

Accounting for revenue is changing

What's the impact on power and utility companies?

In association with the KPMG Global Energy Institute

The new revenue standard – effective from 1 January 2018 – is likely to affect the way you account for revenue. But it is more than just an accounting change.

It could impact:

- timing of revenue recognition for:
 - transfers of assets from customers
 - take or pay arrangements
- treatment of contract costs
- systems and processes, including data collection
- disclosures in annual and interim reports

It's time to engage, particularly as there are also new standards on leases and financial instruments.

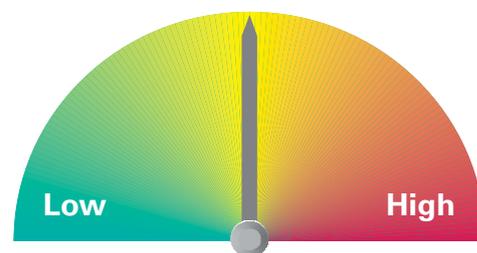
If you have:

- transfers of assets from customers
- take or pay arrangements
- non-monetary exchanges
- contract modifications
- variable consideration
- contracts with multiple goods and services

...it's time to start looking at your contracts and assessing how the new revenue requirements will affect your business.

Engage with your stakeholders to build up expectations of how your KPIs or business practices may change.

Determining the impact



Transfers of assets from customers

Potential impact

- IFRS 15 supersedes current IFRS guidance on transfers of assets from customers.
- Under the new standard, an entity assesses whether it obtains control of the assets received and applies the guidance on non-cash consideration. The entity measures non-cash consideration received from a customer at fair value if that can be reasonably estimated; if not, then the entity uses the stand-alone selling price of the good or service that was promised in exchange for the non-cash consideration.
- The entity then applies the general guidance in IFRS 15 to determine the timing for revenue recognition – i.e. whether to recognise revenue immediately or to defer it.

Actions to consider

- Review the contractual terms of arrangements involving transfers of assets from customers to assess if the timing of revenue recognition will be affected under the new standard.

Take or pay arrangements

Potential impact

- IFRS 15 introduces a new approach for arrangements in which customers do not exercise all of their contractual rights (i.e. breakage). This may affect take or pay arrangements in which customers may not take all of the output to which they are entitled.
- Under IFRS 15, if an entity expects to be entitled to breakage, it recognises the estimated breakage amount as revenue in proportion to the pattern of rights exercised by the customer. Otherwise, breakage is recognised as revenue only when the likelihood of the customer exercising its rights becomes remote. This may change the timing of breakage revenue recognised.

Actions to consider

- Review the contractual terms and business practices relating to take or pay arrangements and assess the implications on accounting and financial reporting.
- Develop accounting procedures needed to determine the treatment of breakage in take or pay arrangements.
- Develop processes, systems and internal controls needed to identify and report take or pay arrangements and their key features.

Non-monetary exchanges

Potential impact

- IFRS 15 explicitly excludes from its scope non-monetary exchanges between entities in the same line of business to facilitate sales to potential customers.
- As a consequence, these exchanges may not result in the recognition of revenues and costs for the amounts exchanged – revenue will only be recognised to the extent that the counterparty is a customer.

Actions to consider

- Review non-monetary exchange arrangements to determine if they qualify for revenue accounting under IFRS 15.
- Determine whether process and system changes are required to identify and report exchange arrangements and their key features.

Contract modifications

Potential impact

- IFRS 15 introduces new guidance on contract modifications. Contract modifications are accounted for either prospectively or by a cumulative-catch adjustment depending on whether distinct goods or services are added to the arrangement and, if so, whether those goods and services are priced at their stand-alone selling price.

Actions to consider

- Identify types of contract modifications that are customary for the business and determine whether they will require prospective or cumulative catch-up accounting.
- Develop accounting procedures to ensure consistency of application.
- Develop systems and internal controls to track modifications and methodology to ensure appropriate application of the new standard.

Contract costs

Potential impact

- Under IFRS 15, an entity is required to capitalise certain costs incurred in obtaining a contract and, if specified criteria are met, of fulfilling a contract. This will include capitalisation of sales commissions payable when a contract is obtained unless the practical expedient is applicable and elected by the entity.
- Capitalised costs are amortised on a systematic basis consistent with the transfer of the associated goods and services, and will be subject to impairment.
- Judgement will be needed to assess which costs should be capitalised and to determine the appropriate period and pattern of amortisation, e.g. whether the amortisation period should include anticipated contracts with the same customer.

Actions to consider

- Review typical contract costs against the new capitalisation criteria and determine whether the timing of cost recognition will change.
- Assess whether systems and internal controls are capable of identifying and tracking costs against individual contracts, including anticipated future contracts if relevant, and subsequently amortising over an appropriate period.

Variable consideration

Potential impact

- Variable consideration is included in the transaction price to the extent it is highly probable that there will be no significant reversal of the cumulative amount of revenue when any pricing uncertainty is resolved. This may include, for example, estimates of the price of unbilled energy supplied to customers and retrospective price adjustments.
- This may require additional judgement to determine the appropriate amount of variable consideration to recognise as revenue.

Actions to consider

- Identify contracts involving variable consideration and assess the implications for accounting and financial reporting.
- Develop processes, adjust systems and internal controls to capture, report, monitor and reassess contracts with variable consideration and underlying features.

Contracts with multiple goods and services

Potential impact

- IFRS 15 includes detailed new requirements on how to determine whether the various goods and services promised in a contract are distinct and so accounted for as separate performance obligations.
- If separate performance obligations are identified, then the total transaction price is allocated to each performance obligation based on the relative stand-alone selling prices of the goods and services.
- This may affect, for example, arrangements in which the sale of multiple commodities is included in the same agreement.

Actions to consider

- Develop new processes and adjust systems and internal controls to capture, estimate and monitor stand-alone selling prices to allocate the transaction price to the performance obligations in the contract.
- Assess whether billing management and related systems and internal controls are capable of supporting the allocation methodology and generation of journals to allocate revenue.

New disclosures

Potential impact

- Extensive new disclosures are required, incorporating both qualitative and quantitative information. There are no exemptions for commercially sensitive information.
- Stakeholders and competitors may take a close interest in the new disclosures related to unsatisfied performance obligations which convey information about future activity.

Actions to consider

- Perform an initial assessment of whether existing systems and processes can collect the necessary data required to provide the new disclosures.

Transition options¹

Potential impact

- IFRS 15 may be adopted retrospectively, by restating comparatives and adjusting retained earnings at the beginning of the comparative period.
- Alternatively, IFRS 15 may be adopted as of the application date, by adjusting retained earnings at the beginning of the first reporting year (the cumulative effect approach).

Actions to consider

- Quantify and evaluate the effects of the different transition options, including the available practical expedients under the retrospective approach.
- Perform a historical analysis of key contracts. Consider whether existing systems provide the data required to produce comparative information if the new standard is applied retrospectively.

The KPMG Global Energy Institute (GEI)

Launched in 2007, the GEI is a worldwide knowledge-sharing forum on current and emerging industry issues. This vehicle for accessing thought leadership, events, webcasts and surveys about key industry topics and trends provides a way for you to share your perspectives on the challenges and opportunities facing the energy industry – arming you with

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1. You can find more detailed information about IFRS 15 in our publications *Transition to the new revenue standard* and *Issues In-Depth*.



KPMG can help



A robust assessment phase is critical to laying the framework for a successful project, and it is important to start the assessment early to provide flexibility during the implementation phase. An assessment phase typically includes the following activities:

Activities	Actions	Deliverables
Accounting diagnostic	<ul style="list-style-type: none"> Identify potential gaps to accounting policy and disclosures by reviewing current accounting policy and sample of contracts Leverage your existing documents and knowledge 	Gap matrix, heat map and contract review summaries
Process and information gap analysis	<ul style="list-style-type: none"> Identify new information and process requirements Trace requirements to existing sources or identify gaps 	Business requirements document, process and information gap analysis report
Technology and broader impact evaluation	<ul style="list-style-type: none"> Identify potential impact on IT, tax, controls, operations, FP&A, investor relations, etc. Identify gaps and linkages across the organisation 	Final gap matrix and heat map, implementation roadmap
Transition option assessment	<ul style="list-style-type: none"> Determine how each option may impact financials and business Assess readiness to elect the retrospective or cumulative effect option 	Transition option assessment report

KPMG's Energy & Natural Resources practice

KPMG's Energy & Natural Resources practice is dedicated to supporting power and utilities companies globally in understanding industry trends and business issues. Member firms offer customised, industry-tailored services that can lead to value-added assistance for your most pressing business requirements. Our extensive network of professionals combines in-depth industry knowledge with extensive experience helping clients managing accounting transitions with what they entail.

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