IFRS 15: REVENUE FROM CONTRACTS WITH CUSTOMERS – TRANSITION ARRANGEMENTS FOR SHIPPING

With the introduction of the new accounting standard IFRS 15, how to incorporate the changes that arise from its initial application may give rise to issues which can be very challenging.

This is something that shipping companies will have to consider. This can involve:

- technical problems, arising from the application of a new standard to previous transactions
- practical challenges in being able to identify which transactions and balances the standard will apply to and obtaining the information needed to actually determine the effect of any change
- existing bookkeeping systems and processes might simply not be set up to obtain the information needed.

In recognition of this, new accounting standards often have transition exemptions that attempt to strike a balance between the pure application of a change and the cost of making any change with the benefit from the improved standard. IFRS 15 is no different in this respect.

Two methods are available for the initial application of IFRS 15:

- retrospective, with some limited expedients, or
- cumulative catch-up.

RETROSPECTIVE

Where the retrospective approach is taken, the changes should be applied to all periods presented, together with a cumulative djustment to the opening statement of financial position for the effect on periods prior to the start of the earliest period.

For an accounting period starting on 1 January 2018, this would mean that the amounts reported for the year ended 31 December 2017 would need to be restated for the changes, with a cumulative adjustment processed as at 1 January 2017, for periods prior to this date.

Practical expedients

To ease this, there are four practical expedients for shipping companies to consider:

1. For completed contracts or voyage charters for example, being a contract where all the services promised under the contract have been transferred, there is no need to restate those contracts which begin and end in the same period, or which are completed at the beginning of the earliest period presented.
2. For completed contracts with variable consideration, the accounting may use the amount at the date the contract was completed and not estimate amounts for the comparative period.
3. Modifications to contracts before the start of the earliest comparative period may be treated in aggregate with the contract when identifying performance obligations, determining the amount to be accounted for and the allocation of the contract price between satisfied and unsatisfied performance obligations.
4. The price allocated to remaining performance obligations and when those obligations are expected to be satisfied does not need to be disclosed for prior periods. As this disclosure applies to contracts with more than twelve months to run, it is only long-term charters that are likely to be caught, and so this expedient may have limited benefit.

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The expedients are intended to assist a preparer by removing the need to make assumptions that can arise during the life of a contractual arrangement that cannot easily be recreated without the use of hindsight.

Although these expedients may ease transition, they are only for completed contracts. For those contracts that are not completed, the "full" requirements of the standard must be complied with. It remains adecision for the shipping entity as to whether it is easier to look at all contracts or whether they need to separate contracts between completed and uncompleted and to then apply a different model to each to determine the amount of any retrospective adjustments.

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CUMULATIVE CATCH-UP

The alternative method permitted by IFRS 15 is still a retrospective approach, but with a fundamental difference to a "typical" retrospective approach. This approach could be described as a modified retrospective approach as it still requires an assessment of contracts or charters prior to the date of initial application, although modified retrospective itself is not a term to be found in IFRS 15.

Comparatives not restated

Under the cumulative catch-up approach, IFRS 15 is still applied retrospectively, but the cumulative effect is recognised as an adjustment at the date of initially applying the standard. For an entity with a 31 December year end, the date of initial application will be 1 January 2018. As the adjustment is made to the financial position at the start of the first period when IFRS 15 is applied, this means that comparatives are not restated.

This may be an attractive option for shipping companies, but it will reduce the comparability of the two periods, especially if application of IFRS 15 leads to a step change in revenue recognition. To assist users of shipping financial statements with this, disclosure must be given of:

- The amount by which each line in the financial statements is affected in the current year
- An explanation of the reason for significant changes.

Current year impact

To determine these disclosures, a shipping company must prepare its revenue and related figures under both IFRS 15 and its previous accounting policies. A preparer of financial statements therefore has a choice to decide which transition basis may be the most straightforward or informative for its shareholders and other stakeholders.

As with the retrospective approach, an entity may adopt some, or all, of the following practical expedients:

- IFRS 15 is only applied to contracts or charters that are not completed as at the date of initially applying the standard, which in many instances will be 1 January 2018
- Contract modifications may be aggregated with the original contract.

This may be applied either to contract modifications that occur before the beginning of the earliest period presented, typically the single comparative period, or to contract modifications that arise before the date of initial application. If contract modifications that occur before the start of the earliest period is opted for, the effect of those modifications are still only accounted for as at the date of initial application.

The cumulative catch-up approach will still require separation of contracts or charters between those which are completed by the date of initial application, from those that are not.

The contract modification expedient adds a further point of contract identification if this is applied to the start of the earliest period presented rather than to date of initial application.

Practical example

A simple example can best illustrate the differences between the approaches, see table below. A vessel owner enters into a time charter to provide a vessel to be used between two specific ports, on a regular service, over three years at an amount of $3m per year. In order to provide the service, the vessel must be modified, for which the charterer agrees to pay the vessel owner $6m. Under IAS 18 (Revenue), the vessel owner treated the two items separately, recognising the $6m in year one and $3m in each year. Under IFRS 15 the vessel modification is not considered a separate performance obligation and is included as part of the transaction price for a single performance obligation.

Comparing the pre-IFRS 15 approach with the transition options will give the following reported revenue:

Approach applied	Year ended 31 Dec 2016	Year ended 31 Dec 2017	Year ended 31 Dec 2018	Equity adjustment	Date of equity adjustment
	$m	$m	$m	$m	
IAS 18	9	3	3	n/a	
IFRS 15: Retrospective	5	5	5	(4)	1 Jan 2017
IFRS 15: Cumulative catch up	9	3	5	(2)	1 Jan 2018

In addition to the above reported revenue in the income statement, under the cumulative catch-up approach, disclosure would need to be made of the revenue that would have been recognised in 2018 under the pre-IFRS 15 requirements, this being $3m.

Under cumulative catch-up, the total amount reported in the financial statements over the contract duration can differ from the contract total. The example above illustrates this with cumulative reported revenue of $17m. Where revenue under pre-IFRS 15 is 'back loaded', the revenue reported could be lower than the contracted amount.

Although IFRS 15 provides two methods for transition, one which does not restate the 2017 figures when they become 2018 comparatives, preparers should not defer considering how they will transition.

An understanding now of the effect of IFRS 15 and the different impact of the two transition methods is required. Each should be examined to determine which may be preferred

Management of the process will be easier when you are in control:
plan –compute – compare – choose.

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