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

**Workshop on Accounting and Financial Reporting Standards**

Monday, 3 October 2016
Room XXVI, Palais des Nations, Geneva
Morning Session

# IFRS 15 – Revenue from Contracts with Customers

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# IFRS 15: INVESTOR PERSPECTIVES

OCTOBER 3RD, 2016

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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)

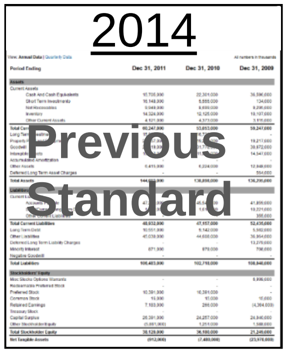
- **Transition Requirements Need to be Investor Focused**
  - Practical expedients will likely undermine comparability of revenue trends reporting

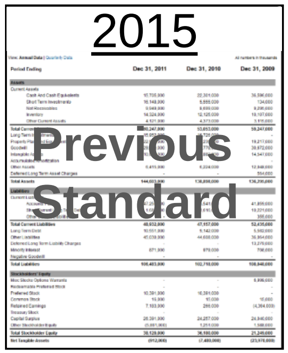
- **Ongoing Need for Investor Education Industry/Business model effects**
  - Licensing intellectual property guidance
  - Cost recognition guidance
  - Long term contracts guidance
  - Customer contract credit risk requirement

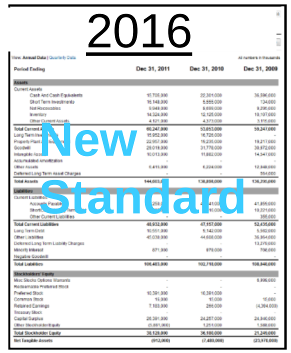
# TRANSITION: COMPARABILITY CHALLENGES

## FIVE-YEAR SELECTED FINANCIAL DATA

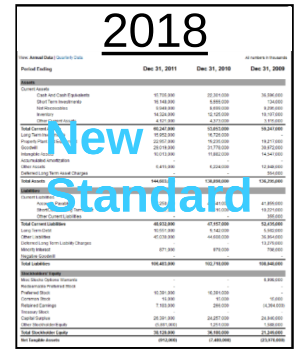
### RETROSPECTIVE



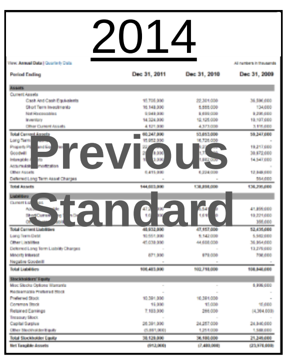



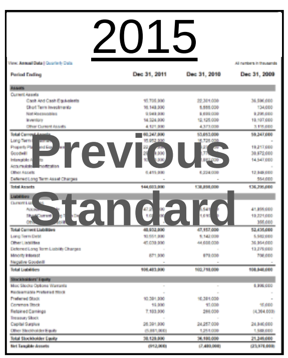



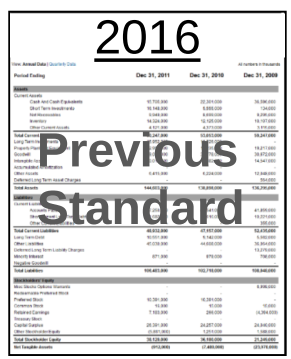


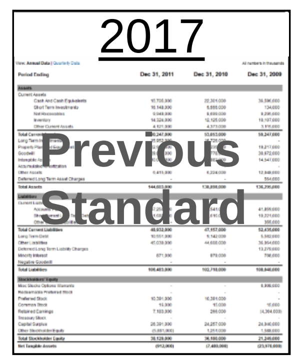


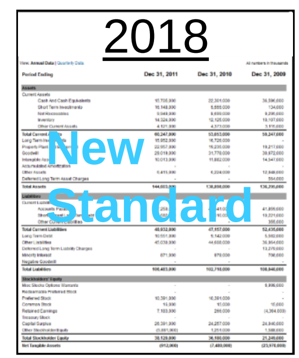

### CUMULATIVE EFFECT




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.