KPMG

Accounting for revenue is changing

What's the impact on your business?

April 2016

The new revenue standard – effective from 1 January 2018 – is likely to affect the way you account for revenue. But it is more than just an accounting change.

It could impact:

- timing of revenue recognition
- profile of margin on contracts
- systems and processes, including data collection
- contract negotiations with customers
- revenue-based metrics
- debt covenants and employee reward schemes
- disclosures in annual report

It's time to engage, particularly as there are also new standards on leases and financial instruments.

If you have:

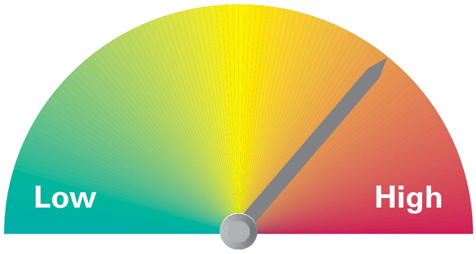
- multiple goods or services in a contract
- contracts that span more than a year
- contracts with variable consideration
- licences or royalty arrangements
- costs to obtain or fulfil a contract
- contracts that change throughout the term
- compensation or debt linked to revenue

…it's time to start looking at your contracts and assessing how the new revenue requirements will affect your business.

---

telecommunications | software | real estate | aerospace & defence | building & construction | contract manufacturing

Determining the impact



Do you have …	What's the potential impact?	Actions to consider
… multiple goods or services in a contract?	– New separation criteria may change which goods and services are bundled/unbundled for revenue recognition purposes. – The transaction price will be allocated using stand-alone selling prices, which may be different from existing methods – e.g. fair values. – As a result, revenue may be recognised earlier or later than at present, and the split of revenue between different goods and service lines may change, affecting key performance indicators.	– Make new judgements on when to bundle/ unbundle. – Develop new valuation models or processes to estimate stand-alone selling prices. – Implement systems to allocate stand-alone selling price. – Identify commercial opportunities.
… contracts that span more than a year?	– New criteria will be applied to determine whether revenue is recognised as work is performed or only when work is complete. – The method for measuring contract progress may need to change to best depict a company's performance – e.g. cost-to-cost instead of units produced – changing the revenue profile. – The finance element of payments received in advance or in arrears may need to be accounted for separately, changing the amount of revenue recognised.	– Align internal controls and processes with the method and timing of revenue recognition. – Update systems to capture the time value of money adjustments. – Develop new estimates to determine the discount rate to be applied.
… contracts with variable consideration?	– Variable consideration – including discounts, rebates, refunds, credits, incentives, bonuses, penalties and contingencies – will be estimated using a specific methodology that may differ from current practices. – Variable consideration will be included in revenue only when it is 'highly probable' that there will be no significant revenue reversal in the future. This assessment will be reviewed at each reporting date.	– Make new judgements on whether a significant revenue reversal is expected. – Develop new models or processes to determine the expected value or most likely amount. – Make changes to existing systems to generate information needed and to track and record variable consideration.
… licences or royalty arrangements?	– New guidance will determine if revenue from a licence is recognised up-front or over the licence period, which may alter the revenue profile. – Sales- and usage-based royalties from licences of intellectual property will be recognised when the sale or usage occurs. For all other royalties, revenue will be estimated at the outset but constrained to a 'highly probable' amount – which may result in greater volatility in revenue recognised. – If a royalty relates partly to a licence of intellectual property and partly to other items, then judgement will be required to determine the predominant item to which the royalty relates.	– Make new judgements on whether licences are distinct. – Make new judgements on whether licences provide a right to use, or access to, intellectual property. – Align internal controls and processes with the method and timing of revenue recognition.
… costs to obtain or fulfil a contract?	– Cost accounting – and therefore profits – will also change, with new criteria on when contract costs can be deferred in the balance sheet. – Amortisation periods may differ from current practice.	– Make changes to existing systems to capture costs that will be capitalised and/or to reflect revisions to amortisation periods.

Do you have …	What's the potential impact?	Actions to consider
… contracts that change throughout the term?	– Changes to a contract will be recognised only when the change is approved, which may be later than at present. – There will be several methods for accounting for changes to contracts, including a cumulative effect approach, which may differ from current practice.	– Amend the processes for contract modification to identify and track components in contracts. – Make new judgements when accounting for contract modifications.
… compensation or debt linked to revenue?	– Changes to revenue and cost recognition may mean that staff incentive or compensation plans are no longer aligned with corporate goals. – Changes in earnings may affect compliance with debt covenants or financial assurance tests.	– Amend employee incentive plans and communicate these changes. – Renegotiate existing debt arrangements or new terms included for new borrowings.
… a clear plan for transition?	– Different transition options may have different effects on revenue trends.	– Quantify the effect of the transition options. – Communicate to investors and other stakeholders the likely impacts, both on transition and on an ongoing basis.

How KPMG can help

A robust assessment phase is critical to laying the framework for a successful project, and it is important to start the assessment early to provide flexibility during the implementation phase. An assessment phase typically includes the following activities:

Activities	Actions	Deliverables
Accounting diagnostic	– Identify potential gaps to accounting policy and disclosures by reviewing current accounting policy and sample of contracts – Leverage your existing documents and knowledge	Gap matrix, heat map and contract review summaries
Process and information gap analysis	– Identify new information and process requirements – Trace requirements to existing sources or identify gaps	Business requirements document, process and information gap analysis report
Technology and broader impact evaluation	– Identify potential impact on IT, tax, controls, operations, financial planning and analysis, investor relations etc. – Identify gaps and linkages across the organisation	Final gap matrix and heat map, implementation roadmap
Transition option assessment	– Determine how each option may impact financials and business – Assess readiness to elect the retrospective or cumulative effect option	Transition option assessment report

KPMG offers a suite of proprietary solutions which assist in the accounting, tax, and reporting aspects of your revenue recognition implementation. We can provide customised options, in which our tools can be tailored to your specific needs and also can be utilised on a combined or individual basis.

Credentials

The following are just a few examples of how our cross-functional teams of specialists have helped clients with the accounting and the operational challenges.

Client	How we helped
A major telecommunications business	We helped our client reduce the costs of implementation by working with them to develop a tool that automates the accounting for complex bespoke contracts with a financing element.
A multinational financial services organisation	We enabled our client to develop an implementation plan for the new standard, by helping them evaluate the impacts and develop an inventory of arrangement types and revenue streams.
A multinational conglomerate organisation	We helped our client efficiently assess the impact of the new standard for select pilot businesses by identifying the key impacts of the new standard for each revenue stream. Additionally, through our approach of assessing select pilot businesses, we were able to help our client articulate a plan, resource needs, etc. for a full project implementation based on the results of the initial pilot assessments.

Contact us

If you have any concerns about the impact of the new revenue standard, or any other accounting issues, please speak to your usual KPMG contact or either of the following.

Markus Kreher
Global Leader, Accounting Advisory Services
+49 89 9282 4310
markuskreher@kpmg.com

Stephen Thomson
US Accounting Change Leader
+1 303 382 7970
sgthompson@kpmg.com

kpmg.com/ifrs

Publication name: *Accounting for revenue is changing: What's the impact on your business?*

Publication date: April 2016