

# Audit committee considerations for the new revenue standard

## What you need to know

- ▶ The new revenue recognition standard will be effective for all entities reporting under IFRS as from 1 January 2017. Early adoption is permitted.
- ▶ Entities will need to begin making disclosures about the effects of the new standard in their next annual financial statements.
- ▶ Audit committees are inquiring about implementation plans now because some entities will be significantly affected.
- ▶ Entities should consider a preliminary assessment to determine the level of effort needed to implement the new standard.

Audit committees have an important role to play overseeing the implementation of the new standard in their organisations.

## Highlights

The new revenue recognition standard, issued jointly by the International Accounting Standards Board (IASB) and the Financial Accounting Standards Board (FASB) (collectively, the Boards), requires action by audit committee members as well as management.

With more than two years until the effective date, it may appear that entities have ample time to implement the IFRS 15 *Revenue from Contracts with Customers*. However, the changes to revenue recognition for some entities may be significant. It is prudent for these entities to use the lead time to assess the impact and prepare for its adoption.

Audit committee members may wish to start discussing their implementation plans with management. Audit committee members may wish to ask whether the entity is performing a preliminary assessment of the impact and how much effort will be required to implement the standard. Changes to processes, systems and controls might require considerably more effort. Audit committee members should also ask about management's plan to communicate with investors and other stakeholders. This would include plans for disclosing the effects of new accounting standards that are issued but not yet effective, as required by IAS 8 *Accounting Policies, Changes in Accounting Estimates and Errors*. Entities need to begin making these disclosures in their next annual financial statements.

## Background

The new standard will supersede the current revenue recognition requirements in IFRS and US GAAP and will apply to all entities that enter into contracts to provide goods or services to customers (unless the contracts are in the scope of other IFRS or US GAAP requirements, such as IAS 17 *Leases*). IFRS 15 also addresses the measurement and recognition of gains and losses on the sale of certain non-financial assets, such as property, plant and equipment (PP&E) and intangibles.

Although IFRS 15 is principles-based, consistent with current IFRS, it is a significant change from the current revenue requirements. Entities will need to exercise more judgement and may make more estimates than they do today. The core principle in IFRS 15 is that an entity recognises revenue at an amount that reflects the consideration to which the entity expects to be entitled in exchange for transferring goods or services to a customer.

IFRS 15 is effective from 1 January 2017. Early adoption is permitted for IFRS preparers, provided that fact is disclosed, and for first-time adopters of IFRS. The effective date for public entities applying US GAAP is periods beginning on or after 15 December 2016, which is essentially the same as for IFRS preparers. However, US public entities will not be permitted to early adopt the standard.

All entities will be required to apply the standard retrospectively, either using a 'full retrospective' or a 'modified retrospective' approach. The full retrospective approach, means that the standard is applied to all periods presented, while the modified retrospective approach, means the standard is applied only to the most current period presented in the financial statements. An entity recognises the cumulative effect of initially applying the standard as an adjustment to the opening balance of retained earnings (or other appropriate components of equity) at the beginning of the earliest period presented under the full retrospective approach or at the date of initial application under the modified retrospective approach. The Boards provided certain practical expedients to make it easier for entities to use a full retrospective approach.

For more information about the effective date and transition options, see our publication *Applying IFRS, A closer look at the new revenue recognition standard* (June 2014).

## Key considerations

Audit committees have an important role to play overseeing implementation of the new standard in their organisations. Understanding the implementation process may be a consideration for audit committees. Many entities are starting their assessment of the potential impact of the standard by ensuring that they identify the arrangements that are within its scope. For example, an entity may need to evaluate its relationships with counterparties to contracts to determine whether a vendor-customer relationship exists. This may not be the case for collaboration agreements when they are more akin to a partnership (i.e., the arrangement would be outside the scope of the IFRS 15).

Existing revenue recognition policies will also need to be evaluated to determine whether any contracts that are within the scope of IFRS 15 will be affected by the new requirements. For example, an entity that sells software may currently account for software contracts with multiple elements (or promises to a customer) as a single arrangement. Under the new standard, the entity may reach a different conclusion about which goods and services in an arrangement should be accounted for separately.

By asking the right questions, audit committees can help entities make a smooth transition.

Because IFRS 15 requires significantly more disclosures than current IFRS, audit committee members may want to understand from management whether the entity has sufficient information to satisfy the new disclosure requirements or whether new systems, processes and controls must be implemented to gather such information and ensure its accuracy. Management will also have to consider whether changes to the entity's existing accounting policies are needed.

Audit committee members also may want to understand an entity's chosen transition method and how that will affect its implementation plans. For example, the standard requires entities that select the full retrospective approach to apply IFRS 15 to each year presented in the financial statements. This will require entities to begin tracking revenue using the new standard earlier than the mandatory effective date. In addition, entities will need to consider any requirements to present additional historical financial information outside the audited financial statements, e.g., in the shareholders' report or as a result of local regulatory requirements, in making their determination of the appropriate transition method to adopt.

Entities should be monitoring the discussions of the Boards' Joint Transition Resource Group for Revenue Recognition (TRG)<sup>1</sup>. While the TRG will not issue guidance, it will discuss implementation issues and refer matters to the Boards that it believes require further interpretation or guidance. Members of the TRG include financial statement preparers, auditors and users from a variety of industries and geographies. The TRG held its first meeting in July 2014, it plans to meet once more in 2014 and four times in 2015.

Entities may also want to monitor the activities of other implementation groups to aid industry stakeholders in implementing the standard, including one or more of the 16 industry task forces that the American Institute of Certified Public Accountants (AICPA) has formed to help develop a new Accounting Guide on Revenue Recognition.

### **Questions to discuss with management**

Audit committees should consider the following questions for management:

- ▶ What is management's plan to perform a preliminary assessment of the standard's impact on the entity?
- ▶ When is the preliminary assessment expected to be complete?
- ▶ What process has the entity implemented to monitor and consider interpretations by the Boards, as well as the activities of the TRG and other implementation groups, such as the AICPA industry task forces?
- ▶ What is the entity's plan for making the IAS 8 disclosures on the effect of new accounting standards?

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<sup>1</sup> See further information at [www.ifrs.org/About-us/IASB/Advisory-bodies/Joint-Revenue-Transition-Resource-Group/Pages/Meetings](http://www.ifrs.org/About-us/IASB/Advisory-bodies/Joint-Revenue-Transition-Resource-Group/Pages/Meetings)

After an entity evaluates the potential effect of IFRS 15, it may need to develop a detailed project plan for implementation to address the issues discussed above and to establish responsibilities and deadlines. This may help to determine the accountability of the implementation team and allow management to identify gaps in resources.

Once the preliminary assessment is complete, audit committee members should consider the following questions:

- ▶ What is the anticipated effect on the entity's businesses, processes and financial reporting?
- ▶ How, and to what extent, will the accounting processes and controls be affected or need to be changed?
- ▶ What are the entity's plans for communicating with stakeholders?
- ▶ What is the planned transition method?
- ▶ What is the expected timing of implementation?
- ▶ Does the entity have sufficient resources for an effective implementation?
- ▶ How do the entity's preliminary assessment and plans benchmark against its competitors?

#### How we see it

Audit committees have an important role to play in overseeing the entity as it implements the new revenue recognition standard. By asking the right questions, audit committee members can help an entity stay on track and make a smooth transition.

### Additional resources

Our publications include:<sup>2</sup>

- ▶ *IFRS Developments Issue 80: IASB and FASB issue new revenue recognition standard – IFRS 15* (May 2014)
- ▶ *Applying IFRS, A closer look at the new revenue recognition standard* (June 2014)
- ▶ *IFRS Developments Issue 85: Joint Transition Resource Group for Revenue Recognition debates implementation issues* (July 2014)

We also plan to issue industry-specific publications that address significant changes to current industry practice.

Our 90-minute webcast on the new standard is also available on demand at [ey.com/webcasts](http://ey.com/webcasts) (under Accounting Technical).<sup>3</sup>

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<sup>2</sup> Available on [ey.com/IFRS-Overview](http://ey.com/IFRS-Overview)

<sup>3</sup> Available on [ey.com](http://ey.com) Thought Center Webcasts