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Revenue will never be the same again…

New IFRS 15 "Revenue from contracts with customers"

A single global standard replaces specific industry guidance on how companies recognise revenue.

Applying the new five-step model requires more judgements and estimates than today.

Many parts of a business are tied to revenue, such as executive compensation agreements and debt covenants, so planning for changes in practices, systems, processes, and controls is essential.

Start preparing now to figure out how the standard affects your financial picture, your investors, and the way you do business.

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IFRS 15, Revenue from contracts with customers

What is the issue?

On 28 May, the IASB and FASB issued their long-awaited converged standard on revenue recognition. Those closely following the project know there are potentially significant changes coming for certain industries, and some level of change for almost all entities.

IFRS 15, Revenue from contracts with customers, will be effective for IFRS reporters for the first interim period within annual reporting periods beginning on or after 1 January 2017, and early adoption is also permitted.

What is the impact?

The new standard will affect most entities that apply IFRS. Entities that currently follow industry-specific guidance should expect the greatest impact. Summarised below are some of the areas that could create the most significant challenges for entities as they implement the new standard.

Transfer of control

Revenue is recognised when a customer obtains control of a good or service. A customer obtains control when the customer has the ability to direct the use of and obtain the benefits from the good or service. Transfer of control is not the same as transfer of risks and rewards. Entities will also need to apply new guidance to determine whether revenue should be recognised over time or at a point in time.

Variable consideration

Entities might agree to provide goods or services for a consideration that varies depending on certain events occurring or not occurring. Examples include refund rights, performance bonuses and penalties. These amounts are often not recognised as revenue today until the contingency is resolved.

Going forward, an estimate of the variable consideration is included in the transaction price provided. It is highly probable that the amount will not result in a significant revenue reversal when the uncertainty is subsequently resolved. Even if the entire amount proposed as a variable consideration fails to attain this threshold, management will need to consider whether a portion (a minimum amount) does meet the criterion. Further, management will need to reassess estimates for each reporting period, and adjust revenue accordingly. There is a narrow exception for intellectual property (IP) licences where the variable consideration is a sales or usage-based royalty.

Allocation of transaction price based on relative stand-alone selling price

Entities that sell multiple goods or services in a single arrangement must allocate the consideration to each of those goods or services. This allocation is based on the price an entity would charge a customer on a stand-alone basis for each good or service. Management should first consider observable data to estimate the stand-alone selling price and estimate the stand-alone selling price if such data does not exist. Some entities will need to determine the stand-alone selling price of goods or services that have not previously required this assessment.

Licenses

Entities that license their IP to customers will need to determine whether the licence transfers to the customer over time or at a point in time. A licence that is transferred over time allows a customer access to the entity's IP as it exists during the licence period. Licences that are transferred at a point in time allow the customer the right to use the entity's IP as it existed when the licence was granted. The customer must be able to direct the use of and obtain substantially all of the remaining benefits from the licensed IP for management to recognise revenue when the licence is granted.

Time value of money

Some contracts provide the customer or the entity with a significant financing benefit (explicit or implicit). This is because performance by an entity and payment by a customer might occur at significantly different times. An entity should adjust the transaction price for the time value of money if the contract includes a significant financing component. The standard provides certain exceptions to applying this guidance and a practical expedient which allows entities to ignore the time value of money if the time between transfer of goods or services and payment is less than one year.

Contract costs

Entities sometimes incur costs (such as sales commissions or mobilisation activities) to obtain or fulfil a contract. Contract costs that meet certain criteria are capitalised as an asset and are amortised as revenue. More costs are expected to be capitalised in some situations.

Disclosures

Extensive disclosures are required to provide greater insight into both revenue that has been recognised and revenue that is expected to be recognised in the future from existing contracts. Quantitative and qualitative information will need to be provided about the significant judgements and changes in those judgements that management makes to determine revenue that is recorded.

New revenue recognition goes beyond accounting: are you ready for this?

You will need to consider the changes beyond accounting well in advance of the deadline for adopting the new standard and determine the level of impact on your business. In particular, companies with large numbers of customer contracts, those offering bundled products and services, providing warranties or rebates, or companies which have contracts where the amount of the consideration varies, should start assessing the impact now.

Systems, controls and processes

These are likely to be the most significantly impacted and take the longest lead time to change. Most systems are set up to draw revenue numbers directly from the billings system. Under the new standard, information from the contracts underlying billings will need to be analysed in order to determine the separate performance conditions of the contracts and the revenue to be recognised from those performance conditions. Interfaces between customer relationship management, sales and distribution and the general ledger systems may be impacted, and previously automated processes may now require intervention.

Contracts

Existing terms could take on new meaning under IFRS 15, and changes to the amount and timing of revenue recognition may trigger contingent consideration or other provisions based on revenue measures. You may need to renegotiate debt covenants or other contracts prior to transition to maintain the original intent. You may also want to rethink how you structure customer agreements in future, for example, if you want to achieve recognition over time rather than at a point in time.

Compensation and bonus plans

Revenue recognition can trigger payments, such as bonuses or commission. You will need to consider how timing changes for revenue recognition affect these and other internal arrangements.

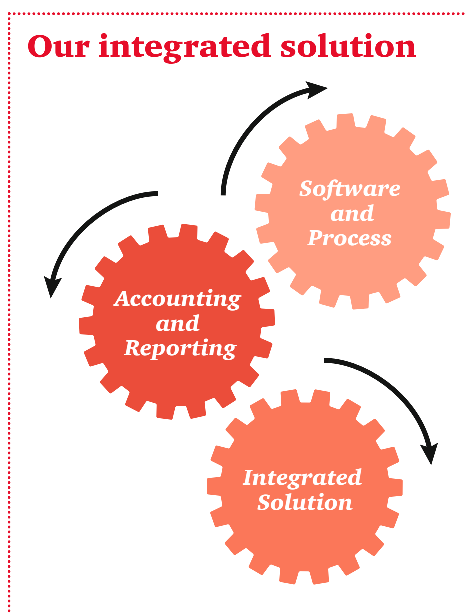
Taxes

The timing of cash tax payments could be affected if, for example, you recognise revenue sooner than in the past with a consistent treatment for tax purposes.

Investor relations

Stakeholders will want to know how your revenue recognition will change and how the new standard will affect your company's financial picture.

Our integrated solution



Our expertise

PwC is already actively working with a number of large companies around the world to manage their transition to the new standard. We have developed an approach that draws on our expertise in accounting and financial reporting, systems implementation and transaction structuring to deliver an integrated solution. We can help you to manage the implementation project from start to finish.

Our global network of multi-disciplinary and cross-industry specialists in each country can assist you with understanding the financial and cross-functional implications and in preparing a roadmap to implement the new revenue recognition requirements in an integrated, measured, efficient and consistent way.

Our integrated implementation solution is based on a proven three-step approach:

Phase 1: Impact study and analysis

The starting point for an integrated and measured implementation is our impact study and analysis. This includes understanding the financial and cross-functional impacts, analysing your business models and contracts underlying your revenue recognition, analysing your IT landscape and highlighting risks and gaps.

Phase 2: Preparation and decision – project delivery

During this phase, a detailed analysis of differences in accounting policies, data gaps and the IT systems landscape including required interfaces will be performed. This will support your decision to go for a contract-by-contract or portfolio implementation approach and your choice of an optimal software solution to comply with the complex requirements of the new standard.

Phase 3: Implementation and embedding of business process changes

During the implementation phase, we will support you in gathering the data, testing the IT concept, adjusting IT systems and testing the results.

Your benefits

PwC ensures that the implementation process runs smoothly by means of continuous knowledge transfer. We offer you customised implementation advice throughout the process to meet your needs and the requirements of the new revenue recognition standard. We will provide you with our proven accounting change methodology, tools, templates, best practices, staff training and, if needed support you in your choice and implementation of a sustainable software solution.

Using our experience in managing accounting changes, you will be able to set up the implementation project, get internal buy-in and sponsorship and be able to integrate implementation processes in your other regulatory and IT change projects as well as your ongoing financial reporting calendar.

With early insight into the reporting and cross-financial impacts of this standard you will be able to spread the costs of implementation (e.g., IT changes) over multiple years and budgets, help raise awareness internally, enable you to engage stakeholders and also communicate the financial and cross-functional impacts on a timely basis.

By leveraging our multi-disciplinary specialists you will reduce implementation risks and ensure you meet the requirements of the new revenue recognition standard in a (cost) efficient way.

About us

Every day, our clients face various tasks, want to implement new ideas and seek advice. They expect us to develop integrated, practice-oriented solutions with maximum benefits. Therefore, we use our full potential for the benefit of each client, regardless of whether the client in question is a global player, a family business or a local institution. It is of major importance to us to maintain a relationship of trust with our clients because the better we know and understand them, the more specifically we can offer them customised support and the higher the value delivered.

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