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

**Workshop on Accounting and Financial Reporting Standards** 

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#### IFRS 15 – Revenue from Contracts with Customers

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# IFRS 15: INVESTOR PERSPECTIVES

OCTOBER 3RD, 2016 VINCENT PAPA, CFA INSTITUTE

## 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

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## 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

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# TRANSITION: COMPARABILITY CHALLENGES

#### FIVE-YEAR SELECTED FINANCIAL DATA

#### **RETROSPECTIVE**











#### **CUMULATIVE EFFECT**









2018			
Trive Annual Data   Quarterly Data			All numbers in theusends
Period Ending	Dec 31, 2911	Dec 31, 2010	Dec 31, 2009
toon			
Oursett Assets			
Cash And Cash Flashelms	15 705 800	22 301 008	36.596.660
Short Term Investments	16.148.300	5,555,000	124,060
Nethodologi	9.549.300	8.698.000	9.295.660
kowolony	14.124.900	12,125,000	19,197,000
Other Country Assets	4,525,000	4,373,000	3,955,000
Total Cornect o	60,347,800	53,653,000	19,247,060
		16,725,000	
Progress Plant In The Cookell Cookel	92.057.000	16,235,000	19,217,000
Goodwill	29.019.000	21,779,000	30.872.000
Interegible Form	10,013,000	11,862,000	14,547,000
Other Assets	0.415.000	6.224.009	12.846.000
Dellaraid Long Term Asset Charges			554,000
Total Associa Cultufficery Constitutions	544,003,000	138,898,000	136,296,660
Accept Paris Short Seeling for the Characteristics	20	541.0 040.00	41,895,060 19,221,060 355,660
Total Cornert Link@dex	49,512,000	67,417,000	52,435,660
Long TermiDett	10.551,000	5.162,009	5.940,660
Other Lindslifes	45 000 300	44,608,000	36.954.000
Delened Long Term Liability Charges			13,275,660
Minority Interest	871,900	679,000	706,000
Negative Goodnill			
Total Liabilities	106,483,900	102,718,000	108,846,660
Else Modifiers' Equity Most Shocks Onlines Warrants			1206.000
Most secon Operate Walters Remainable Probated Total			2,880,000
Professor Stories	10 701 300	16 701 000	
Common Stock	15,000	15,000	15.000
Behinet Carriers	7 103 100	265,000	(4.764.000)
Treasury Stock	1.00000	200,000	(4244)
Capital Sassiva	25.391.800	24,257,000	24340000
Other Neckholder Equity	(5391,000)	1,251,000	1,590,000
Total Stockholder Casely	38,529,000	36,590,000	21,245,660
Set Easylide Assets	(912,000)	(7,480,000)	(23,876,000)

PAY ATTENTION TO TRANSITION RESOURCE GROUP ISSUES

# REVENUE RECOGNITION AND MEASUREMENT

Step #5 Step #3 Step #4 Step #1 Step #2 Recognize **Determine Allocate Identify** Identify Revenue **Transaction** Transaction Price **Performance** Contract(s) Price **Obligation** with Customer

#### 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.