

IFRS15, How we understand company business?

IFRS Digital Reporting Workshop Extra-session

Date and time：18 Sep 2018, 18:30-20:30 (Tokyo)

IFRS 15 - principal/agent, How we understand company's business?

IFRS15 has been effective from 1 Jan 2018 and we found some unexpected disclosures. Recently understanding company's business became more important for dialogue between companies and investors. How should the disclosure be?

In 2018 when IFRS 9 became a hot topic, the due date for mandatory adoption of IFRS 15 (revenue from contract of customers) was also coming. It was said that for many companies, the impact of the changes should be small. But lack of continuity from the previous years and how it may impact the indicator calculation, etc. was a concern. And when the first quarter came, there was a company that announced its earning digests without attaching financial statements because the preparation of IFRS 15 was difficult. Also, there was a company with the sales differing by 2 trillion yen in the first quarter compared to last year.

In general, for trading companies, amount of sales changed considerably. In addition, companies which provide their services over a period, such as points and membership services, the timing of revenue recognition has changed. Therefore, some companies might have needed to make adjustment to record some revenue booked the previous year again because of the change in recognition timing. How should users understand this new standard? Also, how should companies explain?

Revenue recognition criteria (five-step approach)

In line with the application of IFRS 15, the Company recognizes revenue based on the five-step approach outlined below.

Step 1: Identify the contract(s) with a customer

Step 2: Identify the performance obligations in the contract

Step 3: Determine the transaction price

Step 4: Allocate the transaction price to the performance obligations in the contract

Step 5: Recognize revenue when (or as) the entity satisfies a performance obligation

Attendees	14th workshop First round 28th June
Main Speakers	2 company accounting dept. / IASB investor relation team
Attendees	10 Investors, 6 sell-side analyst, 7 Information provider/Media/Researcher, 4 CPA, 6 Company side(including main speakers) , 3 Academic, 6 Regulator/Accounting setter/Analyst Organization

Basic understanding of IFRS15

IASB material, IFRS15

IFRS 15 is a standard that recognizes revenue by focusing on contracts with customers. There are no major impacts on many companies, but projects with complex contracts or long-term contracts, might have an impact.

Example of Acceleration in Revenue Recognition

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Step 4
Allocate the transaction price to the performance obligations

Standalone selling prices analysed to allocate transaction price to the performance obligations.

	ABC Mobile Inc. Wireless Service and Handset Bundle	
1	Service + Handset Bundle Assumption	
	Handset – cash received from customer	0
	Wireless service – cash received from customer (monthly)	60
	Number of months in contract	18
	Aggregate Revenue over life of contract	1080
2	Analysis of Standalone Selling Prices for Allocation of Revenue	
	Standalone selling price of Handset	300
	Standalone selling price of 18 month service contract (monthly rate)	50
	Combined value of standalone selling prices	1200
	Pro-rata share of Handset in Bundle	25%
	Pro-rate share of Service in Bundle	75%

One approach can be to analyse other similar contracts

IFRS

Example of Acceleration in Revenue Recognition

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Allocation of revenue to the performance obligations

Step 1 Identify the contract(s) with the customer

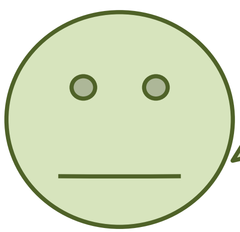
Step 2 Identify the separate performance obligations*

Step 3 Determine the transaction price

Step 4 Allocate the transaction price to the performance obligations

Overall amounts of revenue recognised over the life of contract by ABC Mobile	Current practice	IFRS 15
Handset revenue	-	270
Wireless Service revenue	1,080	810
Total revenue	**1,080**	**1,080**

IFRS



IASB investor Relation team

In the case of a bundled mobile contract, once the contract value is estimated in Step-3, it is allocated to the promises in the contract (the mobile handset delivered at contract inception and the services provided over 18 months). This allocation may be done using relative standalone price calculations as show in the tables. As a result of this allocation, some telcom operators may show an accelerated revenue profile on transition, relative to the old requirements.

Disclosure is also important in IFRS15

What Company should disclose for investors?

Companies should provide information that helps investors understand the impact of new Standards on its financial statements

* Some companies attached the Reconciliation table, but some did not.

SoftBank Group

SoftBank Group Corp. Consolidated Financial Report
For the Three-Month Period Ended June 30, 2018

(3) Effect of adopting new standards and interpretations

Financial impacts of applying "IFRS 9 Financial Instruments" and "IFRS 15 Revenue from Contracts with Customers" on condensed interim consolidated statement of financial position as of April 1, 2018 and condensed interim consolidated financial statements for the three-month period ended June 30, 2018 are as follows:

(Condensed Interim Consolidated Statement of Financial Position)
As of April 1, 2018

(Millions of yen)

	Before adoption	IFRS 9 Adjustment amount	IFRS 15 Adjustment amount	After adoption
ASSETS				
Trade and other receivables	2,314,353	75	6,580	2,321,008
Inventories	362,041	-	(2,539)	359,502
Other current assets[1]	344,374	(177)	12,416	356,613
Intangible assets	6,784,550	-	(13,271)	6,771,279
Costs to obtain contracts[2]	-	-	304,778	304,778
Deferred tax assets	647,514	31	(54,466)	593,079
Other non-current assets[1]	221,232	-	(21,999)	199,233
LIABILITIES AND EQUITY				
Trade and other payables[1]	1,816,010	-	(62,238)	1,753,772
Other current liabilities[1]	658,961	-	46,900	705,861
Deferred tax liabilities	1,085,626	-	41,387	1,127,013
Other non-current liabilities[1]	303,915	-	(58,029)	245,886
Retained earnings[1,2,5]	3,940,259	52,537	248,078	4,240,874
Accumulated other comprehensive Income[5]	317,959	(52,531)	(5,297)	260,131
Non-controlling interests	1,088,846	(22)	21,322	1,110,146

"Companies apply the requirements in IAS 8 Accounting Policies, Changes in Accounting Estimates when adopting new Standards for the first time. The requirements are to explain the nature and amount of impact to financial statements from the first time adoption of the Standard.
If the impact is not material, the requirement can be met by only disclosing that the effect of the change is not material. But if large companies need to discuss about material changes, where these changes came from, they need to disclose.
If the impact is very material, it could be made a separate disclosure, saying this is the amount that came out applying IFRS 15. On the other hand there is a case that no significant change, and no disclosure at all. So there are various cases.
But if you try to comply IAS 8 well, if there is a big impact, companies should explain or make reconciliation table."

Case study (Trading company M)

■ Impact from IFRS15 / for Trading company

Case

- ✓ M had an order from B to purchase Chocolate
- ✓ M select A from several candidates.
- ✓ M negotiated A to have A responsible for obligation of the transaction.
- ✓ M does not have inventory risk
- ✓ The price is decided between M and A , B respectively.

Before IFRS15

- ✓ Performance obligation/Responsibilities are transferred => Net
- ✓ No inventory risk => Net
- ✓ Price determination right => Gross

Since two indicators show NET of the three, we conclude that it is **NET**

After IFRS15

- ✓ Performance obligation/Responsibilities are transferred. But it is the result of self-help efforts (buy-side selection) => Gross
- ✓ No inventory risk => Net
- ✓ Price determination right => Gross

Since two indicators show GROSS of the three, we conclude that it is **GROSS**

POINT

Comprehensive judgment of the three indicators taking account of actual transactions

Case study (Trading company M)

For the Three-Month Periods Ended June 30, 2018 and 2017

	Millions of Yen	
	Three-month Period Ended June 30, 2018	Three-month Period Ended June 30, 2017
Revenue (Note 2, 5, 13 and 15):		
Sale of products	¥ —	¥ 1,042,347
Rendering of services	—	103,058
Other revenue	—	36,255
Revenue	1,556,199	—
Total revenue	1,556,199	1,181,660

- ✓ Introduced a new concept of control to GN judgment.
- ✓ As a result, treatment os some transactions changed from Net to Gross.

For annual report, there will be more explanation, such as information of outstanding contracts.
Meanwhile, at this timing of adoption the new standard, the three revenues of the consolidated income statement are unified.

Though it increased by 374.5 billion yen from the same period of the previous fiscal year, 385 billion yen is the effect of adoption of IFRS 15.

Disclose IFRS 15 revenue by segment

15. REVENUE

Among "Revenue", the disaggregation of revenue recognized from contracts with customers by product segment is as follows. The following categories are same as in Note.5 "Segment Information". Revenue other than revenue recognized from contracts with customers includes revenue related to lease and financial insruments, etc.

	Millions of Yen								
Three-month period ended June 30, 2018:	**Iron & Steel Products**	**Mineral & Metal Resources**	**Machinery & Infrastructure**	**Chemicals**	**Energy**	**Lifestyle**	**Innovation & Corporate Development**	**All Others**	**Total**
Revenue recognized from contracts with customers	¥ 48,545	¥ 103,459	¥ 176,561	¥ 387,015	¥ 57,773	¥ 323,650	¥ 27,860	¥ 886	¥ 1,125,749

Opinion from Attendees

Looking at the definition of the control on slide 9, for example, you have inventory risk, or you have discretionary power to decide on prices, these seem not applicable for trading companies... so it is difficult to understand why the amount of revenue has greatly increased.

Investor

We agree that transactions of trading companies seems not to meet the conditions. But there are various inventory risks. We judge them, one by one.

Trading company M

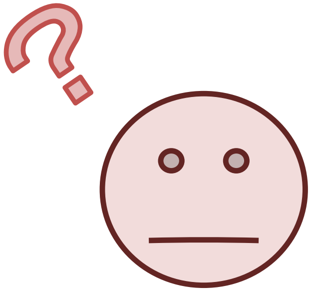
I am concerned about how much this judgment is secured. It will be difficult to compare historically if you can change it flexibly. Moreover, I do not like being able to change judgment criteria arbitrarily.

Investor

We also wondered why each company has a difference. But once it is decided, except when having a rational reason, change is not allowed. We have written down internal accounting rules in the documents. Also from IR perspective, we are asked to explain any accounting change. So I don't think that any company can change it easily.

Trading company M

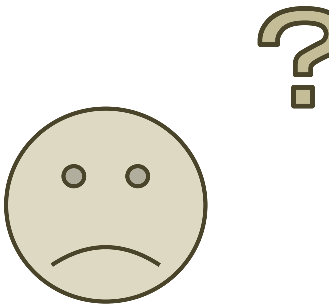
Opinion from Attendees



Investor

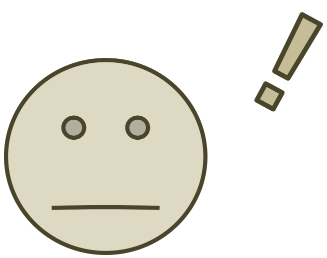
As the first year disclosure, there were companies to disclose the reconciliation table, but not all of them. Who can decide whether it is material information for investors or not?

In other issues, for me, it seems difficult (as operation) that contract costs to set as an assets rather than expenses, if they are required to acquire sales contracts. Usually difficult recognize that which product does connect with that contract..



Other company attendees

From the wording of each contract, we also had to think about whether it was an agent or the principal.



Trading company M

Case Study, Online Shopping R, co.

IFRS 15 affects our credit card business and mobile business. Card business is more affected by "contract acquisition cost". “Mobile" is affected by the timing to "recognize revenue" in the 5 steps.
Both businesses are part of "member acquisition program" of our company. We issue a large number of points when we acquire new customers. Therefore, that deferral affects the accounting process by acquiring contract or proportional distribution of earnings.
In the card business, sales cannot be obtained at the moment we obtain new customers. Subsequent sales cannot be obtained unless the customer uses the card, so there is no "promised sales".
Therefore, points issued are normally treated as an expenses. Then it is deferred because it corresponds to the definition of "acquisition cost of contract".

(4)Assets recognized from costs for acquiring or fulfilling contracts with customers

	Previous year Dec.31.2016	Current year Dec. 31. 2017
Assets recognized from the cost for acquisition of contract	33,094	43,027
Assets recognized from the cost for performance of the contract	5,573	6,863
Total	38,667	49,890

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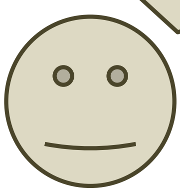
Explanation about those numbers of the table

また、契約コストから認識した資産については、計上時及び四半期ごとに回収可能性の検討を行っています。検討に当たっては、当該資産の帳簿価額が、カード会員との契約が継続すると見込まれる期間に渡り関連するクレジットカード関連サービスと交換に企業が受け取ると見込んでいる対価の残りの金額から、当該サービスの提供に直接関連し、まだ費用として認識されていないコストを差し引いた金額を超過しているかどうか判断を行っています。これらの見積り及び仮定は、前提とした状況が変化すれば、契約コストから認識した資産に関する減損損失を損益に認識することにより、契約コストから認識した資産の金額に重要な影響を及ぼす可能性があるため、当社グループでは、当該見積りは重要なものであると判断しています。

前連結会計年度及び当連結会計年度において、契約コストから認識した資産から生じた償却費は、それぞれ6,870百万円及び9,299百万円です。

R, co. Notes of FS



R company

On the other hand, in the mobile business we issue points to customers at the time of contract, but the customers buy handset at that same timing. Handset price is 50,000 for example, and 20,000 points are given, so even if points are given similarly, this will be treated as deduction from sales. In other words, we will process by sales proportional division.

In Card business assets have increased from 38 to 49 billion yen, it means 11 billion capital increase. But it was expensed, before. The revenue of the card business is 126 billion, such decrease in costs impact by 7 or 8%?

Sell side analyst

Case Study, Online Shopping R, co.

Investor

The mobile business is included in the outstanding contract because it is an increase / decrease of things like sales receivables. But, since other things are included as well, I thought that this influence cannot be recognized by looking at the notes.

R company

We capitalize "acquisition cost", so we also make impairment test thereafter. However, if the business is doing well, the acquisition cost will not be impaired. What can be capitalized in the first place is “the cost incurred when you obtain contracts (which does not occur when contracts are not obtained)." The incentives for outcome compensation or when actually granting points only to contractors, such cost can to be capitalized. However, if you obtain contracts using agency, some might be out of the criteria for that the acquisition cost to be capitalized. Because some case are treated on one by one basis, while others are arranged that agency engage some contracts under comprehensive treatment.

Investor

That is to say that in selling expenses, when we discuss which is included or not, there are some vagueness?? For example, instead of advertisement, to give samples as a "promotional object" to business partners, if they purchase something....Or send sales people ...

R company

The criterion itself is clear, but you can set the contract so that costs incurred can be capitalized if you take into account the requirements in the standards. On the other hand, I think that you can set the contract to have it not capitalized.

Opinion from Attendees

In the case of Company R, if classifying revenue from smartphone contract as only "service revenue" in the past, it should be categorized as a handset and service separately now, did you have such the impact by it?

Investor

Yes, this is exactly the impact. In the case of our company, it is actually handset is a discount or point awards, but they will not become a discount in full. For example, if you discount 50,000 yen for the handset that price is 50,000 yen, the discount should be allocated. That is, it will be the same as bringing the charge for mobile communication fee to handset price at the beginning. (ahead)

Company R

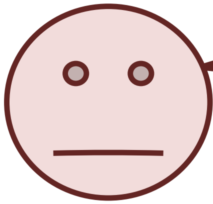
If you have written what you said now in the disclosure material, we can be understanding more. But if you just saying "recognized", maybe we can not question.

Investor

After all, it is difficult to understand unless you explain that you have recognized revenue by associating the note with the business model.

Researcher

Opinion from Attendees



I think that those changes should not be missed if we think about ROE calculation, because they become asset / or not, depending on the conditions. At least we need some explanation why it becomes an asset or not.

Company R is explaining about services and goods in the financial statements.

当連結会計年度(自　2017年１月１日　至　2017年12月31日)

(単位：百万円)

		セグメント		
		インターネットサービス	FinTech	合計
主要なサービスライン	楽天市場及び楽天トラベル	211,191	—	211,191
	Ebates	71,661	—	71,661
	爽快ドラッグ及びケンコーコム	69,842	—	69,842
	楽天モバイル	35,109	—	35,109
	楽天ブックス	31,531	—	31,531
	OverDrive	24,619	—	24,619
	楽天コミュニケーションズ	[illegible]	—	19,672
	東北楽天ゴールデンイーグルス	12,888	—	12,888
	楽天カード	—	126,689	126,689
	楽天銀行	—	[illegible]	62,612
	楽天証券	—	49,113	49,113
	楽天生命	—	32,168	32,168
	その他	184,804	12,575	197,379
	合計	661,317	283,157	944,474
顧客との契約から認識した収益		661,297	100,659	761,956
その他の源泉から認識した収益		20	182,498	182,518

(注)　グループ会社間の内部取引控除後の金額を表示しています。

IFRS 15 requirements.
The relation between Segments and each service and goods.

なお、利息及び配当収益等についてはIFRS第９号に基づき、また、保険事業から生じる収益はIFRS第４号に基づいて売上収益として計上しています。IFRS第９号に基づく楽天カード、楽天銀行及び楽天証券の売上収益は前連結会計年度(自　2016年１月１日　至　2016年12月31日)はそれぞれ72,171百万円、44,225百万円及び15,440百万円です。また、IFRS第４号に基づく楽天生命の売上収益は31,324百万円です。当連結会計年度(自　2017年１月１日　至　2017年12月31日)はそれぞれ84,424百万円、46,190百万円及び19,415百万円です。また、IFRS第４号に基づく楽天生命の売上収益は31,560百万円です。

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システム利用に関するサービスについて、当社グループは規約に基づき、出店者・旅行関連事業者に対して出店者・旅行関連事業者と主として楽天会員との間での個々の取引の成立に関するサービスの提供を行う義務を負っています。当該履行義務は、出店者・旅行関連事業者と主として楽天会員との個々の取引の成立時点で充足されるものであり、当該履行義務の充足時点で、流通総額（出店者・旅行関連事業者の月間売上高）にサービス別・プラン別・流通総額の規模別に定められている料率を乗じた金額にて収益を計上しています。当該金額は、履行義務の充足時点である取引成立時点から概ね３ヶ月以内に支払いを受けています。

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explanation each service and goods

楽天モバイル

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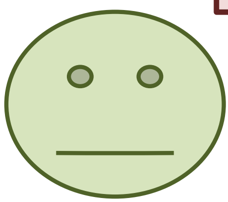
Opinion to IFRS 15

Investor

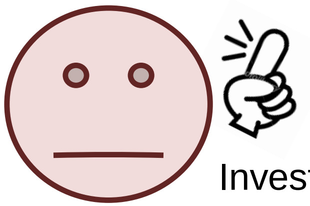
I felt that IFRS 15 is the standard such as it made the financial statements seems difference, depending on the view-angle, even though the actual cash flow does not change, if my understanding is correct.
Just because the cash flow does not change, so could I say that there is no actual change?
But in the case of Company R, it affects PL, and for investors, it will affect how we see payout ratio. If you say “We have increased profits, but we do not change dividends”, you might be misunderstood by investors. Therefore, even the net income increased due to the effect of IFRS 15, if the cash flow does not change, you should be better to explain. For example, "This is due to the change in accounting standards. So we are going to change the payout ratio/dividend policy." etc. Besides, ROE also changes. In that case, it may affect the stock price.



CPA

The background of IFRS 15 introduction, it has been discussed by IASB with the US, but since IFRS hasn't had a clear guidance so far, IASB wanted to clarify the standards. In US, there are many detail rules, on the contrary, it is difficult to understand, so they seem wanted to establish principles too. This standard is clear. But at the stage of implementation, there are various contracts, so even if it looks like a similar contract, it might have the different implication. Besides, the transactions may recognize revenue differently, i.e. over time or point in time.

While the cost of acquiring the contract is large, the profit also seems larger... it is a characteristic of this standard. I felt that its focus on the revenue/cost matching, it may be not bad. On the other hand, the distortion from cash flow will become larger, especially during the business expansion period. It is like a contradiction between a certain meaning accrual concept and cash-basis concept. Maybe it comes from the theory of profit/cost matching... After all, we have to carefully look at the all statements, BS, PL, and cash flow. Yes, we need cash flow statements too.



Investor

Discussion Result

We discussion summary was…

- Since IFRS 15 requires to recognize revenue for each service and product separately, so we can know the details of each business.

- On the other hand, it might make a distortion between cash flow and profit-loss. Therefore, it is necessary more explanation and understanding about structures of each business.

- Need to be careful to understand, especially at the first year adoption.

- The disclosure of IFRS 15, the company should explain well their business, services, and products in the financial statements sections.

Better disclosure needs to be discussed for the introduction of revenue standards in J-GAAP three years from now.