Special Interest Session

Implementing forthcoming
Revenue from Contracts with Customers

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IASB

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Partner, Deloitte
Member, ASC

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Senior Vice President & Chief Accounting Officer
Head of Corporate Financial Reporting
SAP AG
Implementing forthcoming Revenue Recognition requirements

To assist you to prepare for the implementation of forthcoming IFRS—Revenue Recognition, the IFRS Foundation will hold an intensive half-day session immediately before the IFRS conference, on the morning of 29 May 2014.

09:00  Registration and refreshments

09:30  Introduction to the requirements
Patricia McConnell
Member
IASB

10:15  Advisor’s perspective
Cheung Pui Yuen
ASC member and
Partner
Deloitte

10:45  Preparer's perspective
Christoph Hütten
Senior Vice President and
Chief Accounting Officer, Head of Corporate Financial Reporting
SAP AG

11:15  Round-table Q&A
Chair: Patricia McConnell, Member, IASB
Panellists:
- Cheung Pui Yuen
- Christoph Hütten

11:55  Concluding comments
Patricia McConnell
Member
IASB

12:00  Close session
Revenue Recognition

International Financial Reporting Standards

At a glance

• Issue new Revenue Standard Q2 2014
  – Joint Standard with FASB
  – Replaces IAS 18, IAS 11 and related Interpretations
  – Culmination of extensive due process
• Framework for revenue recognition
• Effective date 1/1/2017, early application permitted
• Transition
  – Retrospective or
  – Cumulative effect at the date of application
• Revenue Transition Resource Group

The views expressed in this presentation are those of the presenter, not necessarily those of the IASB or IFRS Foundation.
All contracts with customers, except
- Lease contracts
- Insurance contracts
- Financial instruments
- Non-monetary exchanges in the same line of business to facilitate sales to customers

Main steps to apply Standard

1. Identify the contract with a customer
2. Identify the performance obligations in the contract
3. Determine the transaction price
4. Allocate the transaction price to the performance obligations
5. Recognise revenue when (as) a performance obligation is satisfied
**Step 1: Identify the contract**

**Existence of a contract**
- Must meet specified criteria to apply the model

**Combine contracts**
- Negotiated as a package
- Linked consideration
- Goods or services form one performance obligation

**Contract modifications**
- Separate contract if add distinct goods/services at standalone selling price
- Prospective if remaining goods/services distinct
- Otherwise, cumulative catch-up

**Step 2: Identify the performance obligations**

**Promise to transfer a distinct good or service**
- On its own

**Customer can benefit from good or service**
- Together with other readily available goods or services (including goods or services previously acquired from entity)

**Promised good or service is separable from other promises**
- No significant service of integrating the good or service
- Good or service does not significantly modify or customise another good or service in the contract
- Good or service is not highly dependent on or interrelated with other goods or services
Step 3: Determine the transaction price

Amount of consideration to which entity expects to be entitled in exchange for goods or services

- **Variable consideration**
  - Estimate using:
    - Expected value
    - Most likely amount
    - But 'Constrained'

- **Significant financing**
  - Adjust consideration if timing provides customer or entity with significant benefit of financing

- **Non-cash consideration**
  - Measure at fair value unless cannot be reasonably estimated

- **Consideration payable to customer**
  - Reduction of the TP unless in exchange for a distinct good or service

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Step 3: Constraining variable consideration

Include estimate of variable consideration in the transaction price to extent it is highly probable a significant reversal of revenue will not occur as a result of a change in that estimate

- Entity’s expectations of revenue reversal assessed using indicators, eg
  - Factors outside entity’s influence (market, 3rd-party actions)
  - Entity’s level of experience with similar types of contracts
  - Length of time before uncertainty resolved
Step 4: Allocate the transaction price

Allocate to each performance obligation the amount to which entity expects to be entitled in exchange for satisfying that performance obligation

- Relative stand-alone selling price basis
  - estimate selling prices if not observable
  - residual estimation techniques may be appropriate
- Discounts and contingent amounts allocated entirely to specific performance obligation if specified criteria met

Step 5: Recognise revenue when (as) a performance obligation is satisfied

Performance obligation is satisfied by transferring good or service

Performance obligations satisfied over time if specified criteria met

Revenue is recognised by measuring progress towards complete satisfaction of the performance obligation
- Units produced or delivered may be a reasonable proxy in some cases
- Input methods may need to be adjusted (eg uninstalled materials)

All other performance obligations satisfied at a point in time

Revenue is recognised at the point in time when the customer obtains control of the promised asset. Indicators of control include:
- Present right to payment
- Legal title
- Physical possession
- Risks and rewards of ownership
- Customer acceptance
A performance obligation is satisfied over time (ie revenue recognised over time) if one of three criteria are met:

- The customer receives and consumes the benefits of the entity’s performance as the entity performs
  - assessed by considering (hypothetically) whether another entity would need to substantially re-perform the work completed to date if that other entity were to fulfil the remaining obligation
- The entity’s performance creates or enhances an asset (eg WIP) that the customer controls as the asset is created or enhanced
- The entity’s performance does not create an asset with an alternative use to the entity and the entity has a right to payment for performance completed to date, and it expects to fulfil the contract as promised

Agreements for the Construction of Real Estate (Withdrawing IFRIC 15)

An entity satisfies a performance obligation over time when…

…the entity’s performance does not create an asset with an alternative use to the entity and the entity has a right to payment for performance completed to date and it expects to fulfil the contract as promised.

What are the enforceable rights and obligations in the contract?

- Can the “alternative use” criterion be met?
  - Consider whether the developer would be contractually precluded from selling a specific unit (say apartment 1102) to another buyer after entering into an agreement
- Can the “right to payment for performance to date” criterion be met?
  - Is the entity legally entitled to be paid for the performance to date if the buyer terminates the contract?
  - Consider whether progress payments correspond to performance to date and whether they are refundable
## Contract costs

<table>
<thead>
<tr>
<th>Costs of obtaining a contract</th>
<th>Costs of fulfilling a contract</th>
<th>Onerous contracts</th>
</tr>
</thead>
<tbody>
<tr>
<td>Recognised as an asset if:</td>
<td>Recognised as an asset if:</td>
<td>Apply IAS 37</td>
</tr>
<tr>
<td>• Incremental</td>
<td>• Relate directly to a contract</td>
<td></td>
</tr>
<tr>
<td>• Expected to be recovered</td>
<td>• Relate to future performance</td>
<td></td>
</tr>
<tr>
<td>For example:</td>
<td>• Expected to be recovered</td>
<td></td>
</tr>
<tr>
<td>Selling commissions</td>
<td>For example: Pre-contract or setup costs</td>
<td></td>
</tr>
</tbody>
</table>

**Implementation guidance**

- Warranties
- Licences (next slide)
- Right of return
- Customer options for additional goods or services
- Breakage (customers’ unexercised rights)
- Principal versus agent
- Bill-and-hold arrangements
- Repurchase agreements
- Non-refundable upfront fees
- Customer acceptance
Implementation guidance: Licences

Step 2: Identify the performance obligation(s)

Is the licence distinct?

Yes

No

Account for bundle of goods and services

No

Sales- and usage-based royalties?

Yes

Apply criteria to determine whether nature of entity’s promise in granting licence is to provide:

- a right to access the entity’s intellectual property as it exists throughout the licence period (i.e., a performance obligation satisfied over time); or
- a right to use the entity’s intellectual property as it exists at the point in time at which the licence is granted (i.e., a performance obligation satisfied at a point in time)

Disclosure requirements

Disclosure objective: To enable users of financial statements to understand the nature, amount, timing and uncertainty of revenue and cash flows arising from contracts with customers

User needs

Preparer concerns

Clarifications and refinements to disclosure requirements

- Disaggregation of revenue
- Information about contract balances
- Remaining performance obligations
- Interim requirements
Transition, effective date and early application

<table>
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<tr>
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<th></th>
</tr>
</thead>
<tbody>
<tr>
<td>Retrospective (with optional practical expedients)</td>
<td>Cumulative catch-up</td>
<td>Contracts under new standard</td>
<td>Contracts restated</td>
<td></td>
</tr>
<tr>
<td>Cumulative effect at date of application</td>
<td>Contracts not restated</td>
<td>Cumulative catch-up</td>
<td>Existing* and new contracts under new standard</td>
<td>Existing and new contracts presented under legacy IFRS/US GAAP</td>
</tr>
</tbody>
</table>

*contracts not completed in prior years as determined under legacy revenue guidance

- Effective date: annual reporting periods beginning on or after 1 January 2017
- Early application permitted (IFRS only)

Revenue Transition Resource Group

- Public discussion to support initial application of the new Revenue Standard
- Will **not** issue authoritative guidance
- Limited life group
- More details to be announced…
Thank you
A New Revenue Recognition Framework

How it might impact you

Cheung Pui Yuen
29 May 2014

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What will change?

It depends on what you did before...

Before:
• Not many rules and applying lots of judgment

Now:
• Detailed written rules/guidance
What are the key changes?

Key areas:

- Unbundling of contracts
- Allocation of total revenue to the unbundled parts
- Uncertain revenue or variable consideration
- Recognition of revenue at a point of time or over time
- More extensive disclosure requirements

Which industries might be significantly impacted?

**New Revenue Recognition Framework**

The most impacted industries:

- Telecom
- Contract manufacturing
- Software
- Real estate (specifically apartment block building)
Implications of the new framework

Key areas:

- **Telecom**: Unbundle contracts, discounts, subscriber acquisition costs, handset costs
- **Contract manufacturing**: Unbundle contracts, progress payments, performance obligations satisfied over time or at a point in time
- **Software**: Unbundle contracts and allocate the transaction price, recognize revenue over time or at a point in time
- **Real Estate**: Recognition of revenue over time or at a point in time

Example – Telecom

**Differences in allocation of transaction price between current and new practice**

**Facts:**
Operator A sells mobile handsets and wireless services to their customers. They offer two different packages:

<table>
<thead>
<tr>
<th>Package 1</th>
<th>Package 2</th>
</tr>
</thead>
<tbody>
<tr>
<td>• Handset X for free</td>
<td>• Handset X SUPER PLUS for CU 150</td>
</tr>
<tr>
<td>• Wireless service CU 40 per month over a two-year contract</td>
<td>• Wireless service CU 40 per month over a two year contract</td>
</tr>
<tr>
<td>• Total price of CU 960</td>
<td>• Total price of CU 1,110</td>
</tr>
</tbody>
</table>

Standalone selling price for handset X is CU 250
Standalone selling price for handset X SUPER PLUS is CU 400
Example – Telecom

**Illustration of impact:**
Differences in allocation of transaction price between current and new practice

<table>
<thead>
<tr>
<th>Package 1 Current</th>
<th>Package 1 New</th>
<th>Package 2 Current</th>
<th>Package 2 New</th>
</tr>
</thead>
<tbody>
<tr>
<td>Wireless service (Yr 2)</td>
<td>480</td>
<td>381</td>
<td>480</td>
</tr>
<tr>
<td>Wireless service (Yr 1)</td>
<td>198</td>
<td>150</td>
<td>326</td>
</tr>
</tbody>
</table>

Note: The current practice is somewhat divergent

Example – Contract Manufacturing

**Question:**
Should the revenue be recognized over time or at a point of time?

**Answer:**
Revenue should be recognized over time.
Example – Software

Sells a software licence and provides consulting services for customising the software

Entity A

Customer Y

CU600,000

Current practice: Unbundle the licence from the add-on services

New practice: The licence and professional services may be considered a single performance obligation and revenue for the arrangement will be recognised over the service period.

Example – Real Estate

Current practice: Revenue recognised over time in some situations

New practice: Assess if asset has alternative use to Developer and there is right to payment for performance to date.
More extensive disclosures

**Overall objective:**
Enable users of financial statements to understand the nature, amount, timing and uncertainty of revenue and cash flows arising from contract with customers.

New disclosure requirements

**More extensive disclosures in the following areas:**

- **Disaggregation of revenue** to "depict how the nature, amount, timing and uncertainty of revenue and cash flows are affected by economic factors”
- **Changes in contract balances** e.g. opening and closing balances of contract assets and liabilities
- **Contracts extending beyond one year** – aggregate amount of transaction price allocated to the remaining performance obligation and explanation of expected timing of revenue recognition
- **Contract costs** – information about asset recognised for costs to obtain or fulfil a contract
New disclosure requirements

More extensive disclosures in the following areas:-

- **Information about contracts** - types of goods or services, significant payment terms, typical timing of satisfying obligations
- **Significant judgments** about the amount and timing of revenue recognition
- **Policy decisions** made by entity related to practical expedients
- **Information about methods, inputs and assumptions** used to determine transaction price and price allocation

**Interim reporting** - Disclosures limited to certain areas.

Convergence with FASB

**Potential areas of differences**

- Ability to early adopt standard
- Extent of interim disclosure requirements
- Others to the extent that the revenue recognition requires reference to other standards
How it might impact you?

Significant changes to
timing/amount of
revenue recognition?

Need to revisit detail
do current policies in
light of significant
increase in detailed
revenue guidance?

FINANCIAL REPORTING

Information system

Financial information
and links with internal
reporting

Impact Assessment Approach
Summary of the key approach that entities could consider in addressing the requirements of the new Revenue Recognition framework

Key activities
- Evaluate significant revenue streams
- Identify, evaluate and summarise key contracts
- Capture and define key accounting issues and new policy requirements
- Identify key data gaps, process requirements
- Assess opportunities to automate key accounting steps
- Assess other potential system impacts
- Analyse / determine additional disclosure needs
- Determine long-term training requirements

Key issues
- Definition of contract and performance obligation
- Bundled offers/services
- Variable pricing
- Allocation and measurement of performance
- Contract modifications
- Onerous contracts
- Disclosures/presentation

Revenue Streams/ Areas of Business Focus (An Example)
- Enterprise contracts
- Outsourced service arrangements
- Wholesale telecom contracts
- State-based telecom contracts

Deliverables
- Evaluation of contract types and summary of issues
- Data gap identification
- Accounting and tax issue summary
- Operational issues and process changes
- Implementation roadmap and workplan
Operational Considerations

Revenue systems
Multiple billing and transaction systems service different customer types and channels; many are likely to be impacted by the proposed revenue recognition rules.

Performance metrics
Performance measures and other key performance metrics for commission and bonus plans may likely be impacted by timing of targets being achieved and likelihood of targets being met.

Taxation
There may be tax impact depending on how a jurisdiction treats accounting profits.

Profit distribution
Timing and amounts of revenue recognition, and hence profit recognition may change, affecting availability of profits for dividend policies.

Loan covenants
Timing and amounts of revenue recognition, and hence profit recognition may impact calculations for compliance with covenants for loans.

Internal controls
New data and calculations necessitate design and implementation of new or revised internal controls.

Financial reporting systems
Extensive disclosures may warrant systems re-configuration. Reconciliation between IFRS and other reporting GAAPs may be required.

Key Takeaways

- Impacts entities across all types of industries and businesses
- Changes to timing and measurement of revenue expected in some cases
- Increased disclosures for most entities
- Practical expedients are available in several areas
- Assess impact as soon as possible or revisit previous analysis for any changes
How Deloitte can help

Global IFRS and Offering Services (GIOS)

IFRS Implementation Services
Our GIOS team offers the following services to assist companies plan and execute the implementation of complex and challenging new IFRS:

• Evaluate the potential impacts of the new accounting standards
• Assess readiness for implementation
• Assist to develop detailed plan and roadmap
• Providing technical subject matter expertise and support on:
  ✓ Project management
  ✓ Technical research
  ✓ Training

By leveraging on our previous experience and the extensive industry expertise of our global IFRS network, our IFRS methodology is structured to address the implications of new IFRS across different industries.

Deloitte Contacts

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Deloitte’s IFRS Resources

IAS Plus
IAS Plus features an extensive collection of news and resources about International Financial Reporting Standards (IFRS), the International Accounting Standards Board (IASB), and international accounting development.

http://www.iasplus.com/

Useful publications include:

• IFRS in Focus
• IFRS Project Insights
• IFRS Industry Insights
• IFRS model Financial Statements
Thank you…
Implementing IFRS 15
“Revenue from Contracts with Customers”
– Preparer’s Perspective –
Dr. Christoph Hütten – SVP & Chief Accounting Officer, SAP
May 29, 2014

SAP’s Financial Reporting and Revenue Recognition History

- 1972: Going Public in Germany
- 1988: Going Public in the U.S.
- 1998: German GAAP
- 2009: IFRS

SAP introduces industry specific US GAAP revenue recognition guidance (SOP 97-2) and adjusts certain business models to achieve a more favourable revenue recognition.

SAP establishes IFRS accounting policies „as close as possible to US GAAP“ => SAP’s IFRS revenue recognition policies heavily US GAAP influenced.
SAP is a “Revenue Recognition-Driven” Company

- **705** No. of Pages
- **> 65** No. of Employees
- **> 3 1/2** No. of Pages

**Revenue Recognition Guideline**

**Fully Dedicated Revenue Recognition Experts on Payroll**

**Revenue Recognition Policy Disclosure in IFRS Financial Statements**

Most arrangements are multi-element arrangements

Delivery not always easy to determine for software

Highly variable software pricing due to low direct cost

High number of large deals with individualised contracts

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**The New Standard:**
A Change in Mind-set ... Rather than only an Accounting Change

**SAP is under a very tight revenue recognition regime ... this may change**

**Example 1**

<table>
<thead>
<tr>
<th>Under SAP’s Current Policies</th>
<th>Under IFRS 15</th>
</tr>
</thead>
<tbody>
<tr>
<td>Allocation of transaction fee to individual performance obligations based on Vendor Specific Objective Evidence of Fair Value (VSOE)</td>
<td>Allocation of transaction fee to individual performance obligations based on Estimated Standalone Sales Prices (ESP)</td>
</tr>
<tr>
<td>Frequent pricing changes over time may be a significant issue</td>
<td>Frequent pricing changes over time are less of an issue</td>
</tr>
<tr>
<td>Low pricing flexibility</td>
<td>High pricing flexibility</td>
</tr>
</tbody>
</table>
The New Standard:
A Change in Mind-set … Rather than only an Accounting Change

SAP is under a very tight revenue recognition regime … this may change

Example 2

Under SAP’s Current Policies
Strict residual method due to lacking VSOE for
software: Allocate amounts equaling VSOE to
all elements other than software and residual to
software

All discounts run against software revenue

Under IFRS 15
Full allocation of a discount to the triggering
performance obligation may be appropriate
even under residual approach

Discounts triggered by a specific performance
obligation may not affect “the residual”

The New Standard:
A Change in Mind-set … Rather than only an Accounting Change

SAP uses revenue recognition to steer the business … this may need to change

Example 3

Under SAP’s Current Policies
Allocation of transaction fee to individual
performance obligations based on VSOE
High pricing consistency required
to establish VSOE

Strong incentive to focus on pricing consistency
and to limit discounting on services

Under IFRS 15
Allocation of transaction fee to individual
performance obligations based on Estimated
Standalone Sales Prices (ESP)
ESP deemed determinable
even if pricing consistency is low

Weaker incentive to focus on pricing
consistency because discounting of
non-software deliverables has less of an impact
The New Standard:  
A Change in Mind-set ... Rather than only an Accounting Change

SAP uses revenue recognition to steer the business ... this may need to change

Example 4

Under SAP's Current Policies
Due to lacking VSOE for software all revenue of a transaction is deferred if a future functionality is committed to the customer in a multi-element arrangement

Strong incentive to refrain from committing future functionalities

Under IFRS 15
Only amounts equal to the ESP of the future functionality are deferred if a future functionality qualifying as a separate performance obligation is committed to the customer in a multi-element arrangement

Weaker incentive to refrain from committing future functionalities

How We Prepare What is Coming

<table>
<thead>
<tr>
<th>2008</th>
<th>2014</th>
<th>2015</th>
</tr>
</thead>
<tbody>
<tr>
<td>Phase 1</td>
<td>Impact the New</td>
<td>Phase 2</td>
</tr>
</tbody>
</table>

Aim
- Understand the proposals and their potential impact on SAP
- Actively participate in IASB Due Process to achieve a feasible outcome

Efforts
- Discuss proposals internally
- Discuss proposals with industry peers
- Discuss proposals with external auditor
- Comment on Discussion Papers and EDs (both alone and with industry peers)
- Liaise with IASB staff, IASB board members and national standard setter
How We Prepare What is Coming

2008  2014  2015

Phase 1  Impact the New  Phase 2  Prepare for the New  Phase 3  Implement the New

Aim
- Understand the final standard and its impact on SAP
- Create awareness in the company
- Develop implementation strategy

Efforts
- Discuss final guidance internally and with industry peers to identify (a) required changes and (b) possible changes to business models, go-to-market models, accounting, internal controls, IT-systems, compensation models, finance processes etc.
- Align views on new proposals with external auditor
- Hold trainings for management and all internal stakeholders (accountants, other finance functions, sales force etc.)
- Decide on implementation strategy ("Minimize Differences" vs. "Use the Opportunity") and transition approach

How We Prepare What is Coming

2008  2014  2015

Phase 1  Impact the New  Phase 2  Prepare for the New  Phase 3  Implement the New

Aim
- Implement new guidance
- Optimise processes regarding efficiency & effectiveness

Efforts
- Re-write revenue recognition guideline and amend accounting guideline
- Hold trainings across the organisation
- Re-design/adjust processes and IT systems and rollout the changes
- Adjust business models, go-to-market models, contracts, internal controls, compensation models, etc.
- Determine high level pro forma financial impact on prior periods
- Start executing and recording transactions under new guidance
- Prepare new disclosures
Thank you

Contact information:

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SVP & Chief Accounting Officer
SAP