Financial Reporting Council

IFRS 15 'Revenue from Contracts with Customers'

A follow-up thematic review

SEPTEMBER 2020

Key to symbols

Represents good practice

Represents an omission of required disclosure or other issue

Represents an opportunity for enhancing disclosures

Reference to Covid-19

Examples of better disclosure…

Examples of inadequate disclosure…

Executive summary

Introduction

This thematic report focuses on the matters which gave greatest cause for concern in the FRC's October 2019 IFRS 15 Thematic Review. We have assessed whether companies provided sufficient information to enable users to understand how certain areas of IFRS 15 'Revenue from Contracts with Customers' has been applied, and whether the accounting appeared appropriate in the circumstances.

Alongside our key findings, we have identified examples of poorer, as well as better, disclosures to help preparers understand where information provided continues to fall short of the requirements and best practice.

In addition to a closer look at certain aspects of revenue reporting by a sample of 22 companies, we performed 'Quick Reviews' of 50 companies to substantiate and further inform the findings from the 22 more detailed reviews. We have also incorporated some relevant findings from our routine reviews into this report.

Key findings

We found good company-specific explanations about accounting for revenue in many of the accounts we reviewed, where companies had clearly sought to help users understand how IFRS 15 had been applied in practice. However, we still came across disclosure gaps or inconsistencies in the information provided, even in those companies we refer to as having examples of better disclosures.

Many of the issues arising from this review relate to new requirements introduced by IFRS 15, where best practice is still emerging – specifically, variable consideration and costs to obtain and fulfil a contract. Often it was difficult to assess the appropriateness of the accounting in these areas as limited information was provided in the accounts.

In relation to the more familiar aspects of IFRS 15, such as the timing of revenue recognition and the explanation of significant judgements made by management, we found that companies' disclosures continue to lack clarity. Several companies sampled could have achieved a significant improvement in disclosure of these areas with some simple elaboration.

The principal findings of our thematic review are set out below.

Some companies are still not clearly communicating when their performance obligations are satisfied and thus **when revenue is recognised**. Where revenue is recognised over time, often the specific method used to measure progress is not provided.

Disclosures about the nature of **variable consideration** and how it is estimated and constrained were sparse, if provided at all. We also found a few instances where disclosures about the related risks were poorly articulated and potentially misleading.

In general, companies provided helpful **disaggregated revenue disclosures** but, in some instances, the categories selected could have better illustrated how the nature, amount, timing and uncertainty of revenues and related cash flows are affected by economic factors.

Information about **significant judgements** relating to revenue sometimes lacked clarity about the specific judgements made by management. Quantitative disclosure, such as sensitivities or ranges of potential outcomes, was often not provided for judgements involving estimation uncertainty.

There is scope to improve disclosures about material **contract balances**, particularly in relation to how they arise and explanation of year-on-year variances. Better disclosures clearly explained the relationship between the delivery of performance obligations and the timing of cash flows.

We are concerned that some companies have overlooked the accounting requirements under IFRS 15 for **costs to obtain or fulfil a contract** when these appear relevant to the companies' activities. Only a small proportion of companies included a policy for these costs and even fewer provided any quantitative information.

We encourage companies to consider the findings of this review when preparing their forthcoming annual and interim accounts, and to discuss any issues arising with their external auditors.

Thematic overview: Scope and sample

Scope of our review

We performed a desktop review of the annual reports and accounts of companies applying IFRS 15 'Revenue from Contracts with Customers' in its second year following adoption. In particular, we focused on those matters which gave greatest cause for concern in our 2019 review, the findings from which we published in October.

In this review, we assessed the comprehensiveness and quality of revenue disclosures against IFRS 15 requirements and considered whether certain areas of the standard had been applied correctly. We focused on the following:

- Timing of revenue recognition;
- Variable consideration;
- Revenue disaggregation;
- Contract balances;
- Significant judgements; and
- Costs to obtain and fulfil a contract.

In line with our philosophy of promoting continuous improvement in reporting, we have identified both examples of better practice and anonymised examples of inadequate disclosure. These examples stem from reviews performed for the purpose of this thematic as well as our routine reviews. They are provided alongside our key findings and demonstrate the level of detail, both entity- and industry-specific, we expect companies to provide.

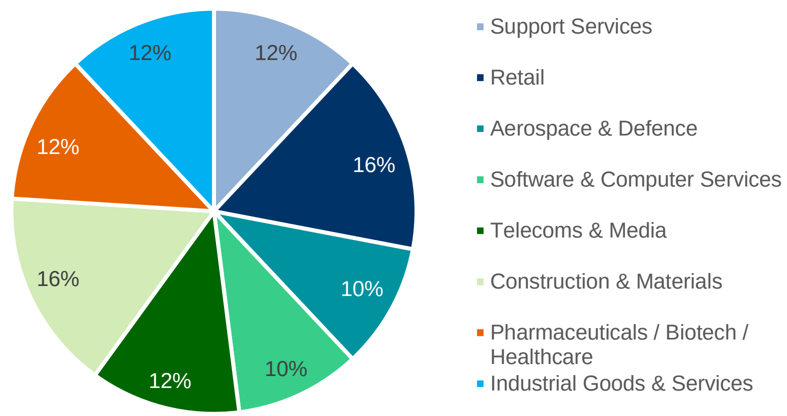
Our sample

We reviewed the full-year accounts of a sample of 22 entities, none of which were pre-informed of our review, and none of which were included in any IFRS 15 reviews of prior periods. Our sample was spread over a greater number of industries than previous thematics, as our focus has shifted from those that were more heavily impacted by the transition to the standard, to general application and disclosure matters which are relevant for all companies.

We also performed a 'Quick Review' of the disclosures of 50 companies in targeted industries and across the FTSE and AIM markets, to further inform the findings from our more detailed review.

Industries Sampled: Detailed Review x 22	
Industrial Goods & Services	4
Software & Computer Services	3
Telecoms & Media	3
Retail	3
Pharmaceuticals / Biotech / Healthcare	3
Support Services	2
Travel & Leisure	1
Utilities	1
Aerospace & Defence	1
Food & Beverage	1

Industries Sampled: Quick Review x 50

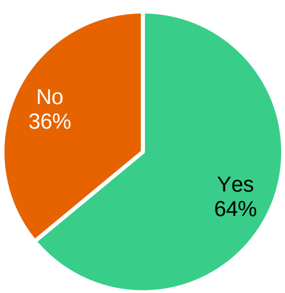


Timing of revenue recognition

Comprehensive accounting policies should clearly explain all of the company's significant performance obligations and detail the precise point, or period over which, these are satisfied.

We continue to find revenue policies with vague or missing descriptions of performance obligations. A third of the companies sampled in our Quick Review did not clearly explain all their performance obligations. For example, we were unable to match some accounting policies to performance obligations or understand the specific nature of the goods or services the company had promised to transfer. Occasionally, policies for certain performance obligations were overlooked altogether. Furthermore, we note that simply rolling forward wording used under previous revenue standards is unlikely to meet the requirements of IFRS 15. Often a simple cold read of the disclosures will highlight gaps or inconsistencies in the information provided which can be easily addressed, and significantly improve the quality of information provided.

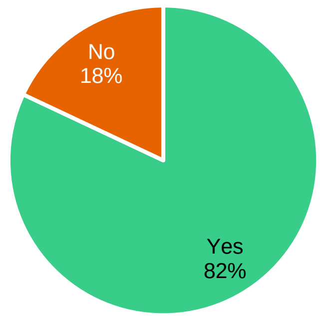
Are performance obligations clearly explained?



Source: Quick Review

IFRS 15 requires entities to disclose when they typically satisfy their performance obligations. One in five companies in our Quick Review did not clearly communicate, for those performance obligations identified, when these were satisfied, be that at a point in time or over time.

Is it clear when performance obligations are satisfied?



Source: Quick Review

The remainder of this section takes a deeper look at disclosures which describe the timing of revenue recognition and identifies areas for improvement.

What is good about this disclosure?

- ✓ Users can link the policy with the performance obligation.
- ✓ It describes when control of the goods is transferred in practice.
- ✓ It is company-specific.

Performance obligations satisfied at a point in time

Examples of inadequate disclosure…

"Revenue from the sale of product X and product Y is recognised in the income statement when control of the goods has transferred."

Examples of inadequate disclosure…

"Revenue from the sale of product Z is recognised when the invoice is raised."

As illustrated by the examples above, our thematic and routine reviews continue to find disclosures which do not pin-point when a customer obtains control of a promised asset and the performance obligation is satisfied. Good disclosures will also provide details of special arrangements with customers, such as consignment and bill-and-hold arrangements, and explain how the company determines when control has passed to the other party.

Examples of better disclosure…

"Revenue is recognised when the Group's performance obligations are fulfilled, i.e. when control over goods is transferred to customers. Customers obtain control of the goods when they are delivered to and have been accepted at their premises or made available for ex-works collection, depending on individual customer arrangements."

Fevertree Drinks Plc, 2019, p73

Timing of revenue recognition (continued)

Performance obligations satisfied over time

For performance obligations satisfied over time, the method used to recognise revenue and why that method faithfully depicts the transfer of the goods or services should be disclosed.

In the majority of our reviews, we were able to identify the performance obligations satisfied over time. However, the extent of some disclosures was unsatisfactory. The main issues identified were:

- Boilerplate policies with no company-specific information.
- Insufficient information to enable a user to determine why it is appropriate for revenue to be recognised over time rather than at a point in time.
- The specific method used to measure progress of delivery was not disclosed beyond stating that an output or input method was applied. Consequently, users were unable to understand the pattern of revenue recognition beyond the fact that it was recognised over time.
- Some descriptions of the specific methods used to measure progress lacked clarity.

We remind companies that any significant judgements made in determining the timing of satisfaction of performance obligations should be disclosed. In some cases valuable information giving users insight into management's assessments on transition to IFRS 15 and providing greater context to the accounting was not repeated in subsequent accounts.

The following are anonymised examples of poor disclosures identified in our thematic reviews. Examples of better disclosures are provided on the next page.

Examples of inadequate disclosure…

"Revenue in respect of service contracts is recognised as the services are performed in line with the contractual terms."

What is wrong with this disclosure?

- Does not identify the specific services to which the policy relates.
- Method used to measure progress of delivery of the service contracts not provided.
- Refers to contractual terms but does not explain what they are.

Examples of inadequate disclosure…

"An input method is used where there is a direct relationship between resources expended and the transfer of control of goods and services and an output method is applied where the deliverables of the contract are based on the progress of goods and services transferred."

What is wrong with this disclosure?

- Confused explanation of the basis for using an output method. Output methods recognise revenue on the basis of direct measurements of the value to the customer of the goods or services transferred to date relative to the remaining goods or services under the contract.
- Unclear under what circumstances each method applies.

Examples of inadequate disclosure…

"Revenue is recognised using a percentage complete method by reference to effort incurred to date relative to total effort to complete the contract."

What is wrong with this disclosure?

- Lacks clarity about the input method applied as the term "effort" is not defined. This could represent labour hours expended, costs incurred, machine hours incurred or some other input basis.

Examples of inadequate disclosure…

"Revenue from the provision of services is recognised on completion of the services rendered."

What is wrong with this disclosure?

- Should articulate why revenue is not recognised over time (e.g. due to very short service cycles) when criteria for over time recognition appear to be met based on information elsewhere in the accounts.

Timing of revenue recognition (continued)

Performance obligations satisfied over time (continued)

The following examples provided clear and informative disclosures about performance obligations recognised over time.

Examples of better disclosure…

"The principal revenue stream of the Group is derived from the sale of its software and related services for desktop and mobile which protect users' security, online privacy, and device performance. Licence agreements with customers include a pre-defined subscription period during which the customer is entitled to the usage of the products, including updates of the software. The typical length of a subscription period is 1, 12, 24, or 36 months. Antivirus software requires frequent updates to keep the software current in order for it to be beneficial to the customer and the customer is therefore required to use the updated software during the licence period. This provides evidence that the licence grants the right to access the software over time and therefore revenue is recognised evenly over the term of the licence. The software licence, together with the unspecified updates, forms a single distinct performance obligation."

Avast Plc, 2019, p123

What is good about this disclosure?

- ✓ Clear description of the nature of the performance obligation, contract terms and why control of the software licence transfers over time.

What is good about this disclosure?

- ✓ Identifies each promise in the contract.
- ✓ Explains which criterion for over time recognition has been met and specifies how progress towards complete satisfaction is measured.

Examples of better disclosure…

"Maintenance and support revenue is typically recognised based on time elapsed and thus rateably over the term of the support arrangement. Under the standardised maintenance and support services, the Group's performance obligation is to stand ready to provide technical product support and unspecified updates, upgrades and enhancements on a when-and-if-available basis. The customers simultaneously receive and consume the benefits of these services."

Sage Group plc, 2019, p156*

What is good about this disclosure?

- ✓ Clarifies the nature of the performance obligation is to "stand-ready" and that progress is measured on a straight-line basis over the period of the arrangement.

Examples of better disclosure…

"Design and manufacture of high-integrity equipment
The Group designs and manufactures mission-critical systems under long-term contracts with customers. The promises in these contracts include the design and manufacture of systems for delivery to the customer and standard assurance warranties. The promises in these contracts are combined as a single performance obligation because the customer cannot benefit from the promises on their own, and they are not separately identifiable in the context of the contract. In some instances, the contract will also include a promise to install the equipment at the customer site. Where installation is included in the contract, this is not generally considered a separate performance obligation as the promise is not separately identifiable in the context of the contract. Some contracts will include:

- *a promise to store the equipment or an option to purchase storage services at a future date. Storage services are provided in the period between acceptance of the equipment by the customer and shipping. Where storage services are provided, this is considered a separate performance obligation, and/or*
- *extended service warranties which are a separate performance obligation.*

The systems that are designed and manufactured are bespoke for each customer and do not have an alternative use to the Group. Where the Group has an enforceable right to payment for performance completed to date, being recovery of costs incurred in satisfying the performance obligation plus a reasonable profit margin, the performance obligation is satisfied over time, as it meets the requirements of IFRS 15.35(c). The measurement of progress towards complete satisfaction of the performance obligation is measured using the input method, based on costs incurred compared to total contract costs. Costs are only included in the measurement of progress towards satisfying the performance obligation where there is a direct relationship between the input and the satisfaction of the performance obligation.
For storage services, the customer receives and consumes the benefit over the storage period. The performance obligation is satisfied over time under IFRS 15.35(a). Revenue is recognised on an output basis, based on daily rate for the period of storage. For extended warranties, the customer receives and consumes the benefit of the warranty over the extended warranty period. The performance obligation is satisfied over time under IFRS 15.35(a). An output method, based on straight line recognition over the period of the warranty, is used to measure progress towards complete satisfaction of the extended warranty performance obligation."

TP Group plc, 2019, p70 & 71

*Not part of thematic or Quick Review sample

Timing of revenue recognition (continued)

Performance obligations satisfied over time (continued)

The table below shows the methods used to recognise revenue over time by the companies in our Quick Review, by industry. Generally, a range of methods was applied across and within each industry, reflecting the variability in contract terms and performance obligations undertaken by the companies sampled. We were pleased to see some examples where companies had clearly considered individual contracts and how progress was best measured in those specific cases.

These quick reviews reinforced our findings from the more detailed thematic reviews that some companies failed to address the disclosure requirements of paragraph 124 of IFRS 15 by not specifying the type of output or input method applied for all or some of their significant performance obligations satisfied over time. We will continue to focus on this aspect of revenue reporting in our future routine reviews, and will write to companies where this is not clear.

	Industry							
Methods of measuring progress	**Support Services**	**Aerospace & Defence**	**Software & Computer Services**	**Telecoms & Media**	**Construction & Materials**	**Pharmaceuticals / Biotech / Healthcare**	**Industrial Goods & Services**	**Retail**
Output methods:								
Output method (not specified)	X			X			X	X
Surveys of performance completed to date					X			
Milestones reached	X		X	X		X		
Revenue equal to invoiced amount (IFRS 15.B16)	X		X					
Input methods:								
Input method (not specified)						X		
Labour hours expended						X	X	
Costs incurred		X	X	X		X		
Time elapsed			X	X		X	X	

Source: Quick Review

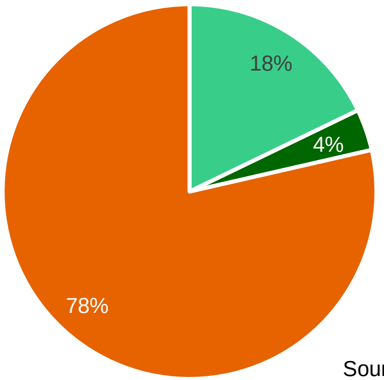
Variable Consideration

We continue to highlight the need for better quality disclosures about the types of variable consideration in companies' contracts with customers and how they are both estimated and constrained.

In last year's thematic review, we reported that disclosures about variable consideration were inadequate. Unfortunately, we saw no improvement in disclosures in this year's sample. For example, many companies did not explain the method they used to estimate variable consideration, and others referred to arrangements in the strategic report which would indicate the existence of variable consideration, but then disclosed no further information on the matter.

When variable consideration exists and is material, we expect companies to provide sufficient company-specific information about how it arises and how it is estimated and constrained. This page includes examples of disclosures that failed to provide this information.

What estimation method did sampled companies disclose? (where this issue appeared relevant)



Source: Quick Review

Examples of inadequate disclosure…

"If the consideration promised by a customer is variable, a company will estimate it using either the expected value or the most likely amount, depending on which amount better predicts the amount of consideration to which the company will be entitled. Some or all of the estimated amount of variable consideration is 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."

What is wrong with this disclosure?

- Boilerplate policy copied from IFRS 15, i.e. not company-specific.
- Nature of variable consideration not disclosed.
- Does not match the method of estimation to the form of variable consideration.
- Unclear how management interprets and applies the variable consideration constraint.
- No explanation of judgements made in assessing whether estimates of variable consideration should be constrained.

What is wrong with this disclosure?

- There are no specific details explaining how the variable consideration constraint is applied.

Examples of inadequate disclosure…

"When sales discount and rebate arrangements result in net variable consideration, appropriate provisions are recognised as a deduction from revenue at the point of sale. The Group typically uses the expected value method for estimating rebates, reflecting that such contracts have similar characteristics and a range of possible outcomes. The Group recognises revenue to the extent that it is highly probable that a significant reversal in the amount of cumulative revenue will not be required."

Estimates of variable consideration should reflect uncertainties arising from the Covid-19 pandemic. Disclosures should help users understand changes to the transaction price arising from Covid-19 including changes to the assessment of whether an estimate of variable consideration should be constrained.

Variable Consideration (continued)

We found the following examples in our sample where there was scope to improve the disclosures:

- An advertising company which disclosed that the transaction price for most customer contracts incorporated a share of customer revenue, or minimum revenue commitments which were aligned to specific performance criteria, but disclosed no information about how the company estimated revenue for these arrangements.
- A transport company that stated passenger refunds were recorded as a reduction in revenue without providing information about the estimation process.
- A manufacturer that disclosed use of both the most likely amount and expected value methods of estimating variable consideration, depending on which best suited the volume rebate arrangement in question, with no details on the different types of rebate arrangements or under which circumstances each method was used.
- Some companies attempted to adapt explanation of the constraint (i.e. the requirement to only include variable consideration to the extent that it is highly probable that a significant revenue reversal will not occur) and ended up with wording that was confusing and potentially inconsistent with the standard.

Helpful policies explain both the nature of variable consideration and describe how it is measured. Some examples of better disclosure are set out below.

Examples of better disclosure…

"Some long-term contracts include an excess profit clause which is a variable consideration factor that could impact the transaction price. Excess profits are estimated at contract inception and at the end of each reporting period to ensure that the transaction price is not under or overstated. Any required adjustment will be made against the transaction price in the period in which it occurred. The Group does not offer any right of return or refunds which could impact the transaction price at inception. Certain contracts attract bonuses and/or penalties which are variable and will have an impact on transaction price at contract inception. The Group assesses variable consideration in relation to bonuses and penalties at contract inception using the most-likely method and this forms part of the transaction price recognised over time as costs are incurred. The Group only includes bonuses and penalties into the transaction price to the extent that it is highly probable that a significant reversal of revenue will not occur in future periods. Historical evidence and experience shows that even where a reduction has been required, that reduction has been immaterial to the Group."

QinetiQ Group plc, 2020, p164*

Examples of better disclosure…

"The Group agrees to pay customers various amounts either in the form of sales related rebates and discounts earned or as part of the trading investment (e.g. sales driving investment, growth over-rider investment, incentives for purchasing full loads, payment for new store openings, payment for listing new products). Where the consideration the Group is entitled to will vary because of a rebate, refund incentive or price concession or similar item; or is contingent on the occurrence or non-occurrence of a future event, e.g. the customer meeting certain agreed criteria, the amount payable is deemed to be variable consideration. The Group uses the most likely method to reflect the consideration that the Group is entitled to. Variable consideration is then only included to the extent that it is highly probable that the inclusion will not result in a significant revenue reversal in the future. Accruals are made for each individual promotion or rebate based on the specific terms and conditions of the customer agreement. Management make estimates on an ongoing basis to assess customer performance and sales volume to calculate total amounts earned to be recorded as deductions from revenue."

Britvic plc, 2019, p93**

Disclosure tips

- Be specific – text copied from the standard is unhelpful.
- Describe how consideration is variable.
- Describe how management ensures revenue recognised is within the constraint.
- If variable consideration is worthy of comment in the front half, consider what disclosures are required in the financial statements.
- Provide examples to help users' understanding.
- Explain the accounting and the underlying requirements where helpful, rather than referring to paragraphs within IFRS 15.

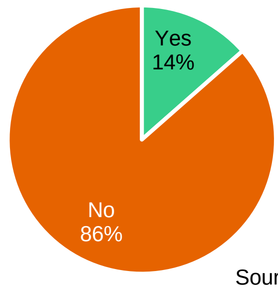
*Part of Quick Review sample **Not part of thematic or Quick Review sample

Variable Consideration (continued)

Across our sample, disclosures about the variable consideration constraint did not meet expectations. Few companies for which this appeared relevant disclosed any accounting policy, as shown by the pie chart, and often policies that were reported were incomplete.

In assessing whether to apply the constraint, companies should consider both the likelihood and magnitude of a revenue reversal. IFRS 15 provides some guidance on what factors should be considered in doing so in paragraph 57.

Did companies disclose an accounting policy on the variable consideration constraint (where this issue appeared relevant)?



Source: Quick Review

Paragraph 126(b) of IFRS 15 requires an entity to disclose information about the methods, inputs and assumptions used when assessing whether an estimate of variable consideration is constrained. We expect companies to explain how in practice they assess, interpret or estimate the variable consideration constraint threshold when variable consideration is material. Good disclosures will detail the basis for management's decisions such as historical experience or projected market conditions.

Any significant judgements made when assessing whether estimates of variable consideration should be constrained should also be disclosed. We found that helpful information disclosed by sampled companies in this regard was limited. Further detail on this, and the linkage with disclosures about significant judgements and estimates under IAS 1 'Presentation of Financial Statements', is set out on the right-hand side of this page. We continue to encourage companies to improve the quality of disclosures about their approach to this area of the standard, and to ensure that information provided is helpful and company-specific.

Examples of better disclosure…

"Variable consideration includes the estimate of payments in the form of contingent development-related and regulatory approval milestones. These milestones are included in the transaction price when the most likely outcome is that they will be received. Once this is established, the entire transaction price is constrained to the extent that it is highly probable that a significant reversal of revenue will not occur in future periods. The estimate is reassessed for each reporting period. The initial transaction price for the development of the generic GSK Ellipta® portfolio with Hikma has been assessed as $20.0m, which includes a second $5.0m milestone due on completion of the device development services. The second milestone is being constrained (i.e. not recognised) until completion is considered highly probable. If this $5.0m milestone had not been constrained, additional revenue of £3.1m (2018: £2.2m) would have been recognised in 2019."

Vectura Group plc, 2019, p105*

We encourage companies to think carefully about how the application of the variable consideration constraint impacts disclosures about estimation uncertainties.

It was pleasing to see some companies provide sensitivities and/or ranges of reasonably possible outcomes to help explain the estimation uncertainty related to variable consideration.

However, some of the quantified disclosures we saw indicated that some companies judged there to be an equal possibility of downward adjustment to revenue (i.e. reversal of revenue) as there was of upward adjustment. The variable consideration constraint introduces a downward bias to revenue measurement and we would therefore expect this to be clearly reflected in disclosures about sensitivities or ranges of outcomes. Accordingly, we would expect companies to disclose a greater potential for *upward* rather than downward adjustment. When challenged on this point as part of our routine reviews, these companies accepted that the risks had not been properly articulated through their analysis. This observation also applies where companies make IAS 1 sensitivity disclosures about variable consideration uncertainty where there is a significant risk of material adjustment to the carrying amounts of contract balances within the next financial year.

We will continue to write to companies where there is evidence that the variable consideration constraint has not been appropriately applied – for example, when companies suggest that there is equal downside and upside risk as explained above, or indeed when we see examples of revenue being reversed which are not sufficiently explained. We would not expect there to be a significant risk of a material downward adjustment to revenue, if the variable consideration constraint has been applied appropriately. Any sensitivity analysis under IAS 1 would be expected to reflect the potential for upward rather than downward adjustment.

*Part of Quick Review sample

Revenue disaggregation

Most companies disaggregate revenue using the example categories in IFRS 15, but alternative or additional categories may better illustrate how revenue is impacted by economic factors. When done well, this disclosure provides meaningful information to users, allowing, for example, an understanding of the inherent risks attached to different revenue streams.

Most common categories of disaggregation (Source: Quick Reviews)	%
Geographical region (for example, country or region)	34%
Type of good or service (for example, major product lines)	27%
Timing of transfer of goods and services (for example, over time and point in time)	14%
Market or type of customer (for example, government and non-government)	12%
Other	13%
	100%

In our Quick Review sample, the most common categories of disaggregation used by companies when reporting under IFRS 15 or IFRS 8 'Operating Segments' were geographical region or type of good or service. No company appeared to provide significantly different disaggregated data to their peers, although some provided more categories than others. However, a more detailed look at companies in our thematic sample identified the following issues, casting doubt over whether the disclosure objective had been met:

- Thoughtful explanations and analysis of revenue in the strategic report not replicated or included by cross reference to the financial statements.

One company thoughtfully presented in its Chief Executive's review the proportion of revenue by size of order, explaining that smaller orders (<£100,000) generated three quarters of total revenue, while the largest orders (>£1m) just 5% of revenue. This was important as it demonstrated that revenue was largely dependent on customers' operational, rather than capital, budgets. Changes in revenue composition could then be linked to underlying economic conditions. Another company implied in its business review that revenue was impacted by the sector of its end customers. However, neither company disaggregated revenue on these bases in their respective financial statements.

- The impact of economic factors on revenue sometimes did not appear to be fully considered, resulting in useful disaggregation not being disclosed.

In its strategic report, one company discussed the impact of Covid-19 on its On-Trade sales, yet did not disaggregate revenue between On-Trade and Off-Trade sales in its financial statements.

- Disaggregated revenue disclosures did not reflect intended changes to divisional structure.

One company reported in its strategic report that in the following year it would adopt a new divisional structure with new market-focused divisions, but did not disaggregate revenue on the new basis in addition to the old, which may have helped users' evaluation of performance.

- More granular data given in the strategic report than in the financial statements.

A telecommunications company split revenue between voice revenue and data revenue in its strategic report but provided just a total revenue figure in its financial statements.

Disclosure tips

- Consider consistency with information presented in the strategic report and in communications outside of the annual report (e.g. management reports, investor presentations).
- Use categories specific to the company's circumstances.
- Categories should reflect the risks to which the nature, amount and timing of revenue is most sensitive.
- Provide users with the most appropriate data to evaluate performance.

Contract balances

Several companies sampled disclosed helpful information about the recognition of, and year-on-year movement in, contract balances.

The majority of companies sampled clearly explained the reasons behind recognising contract balances, drawing the connection between the timing of cash flows and the delivery of associated performance obligations. We also saw some good disclosures explaining significant movements in these balances during the year. Two examples of these better disclosures are highlighted on this page.

However, several companies sampled disclosed material contract assets and/or liabilities either on the face of the balance sheet or in the notes, but did not provide any further information about the nature of these balances or the accounting.

Examples of inadequate disclosure…

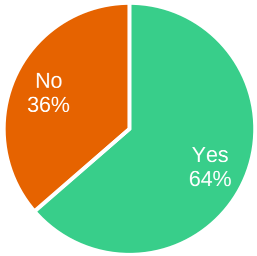
"No revenue recognised in the year was included as a contract liability at the beginning of the year (2019: nil)", However, this statement was followed by a table which showed material amounts of 'deferred income' in the current and prior years.

What is wrong with this disclosure?

- No explanation of what deferred income balance relates to, and why it does not constitute a contract liability.

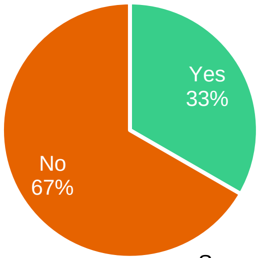
Companies should also note that an amount should only be classified as a receivable if the right to consideration is unconditional, with payment only subject to the passage of time. We saw some evidence of amounts presented as receivables when they were actually contract assets. There is a difference in both the nature and risk of such balances, and the two should be distinguished.

Where relevant, did sampled companies explain what contract balances represented?



Source: Quick Review

Where relevant, did sampled companies explain material movements in contract balances?



Source: Quick Review

Examples of better disclosure…

"When the right to consideration is conditional only on the passage of time, the balance does not meet the definition of a contract asset and is classified as an unbilled receivable. This typically arises where the timing of the related billing cycle occurs in a period after the performance obligation is satisfied."

Experian plc, 2020, p144

"The majority of software licences are invoiced annually in advance. Where these licences relate to Experian-hosted solutions, revenue is recognised over the period that the service is available to the customer, creating a contract liability. Delivery services are generally invoiced during the delivery period, creating a contract liability for the advanced consideration until the delivery is complete. Where the delivery relates to Experian-hosted solutions, revenue is recognised over the period that the service is available to the customer, reducing the contract liability over time. Where the delivery relates to an on-premise solution, the contract liability is released on delivery completion. Support and maintenance agreements are often invoiced annually in advance, creating a contract liability, which is released over the term of the maintenance period as revenue is recognised...
Revenue recognised in the year of US$370m (2019: US$448m) was included in the opening contract liability. Cash received in advance not recognised as revenue in the year was US$377m (2019: US$390m). The increase in contract liabilities resulting from business combinations during the year was US$7m (2019: US$6m)."

Experian plc, 2020, p151

What is good about this disclosure?

- Contract assets are clearly distinguished from receivables.
- The difference between timing of cash flow and revenue recognition pattern, which creates the contract liability, is highlighted.
- The pattern of recognition of the contract liability in revenue is explained for each different type.

Significant judgements

Significant judgements made when applying IFRS 15 that affect the amount and timing of revenue recognition should be clearly explained and be company-specific.

Several companies in our sample did not disclose sufficient information about the significant judgements made in applying their accounting policies under IFRS 15. Any disclosures about significant judgements under IFRS 15 are in addition to the requirements of IAS 1, and companies should note that a judgement that would not ordinarily qualify for disclosure under IAS 1 may still need to be disclosed under IFRS 15.

Several companies referred to judgements which appeared to be significant, but did not explain what they were. Alternatively, they made statements about a specific application of the standard, without explaining the judgements that led to the chosen accounting treatment. For example, one company in our Quick Review explained that they had treated licence sales as a right to use their intellectual property, thereby recognising revenue at a point in time (as opposed to 'right to access' licences which would necessitate over time recognition). However, there was no explanation of how and why they arrived at this conclusion. As it was their largest revenue stream and this is a judgemental area of the standard, this was a point on which we expected some discussion.

We also found one example where the Audit Committee report discussed the risk of revenue being inappropriately recognised for multiple-element contracts due to incorrect apportionment to products and services. However, the company did not disclose any information about, for example, the judgements made in determining standalone selling prices or the number of performance obligations in these multiple-element contracts.

Another company earned a significant proportion of revenue during the year from one contract, but disclosures did not appear to have been updated to reflect the judgements made to account for it. Again, the Audit Committee report referred specifically to management's application of IFRS 15 to this contract when discussing the year's significant reporting issues and judgements, but the accounts included no disclosures about the significant judgements management had made.

Examples of better disclosure…

"Stores within the Domino's Pizza system contribute into a National Advertising Fund ('NAF') and eCommerce fund (together 'the Funds') designed to build store sales through increased public recognition of the Domino's brand and the development of the eCommerce platform. The Funds are managed with the objective of driving revenues for the stores and are planned to operate at break-even with any surplus or deficit carried in the Group balance sheet… Whilst commercially and through past practice, the use of the Funds are directed by franchisees through the operation of the Marketing Advisory Committee…, the terms of the Standard Franchise Agreement…allow the Group to control the Funds. The Group monitors and communicates the assets and liabilities on a separate basis, however from a legal perspective under the franchise agreement these assets and liabilities are not legally separated…As a result, for the purposes of accounting we consider that we are principal over the operation of the Funds. For this reason, contributions by franchisees into the Funds are treated as revenue, and expenses which are incurred under the Funds are treated as administrative expenses by the Group. This results in an increase to statutory revenue and administrative expenses of the Group."

Dominos Pizza Group plc, 2019, p107*

Examples of inadequate disclosure…

"*The Group has considered whether it is an agent or principal under IFRS 15 for each commercial arrangement and accounted for these accordingly.*"

Examples of inadequate disclosure…

"*The Group is required to assess each of its contracts with customers to determine whether performance obligations are satisfied over time or at a point in time in order to determine the appropriate method for recognising revenue.*"

What is wrong with this disclosure?

- Information provided is generic.
- The company has not articulated what they consider when performing the judgement – e.g. the circumstances under which they would conclude that point in time vs over time recognition is appropriate.

Examples of better disclosure…

"Revenue has been recognised over time, rather than at a point in time, following judgement made on the Group's enforceable right to payment under certain contracts with the Ministry of Defence, where there is a right for the customer to terminate without cause and prior to contract completion under various versions of DEFCON 656. Under this DEFCON there is no explicitly stated right of recovery of profit, however there is an implication that this is allowed for within the DEFCON wording. The revenue recognition determination under these contracts has taken this implied wording into account. This judgement is based on management's understanding of the commercial reality underlying such contracts, and experience of similar contracts which do contain explicit rights to recover profit."

TP Group plc, 2019, p68

What is wrong with this disclosure?

- The company has not specified what it concluded in its assessment and the resultant accounting.

*Not part of thematic or Quick Review sample

Significant judgements (continued)

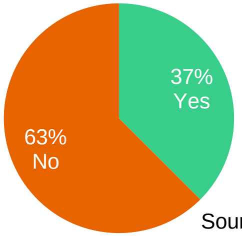
*Part of Quick Review sample

Some areas of significant judgement also involve estimation uncertainty – that is, assumptions and estimates that have a significant risk of resulting in a material adjustment to the carrying amounts of assets and liabilities within the next financial year. The disclosure requirements for estimates are governed by paragraphs 125 to 129 of IAS 1 and extend to quantitative information, such as sensitivity analysis or ranges of potential outcomes.

Most of the companies that disclosed revenue-related estimation uncertainty under IAS 1 did sufficiently explain why there was a significant risk of a material adjustment within the next year.

One company in our thematic sample did not provide any quantitative information despite disclosing that there were two revenue-related areas which involved significant estimation uncertainty. In our Quick Review sample this disclosure omission was more widespread, as evidenced by the chart below.

Where revenue-related estimation uncertainty was identified, did company provide quantitative information?



Source: Quick Review

We also noted that many companies discussed historical data as being a basis for calculating estimates. We encourage companies to ensure that they have adequately assessed whether such information represents a sufficiently reliable estimate of future outcomes, or whether adjustments are required to reflect expected trends. This is particularly relevant in the light of Covid-19.

The disclosure tips on this page are designed to help companies strike the right balance when disclosing information about significant judgements.

Examples of better disclosure…

"Bioprocessing of clinical / commercial product for partners is recognised on a percentage of completion basis over time as the processes are carried out. Progress is determined based on the achievement of verifiable stages of the bioprocessing process. Revenues are recognised on a percentage of completion basis and as such require judgement in terms of the assessment of the correct stage of completion including the expected costs of completion for that specific bioprocessing batch. The value of the revenue recognised and the related contract asset raised with regards to the bioprocessing batches which remain in progress at year end is £20,863,000. If the assessed percentage of completion was 10 percentage points higher or lower, revenue recognised in the period would have been £2,086,300 higher or lower."

Oxford Biomedica plc*, 2019, p124

Examples of inadequate disclosure…

"Fixed priced development or consultancy projects also require estimates in respect of the percentage completion of each project."

What is wrong with this disclosure?

- Basis for calculating percentage completion not given.
- What is particularly hard to estimate is not specified.
- The balance that is at risk of material adjustment in the next year has not been identified.
- No quantitative information is provided.

Examples of inadequate disclosure…

"The Group's pricing structure involves rebate arrangements with several of its direct and indirect customers. These can be complex in nature and involve estimation in determining the required level of provision for rebate liabilities, particularly where the Group is reliant on information from customers which may not be available at the time the liabilities are assessed."

What is wrong with this disclosure?

- Method of estimation is not explained.
- No quantitative information is provided.

Companies should clearly explain the significant judgements and sources of estimation uncertainty affected by or arising from Covid-19. For example, risks associated with estimating the transaction price and/or contract costs may be heightened as a result of the virus. Furthermore, users want to understand not only how historical financial performance has been impacted by Covid-19, but also what it means for the company's future prospects. Disclosure of sensitivities or range of possible outcomes should provide users with that information in relation to estimation uncertainties.

Disclosure tips

- Ensure completeness of disclosures about judgements - those that would not ordinarily qualify for disclosure under IAS 1 may still need to be disclosed under IFRS 15.
- Ensure disclosures about significant judgements are consistent with information in other areas of the annual report such as the Audit Committee Report or the Independent Auditor's Report.
- For companies in industries where readers might expect there to be significant judgements made in relation to revenue, it may be helpful to clarify when management has concluded that such judgements are not significant or are immaterial, rather than remaining silent.
- Where judgements also involve significant estimation uncertainty, ensure quantitative disclosures are also provided. IAS 1 provides examples of this information, such as sensitivities or ranges of potential outcomes.

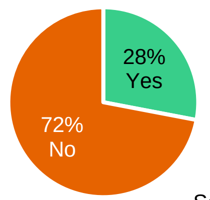
Costs to obtain or fulfil a contract

We are concerned by the lack of information disclosed about contract costs by companies whose activities suggest they may be relevant.

Less than a third of companies in our Quick Review sample disclosed an accounting policy for contract costs. Even fewer companies disclosed the closing balances of assets recognised from costs incurred to obtain or fulfil a contract by type of cost, perhaps as a result of contract costs generally being expensed rather than capitalised. While it is difficult to discern from a Quick Review of accounts whether costs to obtain or fulfil a contract eligible for capitalisation are material and relevant to a company, we note that at least one company from each of the industries sampled did address the accounting for these costs. We are therefore concerned that some companies may have overlooked the reporting requirements in this area. We remind companies that, under IFRS 15:

- incremental costs to obtain contracts **should** be capitalised unless the practical expedient in paragraph 94 of IFRS 15 is taken;
- costs to fulfil contracts **should** be capitalised if the criteria in paragraph 95 are met (i.e. the costs (a) relate directly to a contract/anticipated contract (b) generate/enhance resources of the company that will be used to satisfy future performance obligations and (c) are expected to be recovered) and they do not fall within the scope of another standard such as IAS 2 ‘Inventories’, IAS 16 ‘Property, Plant and Equipment’ or IAS 38 ‘Intangible Assets’ and
- the paragraph 94 practical expedient **does not apply** to costs to fulfil contracts.

Accounting policy for contract costs?



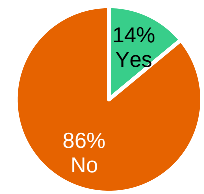
Source: Quick Review

Industry	Accounting policy for contract costs
Aerospace & Defence	5 of 5 companies
Construction & Materials	1 of 8 companies
Industrial Goods & Services	2 of 6 companies
Pharmaceuticals / Biotech / Healthcare	1 of 6 companies
Retail	1 of 8 companies
Software & Computer Services	2 of 5 companies
Support Services	2 of 6 companies
Telecoms & Media	1 of 6 companies

All Aerospace & Defence companies in our Quick Review sample provided an accounting policy for contract costs. One company simply clarified that it did not incur significant incremental costs to obtain contracts while another specified that pre-contract bidding costs were expensed as they would have been incurred regardless of whether the contract was won or lost.

In contrast, just one of eight Construction & Materials companies in our Quick Review sample disclosed a policy for contract costs. That company explained that costs were incurred to secure contracts, i.e. commissions. The apparent absence of contract costs in the other seven companies was surprising given costs to fulfil a contract (e.g. set-up

Type of contract costs quantified?



Source: Quick Review

costs) may be relevant to these companies, such as labour, transportation and other overheads, before contracts commence. Similar set-up costs might also arise in other industries, such as Support Services and Software & Computer Services.

We will write to companies where we believe, based on our knowledge of the company or the industry in which it operates, they may have costs that qualify for capitalisation under the standard or the accounting for these costs is unclear. For example, where a company refers to commissions payable to sales teams in the strategic report but does not address the accounting for commission costs in their accounts. Helpful disclosures which will aid readers’ understanding include:

- ✓ Confirming that contract costs eligible for capitalisation are not a material consideration to the company if contract costs are common in a particular industry;
- ✓ Clarifying whether the paragraph 94 practical expedient to expense the incremental costs to obtain a contracts has been applied; and
- ✓ Making clear the nature of capitalised contract fulfilment costs that are in the scope of another standard and disclosing the applicable standard.

Costs to obtain or fulfil a contract (continued)

The key issues identified from a detailed review of companies' disclosures in our thematic sample were:

- Not describing the specific nature of costs to obtain or fulfil contracts.
- Capitalising third party licence costs under IFRS 15 where these appeared to fall within the scope of IAS 38 'Intangible assets'.
- Confusion caused by referring to both contract costs and contract assets (as defined in IFRS 15 Appendix A) as contract assets.
- Not disclosing the closing balances of costs to obtain or fulfil a contract by main category of asset e.g. sales commission costs, set-up costs.
- Contradictory disclosures.

One company explained that contract costs were amortised on a straight-line basis over the term of the contract. However, elsewhere in the accounts it stated amortisation was over the period of significant modification and optimisation of the software. Both policies may have been applicable but it was unclear under what circumstances each applied.

Examples of better disclosure…

"Significant Accounting policies - Costs incurred prior to the satisfaction or partial-satisfaction of a performance obligation are first assessed to see if they are within the scope of other standards. Where they are not, certain costs are recognised as an asset providing they relate directly to a contract (or an anticipated contract), generate or enhance resources that will be used in satisfying (or to continue to satisfy) performance obligations in the future and are expected to be recovered from the customer. Costs which meet this criteria are deferred as contract costs and these are amortised on a systematic basis consistent with the pattern of transfer of the related goods or services. Costs to obtain a contract predominantly comprise sales commissions costs. Costs to fulfil a contract predominantly comprise of labour costs directly relating to the implementation services provided.

Contract costs - The carrying amount of assets recognised from costs to obtain and costs to fulfil contracts with customers at 31 March 2020 is US$28m and US$68m respectively (2019: US$26m and US$74m). Amortisation of contract costs in the year is US$74m (2019: US$77m) and recognised impairment losses totalled US$5m (2019: US$1m). Contract costs are amortised on a systematic basis consistent with the pattern of transfer of the related goods or services. A portfolio approach has been applied to calculate contract costs for contracts with similar characteristics, where the Group reasonably expects that the effects of applying a portfolio approach does not differ materially from calculating the amounts at an individual contract level."

Experian plc, 2020, p144 & p151

What is good about this disclosure?

- ✓ Explains the nature of contract costs capitalised e.g. commissions and labour costs.
- ✓ Discloses the closing balances of capitalised contract costs by category.
- ✓ Amortisation and impairment losses are quantified.
- ✓ Highlights that a portfolio approach has been applied to calculate contract costs for contracts with similar characteristics.

Next steps

Engagement with companies

We are writing letters to 8 companies included in our sample where there is a substantive question relating to their revenue reporting and/or accounting, and to a further 3 companies drawing their attention to aspects of their revenue disclosures which could be improved.

Impact on our future reviews

We acknowledge that IFRS 15 is a relatively new standard and best practice is clearly still evolving. We encourage companies applying IFRS 15 to consider the findings within this report when preparing their disclosures in future annual reports and accounts.

We will continue to challenge companies during our routine reviews when we see:

- Unclear descriptions of performance obligations and of exactly when revenue is recognised (i.e. when the customer obtains control) for ‘point in time’ performance obligations, and insufficient information about the methods used to measure progress of ‘over time’ performance obligations
- Unclear descriptions of the types of variable consideration that exist within contracts and how they are both estimated and constrained
- Disaggregated revenue disclosures which are inconsistent with messages provided in other parts of the annual report, or other documents
- Material contract assets and liabilities left unexplained, especially when there are significant movements in these balances
- Unclear or absent explanations of significant judgements made in determining the amount or timing of revenue
- No quantification of estimation uncertainties relating to revenue (such as sensitivities or ranges of possible outcomes)
- No accounting policies for costs capitalised under IFRS 15, along with a breakdown by type of cost if relevant

Financial Reporting Council

Information about the Financial Reporting Council can be found at:
https://www.frc.org.uk

Follow us on Twitter @FRCnews or Linked

Our purpose
The FRC's purpose is to serve the public interest by setting high standards of corporate governance, reporting and audit, and by holding to account those responsible for delivering them.

FINANCIAL REPORTING COUNCIL
8TH FLOOR
125 LONDON WALL
LONDON EC2Y 5AS

+44 (0)20 7492 2300

www.frc.org.uk