UNCTAD-Intergovernmental Working Group of Experts on International Standards of Accounting and Reporting

Workshop on Accounting and Financial Reporting Standards

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Morning Session

IFRS 15 – Revenue from Contracts with Customers

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REVENUE MATTERS TO INVESTORS

- **Key valuation and performance measurement input**
  - ICAS and EFRAG paper on use of financial statements: Revenue alongside EBITDA are two most useful performance measures

- **Indicator of failure of corporate governance**
  - Case studies: Toshiba, Boeing and Tesco

- **Significant Information Risk**
  - FRC 2015 corporate report review identifies revenue as one of the top 10 areas of concern

- **Need for companies to engage with investors on impacts of new standard**
  - Timing of revenue,
  - Timing of costs,
  - Changes in customer contracts, business practices
ANTICIPATED IMPROVEMENTS

- Convergence with US GAAP
  - Enhances comparability of financial statements

- Reduced Complexity Due to Shift from Industry Guidance (More pertinent for US GAAP)

- Strengthened IFRS recognition and measurement guidance
  - Multiple-element contracts
  - Licensing intellectual property
  - Contract modification
  - Contracts with significant financing components
  - Less diversity in practice in certain aspects (unexercised customer rights, sales with rights of return, principal versus agent?)
  - Incremental cost recognition requirements

- Enhanced Disclosures
  - Significant judgments and changes in judgments
  - Disaggregation of revenue
  - Changes in contract assets and contract liabilities
  - Performance obligations (>1 year)
GENERAL INVESTOR CONCERNS

- Diverging of “Converged Standard” during TRG process

- TRG Changes - Needed Investor Outreach
  - Changes to key issues have occurred with minimal investor input (e.g. Transition requirements, Principal versus Agent definition, IP Licenses)

- Transition Requirements Need to be Investor Focused
  - Practical expedients will likely undermine comparability of revenue trends reporting

- Ongoing Need for Investor Education Industry.Business model effects
  - Licensing intellectual property guidance
  - Cost recognition guidance
  - Long term contracts guidance
  - Customer contract credit risk requirement
TRANSITION: COMPARABILITY CHALLENGES

FIVE-YEAR SELECTED FINANCIAL DATA

### RETROSPECTIVE

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PAY ATTENTION TO TRANSITION RESOURCE GROUP ISSUES
REVENUE RECOGNITION AND MEASUREMENT

Step #1
Identify Contract(s) with Customer

Step #2
Identify Performance Obligation

Step #3
Determine Transaction Price

Step #4
Allocate Transaction Price

Step #5
Recognize Revenue

IMPORTANT FOR INVESTORS TO UNDERSTAND BUILDING BLOCKS

- **FIVE STEPS** – Determine the amount, timing and measurement reliability of recognized revenue.
- **BUSINESS MODEL ➤ STEPS** – Impact of particular step will depend on business model.
- **STEPS NOT SEQUENTIAL** – These steps are jointly considered and do not necessarily occur in sequential fashion.
SPECIFIC AREAS OF INTEREST

- **Multiple element contracts (Steps 2 and 4)**
  - Implications on timing of revenue
  - Changes in business practices and customer contracts
  - Estimated selling prices in multiple element contracts (No need to prioritize market-based evidence of prices)

- **Long-term contracts (Steps 1, 3 and 5)**
  - Revenue recognition over time- eligibility criteria
  - Implications of significant financing components on key ratios
  - Implications of contract terms, modifications

- **Uncertain Revenue (Step 3)**
  - Bill and Hold arrangements (Lower threshold than existing requirements)
  - Sales with rights of return
  - Unexercised customer rights
SPECIFIC AREAS OF INTEREST

- **Cost Recognition Requirements**
  - Impact on margins
  - Broadly specified requirements could undermine comparability of reported margins
  - Concerned about amortization and impairment occurring through anticipated contract renewal periods

- **Disclosures**
  - Number of practical expedients may undermine information content of disclosures
  - Improvements to revenue disclosures could be undermined by the disclosure overload narrative
ANALYSIS: EXISTING REVENUE DISCLOSURES

Analysis of 16 US companies with long term contracts (e.g. Boeing)- Mulford and Austin (2015)

• Only 7 of 16 companies disclosed POC-related percentage of revenue.

• Only 8 of 16 separately reported advances or customer advances.

• For 7 of 16, it was unclear whether the company over-billed or under-billed on its contracts.

• Only 5 of 16 disclosed timing of revenue recognition versus cash receipt.

• Only 9 of 16 mentioned POC or contract accounting in the risk factors section.
REMEMBER WHAT INVESTORS CARE ABOUT

• Amount, timing, and uncertainty of revenue from customer contracts;
• Margin profiles;
• Cash conversion of revenue;
• Future revenue potential as inferred from order backlog, contract liabilities, and performance obligations.