

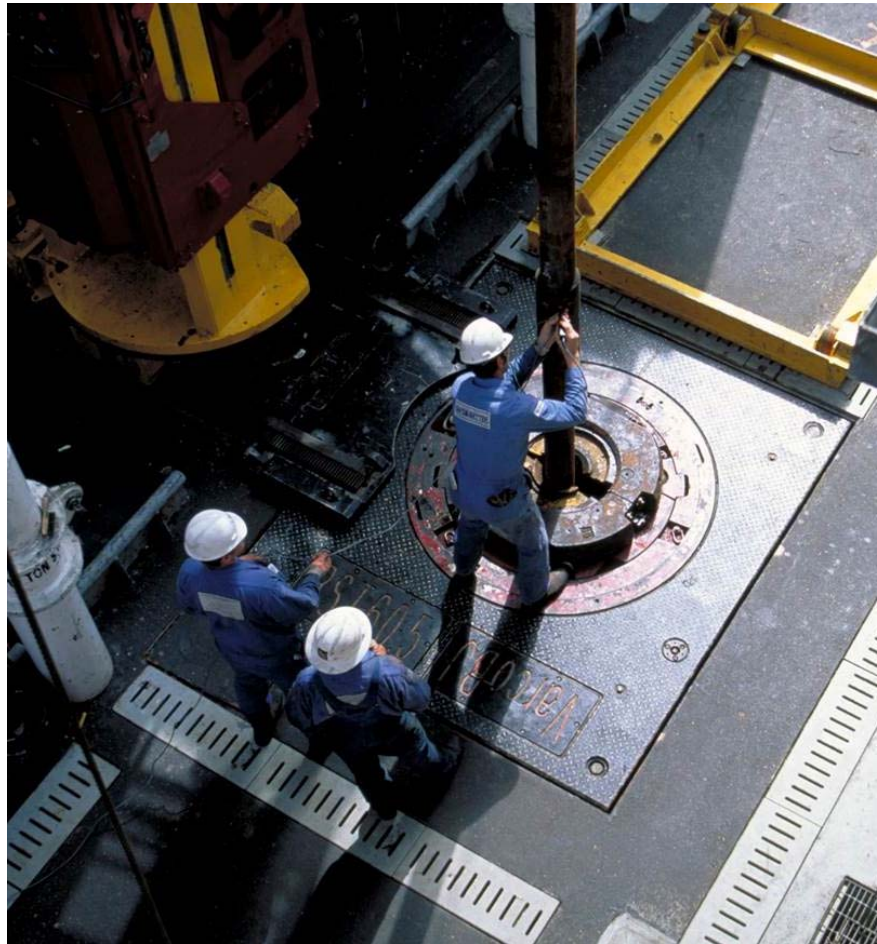
PwC Alert

The new revenue standard is here. How will it affect oil and gas companies?

Page 4
Preparing for the impending change

Page 6
The core principle: a new 5-step model

Pages 8 & 18
Its impact on oil and gas companies and what can go wrong







Why change?

The objective of MFRS 15 is to provide one comprehensive revenue recognition model for all contracts with customers to improve comparability within industries, across industries, and across capital markets.

The new framework for revenue recognition is here.

On 2 September 2014, the Malaysian Accounting Standards Board issued MFRS 15 *Revenue from Contracts with Customers*. This standard is word for word that of IFRS 15 issued by the International Accounting Standards Board. Entities are required to apply MFRS 15 for annual periods beginning on or after 1 January 2017. Early adoption is permitted.

The new revenue standard will replace all existing revenue recognition guidance under IFRS, MFRS and FRS.

This standard will affect many companies, but those most significantly impacted are likely to be companies with a longer delivery cycle, complex contract terms, and goods and services that come as a package.

Before diving into the financial reporting implications - which can be significant - consider the strategic ones. This means looking across the business, which could require input from business unit heads, operations, sales, legal, HR, finance, tax, and IT. This cross functional team can evaluate how revenue recognition affects each function and the business as a whole.

Oil and gas companies should start reviewing existing revenue arrangements, contract terms, and business practices, to identify where changes might occur:

- Will you have to rethink customer negotiations?
- What might compensation and benefit plans look like in the future?
- Should you rethink how you sell your products?
- What do you need to communicate to your investors and when?
- Are there business opportunities resulting from increased flexibility?

Preparing for the impending change

“Given the complexities that may exist in oil and gas contracts, companies cannot afford to sit back until the effective date in 2017 to assess the impact and make possible changes in contract terms, as necessary, to achieve desired outcomes.”



Two adoption methods

(1) Full retrospective method

Companies can choose how they want to adopt the new standard. One way is by restating prior period financial statements as if the guidance had always existed, which may require a lot of time and effort.

(2) Simplified transition method

Companies can instead choose to apply the new guidance prospectively and show the numbers in the year of adoption under both the new and old models. For example, this method requires presenting the 2017 financial statements under the new guidance while including a footnote disclosure of all financial statement line items and the amounts they would have been under legacy guidance for 2017. This method offers a simpler alternative but it isn't without its challenges.

Manage the transition

Transition could be especially difficult for companies with multi-year contracts. Start record keeping soon if retrospective application is a consideration. Do a cost-benefit analysis: Do you have the resources at hand to do one method more effectively than the other? Is there a benefit to your business in having comparability between the before-and-after? What do your investors expect? What are your competitors doing?

Plan for adoption

Your plan for adoption should include forming a cross-functional steering committee that oversees the entire process and takes into consideration the impact on your business as a whole.

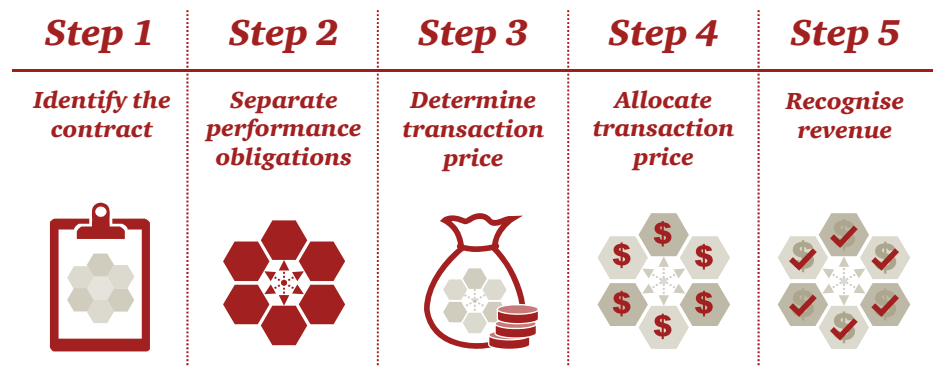
Take inventory of arrangements that may be impacted and identify the gaps in your systems and controls before deciding on an implementation plan.

(See Appendix (page 22) for key areas and activities to consider in your implementation plan)



The core principle: a new

The core principle of MFRS 15 is that revenue is recognised when the goods or services are transferred to the customer at the transaction price. Revenue is recognised in accordance with that core principle by applying a 5-step model.



Step 1: Identify contract(s) with customer

A contract creates enforceable rights and obligations. It may be written, oral, or implied by customary business practice. Contracts are combined when they are entered into at or near the same time and are negotiated as a package, payment of one depends on the other, or goods/services promised are a single performance obligation. Specific guidance about contract modifications is prescribed to account for modifications as a separate contract or continuation of the original contract prospectively or with cumulative catch-up.

Step 2: Identify separate performance obligations in the contract(s)

Performance obligations are promises in a contract to transfer goods or services, including those a customer can resell or provide to its customer. Use the MFRS 15 indicators to separate the performance obligations if they are capable of being distinct and if they are distinct based on the context of the contract (separately identifiable from other promises in the contract).

5-step model

Step 3: Determine the transaction price

Transaction price is the amount of consideration an entity is entitled to receive in exchange for transferring goods or services to customers. Determining the transaction price is straightforward when the contract price is fixed, it becomes more complex when it is not fixed. Discounts, rebates, refunds, credits, incentives, performance bonuses, and price concessions could cause consideration amount to be variable. In situations where there are variable considerations, transaction price is estimated based on the expected value or the most likely amount but is constrained up to the amount that is highly probable of no significant reversal in the future. The minimum amount that meets this criteria is included in the transaction price. Assess your experience with similar types of performance obligations in making this determination.

Step 4: Allocate the transaction price

Transaction price should be allocated to distinct performance obligations based on relative standalone selling price. This may be the standalone selling price of a good or service when sold separately to a customer in similar circumstances and to similar customers. If a standalone selling price is not directly observable, estimate it by considering all information that is reasonably available, such as market conditions, specific factors, and class of customers.

Step 5: Recognise revenue when the performance obligation is satisfied

Recognise revenue when the promised goods or services are transferred to the customer and the customer obtains control. This may be over time or at a point in time.

The new standard provides indicators when control is transferred. Additionally, the new standard introduces a new concept where revenue is required to be recognised over time when:

- i) the asset being created has no alternative use to the company; and
- ii) the company has an enforceable right to payment for performance completed to date.

What are some of the most significant changes?



Identifying performance obligations and allocating transaction price to separate performance obligations

Any bundled goods or services that are distinct must be separately recognised. Additional performance obligations may be identified (e.g.: custodial services in case of bill and hold sales) which require allocation of transaction price. In doing so, discounts or rebates on the contract price must generally be allocated to the separate elements.



Identifying customers

In a production sharing arrangement or similar contracts, the government could be identified as a customer and accordingly these contracts would need to be accounted for under MFRS 15.



Within scope of standard or not?

Buy-sell arrangements and under-lift/over-lift may be in or out of scope of the new revenue standard depending on the settlement terms and substance of the arrangements.

Its impact on Oil and Gas companies

The Oil and Gas industry has various types of companies involved in the wide spectrum of the oil and gas life cycle. Depending on the stage in which the entity is involved, the type of contracts and terms of sale are widely different and hence, the accounting impact may be different.

Non-monetary exchanges

It is customary for oil and gas companies to enter into contracts for exchange of oil or gas in order to facilitate sales to customers. Shown below are two of such arrangements:

(a) Underlift/ Overlift

Many joint arrangements share the physical output (for example, crude oil) between the joint arrangement partners. Each partner is then responsible for either using or selling the output it takes. The physical nature of lifting output, such as oil, means that it is often more efficient for each partner to lift a full tanker-load at a time. The amount of oil lifted by each partner may not be equal to its ownership interest in the field at the balance sheet date. Some partners will have taken more than their share (overlifted); others will have taken less than their share (underlifted). In Malaysia, settlement of underlifting or overlifting would normally be made through the exchange of similar crude stock in subsequent periods. Where similar crude stock is not available, the underlift and overlift balance will be cash settled. However, different forms of settlement may also exist depending on contact terms.

(b) Buy-sell arrangements

This arrangement is usually driven by one or both entities being short of a commodity in one of the locations and the other counterparty having excess volume in the same location. It also often occurs between two transportation hubs, where counterparties can exchange titles to commodities at either end and avoid transportation costs. Whether the same grade of commodity or same volume of the commodity is exchanged will depend on the facts. Settlement of such transactions may take different forms: gross, net or exchange of similar commodities. This type of arrangement also can exist in the case of gas fields where gas shortages in one field is compensated by production in another gas field.



Non-monetary exchanges (continued)

Applying the principles of MFRS 15:

MFRS 15 applies to a contract only if the counterparty to the contract is a customer. A customer is a party that has contracted with an entity to obtain goods or services that are an output of the entity's ordinary activities in exchange for consideration. A counterparty to the contract would not be a customer if, for example, the counterparty has contracted with the entity to participate in an activity or process in which the parties to the contract share in the risks and benefits that result from the activity or process (such as developing an asset in a collaboration arrangement) rather than to obtain the output of the entity's ordinary activities.

In underlift/overlift arrangements and buy-sell arrangements described above, it is first necessary to assess whether the counterparties meet the definition of a customer within the standard. A contract with a collaborator or a partner (for example, a joint arrangement as defined in MFRS 11 'Joint Arrangements') could also be within the scope of MFRS 15 if that collaborator or partner meets the definition of a customer for some or all of the terms of the arrangement. Identifying customers requires judgement and depends on facts and circumstances and substance of the arrangement such as the purpose of the activities undertaken by the counter party.

MFRS 15 also excludes from its scope non-monetary exchanges between entities in the same line of business to facilitate sales to customers. For example, MFRS 15 would not apply to a contract between two oil companies that agree to an exchange of oil to fulfil demand from their customers in different specified locations on a timely basis. In both underlift/overlift and buy-sell arrangements, even if the counterparty meets the definition of a customer, an assessment is required on whether the contact is primarily a non-monetary exchange which would be scoped out of the standard. One consideration in making this assessment is the mode of settlement of the transaction; if there is often no or minimal cash exchanged, it is likely to be scoped out of the standard. The assessment on whether the contracts are for non-monetary exchanges should be performed separately for each such arrangement in place depending on the terms and substance of the arrangements. Transactions that are not within the scope of MFRS 15 should be recorded in accordance with the requirements of the other standards.



Production Sharing Arrangements (PSA)

A PSA enables governments to facilitate the exploitation of their country's hydrocarbon resources by using the expertise of a commercial oil and gas entity. There are many forms of PSA. In Malaysia, Production Sharing Contracts (PSC) and Risk Service Contracts (RSC) are common.

(a) Production Sharing Contract

An oil and gas entity in a typical PSC will, at its own expense, explore the field, develop the resources, build the infrastructure and lift the resources. The oil and gas entity (usually referred to as the operator) will have the right to extract resources over a specified period – typically, the production life of the field – so the infrastructure has a minimal residual value at the end of the PSC. A PSC usually includes an asset-decommissioning obligation for the operator. The operator is usually entitled to a share of the oil produced, which will allow the recovery of specified costs ('cost oil') plus profit margin ('profit oil'). Petronas, which is controlled by the government, will retain title to the hydrocarbon resources (whatever the quantity that is ultimately extracted) and will often have legal title to the infrastructure constructed to exploit the resources. However, if the residual value of that infrastructure is minimal in most cases and the operator would decommission it under the PSC. Petronas will take a share of the output, which may be delivered in product or paid in cash under a pricing formula.

(b) Risk Service Contract

An RSC contract, though shares some similarities, is different from a PSC contract because the operator has no right to the oil or gas produced. Instead, the operator is entitled to reimbursement of all costs incurred plus a remuneration for its services to explore, develop and produce from the field. The remuneration is determined based on meeting certain agreed key performance indicators (KPI).

Applying the principles of MFRS 15:

MFRS 15 applies to all contracts with customers except for specific arrangement which are excluded from the scope of the standard. Management should, based on terms of the contracts, carefully assess whether the government is a customer in such arrangements. In doing so, consideration should be given to the substance of the arrangement. Does the contract provide the operator a right to extract and sell minerals jointly with the government or does the operator provide services to the government in the form of exploration, development and production? Terms relating to manner of cost recovery, sharing of risks and rewards of arrangement (incremental production, recovery of minerals, etc), roles and responsibilities of counterparties in the arrangement, control of counterparties on decision making relating to the activity, could assist in making the assessment. Should the government be identified as a customer and goods and services (performance obligations) are provided in the form of exploration, production and development of minerals under the contract, the contract is within the scope of the standard. The operator will recognise the revenue when it satisfies a performance obligation in the PSA. If, however, the government is not a customer in the arrangement, the PSA is outside the scope of the standard and revenue is only recognised when the operator delivers oil to its customers. Identifying whether the government is a customer requires judgement.



Multiple element arrangements (see Illustrations 1 and 2)

Oil and gas companies may enter into a contract with a customer which contains various promises (multiple element arrangements). Each of these promises may lead to a separate performance obligation. Performance obligations are the unit of account for purposes of applying the revenue standard and therefore determine when and how revenue is recognised. Identifying distinct performance obligations within a contract and accounting for it separately in accordance with the MFRS 15 model requires judgement.

Some examples of multiple element arrangements are as follows:

- a) **Seismic data acquisition and processing:** Contracts for acquisition of seismic data normally include licenses for right to seismic data, tapes for viewing data, combined with acquisition and data processing services. Each of these obligations would need to be assessed to identify separate performance obligations.
- b) **Software licenses with maintenance services:** In the case of contracts for sale of software which includes a service (such as continuing maintenance), a separate performance obligation may exist for the maintenance service. Performance obligations are accounted for separately if they are capable of being distinct and if they are distinct based on the context of the contract.
- c) **Bill and hold arrangements:** Such arrangements arise when a customer is billed for goods that are ready for delivery but the entity does not ship the goods to the customer until a later date. It is customary for pipe manufacturing companies to hold the manufactured pipes at their warehouses based on specific request from customers. Entities must assess in these cases whether control has been transferred to the customer, even though the customer does not have physical possession of the goods. In addition, entities should evaluate whether the custodial service is a separate performance obligation.
- d) **Warranties:** An entity may sell goods together with a maintenance service intended to maintain the level of performance for a period after sale. In addition, the entity may also provide assurance that it will make good any manufacturing defect in the good upon purchase. Warranties that provide assurance that the product meets agreed upon specifications is not a separate performance obligation. However, the maintenance service is a separate performance obligation.

Options to acquire additional goods or services (see Illustration 3)

Contracts for purchase of software licenses, equipment sales, drilling services and certain product sales contain terms which provide an option to the customer to acquire additional goods or services at or below the contracted price for similar goods in the contract. Should the options provide the customer with a material right, the options give rise to a separate performance obligation under the contract.

An option that provides a customer with free or discounted goods or services in the future might be a material right. An option to purchase additional goods or services at a price equal to their standalone selling prices is a marketing offer and therefore not a material right. This is true regardless of whether the customer obtained the option only as a result of entering into the prior arrangement. An option to purchase additional goods or services in the future at a current standalone selling price could be a material right, however, if prices are expected to increase. This is because the customer is being offered a discount on future goods and services compared to what others would be required to pay.

Sales with a right of return (see Illustration 4)

Contracts for sale of drilling products and chemicals normally include a right for customer to return products if not used. A right of return often entitles a customer to a full or partial refund of the amount paid or a credit against the value of previous or future purchases. A right of return is not a separate performance obligation but it affects the estimated transaction price for transferred goods. This is a form of variable consideration since the customer is entitled to a refund of the original consideration to the extent of returned goods. The variable consideration included in the transaction price is measured using a probability-weighted or the most likely amount, whichever best predicts the consideration the entity is entitled to. There is a constraint whereby variable consideration is included in the transaction price only to the extent that it is highly probable that a significant reversal in the amount of cumulative revenue recognised will not occur when the uncertainty associated with the variable consideration is subsequently resolved.

The difference in accounting under MFRS 15 for such contracts is that revenue for the transferred products is the amount of consideration to which the entity expects to be entitled (therefore, revenue would not be recognised for the products expected to be returned). In addition, an asset for the right to return of the inventory as well as a liability for the refund are required to be recognised.

The asset represents the entity's right to recover goods from the customer. The asset is initially measured at the carrying amount of the goods at the time of sale, less any expected costs to recover the goods and any expected reduction in value.

The refund liability represents the amount of consideration that the entity does not expect to be entitled to because it will be refunded to customers. The refund liability is remeasured at each reporting date to reflect changes in the estimate, with a corresponding adjustment to revenue.

The asset for the right to recover goods from the customer is presented separately from the refund liability. The asset shall initially be measured by referring to the former carrying amount of the product (for example, inventory) less any expected costs to recover these products. An entity shall update the measurement of the asset and refund liability arising from changes in expectations about products to be returned. When there are changes to the refund liability, an entity shall recognise corresponding adjustments as revenue (or reductions of revenue).



Efficiency floors

Certain exploration and drilling contracts include a minimum amount of consideration for delivery of goods and rendering of services. The entity would normally have the right to bill any shortage between actual delivery and the minimum amount at the completion of the contract. The existence of efficiency floors gives rise to a variable consideration which affects the transaction price for revenue recognition purposes. Variable consideration is included in the transaction price only to the extent that it is highly probable that a significant reversal in the amount of cumulative revenue recognised will not occur when the uncertainty associated with the variable consideration is subsequently resolved.

As such, to the extent the minimum is not exceeded during the period, the difference between minimum versus actual delivery may be recognised in the period when the services are provided.



Illustration 1

**Identifying performance obligations:
Fabrication and installation services**

An oil and gas service provider enters into a contract to fabricate an oil and gas platform and install the platform offshore. The contract value as mutually agreed is RM100 million. The platform is to be integrated with other platforms of the customer.

The customer expects to receive a fully integrated platform as a final product and the installation is highly dependent on and highly inter-related with the fabrication works.

Illustration 2:

**Multiple element arrangements:
Identify performance obligations/
Allocation of transaction price**

An entity enters into sales arrangements with two different customers: Customer A and Customer B. The entity does not sell seismic acquisition on its own. The stand-alone selling prices for the following services are:

- Seismic acquisition and offshore data processing – RM200,000
- On shore data processing – RM150,000

Customer A enters into the Seismic acquisition and offshore data processing and on-shore data processing contract separately.

Customer B enters into the bundled service which provides all the above services for a price of RM300,000.

How many separate performance obligations are in this contract?

There are two services in this contract, fabrication of oil and gas platform and installation of the platform. The two services will be accounted for as separate performance obligations if they are capable of being distinct and if they are distinct in the context of the contract.

A good or service is distinct if both of the following criteria are met:

- i) The customer can benefit from the good or service either on its own or together with other resources that are readily available to the customer (i.e., the good or service is capable of being distinct); and
- ii) The entity's promise to transfer the good or service to the customer is separately identifiable from other promises in the contract (i.e., the good or service is distinct within the context of the contract)

In this illustration, the fabrication and installation will be accounted for as a single performance obligation because the two services are not separately identifiable (due to the fact that the two services are highly dependent and inter-related with each other).

How should the transaction price be allocated to the performance obligations in the contracts with Customer A and B?

The 5-step model is applied here.

Step 2:

On entering contracts with customers, the entity needs to identify the separate performance obligations within the contracts. A good or service is distinct if either the customer can benefit from the good or service on its own or together with other services and the good or service is separately identifiable from the context of the contract. There are three promises in the contract, seismic acquisition, offshore data processing and on-shore data processing. Seismic acquisition and offshore data processing are not distinct because the customer cannot benefit from seismic acquisition alone. The data acquired through seismic acquisition needs to be processed to be meaningful and usable. The customer is unable to acquire offshore data processing on its own as this is not sold separately, hence the customer is unable to benefit from the seismic acquisition together with other available services.

Onshore data processing is considered distinct, because customers can benefit from processing data already acquired previously. Onshore data processing is also distinct from the context of the contract. Hence there are two separate performance obligations, seismic acquisition and offshore data processing, and onshore data processing.

How should the transaction price be allocated to the performance obligations in the contracts with Customer A and B? (continued)

Steps 3 & 4:

The transaction price for the contracts is identified and allocated based on the standalone price for seismic acquisition & offshore data processing and on-shore data processing. This is illustrated as follows:

	Customer A	Customer B
	Standalone price	Under MFRS15
	RM'000	RM'000
Seismic acquisition & offshore data processing	200	(a) 171
On-shore data processing	150	(b) 129
	<u>350</u>	<u>300</u>

- (a) Seismic acquisition and offshore data processing is allocated a transaction price based upon standalone transaction price [(RM200/RM350)*RM300]
- (b) On-shore data processing is allocated a transaction price based upon standalone transaction price [(RM150/RM350)*RM300]

Step 5:

Revenue is recognised when a promised good or service is transferred to the customer and the customer obtains control of that good or service. Control could pass to the customer over time or at a point in time. MFRS 15 requires an entity to first assess if the following criteria for recognition of revenue at a point of time are met:

- i) The customer concurrently receives and consumes the benefits as the entity performs the obligations
- ii) The entity's performance creates or enhances a customer-controlled asset
- iii) The entity's performance does not create an asset with alternative use and the entity has right to payment for performance complete to date

If none of the criteria above are met, revenue is recognised at a point in time when control of the good or service transfers.

Its impact on Oil and Gas companies

Illustration 3:

Options to acquire additional goods or services: Option to acquire software at a discount

An oil and gas software license, which assists in geological studies of reservoir, is sold to a customer at RM1,000 for a period of 5 years. At the end of the 5 years, customer has an option to purchase an additional license at a discount of 30% from the normal price of RM1,000. The likelihood of customer exercising the option is estimated to be 80%.

The management assessed that the option is a material right to the customer as the additional licenses are priced higher if it were purchased without entering into this contract. Hence, the option is a separate performance obligation.

	License	Option	Total
Consideration as provided under the contract (RM)	1,000	0	1,000
Standalone selling price (RM)	1,000	(a)240	1,240
Allocation of transaction price	(b) 806	(b) 194	1,000

(a) Reflects the entity's estimated standalone selling price, being the discount of RM300 [RM1,000*30%] multiplied by the likelihood of the option being exercised. [RM300*80%]

(b) Revenue is allocated a transaction price by reference to a relative stand-alone price:
License: [(RM1,000/RM1,240)*RM1,000]
Option to acquire additional license: [(RM240/RM1,240)*RM1,000]

How should the option to acquire additional services be accounted for?

The entity needs to identify if there is a material right to the customer within the contract. If a material right exists, the options shall be allocated a transaction price by reference to a relative stand-alone selling price unless it is not directly observable, in which case, the entity shall estimate it. That estimate shall reflect the discount that the customer would obtain when exercising the option, adjusted for both of the following:

- any discount that the customer could receive without exercising the option; and
- the likelihood that the option will be exercised.

The entity recognises revenue allocated to the option when the future services are transferred or when the option expires.

Impact to the financial statements?

Depending on the terms of the contract, the amount of revenue under MFRS 15 could be lower in the first five years to account for likelihood of the option being exercised as well as the relative standalone selling price. In effect, the customer pays the entity in advance for future goods and services.

Illustration 4

Sales with a right of return

An oil and gas service entity sells drilling fluids (10 boxes) at a price of RM10 to customer A. Drilling fluids are delivered to customer A's rig. The contract terms include a right to the customer to return the unused drilling fluid at the purchase price of RM10. Cost of manufacturing each box amounts to RM6. The entity, based on historical trend expects 30% of the sales to be returned.

How should sales with right of return be accounted for?

Because the contract allows a customer to return the unused drilling fluid, the consideration received from the customer is variable. To estimate the variable consideration to which the entity will be entitled, the expected value method is used because it is the method that the entity expects to better predict the amount of consideration to which it will be entitled. The entity expects that it is highly probable that a significant reversal in the amount of cumulative revenue recognised will not occur if the estimate of expected return of 30% changes.

Using the expected value method, the entity estimates that 7 boxes (10*70%) will not be returned, hence revenue of RM70 is recognised (7 boxes @ RM10). In addition, the entity recognised:

- (a) A refund liability of RM30 (3 boxes @ RM10) for goods expected to be returned; and
- (b) An asset for the right to recover the product from customers of RM18 (3 boxes @ RM6)



What can go wrong?

While the effective date may seem a long way off, it is important to understand the implications of applying the standard. Key impact will be to revenue profile, to certain cost recognition and ultimately profit recognition. An assessment will be required that will reinforce the notion that planning for implementation should start early.

Here are some of the anticipated common issues when applying the new standard for the first time.

Identification of contracts with terms which have implications on revenue recognition (“non-standard contracts”)

Contracts management is a key process supporting the revenue generation for most of the oil and gas companies. The contracts management function may not have information with sufficient detail to identify contracts with non-standard terms. Further, they may not be trained to perform the necessary reviews to identify such non-standard terms. Finance function may not be sufficiently involved in this identification.

Processes may not be in place for determination of revenue recognition relating to contracts, which may have identified to include non-standard terms. Sufficient review and approvals may not be in place to ensure that key judgements applied are documented and reasonable.

Inadequate capacity of accounting systems to handle information

Accounting systems may not be capable to automate the revenue recognition in contracts with implications. Depending on the size and nature of the business, the number of contracts with implications could be a handful or voluminous. Whilst a manual fix may be efficient in cases where only a handful of contracts is impacted, sufficient automation may be necessary in cases where the impact

is pervasive and large number of contracts are impacted. Some accounting systems may not be flexible enough to cater for automation.

Mismatch of cash flows and revenues

Revenue recognition is largely dependent on terms explicit or implied in contracts with customers. Contracts must be carefully scrutinised in line with the requirements of the standard during its development phase to avoid surprises.

Given the various principles introduced by the standard, timing of cash flows will be different from revenue recognised. Hence timing of cash flows and revenue should be assessed together in deciding on capital expenditure and project appraisals.

Tax and Regulatory Implications

With the widening gap between timing of revenue recognition and cash received, as well as changes in timing of expenses and capitalised costs, this may significantly impact current tax planning that companies have in place.

Inadequate management processes

Management process flow must be in place in order to identify, assess and conclude on the treatment before key products are introduced to the market.

The formalisation of a dynamic management process must be in place to enable timely assessment and reaction to competition in the market. This includes preparation and maintenance of supporting documentation to document judgement and estimates.

Without a dynamic and complete management process in place, data for assessments may be outdated or incomplete, companies may lag behind the competition and even risk erroneous conclusions, resulting in deviations from budgets or even financial losses. Design and implementation of management processes will require technical expertise.

Lack of documentation on judgements and estimates

Revenue recognition policies for individual products largely depends on management's judgement and estimates subsequent to careful assessment. Documentation on basis of judgement and estimates must be in place to withstand scrutiny by auditors, tax authorities and regulators.

Close collaboration between other functions and Finance teams are essential in arriving at a reasonable conclusion.

Lack of documentation could result in inconsistency of application and the lack of an audit trail in the event of review, leading to potential restatement of financial results.

Other matters to consider

Contracts may need to be revisited

Existing terms could take on new meaning under the new standard, so you may need to re-negotiate debt covenants or earn-out arrangements to maintain the original intent. You may need to rethink how customer agreements should be restructured in future, for example if revenue is to be recognised over time rather than at a point in time.

Compensation and bonus plans may need to be analysed

Revenue recognition can trigger payments like bonuses or commission. You will need to consider how timing changes for revenue recognition may affect these and other internal arrangements.

Financial disclosures may need to be enhanced

Companies also need to be more transparent and comprehensive in disclosing revenue recognition policy and arrangements.

Investor relations plans need to be developed

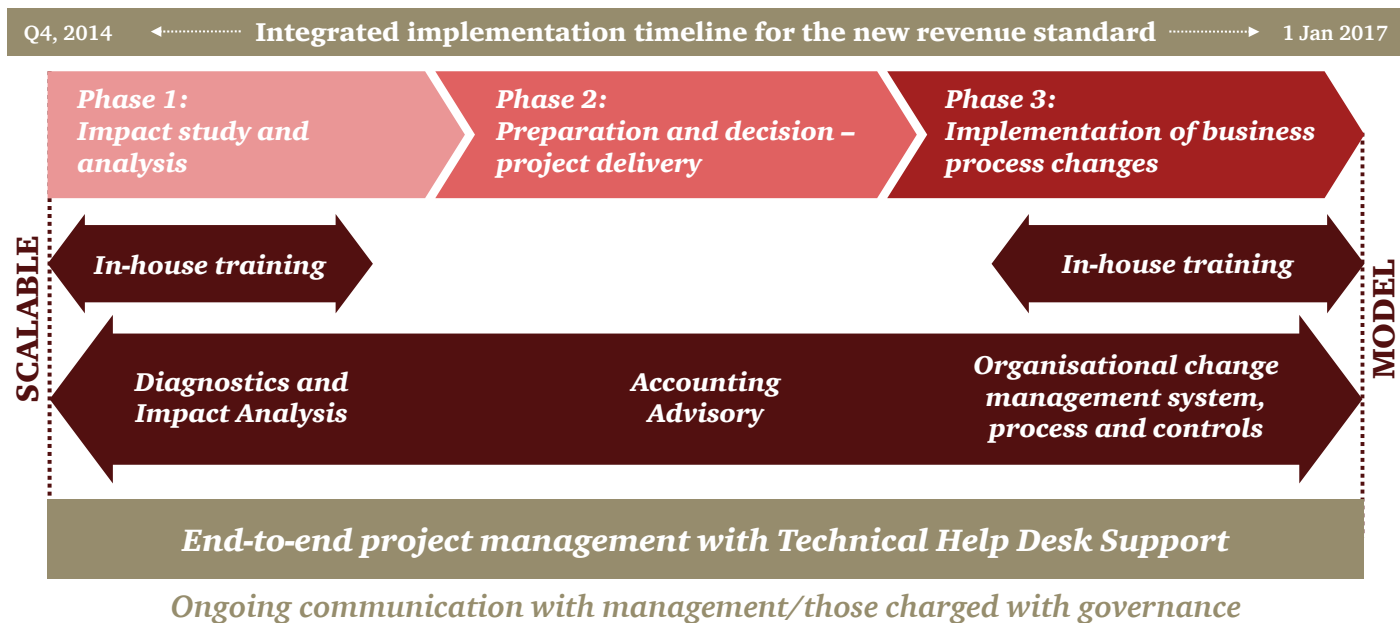
Stakeholders will need to be managed and made to understand how revenue recognition will change and how the new standard affects your company's financial picture.

How we can help

Our 'one firm' solution

PwC is already working with a number of large companies around the world to manage their transition to the new standard.

We have developed an approach that draws on our expertise in accounting, systems implementation and transaction structuring to deliver an end-to-end integrated solution.



Described below are some of the ways in which we can help you as you plan for adoption. All the services described below can be customised to suit your needs.

Service	What we will do
In-house training and technical help-desk	<ul style="list-style-type: none"> • Provide you with training for your accounting, IT, legal and compliance teams on specific areas and implementation issues you may face • Provide on-going implementation and technical support to finance team and other cross functional teams on ad-hoc questions through the transition phase
Diagnostics	<ul style="list-style-type: none"> • Perform diagnostic review of your existing arrangements / accounting policies to assess business issues and financial reporting implications and provide proposed practical solutions and recommendations • Perform diagnostic that includes understanding the financial and cross-functional impact; analyse your business models and contracts underlying your revenue recognition; analyse your IT landscape and an overview of risks and gaps. This will help you understand the breadth and depth of the impact (e.g. accounting, reporting, sales contracts, controls and process, systems, remuneration, taxes and investor relations) so you can plan for implementation
Impact analysis	<ul style="list-style-type: none"> • Work closely with your finance team to model the impact of adoption under different revenue recognition scenarios to your earnings, business model, compensation plans, debt covenants and any other impact areas identified by you • Perform a detailed analysis of differences in accounting policies, data gaps and IT systems landscape including required interfaces to be deployed / upgraded based on business requirement and functional design specifications • Based on the impact analysis, develop and execute a cross-functional communication strategy both internally and externally to your investors, audit committee, board of directors and other stakeholders on a timely basis
Accounting advisory	<ul style="list-style-type: none"> • Undertake a detailed analysis of your specific revenue contract considering your business model while also being mindful of your objectives and propose possible solutions for you • Active participation on the implementation of the proposed solutions, for example, participation in discussions with your lawyers for possible changes to contracts, internal meetings with other cross-functional teams to coordinate implementation, etc
Systems, process and control	<ul style="list-style-type: none"> • Work with your finance and IT teams on updating revenue recognition process, system change, books and records through the transition period • Collaborate with your finance and IT teams on updating revenue recognition process, contract reviews, system change, books and records through the transition period • Support you to determine a sustainable software solution that is able to support compliance with the complex accounting requirements for revenue recognition
Full Scale Implementation	<ul style="list-style-type: none"> • A combination of all of the above to assist with your full scale implementation of the standard (from implementation in-house education, initial diagnostic phase, impact analysis, to embedding changes in your financial reporting tool) utilising PwC developed and tested implementation tools and methodologies • Support you in gathering the data, testing IT concept, adjusting IT systems and testing the results

Appendix: Implementation plan

Here is an example of some of the key areas and activities you may wish to consider in your implementation plan:

Key stages	Overall objectives	Key activities	Done?
1. Inception and Baseline	Inventorise and quantify existing business transactions that carry an impact arising from MFRS 15	<ul style="list-style-type: none"> Understand existing contractual arrangements Identify separate performance obligations and incremental costs through the contracts and plans review Compile list of non-standard terms that is typically entered into in specific lines of business 	
2. Information Gaps and Impact Study	Identify information gaps for MFRS 15 compliance and conduct a business and financial impact study	<p>Assess Information Gaps</p> <ul style="list-style-type: none"> Agree approach to determine transaction price Identify information required to meet MFRS 15 requirements Assess the availability of information through existing system or manual sources Explore options to address the information gaps (e.g. IT enhancement or package re-structuring) <p>Conduct Impact Study</p> <ul style="list-style-type: none"> Conduct high level financial impact study to simulate the financial impact of IFRS 15 on Company performance Conduct a business impact study based on the options available, taking into consideration existing process and IT infrastructure Develop decision paper for adopting “Contract” or “Portfolio” approach. The decision paper shall contain a cost benefit analysis and project risk assessment (e.g. project complexity and ability to deliver on time) 	

Here is an example of some of the key areas and activities you may wish to consider in your implementation plan: (cont'd)

Key stages	Overall objectives	Key activities	Done?
3. Solution Design	Design the detailed solutions and implementation roadmap	<ul style="list-style-type: none"> • Work with respective business divisions to develop a solution blueprint that clearly defines: <ul style="list-style-type: none"> – the IT enhancements initiatives; – Refinement of incentive plans; – Fine tuning of existing contract templates and processes; and – Revision of bundling contracts, if applicable • Develop implementation plans and roadmap • Seek endorsement and commitment from all business partners 	
4. Solutions rollout	Develop all changes required on the systems, policies, processes and templates. Train the relevant stakeholders and roll out to the operations	<ul style="list-style-type: none"> • Construct IT enhancements and develop tracking database • Complete system testing and user training • Update Policies & Procedures to incorporate new processes and controls to capture information to meet MFRS 15 requirements • Update relevant templates and forms jointly with the business owners (e.g. contract template, incentive calculation, tax computation, budget and management report, etc.) • Develop guidelines and processes for the development of new Incentive Plans and bundling contracts in the future • Streamline and refine existing incentive plans and bundling contracts, if applicable • Conduct rollout training and final rollout to the operations 	
5. Revenue reporting and post implementation optimisation	Assess impact of new revenue reporting and optimise the approach	<ul style="list-style-type: none"> • Determine transaction prices • Determine standalone transaction prices • Allocate the transaction price to separate performance obligations • Simulate financial closing with MFRS 15 requirements to assess the financial impact to company performance • Update company budget or targets 	

Let's talk



Nurul A'in binti Abdul Latif

Partner
PricewaterhouseCoopers (AF1146)

Tel: +603 2173 0935
nurul.ain.abdul.latif@my.pwc.com



Soo Kwai Fong

Senior Executive Director
PricewaterhouseCoopers (AF1146)

Tel: +603 2173 0774
kwai.fong.soo@my.pwc.com

pwc.com/my

PwC Alert is a digest of topical financial and business information for clients and business associates of PwC Malaysia. Whilst every care has been taken in compiling this newsletter, we make no representations or warranty (expressed or implied) about the accuracy, suitability, reliability or completeness of the information for any purpose. PwC Associates Sdn Bhd, its employees and agents accept no liability, and disclaim all responsibility, for the consequences of anyone acting, or refraining to act, in reliance on the information contained in this publication or for any decision based on it. Recipients should not act upon it without seeking specific professional advice tailored to your circumstances, requirements or needs.

© 2014 PricewaterhouseCoopers. All rights reserved. "PricewaterhouseCoopers" and/or "PwC" refers to the individual members of the PricewaterhouseCoopers organisation in Malaysia, each of which is a separate and independent legal entity. Please see www.pwc.com/structure for further details.

Publisher: PricewaterhouseCoopers Malaysia (AF1146) Level 15, 1 Sentral, Jalan Travers, Kuala Lumpur Sentral, P O Box 10192, 50706 Kuala Lumpur, Malaysia. Tel: +60 (3) 2173 1188 Fax: +60 (3) 2173 1288 E-mail: pwcmsia.info@my.pwc.com | Design and printing: PricewaterhouseCoopers. CS07420