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IFRS Today

KPMG's podcast series on IFRS and financial reporting

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EPISODE 1 TRANSCRIPT

Revenue – Embedding and explaining the changes

Speakers

- Allison McManus
- Nick Chandler
- Jorge Castano
- James Bowe (Host)

Host

Hello and welcome to episode 1 of *IFRS Today*, KPMG's podcast series on IFRS and financial reporting. Our aim in this series is to help you understand and embed the many changes currently under way across the financial reporting landscape.

My name is James Bowe and I'm a member of KPMG's Global IFRS Institute. Today I'm pleased to have with me three KPMG colleagues, who between them boast an impressive range of experience gained helping clients make the transition to the new accounting standards.

First we have Nick Chandler – Nick is a UK firm partner who leads the Accounting Advisory Services team here in the United Kingdom. A big part of Nick's work in recent years has been supporting clients in implementing IFRS 15. He's joined by Allison McManus, an accounting advisory partner in the Canadian firm who was involved in developing IFRS 15 at the IASB and has since led and advised on numerous projects to implement the new revenue standards under both IFRS and US GAAP. And Jorge Castano, a director in the UK firm's management consultancy arm. Jorge has a strong track record in designing and managing transformation journeys across multiple functions and business divisions.

So Nick, Allison and Jorge – Thanks for joining us on *IFRS Today*…

Host

Great. Let's make a start – IFRS 15, the new global standard for revenue recognition has well and truly landed. It's been effective since the start of the year and it is really a big deal. The degree of impact does vary but all companies are now subject to extensive new disclosure requirements. In this podcast, we'll take a look at some of the issues around this. How are companies coping so far with what's required? How are they approaching the disclosure of the effect of the change? Do we have a sense yet of how effectively the changes are being embedded into systems and processes? And if not, why is this important and what steps do they need to take to make this happen?

First up, Nick – To what extent do you feel that companies are successfully both explaining and embedding the changes?

Nick

Many organisations have – as required – made disclosures in 2017 year-end accounts on likely effects of IFRS 15 and that's both narrative and, where material, numbers perspective.

But, in a number of cases we've seeing very much a disclosure-led approach – what I mean by that is, for the purposes of preparing the 2017 disclosures, they are going through a process of either proving that the materiality is insignificant or working out adjustments based on group materiality.

So for many groups, there hasn't yet been a lot of thought about how they are going to operationalise the changes that IFRS 15 presents – and what I mean by that is creating a sustainable process to support the ongoing accounting and disclosure. And that's not just at a consolidated level, but also for individual subsidiaries.

Allison – I'm really interested to know how this experience aligns with what you're seeing in Canada?

Allison

In terms of pre-implementation disclosures in Canada in the 2017 annual financial statements, we didn't actually see a lot of quantitative information either in terms of the expected impact of IFRS 15. There are probably a few reasons / contributing factors, including that a number of companies just aren't seeing material impacts of IFRS 15.

However, an interesting difference in Canada is that public companies are required to report quarterly and now we are starting to see the first interim financial statements being prepared under IFRS 15. So we are no longer in that period of 'expectations' of impact! But, rather, we are now in that situation where the impacts are coming through in the financial statements.

In some of my initial conversations, I'd say that a number of companies have been a bit caught off guard in terms of the impact of the disclosures – both qualitatively and quantitatively in terms of the volume. Some of them are surprised that when a quantitative impact of adopting IFRS 15 is not that material, there is still a number of disclosures that would need to be provided.

So I think many have had a similar attitude prior to their quarterlies that you described in the UK, Nick – in that they are thinking *It's not very material so what is it that we really need to disclose here?* But now IFRS 15 [is effective] people have realised that it's really similar to a change in framework and as I mentioned there is a significant increase in disclosures relative to typical interim or quarterly statements that we usually see because these new interims must include a new accounting policy under IFRS 15, to try to ensure that investors understand the nature and the effect of the change in the new accounting standards.

This increase in disclosures, coupled with the fact that some haven't quite embedded IFRS 15 into their processes, has led to at least some scrambling to pull things together for their quarterly financial statements…

Host

OK – So it's interesting to hear how different reporting timelines in the UK and Canada have affected the way companies are responding… From what you're both saying, it's open to question whether companies are managing their transition in a really sustainable way. Allison – what are the risks of not embedding IFRS 15 in processes and controls in a sustainable way?

Allison

Well, obviously the biggest risk of not embedding the new revenue framework into processes is not getting it right the first time. So, not getting your revenue numbers, your adjustments right in your first disclosures is not really a great spot to be in for your 'top line' information. These are very much at risk because, in a lot of cases we're seeing companies trying to implement IFRS 15 using manual, top-side adjustments at the consolidated level and this might make sense for initial adoption to calculate your adjustment but at some point repeating these tasks or these adjustments each quarter is probably going to get a little bit tiresome and, of course, risky!

So, in other cases where companies have been embedding the changes into their processes, they have been surprised at how long or how much effort it takes to do that, to embed those processes.

And getting the accounts right is one thing but if we are talking about disclosures there is additional risk related to those disclosures. More information is going to be needed in financial statements, both on a quarterly and an annual basis. One example of that is disclosure related to the remaining performance obligations. A significant amount of data may be needed to prepare that disclosure and manual workarounds on adjustments may not give companies the data that they need to provide such disclosures.

Therefore, companies really need the processes to accommodate the ongoing accounting as well as the disclosures, so that they can generate the data that they need to provide the right transparency.

Nick

I would echo Allison's comments. I would add that in some countries – such as the UK – subsidiaries will need to create their own statutory accounts and of course they can't do that if adjustments are only calculated at a consolidated level.

And to Allison's point that having manual workarounds simply introduces another level of risk in the year-end reporting process, this is clearly not desirable and particularly in an environment where errors are highlighted more readily and punished more severely than ever before.

And I think when I talk about embedding IFRS 15, I don't just mean introducing a repeatable accounting process. I think we would all agree it's much broader than that. As an example, companies now need processes and controls in place whereby the finance team is involved early in the assessment of potential new contracts and business models and this is to ensure that the accounting implications are understood at an early stage because of course it is only at that early stage that you have the chance to make sure the commercial terms you agree actually support the accounting that you want.

The alternative is that companies enter into new contract types when they don't understand properly how they will be reflected in the P&L and impact the KPIs.

Host

Jorge – from an operational controls and processes perspective – can you share your experiences of how companies should go about embedding IFRS 15 in an effective way?

Jorge

Indeed. Firstly, regulatory-led problems are becoming more prevalent, given the scale, scope and intensity of new regulations impacting organisations. IFRS 15 is not an exception. Secondly, data and digital are prime-time topics in clients' conversations. The ability to have good data to provide insights or just to become compliant, enhanced through digital technology, is seen as a critical advantage for many clients. It is not only about delivering results but also doing it in a sustainable manner.

As Nick mentioned, one problem arises when clients don't appreciate the full scale of change required.

To successfully embed IFRS 15 in operational controls and processes, businesses need to develop a long-term solution that incorporates all impacted areas and focus on defining a future complete operating model.

So, how to go about this? Here are a few pointers…

- First, it's crucial that the **contract and customer lifecycle** are assessed and the most significant impacts identified on surrounding business and finance processes, as well as data and system requirements highlighted and prioritised.
- **All the applications and system points in the current systems landscape** should also be reviewed. Questions such as:
  - *Do we need a new CRM system?*
  - *How will we store contracts?* And
  - *Where and how do we want the new technology solution to be integrated into the various ERP systems that might currently exist?*
- **Finance and business processes** will need to be assessed and redesigned across the organisation – it is more than just creating an accounting engine to calculate the IFRS postings.
- **Adequate controls** across the entire end-to-end process will need to be designed and properly stress-tested. The technology should enhance those. In the end, properly planned automated controls can reduce manual effort and the risk of human error, or even fraud.
- Systems should have **the ability to automatically generate the relevant information** for required disclosures under IFRS 15.

Getting all these points right will give you the ability to become compliant and transform the way you operate, and I strongly believe compliance can drive more benefits than costs.

Host

Allison – So for IFRS 15 to become 'business as usual' what would you expect to see?

Allison

Well, in addition to the points that Jorge has made, I think the familiarity of the language of IFRS 15 principles in the accounting team is critical. In training, the finance team either consolidate at a group level or even, for large companies, they may need to consider training for local or component management.

As Nick mentioned, embedding processes for vetting new deals or new contracts before they are signed, so they may want to think about training the commercial team or the sales force, so that they understand the accounting for contracts and offers that they are providing to their customers, and a process where they can link up with the finance folks to talk about the deal before it is signed.

Importantly, as I think we have mentioned a few times, accounting at the contract level for IFRS 15 principles instead of just top-side adjustments, and having processes and controls to support that accounting.

Host

Nick – Anything else you'd like to add?

Nick

Well I think there is also a trust issue here. Analysts have been sceptical about the quality of accounting in some sectors. In some cases, a company or, indeed, the whole sector is marked down because investors just don't understand and therefore don't trust some of the information that is presented.

IFRS 15 will help address that by enabling a more consistent and transparent model for reporting revenue.

At the end of the day, the increase in the level of disclosures in IFRS 15 was primarily in response to complaints from investors.

So what we have here is an opportunity to wipe the slate clean and provide the transparency that investors have been asking for. Companies really need to stay focused on delivering what's useful to the investor and have processes and controls in place to help them deliver that information in a reliable and efficient way.

Host

OK. Some really good pointers there…

So, in summary, the process of explaining and embedding the change required by the new revenue standard is still presenting challenges for many companies. On the whole, it looks like there's a lot more work to be done!

For more information on the application of IFRS generally, visit KPMG's Global IFRS Institute at kpmg.com/ifrs or follow KPMG IFRS on LinkedIn.

Thank you all very much for taking the time to listen to our podcast and thank you to our panel. Look out for our next podcast, which will be released in the coming weeks.

Have a great day!