Implementing the new revenue recognition standard AASB 15

15 September 2015

Your facilitators are...

Kim Heng

Partner

Department of Professional Practice

Anita Pozo-Jones

Senior Manager

Department of Professional Practice

Abu Kibria

Manager

Department of Professional Practice

Agenda

- Review core concepts
- Implementation issues
- Transitioning
- Future changes to AASB 15
- Business implications
- Q&A

Current developments

- Effective date set to be deferred to 1 January 2018
- FASB proposing somewhat extensive amendments. IASB making some changes
- Transition Resource Group (TRG) continues to discuss implementation issues
- AICPA have 16 industry groups looking at implementation issues. Industry groups include construction contractors, software, asset management, telecommunications, etc

Review core concepts

The core principle and the five-step model

Core principle

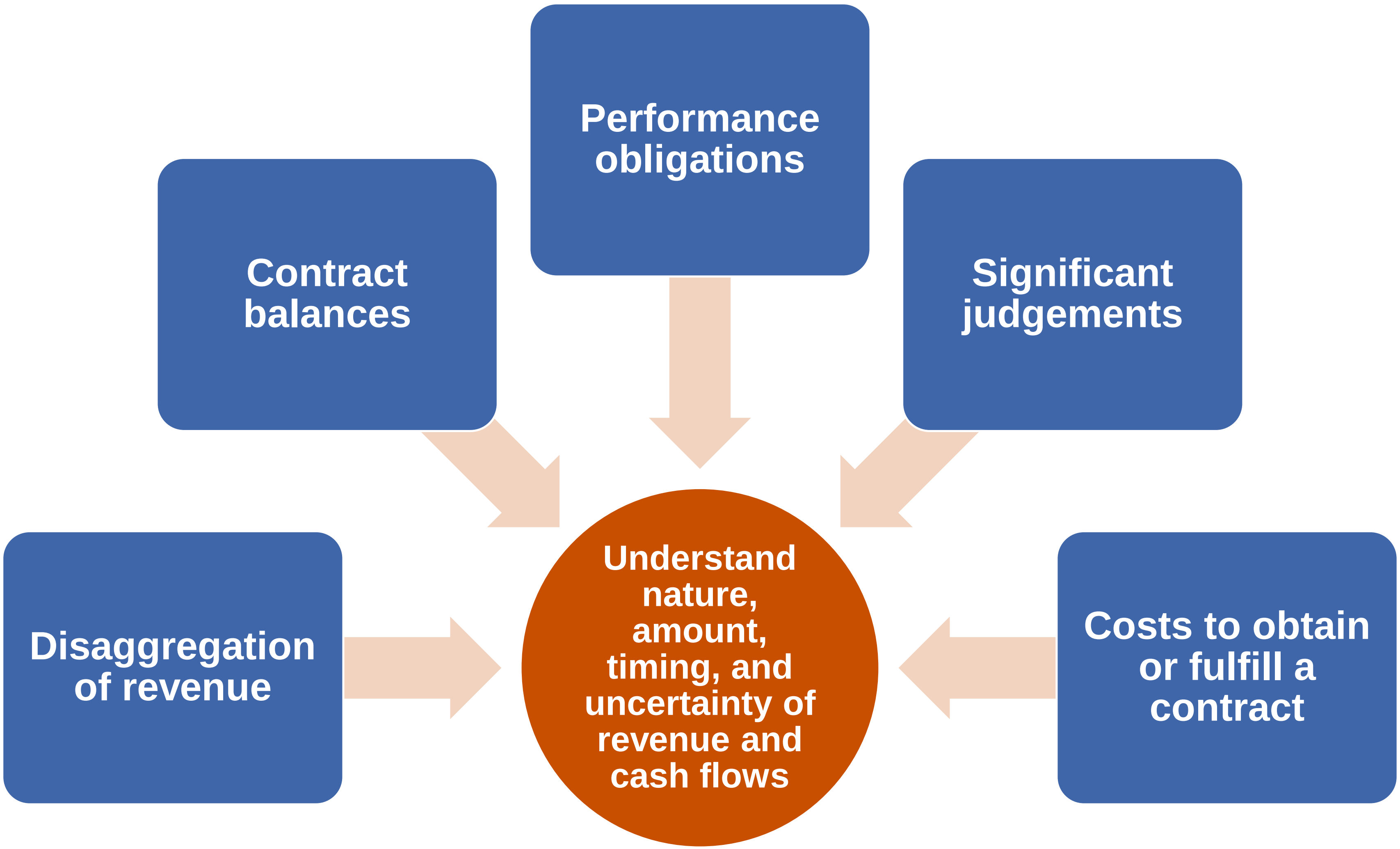
Recognise revenue to depict transfer of promised goods or services to customers in amount that reflects consideration to which entity expects to be entitled in exchange for those goods or services

1. Identify the contract(s) with a customer
2. Identify the performance obligations in the contract
3. Determine the transaction price
4. Allocate the transaction price to the performance obligations in the contract
5. Recognise revenue when (or as) the entity satisfies a performance obligation

Few notable differences from current requirements

Current guidance	New standard
Guidance contained in multiple standards and interpretations	All guidance contained in a single standard
Risk and rewards based model	Control based model. Risk and rewards is retained as indicator of control transfer for performance obligations satisfied at a point in time.
Revenue measured at the fair value of the consideration received or receivable	Consideration measured as amount entity expects to be entitled to
Limited guidance on identifying performance obligations in a contract	Specific guidance on identifying performance obligations in a contract
Guidance for recognising revenue over time may apply in different circumstances (e.g. construction contracts, service arrangements)	Specific criteria provided to determine when a performance obligation is satisfied over time
Capitalising contract acquisition costs optional	Capitalising contract acquisition costs mandatory, if certain criteria met
Revenue disclosures limited to policy discussion	Extensive new disclosures

Disclosure requirements



Implementation issues

2 Identify performance obligations in the contract

A performance obligation is a promise to deliver a **good or service** that meets **both** of the following criteria

Criterion 1: Can customer benefit from good or service either on its own or together with other resources that are readily available to customer?

+

Criterion 2: Is promise to transfer good or service separately identifiable from other promises in contract?

(see next slide)

Yes → **Distinct performance obligation**

No → **Not distinct – combine with other goods and services**

2 Is good or service distinct within contract?

Factors indicating promise to transfer good or service is NOT separately identifiable (i.e. NOT distinct within contract) include:

- Entity provides significant service of integrating good or service into bundle of goods or services for which customer has contracted
- Good or service significantly modify or customise another good or service promised in contract
- Good or service is highly dependent on, or highly interrelated with other promised goods or services

2 Example 1: How many performance obligations?

Scenario

Company A enters into a contract with Customer B to build specialised equipment. Promises in contract include:

- Supply of equipment
- Free installation
- 1-year standard warranty
- 2-year extended warranty

Only A can perform installation. The installation does not significantly modify or customise equipment.

Q: How many performance obligations (POs) does A's contract with B have?

2 Example 1: How many performance obligations? (continued)

Evaluation (1/2)

- Promises include supplying equipment and installing equipment with existing plant
- Installation does not significantly modify or customise equipment. Equipment and installation services are not combined in way that transforms them into different, combined output. Equipment and installation services are separate POs.
- Standard 1-year warranty is assurance-type warranty, not a separate PO
- 2-year extended warranty is service-type warranty, is a separate PO

Watch out for future changes

2

Example 1: How many performance obligations? (continued)

Evaluation (2/2)

- Performance obligations would be:

Promises in the contract	Performance obligation
Supply of equipment	Yes
Installation/integration	Yes
1-year standard warranty	No (combined with equipment)
2-year extended warranty	Yes

3 Determine the transaction price

Variable consideration and the constraint

Consideration payable to a customer

…reduction to transaction price unless it's a payment for a distinct good or service.

Transaction price

Non-cash consideration

…measured at fair value unless it cannot be reliably measured.

Significant financing component

(Practical expedient available)

Exception: Variable consideration is not estimated for sales – or usage-based royalties on licences of intellectual property.

3 Consideration payable to customers

Is consideration payable to customer a payment for distinct good or service?

Yes → Reasonably estimate fair value of good or service received?

No → (see right-hand box)

Reasonably estimate fair value of good or service received?

Yes → Consideration payable exceed fair value of distinct good or service?

No → (see right-hand box)

Consideration payable exceed fair value of distinct good or service?

Yes:

- Excess consideration payable accounted for as reduction of transaction prices
- Remainder accounted for as purchase from suppliers

No:

Consideration payable accounted for as purchase from suppliers

Consideration payable accounted for as reduction of transaction price and recognised at **<u>latter</u>** of when entity:

- recognises revenue for transfer of related goods or services
- pays or promises to pay consideration

3

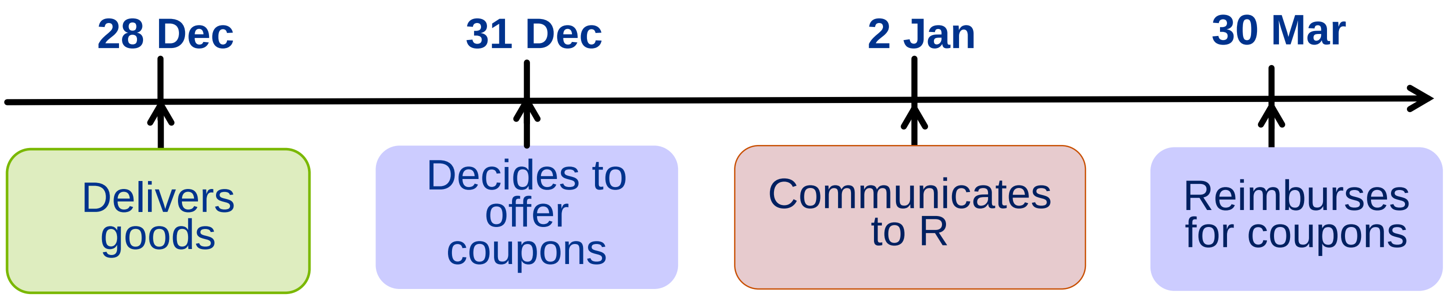
Example 2: Consideration payable to customers

Scenario

- Manufacturer M enters into contract to sell new consumer product A to a Retailer R (a retail store chain) on 15 December
- M delivers 1,000 units of A at $10/unit to R on 28 December
- On 31 December M decides to offer $1-off coupons in newspapers to encourage consumers to buy A from R. M has no previous history of entering into similar coupon offerings.
- On 2 January, M communicates to R that it will reimburse R on 30 March for any coupons redeemed by R's customers
- M is a calendar year-end company

Q: When should M recognise reimbursement to R?

Polling question #3



3 Example 2: Consideration payable to customers (continued)

Evaluation

- Coupon not explicitly stated in contract between M and R when they entered into contract. R cannot have had a valid expectation M would accept consideration that less than price stated in contract, as M has no history of providing coupons in the past
- M recognises reduction of revenue on 2 January being the date latter of when the revenue is recognised (28 December) or consideration is promised to the customer/retailer
- One-off coupon is not variable consideration as no facts and circumstance would indicate M intended to offer a price concession when entering into contract with R, i.e. the coupon is not variable consideration

Q: What if M has a past practice of offering discount coupons?

3 Consideration payable to customers

Other examples of consideration payable to customers

- Non-refundable compensation paid to customer – compensation for changes required to systems or equipment to accommodate goods or services
- Payments for display cases for goods
- Co-branding advertising
- Slotting fees – product placement fees
- Loyalty cards
- Vouchers
- Credits
- Rebates
- Payments direct to customer's customer

5 Recognise revenue as performance obligations satisfied

An performance obligation is satisfied over time if either:

1. Customer simultaneously receives and consumes benefits as entity performs
   - Routine or recurring services

2. Customers controls asset as entity creates or enhances it
   - Asset built on customer's site

3. Entity's performance does not create an asset for which entity has an alternate use and there is a right to payment for performance to date
   - Asset built to order

Performance obligation not satisfied over time is satisfied at a point in time

5 Transfer of control indicators

Transfer of control at a point in time when customer has…

- A present obligation to pay
- Legal title
- Physical possession
- Risks and rewards of ownership
- Accepted the asset

Exception: Separate requirements for distinct licences of intellectual property.

5

Licence of IP – Right to access vs right to use

Watch out for future changes

What is provided by the licences	When revenue is recognised
Right to use intellectual property as it exists at time licence is granted.	Point in time
A right to access the intellectual property as it exists throughout licence period.	Over time

Guidance for when a licence provides access

- Licensor will undertake activities that significantly affect intellectual property to which customer has rights
- Rights granted by the licence directly expose customer to any effects
- Licensor's activities do not otherwise transfer a good or service to customer as they occur

Sales or usage based royalties exception

Sales or usage based royalties from licences of intellectual property are included in the transaction price at the latter of:

- subsequent sale or usage; and
- satisfaction of performance obligation for which sales-based usage has been allocated

5 Example 3: Licence of IP – Right to access vs right to use

Scenario

- Franchisor A grants 10-year franchise licence to Franchisee B
- B will pay upfront fee of $2million and 5% on-going royalty payment from future sales
- A will provide B with one-off training ($100k) and equipment ($900k) at stand-alone selling prices, which are not regularly sold together at a discounted price
- B will purchase products from A at current selling price
- B reasonably expects A to develop new products and continue to market the franchise name

Q: When and how should A recognise upfront fee of $2million? When should 5% of future sales be recognised?

5

Example 3: Licence of IP – Right to access vs right to use (continued)

Evaluation (1/2)

Promises in the contract	Performance obligation	Transaction price
10-year franchise license	Yes	$1m
One-off training	Yes	$100k
Equipment	Yes	$900k
Future products	No	n/a

Q: How should the royalty payment be accounted for?

5

Example 3: Licence of IP – Right to access vs right to use (continued)

Evaluation (2/2)

License ‘right to access’ guidance	Y / N
Activities significantly affect IP	Yes
Exposure to effects of license	Yes
Activities do not transfer a good or service as they occur	Yes

Right to access ➔ Recognised over time (e.g. 10 year license period)

Licence of IP – Right to access vs right to use

Areas of licensing intellectual property

- Software and technology
- Media and entertainment
- Franchises
- Patents
- Trademarks
- Copyrights

Capitalisable pre-contract costs

Incremental costs	Fulfilment costs
Costs entity would not have incurred if contract had not been obtained	Relate directly to an existing contract or specific anticipated contract
	Generate or enhance resources of entity that will be used to satisfy performance obligations in the future
Expedient: Expense costs if amortisation one year or less	Expected to be recovered

Direct costs – eligible for capitalisation	Costs expensed when incurred
Direct labour – e.g. employee wages	**General and administrative costs** – unless explicitly chargeable under contract
Direct materials – e.g. supplies	**Costs that relate to satisfied PO**
Allocation of costs that relate directly to contract – e.g. depreciation and amortisation	**Costs of wasted materials, labour, or other contract costs**
Costs that are explicitly chargeable to customer under contract	**Costs that do not clearly relate to unsatisfied performance obligations**
Other costs that were incurred only because entity entered into the contract – e.g. subcontractor costs	

Example 4: Capitalisable pre-contract costs

Scenario

- Entity C wins a contract to build an infrastructure asset for a customer over 5 years, incurring the following bidding costs:

Bid and proposal costs – $35,000

External legal costs – $15,000

Travel costs to deliver proposal – $20,000

Commissions to salesperson – $10,000

Q: How are these costs accounted for?

Example 4: Capitalisable pre-contract costs (continued)

Evaluation

Cost		Evaluation
Bid and proposal costs – $35,000	✗	Costs are not incremental costs of obtaining the contract. Therefore they should be expensed when incurred.
Travel costs to deliver proposal – $20,000	✗	
External legal costs – $15,000	✗	
Commissions to salesperson – $10,000	✓	Commissions are incremental costs of obtaining contract, they are capitalised and amortised

Capitalisable pre-contract costs

Areas of incremental pre-contract costs

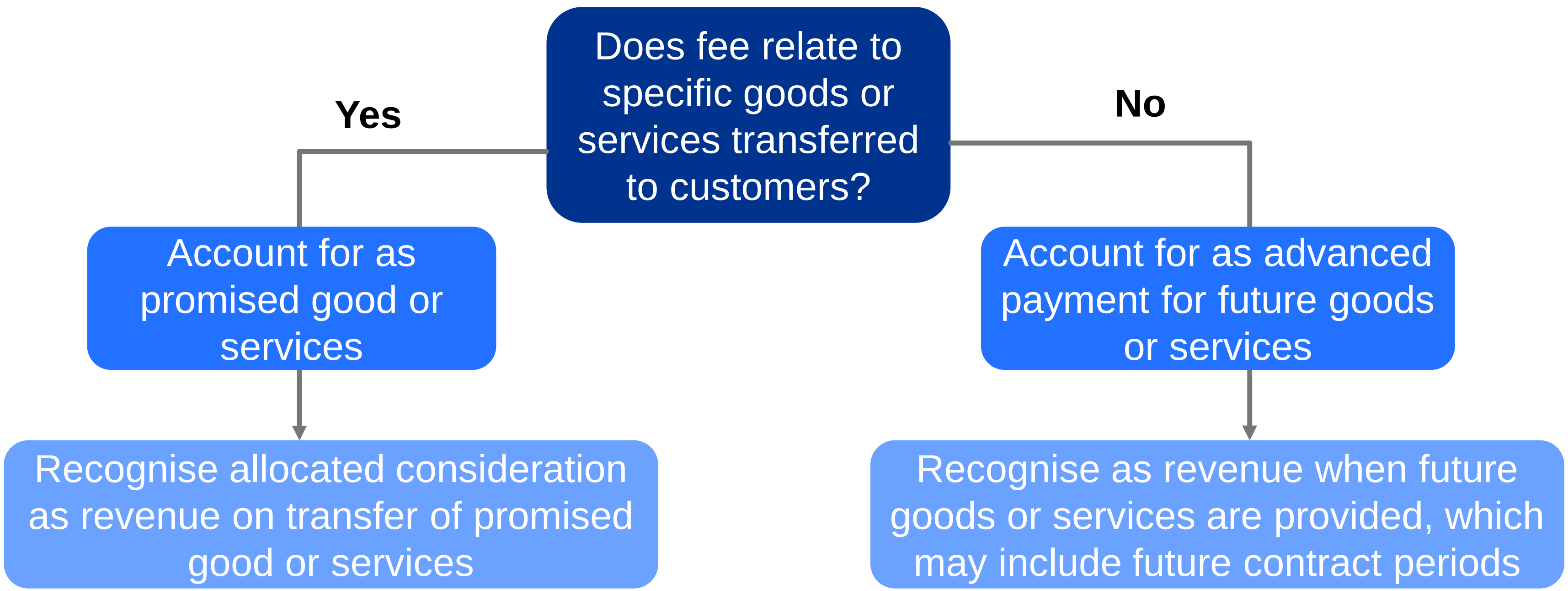
- Software and technology
- Media and entertainment
- Construction
- Homebuilders
- Telecommunication

Contract duration and upfront fee

Contract duration:

AASB 15 does not apply to wholly unperformed contracts if each party to contract has unilateral enforceable right to terminate contract without penalty

Upfront fees:



1 2 Example 5: Contract duration and upfront fee

Scenario

- Service company S enters into service contract with Customer C
- Stated duration of contract is 24 months. Either party can terminate contract without compensating other party with 1 months notice. If not terminated by the 24th month, contract will continue for another 12 months
- Monthly fee payable by C is $100k. However, S requires each customer to pay a non-refundable upfront fee of $50k to cover set-up costs
- S continues to provide services for stated period or until contract gets terminated

Q: What is contract period? When should upfront fee be recognised?

1

2

Example 5: Contract duration and upfront fee (continued)

Evaluation

- Is contract period:
  - 24 months – stated duration of contract
  - 36 months – stated duration including extension
  - 1 month – minimum notice period prior to contract termination

- As contract can be terminated by each party at any time without compensating other party for termination with 1month's notice, duration of contract does not extend beyond 1 month

- If there was a termination penalty for termination within a set period, contract duration would be period for which termination penalty is required

- Set-up does not transfer a good or service to customer. If a material right, upfront fee of $50K recognised over estimated contract life, potentially > 36 months. If not a material right, then upfront fee recognised over 1 month contract period

Contract duration and upfront fee

Other examples of upfront fees

- Joining fees for memberships - for clubs, associations etc
- Activation fees for contracts – such as for telecommunication contracts
- Set up fees for outsourcing contracts
- Mobilisation fee charged by mining services entity
- Upfront installation fee – such as electricity connection fee
- Contract sign-on fee
- Administration fee

Transitioning to AASB 15

Transition options

Approach	2017*	2018*	Date of equity adjustment
Retrospective – no practical expedients	AASB 15	AASB 15	1 January 2017
Partial retrospective – with practical expedients	Mixed requirements	AASB 15	1 January 2017
Cumulative effect	AASB 111, 118	AASB 15 AASB 111, 118	1 January 2018

Cumulative effect approach: entity also needs to disclose revenue amounts that would have been presented under AASB 111 and 118

*** Assuming the AASB approve the deferral of AASB 15 to 2018**

Retrospective method with practical expedients

PE #1

For *completed contracts*, no restatement of contracts that begin and complete in same annual reporting period

PE #2

For *completed contracts* with variable consideration, use the transaction price at date contract was completed

PE #3

For periods before date of initial application, exempt from providing disclosures for remaining performance obligations

Completed contract: a contract in which entity had transferred all of goods and services identified under AASB 118 / AASB 111 to customer

Watch out for future changes

Who will find each option most relevant?

Full retrospective	Entities expecting significant change from application and want to present comparable trend information
Retrospective with practical expedient 1	Entities with large populations of short-term contracts
Retrospective with practical expedient 2	Entities with long-term contracts that include variable consideration
Retrospective with practical expedient 3	Entities with long-term contracts where performance is satisfied over time
Cumulative effect	Entities that expect little change from application

Future changes to AASB 15

Amendments to AASB 15

FASB			IASB
Licences	One year deferral of the effective date	Sales tax presentation: Gross verses net	One year deferral of the effective date
Principal vs agent		Measurement of noncash consideration	Licences
Identifying performance obligations		Collectibility	Principal vs agent
Accounting for shipping and handling Services		Practical expedients upon transition	Identifying performance obligations
			Practical expedients upon transition

Licences

Functionality

Clarifications focusing on form/functionality of licence for:

<u>Up-front</u> recognition: if functionality exists at a point in time, e.g. movie

<u>Over time</u> recognition: if form or functionality changes constantly, e.g. brand

Sales-based royalties

Clarification that exception applies only to a licence or where the licence is predominant item

When royalty relates to more than one item, exception applies to:

All the items

Or

Nothing

Principal vs agent

Transfer of control

Clarifications focusing on transfer of control to identify if an entity is:

Principal Or Agent

Virtual or intangible goods

New examples being added to clarify complex cases of:

Virtual Or Intangible goods

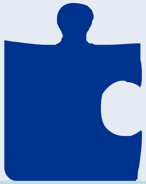
Identifying performance obligations

Single vs separate PO

New and revised examples to illustrate when goods and services are accounted for:

As a bundle, e.g single PO

Or



Individually, e.g. separate PO

New examples

New examples are being added to illustrate difficult cases of:

Installation services

Multiple items

Equipment and consumables

Practical expedients upon transition

Objective of changes

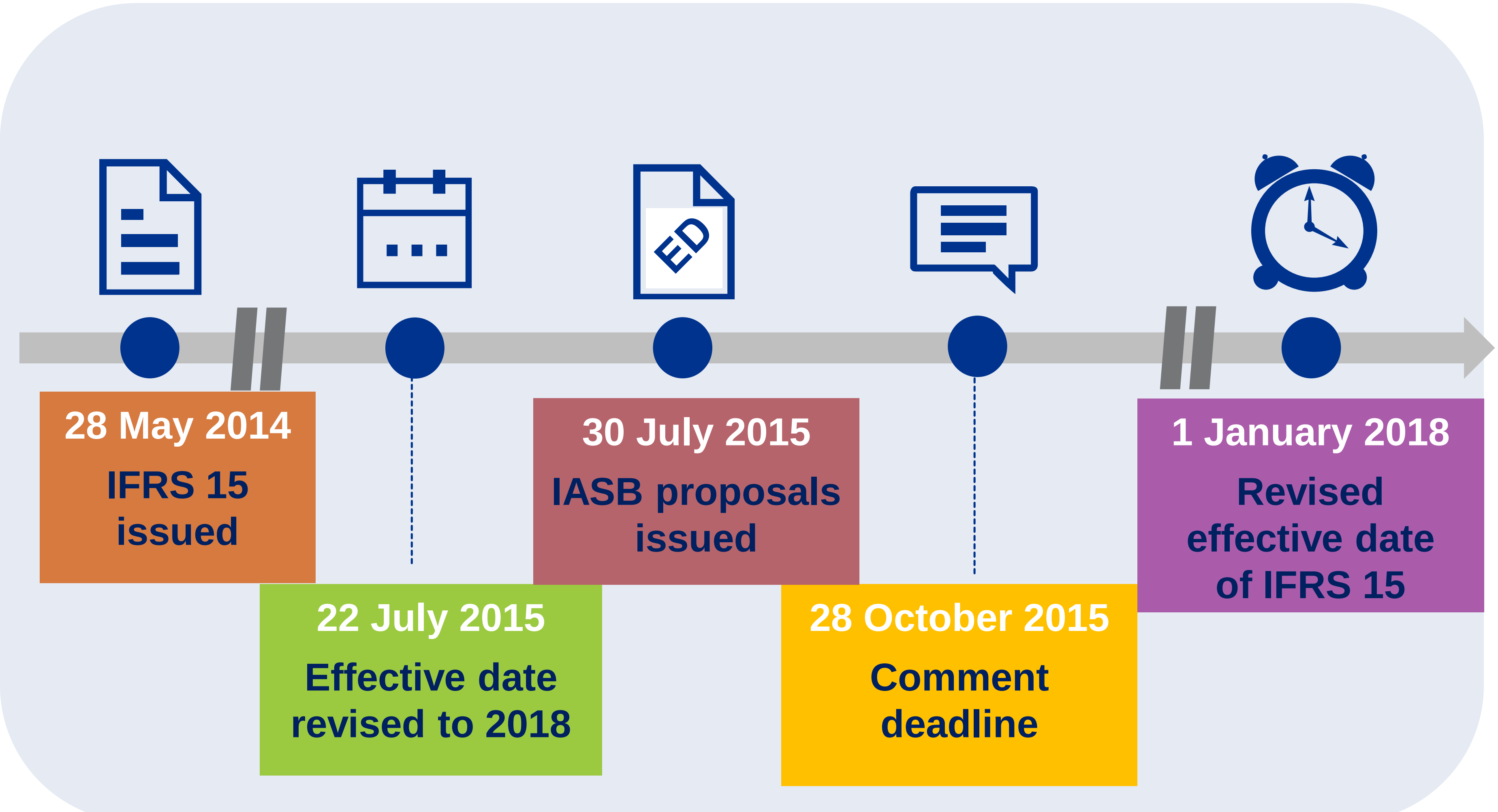
Objective is to reduce complexity upon transition

New reliefs

New reliefs will allow entities to:

- Use hindsight when determining effects of contract modifications
- Not restate for completed contracts when applying the retrospective method

When applicable?



Business implications

Not just an accounting change…

For many companies, implementation of new revenue recognition standard is not just an accounting exercise, as many different groups across the organisation need to be involved

Financial and operational system changes

- Existing systems may not capture required data
- Inventory of incremental information
- Processes re-designed
- Update systems vs new systems
- Dual systems for certain transition options
- Processing changes to contracts

Internal control assessment

- Effect on internal control environment
- New controls vs modify existing controls
- Identify new risk points
- Management review controls
- IT controls
- Process level controls

Governance and change

- Impact on internal resources
- Revenue change management team
- Change to contract practices
- Training (accounting, sales, etc)
- Multi-national locations
- Effect on management compensation metrics
- Impact on forecasting and budgeting processes

Communication with stakeholders

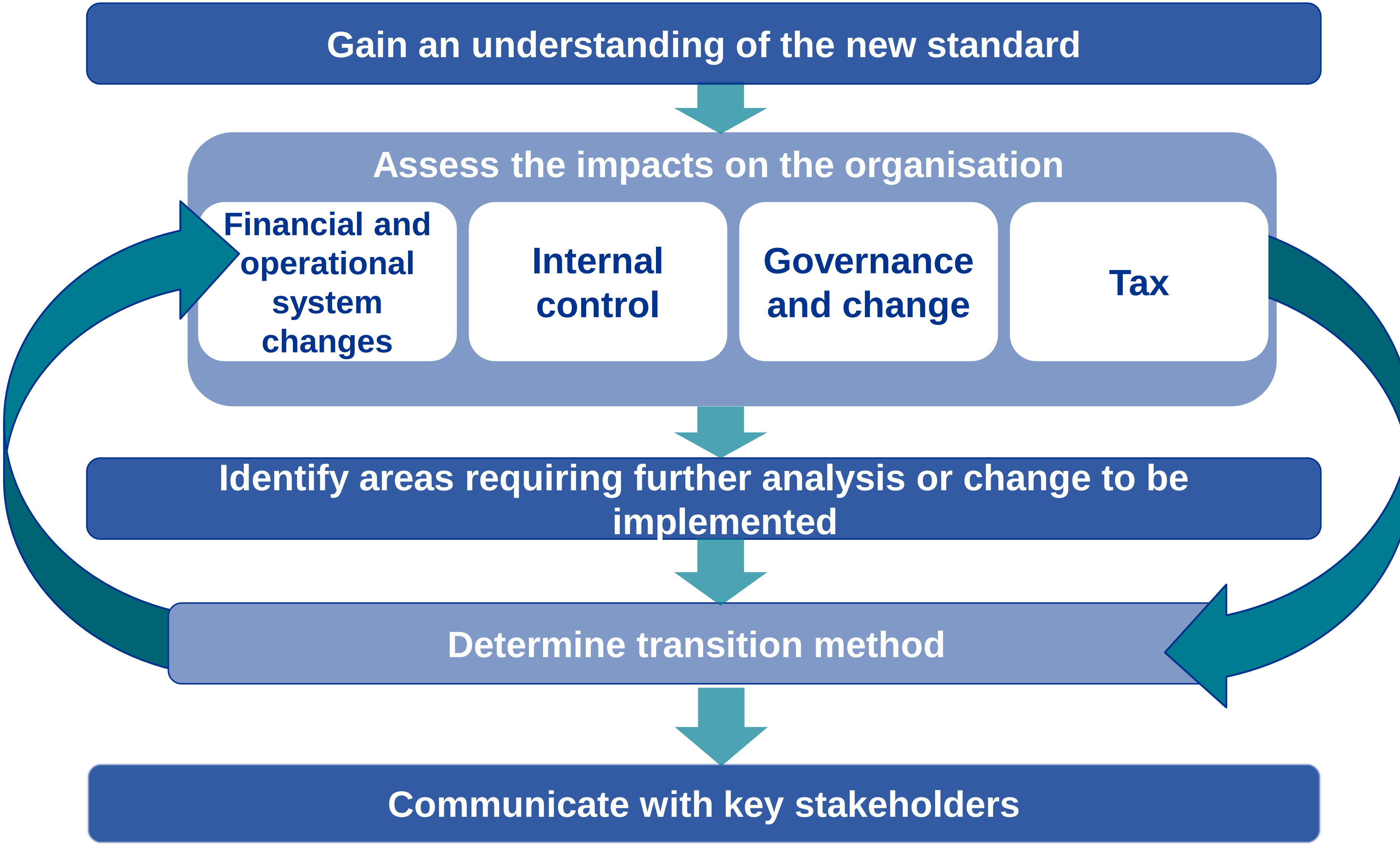
- Key to successful implementation
- Identify relevant stakeholders
- Messaging
- Timing of communication
- Comparability of data communicated
- Expected impact of change

Key reminders

- Impacts will vary depending on industry, company, contractual terms and customary business practice
- All companies impacted – need to go through analysis
- Lots of implementation issues to resolve prior to 1 January 2018*
- Keep up to date with future changes to AASB 15
- Not just an accounting change – there will be business impacts

* Assuming AASB also agrees to defer effective date

Next steps


Gain an understanding of the new standard
Assess the impacts on the organisation
Financial and operational system changes
Internal control
Governance and change
Tax
Identify areas requiring further analysis or change to be implemented
Determine transition method
Communicate with key stakeholders

Contact details

- Kim Heng
  Audit
  Partner
  Email : kheng@kpmg.com.au
  Phone : (02) 9455 9120

- Anita Pozo-Jones
  Audit
  Senior Manager
  Email : apozojones1@kpmg.com.au
  Phone : (02) 9335 7201

- Abu Kibria
  Audit
  Manager
  Email : abukibria@kpmg.com.au
  Phone : (02) 9335 8121

Accounting & Reporting webinars on YouTube

Missed one of our previous webinars in the Accounting & Reporting series? Visit the KPMG Australia YouTube channel to catch-up.

The Accounting and Reporting playlist features full webinar recordings and insight videos from our presenters.

Youtube.com/KpmgAustralia

kpmg.com/au/accountingreporting

KPMG

cutting through complexity