Staff paper

Agenda reference: 30E

IASB® meeting

Date	**July 2024**
Project	**Second Comprehensive Review of the *IFRS for SMEs®* Accounting Standard**
Topic	**Sweep and other issues**
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Purpose of this paper

1. The purpose of this paper is to ask the International Accounting Standards Board (IASB) to consider:

   (a) a sweep issue on transaction price terminology the staff identified during the drafting of the third edition of the *IFRS for SMEs* Accounting Standard;

   (b) additional feedback and analysis on the proposed requirements in the Exposure Draft *Third edition of the* IFRS for SMEs *Accounting Standard* (Exposure Draft) for accounting for a sale with a right of return (discussed at the May 2024 IASB meeting); and

   (c) whether to amend the *IFRS for SMEs* Accounting Standard to incorporate guidance in SME Implementation Group (SMEIG) Q&As during the second comprehensive review.

2. In this paper, the term SMEs refers to entities that are eligible to apply the *IFRS for SMEs* Accounting Standard (the Standard).

Staff recommendation

3. The staff recommend the IASB:

   (a) require an SME to initially measure basic financial instruments that are trade receivables at the amount determined by applying the revised Section 23, unless the contract constitutes, in effect, a financing transaction and the SME does not apply the exemption proposed in paragraph 23.59 of the Exposure Draft;

   (b) add to Appendix B *Glossary of terms* a definition of 'transaction price (for a contract with a customer)' that matches the description of the term proposed in paragraph 23.41 of the Exposure Draft; and

   (c) require an SME to account for sales with a right of return based on the products expected to be returned;

   (d) not amend the Standard to incorporate guidance in the SMEIG Q&As.

Structure of this paper

4. This paper is structured as follows:

   (a) transaction price terminology (paragraphs 6–17);

   (b) sale with a right of return (paragraphs 18–52);

   (c) treatment of SMEIG Q&As (53–59); and

   (d) Appendix—Figures illustrating changes to the proposed requirements for refund liabilities and sales with a right of return.

5. This paper includes three questions for the IASB, which are included at the end of the staff analysis on each topic.

Transaction price terminology

Proposals in the Exposure Draft

6. The Exposure Draft proposed aligning the *IFRS for SMEs* Accounting Standard with IFRS 15 *Revenue from Contracts with Customers* by revising Section 23 *Revenue* of the *IFRS for SMEs* Accounting Standard.

7. The proposed revised Section 23 requires SMEs to determine the transaction price for contracts with customers. Paragraph 23.41 of the Exposure Draft states:

> The transaction price is the amount of consideration to which the entity expects to be entitled in exchange for transferring goods or services promised to a customer, excluding amounts collected on behalf of third parties (for example, some sales taxes).

8. The term 'transaction price' is used elsewhere in the Standard but is not defined in Appendix B *Glossary of terms* of the Standard.

9. The proposed revised Section 23 includes requirements for accounting for trade receivables arising from contracts with customers. Paragraph 23.117 of the Exposure Draft states that a receivable is 'an entity's right to consideration that is unconditional' (that is, an unconditional right to consideration). Paragraph 23.118 of the Exposure Draft requires SMEs to present any such rights separately.

10. The Exposure Draft proposed amending the scope of Part I of Section 11 *Basic Financial Instruments* to include trade receivables arising from contracts with customers.[1] Paragraph 11.13 of the Standard requires SMEs to initially measure basic financial instruments at the transaction price (unless the arrangement constitutes, in effect, a financing transaction).

[1] See paragraph 11.7(g) of the Exposure Draft.

Staff analysis

Initial measurement of trade receivables

11. SMEs applying the proposed revised Section 23 would present any unconditional right to consideration separately as a receivable. But the receivable might be measured, at initial recognition, at an amount that differs from the amount of the transaction price recognised as revenue. Such differences could occur, for example, when the transaction price includes variable consideration or when an SME has a right to an amount of consideration that is conditional.[2]

12. However, applying paragraph 11.13 of the Standard, at initial recognition, an SME would *always* measure the trade receivable at its transaction price (unless the arrangement constitutes, in effect, a financing transaction).

13. To remove the inconsistency described in paragraphs 11–12 of this paper, an SME would need to initially measure basic financial instruments that are trade receivables at the amount determined by applying the revised Section 23 (unless the contract constitutes, in effect, a financing transaction). Similarly, the SME would need to initially measure a receivable at the amount determined by applying the revised Section 23 if the receivable arises from a contract that constitutes a financing transactions and the SME has not applied the exemption proposed in paragraph 23.59 of the Exposure Draft.[3]

14. A similar inconsistency existed in full IFRS Accounting Standards because of the requirements and terminology used in IFRS 9 *Financial Instruments* and IFRS 15. The IASB removed this inconsistency by amending IFRS 9.[4] The amendment is similar to the change described in paragraph 13 of this paper.

[2] See Example 39 and Example 40 accompanying IFRS 15 *Revenue from Contracts with Customers*.

[3] The exemption proposed in paragraph 23.59 of the Exposure Draft permits an SME to not account for a financing transaction as a financing transaction if it expects, at contract inception, that the period between when it transfers the good or service promised to a customer and when the customer pays for that good or service will be one year or less. The exemption is similar to the practical expedient in paragraph 63 of IFRS 15.

[4] See *Annual Improvements to IFRS Accounting Standards—Volume 11* issued in July 2024.

Transaction price terminology

15. As a consequence of using the term ‘transaction price’ in the proposed revised Section 23, the Standard will:

    (a) use the term in the context of recognising revenue in the revised Section 23; and

    (b) use the term outside the context of recognising revenue (for example, in paragraphs 11.13, 12.7, 14.8 and 15.14 of the Standard).

16. Instances where the term ‘transaction price’ is used outside the context of recognising revenue have existed since the Standard was issued. The staff believe the term is understood in these instances, despite the term not being defined in the Standard. However, as a consequence of using the term in the revised Section 23, the staff think it would be beneficial to clarify whether the term is used in the context of recognising revenue. This could be done defining the term in Appendix B *Glossary of terms* of the Standard using the description of the term proposed in paragraph 23.41 of the Exposure Draft, and specifying the definition is for determining revenue from a contract with a customer. This would be consistent with the Glossary for IFRS Accounting Standards, which includes the definition of the term from Appendix A *Defined terms* of IFRS 15:

    transaction price
    (for a contract with a customer)

    The amount of consideration to which an entity expects to be entitled in exchange for transferring promised goods or services to a customer, excluding amounts collected on behalf of third parties.

Staff recommendations and question for the IASB

17. The staff recommend the IASB:

    (a) require an SME to initially measure basic financial instruments that are trade receivables at the amount determined by applying the revised Section 23, unless the contract constitutes, in effect, a financing transaction and the SME does not apply the exemption proposed in paragraph 23.59 of the Exposure Draft; and

    (b) add to Appendix B *Glossary of terms* a definition of 'transaction price (for a contract with a customer)' that matches the description of the term proposed in paragraph 23.41 of the Exposure Draft.

Question for the IASB
1. Does the IASB agree with the staff recommendations in paragraph 17 of this paper?

Sale with a right of return

Background

18. The Exposure Draft proposed requirements for determining the transaction price where the consideration promised in a contract is variable. Under the proposals, an SME would determine the amount of variable consideration to include in the transaction price by:

    (a) estimating the amount of consideration that the SME expects to be entitled to; and

    (b) constraining the estimate of variable consideration in (a) by applying paragraph 23.46 of the Exposure Draft.

19. The requirements proposed in the Exposure Draft are similar to the requirements in IFRS 15. However, the requirement to constrain estimates of variable consideration

in paragraph 23.46 of the Exposure Draft was expressed differently to make it easier for SMEs to understand and apply. To reduce the likelihood SMEs reverse amounts of variable consideration recognised in subsequent periods, the requirement uses the same 'highly probable' confidence level as IFRS 15[5]:

> 23.46 An entity shall include in the transaction price some or all of an amount of variable consideration estimated in accordance with paragraph 23.44 only to the extent that it is **highly probable** that this amount will become due when the uncertainty associated with the variable consideration is subsequently resolved.

20. At its February 2024 meeting, the IASB tentatively decided to confirm its proposal to require an SME to constrain estimates of variable consideration by applying paragraph 23.46 of the Exposure Draft.[6]

21. In addition to variable consideration, the Exposure Draft included requirements for:

    (a) refund liabilities; and

    (b) sales with a right of return.

Refund liabilities

22. An entity might receive consideration from a customer before the uncertainty associated with the variable consideration is resolved. For example, an entity might be required to refund some or all of the customer's consideration if the contract is not completed by a specific date.

[5] Paragraph 56 of IFRS 15 *Revenue from Contracts with Customers*.

[6] See IASB *Update* from the February 2024 IASB meeting.

23. Paragraph 23.49 of the Exposure Draft proposed:

> … [an] entity shall recognise as a refund liability the amount of consideration that the entity reasonably expects to refund to the customer.

24. The proposal for recognising refund liabilities in paragraph 23.49 of the Exposure Draft is different to IFRS 15. In IFRS 15, the amount of consideration excluded from the transaction price is recognised as a refund liability.[7]

25. The proposals in paragraphs 23.46 and 23.49 of the Exposure Draft would mean the amount of consideration included in the transaction price, plus the amount of consideration recognised as a refund liability, will not equal the total consideration received (or receivable). This difference arises because, unlike IFRS 15, the proposed requirements for refund liabilities are not based on the amount of consideration excluded from the transaction price. Figure 1 in the appendix to this paper illustrates this difference.

Tentative decision at the May 2024 IASB meeting

26. To resolve the inconsistency described in paragraph 24 of this paper, the IASB tentatively decided to change the proposed requirements for accounting for refund liabilities at its meeting in May 2024.[8] Based on the change, the amount of consideration recognised as a refund liability will be measured based on the amount of consideration excluded from the transaction price, similar to IFRS 15. Figure 2 in the appendix to this paper illustrates the proposed requirements for refund liabilities as a consequence of the change.

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[7] Paragraph 55 of IFRS 15.

[8] See IASB *Update* from the May 2024 IASB meeting.

Sales with a right of return

27. Entities might sell products that give a customer a right to a refund that is conditional on the customer returning the product (a right of return). Until the customer's right is exercised or lapses, the amount of consideration that the entity is entitled to is uncertain. Therefore, the consideration promised in the contract is variable.

28. When accounting for sales with a right of return, the Exposure Draft proposed that SMEs recognise:

    (a) revenue for products expected not to be returned; and

    (b) a refund liability for products expected to be returned.[9]

29. To determine the amount of revenue to recognise for sales with a right of return, paragraph 23.54 of the Exposure Draft proposed an SME:

    > … recognise revenue only to the extent that it is highly probable that the products will not be returned. The amount of consideration received (or receivable) that is not recognised as revenue shall be recognised as a refund liability …

30. Paragraph 23.54 of the Exposure Draft incorporated the proposed requirement to constrain estimates of variable consideration in paragraph 23.46 of the Exposure Draft (see paragraph 19 of this paper). This was done to avoid SMEs from having to work out how the general requirements for measuring variable consideration apply to sales with a right of return. As a consequence, paragraph 23.54:

    (a) uses a 'highly probable' confidence level; and

    (b) is expressed in relation to products that 'will not be returned' (and therefore, recognised as revenue). This is consistent with paragraph 23.46, which is

[9] Paragraph 23.53 of the Exposure Draft.

expressed in relation to consideration that 'will become due' (and therefore, recognised as revenue).

31. Figure 3 in the appendix to this paper illustrates the proposed requirements in paragraph 23.54 of the Exposure Draft.

Discussion at the May 2024 IASB meeting

32. At its May 2024 meeting, the IASB discussed whether to change paragraph 23.54 of the Exposure Draft so it is expressed in relation to products that 'will be returned' (that is, expressed in the positive). Table 1 shows the effect of expressing the requirement in the positive.

Table 1—Requirement for a sale with a right of return expressed in the negative and positive

Expression	Focus	Specifies
Negative ⊖	Products that will not be returned (*per the Exposure Draft*)	Recognition of revenue (*per the Exposure Draft*)
Positive ⊕	Products that will be returned	Recognition of refund liabilities

33. Agenda Paper 30A of the May 2024 IASB meeting analysed how to express paragraph 23.54 in the positive, while maintaining a revenue recognition threshold similar to the proposed threshold for variable consideration in paragraph 23.46 of the Exposure Draft.[10] Expressing paragraph 23.54 in the positive would mean any confidence level specified in the requirement would apply to the measurement of the refund liability, not revenue. For example, if the paragraph was expressed in the positive and the 'highly probable' confidence level was retained, the revenue recognition threshold would be lower than the proposed threshold for variable

[10] See paragraphs 28–39 of Agenda Paper 30A *Proposed revised Section 23* Revenue from Contracts with Customers—*Other matters raised in feedback* of the May 2024 IASB meeting.

consideration in paragraph 23.46. To prevent lowering the threshold, the staff recommended expressing paragraph 23.54 in the positive and using a 'probable' confidence level.

34. The IASB did not support changing paragraph 23.54.

Feedback received during drafting of the revised Section 23

35. At its May 2024 meeting, the IASB also discussed simplifying how the requirements in the proposed revised Section 23 are expressed so they are easy for SMEs to understand and apply.[11] As part of the drafting process, SMEIG members provided feedback on how to express the requirements for accounting for sales with a right of return more simply.

36. SMEIG members were equally split between those who thought paragraph 23.54 of the Exposure Draft should be changed and who thought the paragraph should remain unchanged.

37. All SMEIG members who thought the paragraph should be changed said the paragraph would be easier to understand or apply if it was expressed in the positive. This is because it is easier for SMEs to judge what products customers will return and gather information that supports this estimate.

38. Many of the SMEIG members who thought the paragraph should remain unchanged said they could understand the paragraph as written. However, some SMEIG members who thought the paragraph should remain unchanged said it would be easier to understand if it was expressed in the positive. Of these SMEIG members, one thought SMEs in their jurisdiction would continue to recognise revenue from sales with a right of return based on the products the SMEs expect to be returned (that is, current practice will remain unchanged regardless of how the requirements are expressed).

[11] See Agenda Paper 30B *Proposed revised Section 23* Revenue from Contracts with Customers—*Length and language* of the May 2024 IASB meeting.

39. Some of the SMEIG members who thought the paragraph should remain unchanged thought the amount of revenue recognised in accordance with the paragraph 23.54 equals the difference between the total consideration received (or receivable) and the products highly probable to be returned. Figure A illustrates their understanding.

Figure A—Perceived relationship between the requirements for a sale with a right of return expressed in the negative and positive

TOTAL CONSIDERATION RECEIVED (OR RECEIVABLE)

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CONTRACT LIABILITY
Consideration received (or receivable) for products highly probable to be returned (that is, products expected to be returned applying a 'highly probable' confidence level)

=

REVENUE RECOGNISED IN ACCORDANCE WITH PARAGRAPH 23.54
Consideration received (or receivable) for products highly probable not to be returned (that is, products expected not to be returned applying a 'highly probable' confidence level)

40. However, because the 'highly probable' confidence level is being applied to the measurement of the refund liability, this would not achieve the same result as applying the 'highly probable' confidence level to the measurement of revenue (as discussed in paragraph 33 of this paper).

Staff analysis

41. In light of the feedback from SMEIG members, the staff considered the interaction between the revenue recognition threshold and confidence level specified in paragraph 23.54 of the Exposure Draft.

42. Constraining estimates of products expected to be returned reduces the amount of consideration recognised as a refund liability. Reducing the amount of consideration recognised as a refund liability increases the amount of consideration

recognised as revenue. Therefore, requiring SMEs to constrain estimates of products expected to be returned lowers the revenue recognition threshold compared with requiring SMEs to not constrain such estimates (that is, accounting for sales with a right of return based on an unconstrained estimate of products expected to be returned).

43. Other sections of the Standard require SMEs to use unconstrained estimates to recognise assets and liabilities. Section 21 *Provisions and Contingencies* of the current Standard includes requirements for sales with a right of return and requires SMEs to recognise a provision for refunds if it is probable goods will be returned. The provision is measured based on the 'best estimate' of the amount required to settle the refund.[12] The 'probable' confidence level used to recognise the provision does not apply to its measurement.

44. Based on the feedback and analysis in paragraphs 38–43 of this paper, the staff recommend withdrawing paragraph 23.54 of the Exposure Draft and instead requiring an SME to account for sales with a right of return based on the products expected to be returned. By doing so, the requirements would:

    (a) be easier to understand and less complicated to apply compared to paragraph 23.54;

    (b) avoid changing current practice unnecessarily; and

    (c) avoid lowering the revenue recognition threshold compared with if paragraph 23.54 was expressed in the positive and a confidence level was specified.

45. Figure 4 in the appendix to this paper illustrates the recommended change to the proposed requirements.

[12] Paragraph 21.7 of the *IFRS for SMEs* Accounting Standard.

Lower revenue recognition threshold

46. The staff recommendation in paragraph 44 of this paper would mean the revenue recognition threshold for sales with a right of return would be lower than other types of variable consideration. This is because an SME would not apply the 'highly probable' confidence level proposed in paragraph 23.46 of the Exposure Draft when recognising revenue from sales with a right of return. Introducing a lower revenue recognition threshold could increase the likelihood that SMEs reverse amount of revenue recognised from sales with a right of return in subsequent periods.

47. However, if an SME grants a right of return, the right usually applies to all products they sell and exists for a limited period (for example, a 30-day returns period that applies to all products sold). These characteristics mean the likelihood of revenue reversals from sales with a right of return is typically less than contracts with other types of variable consideration (for example, long-term construction contracts with performance bonuses). This is because for sales with a right of return:

    (a) there are only two possible outcomes for each contract (the product is retained or returned);

    (b) the uncertainty is resolved in a short period of time; and

    (c) SMEs will usually have experience with similar types of contracts that can be used to predict the contract's outcome.

48. As the likelihood of revenue reversals from sales with a right of return is expected to be less than contracts with other types of variable consideration, the staff think introducing a lower revenue recognition threshold for these types of sales is an acceptable consequence of making the requirements easier to understand and apply.

Exception for sales with a right of return

49. The staff recommendation in paragraph 44 of this paper would introduce an exception to the proposed requirements for variable consideration in the revised

Section 23 for sales with a right of return. Introducing exceptions for specific transactions can make standards more difficult to apply because preparers must learn the 'rule and exception' and identify when the exceptions apply.

50. The staff think any additional complexity created by the exception for sales with a right of return would be outweighed by the benefit of introducing requirements that are easy to understand and apply. The staff also think the exception would add only a limited amount of complication for preparers because:

(a) SMEs that sell products with a right to return usually have no contracts with other types of variable consideration.

(b) SMEs should be able to identify easily when the exception applies. This is because sales with a right of return are economically different to contracts with other types of variable consideration as the asset transferred to the customer is returned to the entity.

(c) Section 21 of the current *IFRS for SMEs* Accounting Standard includes separate requirements that apply to sales with a right of return in addition to Section 23. Therefore, having an exception for these contracts is similar to current practice.

51. At its May 2024 meeting, the IASB discussed some of the revenue recognition requirements for SMEs being included in an appendix to Section 23 which has the same authority as the Section.[13] The appendix could include the requirements for sales with a right of return to emphasise the requirements create an exception to the general requirements for measuring variable consideration in the Section. This would be consistent with IFRS 15, where Appendix B *Application Guidance* of IFRS 15 includes requirements for sales with a right of return.

[13] See paragraph 18(a) of Agenda Paper 30B *Proposed revised Section 23* Revenue from Contracts with Customers—*Length and language* of the May 2024 IASB meeting.

Staff recommendation and question for the IASB

52. The staff recommend the IASB require an SME to account for sales with a right of return based on the products expected to be returned.

Question for the IASB
2. Does the IASB agree with the staff recommendation in paragraph 52 of this paper?

SMEIG Q&As

Background

53. The SMEIG is an advisory body to the IASB on the *IFRS for SMEs* Accounting Standard. One of SMEIG's roles is to consider questions on the application of the Standard, decide which questions merit published educational material and develop Q&As, which are educational materials.

54. The IASB has previously stated that it will consider all Q&As issued by the SMEIG at each comprehensive review of the Standard to decide whether to incorporate those Q&As into the Standard or into the educational material.

Q&As issued since the first comprehensive review

55. Since the second edition of the Standard was issued following the IASB's first comprehensive review of the Standard, the SMEIG has issued two Q&As:

    (a) *Accounting for financial guarantee contracts in individual or separate financial statements of the issuer* (Q&A 2017/12.1). Q&A 2017/12.1 provides guidance on how an entity should account for issued financial guarantee contracts. As part of this second comprehensive review, the IASB has tentatively decided to include a definition of a 'financial guarantee contract' and include specific requirements for issued financial guarantee contracts in the Standard. Therefore, the guidance in Q&A 2017/12.1 would no longer be required to support the third edition of the Standard and would be outdated. Agenda Paper 30D *Issued Financial Guarantee Contracts* for this meeting discusses the requirements for issued financial guarantee contracts. The staff recommend the Q&A should be retained on the website whilst the second edition of the Standard is being used by SMEs and then removed.

(b) *Application of the undue cost or effort exemption when measuring fair value on transition to the IFRS for SMEs Standard* (Q&A 2020/35.1). Q&A 2020/35.1 provides guidance on application of the undue cost or effort exemption when measuring fair value on transition to the Standard. The treatment of this Q&A during this second comprehensive review is discussed below.

Q&A 2020/35.1[14]

56. Q&A 2020/35.1 addresses the following issue: Should a first-time adopter assess whether the fair value of an asset or liability can be measured reliably at the date of transition to the Standard without undue cost or effort:

(a) using information about the costs and benefits at the date of transition, or

(b) using information about the costs and benefits at the date of its first financial statements prepared applying the Standard.

[14] SMEIG Q&A Section 35 Issue 1 (ifrs.org)

57. Q&A 2020/35.1 provides the following guidance:

(a) when preparing its first financial statements applying the Standard, an SME assesses whether the fair value of an asset or liability can be measured reliably at the entity's date of transition to the Standard without undue cost or effort using information about the costs and benefits at the date of transition to the Standard; and

(b) the SME does not consider the additional cost or effort due to the elapse of time between the date of transition and the date of its first financial statements prepared applying the Standard.

58. The staff think the guidance in Q&A 2020/35.1 is educational in nature and recommend it is added to Module 35 of the educational material when that module is updated. Following this, the Q&A should be removed from the website. The staff does not think the requirements in the Standard need to be amended.

Staff recommendation and question for the IASB

59. The staff recommend the IASB not amend the Standard to incorporate guidance in the SMEIG Q&As.

Question for the IASB
3. Does the IASB agree with the staff recommendation in paragraph 59 of this paper?

Appendix—Figures illustrating changes to the proposed requirements for refund liabilities and sales with a right of return

Figure 1—Summary of the requirements for refund liabilities proposed in the Exposure Draft

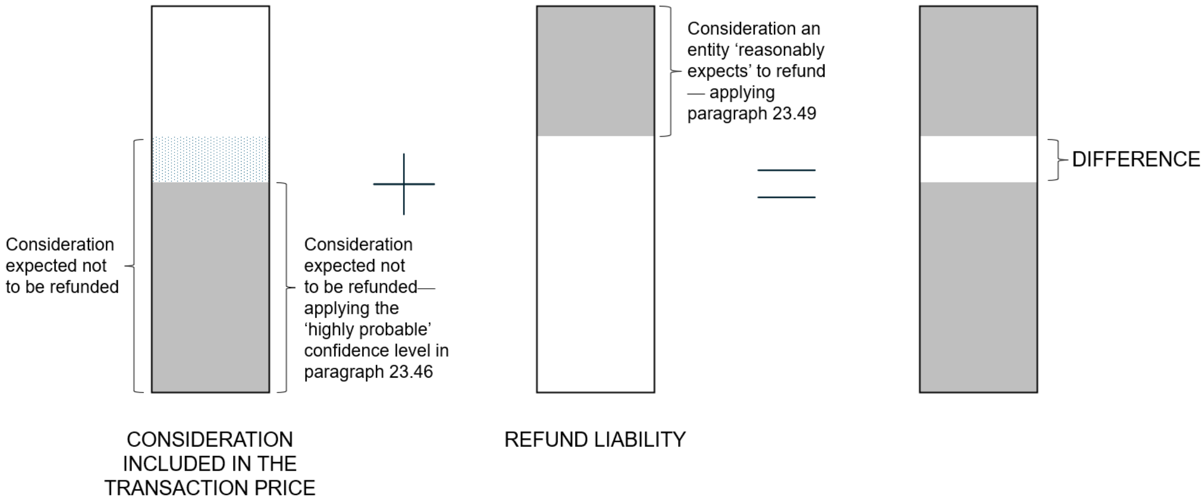

Figure 2—Summary of the requirements for refund liabilities as a consequence of the IASB's tentative decision in May 2024

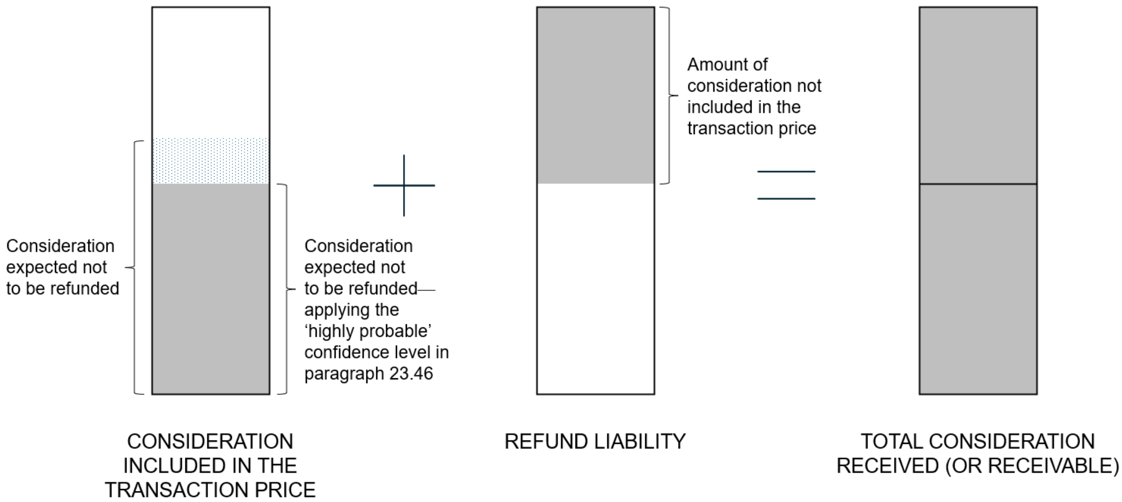

Figure 3—Summary of the requirements for sale with a right of return proposed in paragraph 23.54 of the Exposure Draft

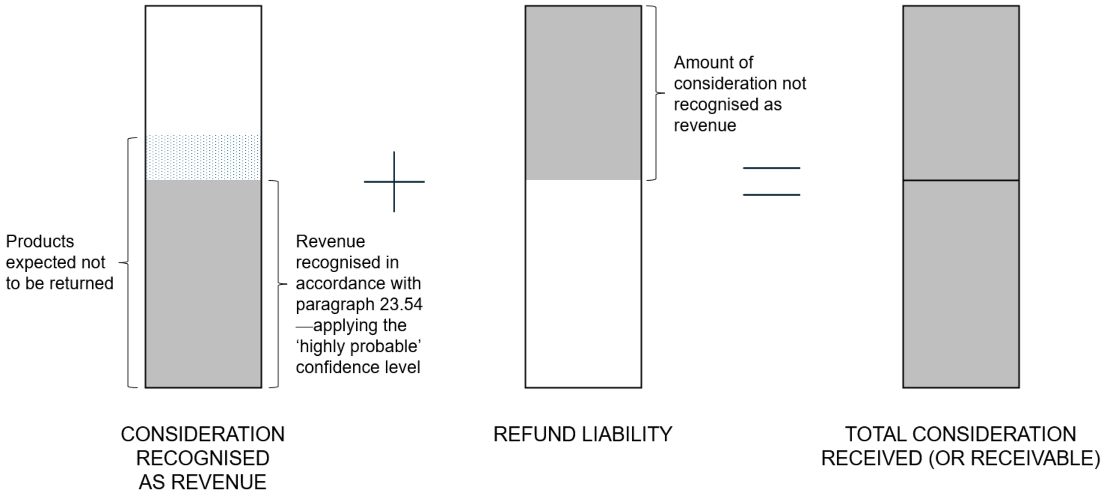

Figure 4—Summary of the requirements for sale with a right of return as a consequence of the staff recommendation in paragraph 44 of this paper