Financial Reporting Alert:

IFRS 15: The "New" Revenue Recognition Standard One Year Later

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IFRS 15 Turns One!

As the IASB's IFRS 15: Revenue from Contracts with Customers passes that all-important first milestone, we look back on what has happened in the first year, and what is expected in the years to come. The new standard, jointly issued with the FASB, replaces all existing revenue recognition guidance and aims to provide one overall principle by which companies, public and private, across industries and jurisdictions, will recognize revenue in the near future.

The Effective Date will likely be Delayed One Year

A year after the issuance of IFRS 15, the IASB (following the FASB) has already proposed a one-year delay in the effective date to fiscal years beginning on or after January 1, 2018. The comment period ends July 3rd, but it appears most constituents support a deferral.

It's no secret that the primary driver of the deferral was the amount of work required to implement the standard, as companies discovered there simply was not enough time to implement the necessary system and process changes. While the timeline is still short for companies electing a full retrospective transition method, the deferral should allow companies the additional time necessary to determine the technical implications, and present comparative financials if desired, which many were finding impossible to achieve with the fast-approaching implementation date.

The IASB Plans to Clarify Licensing and Performance Obligations

The IASB plans to issue an Exposure Draft in June to clarify IFRS 15 regarding licensing and identifying performance obligations, two primary areas of confusion surrounding the technical interpretation of the IASB's standard.

As implementation of the standard progresses, more questions regarding the interpretation and application of the standard naturally occur. These questions were anticipated, especially with a standard aiming to provide guidance on concepts and principles of revenue recognition which apply to all industries within scope rather than provide guidance which is specific to any industry. To address these questions and with the goal of keeping the IASB and FASB standards as converged as possible at the effective date, the Boards established the Joint Transition Resource Group (TRG) to debate such questions and determine whether further guidance from the Boards was necessary. These two clarifications are largely a result of those discussions within the TRG and the May Exposure Draft issued by the FASB.

Licensing

The IASB plans to clarify the license guidance within IFRS 15 but will not follow the FASB's requirement to determine whether the license is functional or symbolic (see below for details of the FASB's Exposure Draft). Regardless, the FASB and IASB agreed that their respective guidance, when amended, should still result in similar conclusions. Clarifications proposed by the FASB regarding the sales-based royalty exception will also be proposed by the IASB, but the other items related to licensing included in the FASB's May 12th Exposure

Draft will not be included in the IASB's Exposure Draft when it is released. The IASB, typically opting for less prescriptive guidance, believes the existing principles and discussion in the Basis for Conclusions as well as other public discussions should be sufficient for companies to come to reasonable and consistent answers.

The FASB's guidance as proposed in the Exposure Draft is as follows:

Functional vs. Symbolic: Determining whether a license provides customers with a right to access or a right to use an entity's intellectual property drives recognition of revenue overtime (for a right to access) or a point in time (for a right to use). The FASB has clarified the concept in terms of functionality of the license. A license has significant stand-alone functionality if it can be used as it exists at the point in time the license is granted, unless the entity is expected to undertake activities that will change the functionality of the intellectual property. Functional licenses should be recognized at a point in time and include software, biological compounds or drug formulas, and completed media content. Symbolic licenses do not have significant stand- alone functionality and thus include supporting or maintaining that intellectual property during the license period. These licenses will be recognized over time and include brands, trade names, logos, and franchise rights.

Licenses as Part of a Bundled Performance Obligation: If a license isn't a separate performance obligation but is combined with other promised goods and services, there has been confusion as to which part of the guidance should be considered. The FASB has now clarified that the license, if the dominant deliverable, should be evaluated as to whether its nature is functional or symbolic, to determine the recognition of the overall performance obligation.

Sales and Usage-Based Royalties: The exception whereby sales and usage-based royalties for licenses of intellectual property are recognized when the sale/usage occurs or the performance obligation is satisfied. Such royalties should not be split and will be looked at as an overall royalty stream, and the guidance will apply whenever the predominant item to which the royalty relates is a license of intellectual property.

Identifying Performance Obligations

The IASB decided to add some illustrative examples to the new standard to clarify how the guidance on identifying performance obligations should be applied, particularly around determinations of when a promised good or service is separately identifiable from others in a contract. While the FASB issued an Exposure Draft on May 12th which also addressed this, the Exposure Draft included several items which the IASB does not intend to include. For instance, the FASB clarified that entities would not be required to identify goods or services promised in a contract with a customer that are immaterial in the context of the contract, nor aggregate them for materiality assessment at the entity level. The IASB has preliminarily decided this does not warrant inclusion in their guidance. As for shipping and handling, on which the IASB has yet to decide, the FASB proposed that shipping and handling should be considered a fulfillment cost if incurred before control transfers rather than a separate performance obligation, but that an accounting policy election could be made to treat it as a fulfillment cost rather than a separate performance obligation after control transfers.

Further Plans to Clarify the Standard

There is no shortage of technical questions arising as companies begin to apply the complex standard to their own contracts. A few of the other issues discussed by the TRG are getting attention by the FASB& IASB, such as principal vs. agent (gross vs. net) determination for certain types of taxes or other amounts collected on behalf of third parties - the FASB has tentatively decided to include a practical expedient that such taxes can be presented net as a policy election rather than performing the lengthy jurisdiction- by-jurisdiction assessment, though the IASB concluded a similar expedient is not necessary. Another area causing confusion in application is the assessment of probability of collection in Step 1: Identification of the Contract - the FASB will propose that the analysis should be focused on goods or services that will be transferred to the customer as opposed to the entire amount promised, while the IASB will perform more research on this issue. Of course there are a number of other issues which have been raised and are currently being debated as well.

Implementation Challenges and Lessons Learned

1. *Getting Started:* Sometimes the hardest part is getting started. Inertia is a powerful force, and with the multiple demands on the time of Finance & Accounting personnel, not only from the normal day-to-day accounting and reporting cycles, but also the increasing number of business acquisitions, dispositions, system implementations and finance transformations, finding the right time to begin an overwhelming project like this can be challenging. Start by identifying a core team, appointing a project lead, and getting the team educated on the key provisions. An impact assessment is a logical next step,which entails identifying the revenue streams and examining some contracts to determine the impact. It's important to understand the current accounting, and then the gaps will become apparent once you layer on the future accounting. This process will help determine how much work is required to implement the guidance and allow you to develop a detailed strategy.

2. *Not Just a Finance & Accounting Project:* Although it's up to the Finance & Accounting team to drive the project, other departments and the business units will need to be involved to properly determine the impact and successfully implement change throughout the organization. Sales and marketing will be instrumental in optimizing revenue contract provisions and a go-to-market strategy; financial planning and investor relations will be interested in any shift in revenue or margin; internal audit needs to be aware of changes to processes and controls; the legal department will be helpful in interpreting contract provisions, negotiating/drafting amendments as necessary, and locating certain contracts; and human resources/benefits can help manage issues with compensation programs.

3. *Resource Constraints:* Feedback from many companies has been that implementation takes longer than they thought, even for those not expecting a significant change to the amount or timing of their revenue, due to additional documentation requirements, required disclosures, and changes in process. In many cases, their internal resources are not sufficient to assess the impact, design the necessary solution, and implement required changes to their systems and processes. The deferral should allow enough time to thoughtfully employ the right mix of internal and external resources to meet the deadlines, and potentially reduce costs. Communication is key in managing the process, and should start early to get commitment and approval for budget to complete the project plan, secure time from internal personnel, and hire an advisor/partner if necessary.

4. *Systems Solutions:* Companies are looking for the most efficient and controlled way to sustain this complex accounting on an ongoing basis. A long-term system solution is recommended, as spreadsheets can have control issues and introduce additional risk into the revenue accounting cycle. However, system solutions aren't implemented overnight - these involve a lengthy process from capital budget approval to user testing. Ideally, companies electing a full retrospective adoption should plan to implement a new system for dual reporting beginning January 1,2016.

Companies always want to know where others are in the implementation process, and of course that varies greatly by company. Some companies have been evaluating the impact long before the standard was ever finalized and have now moved into the implementation phase - some are even planning to early adopt. Others have waited...waited to see if a deferral would be approved, waited to see if and how the IASB and FASB will clarify the guidance, and waited to see what their peers will do. But there's no more time to wait. At a minimum, companies should be looking at the impact. Nobody wants a big surprise when the assessment is finally performed, or the fire drill that would surely ensue to prevent a financial statement misstatement or control deficiency. Take advantage of the lessons learned and time granted this past year to plan your strategy, assess the impact, and determine the appropriate implementation method and timeline to minimize disruption and cost to your company.

So while it's too late to get started early, you can still get started now and be well on your way to implementation by the next birthday of IFRS 15.