Perspective

This is one of a series of articles where experts in assurance, reporting and regulatory matters discuss recent technical and policy developments in these areas.

Transitioning to the new revenue standard - Weighing up your options

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The new revenue standard, AASB 15 *Revenue from Contracts with Customers* comes into effect for annual reporting periods beginning on or after 1 January 2018 (i.e. 1 January 2018 for December year end entities and 1 July 2018 for June year end entities). If an entity with a December year end is looking at transitioning using the full retrospective approach, then transition date is 1 January 2017!

This standard is complex, and in many cases will fundamentally change the timing of revenue recognition compared with current practice. It will also require fundamental changes to an entity's processes and systems. Time is running out!

One of the key decisions when adopting AASB 15 is which of the numerous transitional options to elect. While the transitional provisions give some relief to entities, the number of options available means that it can be challenging to determine which approach is the most appropriate, and importantly, which transition options will be used by your peers. The various transitional options, which have different levels of complexity, will result in different reported profit or loss. Depending on the chosen method, and the type of transaction, an entity may find itself 'losing' or 'gaining' revenue on transition.

If adoption of the more recent standards is a guide (e.g. adoption of AASB 10 *Consolidated Financial Statements*, AASB 11 *Joint Arrangements*, AASB 12 *Disclosure of Interests in Other Entities,* and AASB 13 *Fair Value Measurement*), understanding the transition requirements is often left until late in the adoption process. For AASB 15, entities should begin their analysis now to identify which options are relevant to their revenue streams, and which options are best suited to their needs, and those of users of their financial statements.

There are a number of ways to transition to AASB 15:

- The retrospective method,
- The retrospective method with (any or all of the four) practical expedients, or
- The cumulative effect method.

Under the retrospective method:

- AASB 15 is applied retrospectively to each prior reporting period presented in the financial statements
- The adjustment to old AASB 118*Revenue* numbers is at the start of the earliest comparative period presented (1 January 2017 for December year ends and 1 July 2017 for June year ends)
- The comparative period will show AASB 15 numbers for all contracts
- There is a choice of four practical expedients that can be applied when using the retrospective method.

Under the cumulative effect method:

- The cumulative effect of transition is shown as an adjustment to retained earnings at the date of initial application (1 January 2018 for December year ends and 1 July 2018 for June year ends)
- No adjustments are made to comparative figures
- One practical expedient is available when using this approach.

At first glance, the cumulative effect method may be more appealing since it is an easier method to apply. It is likely to be less time consuming, and will require less prior information as the comparative figures remain unchanged. However, using the cumulative effect method impairs the comparability of the current year financial statements to prior years because of the application of different standards. This can be problematic for users of financial statements who want to see trend and variance analysis. It will also impose a significant burden on an entity in its first year of adoption whereby the entity will, in order to meet the disclosure requirements, have to disclose its result as if AASB 118 had continued to be applied in the first year of application. This means an entity would have to operate 'two sets of books' in the first year of application.

While the retrospective method involves more upfront planning, it does provide a clearer financial picture for users since the current year and comparative figures are both presented under AASB 15. This is relevant information to perform trend and variance analysis.

The following examples show how the chosen transition method and the type of transaction may result in an entity 'losing' or 'gaining' revenue in retained earnings on transition.

Example 1

A music record label company licenses a specified recording of a Beethoven symphony to a customer from 1 March 2017 to 28 February 2018 for $1,000 per month.

The customer has the right to use the recording in all types of advertising campaigns (including television, radio and online media). The nature of the company's promise to its customer is to provide access to the recording in its condition as at the start of the license period.

The company has a December year end and applies AASB 15 from 1 January 2018.

Accounting under AASB 118	Accounting under AASB 15
Recognised straight-line over 12 months	Recognise the revenue at the point in time when the license is granted i.e. 1 March 2017

Transition under AASB 15	
Retrospective Method The 2017 comparative figures are adjusted for AASB 15 accounting.	Cumulative Effect Method No adjustments to 2017 revenue figures. At the date of initial application (1 January 2018), an adjustment is made to opening retained earnings for the difference in revenue that would have been recorded in previous periods under the new standard.

	2018	2017
Revenue reported in profit or loss		
AASB 118	$2,000	$ 10,000
AASB 15 Retrospective Method	-	$ 12,000
AASB 15 Cumulative effect Method	-	$ 10,000
Effect on opening retained earnings		
AASB 15 Cumulative effect Method	$2,000	-

In this example, $2,000 additional revenue is recognised under the retrospective method than under the cumulative effect method. Under the cumulative effect method this $2,000 difference is 'lost' and will not be recognised as revenue through the income statement because it is an adjustment to opening retained earnings in 2018.

Example 2

A vendor enters into a contract to sell 200 units of a product for $16,000 ($80 per unit), to be supplied evenly over a ten month period, commencing on 1 April 2017 (20 units per month). On 1 December 2017, after 160 units have been delivered, the contract is modified to require the delivery of an additional 80 units over a four moth period (20 units per month). This is in addition to the remaining 40 units that have not yet been delivered under the terms of the original contract.

At the point at which the contract is modified, the stand-alone selling price of one unit of the product has declined to $75. Under AASB 15, the additional units are considered distinct. The selling price of the additional 80 units is $65.

The vendor has a December year end and applies AASB 15 from 1 January 2018.

Accounting under AASB 18	Accounting under AASB 15
The vendor recognised revenue of $80 per unit for the first 200 units evenly over the ten months. Revenue is recognised at an amount of $65 per unit for the additional 40 units as they are being delivered. 2017:(180 units @$80) + (20 units @$65) = $15,700 2018:(20 units @$80) + (60 units @$65) = $5,500	The selling price ($65) of the additional units is not the stand-alone price ($75) at the date of contract modification. Therefore the original contract is considered to be terminated at the point of contract modification. The remaining units to be sold that were covered by the original contract (40 units), together with the additional units from the contract modification (80 units), are combined and accounted for as being sold under a new contract. The amount of revenue recognised for each of the units is a weighted average price of $70. This is calculated as ((40 units @$80) + ((80-40 units) @$65)) / 120 units.

Transition under AASB 15	Transition under AASB 15
Retrospective Method Revenue for the original 160 units is recognised as delivered at a price of $80 per unit. When the contract is modified, the remaining 40 units, plus the additional 40 units are recognised at a price of $70 per unit. 2017: (160 units @$80) + (40 units @$70) = $15,600 2018: (80 units @$70) = $5,600	Retrospective Method Revenue for the original 160 units is recognised as delivered at a price of $80 per unit. When the contract is modified, the remaining 40 units, plus the additional 40 units are recognised at a price of $70 per unit. 2017: (160 units @$80) + (40 units @$70) = $15,600 2018: (80 units @$70) = $5,600

	2018	2017
Revenue reported in profit or loss		
AASB 18	$5,500	$ 15,700
AASB 15 - Retrospective Method	$5,600	$ 15,600
AASB 15 - Cumulative effect Method	$5,600	$ 15,700
Effect on retained earnings		
AASB 15 Cumulative effect Method	$(100)	-

In this example, $100 less revenue is recognised under the retrospective method than under the cumulative effect method. Under the cumulative effect method, this $100 difference is recognised as a negative adjustment to opening retained earnings in 2018 and the total revenue recognised ($21,300) is greater than the total consideration received under the contract ($21,200) because some revenue is recognised twice.

Practical expedients

There are four practical expedients available for entities applying the retrospective approach to ease the transition to AASB 15. An entity can choose to apply one or more of the following practical expedients:

- For completed contracts (i.e. contracts where all goods or services have been transferred) that begin and end within the same annual reporting period, or are completed contracts at the beginning of the comparative period, an entity need not restate these contracts.
- For completed contracts that have variable consideration, an entity can use the transaction price at the date the contract was completed rather than having to estimate the variable consideration amounts that existed in the comparative reporting periods.
- For contracts that were modified two or more times before the beginning of the comparative period, an entity may elect not to restate for contract modifications, but instead account for the contract based on the revised terms as it stands at the earliest period presented.
- Relief from disclosing in the comparative period, the amount of the transaction price allocated to the remaining performance obligations, or disclose an explanation of when that amount is expected to be recognised as revenue.

If the cumulative effect method is used, the practical expedient related to contract modifications may also be applied.

Conclusion

The transition date for AASB 15 is fast approaching and time is running out. Entities need to determine the impact of this new standard and weigh up their transition options that are available - which option/s are most relevant to your entity's revenue streams? Which options are best suited to your entities' needs and those of users of your entity's financial statements?