

Revenue – a new global standard

How will it affect your top line?

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IN THE HEADLINES

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“ For many organisations, the new standard will have a broad impact – not just changing the amounts and timing of revenue, but requiring an overhaul of the core systems used to produce the numbers. ”

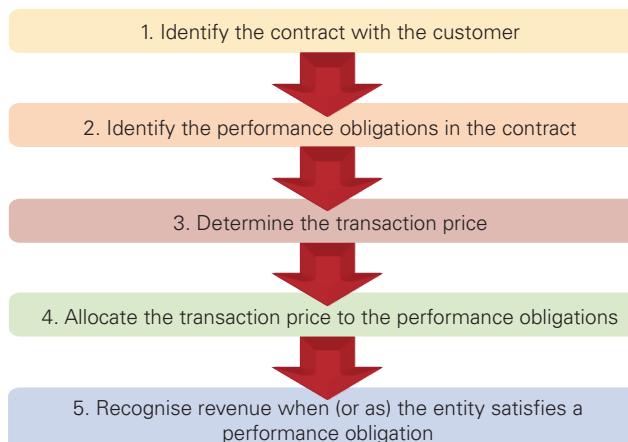
– Phil Dowad,
KPMG's global IFRS revenue
recognition leader

A single global standard

The new revenue standard is likely to affect the way you account for revenue. Issued on 28 May 2014, it replaces existing IFRS and US GAAP guidance and introduces a new revenue recognition model for contracts with customers. For some, the new standard will have a significant impact on how and when they recognise revenue, but for others transition will be easier. For example, if your company has operations in telecommunications, software, real estate, aerospace and defence, building and construction or contract manufacturing, then you are more likely to be significantly affected by one or more of the new requirements. However, all companies will be subject to extensive new disclosure requirements.

One model, two approaches, five steps

The standard contains a single model that applies to contracts with customers and two approaches to recognising revenue: at a point in time or over time. The model features a contract-based five-step analysis of transactions to determine whether, how much and when revenue is recognised. The five steps are as follows.



All companies will need to assess the extent of the impacts, so that they can address the wider business implications, including communications with investors and analysts.

Revenue recognition may be accelerated or deferred

Revenue may be recognised over time, in a manner that best reflects the company's performance, or at a point in time, when control of the good or service is transferred to the customer.

For complex transactions with multiple components and/or variable amounts of consideration, or when the work is carried out under contract for an extended period of time, applying the standard may lead to revenue being accelerated or deferred in comparison with current requirements.

New estimates and judgements

New estimates and judgemental thresholds have been introduced, which may affect the amount and/or timing of revenue recognised. They include:

- estimating and recognising variable consideration;
- identifying separate goods and services in a contract; and
- estimating stand-alone selling prices.

Significant judgement may be required to determine how these estimates and thresholds apply to you. The new estimates and judgements might be particularly difficult to apply if you are launching a new business line or new products, or entering a new market.

Stage-of-completion accounting has been retained

The standard includes new criteria to determine when revenue should be recognised over time, addressing fact patterns such as construction contracts and contracts for services. Some contracts that are currently accounted for under the stage-of-completion method may now require revenue to be recognised on contract completion; but for other contracts, the stage-of-completion method may be applied for the first time under the new model.

Making this assessment based on the criteria provided will require a detailed review of contract terms and – for contracts to sell real estate – property law.

Notable differences from current practice

- All guidance contained in a single standard
- Control-based model ('risks and rewards' concept is retained as an indicator of control transfer)
- Consideration measured as the amount to which the company expects to be entitled, rather than fair value
- New guidance on separating goods and services in a contract
- New guidance on recognising revenue over time

Limited guidance on costs

New judgements will be required when accounting for contract costs, as the new standard replaces existing cost guidance in IAS 11 *Construction Contracts* with limited new guidance on the costs of obtaining and fulfilling a contract. This will directly affect profit recognition, especially when revenue is recognised over time. You will need to evaluate the impact of the new guidance on the costs to be capitalised and also consider the period over which they can be amortised.

New disclosure requirements

The standard includes extensive new disclosure requirements. You may have to redesign, and in many cases significantly expand, the information captured about unfulfilled performance obligations in order to draft the notes to the financial statements dealing with revenue.

The new disclosures could convey important additional information about business practices and prospects to investors and competitors. No exemptions have been provided for commercially sensitive information.

Changes to systems and processes

The estimates, thresholds and disclosure requirements may lead to changes in systems and processes to capture and review the required data, for the current and, if applicable, comparative periods. These changes may be necessary even if there is no effect on the numbers.

You may need to reconsider your processes, to ensure that management judgement is exercised at the key points as financial information is prepared.

Transition options

The standard may be adopted retrospectively, or as of the application date by adjusting retained earnings at that date and disclosing the effect of adoption on each line of profit or loss (the 'cumulative effect approach'). Practical expedients are available to those taking a retrospective approach.

A first-time adopter of IFRS can choose to apply the standard using either the retrospective approach or the cumulative effect approach, from the date of transition to IFRS.

Historical analysis or retrospective application may require you to introduce new systems and processes well in advance of the new standard's effective date, and to run them in parallel with those already in place.

The impacts may be felt right across your organisation

All of your financial ratios may be affected, which could impact your share price or access to capital. Changes to the timing of revenue recognition may affect the timing of tax payments and the ability to pay dividends in some jurisdictions. Staff bonuses and incentive plans might also need to be reconsidered. You may wish to reconsider current contract terms and business practices – e.g. distribution channels – to achieve or maintain a particular revenue profile. Investors, analysts and other stakeholders will want to understand the impact of the standard on your business.

You need to start looking at your contracts now ...

“While the effective date may seem a long way off, decisions need to be made soon – namely, when and how to transition to the new standard.”

– Jamil Khatri, KPMG's global head of Accounting Advisory Services

Basic facts

IFRS 15 *Revenue from Contracts with Customers* was issued by the IASB on 28 May 2014.

The standard replaces IAS 11 *Construction Contracts*, IAS 18 *Revenue*, IFRIC 13 *Customer Loyalty Programmes*, IFRIC 15 *Agreements for the Construction of Real Estate*, IFRIC 18 *Transfer of Assets from Customers* and SIC-31 *Revenue – Barter Transactions Involving Advertising Services*.

The new standard applies to contracts with customers. However, it does not apply to insurance contracts, financial instruments or lease contracts, which fall in the scope of other IFRSs. It also does not apply if two companies in the same line of business exchange non-monetary assets to facilitate sales to other parties. Furthermore, if a contract with a customer is partly in the scope of another IFRS, then the guidance on separation and measurement contained in the other IFRS takes precedence.

The standard is the result of a joint project between the IASB and the FASB and is converged with FASB ASC Topic 606.

The standard is effective for annual periods beginning on or after 1 January 2017, with early adoption permitted under IFRS.

Find out more

For more information on the new standard, please go to the [IASB press release](#), or speak to your usual KPMG contact.

Timeline¹



¹ Assumes a 31 December year end.