CONNOR GROUP

Revenue Hub®

SAB 74 Disclosures Related to ASC 606 (IFRS 15) by US Public Companies

Methods, Dates, and Anticipated Impact

July 28, 2016

Executive Summary

- This study was performed by Connor Group and RevenueHub to provide an overview of current disclosures made by US public companies regarding the upcoming adoption of ASC 606, Revenue from Contracts with Customers (or its IFRS equivalent, IFRS 15).
- The study was conducted in July 2016 based on SEC disclosures by 149 companies across various industries, and findings are relevant as of July 28, 2016.
- A summary of the findings is presented below.

- **Almost 90% of the companies reviewed indicate that they are still in the process of assessment and, with a few exceptions, did not provide specific disclosures regarding the impact of ASC 606 (IFRS 15) adoption.**
- **Just 4 companies of those reviewed have announced early adoption of the new standard.**
- **Over 80% of the companies reviewed are currently not able to indicate whether they will use full retrospective or modified retrospective transition method. The remaining companies have split approximately equally between the two methods.**

Sampled Companies/Methodology

Large Companies

- Market Cap >$10Bn
- Form 10-Q
- Filed between 7/15/16 and 7/28/16
- Referred to “Revenue from contracts with Customers”
- 75 Companies

Others with Relevant Disclosures

- Form 10-K’s filed from 2/1/16 to 7/27/16
- Forms 10-Q, 8-K, 20-F filed from 5/1/16 to 7/27/16
- Disclosed adoption date, method, or impact of the new revenue standard
- 76 companies

Notes:

- 2 companies were found in both groups (total sample=149)

Anticipated Adoption Method

	Still Assessing	Full Retrospective	Modified Retrospective
Companies	127/149 (85%)	12/149 (8%) Notable companies: • Netflix • Mondelez • Dreamworks • Microsoft	10/149 (7%) Notable companies: • Edison Int. • IBM • Lennox Int.

- ASC 606 (IFRS 15) allow two adoption methods, full retrospective and modified retrospective.
- Under the full retrospective approach, entities recast all comparative periods presented in their post-adoption financial statements to comply with ASC 606 (IFRS 15).
- Under the modified retrospective approach, entities apply ASC 606 (IFRS 15) provisions to all revenue transactions reported in their post-adoption financial statements.
- Under either approach, the cumulative effect of applying the new standard is recognized in retained earnings as of the beginning of the earlies period presented in accordance with ASC 606 (IFRS 15).

Anticipated Adoption Date

	Not Specified	Standard (After Dec. 15, 2017)	Early (After Dec. 15, 2016)
Companies	71/149 (47%)	74/149 (50%) Notable companies: • IBM • Dr. Pepper Snapple • Sirius XM • Philip Morris • Netflix • Visa • Kellogg Company	4/149 (3%) • Microsoft • Ford • Puget Sound Energy • Kibush Capital Corp

- US public companies are required to adopt ASC 606 (IFRS 15) no later than in fiscal years beginning after December 15, 2017 (“standard” adoption date).
- They may also elect to adopt ASC 606 effective for fiscal years beginning after December 15, 2016 (“early” adoption date).
- IFRS reporting companies may elect to adopt IFRS 15 for earlier periods.

Anticipated Impact

	Still Assessing	Immaterial	Material
Companies	133/149 (89%)	14 (10%) Notable companies • Netflix • Whirlpool • Kimberly Clark • O'Reilly Auto • Chipotle	2 (1%) • Microsoft • Syngenta AG (IFRS)

- SEC Staff Accounting Bulletin (SAB) 74 (Topic 11-M) requires US public companies to disclose the impact of the adoption of recently issued accounting standards in their quarterly and annual financial statements.
- Most companies have made the initial disclosures that indicate the companies have not yet completed the assessment the adoption of ASC 606 (IFRS 15) will have on their financial statements.
- The SEC staff has indicated that it expects these disclosures to evolve over time as companies begin to better understand how the standard will impact their financial statements.

Adoption Impact Disclosures

Only few companies currently comment on the detailed impact of the upcoming adoption. Below are illustrative examples of such comments:

Starbucks: adoption will change timing of recognition and classification of card breakage income, which is currently recognized using the remote method and recorded in net interest income and other. The new guidance will require application of the proportional method and classification within total net revenues on our consolidated statements of earnings.

United Airlines: certain ancillary fees directly related to passenger tickets, such as airline change fees and baggage fees, will likely no longer be considered distinct performance obligations separate from the passenger travel component. In addition, change fees which were previously recognized when received will likely be recognized when transportation is provided.

JetBlue: the new standard will no longer allow it to use the incremental cost method when recording the financial impact of TrueBlue® points earned on JetBlue purchases and will require to re-value the liability with a relative fair value approach.

Masimo (Medical Technology Industry): expects acceleration of certain revenue from product sales to distributors (currently deferred under the "sell-through" method). Also expects deferral of certain contract-related costs that are currently expensed as incurred.

Adoption Impact Disclosures (continued)

Alliance Healthcare: is considering its ability to recognize revenue for contracts where collectability is in question. In addition, it will be required to capitalize costs to acquire new contracts, whereas currently, the company expenses those costs as incurred.

United Technology (Aerospace Industry): expects changes to revenue recognition practices; elimination of the units-of-delivery method for certain U.S. Government programs; and elimination of the completed contract method of accounting.

Orange (IFRS – Cellular Provider): expects changes in accounting for bundled offers which include a handset component with a discounted price and a communication service component: more equipment revenue and less service revenue, with the resulting acceleration of the revenue recognition. Some incremental subscriber acquisition and retention costs (i.e. payments to distributors directly attributable to a contract, excluding subsidies) would be recognized over the duration of the bundled offer.

Mix Telematics (IFRS – Fleet Management Industry): expects judgement will be required to determine the distinct performance obligations in bundled arrangements with specialized hardware and the related asset management solution. Other areas that the Group has identified that will require consideration are lease versus service and agent versus principal assessments.

Adoption Impact Disclosure Example 1

Illustrative full disclosures for two companies with more detailed assessments

Microsoft (expects a material impact)

In May 2014, the Financial Accounting Standards Board ("FASB") issued a new standard related to revenue recognition. Under the new standard, revenue is recognized when a customer obtains control of promised goods or services and is recognized in an amount that reflects the consideration the entity expects to receive in exchange for those goods or services. In addition, the standard requires disclosure of the nature, amount, timing, and uncertainty of revenue and cash flows arising from contracts with customers. The FASB has recently issued several amendments to the standard, including clarification on accounting for licenses of intellectual property and identifying performance obligations.

The guidance permits two methods of adoption: retrospectively to each prior reporting period presented (full retrospective method), or retrospectively with the cumulative effect of initially applying the guidance recognized at the date of initial application (the cumulative catch-up transition method). We currently anticipate adopting the standard using the full retrospective method to restate each prior reporting period presented.

The new standard will be effective for us beginning July 1, 2018, and adoption as of the original effective date of July 1, 2017 is permitted. We currently anticipate early adoption of the new standard effective July 1, 2017. Our ability to early adopt using the full retrospective method is dependent on system readiness, including software procured from third-party providers, and the completion of our analysis of information necessary to restate prior period financial statements.

We anticipate this standard will have a material impact on our consolidated financial statements. While we are continuing to assess all potential impacts of the standard, we currently believe the most significant impact relates to our accounting for software license revenue. We expect revenue related to hardware, cloud offerings, and professional services to remain substantially unchanged. Specifically, under the new standard we expect to recognize Windows 10 revenue predominantly upfront rather than ratably over the life of the related device. We also expect to recognize license revenue upfront rather than over the subscription period from certain multi-year commercial software subscriptions that include both software licenses and software assurance. Due to the complexity of certain of our commercial license subscription contracts, the actual revenue recognition treatment required under the standard will be dependent on contract-specific terms, and may vary in some instances from upfront recognition.

We currently believe the net change in Windows 10 revenue from period to period is indicative of the net change in revenue we expect from the adoption of the new standard.

Adoption Impact Disclosure Example 2

Illustrative full disclosures for two companies with more detailed assessments

Omnicom (expects an immaterial impact)

In May 2014, the FASB issued FASB ASU 2014-09, *Revenue from Contracts with Customers* ("ASU 2014-09"), which will replace all existing revenue recognition guidance under U.S. GAAP. On July 9, 2015, the FASB approved a one-year deferral of the effective date of ASU 2014-09 to all annual and interim periods beginning after December 15, 2017, with early application permitted only for annual and interim periods beginning after December 31, 2016. ASU 2014-09 provides for one of two methods of transition: retrospective application to each prior period presented or recognition of the cumulative effect of retrospective application of the new standard as of the beginning of the period of initial application. Presently, we are not yet in a position to conclude on the application date or the transition method we will choose. Based on our initial assessment, the impact of the application of the new standard will likely result in a change in the timing of our revenue recognition for performance incentives received from clients and the recognition of certain reimbursable out-of-pocket costs as revenue. Performance incentives are currently recognized in revenue when specific quantitative goals are achieved, or when our performance against qualitative goals is determined by the client. Under the new standard, we will be required to estimate the amount of the incentive that will be earned at the inception of the contract and recognize the incentive over the term of the contract. While performance incentives are not material to our revenue, this will result in an acceleration in revenue recognition for certain contract incentives compared to the current method. Certain incidental costs that are reimbursed by our clients and are currently required to be recorded in revenue will likely not be recorded as revenue under the new standard. We expect this will result in less revenue and related cost recorded in our results of operations. While we have not yet completed our assessment, we do not expect this change to have a material impact on our revenue and it will not result in any change to income before income taxes. In March 2016, the FASB issued further guidance on principal versus agent considerations. In certain of our businesses we record revenue as a principal and include certain pass-through costs that are integral to the delivery of our service in revenue. We are currently evaluating the impact of the principal versus agent guidance on our revenue and cost of service, however we do not expect the change, if any, to have a material effect on results of operations.

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RevenueHub publishes plain-English articles and example-based case studies that explain the major aspects of the new revenue recognition standard. We also compile resources from the SEC, FASB, TRG, and major accounting firms: providing one place for accounting professionals to find relevant revenue guidance and improve their understanding of the new revenue standard.

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