IFRS 15 Thematic Review:

Review of Disclosures in the First Year of Application

October 2019

FRC Financial Reporting Council

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Executive Summary

Introduction

This report summarises the key findings of our thematic review of a sample of Annual Reports and Accounts applying IFRS 15 'Revenue from Contracts with Customers' for the first time. We assessed the comprehensiveness and quality of revenue disclosures against IFRS 15 requirements. In particular, we considered those matters which had given cause for concern in our earlier review of a sample of 2018 interim reports, the findings from which were published in November 2018.

Where the impact of adopting IFRS 15 was reported as not being material, we still considered whether significant judgements made in reaching this conclusion had been adequately disclosed and whether the accounting policies and disclosures reflected the new requirements.

The aim of this report is to identify those areas where revenue-related disclosures can be improved. Alongside our key findings we have provided examples which demonstrate the level of detail provided by better disclosures. As stated in our review of interim disclosures, the best disclosures gave information over and above that required by the standard, providing users with a clear understanding of the impact of IFRS 15.

Key findings

We found most of the companies sampled provided sufficient information to enable users to understand the impact of adopting IFRS 15. Generally, companies included helpful company-specific explanations and disclosures covering various aspects of their accounts affected by IFRS 15. We were particularly pleased that all five companies identified from our review of interim reports as having specific areas for improvement provided enhanced revenue disclosures in their year-end accounts.

However, there was room for improvement by all companies – even those where examples of good disclosure are highlighted within this thematic report.

There is scope to improve explanations of accounting policies for revenue recognition such as the specific nature of performance obligations and when they are satisfied, including whether a company is acting as agent in providing any goods and services.

The link between policies and information in the segmental reporting note and strategic report was sometimes not clear.

Information about significant judgements relating to revenue was variable. Some disclosures appeared to list all judgements involved in accounting for revenue rather than those having a significant effect on the amount and timing of revenue recognition. Descriptions often lacked clarity about the specific judgements made. Quantitative disclosure, such as sensitivities or ranges of potential outcomes, were often not provided for judgements involving estimation uncertainty.

We observed more comprehensive disclosures about the balance sheet impact of adopting IFRS 15 in the year end accounts compared to our review of interim accounts. However, some accounts we reviewed made no reference to costs to obtain or fulfil a contract which, in some instances, was surprising given the companies' activities.

Many companies disaggregated the transition adjustment by category of impact, explaining the changes by referring to changes in the accounting policies or methods arising from implementing the new standard. However, it was disappointing that some companies sampled did not provide a quantitative breakdown of the transition adjustment.

In general, companies adopting the modified retrospective approach sufficiently addressed the lack of comparability between the current year revenue prepared under IFRS 15 and prior year revenue prepared under the previous standard. Many companies put in particular effort to ensure that meaningful 'like for like' comparisons were clearly made.

Thematic overview: Scope and sample

Scope of our review

We performed a desktop review of the annual reports and accounts of companies applying IFRS 15 'Revenue from Contracts with Customers' for the first time. In particular, we focused on those matters which had given cause for concern in the FRC's earlier review of a sample of 2018 interim reports. We reported our findings from the review of interim disclosures in November 2018 so that preparers could address the issues raised in their full year accounts.

In this review, we assessed the comprehensiveness and quality of revenue disclosures against IFRS 15 requirements. We evaluated whether there was sufficient information provided in the full-year accounts to enable a user to understand the impact of adopting IFRS 15. We focused on:

- Disclosures explaining the transition to IFRS 15;
- Accounting policy descriptions;
- Judgements in determining the amount and timing of revenue to be recognised;
- Revenue disaggregation; and
- The impact on the balance sheet.

Where the impact of adopting IFRS 15 was reported as not being material, we still considered whether information about judgements made in reaching this conclusion was adequate and whether the accounting policies and related disclosures reflected the new requirements.

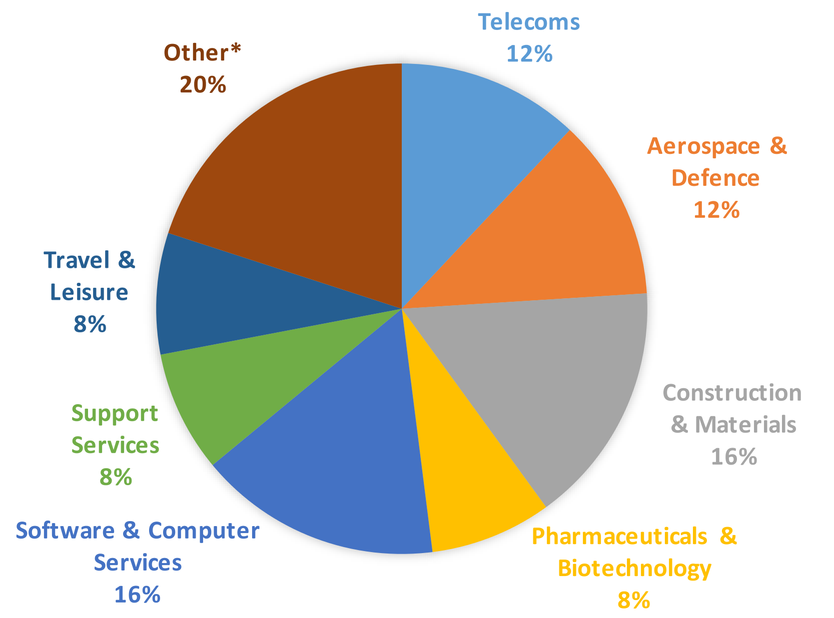
In line with our objective of achieving continuous improvement in reporting, we have identified examples of better practice. These examples are provided alongside our key findings and demonstrate the level of detail, both entity and industry-specific, provided by better disclosures.

Our sample

We reviewed the full-year accounts of a sample of 25 entities. No companies in the sample adopted IFRS 15 early. Six companies were pre-informed of our review. Five of these were identified from our review of interim disclosures as having specific areas for improvement. In relation to the sixth company, we anticipated that management would need to reconsider aspects of its revenue accounting upon adoption of IFRS 15 in the light of a recent FRC review of the company's prior year accounts.

Our sample targeted those industries on which we would expect the implementation of IFRS 15 to have the most significant impact. As a result, our sample was skewed towards the telecommunications, construction, aerospace & defence and software industries.

Industries sampled



* Includes media, utilities, real estate.

Key findings: Transition to IFRS 15

Generally companies sufficiently explained the impact of adopting IFRS 15, but disclosure by some companies was much clearer and more helpful than others.

We observed the following areas of good practice:

- ✓ Disclosure of the transition method adopted.
- ✓ Quantification of the transition adjustment posted to retained earnings disaggregated by categories of impact and by financial statement line item.
- ✓ Explanation of the transition adjustment by category of impact (e.g. principal/agency considerations, timing of recognition, change in percentage of completion method, costs capitalised) referenced to changes in the accounting policies or methods arising from implementing the new standard.
- ✓ Where the modified retrospective method was adopted
  - Disclosure of current year results under previous IFRS, in addition to those presented under IFRS 15, providing users with useful trend information and
  - Clarification that revenue was determined under IFRS 15 in the current period and previous IFRS in the prior period which impacted the comparability of information.
- ✓ Explanation of the transition 'journey' - specifically, any changes in the entity's assessment of the impact of IFRS 15 previously reported.

However, we continued to identify incomplete disclosures in certain areas. Few companies who adopted the fully retrospective method disclosed the impact of transition on the comparative period's earnings per share despite this requirement being referred to in our IFRS 15 thematic review of interim disclosures. Some companies adopting the modified retrospective approach did not disclose the previous accounting policy.

Where the impact of applying IFRS 15 was material, the transition adjustment tended to be caused by a number of factors. Companies generally gave a quantitative break down of the impact. Disappointingly, however, while all the telecommunications companies sampled described the primary impacts of adopting IFRS 15, none provided a quantitative breakdown of the adjustment.

Companies who adopted the modified retrospective approach:

- Generally addressed in their annual reports the lack of comparability between current and prior year revenue figures when the impact was material.
- Some rationalised year on year movements in total/divisional revenue by including the impact of IFRS 15 as a reconciling item. Others focused their discussion of performance on current year revenue prepared under previous IFRS to ensure there was meaningful comparison year on year.

However, some companies did not make clear the impact of IFRS 15 on other financial statement line items. For example, where the impact of IFRS 15 on profit after tax caused the movement on prior year to change from a decrease (had the current year results been prepared under previous IFRS) to an increase, this fact was not highlighted.

Following further review, one company reported that it had changed its preliminary assessment and that revenue from certain contracts would continue to be accounted for on a gross basis. However, while referring to the agent/principal assessment being "a finely balanced judgement" it did not disclose the results of its analysis of the contractual terms and conditions which enabled management to conclude it was acting as a principal.

Key findings: Transition to IFRS 15 (continued)

Examples of good disclosure…

Aveva Group Plc, which adopted the fully retrospective method in its **2019 Annual Report and Accounts**, helpfully provided the following format showing the transition adjustment by category of impact and the effect on each financial statement line item in the prior period.

The group adopted IFRS 15 using the full retrospective method of adoption. In summary, the following adjustments were made to the amounts recognised in the primary statements: (i) Rendering of services – transfer of control (ii) Providing extended payment terms to customers (iii) Stand-alone selling prices.

Impact on balance sheet as at 31 March 2018	£m	IFRS 15 (i) £m	IFRS 15 (ii) £m	IFRS 15 (iii) £m	Restated £m
Non-current assets - Goodwill	1,287.6	-	(0.8)	(3.3)	1,283.5
Current assets - Contract assets	40.6	23.8	1.8	1.4	67.6
Current liabilities - Contract liabilities	(157.2)	16.0	(0.9)	0.4	(141.7)
Non-current liabilities - Deferred tax liabilities	(120.7)	(9.3)	(0.2)	(0.3)	(130.5)
Equity - Other reserves	(1,178.1)	(1.2)	(0.1)	-	(1,179.4)
Equity - Retained earnings	(167.7)	(29.3)	0.1	1.8	(195.1)

Due to the Combination being accounted for as a reverse acquisition, IFRS 15 adjustments that would ordinarily adjust equity in the year ended 31 March 2018 are divided between pre-acquisition and post-acquisition. The pre-acquisition element is accounted for as an adjustment to goodwill, the post acquisition element is adjusted to equity.

Contract assets recognised in relation to contracts with customers were previously presented as accrued income. Contract liabilities were previously presented as deferred revenue.

Impact on the income statement and statement of other comprehensive income Year ended 31 March 2018	£m	IFRS 15 (i) £m	IFRS 15 (ii) £m	IFRS 15 (iii) £m	Restated £m
Revenue	499.1	(10.4)	(0.1)	(2.3)	486.3
Selling and administration expenses	(181.8)	0.5	-	-	(181.3)
Income tax expense	0.8	4.7	-	0.5	6.0
Profit for the period		(5.2)	(0.1)	(1.8)	
Exchange differences on translation of foreign operations	(16.8)	1.2	0.1	-	(15.5)
Other comprehensive income for the period		1.2	0.1	-	
Total comprehensive income		(4.0)	0.0	(1.8)	

Impact on the cash flow statement Year ended 31 March 2018	£m	IFRS 15 (i) £m	IFRS 15 (ii) £m	IFRS 15 (iii) £m	Restated £m
Profit for the period	47.6	(5.2)	(0.1)	(1.8)	40.5
Income tax expense	(0.8)	(4.7)	-	(0.5)	(6.0)
Changes in working capital					
Contract assets	(34.0)	4.5	0.1	0.9	(28.5)
Contract liabilities	22.1	5.4	-	1.4	28.9
Net cash generated from operating activities					

Some explanation on changes to the accounting policies arising on adoption of IFRS 15 consistent with these three adjustments/categories was described in another note to the accounts.

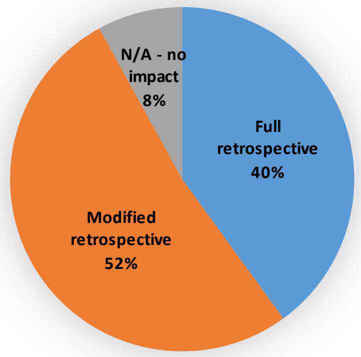
The impact of IFRS 15 on the cash flow statement was also provided giving better visibility of the movements in working capital.

The transition affect on the comparative period's EPS was disclosed.

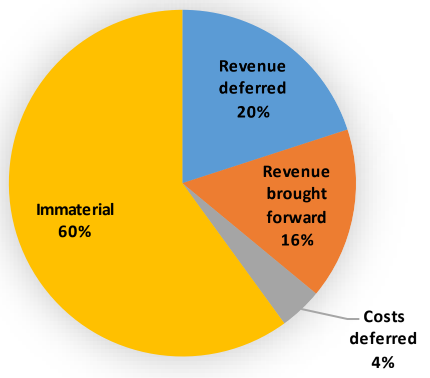
Impact on earnings per share Year ended 31 March 2018	pence	IFRS 15 pence	Restated pence
Earnings per share			
- basic	46.97	(7.05)	39.92
- diluted	46.73	(7.01)	39.72
Adjusted earnings per share			
- basic	78.83	(7.05)	71.78
- diluted	78.43	(7.01)	71.42

Key findings: Transition to IFRS 15 (continued)

Transition method adopted by companies sampled



Impact of transition reported by companies sampled



Method of transition

Marginally more companies in our sample adopted the modified retrospective method than the fully retrospective approach. Other than companies in the telecommunications sector, who all applied the modified retrospective approach, there was no clear preference in method of adoption by companies from the same industries. Two companies reported that on transition, IFRS 15 had no impact on their financial statements.

Impact of transition

The transition impact of adopting IFRS 15 was not material to nearly two thirds of the companies sampled. This was a little surprising given we selected companies from industries which we expected to be significantly impacted. Nevertheless, our review assessed the appropriateness of accounting policies under the new standard and that the disclosure requirements, such as information about significant judgements relating to revenue, had been satisfied.

For those companies where the transition adjustment was material, this was largely affected by either the deferral or acceleration of revenue. However, the transition impact was unique to each company, reflecting the variability in contract terms and performance obligations undertaken by the companies sampled.

Key findings: Accounting policies

Accounting policies for revenue were generally better explained under the new standard than the superseded standards. This was particularly true of companies outside of the FTSE 100 where previous policy descriptions had sometimes lacked detail. However, there is still considerable scope for improvement, especially by those entities who provided generic descriptions of the five-step model which underpins IFRS 15 without tailoring to their particular circumstances or continued to use boiler-plate descriptions and terminology from previous IFRS.

One company explained that where goods or services had a functional dependency, this did not, in isolation, prevent those goods or services from being assessed as separate performance obligations. Helpful information on the specific nature of the goods and services was provided. However, it was not clear what other factors impacted the company's evaluation of whether the promised goods or services were distinct nor the actual accounting treatment of the goods or services.

Accounting policies should clarify whether revenue is presented gross or net and explain how this conclusion was reached by reference to the indicators of control in IFRS 15.

Examples of good disclosure

"The amount of revenue recognised depends on whether we act as an agent or as a principal. The Group acts as principal when we control the specified good or service prior to transfer. When the Group acts as a principal the revenue recorded is the gross amount billed. Out-of-pocket costs such as travel are also recognised at the gross amount billed with a corresponding amount recorded as a direct cost. Certain other arrangements with our clients are such that our responsibility is to arrange for a third party to provide a specified good or service to the client. In these cases, we are acting as an agent and we do not control the relevant good or service before it is transferred to the client. When the Group is acting as an agent, the revenue is recorded at the net amount retained."

Next Fifteen Communications Group plc 2019 AR&A

Good revenue policies had the following attributes

- Clearly described their performance obligations - i.e. the specific nature of the goods and services that the company had promised to transfer. This included explanation of whether goods and services had been combined to create a distinct bundle.
- Highlighted any performance obligation to arrange for another party to transfer goods and services – i.e. whether it was acting as an agent.
- Provided clear linkage between accounting policy disclosures of performance obligations with both information in the segmental revenue note and with information in the strategic report.

One company stated that it bundled services into a single performance obligation but gave no indication of the nature of these services.

Examples of good disclosure

"Customer option that provides a material right – Free goods
Free goods are issued to customers as sale incentives. Under IFRS 15 an option to acquire additional goods or services gives rise to a separate performance obligation, if the option provides a material right that the customer would not receive without entering into that contract. IFRS 15 requires management to estimate the transaction price to be allocated to the separate performance obligations and to recognise a contract liability for the performance obligations that will be satisfied in the future. The Group recognises revenue for the option when those future goods or services are transferred to the customer.

Hikma Pharmaceuticals PLC 2018 AR&A

It should be clear what revenue policies are applied to the different business segments which are described in the strategic report and in the segmental note. For some companies it was not readily apparent how these related.

Key findings: Accounting policies (continued)

Performance obligations are satisfied over time, and revenue recognised over time, when either:

- the customer simultaneously receives and consumes the benefits from the entity's performance;
- the entity's performance creates or enhances an asset the customer controls; or
- the entity's performance does not create an asset with alternative use and the entity has enforceable right to payment (including reasonable profit margin) for performance completed to date.

One company explained that for some programme specific products, markets might not be sufficiently mature to offer an alternative use. In these circumstances, where there is also a right to payment at all times, revenue is recognised over time based on a percentage completion basis. We think it is also helpful to clarify that this right to payment incorporates a reasonable profit margin.

Examples of good disclosure…

"Revenue – Managed Services
The Group sells maintenance, support and management of customers' IT infrastructures and operations. Managed Services revenue is recognised over time, throughout the term of the contract, as services are delivered. The specific performance obligations and invoicing conditions in our Managed Services contracts are typically related to the number of calls, interventions or users that we manage and therefore the customer simultaneously receives and consumes the benefits of the services as they are performed. Revenue is recognised based on monthly invoiced amounts as this corresponds to the service delivered to the customer and the satisfaction of the Company's performance obligations."

Computacenter plc 2018 AR&A

Good revenue policies had the following attributes

- ✓ For performance obligations satisfied over time, better disclosures made clear which of the three criteria under IFRS 15 had been met and provided details of the input or output method adopted to measure progress and why this was appropriate.
- ✓ For performance obligations satisfied at a point in time better disclosures detailed the **point at which control was transferred** and revenue recognised.
- ✓ Descriptions of significant payment terms including detail of variable consideration or significant financing components.

Disclosures about the existence of a significant financing component were limited, possibly because it was not relevant to the companies selected. Where users might expect there to be a significant interval between revenue recognition and payment, due to the nature of the business, we encourage companies to explain why there is no significant financing component.

We encourage companies that apply certain output methods such as "milestones met" to carefully explain why these methods result in the best depiction of performance towards complete satisfaction of a performance obligation. We may challenge companies with significant amounts of work in progress recorded in inventory (in respect of performance obligations satisfied over time) as this may indicate that the method used to measure progress is inconsistent with the pattern of delivery of the performance obligation.

For revenue recognised at a point in time, one company listed four circumstances as to when control of the goods or services might pass to the customer, such as at the point of delivery or when the customer obtained legal title to the asset. We would expect the accounting policy to clarify, by type of performance obligation, which circumstance generally applied and why.

One pharmaceutical company had helpfully described key elements of variable consideration impacting revenue, including provisions for chargebacks, returns, rebates and price adjustments.

Examples of good disclosure…

"Transfer of control – At a point in time
Goods supplied subject to customer acceptance. Within the aerospace industry goods are frequently subject to customer acceptance testing on delivery, or at the Group's facilities. Normally the Group is able, through its own testing procedures, to predict with reasonable certainty that acceptance testing will be successful and accordingly acceptance testing will not affect the determination of when control passes. Where however the Group cannot predict the outcome with reasonable certainty, control is not considered to transfer until the goods have been accepted by the customer.

Meggitt PLC 2018 AR&A*

* Not one of the 25 companies selected for review

Key findings: Accounting policies (continued)

Other findings

Contract variations and claims

We found some references to variations and claims confusing. It was sometimes unclear whether the issue was simply about variable consideration (e.g. claims, incentives and penalties) enforceable under the existing terms of the contract or was related to contract modifications. Variations in the transaction price, such as those arising from **agreed but unpriced** change orders or penalties for delays, should be accounted for as variable consideration and the transaction price constrained to the extent that it is highly probable that a significant reversal in the amount of cumulative revenue recognised will not occur. In contrast contract modifications (which paragraph 18 of IFRS 15 states in some industries and jurisdictions are described as a change order, a variation or amendment) should only be accounted for once they have been **approved** by the parties to the contract.

Variable consideration

The extent of disclosures about variable consideration was disappointing, particularly as this pricing feature (e.g. bonuses, penalties and claims) will be relevant to many companies. Helpful policies detailed the nature of variable consideration and described how it was measured (see example on page 12).

Significant judgements made in assessing whether estimates of variable consideration should be constrained should also be disclosed. Under IFRS 15, variable consideration is only recognised to the extent that it is highly probable that a significant reversal in the cumulative revenue recognised will not occur when the associated uncertainty with the variable consideration is subsequently resolved. Some companies that tried to adapt this wording and explain this in a more straightforward manner (which we would generally welcome) ended up with wording that was no longer consistent with the standard. For example this threshold is not at all the same as saying that “revenue which is highly probable to reverse is not recognised”!

We advise companies to be very careful when both applying and describing this constraint. In particular, we expect companies to explain how in practice they assess when this threshold is met.

Key findings: Accounting policies (continued)

Other findings (continued)

Licences

Companies could have provided clearer explanation, with justification, for the accounting for such arrangements. The new guidance is complicated and many companies have had to reassess their accounting practice in this area. Where licences of intellectual property are granted to customers, users benefit from accounting policy descriptions that articulate the basis for concluding whether or not the licence is distinct from other promised goods or services such as installation services and software updates. For licences that are distinct performance obligations, we expect disclosures to address whether the licence transfers to the customer at a point in time (termed "right to use") or over time (termed "right to access") and provide explanations for their conclusions.

Specific policies

We were pleased to see that many of the companies sampled disclosed specific policies tailored to their individual circumstances. However, it was not always clear exactly how the specific policies complied with the accounting requirements of IFRS 15. For example, one company selected for rotational review (i.e. not part of the thematic sample) explained that revenue from the rendering of services is generally recognised on completion if the service is short-term in nature. Where this is not the case, revenue from services is recognised in proportion to the stage of completion of the performance obligations at the balance sheet date. However the company did not describe the nature and terms of these contractual arrangements which, in the context of the guidance within the standard, led to the difference in timing of revenue recognition between short and long term contracts.

In addition, in some cases, accounting policies were missing in areas where we might have expected them to be relevant based on the nature of the company's operations. For example, the absence of an accounting policy for warranties by a construction company.

Key findings: Disclosure of significant judgements

Significant judgements made in applying IFRS 15 that affect the amount and timing of revenue recognition should be clearly explained and company specific.

Examples of good disclosure…

"Performance obligations: Judgement is applied in determining how many performance obligations there are within each contract and whether the development phase represents a separate obligation. In most cases, the development phase is not considered to be distinct as the customer does not benefit from the development activities alone. It is instead combined with the early contracted production phases such as low rate initial production (LRIP) which are considered a key part of the development cycle."

Cobham plc 2018 AR&A

Examples of good disclosure…

"At 31 December 2018, deferred revenue relating to the loyalty programme was $1,181m (2017: $1,057m). Based on the conditions existing at the balance sheet date, a one percentage point decrease in the breakage estimate relating to outstanding points would increase this liability by approximately $14m."

InterContinental Hotels Group plc 2018 AR&A

The main issues identified were:

- Disclosure of all judgements rather than those having **a significant affect** on the amount and timing of revenue recognised.
- Some descriptions lacked clarity about the specific judgements made.
- The omission of disclosures by a few companies in industries where we might expect there to be significant judgements.
- Few companies explained why the method used to recognise revenue over time provided a faithful depiction of the transfer of goods or services.
- Where the judgements involved estimation uncertainty quantitative disclosure, such as sensitivities or ranges of potential outcomes, was not always provided.

For example, one company disclosed that judgement was applied in determining whether revenue was recognised over time or at a point in time but did not detail its evaluation of when the customer obtained control of the goods or services transferred.

For example, variable consideration is common across many industries. Companies should disclose the method used to estimate variable consideration and the significant judgements in assessing whether the revenue should be constrained.

IAS 1.129 provides examples of the types of quantitative disclosure that is necessary to provide meaningful information about judgements involving key estimation uncertainty. We expect such quantification to be provided.

Examples of good disclosure…

"Variable consideration, such as price or scope amendments, is included based on the expected value or most likely amount. A constraint is included unless it is highly probable that the revenue will not significantly reverse in the future. This constraint is calculated based on a cautious expectation of the life of certain Risk and Revenue Sharing Partnerships and by assessing the impact of a 10% reduction in expected spares sales. Variations in contract work, claims and incentive payments are included in revenue from construction contracts based on an estimate of the expected value the Group expects to receive. Variations are included when the customer has agreed to the variation or acknowledged liability for the variation in principle."

Melrose Industries plc 2018 AR&A

When a contract with a customer includes a software licence, which is recognised on delivery, and support services, which are recognised over time, the allocation of the transaction price between performance obligations may significantly affect the timing and amount of revenue recognised. Disclosures should convey significant judgements made in determining the amounts allocated such as the method used to estimate the stand-alone selling price and why this is suitable and (if relevant) why discounts have been allocated to certain performance obligations rather than proportionately across all performance obligations. Helpful disclosures quantified the amount of revenue subject to significant judgement.

Key findings: Revenue disaggregation

IFRS 15 requires revenue from contracts with customers to be disaggregated into categories that depict how the nature, amount, timing and uncertainty of revenue and cash flows are affected by economic factors. Many companies we reviewed disaggregated revenue into categories, with the most commonly selected categories including type of market, type of good or service and timing of transfer of goods and services to the customer. Generally we considered the number and type of categories selected to be appropriate based on the company's specific circumstances.

Good disclosures also disaggregated the revenue for each of the reportable segments enabling users to clearly understand the relationship between the two types of data, a requirement of IFRS 15. This information was often concisely presented in a matrix format.

A few companies provided no additional disaggregated revenue information to their segment revenue disclosures which in some cases raised doubt over whether the disclosure objective had been met. For example, the sufficiency of disclosures was questionable where accounting policies indicated revenue was recognised both at a point in time and over time but revenue was not disaggregated on this basis.

Examples of good disclosure…

Revenue comprises income from the sale of goods and services during the year and can be analysed as follows:

£m	Communications and Connectivity	Mission Systems	Advanced Electronic Solutions	Aviation Services	Total 2018
External revenue by market					
US defence/security	43.1	195.0	471.6	-	709.7
UK, RoW defence/security	109.6	162.4	31.7	171.3	475.0
Commerical	398.4	45.3	91.3	143.6	678.6
	551.1	**402.7**	**594.6**	**314.9**	**1,863.3**
External revenue by customer geography					
USA	155.6	288.9	546.2	-	990.7
UK	35.2	21.5	7.7	78.5	142.9
Other EU	219.7	59.2	13.3	5.6	297.8
Australia	5.8	5.0	0.4	206.1	217.3
Asia	91.0	19.2	15.6	17.9	143.7
Rest of World	43.8	8.9	11.4	6.8	70.9
	551.1	**402.7**	**594.6**	**314.9**	**1,863.3**
External revenue by revenue recognition category					
Goods transferred at a point in time	485.3	346.7	339.5	-	1,171.5
Goods transferred over time	14.1	(11.3)	227.6	-	230.4
Services transferred over time	31.2	35.9	19.4	308.8	395.3
Services transferred at a point in time	20.5	31.4	8.1	6.1	66.1
	551.1	**402.7**	**594.6**	**314.9**	**1,863.3**

Cobham plc 2018 AR&A

As stated in our thematic review of interim disclosures, we would expect disaggregated revenue disclosures to be consistent with information provided outside of the financial statements. This includes information in the strategic report, such as the business model and divisional reviews, investor presentations and any other analysis of revenue used to assess performance or allocate resource. For example, where a consumer product business presents volumes sold by product line in the front half of the annual report, we would expect companies to consider whether disclosure of the corresponding revenue by product line is necessary in order to meet the disclosure objective. Categories (such as product lines, geographies, markets etc) with substantially different characteristics should not be aggregated if doing so obscures useful information.

Key findings: Contract balances

We observed more comprehensive disclosures about the balance sheet impact of adopting IFRS 15 in year-end accounts compared to our review of interim accounts.

We found most companies clearly disclosed the opening and closing balances for receivables, contract assets and contract liabilities from contracts with customers either in the primary statements or the notes to the accounts. Accounting policies for these balances were usually provided, although there is scope to improve the quality of explanations in the following areas:

- the difference between contract assets and trade receivables enabling users to understand the different risks associated with each balance; and
- how the timing of satisfaction of performance obligations relates to the typical timing of payment and the effect that those factors have on the contract asset and contract liability balances.

The extent of disclosures explaining significant changes in the contract asset and contract liability balances during the period varied, with the most informative fully reconciling the balance, usually in a table. Where significant movements are not explained, we will consider any relevant information in the strategic report and whether the lack of an explanation casts doubt over whether the report, when taken as a whole, is fair, balanced and comprehensive.

Most companies provided the amount of revenue recognised in the period that was included in the contract liability balance at the start of the year. However, few companies reviewed disclosed revenue recognised in the period from performance obligations satisfied, or partially satisfied, in previous periods, which may be because the amounts were not material although this was not clear. Revenue from performance obligations satisfied in prior periods may arise from changes to the amount of revenue constrained or perhaps from revisions to the estimated percentage of completion. Where this is the case, we would expect the significant judgement disclosures required by paragraphs 126 and 124 respectively to also be provided.

Examples of good disclosure…

"Trade receivables includes applications to the extent that there is an unconditional right to payment and the amount has been certified by the customer. The recoverable amount of applications that have not been certified and other amounts that have not been applied for but represent the recoverable value of work carried out at the balance sheet date are recognised as contract assets within trade and other receivables on the balance sheet."

nmcn plc 2018 AR&A

Examples of good disclosure…

"The timing of payment from customers is generally aligned to revenue recognition, subject to agreed invoice terms. The majority of development programmes have payment terms based on contractual milestones, which are not necessarily aligned to when revenue is recognised, particularly for those contracts recognised over time using percentage of completion methodology. This generally leads to recognition of revenue in advance of customer billings, for which a contract asset is recognised. Where cash is received from the customer in advance of recognising revenue under a contract, a contract liability is recorded (advance payments from customers)."

Cobham plc 2018 AR&A

Examples of good disclosure…

Significant changes in Cohort plc's contract asset balance during the period were clearly presented in the following reconciliation:

Contract receivables	2019 £'000	2018 £'000
Opening balance	11,963	10,172
Acquired	1,440	-
Contract receivable recognised in revenue	12,806	11,864
Contract receivable invoiced	(13,150)	(10,073)
Foreign exchange movement	(15)	-
Closing balance	13,044	11,963

Cohort plc 2019 AR&A

Key findings: Contract costs

When provided, accounting policies and judgements relating to the costs of obtaining and fulfilling revenue contracts were helpful and company specific. However, some accounts we reviewed made no reference to these costs which might be material given the companies' activities, such as those involved in longer term contracts.

Where costs of obtaining a contract such as bid costs and commissions were capitalised, good accounting policies clearly explained the rationale for deferring the costs. However, policies could be further enhanced by describing when capitalisation occurs in practice. We welcome useful industry-specific policies such as that provided by a telecoms company explaining that commissions related to funding customer discounts were accounted for as a deduction from revenue rather than costs to obtain a contract.

In relation to costs to fulfil a contract, such as set-up or mobilisation costs, good disclosures explained the nature of the different costs. They also clarified that costs were first assessed to see if they were within the scope of other standards and, if not, only recognised when they met the three criteria required by IFRS 15 for capitalisation. One company highlighted this as an area of revenue involving significant judgement.

Companies are reminded of the following disclosure requirements relating to assets recognised from the costs to obtain or fulfil a contract with a customer, which were sometimes missing in the accounts we reviewed:

- The amortisation method applied (which should correlate to the transfer of the goods and services to which the asset relates), and the amount of amortisation and any impairment losses recognised in the period; and
- The closing balances **by main category of asset** (for example, commissions, set-up costs).

Examples of good disclosure…

"The Group has capitalised bid costs of £4.9m (2017: £6.2m) and phase in costs of £17.2m (2017 restated: £18.9m) that are realised as a part of the normal operating cycle of the Group. These assets represent up-front investment in contracts which are recoverable and expected to provide benefits over the life of those contracts. Bid costs are capitalised only when they relate directly to a contract and are incremental to securing the contract. Any costs which would have been incurred whether or not the contract is actually won are not considered to be capitalised bid costs. Contract costs can only be capitalised when the expenditure meets all three criteria identified in note 2."*

Movements in the period were as follows:

Capitalised bid and phase in costs	2018 £m	2017 (restated) £m
At 1 January	25.1	27.0
Additions	3.9	5.0
Amortisation	(5.5)	(6.8)
Reclassified to contract asset	(1.2)	
Exchange differences	(0.2)	(0.1)
At 31 December	**22.1**	**25.1**

Serco Group plc AR&A 2018

Examples of good disclosure…

"Costs to fulfil a contract: For some contracts, where revenue is recognised at a point in time (rather than over time), the Group incurs development costs in order to meet its performance obligation and these costs are recognised as an asset. The asset is then amortised to cost of sales as revenue is recognised. Judgement is applied in assessing whether these costs are costs to fulfil a contract or internally generated intangible assets. This judgement will depend on management's assessment of the nature of the underlying costs and whether they principally relate to a particular contract."

Cobham plc 2018 Annual Report

Examples of good disclosure…

"Design and build….Due to the nature of design and build contracts, there can be significant 'learning curves' while the group optimises its production processes. During the early phase of these contracts, all costs including any start-up losses are taken directly to the income statement, as they do not meet the criteria for fulfilment costs."

Melrose Industries PLC 2018 Annual Report

Key findings: Other points

Other points we noted during our review of sampled companies' disclosures are set out below:

IFRS 15 requires disclosure of the amount of the transaction price allocated to performance obligations that were unsatisfied or partially unsatisfied at the end of the period (sometimes referred to as 'backlog') and an indication of when that revenue is expected to be recognised. Some companies did not provide the required information when it appeared to be relevant and possibly material. When such 'backlog' disclosures were provided it was unclear whether the amounts disclosed had been impacted by the variable consideration constraint.

Only one company referred to breakage (customers' unexercised rights) which was relevant to its accounting for a customer loyalty scheme. None of the three telecommunications companies in our sample referred to breakage which may be relevant, for example, to unused amounts on prepaid SIM cards. Where breakage has a significant impact on the timing of revenue recognised, we would expect companies to disclose their accounting policies in this area and any significant judgements.

The standard provides a number of practical expedients applicable on transition or an on-going basis. Good disclosures clarified whether or not these had been used.

IFRS 15 requires entities to assess contract assets for impairment in accordance with IFRS 9 'Financial Instruments'. For some companies we were unable to find evidence that contract assets, in addition to trade receivables, had been assessed for impairment.

The impact on income tax of adopting IFRS 15 was not always clear in the accounts we reviewed. Clearer disclosures explained and quantified the tax effect.

Examples of good disclosure…

"The table below notes the revenue expected to be recognised in the future that is related to performance obligations that are unsatisfied (or partially unsatisfied) at the reporting date."

	2019 £'000	2020 £'000	2021 and beyond £'000	Total £'000
Over time revenue	289,174	157,958	171,253	618,385
Point in time revenue	244,588	91,664	29,224	365,476

Ultra Electronics Holdings plc 2018 AR&A

Examples of good disclosure…

"The group has applied the practical expedient permitted by IFRS 15 to not disclose the transaction price allocated to performance obligations unsatisfied (or partially unsatisfied) as of the end of the reporting period as contracts typically have an original expected duration of a year or less."

WPP plc 2018 AR&A*

Examples of good disclosure…

"The Group applies the IFRS 9 simplified approach to measuring expected credit losses which uses a lifetime expected credit loss allowance for all trade receivables and contract assets. To measure the expected credit losses, trade receivables and contract assets have been grouped based on shared credit risk characteristics and the days past due.

The contract assets relate to unbilled work in progress and have substantially the same risk characteristics as the trade receivables for the same types of contracts. The group has therefore concluded that the expected loss rates for trade receivables are a reasonable approximation of the loss rates for the contract assets."

Aveva Group plc 2019 AR&A

* Not one of the 25 companies selected for review

Next steps

Engagement with companies

We are writing follow-up letters to six companies included in our sample where there is a substantive question relating to their revenue reporting. We will write letters to a further five companies drawing their attention to aspects of their revenue disclosures which could be improved.

Impact on our future reviews

While we saw many examples of good disclosures, no company stood out as a role model in all aspects of their revenue reporting. There is still considerable scope for improvement. We encourage companies applying IFRS 15 to consider the findings within this report when preparing their disclosures in future annual reports and accounts.

We will continue to monitor this aspect of financial reporting, focusing on the following areas:

- Descriptions of the nature of performance obligations in the accounting policies and linkage to information elsewhere in the accounts
- Detail on exactly when revenue is recognised (i.e. when does the customer obtain control) and the factors considered in determining whether this is over time or at a point in time
- Details of significant judgements made in determining the amount or timing of revenue such as: evaluating whether performance obligations are distinct; determining when control is transferred; estimating variable consideration; and determining stand-alone selling prices.
- Quantification of estimation uncertainties relating to revenue and whether sensitivities or range of outcomes have been provided
- Explanations of significant movements in contract assets and liabilities

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