The real effects of the new revenue accounting standard

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Aims of this presentation

• To outline a framework for studying the effects and consequences of new, and amended, accounting regulations and standards

• To apply the framework to examine a specific accounting change – the implementation of IFRS 15 *Revenue from Contracts with Customers*

• To discuss future directions for research into accounting for revenues from contracts with customers
Our framework

New or amended accounting standard

[A] Accounting effects
- [A.1] Recognition changes
- [A.2] Measurement changes
- [A.3] Presentation changes
- [A.4] Disclosure changes

[I] Information effects
- [I.1] Internal users’ understanding of transactions
- [I.2] External users’ understanding of transactions
- [I.3] Communication of effects to stakeholders

[C] Capital market effects
- [C.1] Equity market effects
- [C.2] Debt market effects
- [C.3] Pressure to maintain/improve performance and financial position

[R] Real effects
- [R.1] Implementation and application costs
- [R.2] Contractual changes
- [R.3] Behavioural effects
- [R.4] Regulatory effects
- [R.5] Tax and dividend effects
- [R.6] Other real effects

Direct accounting effects

Additional effects (including indirect accounting effects)
Sources for empirical material

• **Annual reports** of constituent companies of the STOXX Europe 50 index as at 31 December 2018

• **Comment letters** of STOXX Europe 50 companies relating to the IASB’s 2011 revenue exposure draft (ED/2011/6)

• **Interviews** with:
  • A preparer
  • An advisor on implementing IFRS 15
  • An auditor
Our sample – STOXX Europe 50
Recognition and measurement changes were analysed by reference to changes in reported numbers:

- Change in **retained earnings** as a percentage of shareholders’ equity (ΔRE – absolute value ignoring sign)
- Change in **reported revenue** from IAS 11/18 to IFRS 15, as a percentage of the 2018 reported revenue on IFRS 15 basis (ΔR – absolute value ignoring sign)
- Change in **reported profit** from IAS 11/18 to IFRS 15, as a percentage of the 2018 reported profit on IFRS 15 basis (ΔP – absolute value ignoring sign)
### Recognition and measurement changes – II

<table>
<thead>
<tr>
<th></th>
<th>Mean</th>
<th>Median</th>
<th>Min</th>
<th>Max</th>
<th>#Δ&gt;0</th>
<th>#Δ=0</th>
<th>#Δ&lt;0</th>
</tr>
</thead>
<tbody>
<tr>
<td>Company reports that effect is not material</td>
<td>48%</td>
<td></td>
<td></td>
<td></td>
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<td></td>
<td></td>
</tr>
<tr>
<td>(\Delta \text{ retained earnings} / \text{shareholders’ equity} ) [(\Delta \text{RE})]</td>
<td>1.88%</td>
<td>0.05%</td>
<td>0%</td>
<td>57.31%</td>
<td>11</td>
<td>17</td>
<td>20</td>
</tr>
<tr>
<td>(\Delta \text{RE}) excluding the company Airbus</td>
<td>0.70%</td>
<td>0.05%</td>
<td>0%</td>
<td>11.55%</td>
<td>11</td>
<td>17</td>
<td>19</td>
</tr>
<tr>
<td>Effect ((\Delta \text{RE})) &gt;1%</td>
<td></td>
<td>13%</td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>(\Delta \text{ revenue} / \text{revenue} ) [(\Delta \text{R})]</td>
<td>0.72%</td>
<td>0%</td>
<td>0%</td>
<td>13.12%</td>
<td>5</td>
<td>33</td>
<td>10</td>
</tr>
<tr>
<td>Effect ((\Delta \text{R})) &gt;1%</td>
<td></td>
<td>13%</td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>(\Delta \text{ profit} / \text{revenue} ) [(\Delta \text{P})]</td>
<td>0.16%</td>
<td>0%</td>
<td>0%</td>
<td>1.61%</td>
<td>4</td>
<td>38</td>
<td>6</td>
</tr>
<tr>
<td>Effect ((\Delta \text{P})) &gt;1%</td>
<td></td>
<td>8%</td>
<td></td>
<td></td>
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</tbody>
</table>
Disclosure changes – I

• Only 38% of companies provided a separate revenue note:
  • This was an increase on the prior year, when only 25% of companies included a separate note on revenue
  • IFRS 15 disclosures often included in the segment reporting note
  • On average, the revenue note for 2018 took up ¾ of a page, compared to ¼ of a page in the prior year
  • Longest revenue note took up 6 pages
  • Only 1 company – Reckitt Benckiser – reduced disclosure, but this was the effect of a change in definition of operating segments
Disclosure changes – II

• Some comment letters criticised the increase in disclosure:
  • BP raised the issue of how IFRS 15 disclosures interacted with segment information disclosed under IFRS 8

• Interviewees had mixed views about the increase in disclosure:
  • ‘Most people would say that revenue disclosures were generally poor. The intention was that IFRS 15 would give users a lot more information. I think we’re probably only about 60% of the way there in year one and I think year two should show some further improvement.’ [Auditor]
  • ‘Some of the additional disclosures are a waste of time’ [Preparer]
• EADS (now Airbus) saw the additional IFRS 15 disclosures as:
  • ‘An “accounting-only” exercise that will divert our limited internal resources away from other financial reporting areas that we consider to be of more interest to users.’
Real effects – Implementation costs

• **Implementation costs** involved both internal staff resources and external advisory services, often as a three-stage process:
  • Initial impact assessment
  • Technical implementation (detailed study of how IFRS 15 affected the recognition and measurement of the business’s revenue)
  • Practical implementation (updating existing accounting information systems and developing new systems to provide the information required by IFRS 15)

• In its comment letter, Deutsche Telekom claimed that the costs would be ‘at least hundreds of millions of Euros’
• **Contractual changes:**
  Interviewees thought that any changes to contracts would be marginal: if contracts made commercial sense, it would not be appropriate to change them dramatically merely to make it easier to apply IFRS 15

• **Behavioural effects:**
  Interviewees thought that marketing departments would have to change their practices regarding sales incentives that would give rise to additional performance obligations
Directions for future research – I

• Revenue is an under-researched area in accounting

• Number of papers in “accounting” journals that include:

<table>
<thead>
<tr>
<th></th>
<th>revenue</th>
<th>earnings</th>
</tr>
</thead>
<tbody>
<tr>
<td>in the title</td>
<td>139</td>
<td>2,919</td>
</tr>
<tr>
<td>in the keywords</td>
<td>129</td>
<td>2,447</td>
</tr>
<tr>
<td>in the abstract</td>
<td>890</td>
<td>5,156</td>
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</tbody>
</table>

• Source: Scopus (19 October 2020)

• “accounting” journals are journals that include “accounting” in the title
### Directions for future research – II

<table>
<thead>
<tr>
<th>Area</th>
<th>Our research</th>
<th>Possible future research</th>
</tr>
</thead>
<tbody>
<tr>
<td>Accounting effects: recognition &amp; measurement</td>
<td>48 firms and one year</td>
<td>Analyse whether changes have capital market effects, focusing on industries that were more affected</td>
</tr>
<tr>
<td>Accounting effects: disclosure</td>
<td>Quantity of 48 firms in two years</td>
<td>- Quantity using a larger sample, more years and more detailed scoring</td>
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<tr>
<td></td>
<td></td>
<td>- Quality</td>
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<tr>
<td>Information effects &amp; real effects</td>
<td>Three interviews (preparer, advisor and auditor)</td>
<td>Interviews with users (e.g. analysts)</td>
</tr>
<tr>
<td>Capital market effects</td>
<td>Not investigated</td>
<td>Effect on analyst forecasts</td>
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