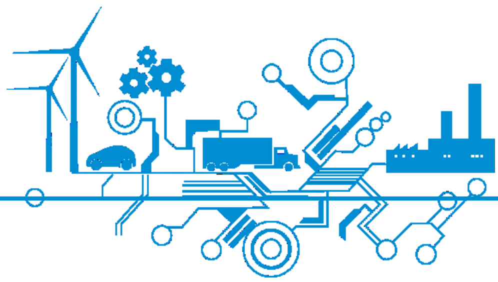
KPIT

An Introduction to the New Standard on Revenue Recognition



Executive Summary

This white paper introduces the International Financial Reporting Standards (IFRS) and the changes that are happening in the new Standard on Revenue Recognition (IFRS 15). The new standard comes with some clear and baseline definitions and clarifications that will help the companies to understand, plan and revise their accounting and processes to comply with the new standard. This white paper discusses the potential impacts of the new standard on the business, the challenges and opportunities that are involved, and promote active participation in adopting this new standard in the existing process.

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Introduction

International Financial Reporting Standards (IFRS) have been discussed a lot in terms of - "what these standards are" and "adoption of the new standards." With this mind, it is important to inform the audience through this white paper as to how relevant IFRS is for their organization. These are broadly defined in the following section.

*IFRS is a globally recognized **set of standards** for the preparation of financial statements by business entities. IFRS prescribe:*

- *the items that should be recognized as assets, liabilities, income and expense;*
- *how to measure those items;*
- *how to present them in a set of financial statements; and*
- *related disclosures about those items.*

Given below is a list[1] of all the standards under IFRS that have been released by the International Accounting Standards Board (IASB) and are being adopted over time globally, for uniform accounting and reporting:

List of International Financial Reporting Standards (IFRS)			
No	TITLE	ORIGINALY ISSUED	EFFECTIVE
IFRS 1	First-time Adoption of International Financial Reporting Standards	2003	1-Jan-04
IFRS 2	Share-based Payment	2004	1-Jan-05
IFRS 3	Business Combinations	2004	1-Apr-04
IFRS 4	Insurance Contracts	2004	1-Jan-05
IFRS 5	Non-current Assets Held for Sale and Discontinued Operations	2004	1-Jan-05
IFRS 6	Exploration for and Evaluation of Mineral Resources	2004	1-Jan-06
IFRS 7	Financial Instruments: Disclosures	2005	1-Jan-07
IFRS 8	Operating Segments	2006	1-Jan-09
IFRS 9	Financial Instruments	2009	1-Jan-18
IFRS 10	Consolidated Financial Statements	2011	1-Jan-13
IFRS 11	Joint Arrangements	2011	1-Jan-13
IFRS 12	Disclosure of Interests in Other Entities	2011	1-Jan-13
IFRS 13	Fair Value Measurement	2011	1-Jan-13
IFRS 14	Regulatory Deferral Accounts	2014	1-Jan-16
IFRS 15	Revenue from Contracts with Customers	2014	1-Jan-18
IFRS 16	Leases	2016	1-Jan-19

[1] International Financial Reporting Standards, Wikipedia.org - https://en.wikipedia.org/wiki/List_of_International_Financial_Reporting_Standards

Currently, there is a growing number of countries that are starting to adopt the use of IFRS. More than 120 nations and reporting jurisdictions permit or require IFRS for domestic listed companies[2].

- European Union (EU) - requires companies incorporated in its member states whose securities are listed on an EU-regulated stock exchange to prepare their consolidated financial statements in accordance with IFRS.1.
- Australia, New Zealand, and Israel - have essentially adopted IFRS as their national standards.2
- Brazil - started using IFRS in 2010.
- Canada - adopted IFRS, in full, on Jan. 1, 2011.
- Mexico - adopted IFRS for all listed entities starting in 2012.
- Japan - has stated that listed companies can use Japanese standards, IFRS or US GAAP
- Hong Kong - has adopted national standards that are equivalent to IFRS
- China - converging its accounting standards with IFRS.
- India - currently permitted on a limited voluntary basis. A few listed companies use IFRS
- Indonesia - companies follow Indonesian Financial Reporting Standards (SAK), which is substantially in line with IFRS.
- Saudi Arabia – IFRS is required for banks and insurance companies. Will most likely adopt IFRS by 2017.
- Switzerland – IFRS is permitted, SWISS GAAP, US GAAP, and other standards may be used.
- United States – US-based entities, financial and economic leaders from various organizations have announced their support for global accounting standards. IFRS is permitted for Non-US based companies without reconciliation to US GAAP.

On May 28, 2014, the Financial Accounting Standards Board (FASB) and International Accounting Standards Board (IASB) issued substantially converged final standards on revenue recognition, identified as IFRS 15.

IFRS 15 - Revenue with Contracts from Customers

The new standard comes with some clear and baseline definitions and clarifications that will help the companies to understand, plan and revise their accounting and processes to comply with the new standard. The high-level details of the Standard are described in following subsections.

The entity will recognize revenue to depict the transfer of promised goods or services to customers. This is a five-step model[3]:

1. *Identify the contract with a customer*

[2] International Financial Reporting Standards (IFRS) - http://www.ifrs.com/pdf/IFRSUpdate_V8.pdf
[3] IFRS 15 - https://en.wikipedia.org/wiki/IFRS_15

2. *Identify all individual performance obligations within the contract*
3. *Determine the transaction price*
4. *Allocate the price to the performance obligations*
5. *Recognize revenue as the performance obligations are fulfilled*

Recognize revenue as the performance obligations are fulfilled

An entity can recognize revenue when performance obligations have been settled; a performance obligation has been settled when the customer has received all the benefits associated with the performance obligation and is able to use and enjoy the asset to his or her own discretion[4].

Performance obligations settled over time

The performance obligations will be settled in the measure of progress towards completion, the measure of progress can be either based on the inputs (in the case of manufactured goods), or the output method[5].

What are the Key Differences in the New Standard (IFRS 15)

It is important to know for Organizations, who are operating either in their local markets or globally, as to what are the "Key Differentiators" and given below is a snapshot of those differences between "what is followed today" vs. "new regulations that will define a whole new way of recognizing revenue."

Current	Under the New Guidance
There are numerous requirements for recognizing revenue	There will be consistent principles for recognizing revenue, irrespective of industry and/or geography
Other than disclosures in accounting policies and segment reporting, most companies and other reporting organizations provide limited information about revenue contracts	The new guidance includes set of disclosure requirements that will provide the users of financial statements, with useful information about the organization's contracts with customers
Many goods or services promised in a contract with a customer are deemed not to be distinct revenue-generating transactions, when in fact those promises might represent separate obligations of the entity to the customer	Reporting organization will identify each goods or services promised, determine if those goods or services represent a performance obligation and recognize revenue when each performance obligation is satisfied
In a multiple arrangement, the amount of consideration allocated to a delivered product, is limited to the amount that is not contingent on delivering future goods or services	Companies will allocate the transaction price to each of the performance obligations in the contract on the basis of the individual prices of the goods or services. This will be impacted by the discount factor that

[4] IFRS 15 - https://en.wikipedia.org/wiki/IFRS_15
[5] IFRS 15 - https://en.wikipedia.org/wiki/IFRS_15

	relates to one or more of the performance obligations in the contract
Accounting for variable consideration differs greatly across industries	A single model to consider for variable consideration, which includes rebates, discounts, bonuses, or a right of return. Variable consideration will be included in the transaction price to the extent it is probable that a significant reversal in the amount of cumulative revenue recognized will not occur

Table Source[6]

Why is it Important to adopt the New Standard (IFRS 15)

CFO's and other senior management are looking towards their Management Teams, Trusted Partners and Auditor's for advice and guidance on what needs to be done outlining the next steps so that they are not caught in the lack of compliance per the regulations. These standards have been issued by FASB for US GAAP and impact all companies who are doing the following:

All reporting organization who[7]

- *Enter into contracts with customers to transfer goods or services, or*
- *enter into contracts for the transfer of nonfinancial assets unless those contracts are within the scope of other standards (for example, insurance contracts or lease contracts).*

Non-compliance of this Reporting Standard, may attract the following penalties:

- *Local governing bodies will impose penalties*
- *Auditors will qualify audit reports for non-compliance and gaps*
- *Shareholder confidence will drop*
- *Last minute effort will need more funding for transition*
- *Companies will be impacted with incorrect billing, revenues, and inaccurate reporting*

NOTE: These are opinion of this author and not been outlined by any regulatory committee

Effective Date of Compliance (IFRS 15)

On August 12, 2015, the FASB issued an Accounting Standards Update deferring the effective date of the new revenue recognition standard by one year[8].

[6] Revenue Recognition: http://www.fasb.org/jsp/FASB/Page/BridgePage%26cid=1351027207987#section_3
[7] Revenue Recognition: http://www.fasb.org/jsp/FASB/Page/BridgePage%26cid=1351027207987#section_4
[8] Revenue Recognition: http://www.fasb.org/jsp/FASB/Page/BridgePage%26cid=1351027207987#section_7

Based on the Board's decision:

- **Public organizations** should apply the new revenue standard to annual reporting periods **beginning after December 15, 2017**. Public organizations should apply the new revenue standard to interim reporting periods within annual reporting periods beginning after December 15, 2017 (that is, a public organization is required to apply the new revenue standard beginning in the first interim period within the year of adoption).
- **Nonpublic organizations** should apply the new revenue standard to annual reporting periods **beginning after December 15, 2018.** Nonpublic organizations should apply the new revenue standard to interim reporting periods within annual reporting periods beginning after December 15, 2019 (that is, a nonpublic organization is not required to apply the new revenue standard in interim periods within the year of adoption).

Special Note:

- Additionally, the Board decided to permit both public and nonpublic organizations to adopt the new revenue standard early, but not before the original public organization effective date (that is, annual periods beginning after December 15, 2016).
- A public organization should apply the new revenue standard to all interim reporting periods within the year of adoption.
- A nonpublic organization is not required to apply the new revenue standard in interim periods within the year of adoption.

What are the Challenges of Implementing IFRS 15

Moving to a new standard is never without any challenges and we see the following as possible impediments to a seamless transition:

- *Getting global clients compliant by Dec 31, 2017, which will include changing processes and technology*
- *Lack of full understanding of the impacts by organizations*
- *Solutions developed and supported by Technology Vendor - Oracle is only for JDE E1 v9.1 and higher.*
- *World and Xe versions will need custom solutions, which can take time and considerable effort, based on the requirements.*

Recommendations for Implementing IFRS 15

- **Understanding of the Standard** is critical here. What needs to change with a good understanding of the **time and effort** to make it happen, is key here.
- **Timing and ability of the organizations to move quickly** to adopt this standard by the compliance date
- **No interruption to normal business for moving to the new standard.** Educate the organization leaders to give them the confidence that this transition can be done without interrupting their business.
  Be Proactive in getting the solution defined and ready for adoption by organizations.

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Sandeep Dixit is a certified Public Accountant and a seasoned finance professional with over 25+ years of experience in accounting, auditing, systems implementation and business process re-engineering projects that have spanned across the continents. Sandeep has led the finance organization in key positions and used accounting standards and principles to be able to contribute on this topic. He has been part of The Thought Leadership in the Finance area. Sandeep is the **Practice Director at KPIT for JDE Edwards practice**, who are focused on Innovation and new ideas.