# Revenue Transition Options

**What is the best option for your business?**

IFRS and US GAAP

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# Contents

# Which option is best?

## Identifying the optimal approach depends on a range of issues, so the answer may not be straightforward.

As companies prepare to adopt the new IFRS and US GAAP standard on revenue recognition, one key decision needs to be made as soon as possible – how and when to transition to the new standard. And making that decision may not be straightforward.

The new standard[1] offers a range of transition options. At one end of the spectrum, an entity can choose to apply the new standard to all its contracts – and retrospectively adjust each comparative period presented in its 2017-2018 financial statements if it waits until the mandatory effective date. At the other end of the spectrum, an entity can recognize the cumulative effect of applying the new standard at the date of initial application – and make no adjustments to its comparative information. Optional practical expedients create additional alternatives which can simplify the restatements process or reduce the number of contracts that need to be restated. While these expedients may ease the transition burden for companies, they reduce comparability which can cause challenges for financial statement users.

The choice of transition option can have a significant effect on revenue trends and may also affect cost information. To identify the optimal approach, a company will need to consider a broad range of other business issues – from IT implementation plans to communications with stakeholders. Companies may also need to consider the differences in the IFRS and US GAAP transition requirements which may result in significantly different outcomes.

There is no 'one size fits all' approach to this complex decision. To help you choose the best transition option for your business, this publication identifies a set of core issues that will be relevant to many businesses – and some simple steps you can take now to inform your decision.

Please speak to your usual KPMG contact if you are facing implementation challenges or would like to discuss any other accounting issues further. You can also find more detailed information about the new revenue standard in our publication Revenue – Issues In-Depth.

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1. IFRS 15 *Revenue from Contracts with Customers* and FASB ASC 606 *Revenue from Contracts with Customers*.

# 1 Transition at a glance

## 1.1 What are the options?

| | |
|---|---|
| **Retrospective method (with optional practical expedients)** | Entities recognize the cumulative effect of applying the new standard at the start of the earliest period presented.<br><br>They can also elect to use one or more of the practical expedients available. The practical expedients help to simplify how contracts are restated or reduce the number of contracts to be restated.<br><br>For entities applying IFRS, the expedients include an option to apply the new standard to only those contracts that are not considered completed contracts under current GAAP at the start of the earliest period presented. |
| **Cumulative effect method (with optional practical expedients)** | Entities recognize the cumulative effect of applying the new standard at the date of initial application[2], with no restatement of the comparative periods presented – i.e. the comparative periods are presented in accordance with current GAAP.<br><br>An entity may choose to apply the new standard to all of its contracts or only those contracts that are *not considered completed contracts* at the date of initial application.<br><br>Entities may also elect to use the practical expedient available with respect to contract modifications to simplify their restatement of contracts.<br><br>Entities, who elect this method, are also required to disclose the quantitative effect and an explanation of the significant changes between the reported results under the new standard and those that would have been reported under current GAAP in the period of adoption. |

## 1.2 How will the options affect your top line?

The different transition options allow an entity to apply the new standard from different dates and also to different populations of contracts. This means that the different transition options can significantly change the revenue numbers and certain costs presented.

Consider the following scenario. Under current GAAP, an entity recognized revenue of 100 for years 2015, 2016 and 2017 and would have recognized revenue of 100

2. The 'date of initial application' is the start of the reporting period in which an entity first applies the new standard. For a calendar year-end public business entity that does not elect to early-adopt the standard, this will be January 1, 2018.

for 2018. Under the new standard, the entity determines that its revenue would be 325, 25, 25 and 25 for the same periods. The following table illustrates the revenue numbers presented under each option.

| | Comparatives | | Current year | |
|---|---|---|---|---|
| | 2016 | 2017 | 2018 | Total |
| **Current GAAP** | | | | |
| Revenue | 100 | 100 | 100 | **300** |
| **Retrospective method (no practical expedients)** | | | | |
| Revenue | 25 | 25 | 25 | **75** |
| Adjustment to opening equity | 225[a] | - | - | **225** |
| **Cumulative effect method** | | | | |
| Revenue | 100 | 100 | 25 | **225** |
| Adjustment to equity | - | - | 75[b] | **75** |

**Notes:**

a. Calculated as 325 - 100, being the amount of revenue that would have been recognized under the new standard in 2015 less the actual amount of revenue recognized in 2015 under current GAAP.

b. Calculated as 375 - 300, being the amount of revenue that would have been recognized under the new standard in 2015, 2016 and 2017 less the amount of revenue recognized in 2015, 2016 and 2017 under current GAAP.

## 1.3 What do you need to consider?

Entities need to consider the potential effects of each transition option on the trends in revenue and certain costs – e.g. contract acquisition costs – in the financial statements. To do this, they will need to understand how to apply each transition option, and be able to answer the following questions.

– What is the effect of each transition option – e.g. will it mean that revenue from a contract is presented more than once, or will revenue deferred under current GAAP never be recognized in profit or loss?

– What is the effect of applying the practical expedients?

– What is the effect if costs that were expensed as incurred under current GAAP are now required to be capitalized and amortized under the new standard?

There are also many qualitative factors, both internal and external, that will need to be weighed in considering the relative benefits, costs and complexities of each transition option. For example, many entities rely heavily on IT systems for revenue reporting so they will need to consider the feasibility and costs of making required changes to their IT systems to comply with the selected transition option. Entities will also need to consider their internal controls and what additional controls and historical data may be required under each adoption method.

There is no 'one size fits all' solution – it will depend on each entity's specific facts and circumstances, and which factors are most relevant. Some entities may consider comparability to peers or comparability between reporting periods to be most relevant, while others may prioritize the cost of implementation. In other cases, an entity may consider comparability as most important but determine that the retrospective method is not feasible because it cannot make the necessary system changes in the required timeframe at a reasonable cost.

## 1.4 What should you do now?

The choice of transition option will have a significant effect on an entity's overall implementation plan so it is important that entities start taking the following actions immediately.

- Perform a high-level gap analysis to identify potential drivers of changes in accounting for revenue and certain costs.
- Determine the contracts that may need to be restated and the information needed to restate them.
- Identify the qualitative factors that may influence the choice of transition option.
- Consider implementing a subgroup within the overall project team responsible for implementation to focus on transition option considerations.
- Develop an implementation plan. The Appendix includes example transition project plans that highlight the key steps involved in undertaking a successful transition project.

# 2 Transition requirements

An entity can apply the new standard using either:

- the retrospective method – i.e. retrospectively adjusting each comparative period presented, with a choice of practical expedients; or
- the cumulative effect method – i.e. recognizing the cumulative effect of applying the new standard at the beginning of the year of initial application, with no restatement of comparative periods, with a choice of practical expedients.

Entities are not permitted to apply the new standard on a fully prospective basis – i.e. they cannot apply the new standard only to contracts entered into after the effective date.

## 2.1 Effective date

The following table lists the mandatory effective date and early adoption provisions of the new standard for IFRS and US GAAP entities.

| Type of entity | Annual periods commencing on or after |
|---|---|
| All entities applying IFRS | January 1, 2018 (with early adoption permitted for any annual period) |
| Public business entities and not-for-profit entities that are conduit bond obligators applying US GAAP | December 16, 2017 (with early adoption permitted for annual periods beginning on or after December 16, 2016) |
| All other US GAAP entities | December 16, 2018 (with early adoption permitted for annual periods beginning on or after December 16, 2016) |

## 2.2 Definition of a completed contract

For the purposes of transition, the new standard introduces a new term – completed contract. The concept of a completed contract is used when applying the practical expedients available under the transition options, which help to simplify how contracts are restated or reduce the number of contracts to be restated. Under the retrospective method, contracts are assessed to determine if they are completed at start of the earliest period presented and under the cumulative effect method, contracts are generally assessed at the date of initial application.

The definition of a 'completed contract' is different in IFRS and US GAAP. Both definitions are based on existing revenue accounting requirements but the IFRS definition focusses on delivery/transfer of identified goods or services whereas the US GAAP definition focusses on the recognition of revenue. The difference in the definition may result in differences in the population of contracts that are required to be restated in accordance with the new standard. Generally, the US GAAP definition of a completed contract will result in fewer contracts meeting the definition of a completed contract.

| | |
|---|---|
| **IFRS definition** | A 'completed contract' is one for which the entity has transferred all of the goods or services identified under current IFRS.<br><br>An entity continues to account for completed contracts in accordance with its accounting policies based on previous revenue standards. |
| **US GAAP definition** | A 'completed contract' is a contract for which an entity has recognized all or substantially all of the revenue under current US GAAP. |

**Example 1 – Application of completed contract definitions**

Manufacturing Company M entered into a contract with Customer C to manufacture and sell a complex piece of machinery. Customer C had a right of return within one month from delivery if the performance of the machinery was not satisfactory. The machinery was delivered on December 15, 2017. Customer C accepted the machinery on January 15, 2018.

As of December 31, 2017, under current GAAP no revenue for the sale of the machinery was recognized due to uncertainty over the possibility of Customer C acceptance and return.

Under IFRS, this is a completed contract as of December 31, 2017 because Manufacturing Company M has transferred all of the goods and services identified under current IFRS.

Under US GAAP, this is not a completed contract as of December 31, 2017 because Manufacturing Company M has not recognized all or substantially all of the revenue under current US GAAP.

## 2.3 Retrospective method

Entities are required to recast each period before the date of initial application that is presented in the financial statements. The entity recognizes the cumulative effect of applying the new standard in equity (generally, retained earnings) at the start of the earliest presented comparative period.

Entities electing to apply the guidance retrospectively will also need to provide the disclosures required by the new standard for the comparative periods presented. The only exception is the exemption available through Practical expedient 4 (see 2.3.2). Entities are also required to comply with applicable disclosure requirements for a change in accounting policy, including the amount of the adjustment for the financial statement line items and earnings per share amounts affected. However, an entity that adopts the new standard retrospectively is not required to disclose the impact of the change in accounting policy on the financial statement line items and earnings per share amounts for the year of initial application.

### 2.3.1 Full retrospective approach

An entity may choose to apply all of the requirements of the new standard to each comparative period presented in accordance with the requirements on accounting changes[3] – i.e. a full retrospective approach. Under this approach, the entity adjusts its financial statements for *all* contracts, including those completed at the beginning of the earliest period presented.

### 2.3.2 Retrospective with practical expedient approach

Alternatively, an entity may elect to use one or more of the following optional practical expedients – i.e. a retrospective with practical expedient approach.

| | |
|---|---|
| **Practical expedient 1** | For completed contracts, an entity need not restate contracts that began and ended in the same annual reporting period. |
| **Practical expedient 1A (IFRS only)** | An entity applying IFRS can choose not to restate contracts that are completed contracts at the beginning of the earliest period presented. |
| **Practical expedient 2** | For completed contracts that have variable consideration, an entity may use the transaction price at the date on which the contract was completed, rather than estimating amounts for variable consideration in each comparative reporting period. |
| **Practical expedient 3** | For modified contracts, an entity need not separately evaluate the effects of the contract modifications before the beginning of the earliest period presented.<br><br>Instead, an entity may reflect the aggregate effect of all of the modifications that occur before the beginning of the earliest period presented in determining the transaction price, identifying the satisfied and unsatisfied performance obligations, and allocating the transaction price to the performance obligations. |
| **Practical expedient 4** | For all periods presented before the date of initial application, an entity need not disclose the amount of the transaction price allocated to remaining performance obligations, nor an explanation of when it expects to recognize that amount as revenue. |

3. IAS 8 *Accounting Policies, Changes in Accounting Estimates and Errors* and FASB ASC Topic 250 *Accounting Changes and Error Corrections.*

Any practical expedients that are elected are applied to all contracts in all comparative periods. The entity discloses the practical expedients that have been used and a qualitative assessment of the estimated effect of applying each expedient.

## 2.4 Cumulative effect method

An entity applies the new standard as of the date of initial application, with no restatement of comparative period amounts. It records the cumulative effect of initially applying the new standard – which affects revenue and costs – as an adjustment to the opening balance of equity[4] at the date of initial application.

Under the cumulative effect method, an entity can choose to apply the requirements of the new standard to:

- all contracts at the date of initial application; or
- only contracts that are open (i.e. not complete as defined under the new standard) under current GAAP at the date of initial application.

An entity that applies the cumulative effect method may also elect to use the contract modifications practical expedient (Practical expedient 3 – see 2.3.2).

The date up to which contract modifications are exempt under the cumulative effect method differs for IFRS and US GAAP:

- under IFRS, an entity can choose between the start of the earliest presented period and the date of initial application; and
- under US GAAP, an entity can apply the practical expedient only at the date of initial application.

In addition, under the requirements on accounting changes an entity discloses:

- the amount by which each financial statement line item is affected in the current period as a result of the entity applying the new standard; and
- an explanation of the significant changes between the reported results under the new standard and those under current GAAP.

4. Profit business entities reporting under US GAAP will generally report the adjustment to opening retained earnings, while entities reporting under IFRS will report the adjustment to each affected component of equity (generally, retained earnings).

## 2.5 Summary of transition options

| Approach | Pre-adoption | Comparative(s) | Year of initial application | Date of equity adjustment |
|---|---|---|---|---|
| Full retrospective – no practical expedients | Current GAAP | **New GAAP** | **New GAAP** | January 1, 2017* |
| Retrospective with practical expedient(s) | Current GAAP | **Mixed requirements** | **New GAAP** | January 1, 2017* |
| Cumulative effect | Current GAAP | Current GAAP | **New GAAP** | January 1, 2018 |

* If an entity with a calendar year-end provides two years of comparatives, then the date of equity adjustment will be January 1, 2016.

# 3 How the options affect the accounting

The following examples illustrate how the transition options may affect trends in revenue and certain costs in the financial statements (the effect on income taxes is excluded). The examples are based on an entity that applies the new standard as of January 1, 2018 and presents three years of financial information – i.e. 2016 and 2017 are presented as comparative periods – in its 2018 financial statements.

In addition to the transition effects illustrated below, entities will also be required to comply with the relevant disclosure requirements.

### Example 2 – Change from point-in-time to over-time recognition

Contract Manufacturer M has a contract with Customer C from May 1, 2017 to February 28, 2018. Over the contract term, Contract Manufacturer M has agreed to deliver 1,000 units per month at a fixed price of 20 per unit.

The contract was not modified.

Under the terms of the contract, Customer C controls all work in progress. The sales value of work in progress at December 31, 2017 was 15,000.

#### Current GAAP

Revenue was recognized using a units-of-delivery method, as follows.

| In thousands | Comparatives | | Current year | |
|---|---|---|---|---|
| | 2016 | 2017 | 2018 | Total |
| Revenue | - | 160[a] | 40[b] | **200** |

**Notes:**

a. Calculated as 8,000 units x 20.

b. Calculated as 2,000 units x 20.

#### New standard

Contract Manufacturer M determines that the contract comprises a single performance obligation that is satisfied over time, because Customer C controls all of the work in progress.

Contract Manufacturer M determines the cost-to-cost method to be the most appropriate measure of progress toward satisfaction of the performance obligation, because of the large work-in-progress inventory controlled by Customer C. As of December 31, 2017, 87.5% of the total costs were incurred.

The tables below set forth only the effects on revenue. Because control of the goods is transferred to Customer C as they are constructed, the associated costs are expensed as incurred; the effect of this is also included in the periods presented and the cumulative effect adjustment at the date of initial application.

### *Retrospective method*

The revenue value of work in progress held on December 31, 2017 is recognized in 2017. There is no adjustment to retained earnings at the start of the earliest comparative period required because the contract began after that date.

| In thousands | Comparatives | | Current year | |
|---|---|---|---|---|
| | 2016 | 2017 | 2018 | Total |
| Revenue | - | 175[a] | 25[b] | **200** |
| Adjustment to opening equity | - | - | - | **-** |

**Notes:**

a. Calculated as 200,000 x 87.5%.

b. Calculated as 200,000 x (100% - 87.5%).

Practical expedient 1 is not relevant because the contract did not begin and complete in the same annual reporting period under current GAAP.

Practical expedient 1A (IFRS only) is not relevant because the contract did not commence until after the start of the earliest period presented.

Practical expedient 2 is not relevant because the contract did not include variable consideration.

Practical expedient 3 is not relevant because the contract was not modified.

### *Cumulative effect method*

Revenue for 2017 as reported under current GAAP is not adjusted, because the new standard is only applied from the date of initial application. Instead, at the date of initial application (January 1, 2018), an adjustment is made to increase opening retained earnings for the additional revenue that would have been recorded in previous periods under the new standard.

| In thousands | Comparatives | | Current year | |
|---|---|---|---|---|
| | 2016 | 2017 | 2018 | Total |
| Revenue | - | 160 | 25 | **185** |
| Adjustment to opening equity | - | - | 15[a] | **15** |

**Note:**

a. Calculated as 175,000 - 160,000 (being the amount of revenue that would have been recognized under the new standard in 2017 less the actual amount of revenue recognized in 2017 under current GAAP).

The choice to apply the new standard to all contracts or only those open at the date of initial application does not affect the accounting because the contract was not completed before the date of initial application.

Practical expedient 3 is not relevant because the contract was not modified.

A comparison between revenue presented under current GAAP and the transition options is included in the table below.

| In thousands | 2016 | 2017 | 2018 | Total |
|---|---|---|---|---|
| **Current GAAP** | | | | |
| Revenue | - | 160 | 40 | **200** |
| **Retrospective method** | | | | |
| Revenue | - | 175 | 25 | **200** |
| Adjustment to opening equity | - | - | - | **-** |
| | | | | **200** |
| **Cumulative effect method** | | | | |
| Revenue | - | 160 | 25 | **185** |
| Adjustment to opening equity | - | - | 15 | **15** |
| | | | | **200** |

## Example 3 – Additional performance obligation identified

Software Provider P entered into a contract with Customer C to provide a software term license and telephone support for two years for a fixed amount of 400,000. The software was delivered and operational on July 1, 2016.

The contract was not modified.

### Current GAAP

Software Provider P treated the contract as a single item, because it did not have vendor-specific objective evidence of fair value (VSOE) for the telephone support. It recognized revenue for the arrangement on a straight-line basis over the 24-month contract term at 16,667 per month.

| In thousands | Comparatives | | Current year | |
|---|---|---|---|---|
| | 2016 | 2017 | 2018 | Total |
| Revenue | 100 | 200 | 100 | **400** |

### New standard

Software Provider P determines that the contract consisted of two performance obligations: the software license and the telephone support. Software Provider P allocates 300,000 of the transaction price to the software and 100,000 to the telephone support.

The software license is deemed to be a point-in-time performance obligation and would have been recognized as revenue on the delivery date of July 1, 2016.

The telephone support performance obligation is deemed to be satisfied over time, and its progress is best depicted by time elapsed as follows:

- 2016: 25,000;
- 2017: 50,000; and
- 2018: 25,000.

### *Retrospective method*

Revenue for the software license is recognized in 2016, when it was delivered. There is no adjustment to retained earnings at the start of the earliest comparative period required, because the contract began after that date.

| In thousands | Comparatives | | Current year | |
|---|---|---|---|---|
| | 2016 | 2017 | 2018 | Total |
| Revenue | 325[a] | 50 | 25 | **400** |
| Adjustment to opening equity | - | - | - | **-** |

**Note:**

a. Calculated as 300,000 for the software plus 25,000 for performance related to the telephone support.

Practical expedient 1 is not relevant because the contract did not begin and complete in the same annual reporting period.

Practical expedient 1A (for IFRS only) is not available because the contract did not commence until after the start of the earliest period presented.

Practical expedient 2 is not relevant because the contract does not include variable consideration.

Practical expedient 3 is not relevant because the contract was not modified.

### *Cumulative effect method*

Revenue for 2016 and 2017 as reported under current GAAP is not adjusted, because the new standard is only applied from the date of initial application. Instead, at the date of initial application (January 1, 2018), an adjustment is made to increase opening retained earnings for the additional revenue that would have been recognized in previous periods under the new standard.

| In thousands | Comparatives | | Current year | |
|---|---|---|---|---|
| | 2016 | 2017 | 2018 | Total |
| Revenue | 100 | 200 | 25 | **325** |
| Adjustment to opening equity | - | - | 75[a] | **75** |

**Note:**

a. Calculated as (325,000 + 50,000) - (100,000 + 200,000), being the amount of revenue that would have been recognized under the new standard in 2016 and 2017 less the actual amount of revenue recognized in 2017 under current GAAP.

The choice to apply the new standard to all contracts or only those open at the date of initial application would not affect the accounting because the contract is not completed before the date of initial application.

Practical expedient 3 is not relevant because the contract was not modified.

A comparison between revenue presented under current GAAP and the transition options is included in the table below.

| In thousands | 2016 | 2017 | 2018 | Total |
|---|---|---|---|---|
| **Current GAAP** | | | | |
| Revenue | 100 | 200 | 100 | **400** |
| **Retrospective method** | | | | |
| Revenue | 325 | 50 | 25 | **400** |
| Adjustment to opening equity | - | - | - | **-** |
| | | | | **400** |
| **Cumulative effect method** | | | | |
| Revenue | 100 | 200 | 25 | **325** |
| Adjustment to opening equity | - | - | 75 | **75** |
| | | | | **400** |

## Example 4 – Contract includes variable consideration

Service Provider P entered into a 20-month contract with Customer C to provide advertising services, beginning on August 1, 2016. The consideration included a fixed amount of 100,000 plus an additional amount of up to 150,000 if certain service levels were attained. The amount would be 150,000 if the levels were attained by February 1, 2018, 125,000 if they were attained by March 1 2018, and zero if they were attained thereafter.

Service Provider P attained the service level on February 15, 2018 and became entitled to 125,000.

### Current GAAP

Service Provider P recognized revenue from the fixed fee on a straight-line basis over the contract term, and assessed the variable fee at each reporting date to determine whether it could be recognized.

It determined that the variable amount should not be recognized until the date on which the service levels were met, and therefore did not recognize it at December 31, 2016 or 2017.

| In thousands | Comparatives | | Current year | |
|---|---|---|---|---|
| | 2016 | 2017 | 2018 | Total |
| Revenue | 25[a] | 60[b] | 140[c] | **225** |

**Notes:**

a. Calculated as 100,000 x (5 / 20) months.
b. Calculated as 100,000 x (12 / 20) months.
c. Calculated as 100,000 x (3 / 20) months + 125,000 of variable consideration.

## New standard

Service Provider P determines that the contract consisted of a single performance obligation that is satisfied over time.

The cost-to-cost method is deemed to have been the most appropriate method for measuring performance: 25% and 85% of the costs were incurred as of December 31, 2016 and 2017, respectively.

Variable consideration is estimated at 125,000 at the inception date, using the most likely amount method. Service Provider P determines that, at the inception date, the 125,000 would have been included in the transaction price, because it was (highly) probable[5] that it would not have been subject to a significant reversal in the future.

Service Provider P re-evaluates the estimate of variable consideration at each reporting period, and determines that there were no changes in the estimate.

The contract was not modified.

### *Retrospective method*

Service Provider P includes in the transaction price from contract commencement its estimate of the amount of variable consideration, and recognizes the transaction price over time. There is no adjustment to retained earnings at the start of the earliest comparative period because the contract began after that date.

| In thousands | Comparatives | | Current year | |
|---|---|---|---|---|
| | 2016 | 2017 | 2018 | Total |
| Revenue | 56[a] | 135[b] | 34[c] | **225** |
| Adjustment to opening equity | - | - | - | **-** |

**Notes:**

a. 56,250, calculated as (100,000 + 125,000) x 25%.
b. 135,000, calculated as (100,000 + 125,000) x (85% - 25%).
c. 33,750, calculated as (100,000 + 125,000) x (100% - 85%).

5. The IFRS version of the revenue recognition standard uses the term 'highly probable' – which is a significantly higher threshold than 'more likely than not' – with the intention of converging with the meaning of the term 'probable' as used in US GAAP.

Practical expedient 1 is not relevant because the contract did not begin and complete in the same annual reporting period.

Practical expedient 1A (IFRS only) is not relevant because the contract did not commence until after the start of the earliest period presented.

Practical expedient 2 is not relevant because the contract was not completed by the date of initial application of the new standard.

Practical expedient 3 is not relevant because the contract was not modified.

### *Cumulative effect method*

Revenue for 2016 and 2017 as reported under current GAAP is not adjusted, because the new standard is only applied from the date of initial application. At the date of initial application, an adjustment is made to opening retained earnings for the additional revenue that would have been recorded in 2016 and 2017 under the new standard.

| In thousands | Comparatives | | Current year | |
|---|---|---|---|---|
| | 2016 | 2017 | 2018 | Total |
| Revenue | 25 | 60 | 34 | **119** |
| Adjustment to opening equity | - | - | 106[a] | **106** |

**Note:**

a. Calculated as (56,250 + 135,000) - (25,000 + 60,000), being the amount of revenue that would have been recognized under the new standard in 2016 and 2017 less the actual amount of revenue recognized up to December 2017 under current GAAP.

The choice to apply the new standard to all contracts or only those open at the date of initial application would not affect the accounting because the contract is not completed before the date of initial application.

Practical expedient 3 is not relevant because the contract was not modified.

A comparison between revenue presented under current GAAP and the transition options is included in the table below.

| In thousands | 2016 | 2017 | 2018 | Total |
|---|---|---|---|---|
| **Current GAAP** | | | | |
| Revenue | 25 | 60 | 140 | **225** |
| **Retrospective method** | | | | |
| Revenue | 56 | 135 | 34 | **225** |
| Adjustment to opening equity | - | - | - | **-** |
| | | | | **225** |
| **Cumulative effect method** | | | | |
| Revenue | 25 | 60 | 34 | **119** |
| Adjustment to opening equity | - | - | 106 | **106** |
| | | | | **225** |

## Example 5 – Opening balance sheet adjustment in retrospective method

Service Provider P entered into a two-year service contract with Customer C on July 1, 2015. The agreed consideration is 10,000 per month. Service Provider P incurred 7,000 in sales commission costs and 1,000 in set-up costs at the inception of the contract.

### Current GAAP

Service Provider P recognized revenue on a straight-line basis. It expensed the sales commission and set-up costs as incurred at contract inception.

| In thousands | | Comparatives | | Current year | |
|---|---|---|---|---|---|
| | 2015 | 2016 | 2017 | 2018 | Total |
| Revenue | 60 | 120 | 60 | - | **240** |
| Sales commission and set-up costs | (8) | - | - | - | **(8)** |

### New standard

Service Provider P determines that the contract consists of a single performance obligation that should be recognized over time at the monthly invoice amount because the invoice amount corresponds directly with the value to Customer C of Service Provider P's performance completed to date.

It determines that the sales commission and set-up costs meet the definition of contract acquisition costs and therefore capitalizes the costs. The amortization period of the capitalized costs is deemed to be the life of the contract.

#### *Retrospective method*

No adjustment to revenue is required, because there is no difference in the revenue recognized under the new standard.

Service Provider P records an adjustment to opening retained earnings at January 1, 2016 to reflect the difference between costs recognized under current GAAP and what would have been recognized under the new standard at that date.

| In thousands | | Comparatives | | Current year | |
|---|---|---|---|---|---|
| | 2015 | 2016 | 2017 | 2018 | Total |
| Revenue | 60 | 120 | 60 | - | **240** |
| Sales commission and set-up costs | (2) | (4) | (2) | - | **(8)** |
| Adjustment to opening equity | - | 6[a] | - | - | **6** |

**Note:**

a. Calculated as 8,000 - 2,000, being the difference between costs recognized under current GAAP and what would have been recognized under the new standard at that date.

Practical expedient 1 is not relevant because the contract did not begin and complete in the same annual period.

Practical expedient 1A (IFRS only) is not relevant because the contract is not completed before the start of the earliest presented comparative period.

Practical expedient 2 is not relevant because the contract does not include variable consideration.

Practical expedient 3 is not relevant because the contract was not modified.

### *Cumulative effect method*

No adjustments are required because the contract is completed before the date of initial application.

| In thousands | | Comparatives | | Current year | |
|---|---|---|---|---|---|
| | 2015 | 2016 | 2017 | 2018 | Total |
| Revenue | 60 | 120 | 60 | - | **240** |
| Sales commission and set-up costs | (8) | - | - | - | **(8)** |
| Adjustment to opening equity | - | - | - | - | **-** |

Practical expedient 3 is not relevant because the contract was not modified.

A comparison between costs presented under current GAAP and the transition options is included in the table below.

| In thousands | 2016 | 2017 | 2018 | Total |
|---|---|---|---|---|
| **Current GAAP** | | | | |
| Sales commission and set-up costs | - | - | - | **-** |
| **Retrospective method** | | | | |
| Sales commission and set-up costs | (4) | (2) | - | **(6)** |
| Adjustment to opening equity | 6 | - | - | **6** |
| | | | | **-** |
| **Cumulative effect method** | | | | |
| Sales commission and set-up costs | - | - | - | **-** |
| Adjustment to opening equity | - | - | - | **-** |
| | | | | **-** |

## Example 6 – Contract beginning and completing in the same annual reporting period

Engineering Company E entered into a contract with Customer C to build a specialized asset for fixed consideration of 100,000, which began on August 1, 2017 and was completed in November 2017.

### Current GAAP

Engineering Company E recognized revenue on the date of delivery.

| In thousands | Comparatives | | Current year | |
|---|---|---|---|---|
| | 2016 | 2017 | 2018 | Total |
| Revenue | - | 100 | - | **100** |

### New standard

Engineering Company E determines that control transferred over time, and that revenue should therefore be recognized over time using the cost-to-cost method.

#### *Retrospective method*

There is no impact on revenue presented for the annual period because the contract is completed under both current GAAP and the new standard within the same annual period.

| In thousands | Comparatives | | Current year | |
|---|---|---|---|---|
| | 2016 | 2017 | 2018 | Total |
| Revenue | - | 100 | - | **100** |

Practical expedient 1 is relevant. If it is elected, then Engineering Company E is not required to assess the contract under the provisions of the new standard. If Engineering Company E does not elect Practical expedient 1, then it restates its interim results to reflect the accounting required under the new standard – i.e. over-time reporting.

The contract is considered complete under both the IFRS and US GAAP definition of a completed contract because the specialized asset has been delivered and the consideration is fixed – i.e. the item has been transferred (IFRS) and the revenue accounting is complete (US GAAP).

Practical expedient 1A (IFRS only) is not relevant because the contract commenced after the start of the earliest period presented.

Practical expedient 2 is not relevant because the contract does not include variable consideration.

Practical expedient 3 is not relevant because the contract was not modified.

### *Cumulative effect method*

No adjustments are required because the contract is completed by December 31, 2017.

| In thousands | Comparatives | | Current year | |
|---|---|---|---|---|
| | 2016 | 2017 | 2018 | Total |
| Revenue | - | 100 | - | **100** |

Practical expedient 3 is not relevant because the contract was not modified.

No comparison table is included for this example because there is no difference between the annual revenue reported under current GAAP and under the transition options.

## Example 7 – Applying the contract modification expedient

Manufacturing Company M entered into a contract with Customer C to manufacture and sell a complex piece of machinery, which began on April 1, 2014 for a fixed amount of consideration of 1,000. The contract is expected to be completed by December 31, 2018.

Before the start of the earliest period presented – i.e. January 1, 2016 – the contract was modified numerous times, changing both the scope of work and the amount of consideration. All of these modifications were agreed and approved before December 31, 2015.

At January 1, 2016, Manufacturing Company M determines that the modified contract includes two performance obligations under the new standard:

– the item of machinery, the specification of which has been modified since contract inception; and

– repair and maintenance services.

The modified amount of consideration is:

– a fixed amount of 5,000; and

– an additional amount of up to 15,000 if certain production levels are attained.

### Retrospective method – Without Practical expedient 3

If Manufacturing Company M does not elect to apply the contract modifications practical expedient when restating the contract in accordance with the new standard, then it would be required to assess each contract modification separately and account for it in accordance with the new standard's guidance on contract modifications.

Under this method, Manufacturing Company M starts by treating the contract as a single performance obligation for a fixed amount of 1,000 and then it applies the contract modification guidance to account for each modification to the contract up to January 1, 2016.

### Retrospective method – With Practical expedient 3

Conversely, if Manufacturing Company M elects to use the contract modifications practical expedient, then it does not separately evaluate the effects of the modifications before the start of the earliest period presented. Instead, it considers the aggregate effect of all modifications before the start of the earliest period presented – i.e. the contract as modified for scope and price as of January 1, 2016.

Under this method, at the start of the earliest period presented Manufacturing Company M determines the transaction price, identifies the performance obligations in the contract (both satisfied and unsatisfied) and allocates the transaction price to the performance obligations.

Manufacturing Company M applies the contract modification guidance to account for each contract modification (if any) that occur after the start of the earliest period presented.

### Cumulative effect method

If Manufacturing Company M does not elect to apply the contract modifications practical expedient, when restating the contract in accordance with the new standard, then it would be required to assess each contract modification separately, using the same approach as under the retrospective method without Practical expedient 3. The only difference from the retrospective method is that the comparative periods are not restated.

If Manufacturing Company M elects to use the contract modifications practical expedient and applies the expedient to all modifications that occur before the date of initial application, then the outcome is the same as that described when Practical expedient 3 is applied under the retrospective method, except that modifications that occur in the comparative period are also included in the assessment – i.e. the practical expedient is applied at the date of initial application and not the earliest period presented.

In addition, an IFRS entity may also choose to apply the contract modifications practical expedient only to contract modifications that occur before the start of the earliest period presented, which would result in the same outcome as the outcome described when Practical expedient 3 is applied under the retrospective method.

Manufacturing Company M's choice to apply the new standard to all contracts or only those open at the date of initial application would not affect the accounting because the contract is not completed before the date of initial application.

The table below summarizes the accounting approach required under each method.

| Method | Effect |
|---|---|
| Retrospective method without Practical expedient 3 | Apply the new standard to original contract at contract inception.<br><br>Apply the new standard contract modification guidance to each modification up to the end of the contract.<br><br>Equity adjustment date: January 1, 2016. |
| Retrospective method with Practical expedient 3 | Apply the new standard (using hindsight) to the contract at the start of the earliest presented comparative period.<br><br>Apply the new standard contract modification guidance to contract modifications that occur after the start of the earliest comparative period.<br><br>Equity adjustment date: January 1, 2016. |
| Cumulative effect method without Practical expedient 3 | Apply the new standard to original contract at contract inception.<br><br>Apply the new standard contract modification guidance to each modification up to the end of the contract.<br><br>Equity adjustment date: January 1, 2018. |
| Cumulative effect method with Practical expedient 3 applied to all modifications that occur before the date of initial application | Apply the new standard (using hindsight) to the contract at the date of initial application.<br><br>Apply the new standard contract modification guidance to contract modifications that occur after the date of initial application.<br><br>Equity adjustment date: January 1, 2018. |

| Method | Effect |
|---|---|
| Cumulative effect method with Practical expedient 3 applied to all modifications that occur before the start of the earliest comparative period presented (IFRS only) | Apply IFRS 15 (using hindsight) to the contract at the start of the earliest comparative period presented.<br>Apply IFRS 15 contract modification guidance to contract modifications that occur after the start of the earliest comparative period presented.<br>Equity adjustment date: January 1, 2018. |

# 4 Summary of the effect of each transition option

The table below contrasts the effects of applying the new standard using a full retrospective approach, which gives the most comparability, with the cumulative effect method, which generally results in the least comparability. As explained below, electing certain practical expedients can result in outcomes that sit between these two extremes.

| Full retrospective method | |
|---|---|
| **What is the accounting impact?** | The new standard is applied to all contracts that are considered to be open under the new standard at the start of the earliest comparative period presented.<br>Transition adjustments are recorded against equity (generally, retained earnings) at the beginning of the earliest comparative period presented. |
| **What are the benefits?** | The revenue figure is comparable from one period to the next. Investors would likely welcome the visible trend data. |
| **What are the main drawbacks?** | This method requires an entity to look at all of its contracts that were open at the beginning of the earliest period presented under the new standard.<br>It requires an entity to investigate and document the facts and circumstances required to apply the new standard to comparative periods.<br>The historical information required to apply the concepts of the new standard may not be readily available.<br>It requires an entity to calculate the adjustment to the new standard for each comparative period, including interim reporting periods. This may increase the time and cost to implement. |

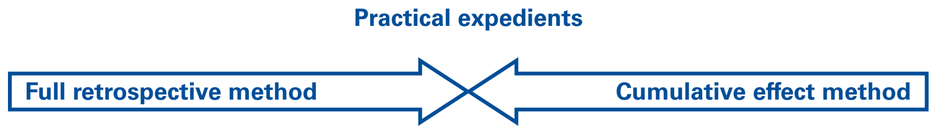
| Full retrospective method | |
|---|---|
| **Who will find this the most relevant?** | Entities expecting little change as a result of applying the new standard are likely to find the full retrospective method relatively straightforward.<br>Entities that expect significant change to their revenue accounting as a result of applying the new standard may find the greater comparability most relevant. |

| | | |
|---|---|---|
| ↑ Enhanced comparability | ↓ Need to look at *all* contracts – i.e. closed and open contracts under current GAAP | ↓ Requires more historical information |

| Cumulative effect method applied to open contracts only | |
|---|---|
| **What is the accounting impact?** | The new standard is applied to only those contracts that are open under current GAAP at the start of the current period.<br>The current period is presented in accordance with the new standard, and comparative periods are presented in accordance with current GAAP.<br>Transition adjustments are recorded against equity (generally, retained earnings) at the date of initial application. |
| **What are the benefits?** | Under this method, the population of contracts that needs to be considered for compliance with the new standard may be significantly reduced.<br>Entities are not required to calculate the impact of the new standard on each of the comparative periods, including interim reporting periods.<br>Reduction in the amount of historical information needed to apply the requirements of the new standard – e.g. to calculate stand-alone selling prices – and the need to recreate historical circumstances (without using hindsight). |

| Cumulative effect method applied to open contracts only | |
|---|---|
| **What are the main drawbacks?** | This method will lead to a loss of comparability between comparative periods and the current period, because they are presented under different revenue recognition requirements. Depending on the degree of change, it is likely that investors' expectations would not be met if less trend data were provided.<br><br>Fluctuations may arise in revenue and certain costs, because they are presented on a different basis for the comparative periods and the current period.<br><br>The date at which an entity can quantify its opening adjustments is deferred until after the start of the current period, which will increase the time pressure on current year financial reporting, particularly if an entity reports on a quarterly basis. For example, an entity with quarterly reporting on March 31, 2018 will not only be reporting current period revenue under the new standard but also calculating the opening adjustment during that same quarterly period.<br><br>Dual reporting is required in the year of initial application as entities are required to disclose what the financial statements would have been under the previous accounting. Dual reporting may also lead to an entity providing management commentary about current period results under two methods. |
| **Who will find this the most relevant?** | Entities that do not expect significant change to their revenue accounting as a result of applying the new standard are likely to find the cumulative effect method most relevant. |

| | | |
|---|---|---|
| ↓ Reduced comparability, dual reporting in year of initial application | ↑ Only need to look at contracts open under current GAAP – not all contracts | ↑ Requires less historical information |




The choice of transition option and the use of practical expedients will have a significant impact on the comparability of the financial information presented.

As noted above, the full retrospective method results in the most comparable information. However, it comes at a cost because it requires an entity to assess all of its contracts with customers and perform revenue cut-off calculations for each comparative reporting period, including interim reporting periods.

To reduce this cost, the entity may elect one or more practical expedients. Practical expedient 1 reduces the number of contracts to be restated and an entity that applies this practical expedient is not required to consider the effect on interim periods for contracts that are in its scope. Practical expedients 2 and 3 simplify how an entity restates the contracts in its scope – e.g. Practical expedient 2 allows the use of hindsight when estimating variable consideration.

Entities applying IFRS could also apply Practical expedient 1A, which would result in similar outcomes to the cumulative effect method when it is applied to only incomplete contracts, except that the comparative periods would also be restated.

The extent to which each practical expedient effects an entity's transition will depend on the nature of its contracts. In some cases, an entity may be able to elect a practical expedient with minimal loss in comparability but still reduce the scope of its implementation project.

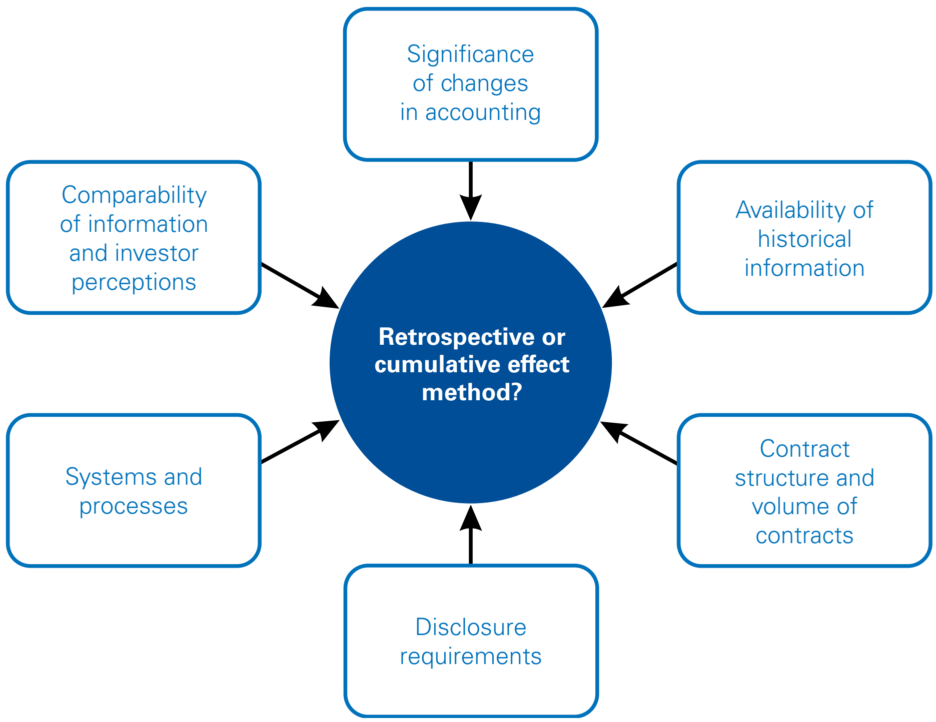
The cumulative effect method automatically reduces comparability, because an entity does not restate its comparatives. However, if an entity chooses to apply this method to all contracts rather than just to open contracts, then the accounting result in the current period is similar to applying the full retrospective method. Although it does not provide the same level of comparability in the first set of financial statements as the retrospective method, it does result in a consistent starting point for all contracts held by an entity.

The contract modifications practical expedient allows the entity to avoid accounting for each contract modification separately, which may significantly reduce the burden of applying the new standard to existing contracts. However, it also means that those contracts are not in full compliance with the new standard, which may reduce comparability in the current and in future years for contracts with a long duration. The impact of applying this practical expedient is similar under the retrospective and cumulative effect methods.

Selecting certain practical expedients may also give rise to differences between entities applying IFRS and those applying US GAAP. This is due to the fact that additional options are available under IFRS and that there is a difference in the definition of a completed contract.

# 5 Additional factors to consider

Entities need to consider a range of factors in weighing the relative benefits, costs and complexities of each method and choosing the best option for their business.




## 5.1 Significance of changes in accounting

Entities will need to conduct an overall assessment of the impact of the new standard on reported revenues and costs, as compared to current GAAP.

If the impact of the new standard is high, then the cumulative effect method may significantly affect trend data, introducing a fluctuation in revenue and impairing the comparability of current and comparative period information in the year of application. For example, it may result in a significant amount of deferred revenue being eliminated and included in opening equity at the date of application.

In these circumstances, an entity may consider using the retrospective method to enable users of the financial statements to better understand the revenue and profitability trends on a consistent and comparable basis.

Entities that report under both US GAAP and IFRS should also consider whether the differences between the US GAAP and IFRS versions of the new standard create any reconciliation differences. Entities may be able to avoid differences arising from differences in the transition requirements by careful selection of a transition method and practical expedients. For example, an entity could avoid potential differences as a result of the different definition of a completed contract by selecting the retrospective method, or if applying the cumulative effect method by choosing to apply the new standard to all contracts rather than only those not completed at the date of initial application.

## 5.2 Availability of historical information

The extent of historical information needed will depend on the transition option and the length of contracts that exist during the transition period, or that are not completed by the date of initial application. Entities should consider the availability of information needed to transition to the new standard – particularly if they are considering the retrospective method, because this method is likely to require more historical information than the cumulative effect method.

Factors that may impact the availability of historical information include:

- whether the necessary information can be generated from existing systems and whether manual processes will be needed to accumulate the necessary data;
- previous changes to the entity's systems that could potentially limit the availability of historical information;
- changes to the processes by which the necessary data has been collected over the relevant periods, depending on the transition option being considered;
- whether new performance obligations have been identified under the new standard, requiring information to estimate their stand-alone selling price; and
- whether new information is needed to address the required changes to the timing of revenue recognition or cost recognition.

If an entity elects the retrospective method, then it may need to start capturing the historical information almost immediately, depending on the length and nature of its contracts, because the cumulative effect adjustment would be as of January 1, 2016 for an entity presenting two periods of comparatives.

## 5.3 Contract structure and volume of contracts

The level of effort and cost involved in using a particular transition option will be directly impacted by:

- the number of contracts that an entity holds with unfulfilled performance obligations at the date of initial application;
- the duration of an entity's contracts; and
- the degree of consistency between the contractual terms and conditions and the performance obligations included in the entity's contracts.

For entities with very short-term contracts that involve standard or homogeneous goods and services, it may be clear that the cumulative effect method will require less effort than the retrospective method. However, it may also be that the incremental effort of using the retrospective method is minimal for such entities. By using practical expedients, such as the expedient related to contract modifications, an entity may be able to further reduce the incremental effort between applying the retrospective and cumulative effect methods.

Entities with long-term contracts that have non-standard terms and conditions, or that provide disparate performance obligations, will generally find the analysis more complex – but again, the incremental cost of using the retrospective method rather than the cumulative effect method may not be significant.

For example, an entity with contracts that average seven years in length would need to assess them over a nine-year period under the retrospective method. This may not require significantly more effort than assessing them over a seven-year period under the cumulative effect method. The most significant differentiating factors may be the availability of information and the calculation of revenue cut-off for each quarterly reporting period, if required.

## 5.4 Disclosure requirements

Entities apply the disclosure requirements of the new standard to all periods presented in accordance with the new standard. Therefore, if an entity elects to apply the retrospective method, then it applies the new disclosure requirements for the initial year of application *and* all comparative periods presented. However, Practical expedient 4 offers limited relief from all of the new disclosure requirements.

To meet the disclosure requirements, entities will need to provide qualitative and quantitative information about:

- their contracts with customers – including disaggregated revenue, contract balances and performance obligations;
- significant judgments in applying the guidance – including determining when performance obligations are satisfied, and determining the transaction price and the amounts allocated to them; and
- any assets recognized from the cost to obtain or fulfill a contract with a customer.

Entities will therefore need to consider how much effort will be needed to meet the new disclosure requirements and whether they need to capture new information.

Entities will also need to comply with the general disclosure requirements that apply when a change in accounting principle occurs, including the amount of the adjustment for the financial statement line items and earnings per share amounts affected. This may require them to track information under both the new standard and current GAAP. However, an entity that adopts the standard retrospectively is not required to disclose the impact of the change in accounting policy on the financial statement line items and earnings per share amount for the year of initial application. The cumulative effect method specifically requires entities to disclose what the revenue and relevant cost line items in the initial period of application would have been under current GAAP in the year of application.

Entities should also consider whether there are any local regulatory requirements that would require them to follow a certain approach or restate additional comparative information. For example, local regulation may require an entity to present multiple years of selected financial information.

Local regulators may also set out requirements or expectations with respect to the transition disclosures that entities include in financial statements for the periods leading up to the first period of application of the new standard. These disclosures may include detailed qualitative discussion about potential changes in revenue accounting and expected quantitative impacts of the new standard on financial statement line items.

## 5.4.1 Considerations specific to SEC registrants

### 5.4.1.1 Selected financial data

Under Regulation S-K[6], SEC registrants are required to disclose at least five years of selected financial data to highlight significant trends in financial conditions and the results of operations. However, the SEC staff stated that it will not object if registrants that elect to apply the new standard retrospectively choose to do so only for the periods covered by the financial statements when preparing their selected financial data, provided that they clearly indicate that the earlier periods are prepared on a different basis than the most recent periods.[7]

### 5.4.1.2 Registration statements with the SEC during 2018 may require earlier periods to be revised when retrospective transition is elected

Registration statements filed with the SEC need to include or incorporate by reference financial statements that retrospectively reflect a change in accounting principle. For calendar year-end entities that adopt the standard on January 1, 2018 using the retrospective transition method, current rules would require new registration statements filed during 2018 after the first quarter Form 10-Q is filed to include or incorporate by reference retrospectively revised historical financial statements for the three-year period ended December 31, 2017. This would include 2015, which is a period that would not otherwise require retrospective revision for annual reporting requirements.

6. SEC Regulation S-K, Item 301, Selected Financial Data, available at www.sec.gov.
7. 11100.1 of SEC Division of Corporation Finance's Financial Reporting Manual, available at www.sec.gov.

#### 5.4.1.3 Significance test for equity method investees not required to be recalculated

Under Regulation S-X[8], SEC registrants are required to provide separate audited financial statements for significant investments. The SEC has stated that when entities are applying the significance test to determine whether an investment requires separate financial statements, they will not be required to recalculate the significance test for years revised under a retrospective adoption of the new standard. Instead, registrants can use their pre-transition measure to apply the significance test.[9]

#### 5.4.1.4 Quarterly supplemental data for emerging growth companies

Emerging growth companies that have elected to follow non-issuer effective dates are not required to accelerate adoption of the new standard to interim periods within the annual reporting period of adoption for the sole purpose of reporting quarterly supplemental data.[10]

## 5.5 Systems and processes

### 5.5.1 Dual reporting

If an entity elects to use the retrospective method, then one option is to implement the necessary process and policy changes such that it can account for contracts under the new standard, as well as under current GAAP, on a real-time basis from the beginning of the earliest comparative period presented.

How easily this process can be implemented will depend on the entity's specific facts and circumstances, but will include factors such as:

– the complexity of the entity's transactions;

– the nature of the change in accounting; and

– the capabilities of the entity's IT environment.

Entities that present two years of comparatives will need to consider whether the necessary IT system, policy and process changes can still be implemented because the beginning of the earliest comparative period has already passed– i.e. beginning on January 1, 2016. This means that such entities may want to consider implementing the system changes for periods beginning on or after January 1, 2017, which would still give an entity one complete year of dual reporting.

Other entities will choose not to run two sets of figures on a real-time basis, and will instead choose to look back and adjust the numbers reported under current GAAP. Early in the transition process, these entities should consider how they can most effectively quantify the effect of applying the new standard under the transition requirements. For example, if an entity can identify homogeneous sub-populations of contracts rather than assess every contract, then it may be able to quantify the

8. SEC Regulation S-X, Item 309, *Separate Financial Statements of Subsidiaries Not Consolidated and 50 Percent or Less Owned Persons*, available at www.sec.gov.
9. Remarks by Wesley Bricker, Deputy Chief Accountant, Office of the Chief Accountant at the SEC, December 2015 AICPA National Conference on Current SEC and PCAOB Developments.
10. 11100.2 of SEC Division of Corporation Finance's Financial Reporting Manual, available at www.sec.gov.

effect on a sample of contracts and use that information to help account for the homogeneous sub-population. A statistical sampling tool may help some entities with this exercise. An entity that has contracts that are individually significant, or that do not have characteristics in common with other contracts, may need to analyze those contracts individually.

If an entity elects to use the cumulative effect method, then it will need to consider its dual reporting capabilities in the year of initial application to comply with the disclosure requirements (see 5.4).

### 5.5.2 Internal control considerations

Regardless of the transition option elected, entities will need adequate processes and controls to ensure that the information used to comply with the new standard and transition requirements is complete and accurate. They may want to consider the cost and timeframe for designing and implementing these processes and controls when choosing a transition method. Some entities may want to implement their process and control changes before signing any certifications relating to internal control under Sarbanes-Oxley, so that they can be documented and tested, and any deficiencies addressed, before the year end.

## 5.6 Comparability of information and investor perceptions

### 5.6.1 Period-to-period

The comparability of information from one period to the next will be important for both internal and external users of financial statements – particularly if an entity is seeking financing, or is expecting to initiate an exit event in the near term, such as an initial public offering or a sale. In these situations, the benefit of having consistency across all periods presented in the financial statements may outweigh the incremental costs required by the retrospective method.

If an entity elects to apply one or more of the practical expedients available under the retrospective method, or elects the cumulative effect method, then revenue will not be presented on a consistent basis in all periods. This inconsistency may make it difficult for external users to evaluate the financial performance of an entity, and for internal users to assess financial performance and prepare budgets or forecasts for future periods.

### 5.6.2 Internal reporting

Significant changes in the amount or timing of revenue and earnings could lead to changes in key performance indicators (KPIs) or other metrics used to communicate financial results. Management compensation metrics may also be affected or need to be adjusted for the transition impact. If applying the new standard creates a lack of comparability against previously used metrics, or results in the need to use different metrics or to adjust previous metrics, then it may be beneficial to use the retrospective method because it provides greater comparability across all periods presented in the financial statements. Entities should develop internal and external communication plans so that interested parties can understand the implications of the new measures for historical and current KPIs.

### 5.6.3 Peer-to-peer

Entities should consider which transition option their peers are planning to elect, and whether external users of financial information generally expect consistency in the application of financial reporting across that group. It may be important for an entity to follow the industry norm.

# 6 Next steps

The choice of transition option will have a significant impact on the extent and timing of system and process changes, and should be considered as soon as possible.

We recommend that entities consider both the quantitative effects of each method *and* the relevant qualitative factors. Advance planning will allow time for unanticipated complexities, and will offer greater flexibility in maximizing the use of internal resources by spreading the required work over a longer period.

Entities should therefore take steps to understand the new standard and to evaluate the effects of the transition options on their financial reporting. Some entities may quickly decide that the impacts are minimal, in which case it may be appropriate to wait longer to evaluate the transition options. However, others will be faced with substantial impacts requiring major effort, and should therefore start planning as soon as possible. Entities should consider completing the following actions.

– Perform a high-level gap analysis to identify potential drivers of changes in accounting for revenue and certain costs.

– Determine the population of contracts that may need to be restated. This may include identifying any individually significant contracts that should be assessed separately, or sub-populations of contracts with similar characteristics that can be evaluated in the aggregate.

– Begin assessing the information that will be needed to comply with the new standard. Compare this with currently available information to identify potential gaps that should be considered in the broader implementation of the new standard.

– Identify the qualitative factors that may influence your choice of transition option. Key stakeholders may need to be engaged to understand which factors are most relevant.

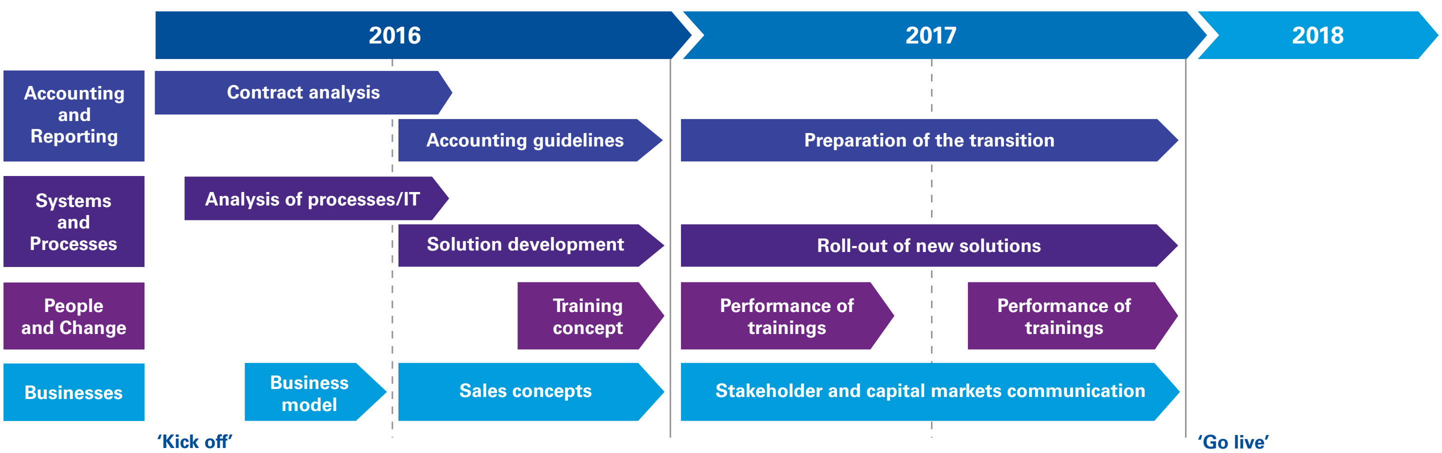
– Ensure that transition options are evaluated in conjunction with the broader implementation effort for the new standard. Consider implementing a subgroup within the overall project team responsible for implementation, to focus on transition option considerations.

– Develop an implementation plan. The Appendix includes example transition project plans that highlight the key steps involved in undertaking a successful transition project.

# Appendix - Example transition project plans

As highlighted in this publication, transitioning to the new standard requires more than just consideration of the potential changes in accounting. A successful implementation plan needs to take into account all relevant factors and will require the involvement of more than just those in the finance and reporting functions. The illustrations below set out the common features of a transition project plan and the sequencing of the steps.

## Example 1




### Analysis

- Project set up
- Identification of significant revenue streams and types of contracts
- Analysis of current revenue recognition, guidelines and practices
- Analysis of IT- landscape, processes and controls
- Identification of IT- and process gaps
- Implications on business models as follows:
  - Customer contracts
  - Products
  - Sales
- Determination of transition options

### Design

- Preparation of accounting memoranda
- 'Portfolio-' or 'contract-by-contract' approach
- Update of the following:
  - Accounting guidelines
  - Chart of accounts
  - Posting logic
- Determination of disclosures
- KPIs and reporting
- Preparation of specifications for necessary adaptations of the existing IT infrastructure
- Preparation of training materials and set up of a training concept

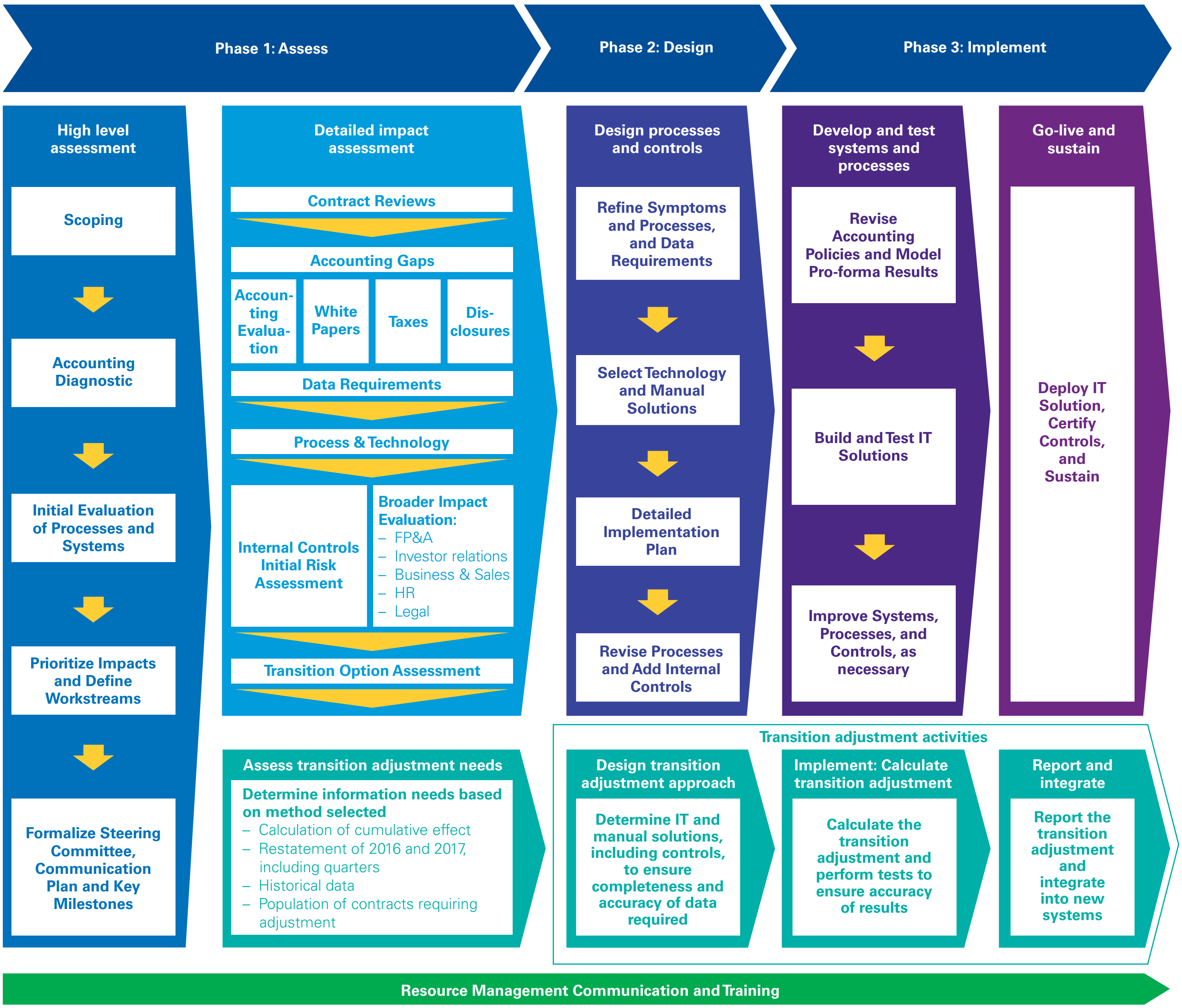
### Implementation

- Roll-out of accounting adjustments and calculations
- Adaption of IT systems and processes and roll-out to single entities
- Implementation of new controls
- Roll-out of adjusted sales processes
- Performance of trainings
- Adaption of business plan, KPIs and reporting
- Stakeholder communication
- Performance of group dry-runs

### Stabilization

- Go-live support
- Hotline
- Continuous improvement of roll-out solutions

# Example 2


Phase 1: Assess
Phase 2: Design
Phase 3: Implement
High level assessment
Scoping
Accounting Diagnostic
Initial Evaluation of Processes and Systems
Prioritize Impacts and Define Workstreams
Formalize Steering Committee, Communication Plan and Key Milestones
Detailed impact assessment
Contract Reviews
Accounting Gaps
Accounting Evaluation
White Papers
Taxes
Disclosures
Data Requirements
Process & Technology
Internal Controls Initial Risk Assessment
Broader Impact Evaluation:
– FP&A
– Investor relations
– Business & Sales
– HR
– Legal
Transition Option Assessment
Design processes and controls
Refine Symptoms and Processes, and Data Requirements
Select Technology and Manual Solutions
Detailed Implementation Plan
Revise Processes and Add Internal Controls
Develop and test systems and processes
Revise Accounting Policies and Model Pro-forma Results
Build and Test IT Solutions
Improve Systems, Processes, and Controls, as necessary
Go-live and sustain
Deploy IT Solution, Certify Controls, and Sustain
Assess transition adjustment needs
Determine information needs based on method selected
– Calculation of cumulative effect
– Restatement of 2016 and 2017, including quarters
– Historical data
– Population of contracts requiring adjustment
Transition adjustment activities
Design transition adjustment approach
Determine IT and manual solutions, including controls, to ensure completeness and accuracy of data required
Implement: Calculate transition adjustment
Calculate the transition adjustment and perform tests to ensure accuracy of results
Report and integrate
Report the transition adjustment and integrate into new systems
Resource Management Communication and Training

# About this publication

This publication has been produced jointly by the KPMG International Standards Group (part of KPMG IFRG Limited) and the Department of Professional Practice of KPMG LLP. It considers the transition requirements of IFRS 15 *Revenue from Contracts with Customers* and FASB ASC 606 *Revenue from Contracts with Customers*.

In many cases, further interpretation will be needed for an entity to apply IFRS or US GAAP to its own facts and circumstances, and individual transactions.

IFRSs and US GAAP and their interpretation change over time. Accordingly, neither this publication nor any of our other publications should be used as a substitute for referring to the standards and interpretations themselves.

# Acknowledgements

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