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cutting through complexity

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Accounting for revenue is changing

Impact on transport companies

Have you planned for the effects on:

- loyalty programmes?
- ticket breakage?
- rebates?
- ancillary services and extra charges?
- freight and shipping?
- new disclosures?
- transition options?

How could your business be affected?

Now that the IASB and FASB have published a new joint standard on revenue recognition, the real work for transport companies is just beginning. IFRS 15 *Revenue from Contracts with Customers* was issued in May 2014, replacing the existing IFRS revenue guidance, and introducing a new revenue recognition model.

Transport companies will need to carefully consider the impacts of the new standard and assess how their financial reporting, information systems, processes and internal controls will be affected. In addition, the new disclosure requirements are extensive and might require changes to systems, processes and internal controls to collect and report the necessary data. Companies will need to engage with their investors and other stakeholders to establish expectations of how their key performance indicators or business practices may change under the new standard.

Some companies have called for more time to implement the new standard due to the significance of the changes they face and the complexity of IT solutions needed. It seems likely that the effective date of January 2017 will be deferred for one year. While it may seem a long way off, decisions need to be made soon – namely, when and how to transition to the new standard. An early decision will allow you to develop an efficient implementation plan and inform your key stakeholders.

Determining the impact

Loyalty programmes

Potential impact

- Many passenger transport companies have loyalty programmes which are currently accounted for under IFRIC 13 *Customer Loyalty Programmes* – e.g. frequent flyer programmes of airlines. The guidance on customer loyalty programmes in the new standard is broadly similar to IFRIC 13 – i.e. when a company grants loyalty points with the purchase of a passenger ticket, the loyalty points are separated from the passenger ticket and accounted for as a separate performance obligation.
- Under the new requirements, the amount of consideration allocated to loyalty points is based on the relative stand-alone selling price of the loyalty point – rather than fair value as at present – and takes into account the likelihood of redemption. This may not always be easy to establish. Possible methods include the stand-alone price at which loyalty points are sold to third parties, such as credit card companies who give miles for qualifying spend, or estimates based on cost and a reasonable margin. The residual approach to allocate consideration between the sales transaction and the loyalty points is allowed under the new standard, but a transport company needs to meet specified criteria in order to use it and that may be a challenge.
- Similar to the current requirements, revenue allocated to loyalty points is recognised as the points are redeemed.

Actions to consider

- Transport companies that have loyalty programmes should assess whether the allocation method that they currently apply remains acceptable under the new standard. Most loyalty programmes are unlikely to meet the criteria for the residual method.
- For multi-party schemes, only the selling party is considered under the new standard, with buyers of customer loyalty programme points – e.g. credit card companies – needing to refer to other guidance, such as that on inventory and cost of sales, to determine the appropriate accounting.

Ticket breakage

Potential impact

- Some tickets are not used for travel and cannot be refunded. This is often referred to as ‘ticket breakage’. Unlike current requirements, the new standard includes specific guidance on revenue related to ticket breakage that may result in changes for some transport companies.
- If a passenger transport company expects to be entitled to breakage, then the estimated amount is recognised as revenue, to the extent it is highly probable that there will be no significant revenue reversal. For example, if an airline expects that some tickets will not be used, for the entire or part of a journey, and it can make a sufficiently reliable estimate, then it would recognise breakage revenue prior to ticket expiry – e.g. on intended departure date.
- However, if a passenger transport company cannot estimate breakage with sufficient confidence that there will be no significant revenue reversal, then any related revenue is recognised only when the likelihood of the customer exercising its remaining rights becomes remote – e.g. if an airline cannot estimate breakage with sufficient reliability, then it recognises breakage revenue on ticket expiry.

Actions to consider

- Consider if data is available to estimate the level of breakage with sufficient reliability.
- Consider whether the current accounting for breakage revenue remains acceptable under the new standard.
- Consider whether new internal controls need to be established around the breakage data.

Rebates

Potential impact

- Some transport companies provide rebates to their customers – e.g. when a customer reaches a specified threshold of tonnage shipped it gets back 5% of the fees paid. Under the new standard, rebates are treated as variable consideration.
- Variable consideration is included in the transaction price at the transport company’s best estimate and is included in revenue only to the extent it is highly probable that there will be no significant revenue reversal.
- The new requirements for variable consideration may change the profile of revenue recognition for some transport companies. For example, it may be necessary to assume a higher level of rebates – and recognise less revenue – in the early periods compared to current practice, particularly if the transport company is dealing with a new customer or entering a new market and so has less relevant experience on which to base its estimates.

Actions to consider

- Review arrangements involving rebates and determine their impact on the transaction price.
- Consider whether the systems are capable of providing data for estimating variable consideration, including rebates.
- Consider whether new internal controls are needed to support the estimates.

Ancillary services and extra charges

Potential impact

- Most passenger transport companies provide a number of ancillary services either as part of the ticket fare or at an extra charge – e.g. lounge access on the day of travel, meals, terminal transfers, Wi-Fi access, seat assignment or upgrades, extra baggage and ticket changes. For many of these items revenue is currently recognised at the time of travel; however, for some items revenue is recognised at the time the service is provided and charges are collected – e.g. ticket changes. The new standard may result in a change for some of the items.
- Under the new standard, a transport company needs to determine if ancillary services or extra charges are distinct from the transportation service and should be accounted as separate performance obligations.
- If they are not, then revenue for these items is recognised in line with the journey.
- The new requirements may also impact the disaggregation of revenue in the financial statements. For example, if an airline has previously presented ancillary revenue separately to passenger revenue, it may reconsider whether it would be more useful to the users of financial statements if all revenue from the same performance obligation were presented as a single line item in the statement of comprehensive income.

Actions to consider

- Review arrangements involving ancillary services and extra charges to identify performance obligations under the new standard. Develop new processes and adjust systems and internal controls to capture, estimate and monitor stand-alone selling prices to allocate the transaction price to the performance obligations in the contract.
- Assess whether billing management and related systems and internal controls are capable of supporting the allocation methodology and generation of information needed to allocate revenue.
- Determine if the presentation of revenue from ancillary services in the financial statements needs to be revised under the new standard.

Freight and shipping

Potential impact

- There is currently diversity in practice in applying IFRS to freight and shipping contracts – some transport companies recognise revenue at the point in time when goods are delivered, whilst others recognise revenue over time – e.g. based on voyage days.
- A shipping company needs to consider various factors in the new standard to determine when it transfers control over goods or services to the customer, including whether another company would need to substantially re-perform work if it were to fulfil the remaining performance obligation.
- In the usual case that a transport company determines that revenue from freight or shipping services should be recognised over time, the next matter to consider is the appropriate measure of progress – i.e. voyage days or cost. This may be a challenge because some voyages involve both land and sea, and costs for different parts of the voyage may differ.

Actions to consider

- Analyse the contractual arrangements for freight and shipping services to determine the appropriate timing and basis for revenue recognition under the new standard.
- Assess whether billing management and related systems and internal controls are capable of supporting revenue recognition over time, if applicable.

New disclosures

Potential impact

- Extensive new disclosures are required, incorporating both qualitative and quantitative information. There are no exemptions for commercially sensitive information.
- Stakeholders and competitors may take a close interest in the new disclosures related to unsatisfied performance obligations, as they convey information about future activity.

Actions to consider

- Perform an initial assessment of whether existing systems and processes can collect the data necessary to compile the new disclosures.
- Develop, test and document any new internal controls that need to be established over the systems and process changes.

Transition options

Potential impact

- IFRS 15 may be adopted retrospectively, by restating comparatives and adjusting retained earnings at the beginning of the comparative period.
- Alternatively, IFRS 15 may be adopted as of the application date, by adjusting retained earnings at the beginning of the first reporting year (the cumulative effect approach).

Actions to consider

- Quantify and evaluate the effects of the different transition options, including the available practical expedients under the retrospective approach.
- Perform a historical analysis of key contracts. Consider whether existing systems provide the data required to produce comparative information if the new standard is applied retrospectively.

You can find more detailed information about IFRS 15 in our publications [Transition to the New Revenue Standard] and [Issues In-Depth].

How we can help

KPMG's Transport practice

KPMG's Transport practice is dedicated to supporting all companies in the transport sector, from airlines to freight and shipping companies, in understanding industry trends and business issues. Member firms offer customised, industry-tailored services that can lead to value-added assistance for your most pressing business requirements. Our extensive network of professionals combines in-depth industry knowledge with extensive experience helping clients with accounting transitions and what they entail.

For those affected by the new revenue recognition requirements, the impact may be felt far beyond accounting change. The following are just a few examples of how KPMG member firms, working in cross-functional teams of experts, have helped clients across various sectors – including the transport industry – with the accounting and operational challenges.

- Performing an overall impact assessment to identify the key revenue streams that may be impacted by IFRS 15.
- Performing a detailed accounting diagnostic to identify and prioritise the impacts on accounting policies and disclosures, including information gaps.
- Reviewing key accounting policies and accounting manuals.
- Identifying and analysing key contracts under the IFRS 15 lens.
- Assisting in redrafting contract documentation.
- Identifying the impacts to internal management reporting, including key financial measures and ratios.
- Assisting in developing clear communication with stakeholders regarding the impact of IFRS 15 on earnings.
- Mapping information requirements to existing sources and defining required information that is not currently available in your existing systems.
- Identifying data collection needs to meet the new disclosures requirements.
- Assisting in changing systems and processes to meet the new requirements.
- Providing training to finance teams.
- Identifying corporate and indirect tax implications, and impact on distributable dividends.

Starting now will allow you to assess the impact and design an appropriate response plan that allows time for unanticipated complexity.

Contact us

Steffen Wagner
Global Head, Transport and Leisure
T: + 49 69 9587 1507
E: steffenwagner@kpmg.com

John Luke
Global Head, Shipping
T: +44 20 7311 6461
E: john.luke@kpmg.co.uk

Justin Zatouroff
Global Head, Post and Express
T: +44 20 7311 8415
E: justin.zatouroff@kpmg.co.uk

James Stamp
Global Head, Aviation
T: + 44 20 7311 4418
E: james.stamp@kpmg.co.uk

Mark Kemper
Global Head, Logistics
T: + 31206 567753
E: mark.kemper@kpmg.com

www.kpmg.com/ifrs

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