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Directors' Series

Readiness Self-Assessment for Directors

IFRS 15 *Revenue from Contracts with Customers* – Are you ready yet?

In May 2014 the International Accounting Standards Board (IASB) and the Financial Accounting Standards Board (FASB) jointly issued *Revenue from Contracts with* Customers (IFRS 15 under IFRS and ASU 2014-09 (Topic 606) under US GAAP), a converged standard[i] on the recognition of revenue from contracts with customers. This new Standard supersedes existing standards and interpretations related to revenue and is mandatorily effective for annual periods beginning on or after January 1, 2017[ii], with earlier application permitted. IFRS 15 establishes a comprehensive framework for revenue from contracts with customers, with a core principle that an entity should recognize revenue to depict the transfer of promised goods or services to customers in an amount that reflects the consideration to which the entity expects to be entitled in exchange for those goods or services (using a five-step model).

The Standard is applicable to all types of contracts with customers in all industries, therefore it may have broad and significant implications on entities. Entities will need to begin considering early on, not only the financial reporting implications, but the extent to which changes may be required in processes, IT systems, internal controls, as well as impacts it may have on key performance indicators (KPIs), loan covenants, and future contract terms and conditions, to name a few.

The Standard is to be applied retrospectively, using either a full retrospective approach (subject to certain practical expedients) or a modified retrospective approach.

For more information on the new Standard refer to our IFRS 15 page on Deloitte.ca.

What is the role of the board in this implementation?

As with any new IFRS implementation, board oversight at an early stage and on an ongoing basis is critical. In order to ensure an effective and efficient implementation process, it is imperative that the board remains engaged in this process and sets the tone for the entity. The board must be aligned with management in setting the direction and strategy for this IFRS implementation. It is important for the board to have a proficient understanding of the new Standard and its potential implications on areas such as financial reporting, KPIs used in benchmarking, loan covenants and remuneration schemes. Without a clear understanding, it may be challenging for the board to maintain an effective level of oversight and to engage in productive and insightful dialogue with management.

Why get started now?

Although still in the early stages of their implementation plan, some entities have already begun to encounter a number of unforeseen challenges, which further substantiates the need to begin the implementation process early. As you begin to discuss implementation with management, consider the following issues that have been identified by select entities, and think about whether management has planned sufficient time to address these issues.

- Contracts are not as 'standard' as expected. The terms and conditions within contracts are critical drivers to applying the five-step model. Many entities are finding that the language included within contracts is not quite as straight-forward as expected and consultation with those external to the financial reporting function (e.g. legal counsel) is required. Meaning, existing terms within the contract are challenging to interpret and apply under the context of IFRS 15. Although this presents itself as a challenge on implementation, this can also be viewed as an opportunity to rethink the terms and conditions of contracts on a forward going basis to ensure the original intent of the contracts can be conveyed in the context of IFRS 15.
- Obtaining information from legacy systems. Given the retrospective application of the Standard and the increased disclosures, entities are finding that an increased volume of information is required. This information is not always readily available from legacy systems, which may not have captured and maintained the data at the level of detail required under IFRS 15. One such example may include the new quantitative disclosure requirements around disaggregation of revenue.
- Lack of appropriate software and tools in the marketplace (currently) to support the transition and ongoing reporting requirements. Now that some entities are slowly beginning to understand their needs for implementation and ongoing reporting, they are also identifying gaps in the tools that are currently available to meet these needs. Given the very specific requirements of the new Standard, information required for both accounting and disclosure purposes needs to be captured and assessed in a certain manner. To avoid or limit manual intervention and reconciliations, the importance of integrated, cross-functional tools and software is becoming more apparent.
- Volume of data can be very challenging. As noted above, the new Standard calls upon a significant amount of data accumulation for both accounting and disclosure purposes - this is a process that cannot be underestimated. For example, the new Standard requires the increased use of estimates in certain areas such as when estimating variable consideration or determining standalone selling prices when observable prices are not available. In order to make such estimates, an increased amount of data will be required, to be compiled and analyzed in a meaningful manner to ensure estimates are reliable and appropriate.

- Not just a revenue standard – scope is broadened to also deal with how to account for costs. The impact may not just be on reported revenue but also on the incremental costs of obtaining a contract and the costs to fulfill a contract.

- Not just financial reporting changes, but KPIs too. Consensus and discussion will need to occur in order to ensure that KPIs are appropriately considered, adjusted and reflected in both internal and external reporting (e.g. Operating and Financial Reviews, Management Discussion & Analysis, etc.)

What are some of the key questions that the board should be considering in order to carry out their mandate?

- Is the board sufficiently educated on the Standard, its intricacies and potential impacts (including impacts that span beyond the scope of financial reporting, e.g. – KPIs used in benchmarking, tax effects, etc.)?

- How will the board remain informed and monitor management's plan and progress towards implementation?

- How will the board ensure alignment with management's conclusions on accounting policies? More specifically, how will the board ensure these policies are in line with those adopted within the industry, appropriate alternatives have been considered, etc.?

- How will the board manage stakeholders' perceptions of the impacts?

What are some key questions that the board should ask of management?

- Has an implementation plan been developed? Does this implementation plan (among other requirements) consider project interdependencies and lead-times?

- What issues does management foresee when trying to obtain the information required to determine the correct accounting of existing contracts? How do they intend to overcome these issues?

- Have key participants across the various functions of the entity been aligned (i.e. need to ensure there is 'buy-in' throughout the entity)?

- What is the timeline and budget for implementation?

- How will business practices change?

- Will current systems support both the implementation process and the requirements going forward?

- What impact will this have on internal controls over financial reporting? What about the CEO/CFO attestation process?

- Have the appropriate groups of individuals been involved (e.g. internal auditors, independent auditors, consultants, legal experts, IT contacts, tax experts, sales team(s), etc.)?

- Have issues common to the industry been identified and is there consensus in approaches to these issues?

- What does management foresee as the most significant impact(s)?

- How is training and education being deployed across the entity? Are those outside of the financial reporting function being appropriately educated?

- How are other entities such as subsidiaries, joint arrangements and associated entities being incorporated into this plan?

- How is management monitoring developments in the application of the new Standard?

- What are the additional areas of judgment? How are these judgments being communicated to the board?

- What are the areas in which decisions need to be made (e.g. accounting policy choices, transitional alternatives, practical expedients, etc.)? How are these decisions being communicated to the board?

- How are stakeholder (e.g. investors and analysts) perceptions and expectations being managed?

How can the board stay informed of developments related to the new Standard?

There are a number of ongoing discussion forums in which implementation and application issues are being discussed as well as a number of Deloitte resources that can be leveraged.

Deloitte Resources

Visit our section dedicated to IFRS 15 on our website where you will find:

- IFRS Industry Insights
- IFRS in Focus
- IFRS 15 Webcast

Our US firm also released guidance on the equivalent standard (i.e. ASU 2014-09 (Topic 606)) on US GAAP Plus:

- Accounting Roundup
- Heads Up
- Industry Spotlights

Other Resources

- Transition Resource Group ('TRG') – Group that solicits, analyses, and discusses stakeholder issues arising from implementation of the new Standard in order to inform the IASB and the FASB about implementation issues, which will help the boards determine what, if any, action will be needed to address those issues.
- AICPA Industry Groups - Sixteen industry task forces formed to help develop a new *Accounting Guide on Revenue Recognition* that will provide helpful hints and illustrative examples on how to apply the new Standard.

If you have any further questions on the new Standard, please do not hesitate to contact our experienced team of professionals that are capable of providing a full breadth of services and competencies needed to help addressing your questions.

Contacts

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For further information, visit our website at
http://www2.deloitte.com/ca/en/pages/audit/articles/IFRS15.html

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[i] Note - Some minor differences exist, refer to Appendix A of Basis for Conclusions.

[ii] Note - FASB will be performing outreach to determine whether to defer this effective date. A decision is planned to be made no later than Q2 of 2015. The FASB will share the results of their outreach with the IASB.