the revenue recognition standards were in need of improvement.
- 22 The main problems identified with the revenue recognition standards being replaced by AASB 15 are attributed to the following factors:
- (a) Significant diversity in revenue recognition practices had arisen because IAS 18 *Revenue* and IAS 11 *Construction Contracts* (and the corresponding Australian standards AASB 118 and AASB 111) contain limited guidance on many important topics, such as accounting for arrangements with multiple elements. Furthermore, the limited guidance that is provided was often difficult to apply to complex transactions. Consequently, in the absence of clear and comprehensive principles and guidance, there can be significant uncertainty among preparers of financial statements about how the existing revenue standards should apply to new or evolving types of transactions (such as transactions involving digital content). The uncertainty, and resulting diversity, in the application of existing revenue standards also has a detrimental effect on the usefulness of the revenue information reported by entities because different judgements made in applying the standards will diminish the comparability and credibility of the revenue line in the financial statements as a measure of an entity's financial performance.
 - (b) The disclosure requirements in IAS 18 and IAS 11 (and, in Australia, AASB 118 and AASB 111) often result in information that is inadequate for investors to understand an entity's revenue, and the judgements and estimates

made by the company in recognising that revenue. For instance, investors have been concerned that the revenue information disclosed is often 'boilerplate' in nature or is presented in isolation and without explaining how the revenue recognised relates to other information in the financial statements.

- 23 To address these problems, the IASB and the FASB initiated a joint project to clarify the principles for recognising revenue and to develop a common revenue standard for IFRS and US Generally Accepted Accounting Principles (US GAAP). The AASB and Australian constituents were active participants in the joint IASB/FASB project. The issuance by the IASB of IFRS 15 signified the culmination of that joint project.
- 24 A consequence of the IASB issuing IFRS 15 is that the AASB has to incorporate that standard into Australian accounting standards if Australian entities are to be able to continue to claim that their financial statements prepared in accordance with Australian accounting standards are also simultaneously prepared in compliance with IFRS.

RIS Section 2: The need for regulatory action

Key points:

- The objectives for undertaking regulatory action to improve revenue recognition requirements in Australian accounting standards include: removing inconsistencies and weaknesses in existing standards; improving comparability of revenue recognition practices across entities; and providing more useful information to users of financial statements.
- Failure to adopt IFRS 15 in Australia would mean that international capital markets would cease to regard Australia as an IFRS compliant jurisdiction even if an individual entity did not have any revenue to recognise from contracts with customers.

- 25 Regulatory action is required for two reasons. Firstly, issuing AASB 15 is required to ensure that Australian entities that prepare financial statements in accordance with Australian accounting standards can also simultaneously be prepared in compliance with IFRS. This is because Australian entities would lose the ability to—and the benefits of—claiming that their financial statements are prepared in compliance with IFRS if the AASB chose to either not adopt or to modify an IFRS for application in Australia. IFRS, and therefore Australian accounting standards, require a relevant entity to make an explicit and unreserved statement in the notes to its financial statements that its financial statements comply with IFRS.⁹ Those requirements further clarify that an entity cannot describe financial statements as complying with IFRS unless they comply with all the requirements of IFRS. When an entity's financial statements include an unreserved statement of compliance with IFRS the Corporations Act requires the directors to make an explicit and unreserved statement of compliance with IFRS in their directors' report,¹⁰ and Australian auditing standards require an auditor to state that, in the auditor's opinion, the financial report complies with IFRS.¹¹
- 26 Consequently, even though the issuance of AASB 15 may not have a material impact on the amount and timing of revenue recognition for some entities (especially those entities with straightforward transactions), the fact that an entity is not applying AASB 15 (as the Australian standard that incorporates IFRS 15) would mean that the entity would be unable to claim that its financial statements are prepared in compliance with IFRS. Furthermore, failure to adopt IFRS 15 in Australia would mean that international capital markets would cease to regard Australia as an IFRS compliant jurisdiction even if an entity did not have any revenue to recognise from contracts with customers. This is also discussed in paragraph 34 below.
- 27 Secondly, regulatory action would address the main problems identified with the existing revenue recognition standards (see paragraph 22 above). In that regard, the

⁹ See IAS 1 *Presentation of Financial Statements* paragraph 16 and AASB 101 *Presentation of Financial Statements* paragraph 16

¹⁰ See section 295(4)(ca) of the Corporations Act

¹¹ See paragraph Aus37.1 of Auditing Standard ASA 700 *Forming an Opinion and Reporting on a Financial Report* (July 2013)

objectives for undertaking regulatory action to improve the revenue recognition requirements in Australian accounting standards are as follows:

- (a) to remove inconsistencies and weaknesses in AASB 118 and AASB 111 and related Interpretations (which reduces risk for users when they use revenue information to determine an entity's financial performance and value);
- (b) to provide a more robust framework for addressing revenue issues, and thereby reducing the need for interpretive guidance to be developed on a case-by-case basis to address emerging revenue recognition issues (which reduces the time required for preparers to determine appropriate accounting policies to apply when preparing their financial statements);
- (c) to simplify the preparation of financial statements by reducing the number of requirements to which an entity must refer (which also reduces the time required for preparers to prepare their financial statements);
- (d) to improve comparability of revenue recognition practices across entities, industries, jurisdictions and capital markets (which reduces risk for users when making capital allocation decisions and, therefore, leads to more efficient decision making and more efficient capital markets); and
- (e) to provide more useful information to users of financial statements through improved disclosure requirements (which also reduces risk for users when making capital allocation decisions).

RIS Section 3: Policy options

Key points:

- This Regulation Impact Statement identifies three policy options to address the policy problem. One option is to maintain the status quo by retaining the existing revenue standards. Other options are to: revise the existing revenue standards; or replace the existing revenue standard with a standard based on IFRS 15.

- 28 This Regulation Impact Statement identifies the following three actions available to the AASB and the extent to which each of those options would achieve the objectives of:
- (a) maintaining the ability of Australian entities to claim that their financial statements are prepared in compliance with IFRS; and
 - (b) improving the revenue recognition requirements in Australian accounting standards.

Option	Description
Option 1 – Replacement revenue standard based on IFRS 15	This option would replace the existing revenue standards with the requirements of IFRS 15, which would be adopted into Australian accounting standards as AASB 15.
Option 2 – Australian specific revisions to existing revenue standards	This option could involve the AASB revising the existing revenue standards to ‘harmonise’ some of those requirements with selected aspects of IFRS 15. The AASB would consult with participants in the Australian financial reporting system before deciding which requirements should be harmonised with IFRS 15.
Option 3 – Existing revenue standards (<i>status quo</i>)	This option would retain the existing revenue standards. Under this option, entities would need to continue to develop accounting policies to account for revenue transactions that are not specifically addressed in existing standards. Entities could choose to refer to the requirements of IFRS 15 when developing those accounting policies, but would not be required to do so.

Overview of Option 1

- 29 Option 1 adopts IFRS 15 into Australian accounting standards. Consistently with IFRS 15, AASB 15 would establish a comprehensive framework for determining when to recognise revenue and how much revenue to recognise. The core principle in that framework is that an entity should recognise revenue to depict the transfer of promised goods or services to customers in an amount that reflects the consideration to which the entity expects to be entitled in exchange for those goods or services.

30 For all types of contracts with customers,¹² an entity would recognise revenue in accordance with that core principle by applying the following steps:

- (a) **Step 1: Identify the contract(s) with a customer**—The requirements of AASB 15 would apply to each contract that has been agreed upon with a customer and meets specified criteria. In some cases, AASB 15 would require an entity to combine contracts and account for them as one contract. AASB 15 also would provide requirements for the accounting for contract modifications.
- (b) **Step 2: Identify the performance obligations in the contract**—A contract includes promises to transfer goods or services to a customer. If those goods or services are distinct, the promises are performance obligations and are accounted for separately. A good or service is distinct 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 and the entity's promise to transfer the good or service to the customer is separately identifiable from other promises in the contract.
- (c) **Step 3: Determine the transaction price**—The transaction price is the amount of consideration in a contract to which an entity expects to be entitled in exchange for transferring promised goods or services to a customer. The transaction price can be a fixed amount of customer consideration, but it may sometimes include variable consideration or consideration in a form other than cash. The transaction price is also adjusted for the effects of the time value of money if the contract includes a significant financing component and for any consideration payable to the customer. If the consideration is variable, an entity estimates the amount of consideration to which it will be entitled in exchange for the promised goods or services. The estimated amount of variable consideration will be 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.
- (d) **Step 4: Allocate the transaction price to the performance obligations in the contract**—An entity typically allocates the transaction price to each performance obligation on the basis of the relative stand-alone selling prices of each distinct good or service promised in the contract. If a stand-alone selling price is not observable, an entity estimates it. Sometimes, the transaction price includes a discount or a variable amount of consideration that relates entirely to a part of the contract. The requirements specify when an entity allocates the discount or variable consideration to one or more, but not all, performance obligations (or distinct goods or services) in the contract.
- (e) **Step 5: Recognise revenue when (or as) the entity satisfies a performance obligation**—An entity recognises revenue 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).

¹² Other than some nonmonetary exchanges and contracts with customers that are within the scope of another, more specific standard, such as AASB 117 *Leases*, AASB 4 *Insurance Contracts* or AASB 9 *Financial Instruments*.

The amount of revenue recognised is the amount allocated to the satisfied performance obligation. A performance obligation may be satisfied at a point in time (typically for promises to transfer goods to a customer) or over time (typically for promises to transfer services to a customer). For performance obligations satisfied over time, an entity recognises revenue over time by selecting an appropriate method for measuring the entity's progress towards complete satisfaction of that performance obligation.

- 31 AASB 15 also would include a cohesive set of disclosure requirements that would result in an entity providing users of financial statements with comprehensive information about the nature, amount, timing and uncertainty of revenue and cash flows arising from the entity's contracts with customers. Specifically, AASB 15 would require an entity to provide information about:
- (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 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 to those contracts; and
 - (e) assets recognised from the costs to obtain or fulfil a contract with a customer.
- 32 Option 1 would also ensure that the financial statements of Australian entities prepared in accordance with Australian accounting standards would also be simultaneously prepared in accordance with IFRS.

Overview of Option 2

- 33 Option 2 represents a compromise between the adoption in Australia of IFRS 15 (that is, Option 1) and the retention of the status quo (that is, Option 3). More specifically, Option 2 contemplates a process of harmonising the requirements of existing revenue standards in Australia with the requirements of IFRS 15. The degree of harmonisation between the revised Australian standards on revenue and IFRS 15 would depend, in part, on the outcomes of consultation with Australian constituents about which requirements from IFRS 15 should be included in a revised Australian standard. One possible approach would be to retain AASB 111 and harmonise AASB 118 with the requirements in IFRS 15 to apply to all contracts with customers other than construction contracts (which would remain within the scope of AASB 111). For the purposes of this analysis, this approach is considered as an option because, on a relative basis, AASB 118 is in greater need of improvement due to a lack of specific guidance on core issues such as determining the components of a contract that should be accounted for separately and allocating the transaction price to each of those components. In contrast, the requirements in AASB 111 are not considered to have the same breadth of deficiencies.

- 34 A decision by the AASB to selectively harmonise revenue recognition requirements with IFRS 15 would generally not permit Australian entities to claim that their financial statements are prepared in accordance with IFRS. An exception might arise if the requirements of a revised and harmonised AASB 118 were identical to all of the requirements in IFRS 15 and a particular entity's contracts were all within the scope of AASB 118 and not AASB 111. In that circumstance, individual entities in Australia might be able to claim that their financial statements are prepared in compliance with IFRS, but the Australian financial reporting system as a whole would not be regarded as 'IFRS compliant'. If international capital markets perceive the entire Australian financial reporting system in that manner it could be sufficient to increase the cost of capital for all Australian entities regardless of whether an individual entity's financial statements is prepared in compliance with IFRS.
- 35 During the development of AASB 15, the AASB did not need to give much consideration to Option 2. In particular, the AASB did not specifically discuss or invite public comment on an approach that would retain AASB 111 and harmonise AASB 118 with the requirements in IFRS 15. This is because the AASB is issuing AASB 15 as part of its ongoing adoption of the IFRS regime. Consequently, the threshold decision for the AASB when deciding whether to adopt AASB 115 or any other new international standard is a binary decision of whether:
- (a) to adopt the new international standard—and remain an IFRS compliant jurisdiction (this is Option 1); or
 - (b) to not adopt the new international standard—and therefore abandon the current policy of adopting IFRSs in Australia, which has the consequence of making the financial statements of Australian entities no longer compliant with IFRS (this is Option 3).
- 36 Option 2 represents a separate and subsequent decision point that is relevant only if a decision is made to not adopt a new international standard. It is only in that circumstance that the AASB would consider unilaterally developing amendments to its existing standards to address the problems and deficiencies in those standards. During the development of the revenue standard, the AASB invited comment in ED 198 and ED 222 on whether the proposals for a new revenue standard were in the best interests of the Australian economy. Because there was general support for the requirements of IFRS 15 and no comments were made that suggested that Australia should abandon the IFRS regime, the AASB did not have to give specific consideration to Option 2 and therefore did not need to consult on how Option 2 might be designed and implemented in Australia.

Overview of Option 3

- 37 Option 3 would retain the existing revenue standards in Australian accounting standards, which are AASB 118, AASB 111 and the related Interpretations of those standards. Option 3 would therefore rely on non-regulatory means to achieve improvements in revenue recognition. This might involve entities choosing to refer to the requirements of IFRS 15 for either or both of the following purposes:
- (a) to develop accounting policies to account for revenue transactions that are not specifically addressed in AASB 118 or AASB 111; and

(b) to improve the disclosure of revenue information.

38 Option 3 also has a broader effect on the Australian financial reporting system. Because Option 3 does not result in the replacement of existing revenue standards with the adoption of IFRS 15 in Australia, Australian entities would no longer be able to claim that their financial statements are prepared in accordance with IFRS.

RIS Section 4: Analysis of likely net benefit of each option

Key points:

- A new accounting standard on revenue recognition would apply to almost all entities that are required to prepare financial statements in accordance with Australian accounting standards.
- The effect of the standard on the amount and timing of revenue recognition is expected to differ depending on the type of entity, the type of transaction and the industry involved.

Affected parties

- 39 The development of an accounting standard follows an extensive and open due process, which includes inviting public comments on discussion papers, exposure drafts and other documents. The AASB also conducts roundtable discussions and targeted liaison to elicit comments from key stakeholders. The input received from stakeholders is taken into account in developing the standards. Standards that incorporate an IFRS are subject to an international due process that is conducted by the IASB and, as noted above, a domestic due process that is conducted by the AASB. Further details of the AASB's due process is described in the Policy Statement *AASB Policies and Processes*¹³ and the IASB's due process is set out in its *Due Process Handbook*.¹⁴
- 40 A new accounting standard on revenue recognition would apply to almost all entities that are required to prepare financial statements in accordance with Australian accounting standards. This is because almost all of those entities would be undertaking activities that are either generating revenue or expected to generate revenue in the future. Although the standard would apply broadly, the effect that the standard would have on the amount and timing of revenue recognition is expected to differ depending on the type of entity, the type of transaction and the industry involved. For some entities, a new revenue standard would not change the amount and timing of revenue recognition. However, for other entities, there would be changes and those changes could be significant. For example, areas in which changes would be expected include:
- (a) Revenue has not always been identified as relating to subsequent services such as extended warranties that are promised in addition to the good that is delivered to the customer.
 - (b) There has been uncertainty about whether, for some construction or production contracts, revenue should be recognised as the construction or production occurs or when construction or production is complete.

¹³ http://www.aasb.gov.au/admin/file/content102/c3/Policy_Statement_03-11.pdf

¹⁴

http://www.ifrs.org/DPOC/Documents/2013/Due_Process_Handbook_Resupply_28_Feb_2013_WEBS ITE.pdf

- (c) For the sale of software, some practices have resulted in delaying revenue recognition when an item of software is sold with the promise of subsequent updates or additional functionality that is not sold separately.

41 Changes to the amount and timing of revenue recognition for some entities is necessary if the AASB is to achieve its objective of addressing the diversity in existing revenue recognition practices by developing a single comprehensive framework for recognising revenue that can be applied consistently to all contracts for goods or services. However, changes to the amount and timing of revenue recognition do not just directly affect the entities preparing financial statements. A new revenue standard also directly affects the users of those financial statements, such as:

- (a) existing and potential resource providers (including investors, creditors and employees); and
- (b) participants in the Australian capital markets;
- (c) parties performing a review or oversight function (including analysts, ASIC and ASX); and
- (d) management and governing bodies (including use of these reports in the discharge of accountability).

Approach to identifying costs and benefits

42 The objective of financial statements is to provide information about the financial position, financial performance and cash flows of an entity that is useful to a wide range of users of financial statements in making economic decisions. To attain that objective, accounting standard setters try to ensure new requirements meet a significant need and that the overall benefits to economic decision-making that would result from improved financial reporting justify the costs of providing such information. The costs of providing financial information are incurred, in the main, by preparers of the financial statements, but extend in various direct and indirect ways to the users of those financial statements. Consequently, in assessing the costs of financial information, accounting standard setters consider the comparative advantage preparers have in developing information, compared with the costs users of financial statements would incur to develop surrogate information. In this evaluation, it is recognised that the costs of implementing a new standard might not be borne evenly by participants in the financial reporting system. However, both the users of financial statements and the entities that prepare those financial statements benefit from improvements in financial reporting that facilitate the functioning of markets for capital, including credit and the efficient allocation of resources in the economy.

43 The AASB assesses from a public interest perspective whether the costs of requiring the provision of financial information would exceed the benefits to be derived from its provision. Similar costs and benefits analyses are performed by the IASB in developing IFRSs. The AASB is an active participant and contributor to the development of IFRS, including in relation to the costs and benefits of IASB proposals, and the AASB uses its reputation as a long-standing thought leader in accounting standard-setting to influence the direction of international standard setting activities. In making an Australian accounting standard that incorporates an IFRS, the

AASB considers the costs and benefits of the individual requirements as well as taking a broader perspective of whether adopting the IFRS is in the best interests of the Australian economy. In making that decision, the AASB is aware that, if it either chooses to not adopt the IFRS or to modify the IFRS, Australian entities preparing their financial statements in accordance with Australian accounting standards would no longer be able to claim their financial statements are also prepared in compliance with IFRSs. Consequently, the AASB cannot assess the costs and benefits of individual Standards in isolation of the overall policy of adopting IFRS in Australia.

- 44 There is no universally accepted methodology for quantitatively measuring costs and benefits of information presented in financial statements. In this context, the IASB and the AASB are often guided by the feedback received from stakeholders as to the range and nature of costs that may be involved in implementing new and revised accounting requirements, and the benefits that may accrue from using the information reported in accordance with those requirements. The AASB specifically invited stakeholders to provide quantitative and/or qualitative information on costs and benefits in their responses to ED 222. The information received was qualitative in nature. More recently, some stakeholders provided limited quantitative information on the likely type, range and mix of costs and benefits of the new revenue recognition proposals only when asked during direct discussions with the AASB. The challenges with obtaining quantitative information is indicative of the nature of those costs and benefits and the fact that they are generally difficult to measure with reliability.
- 45 A key reason that quantitative information on benefits of a specific accounting standard is generally not be able to be determined is that it is not feasible to link particular decisions or transactions to particular information provided to users. This is because capital providers and other users of financial statements typically make decisions to invest or lend capital to an entity based on a wide range of information sources.
- 46 A key reason that quantitative information on costs is generally difficult to measure is that entities maintain information systems and engage advisers and auditors to serve multiple purposes, including to enable: the effective management and governance of the entity; the provision of information to the Australian Taxation Office; and for the purpose of preparing general purpose financial statements. Thus, a decision to not set an accounting standard on a particular topic would not relieve an entity from accounting for the impact of relevant transactions or events. Nor would it relieve an entity from obligations to keep written financial records (see, for example, section 286 of the Corporations Act). Furthermore, the collection and reporting of information tends to be streamlined over time as improvements are made to processes and information systems. Consequently, the incremental cost of the requirements in an accounting standard are generally not able to be isolated.
- 47 The limited quantitative feedback indicated that any net costs of complying with the new revenue standard are expected to be largely incurred in the implementation phase. The remaining costs that will be incurred on an ongoing basis are expected to relate mostly to the preparation of additional revenue disclosures. In contrast, the qualitative feedback received from stakeholders indicated that the benefits of the new revenue standard are expected to be ongoing.

- 48 A new standard can also impose costs on users of financial statements. This is because there will be an educational and adjustment period for users of financial statements, during which they may incur costs as they become familiar with the requirements of the standard and the effects it may have on the financial statements of entities that they analyse. The costs incurred by users may include costs to modify their processes and analyses. However, the costs are likely to be non-recurring and are likely to be offset by a longer-term reduction in costs from the additional information that would be provided by the improved disclosure requirements and, more generally, by the greater comparability of revenue information reported by different entities. Users of financial statements may also observe a longer-term reduction in education costs, because of the common framework created by the new standard, which applies across jurisdictions, industries and transactions.

Impact of Option 1

Key points:

- Option 1 would replace the existing revenue standards with the requirements of IFRS 15.
- Benefits are expected to include: access to lower costs of capital for Australian businesses; reduced financial statement preparation costs for foreign and Australian businesses.
- Costs incurred by entities may include both once-off and ongoing costs. Costs resulting from this option may include: training and education and staff, the need for external advice on the application of the new standard; review and revision of contracts, systems and processes; and preparation costs associated with collecting additional information for some transactions and maintaining improved systems.
- The change in regulatory burden of replacing the existing revenue standards with the requirements of IFRS 15 (which is measured on the basis prescribed by the Commonwealth Regulatory Burden Measurement Framework) is estimated to be \$15 million on an annualised basis.

- 49 Option 1 would replace the existing revenue standards with the requirements of IFRS 15, which would be adopted into Australian accounting standards as AASB 15.

Qualitative assessment of benefits of AASB 15

- 50 Revenue is an important number to users of financial statements in assessing an entity's financial performance and financial position. The new revenue standard is expected to provide significant benefits to users of financial statements, including:
- (a) greater comparability and consistency of reporting revenue from contracts with customers;
 - (b) a better depiction of entities' performance; and

- (c) improved understanding of entities' contracts and revenue-generating activities.
- 51 Entities preparing financial statements in accordance with Australian accounting standards are also expected to benefit because the new revenue standard:
- (a) provides a more robust framework for addressing revenue issues, which should therefore reduce the uncertainty and diversity associated with some existing revenue recognition practices; and
 - (b) simplifies the preparation of financial statements by reducing the number of requirements to which an entity must refer.
- 52 Because the new revenue standard would incorporate all of the requirements of IFRS 15, issuing AASB 15 would ensure that Australia is maintaining its policy of adopting IFRS and, as a consequence, Australian entities preparing financial statements in accordance with Australian accounting standards would be able to continue to claim that their financial statements are simultaneously IFRS compliant. Consequently, issuing AASB 15 also benefits the Australian economy more broadly. The benefits to the Australian economy from the adoption of IFRS fall into three broad categories:
- (a) Access to lower costs of capital for Australian businesses because international capital market participants would be expected to charge an uncertainty premium for their capital if an Australian entity's financial statements were prepared on a basis that is different from the standards used internationally. A recent publication noted that "A comprehensive review of nearly 100 academic studies of the benefits of IFRS concluded that most of the studies 'provide evidence that IFRS has improved efficiency of capital market operations and promoted cross-border investment' ".¹⁵
 - (b) Reduced financial statement preparation costs for both Australian businesses with international subsidiaries that are required by overseas regulators to lodge financial statements in accordance with IFRS and for foreign businesses with Australian subsidiaries that are required to lodge financial statements in accordance with Australian accounting standards.
 - (c) The market for accounting-related goods and services has increased in scale and opportunities. Australian businesses and universities are selling accounting professional services, training and education, and other goods and services such as accounting software solutions to international customers and Australian businesses are able to acquire accounting-related goods and services from international providers.

Qualitative assessment of costs of AASB 15

- 53 There will be costs to implement the new revenue standard. The breadth of industries and entities that would be required to apply the new standard, and the diversity in practice that existed under previous revenue recognition requirements, make it difficult to generalise the costs to entities preparing financial statements. However,

¹⁵ Pacter, P, *IFRS as global standards: a pocket guide* (2014), IFRS Foundation, page 27

because of the breadth of industries and entities that would be affected, most entities would incur at least some costs. In broad terms, entities may incur costs in relation to one or more of the following activities in meeting the requirements of the new revenue standard:

- (a) training and education of the staff involved in the preparation of the entity's financial statements and the costs of educating management and investors about the effects of the new standard on the financial statements; and
- (b) external advice on the application of the new standard;
- (c) review and revision of contracts, accounting systems and processes to ensure that the entity is capturing the information needed to comply with the new requirements in AASB 15, including the disclosure requirements;
- (d) the preparation and audit of the entity's financial statements relating to the period of initial application of the new standard.

54 Many of the activities listed in paragraph 53 will be non-recurring because they relate only to initial application of the standard. To mitigate the burden associated with the costs of these activities, a long period has been provided between making the new revenue standard and its mandatory application to annual reporting periods beginning on or after 1 January 2017. Because the annual reporting periods of many Australian entities end on 30 June, those entities will not need to apply AASB 15 until the 30 June 2018 financial year end. Furthermore, to ease implementation costs and complexities associated with transition to the new revenue standard, an entity can elect to use some practical expedients when applying the requirements to comparative information. In addition, an alternative transition method has been introduced into the new revenue standard that would alleviate the costs of transition for many entities.

55 In relation to some of the other start-up costs that entities might incur, information system upgrades tend to be ongoing; and, by having a long implementation period, there is a good chance that any changes required as a result of the new revenue standard can be undertaken in conjunction with other systems changes that may be necessary. Similarly, education and training about reporting requirements among preparers, auditors and users tend to be ongoing; and the long implementation period provides an opportunity to incorporate information on the replacement Standard in that ongoing education and training.

56 However, some entities applying the new revenue standard may incur increases in the following ongoing costs:

- (a) preparation costs associated with collecting additional information for some transactions and maintaining improved systems to be able to recognise and measure revenue in accordance with the new standard and to disclose the additional revenue information required by the new standard; and
- (b) increase in audit fees because of the increased volume of disclosures and required estimates (for example, estimates of stand-alone selling price and variable consideration).

57 In light of the feedback received during consultations on the costs of complying with the proposals, many aspects of the revenue recognition model were modified or clarified to reduce the burden of implementing and applying the requirements. Those clarifications and modifications included:

- (a) clarifying the use of portfolios—the standard has clarified that many entities would not need to develop systems to account for each contract individually, especially entities that have a large volume of similar contracts with similar classes of customer. In those cases, entities may apply the requirements to a portfolio of similar contracts;
- (b) practical expedients— some practical expedients have been added to the standard (for example, in the requirements for adjusting the transaction price for significant financing components) to simplify compliance with the requirements in circumstances in which it was determined that applying the practical expedient would have a limited effect on the amount or timing of revenue recognition;
- (c) disclosure requirements—the rigidity in the disclosure requirements proposed in the 2011 Exposure Draft that required entities to provide a detailed reconciliation of their contract balances has been eliminated, while still preserving the information that was identified as being most useful to users of financial statements; and
- (d) additional illustrations—in response to requests from stakeholders, additional examples are included to illustrate the various aspects of the standard and, thereby, provide educational guidance to help with implementation and understandability wherever possible. The additional illustrations should help to reduce both the initial and ongoing cost of compliance, as well as enhancing the consistency of application and therefore comparability of financial statements.

Quantitative assessment of costs of AASB 15

58 As noted earlier in the Regulation Impact Statement, only limited quantitative information was able to be obtained on the likely costs associated with replacing the existing revenue standards with AASB 15, relative to the base case (which is Option 3).

59 The quantitative information in this Regulation Impact Statement relating to Option 1 is based on the general information and assumptions outlined below.

Types of entities that apply Australian accounting standards

60 Based on research undertaken for AASB Research Report No 1 *Application of the Reporting Entity Concept and Lodgement of Special Purpose Financial Statements* (June 2014), the AASB understands that approximately 23,500 entities are required by the Corporations Act to prepare financial statements and lodge those financial statements with ASIC. These entities include listed public companies; large companies limited by guarantee (CLG); large proprietary companies; certain foreign-controlled small proprietary companies; certain grandfathered proprietary

companies; unlisted public companies (not CLG); registered schemes; and unlisted disclosing entities.

- 61 Depending on the entity, the financial statements lodged will be either ‘general purpose financial statements’ or ‘special purpose financial statements’. General purpose financial statements are prepared by entities that are regarded as ‘reporting entities’, which are required to prepare financial statements in accordance with all Australian accounting standards. Entities that are not regarded as ‘reporting entities’ prepare special purpose financial statements and apply a subset of Australian accounting standards.¹⁶
- 62 Australian accounting standards classify entities that are required to prepare general purpose financial statements as being either ‘Tier 1’ entities or ‘Tier 2’ entities, depending on whether the entity has public accountability. Examples of entities that have public accountability (and are Tier 1) include entities that have debt or equity instruments traded on a stock exchange or an over-the-counter market and entities that hold assets in a fiduciary capacity for a broad group of outsiders as one of its primary businesses (for example, banks, credit unions, insurance companies, securities brokers/dealers). Australian accounting standards provide some compliance concessions for Tier 2 entities (that is, entities that do not have public accountability) by allowing them to elect to apply the Reduced Disclosure Requirements (RDR) regime. The RDR regime was introduced by the AASB in 2010 to reduce the amount and complexity of information that needs to be disclosed in general purpose financial statements by ‘Tier 2’ entities.

Number of entities applying AASB 15

- 63 After excluding entity classes that are not expected to have any contracts with customers that are material in amount (such as companies limited by guarantee), the AASB estimates that approximately 14,500 entities would be expected to have contracts with customers. Those entities would be either entities that prepare general purpose financial statements or entities that prepare special purpose financial statements. Based on research undertaken for the Research Report, the AASB estimates that:
- (a) approximately 10,150 entities prepare special purpose financial statements; and
 - (b) approximately 4,350 entities prepare general purpose financial statements.
- 64 Of those approximately 4,350 entities that prepare general purpose financial statements, the AASB estimates that:
- (a) approximately 2,850 entities are ‘Tier 1’ entities that are required to comply with the ‘full’ requirements of Australian accounting standards; and
 - (b) approximately 1,500 entities are ‘Tier 2’ entities that are eligible to choose to apply reduced disclosure requirements in Australian accounting standards, including reduced disclosure requirements in AASB 15.

¹⁶ ASIC Regulatory Guide 85 *Reporting requirements for non-reporting entities* (July 2005) states that “ASIC believes that non-reporting entities... should comply with the recognition and measurement requirements of accounting standards” (see page 2).

Assumptions about the extent of change required by AASB 15

- 65 As noted in paragraph 40, the effect that AASB 15 has on the amount and timing of revenue recognition is expected to differ depending on the type of entity, the type of transaction and the industry involved.
- 66 Based on available data, only high-level and generalised assumptions can be made about the effect that AASB 15 may have on each type of entity. ‘Tier 1’ entities, such as listed public companies, are more likely to have extensive business activities and are more likely to enter into complex transactions than entities that are not publicly accountable (that is, Tier 2 entities) or are not reporting entities (that is, entities that prepare special purpose financial statements). Consequently, it is presumed that Tier 1 entities will incur more costs to comply with AASB 15 than those other types of entities. Within the Tier 1 class of entities, public companies in the ASX 100 grouping have been identified as being the type of entity that will be most affected by AASB 15.
- 67 The AASB is not aware of any economy-wide or industry-wide data on the types of transactions entered into by entities. However, because all entities listed on the Australian Securities Exchange are classified into industry sectors according to the Global Industry Classification Standard (GICS),¹⁷ that data has been extrapolated across all entities that would apply AASB 15 to estimate the number of entities operating in each industry sector. In performing that extrapolation, adjustments were made to reflect the fact that some industries are less prevalent among some entity classes such as unlisted companies. For example, banks, insurance companies and a typical mining or energy company that is reliant on finance from equity markets will generally be a ‘Tier 1’ entity that is listed on the Australian Securities Exchange.
- 68 Feedback received from various consultative activities that have been undertaken throughout the revenue project indicated that some types of transactions and industries would be more affected by the new revenue recognition requirements. This would include transactions that are common to the telecommunications industry, the software industry, industries that licence intellectual property, some construction or production contracts and long-term services contracts. However, the extent of change to accounting practices that AASB 15 will require will not necessarily be uniform across the industry because of various factors, including the individual accounting policies adopted by the entity and whether the entity’s existing accounting information systems capture (or can be easily modified to capture) the additional information that is required to apply AASB 15. For the purposes of the analysis, the impact of AASB 15 on each industry (as per the GICS) has been assessed as follows:
- (a) automobile & components: medium;
 - (b) banks: low;
 - (c) capital goods: low;
 - (d) commercial & professional services: medium;
 - (e) consumer durables & apparel: low;

¹⁷ For more information on GICS, refer to <http://www.asx.com.au/products/gics.htm>

- (f) consumer services: low;
- (g) diversified financials: low;
- (h) energy: low;
- (i) food & staples retailing: low;
- (j) food beverage & tobacco: low;
- (k) health care equipment & services: low;
- (l) household & personal products: low;
- (m) insurance: low;
- (n) materials: low;
- (o) media: medium;
- (p) pharmaceuticals, biotechnology & life sciences: medium;
- (q) real estate: medium;
- (r) retailing: low;
- (s) semiconductors & semiconductor equipment: low;
- (t) software & services: high;
- (u) technology hardware & equipment: medium;
- (v) telecommunication services: high;
- (w) transportation: low; and
- (x) utilities: low.

69 As noted above, the AASB expects that most of the costs incurred will relate to transitional activities. Based on discussions with various accounting professionals, the following table outlines estimates of the transitional effort involved in applying the new standard. Due to the breadth of scope of the new standard, these estimates are necessarily very broad approximations of the effort that is might be expended by a typical entity from a specific entity class and industry. The actual experience of an individual entity could be significantly different from the estimates below.

<i>Transitional activity</i>	<i>Estimated effort (very broadly approximated)</i>
Training and education	An entity that is not publicly accountable (that is, a Tier 2 entity or an entity preparing special purpose financial statements) might spend between 1-3 labour hours on training and education

<i>Transitional activity</i>	<i>Estimated effort (very broadly approximated)</i>
Advice	<p>depending on the industry to which the entity belongs. For some of these entities, they will receive education and training on the requirements of AASB 15 in general regulatory update sessions provided by their auditors.</p> <p>For publicly accountable entities (that is, Tier 1 entities, including listed companies), between 2-40 labour hours might be spent on training and education. The number of hours spent will depend on the entity size and the industry to which the entity belongs.</p> <p>It is assumed most entities that are publicly accountable would obtain at least some external advice on the application of the new standard. This is because these entities are likely to have more complex forms of contracts with customers and sophisticated accounting information systems and processes to manage and report on those contracts. Similarly, some large entities that are not publicly accountable would also be expected to obtain external advice. Depending on entity size and industry, external advisers may be engaged to provide between 4-120 hours of advice.</p>
Systems and process changes	<p>Each entity regardless of size and industry will need to review their contracts and accounting systems and procedures to determine the impact that the new standard might have on the entity's preparation of its financial statements.</p> <p>For entities that are not publicly accountable and operate in an industry in which AASB 15 is expected to have a low impact, the level of effort could be as low as 3 labour hours.</p> <p>For some listed companies that operate in industries in which AASB 15 will have a more significant impact, the level of effort could extend to 240 labour hours.</p>
Preparation of initial financial statements	<p>The level of effort expended by an entity to prepare its financial statements relating to the period of initial application of the new standard will depend, in part, on the class of entity, the industry, and on the transition option chosen (as mentioned in paragraph 54 above).</p> <p>For entities that are not publicly accountable and operate in an industry in which AASB 15 is expected to have a low impact, the level of effort could be as low as 2 labour hours.</p> <p>For entities that operate in industries in which AASB 15 is expected to have a medium or high impact, the level of effort will be greater because of the need to recalculate the cumulative amount of revenue recognised for affected contracts in accordance with the new standard. As noted earlier, the effort required will depend on the size of the entity and the complexity of its contracts. Consequently, the effort required could range from 10 labour</p>

<i>Transitional activity</i>	<i>Estimated effort (very broadly approximated)</i>
Audit of initial financial statements	<p>hours to 120 labour hours.</p> <p>The incremental cost of auditing those initial financial statements will depend on the extent of change to the entity's financial statements upon the application of AASB 15. The AASB was unable to obtain relevant input on the likely incremental audit cost because the audit services are provided in a competitive market and the pricing of an audit reflects many different factors.</p> <p>For the purposes of this cost estimate, the AASB has assumed that the incremental audit effort on transition is 10% of the effort expended on the preparation of the initial financial statements.</p>

70 The AASB expects that most of the transitional effort will relate to the review and revision of accounting systems and processes so that, in most cases, the collection and reporting of the additional information required by AASB 15 can be embedded into the entity's normal practices of maintaining the financial records that are necessary for the overall management of the entity. Consequently, the ongoing application of AASB 15 is expected to typically involve a relatively small recurring incremental cost.

71 Based on discussions with various accounting professionals, the following table outlines estimates of the recurring effort involved in applying the new standard. Due to the breadth of scope of the new standard, these estimates are necessarily very broad approximations of the effort that might be expended by a typical entity from a specific entity class and industry. The actual experience of an individual entity could be significantly different from the estimates below.

<i>Recurring activity</i>	<i>Estimated effort (very broadly approximated)</i>
Preparation of financial statements	<p>The ongoing preparation effort will typically relate to information that AASB 15 will require an entity to collect or assess on an ongoing basis. This includes estimating the stand-alone selling prices of goods or services and re-estimating and re-allocating the transaction price when the consideration promised by the customer includes variable amounts. These incremental activities will be more prevalent among entities with complex contracts, which will typically be entities that operate in particular industries (such as telecommunications and software) or entities that enter into contracts with variable pricing or performance bonuses.</p> <p>AASB 15 requires more disclosure of revenue information than existing standards. There will be ongoing effort required to prepare and review those disclosures. For entities that are not publicly</p>

<i>Recurring activity</i>	<i>Estimated effort (very broadly approximated)</i>
Audit of financial statements	<p>accountable, they are either not required to prepare those disclosures (because they prepare special purpose financial statements) or they are able to elect to apply reduced disclosure requirements. Entities that are publicly accountable are not entitled to any relief from the disclosure requirements.</p> <p>Depending on the entity class and industry to which an entity belongs, the ongoing compliance cost with preparing financial statements is expected to range between 0-80 labour hours.</p> <p>The incremental cost of auditing financial statements will depend on the extent of change to the entity's financial statements arising from the ongoing application of AASB 15. The AASB was unable to obtain relevant input on the likely incremental audit cost because the audit services are provided in a competitive market and the pricing of an audit reflects many different factors.</p> <p>For the purposes of this cost estimate, the AASB has assumed that the incremental audit effort is 10% of the incremental effort expended on the preparation of those financial statements.</p>

72 Internal labour rates for activities that are expected to be performed by employees of the entity are based on an annual salary of \$120,000. In accordance with the Regulatory Burden Measurement methodology, this salary amount is adjusted using a default multiplier of 1.75 to account for non-wage on costs and overhead costs. Consequently, for the purposes of this costing, the computed rate for internal labour is \$117 per hour (which assumes 4 weeks annual leave and a working week of 37.5 hours).

73 The AASB considers that an annual salary of \$120,000 is a reasonable estimate of the internal salary of a typical finance and accounting staff member that will be closely involved in implementing and applying the requirements of AASB 15. Using data from the *2014 Hays Salary Guide*, the AASB estimated the annual salary of \$120,000 by blending various salaries based on role and responsibility (for example, financial controller, finance manager, group accountant, financial accountant and systems accountant), business size and the location of the employee.

74 As noted above, external services are expected to be obtained by an entity for the purposes of receiving external advice on the application of the new standard and the incremental effort required to audit the entity's financial statements. As a broad estimate, the costing assumes an external rate of \$350 per hour for advice and auditing services for most entities that prepare financial statements and \$400 per hour for very large entities that would be expected to have more complex systems and transactions

that might require more specialist advice. The AASB consulted some accounting industry professionals to estimate rates that might be generally indicative of the rates charged for those activities. However, it is noted that the actual rates will vary based on many factors, including the length of the engagement, likelihood of future work and resource capacity factors. Furthermore, advice work and external audits may be priced at a fixed amount and subject to competitive tendering. Because the fixed price will be entity specific, for the purposes of this costing the incremental external advice and audit costs have been estimated based on hours of incremental activity required multiplied by an external hourly rate estimate.

Estimated transitional costs of Option 1

75 Based on the assumptions of estimated effort for each activity outlined in paragraph 69, the AASB estimates that the transitional costs would be as follows:

Activity	Total costs (\$m) (14,500 entities)
Training and education	3.647
Advice	26.115
Systems and process changes	22.959
Preparation of initial financial statements	13.993
Audit of initial financial statements	4.224
Total	70.938

Estimated recurring costs of Option 1

76 Based on those assumptions of estimated effort for each activity outlined in paragraph 71, the AASB estimates that the recurring costs would be as follows:

Activity	Total costs (\$m) (14,500 entities)
Preparation of financial statements	6.166
Audit of financial statements	1.826
Total	7.992

Net cost of Option 1

77 The following table sets out the estimated total costs of Option 1 relative to the status quo (ignoring the costs of maintaining the status quo identified in paragraph 139). No

direct cost savings have been identified with Option 1. The amount of costs expected to be associated with applying AASB 15 identified in the table below are broad approximations. They are based on assumptions and estimates that would not necessarily apply in the case of individual entities. Furthermore, the costings have been prepared using the methodology prescribed by the Commonwealth Regulatory Burden Measurement Framework, which may differ from other bases for measuring costs of compliance.

Cost	Total (\$m)
Transition cost divided by 10 years	7.094
Ongoing cost	7.992
Total	15.086

- 78 In preparing this cost estimate, the AASB considers that it is reasonable to spread the transition costs over 10 years on the assumption that AASB 15 would be applied for 10 years or more. The existing standards on revenue recognition have been in force in Australia since 2005 and those standards incorporate the international standards, IAS 11 and IAS 18, which have been in effect since 1993.
- 79 Although a decision by the AASB to issue AASB 15 would impose compliance costs on the Australian economy, the AASB's decision to make AASB 15 as a new Australian accounting standard is based on a cost-benefit analysis that differs from this prescribed quantitative assessment. As noted elsewhere in this Regulation Impact Statement, the AASB's decision to make AASB 15 also takes into account other factors, including the benefits to users of financial statements (such as investors) and the benefits to the Australian economy as a whole from maintaining compliance between Australian accounting standards and IFRS.

Impact of Option 2

Key points:

- Option 2 would involve retaining AASB 111 and harmonising AASB 118 with the requirements in IFRS 15 to apply to all contracts with customers other than construction contracts.
- Some entities with construction contracts might perceive a benefit from retaining AASB 111 and applying the same policies to account for construction contracts. Costs to these entities may include: higher costs of capital, increased financial statement preparation costs and ongoing diversity in some of their revenue recognition practices.
- Entities that do not have construction contracts may incur costs over the longer term if any of the IFRS 15 requirements are modified or amended for application in Australia as part of the ‘harmonisation’ process. Option 2 is expected to result in a number of costs for Australian businesses, particularly in the longer term. For example, the cost of capital is expected to be higher, accounting system costs would be expected to be higher as Australian entities would need to acquire or build systems that are different from other parts of the world, and entities with international operations would need to maintain two sets of financial records.
- The change in regulatory burden of retaining AASB 111 and harmonising AASB 118 with the requirements of IFRS 15 (which is measured on the basis prescribed by the Commonwealth Regulatory Burden Measurement Framework) is estimated to be \$14 million on an annualised basis.

80 Option 2 contemplates a process of harmonising the requirements of existing revenue standards in Australia with the requirements of IFRS 15. Option 2, as envisaged by this Regulation Impact Statement, would involve retaining AASB 111 and harmonising AASB 118 with the requirements in IFRS 15 to apply to all contracts with customers other than construction contracts. The assessment of the benefits and costs of Option 2 has been prepared as a basis for making a comparison of the relative merits and shortcomings of Options 1 and 3. For the reasons outlined in paragraphs 35-36, the AASB did not specifically discuss or invite public comment on Option 2 during the development of AASB 15.

Qualitative assessment of benefits and costs of retaining AASB 111 and harmonising AASB 118

81 The benefits of this option depend on the perspective of each entity that is required to prepare financial statements in accordance with Australian accounting standards.

82 Some entities that have construction contracts might perceive a direct benefit from the retention of AASB 111 and, therefore, the ability to continue to apply the same policies to account for their construction contracts. However, that benefit relates to the costs that would not be incurred in transitioning to, and applying, the new requirements in AASB 15. Those cost savings are estimated at paragraph 98 below. However, other entities—especially entities with both construction contract revenue and revenue from contracts with customers—might consider that the retention of

AASB 111 would have an adverse effect on them. This is because, among other things, the retention of AASB 111 would mean that entities with construction contracts could experience:

- (a) higher costs of capital as a result of being unable to claim that their financial statements prepared in accordance with Australian accounting standards would also be prepared in compliance with IFRS;
- (b) increased financial statement preparation costs for both Australian businesses with international subsidiaries that are required by overseas regulators to lodge financial statements in accordance with IFRS and for foreign businesses with Australian subsidiaries that are required to lodge financial statements in accordance with Australian accounting standards;
- (c) ongoing diversity in some of their revenue recognition practices because some economically similar contracts would continue to be accounted for differently depending on whether they were in the scope of AASB 111 or a 'harmonised' AASB 118; and
- (d) the costs of implementing and applying a harmonised AASB 118 to contracts with customers other than construction contracts without any prospect of being able claim that their financial statements are 'IFRS compliant'.

83 For entities that do not have construction contracts, the only benefit that could be realised from harmonising AASB 118 with the requirements of IFRS 15 would be to modify or amend one or more of the IFRS 15 requirements for recognising and measuring revenue to address 'domestic issues'. Although some entities might perceive a benefit (or cost saving) from making a modification or amendment to an IFRS 15 requirement, such a change is likely to impose greater costs over the longer term because that change would be:

- (a) a reconciling item that needs to be tracked and managed by any Australian entities that either have an international business or are a subsidiary of an international business that is required to also prepare financial statements in accordance with IFRS; and
- (b) an added factor that would need to be introduced into accounting software solutions, training courses and manuals that are prepared for the IFRS market, whether sourced from overseas or from within Australia.

84 More broadly, harmonising to an IFRS is generally not, and is not perceived to be, the same as adoption of an IFRS. Consequently, a decision by the AASB to harmonise AASB 118 with IFRS 15 would be regarded as a decision to abandon IFRS adoption in Australia. The view of the Trustees of the IFRS Foundation and the IASB is clear on 'harmonisation' or 'convergence' efforts that may be pursued by individual jurisdictions.

85 The Trustees explained that:

The Trustees remain committed to the belief that a single set of standards is in the best interests of the global economy, and that any divergence from a single

set of standards, once transition to IFRSs is complete, can undermine confidence in financial reporting.¹⁸

86 In that regard, it is the view of the Trustees and the IASB that “developing national accounting standards ‘based on’ or ‘consistent in all material respects with’ IFRS may be a stepping stone on the path towards adoption, but it is not a substitute for adoption”. Whatever mechanism is used to adopt IFRS in a jurisdiction, it should “enable and require relevant entities to state that their financial statements are in full compliance with IFRS as issued by the IASB”.¹⁹

87 Accordingly, Option 2 would not be consistent with the views of the Trustees of the IFRS Foundation or the IASB on the incorporation of IFRS into domestic accounting standards. Option 2 would also effectively represent a re-implementation of the AASB’s policy on harmonisation that existed prior to the FRC’s decision in 2002 for Australia to adopt IFRS. That policy stated:

“International harmonisation” of Australian accounting standards refers to a process which leads to these standards being made compatible with the standards of international standard-setting bodies to the extent that this would result in high quality standards.²⁰

88 The AASB’s policy on harmonisation was based on the presumption that existed at the time that a single set of internationally accepted accounting standards is not likely to be achievable in the short term. However, following the 2002 decisions to adopt IFRS by the European Union and, shortly after, the Australian government, the AASB’s harmonisation policy became redundant. Around that time, the shortcomings of the harmonisation approach were acknowledged by then Parliamentary Secretary to the Treasurer, Senator Ian Campbell, when he explained the reasons for adopting IFRS in Australia:

Adoption of IASB standards will bring significant benefits such as lower capital and compliance costs and easy comparison of financial accounts of Australian and foreign-based companies. ... Key stakeholders agree this is the course to take. **Having one set of standards will be a considerable improvement on the existing cumbersome procedure whereby Australian standards are periodically updated to reflect IAS.**²¹ [emphasis added]

89 Given the shortcomings of the AASB’s previous harmonisation policy relative to the current policy of IFRS adoption and the views of the IFRS Foundation Trustees and the IASB, the AASB does not consider that reinstating a policy of harmonising existing Australian standards to IFRS would be a viable alternative.

¹⁸ IFRS Foundation, *Report of the Trustees’ Strategy Review 2011 IFRSs as the Global Standards: Setting a Strategy for the Foundation’s Second Decade*, February 2012, page 9 (<http://www.ifrs.org/About-us/IFRS-Foundation/Oversight/Strategy-Review/Documents/TrusteesStrategyReviewFeb2012.pdf>)

¹⁹ See Pacter, P, *IFRS as global standards: a pocket guide* (2014), IFRS Foundation, page 16

²⁰ AASB Policy Statement 4 Policy Statement *International Convergence and Harmonisation Policy* (April 2002)

(http://www.aasb.gov.au/admin/file/content102/c3/ACCPS4_4-02.pdf)

²¹ Parliamentary Secretary to the Treasurer, Press Release 2002-28 *\$2 Million Boost for Adoption of International Accounting Standards* 12 June 2002

(<http://ministers.treasury.gov.au/DisplayDocs.aspx?doc=pressreleases/2002/028.htm&pageID=003&min=igc&Year=2002&DocType=0>)

Quantitative assessment of costs of retaining AASB 111 and harmonising AASB 118

- 90 Consistent with the costing of Option 1, only limited quantitative information was able to be obtained on the likely costs associated with retaining AASB 111 and harmonising AASB 118 with the requirements of IFRS 15.
- 91 The quantitative information in this Regulation Impact Statement relating to Option 2 is based on the following assumptions:
- (a) no incremental compliance costs would be incurred in relation to the ongoing application of AASB 111;
 - (b) the incremental compliance costs of applying a revised version of AASB 118 that is harmonised to IFRS 15 would be the same incremental compliance costs estimated for Option 1 after excluding the compliance costs attributable to construction contracts; and
 - (c) entities with construction contracts that are within the scope of AASB 111 do not have other contracts with customers that would be within the scope of AASB 118. This simplifying assumption is necessary for the purposes of this analysis. The effect of this simplifying assumption is likely to be that it will understate the incremental compliance cost impact of Option 2 and, therefore, overstate the extent of the difference between the compliance costs attributable to Option 1 compared with Option 2.
- 92 Consequently, the cost of complying with Option 2 is estimated as being the cost of Option 1 by those entities that prepare financial statements that are not construction entities. In other words, the only difference between the preparation of compliance cost estimates under Options 1 and 2 relates to assumptions made about the population of entities that will apply the requirements in IFRS 15.
- 93 In the absence of more specific data, the AASB has used extrapolation techniques to estimate the number of construction entities that prepare and lodge financial statements in accordance with Australian accounting standards. Because there is no GICS code for construction, entities listed on the ASX that are involved in construction activities are typically classified as belonging either to the capital goods classification or the real estate classification. After estimating the proportion of construction entities in each classification, the AASB has applied those ratios to estimate the number of construction entities within the Australian financial reporting system. As a result, of the approximate 14,500 entities that would be expected to have contracts with customers (see paragraph 63), the AASB estimates that 1,018 entities are construction entities that would not apply a revised and harmonised AASB 118. This estimate assumes:
- (a) 121 of the 2,850 'Tier 1' entities that are required to comply with the 'full' requirements of Australian accounting standards are construction entities;
 - (b) 116 of the 1,500 'Tier 2' entities are construction entities; and
 - (c) 781 of the 4,350 entities that prepare special purpose financial statements are construction entities.

Estimated transitional costs of Option 2

- 94 Based on those assumptions of estimated effort for each activity outlined in paragraph 69 and adjusted to exclude construction entities, the AASB estimates that the transitional costs of Option 2 would be as follows:

Activity	Total costs (\$m) (13,482 entities)
Training and education	3.459
Advice	24.928
Systems and process changes	21.961
Preparation of initial financial statements	13.418
Audit of initial financial statements	4.050
Total	67.815

Estimated recurring costs of Option 2

- 95 Based on those assumptions of estimated effort for each activity outlined in paragraph 71 and adjusted to exclude construction entities, the AASB estimates that the recurring costs of Option 2 would be as follows:

Activity	Total costs (\$m) (13,482 entities)
Preparation of financial statements	5.917
Audit of financial statements	1.755
Total	7.672

Net cost of Option 2

- 96 The following table sets out the estimated total costs of Option 2 relative to the status quo (ignoring the costs identified in paragraph 139). No direct cost savings have been identified with Option 2. The amount of costs expected to be associated with applying a harmonised AASB 118 identified in this table below are broad approximations. They are based on assumptions and estimates that would not necessarily apply in the case of individual entities. Furthermore, the costings have been prepared using the methodology prescribed by the Commonwealth Regulatory Burden Measurement Framework, which may differ from other bases for measuring costs of compliance.

Cost	Total (\$m)
Transition cost divided by 10 years	6.781
Ongoing cost	7.672
Total	14.453

- 97 In preparing this cost estimate, the AASB considers that it is reasonable to spread the transition costs over 10 years on the assumption that a revised and harmonised AASB 118 would be applied for 10 years or more and that AASB 111 would be retained for a similar period of time.
- 98 On an annualised basis, the estimated compliance costs attributable to Option 2 are only \$0.633m less than the compliance costs attributable to Option 1. However, the AASB considers that this relative compliance cost ‘saving’ would be more than offset by the loss of benefits to Australian entities, and the Australian economy more generally, from not adopting AASB 15 in full as part of the ongoing adoption of IFRS in Australia.

Impact of Option 3

Key points:

- Option 3 would maintain the status quo by retaining the existing revenue standards in Australian accounting standards.
- This option would mean that Australian entities would no longer be able to claim that their financial statements are prepared in compliance with IFRS.
- This option is not expected to have any immediate effect on the direct costs incurred by an entity to prepare financial statements in accordance with Australian accounting standards.
- However, as in Option 2, Option 3 would be expected to result in a number of costs for Australian businesses, particularly in the longer term. These are expected to be similar to those incurred under Option 2. For example, the cost of capital is expected to be higher, accounting system costs would be expected to be higher as Australian entities would need to acquire or build systems that are different from other parts of the world, and entities with international operations would need to maintain two sets of financial records.

- 99 Option 3 would retain the existing revenue standards in Australian accounting standards, which are AASB 118, AASB 111 and the related Interpretations of those standards. Option 3 is the assumed base case scenario.

Qualitative assessment of benefits and costs of Option 3

- 100 Maintaining the status quo would not be expected to have any immediate effect on the direct costs incurred by an entity to prepare financial statements in accordance with Australian accounting standards. This is because, if the existing revenue recognition requirements remain unchanged, then the immediate direct costs of complying with those requirements should equally remain unchanged.
- 101 The benefits of Option 3 would be expected to diminish because a decision to implement Option 3 (by not issuing AASB 15 in Australia) would mean that Australian entities would no longer be able to claim that their financial statements are prepared in compliance with IFRS. Losing the ability to claim compliance with IFRS is expected to give rise to substantial costs to Australian entities that are not in the nature of incremental regulatory costs. Those costs are identified in paragraph 139 and include:
- (a) the cost of capital of Australian entities that prepare general purpose financial statements would be expected to increase because the financial statements of Australian entities would lose comparability with the financial statements of their international peer group;
 - (b) increased financial statement preparation costs for both Australian businesses with international subsidiaries that are required by overseas regulators to lodge financial statements in accordance with IFRS and for foreign businesses with Australian subsidiaries that are required to lodge financial statements in accordance with Australian accounting standards; and
 - (c) the relative pricing of accounting-related goods and services (such as training services, financial reporting software modules and manuals) would be expected to increase over time because the Australian market for those goods and services will continue to reflect the requirements of the existing standards whereas the much larger international market for similar goods and services will be updated to reflect the requirements of IFRS 15.
- 102 Option 3 cannot assume that no changes will be made to existing revenue recognition requirements in the long-term. At some point in time, the deficiencies that have been identified in existing standards would need to be addressed. The AASB expects that these deficiencies in existing standards will become more visible as new types of transactions continue to emerge and as business models continue to evolve.
- 103 The deficiencies in existing revenue standards could be addressed by either:
- (a) self-regulation; or
 - (b) amendments to existing standards.
- 104 A self-regulation approach would involve entities continuing to develop accounting policies to account for revenue transactions that are not specifically addressed in existing standards. Entities could choose to refer to the requirements of IFRS 15 when developing those accounting policies, but would not be required to do so. Consequently, it is possible that under this approach some entities could claim that their financial statements are prepared in compliance with IFRS. However, because

IFRS 15 would not have been adopted into Australian accounting standards, the Australian financial reporting system as a whole would not be regarded as ‘IFRS compliant’. As explained in paragraph 34, if international capital markets perceive the entire Australian reporting system as being not compliant with IFRS, it could be sufficient to increase the cost of capital for all Australian entities regardless of whether an individual entity’s financial statements is prepared in compliance with IFRS.

105 The approach of amending existing standards would involve the AASB needing to develop its own amendments to those standards to address the deficiencies identified because all of the other jurisdictions that adopt IFRS-based standards would have replaced those standards with IFRS 15. Regardless of which approach is preferred, it is expected that the requirements of IFRS 15 would guide the decisions made by the entity in developing a self-regulatory response or the decisions made by the AASB in amending the existing revenue standards. However, the following table analyses some of the implications of using IFRS 15 as a guide for making improvements to existing standards:

<i>Possible improvement</i>	<i>Analysis</i>
Use IFRS 15 to develop accounting policies to account for revenue transactions that are not specifically addressed in AASB 118 or AASB 111.	<p>Because entities would not be required to apply IFRS 15 in those circumstances, it is likely that some diverse accounting practices in accounting for those transactions would continue. Furthermore, a partial adoption of IFRS 15 requirements would mean that the financial reporting by Australian entities would be out of step with their international peers that are required to comply with all of the requirements of IFRS 15.</p> <p>The use of IFRS 15 in this manner has two significant shortcomings:</p> <ul style="list-style-type: none"> • entities that choose to partially adopt IFRS 15 would not be able to claim that their financial statements are prepared in compliance with IFRS; and • entities would not be able to apply all of IFRS 15 (and thereby claim compliance with IFRS) because aspects of IFRS 15 are inconsistent with the existing Australian accounting standards on revenue.
To improve the disclosure of revenue information	<p>Existing revenue disclosure practices could be improved if an entity chose to apply some or all of the disclosures that IFRS 15 would require. However, the relevance of many of those disclosures would be diminished if the entity did not also apply the recognition and measurement</p>

<i>Possible improvement</i>	<i>Analysis</i>
	requirements in IFRS 15.

106 Furthermore, Option 3 would not be able to resolve some of the problems identified in existing revenue standards such as inconsistencies between standards that result in some transactions with economically similar characteristics being accounted for differently. For instance:

- (a) Under AASB 118, revenue recognition for the sale of a good depends largely on when the risks and rewards of ownership of the good are transferred to a customer. This can result in an outcome whereby an entity might not recognise the sale of a good as revenue (because a preponderance of risks and rewards relating to the good have not yet passed to the customer) even though the customer has obtained control over the good. That outcome is inconsistent with the definition of an asset elsewhere in Australian accounting standards, which depends on control of the good, not the risks and rewards associated with owning the good.
- (b) AASB 111 (which applies only to construction contracts that meet specified requirements) allocates contract revenue and contract costs to the reporting periods in which construction work is performed. Contract revenue and contract costs are recognised as revenue and expenses by reference to the stage of completion of contract activity in those cases where the outcome of the construction contract can be estimated reliably. In contrast to the principles in AASB 118, an entity would recognise revenue from a construction contract that is within the scope of AASB 111 as the activities required to complete a contract take place even when the customer does not control the item being constructed or have the risks and rewards associated with ownership.

107 The AASB notes that it was problems such as those described in paragraph 106 that led the IASB to develop IFRS 15 rather than make smaller amendments to IAS 18 and IAS 11.

RIS Section 5: Consultation

Key points:

- The AASB considered the feedback received from Australian stakeholders as it formulated its responses to the IASB. Some Australian stakeholders also provided their comments directly to the IASB.
- Two of the main proposals that generated a substantial amount of feedback during consultations were:
 - Collectability (customer credit risk). As a result of concerns expressed during consultation, it was decided that IFRS 15 would require an entity to disclose impairment losses related to contracts with customers rather than continue with the proposal for those impairment losses to be presented adjacent to the revenue line in an entity's financial statements. It was also decided to include a 'collectability threshold' in IFRS 15.
 - Disclosure requirements. Based on the feedback received, the IASB revised and clarified the application and requirements of several of the revenue disclosures prescribed by IFRS 15.

108 In the process of developing AASB 15, the AASB:

- (a) issued for public comment Invitation to Comment 18 *Request for Comment on IASB Discussion Paper Preliminary Views on Revenue Recognition in Contracts with Customers* and conducted roundtable discussions on the proposals in Melbourne and Sydney;
- (b) issued for public comment Exposure Draft 198 *Revenue from Contracts with Customers*, which incorporated IASB ED/2010/6 *Revenue from Contracts with Customers* (published by the IASB in June 2010); and
- (c) issued for public comment Exposure Draft 222 *Revenue from Contracts with Customers*, which incorporated the IASB's revised ED/2011/6 *Revenue from Contracts with Customers* (published by the IASB in November 2011).

109 The AASB received 30 comment letters on the invitation to comment and exposure drafts. These letters were received from a wide range of stakeholders, including representative bodies. More than 40 stakeholders also attended the two roundtable discussions conducted by the AASB in connection with the revenue proposals. In addition to those formal consultative processes, a range of stakeholders, including corporate entities, accounting firms, and professional accounting bodies were consulted throughout the project.

110 Internationally, the consultation undertaken by the IASB and the FASB included three formal exposure documents—a Discussion Paper and two Exposure Drafts—in response to which the IASB and the FASB received and assessed more than 1,500 comment letters. Over the course of the project, the IASB and the FASB and their staffs also held more than 650 meetings with users of financial statements, preparers,

auditors, regulators and other interested parties in a wide range of industries and a number of jurisdictions. Those meetings included general educational sessions about the proposals and in-depth discussions in relation to particular topics. Some meetings also focused on gaining an understanding of the effects of the proposals in specific industries or on particular transactions. In some cases, the IASB and the FASB undertook additional consultations in those specific industries or on those particular topics for which there were significant operational or other concerns about the effects of the proposals. For example, because of the disparate views of preparers and users of financial statements on the topic of proposed disclosure requirements, the IASB and the FASB sought further feedback in four workshops that brought user and preparer groups together to discuss how to balance the requirements to be more useful for users of financial statements and less burdensome for preparers. In addition, because of the effect of the principles for allocating the transaction price on a typical mobile phone contract, a number of meetings were held with representatives from the telecommunications industry to better understand their concerns and so that those concerns could be considered during redeliberations of the proposals.

- 111 All of the feedback received was considered by the IASB and the FASB in their redeliberations and, as a result, many aspects of the revenue recognition model were modified or clarified to reduce the burden of implementing and applying the revenue recognition requirements. The AASB was an active participant and contributor to the development of IFRS 15.
- 112 Overall, Australian stakeholders and stakeholders from other jurisdictions raised similar issues during the development of the new revenue standard. The AASB considered the feedback received from Australian stakeholders as it formulated its response to the IASB. Some Australian stakeholders also provided their comments directly to the IASB. Australian stakeholders that commented on the proposals included the accounting professional bodies (such as CPA Australia, The Institute of Chartered Accountants in Australia and the Institute of Public Accountants), industry associations (such as the Group of 100), large corporates including a telecommunications company, a resources company, banks and a financial services firm, and accounting firms (such as Grant Thornton and Pitcher Partners). Other large accounting firms in Australia made significant contributions to the comment letters submitted by their international partner firms.²²
- 113 Many Australian stakeholders provided specific feedback on parts of the model where they thought that the principles should be refined or clarified and other parts of the model that they thought were practically difficult to apply. Furthermore, some of those stakeholders also identified parts of the model where they disagreed with the effect of its application. Even though Australian stakeholders did not necessarily agree with each individual proposal in the draft revenue standard, most Australian stakeholders (and most of their peers internationally) indicated support for the revenue project generally and the overall objective of a single revenue model that can be applied across industries and transactions. In particular, no Australian stakeholders indicated that they would prefer that Australia lose its status as an ‘IFRS compliant jurisdiction’ rather than adopt IFRS 15 in Australia. In other words, no stakeholders

²²

Please note that, in considering the comments received by stakeholders, both the IASB and the AASB (when it makes comments to the IASB after considering feedback from Australian stakeholders) are persuaded by the merit of the comment rather than by who made the comment.

raised alternative options for making improvements to revenue recognition requirements that would result in the abandonment of ongoing IFRS adoption in Australia. Consequently, based on that feedback, the AASB's focus was to encourage and influence the IASB in improving specific proposals in the draft standard to address the concerns raised during consultations.

- 114 Two of the main proposals that generated a substantial amount of feedback during consultations were:
- (a) collectability (customer credit risk); and
 - (b) disclosure requirements.²³

Collectability

- 115 Exposure Draft ED 222 proposed that an entity should be required to present, in its financial statements, impairment losses from contracts with customers in a line that is adjacent to the presentation of revenue from contracts with customers. The proposal was intended to highlight the relationship between:
- (a) the amount of revenue recognised, which is the amount the entity is contractually entitled to receive from its customers in exchange for its goods or services; and
 - (b) the amount of revenue that the entity ultimately expects to collect from those customers (after considering the credit risk of those customers).
- 116 The feedback on this proposal was mixed. Most investors support this 'linked' presentation because they would be able to quickly assess the entity's performance in making sales of goods or services and to also assess whether the entity is generating increased sales by selling goods or services to customers with lower credit standings. Other respondents that commented specifically on this proposal, including the accounting professional bodies in Australia, the G100 and several corporates, disagreed strongly with presenting impairment losses adjacent to revenue because it would significantly change the existing, and well understood, practice of presenting impairment losses as part of expenses in the statement of comprehensive income. They also suggested that the adjacent presentation proposal would inappropriately imply that:
- (a) an entity's revenue should be reported net of impairment losses; and
 - (b) the entirety of the impairment expense relates to revenue recognised in the current period.
- 117 Based on the feedback received, the proposal to present impairment losses adjacent to the revenue line was not included in IFRS 15. The IASB acknowledged that requiring impairment losses to be presented adjacent to revenue was too prescriptive, especially

²³ A summary of the feedback received and the response to that feedback for each of these proposals as well as other proposals can be found in *Project Summary and Feedback Statement: IFRS 15 Revenue from Contracts with Customers*, which is available from <http://www.ifrs.org/Current-Projects/IASB-Projects/Revenue-Recognition/Documents/IFRS-15/Revenue-from-Contracts-Project-summary-Feedback-Statement-May-2014.pdf>

because most entities have a relatively low proportion of credit sales that become impaired. However, a concern remained that, if entities were to recognise revenue without a clear link to any associated impairment losses recognised, investors may not correctly assess the quality of the revenue recognised by entities that make credit sales to customers who have significant credit risk. Consequently, it was decided that IFRS 15 would:

- (a) require an entity to disclose impairment losses related to contracts with customers; and
- (b) include a ‘collectability threshold’ similar to existing revenue standards such that it must be probable that a company will collect the consideration from the customer before any revenue can be recognised.

Disclosure

- 118 Exposure Draft ED 222 proposed a cohesive set of disclosure requirements to ensure that entities disclosed sufficient revenue information from their contracts with customers so that investors and other users of financial statements could understand the nature, amount, timing and uncertainty of the entity’s revenue and cash flows.
- 119 The feedback received revealed a divide between the preparers of financial statements and investors about the proposed disclosures. In general, investors agreed with the proposals. In contrast, preparers said that the proposed disclosures were excessive, overly prescriptive, and would require disclosure of information that is not needed by management in running the business and, therefore, of questionable benefit to investors. Comments of this nature were made by all Australian stakeholders who participated in the consultations and are involved in the preparation or audit of financial statements. Given the nature of the feedback received, workshops were held with preparers and investors to discuss how each proposed disclosure would be prepared and how the information would be used. As an example, a proposal to require a full reconciliation of contract asset and contract liability balances was identified as particularly difficult to prepare because existing systems would not track some reconciling amounts. After acknowledging this preparation concern, some investors noted that, especially for some contracts, useful information about contract balances and movements in those balances could be provided without requiring a full reconciliation.
- 120 Based on the feedback received, the IASB revised and clarified the application and requirements of several of the revenue disclosures prescribed by IFRS 15. For example, substantial revisions were made to the requirement for an entity to disclose reconciliation of contract balances. Those revisions focussed on only requiring the disclosure of the most relevant information about contract balances, which investors advised was the opening and closing balances of contract assets and contract liabilities and the reasons for changes in those balances from period to period.

RIS Section 6: Conclusion

- 122 Option 1 is the preferred option because the AASB is confident that this option will yield the greatest net benefit to the Australian economy. This is because only Option 1 (that is, the making of AASB 15) will ensure that Australian entities can continue to obtain the benefits of preparing financial statements that are in compliance with IFRS. Making AASB 15 is also considered to be the preferred means for addressing the deficiencies that have been identified in the existing revenue standards.
- 123 Only Option 1 achieves all the identified objectives in paragraph 27. Option 2 would achieve many of those objectives in paragraph 15 (other than improvements relating to AASB 111) and at a lower regulatory cost as determined using the Regulatory Burden Measurement methodology. However, both Option 2 and Option 3 (the status quo option) are expected to have a lower net benefit to all the parties involved compared to Option 1 because implementing Options 2 or 3 would result in Australia no longer being an 'IFRS compliant' jurisdiction.
- 124 The costs of Option 1 are not expected to be significant for most entities and those costs are largely transitional in nature, rather than being ongoing costs. With ongoing efficiencies in the financial reporting process, many of those costs are expected to reduce over time in relative terms. The AASB considers that the benefits of Option 1 will exceed the costs, and those benefits are expected to be ongoing.

Conclusions of the IASB and the FASB

- 125 Overall, the IASB and the FASB concluded that the improvements to financial reporting would justify the costs of implementing IFRS 15. In making this assessment, the IASB and the FASB considered:
- (a) how revenue from contracts with customers would be reported in the financial statements;
 - (b) how the comparability of financial information would be improved and the benefit of better economic decision-making as a result of improved financial reporting;
 - (c) the likely compliance costs for preparers of financial statements; and
 - (d) the likely costs of analysis for users of financial statements.
- 126 The AASB concurs with the assessment reached by the IASB and the FASB. A summary of that assessment is provided in the paragraphs below.

Reporting revenue from contracts with customers in the financial statements

- 127 IFRS 15 replaces the previous limited revenue recognition requirements in IFRS and the broad revenue recognition concepts and industry-specific requirements in US GAAP with a robust and comprehensive framework that is applied to all revenue contracts with customers (except for lease, insurance and financial instruments contracts which fall within the scope of other, more specific, Standards). This framework provides a basis that should be more easily applied to complex transactions and that provides timely guidance for evolving revenue transactions.

- 128 The framework in IFRS 15 also fills a gap by providing requirements for revenue transactions that had not previously been addressed comprehensively, such as transactions for revenue for the provision of services and for revenue resulting from licences of intellectual property. In addition, IFRS 15 provides requirements for issues such as contract modifications that were previously addressed only for a particular industry. IFRS 15 also provides improved requirements for some transactions such as multiple-element arrangements.
- 129 By providing a comprehensive framework, one of the most significant effects of IFRS 15 in reporting revenue from contracts with customers is greater consistency in the accounting for economically similar transactions. This is because the diversity in practice that developed as a result of weaknesses in previous revenue recognition requirements in IFRS and US GAAP would be eliminated. However, the previous inconsistencies in the accounting and the diversity in practice that existed before the issuance of IFRS 15 may mean that the nature and extent of the changes would likely vary between entities and industries. For example, some industries, such as the telecommunications and software industries, may have significant changes. This is because those industries had narrow and transaction-specific industry revenue recognition requirements in US GAAP (which were often referred to by entities applying IFRS). However, other industries, such as the construction industry, may see minimal changes overall but significant changes for particular entities or jurisdictions that may have interpreted previous requirements differently to apply to their specific transactions. For other contracts, such as straightforward retail transactions, IFRS 15 would have little, if any, effect. The IASB and the FASB were aware of those varying effects when developing IFRS 15 and took them into account in their decision-making. In many cases, the IASB and the FASB observed that the requirements in IFRS 15 may be broadly consistent with previous revenue recognition requirements or practices, thus limiting the effects of IFRS 15 for many entities.

Improved comparability of financial information and better economic decision-making

- 130 Before the issuance of IFRS 15, there were significant differences in accounting for economically similar revenue transactions, both within and across industries for entities applying US GAAP. There was also significant diversity in practice in accounting for revenue transactions for entities applying IFRS. Those differences made it difficult for users of financial statements to understand and compare revenue numbers. Some of this diversity arose because there were limited revenue recognition requirements in IFRS in general and on particular topics. Furthermore, the requirements that were provided were difficult to apply to complex transactions, in part because there was no rationale for those requirements (that is, there was no Basis for Conclusions). Those differences also arose because previous revenue recognition requirements in US GAAP were voluminous and often industry-specific or transaction-specific, which also created difficulty for users of financial statements in interpreting the information about revenue. The IASB and the FASB noted that the diversity in practice and challenges to users were often amplified for entities applying IFRS because some preparers selectively referenced US GAAP.
- 131 Analysis of revenue by users of financial statements was made even more difficult because previous disclosure requirements for revenue were inadequate. Consequently, users of financial statements found it difficult to understand an entity's revenues, as well as the judgements and estimates made by that entity in recognising those

revenues. However, many entities acknowledged a need to provide investors with additional information about revenue and therefore provided this information in other reports outside the financial statements (for example, in earnings releases and shareholder updates).

- 132 By providing a robust, comprehensive framework for entities applying both IFRS and US GAAP, IFRS 15 would eliminate the previous diversity in practice and create greater comparability across entities, industries and reporting periods. In addition, the IASB and the FASB observed that a common revenue Standard should make the financial reporting of revenue comparable between entities that prepare financial statements in accordance with IFRS or US GAAP, resulting in a significant benefit to users. Furthermore, by providing a rationale for the requirements (that is, a Basis for Conclusions), the framework should be more easily applied to a broad range of transactions and contracts.
- 133 In addition, IFRS 15 provides comprehensive disclosure requirements that should greatly improve the information about revenue reported in the financial statements. Specifically, the information about revenue would enable users of financial statements to better understand an entity's contracts with customers and revenue from those contracts and to better predict cash flows. This information should also help users of financial statements to make more informed economic decisions. The IASB and the FASB acknowledged that these improvements may increase the costs of the application of IFRS 15 for preparers. However, the IASB and the FASB concluded that these costs were necessary to improve the usefulness of financial reporting in an area that is critical for users of financial statements to the analysis and understanding of an entity's performance and prospects.
- 134 During consultations, the IASB and the FASB learned that the disclosures required by IFRS 15 may help some entities to eliminate various alternative reporting measures that were created because previous revenue recognition requirements did not adequately depict their performance. Conversely, the IASB and the FASB noted that other industries in which changes may be more significant may be required to create alternative performance measures to help users understand the difference between previous accounting requirements and the requirements under IFRS 15. However, because the requirements adequately depict performance, the IASB and the FASB do not expect that these performance measures would be necessary in the longer term.

RIS Section 7: Implementation and review

135 The AASB will monitor the implementation of AASB 15. Similarly, the IASB will be monitoring the implementation of IFRS 15. In accordance with its due process requirements, the IASB has indicated that it plans to conduct a post-implementation review of IFRS 15 in 2-3 years after the effective date of the standard. Therefore, the review will commence in either 2020 or 2021. The AASB will be an active participant and contributor to the IASB’s review. The AASB plans to also conduct a post-implementation review of AASB 15 which will enable the AASB to assess the impact of AASB 15 domestically and also provide the AASB with feedback to input into the IASB’s review of IFRS 15.

RIS Section 8: Measurement of the Regulatory Burden

136 The table below sets out the estimated compliance costs on business associated with moving from the existing revenue standards to the application of AASB 15 (Option 1). This estimate has been prepared using the methodology prescribed in the Government’s Regulatory Burden Measurement framework.

Table 1: Regulatory burden and cost offset estimate table

Average annual regulatory costs (from business as usual)				
Change in costs (\$million)	Business	Community Organisations	Individuals	Total change in cost
Total, by sector	\$15,086,000	\$0	\$0	\$15,086,000
Cost offset (\$ million)	Business	Community organisations	Individuals	Total, by source
Within portfolio	-\$15,086,000	\$0	\$0	-\$15,086,000
Are all new costs offset? <input checked="" type="checkbox"/> Yes, costs are offset <input type="checkbox"/> No, costs are not offset <input type="checkbox"/> Deregulatory—no offsets required				
Total (Change in costs – Cost offset) (\$million) = \$0				

137 A regulatory offset has been identified from within the Treasury portfolio. This offset relates to the Future of Financial Advice (FOFA) reforms.

The Regulatory Burden Measurement framework and Options 2 and 3

138 Consistent with the requirements of the Regulation Impact Statement process, a regulatory burden and cost offset estimate table has also been prepared for Option 2 even though that option was assessed by the AASB as not being the preferred policy option. The completed table for Option 2 can be found in the Appendix. A separate table has not been prepared for Option 3 (the status quo option) because, under the Government’s Regulatory Burden Measurement framework, it would not impose any incremental regulatory costs.

139 It Because the Regulatory Burden Measurement framework does not measure the benefits and opportunity costs/savings²⁴ of options that do not involve adopting IFRS, the AASB considers that it is important to note that Options 2 and 3 would be expected to give rise to substantial costs that affect the overall assessment of the net benefit of those options, including the following.

- (a) The cost of capital for Australian businesses would be expected to be higher. This would be expected to arise because Options 2 and 3 would result in Australian financial reporting not being IFRS compliant, leading to greater uncertainty about Australian entity financial reporting in international capital markets, which in turn would add an uncertainty premium to Australian entities' cost of equity or debt finance in international markets.
- (b) Entities applying Australian accounting standards that wish to access international capital markets (for example, US capital markets) are likely to be asked to provide either an IFRS set of financial statements, or a statement reconciling their Australian financial statements to IFRS. In this context, it is noted that existing Australian accounting standards require entities that comply with IFRS to make an unreserved statement of such compliance,²⁵ which would mean that each Australian entity would need to go to the effort of determining whether or not, in its particular circumstances, it complies with IFRS. (That is, an entity would need to determine whether the fact that the existing revenue standards, or any revisions made to those standards, are not the same as IFRS 15 has had any impact on the entity's compliance status.)
- (c) In the long term, systems costs would be expected to be higher because Options 2 and 3 would mean that Australian entities would need to acquire or build systems that are different from those used in other parts of the world. It would probably not be feasible to acquire 'off-the-shelf' products from international markets. Furthermore, it may not be feasible to acquire offshore accounting services, or acquiring such services would involve paying a premium to cater for the Australian accounting policies on revenue recognition (that is, Option 3) or construction contract accounting (that is, Option 2).
- (d) Entities with international operations would need to maintain two sets of financial records in for recognising revenue from their contracts with customers, which would be costly in terms of systems, labour costs and auditing. This applies to foreign-based entities operating in Australia and to Australian entities operating overseas. For example, there are many large Australian entities that have substantial operations overseas, including in New Zealand. New Zealand has already adopted the completed version of IFRS 15.
- (e) In the long term, accounting education costs would be expected to be higher in Australia because both IFRS and the Australian accounting requirements (under either Options 2 or 3) would need to be taught. This would be the case for university courses and for post-graduate training provided within accounting firms (which are generally international and roll out international

²⁴ See OBPR Guidance Note *Regulatory Burden Measurement Framework* (July 2014), page 3

²⁵ AASB 101 *Presentation of Financial Statements* (IAS 1), paragraph 16

training programs) or training acquired from third-party providers (many of which roll out international training programs).

- (f) In the long term, audit costs would be expected to be higher because Options 2 and 3 would mean that the many auditing firms that roll out auditing systems internationally would need to develop and maintain separate Australian systems to cater for the auditing of an entity's recognised revenue.
- (g) In the long term, staff costs are expected to be higher because Options 2 and 3 would mean that staff from overseas who are expert in revenue recognition matters would not be readily transferable into the Australian environment. Similarly individual Australians with revenue recognition expertise would be adversely affected because they would not be able to readily transfer their skills to positions in other jurisdictions.

Measurement of the Regulatory Burden for Option 2

Option 2 is assessed as not providing a net benefit to the Australian economy, and consequently it is not the AASB’s preferred policy option. However, because it is a requirement of the Regulation Impact Statement process, the table below sets out the estimated compliance costs on business associated with moving from the existing revenue standards to Australian-specific revisions to those existing standards (Option 2). This estimate has been prepared using the methodology prescribed in the Government’s Regulatory Burden Measurement framework (see also paragraphs 90-98). If Option 2 was the AASB’s preferred option, the AASB assumes that the costs of associated with Option 2 would be able to be offset because the cost of that option is less than the cost of Option 1, which is the AASB’s preferred option. The regulatory offset would have related to the FOFA reforms.

Table A1: Regulatory burden and cost offset estimate table

Average annual regulatory costs (from business as usual)				
Change in costs (\$million)	Business	Community Organisations	Individuals	Total change in cost
Total, by sector	\$14,453,000	\$0	\$0	\$14,453,000
Cost offset (\$ million)	Business	Community organisations	Individuals	Total, by source
Within portfolio	-\$14,453,000	\$0	\$0	-\$14,453,000
Are all new costs offset?				
<input checked="" type="checkbox"/> Yes, costs are offset <input type="checkbox"/> No, costs are not offset <input type="checkbox"/> Deregulatory—no offsets required				
Total (Change in costs – Cost offset) (\$million) = \$0				

Setting Australian accounting standards

Under section 227(1) of the *Australian Securities and Investments Commission Act 2001* (ASIC Act), the functions of the AASB are to:

- develop a conceptual framework, not having the force of an accounting standard, for the purpose of evaluating proposed accounting standards and international standards;
- make accounting standards under section 334 of the *Corporations Act 2001* for the purposes of the corporations legislation;
- formulate accounting standards for other purposes; and
- participate in and contribute to the development of a single set of accounting standards for world-wide use having regard to the interests of Australian corporations that raise or propose to raise capital in major international financial centres.

In accordance with those functions, the AASB makes accounting standards for the preparation of general purpose financial statements by entities that operate in either the for-profit, not-for-profit or public sectors. The AASB makes those accounting standards with a view to requiring like transactions and events to be accounted for in a like manner for all types of entities. This is referred to as ‘transaction neutrality’. By making accounting standards that are transaction neutral, the AASB avoids unnecessary duplication of regulation that would otherwise be required under a sector-specific approach. The AASB only makes sector-specific Standards to extent they are essential to deal with issues that are specific to that sector.

In 2002, the Financial Reporting Council (FRC), which is a Ministerial Advisory Council, used its powers under section 225(2)(c) of the ASIC Act to direct the AASB to adopt International Financial Reporting Standards (IFRS) issued by the IASB into Australian accounting standards from 1 January 2005. In making that decision, the FRC noted that a single set of high quality accounting standards which are accepted in major international capital markets will greatly facilitate cross-border comparisons by investors, reduce the cost of capital, and assist Australian companies wishing to raise capital or list overseas.²⁶ Together with European Union member countries, Australia was a leader in the adoption of IFRS. Since 2005, many other jurisdictions have followed Australia’s and Europe’s lead and there are now more than 100 countries that mandate the use of IFRS for most public companies and there are further countries (including the USA and Japan) that permit the use of IFRS in some circumstances.

The FRC decision in 2002 was, in effect, a decision to adopt the IFRS regime. This is because the adoption of IFRSs is an ongoing process that requires the AASB to continue to adopt new and revised IFRS as they are issued by the IASB so that Australian businesses can continue to state that their financial statements are IFRS compliant. If the AASB instead chose either to not adopt an IFRS or to modify an IFRS, Australian entities would lose the ability to—and the benefits of—claiming that their financial statements are prepared in compliance with IFRS.

²⁶ FRC Bulletin 2002/4 *Adoption of International Accounting Standards by 2005*