IFRS Notes

Ind AS 115 applicable from 1 April 2018

11 April 2018

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Introduction

The Ministry of Corporate Affairs (MCA), on 28 March 2018, notified Ind AS 115, *Revenue from Contracts with Customers* (which is based on IFRS 15, *Revenue from Contracts with Customers*) as part of the Companies (Indian Accounting Standards) Amendment Rules, 2018. The new standard is effective for accounting periods beginning on or after 1 April 2018, thus aligning the Ind AS 115 applicability date with the IFRS applicability date i.e. 1 January 2018.

The new standard replaces existing revenue recognition standards Ind AS 11, *Construction Contracts* and Ind AS 18, *Revenue* and revised guidance note of the Institute of Chartered Accountants of India (ICAI) on Accounting for Real Estate Transactions for Ind AS entities issued in 2016.

This standard also modifies other Ind AS for e.g. Ind AS 16, *Property, Plant and Equipment* for determining the date of sale of Property, Plant and Equipment (PPE) i.e. date of disposal of an item of PPE is the date the recipient obtains control of that item in accordance with Ind AS 115. The corresponding changes to other Ind AS have also been notified.

This issue of IFRS Notes provides an overview of Ind AS 115.

Overview of guidance in Ind AS 115

Core principle of Ind AS 115

The core principle of the new standard is that revenue should be recognised when (or as) an entity transfers control of goods or services to a customer at the amount to which the entity expects to be entitled. To achieve the core principle, the new standard establishes a five-step model that entities would need to apply to determine when to recognise revenue, and at what amount.

Five-step model

Step 1 Identify the contract with the 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

Step 5 Recognise revenue when (or as) the entity satisfies its performance obligations

The new model is expected to bring about significant changes in the way companies recognise, present and disclose their revenue. There is a paradigm shift from the present 'transfer of risk and rewards model' to a 'five-step model' which mainly focusses on transfer of control of goods and services by an entity under a contract with its customers.

Overview of guidance in Ind AS 115 (cont.)

Scope of Ind AS 115

The new standard applies to contracts with customers to deliver goods or services, except when those contracts are for:

- Lease contracts under Ind AS 17, *Leases*
- Insurance contracts under Ind AS 104, *Insurance Contracts*
- Rights or obligations that are in the scope of certain financial instruments guidance (such as Ind AS 109, *Financial Instruments*) e.g. derivative contracts or
- Non-monetary exchanges between entities in the same line of business that facilitate sales to customers other than the parties to the exchange.

Overview of the five-step model

Step 1: Identify the contract with the customer

The new standard defines a 'contract' as an agreement between two or more parties that creates enforceable rights and obligations and specifies that enforceability is a matter of law. Contracts can be written, oral or implied by an entity's customary business practices.

A contract with a customer exists when it meets all of the following criteria:

A contract exists if legally enforceable and …

- **… collection of consideration is considered probable**
- **… rights to goods or services and payment terms can be identified**
- **… it has commercial substance**
- **… it is approved and the parties are committed to their obligations**

The new standard also provides guidance regarding combination of two or more contracts entered into at or near the same time and with the same customer (or related parties of the customer), which are accounted for as a single contract with a customer if they satisfy the specified criteria.

Sectors likely to be significantly affected

The new requirements are expected to affect different sectors in different ways. The following section highlights the areas of accounting for relevant sectors that may have an impact due to revised requirements specific to identification of contract:

Construction/ real estate	Software and technology	Aerospace and defense
• Claims and variation • Collectability assessments	• Renewal of contracts	• Government approvals • Termination clauses

Step 2: Identify the performance obligation

The new standard requires an entity to identify the performance obligations, i.e. the unit of account for revenue recognition. A promise to deliver a good or provide a service in a contract with a customer constitutes a performance obligation if the promised good or service is distinct.

Overview of guidance in Ind AS 115 (cont.)

A promised good or service is distinct from other goods and services in the contract if meets two criteria:

Criterion1:

Capable of being distinct

Customer can benefit from the good or service on its own or together with other readily available resources

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Criterion 2:

Distinct within the context of contract

Promise to transfer good or service is separately identifiable from other promises in the contract

Yes → **Distinct performance obligation**

No → **Not distinct – combine with other goods and services**

The following table highlights few examples of scenarios of single and multiple performance obligations:

Description of scenario	Conclusion
Entity provides a significant integration service for a building construction and delivers a single output to the customer	Single performance obligation
Entity provides a customer with equipment and a separately identifiable installation service	Multiple performance obligation
Entity provides the customer with equipment and proprietary consumable that are separately identifiable	Multiple performance obligation
Entity provides the customer with good and an implicit promise to provide a service to the customer's customer who purchase the good	Multiple performance obligation

If a promised good or service under the contract does not qualify to be a separate performance obligation, the entity would need to combine such good or service with other goods or services until the bundled arrangement qualifies to be a performance obligation. Identification of a performance obligation requires significant judgement and entails an assessment of the promised goods and services under the contract (including implied and customary promises).

Sectors likely to be significantly affected

Telecommunication

- Devices and handsets
- Activation and installation
- Telecom services (voice data and SMS)

Technology

- Licences
- Customisation
- Customer Support
- Updates

Real estate

- Common areas
- Amenities (e.g. car park, club membership)

Pharmaceuticals

- Licence for compound combined with research and development and manufacturing services

Overview of guidance in Ind AS 115 (cont.)

Step 3: Determine the transaction price

Ind AS 115 requires an entity to consider the terms of the contract and its customary business practices to determine the transaction price. The transaction price is the amount of consideration to which an entity expects to be entitled in exchange for transferring goods or services to a customer.

The entity should consider the following when determining transaction price:

- Variable consideration and the constraint: If the consideration includes a variable amount, an entity should estimate the amount of consideration to which it will be entitled in exchange for transferring the promised goods or services to a customer. Items such as discounts, credits, price concessions, returns and performance bonuses may result in variable consideration.
- The existence of a significant financing component in the contract: In determining the transaction price, an entity should adjust the promised amount of consideration for the time value of money if significant financing components exist.
- Non-cash consideration: Non-cash consideration is measured at fair value, if that can be reasonably estimated. If not, an entity uses the stand-alone selling price of the good or service that was promised in exchange for non-cash consideration.
- Consideration payable to a customer: Entities need to determine whether consideration payable to a customer represents a reduction of the transaction price, a payment for a distinct good or service, or a combination of the two.

Sectors likely to be significantly affected

Construction/ real estate	Telecommunication	Hospitality
• Cost escalations • Completion and performance bonus • Deferred and advance payments	• Quantity related discounts • Enterprise service contract with usage fee • Wireless instalment plan with service contract	• Club memberships

Step 4: Allocating the transaction price

Under Ind AS 115, entities are required to allocate the transaction price to each performance obligation (or distinct good or service) in proportion to its stand-alone selling price i.e. the price at which an entity would sell the promised good or service separately to a customer.

The best evidence of the stand-alone selling price is an observable price from stand-alone sales of that good or service to similarly situated customers. However, if the stand-alone selling price is not directly observable then the entity should estimate the stand-alone selling price using the following methods:

- The adjusted market assessment approach
- Expected cost plus margin approach
- Residual approach (only in limited circumstances).

Sectors likely to be significantly affected

Technology	Telecommunication
• Stand-alone selling prices of various performance obligations e.g. licences, upgrades, etc. • Allocation of discounts and variable consideration	• Complex telecommunication contracts • Stand-alone selling prices to be reassessed frequently

Overview of guidance in Ind AS 115 (cont.)

Step 5: Recognise revenue

As per the new standard, revenue may be recognised either at a point in time (when the customer obtains control over the promised service) or over a period of time (as the customer obtains control over the promised service). For the purposes of the standard, control refers to the customer's ability to direct the use of and obtain necessary benefits from the asset, i.e. the promised services.

An entity would have to determine at contract inception whether it satisfies the performance obligation over time or at a point in time.

At the end of each reporting period, for each performance obligation satisfied over time, revenue should be recognised by measuring the progress towards complete satisfaction of that performance obligation. An entity should use a single method consistently for such measurement. Ind AS 115 specifies two types of methods: input method and output method, which an entity should consider based on the nature of the goods or services. The objective is to use a method that depicts the transfer of control of goods or services to the customer.

If a performance obligation is not satisfied over time, then an entity recognises revenue at the point in time at which it transfers control of the good or service to the customer. The new standard includes indicators of when the transfer of control occurs.

Sectors likely to be significantly affected

Aerospace, defense and construction

- Over time vs point in time
- Output vs input method to measure performance
- Uninstalled material

Real estate/ construction

- Over time vs point in time

Licences

- Licensing revenue based on right-to-use or right-to-access intellectual property

Other issues

Contract costs

Under the new standard, an entity is required to capitalise certain costs incurred in obtaining a contract if specified criteria are met. Ind AS 115 provides following guidance in respect to recognition of contract costs:

- **Incremental cost of obtaining a contract with a customer**: Entity should recognise as an asset if the entity expects to recover those costs. These are expenses which an entity would not have incurred if the contract had not been obtained i.e. costs incurred are direct incremental costs associated with obtaining the contract (e.g. sales commission).
- **Cost to fulfil a contract**: An entity should recognise an asset for the cost incurred to fulfil a contract if those costs:
  - Relate directly to an existing contract or specific anticipated contract
  - Generate or enhance resources that will be used in satisfying the performance obligation in the future
  - Are expected to be recovered.

Judgement would be required to assess which costs should be capitalised and for determination of the appropriate period and pattern of amortisation, e.g. whether the amortisation period should include the anticipated contracts with the same customer. However, a practical expedient allows an entity to expense as incurred, the incremental costs of obtaining a contract if the amortisation period of the asset would be a year or less.

Contract modifications

A contract modification may either be for a change in scope of services or price or both. Under the new standard, a contract modification is accounted for as a separate contract if distinct goods and services are added to the arrangement, and if those goods and services are priced at their stand-alone selling prices. Else, contract modifications are accounted for either prospectively or by a cumulative catch-up adjustment. No such guidance is provided explicitly in the existing standard on revenue recognition.

Currently there is a diversity in practice when it comes to recognition of revenue from contract modifications (such as claims and variations in the construction industry). Some entities wait until such modifications are approved but some do recognise before formal approvals.

Overview of guidance in Ind AS 115 (cont.)

Licences

Specific application guidance is provided on assessing whether revenue from a distinct licence of intellectual property is recognised at a point in time or over time. If the licence is not distinct from other promises in the contract, then the general model for revenue recognition is applied. Otherwise, the entity applies different criteria to determine what the distinct licence provides to the customer, and therefore when to recognise the revenue.

Ind AS 115 distinguishes between licences that represent the transfer of a right to use an entity's intellectual property and licences that represent the provision of access to an entity's intellectual property over a period of time. Revenue from the former would be recognised at a point in time and for the latter, over a period of time.

Other additional application guidance under Ind AS 115

- Sale with a right of return
- Consignment arrangements
- Warranties
- Principal versus agent
- Customer acceptance
- Bill and hold
- Non-refundable upfront fees
- Customer options for additional items
- Repurchase arrangements
- Customers' unexercised rights.

Effective date and transition

The new standard notified by MCA is effective for accounting periods beginning on or after 1 April 2018. Early adoption is not permitted. Further, an entity can elect to adopt the new standard in a variety of ways, including retrospectively with or without optional practical expedient or through a cumulative effect adjustment as of the start of the first period for which it applies the new standard.

Approach	2017	2018	Date of equity adjustment
Full retrospective – no practical expedients	Ind AS 115	Ind AS 115	1 April 2017
Full retrospective – practical expedients	Mixed requirements	Ind AS 115	1 April 2017
Cumulative effect	Ind AS 11/ Ind AS 18	Ind AS 115	1 April 2018

Overview of guidance in Ind AS 115 (cont.)

Disclosure requirements

Ind AS 115 contains extensive disclosure requirements as compared to those under the current Ind AS. The objective of the disclosure requirements is for an entity to disclose sufficient information to enable users of the financial statements to understand the nature, amount, timing, and uncertainty of revenue and cash flows arising from contracts with customers.

Accordingly an entity should disclose following:

- Disaggregation of revenue
- Contract balances
- Performance obligations
- Significant judgements
- Costs to obtain or fulfil a contract.

Key differences from current Ind AS requirements

Following are some of the key differences between current Ind AS (Ind AS 11 and 18) and Ind AS 115:

- New single five-step revenue recognition model - control based model
- Risks and rewards is retained as indicator of control transfer for performance obligations satisfied at a point in time
- Consideration measured as the amount the entity expects to be entitled to
- Detailed guidance on identifying performance obligations in a contract
- Specific criteria provided to determine when a performance obligation is satisfied over time.
- New guidance relating to software licence, cost of obtaining and fulfilling contracts, contract modifications, etc.

Differences from IFRS 15

Following are the differences between Ind AS 115 and IFRS 15:

- Ind AS 115 excludes penalties from the list of variable consideration and provides specific accounting treatment in case of penalties
- Ind AS 115 requires an entity to present separately the amount of excise duty included in the revenue recognised in the statement of profit and loss
- Ind AS 115 requires an additional disclosure as compared to IFRS 15. Under the new standard, entities are required to present reconciliation of the amount of revenue recognised in the statement of profit and loss with the contracted price showing separately each of the adjustments made to the contract price specifying the nature and amount of each such adjustment separately
- Ind AS 115 provides additional guidance on the accounting treatment in case of transfer of control of a product to a customer with an unconditional right of return.

Our comments

The notification of Ind AS 115 is a welcome step as it aligns the applicability date of the new standard to the global adoption of IFRS 15.

The new standard aims to provide more transparent accounting for revenue. However, it is expected to have a significant impact on revenue recognition and will require significant use of judgement and estimates. Revenue is a crucial financial performance indicator for entities and the new standard is expected to have a pervasive impact due to the addition of significant new concepts on the recognition, measurement and disclosure of revenue.

While this accounting change may impact almost all companies, the impact may particularly be severe for companies involved in complex transactions with multiple components or variable consideration, specifically in sectors such as telecommunications, technology, real estate, aerospace and defence, building and construction and contract manufacturing.

Our comments (cont.)

Since the government has notified the new standard i.e. Ind AS 115, companies have to adopt the new standard from 1 April 2018. Listed companies would face challenges to present their first quarter results under Ind AS, considering the extensive accounting changes and the short implementation time frame available to them.

Additionally, entities in India would have to disclose the impact of new standards along with their annual financial results for 31 March 2018 as per the requirements of Ind AS 8, *Accounting Policies, Changes in Accounting Estimates and Errors.* Ind AS 8 requires an entity to disclose the likely impact of a standard that has been issued but is not yet effective on the entity's financial statements in the period of initial application. Since the new standard is notified by MCA on 28 March 2018, entities are required to present the likely impact of Ind AS 115 on their financial statements as part of their annual financial reports for 31 March 2018.

Next steps

Revenue is an important performance measure for many Indian companies and with very limited time to transition, companies would, therefore, need to plan and invest time in rapid implementation of the new standard. Given the pervasive nature of the impact of the standard, in addition to the financial reporting impact, companies would also have to assess impact on business contracts and processes, as well as the needs of stakeholders such as investors and analysts. India Inc. should gear up with a robust implementation plan as companies might face challenges in implementing the new guidance.

Ind AS 115 – 10 things to look out for

- How revenue may change for key types of contract?
- What are the key drivers for that change – e.g. legal terms, rebate schemes and milestone definitions?
- Are there any alternatives to change contract terms to maintain the revenue profile – e.g. introducing enforceable right to payment clauses?
- Would these changes due to Ind AS 115 be pervasive and therefore change common market terms and conditions for your business?
- What changes are therefore necessary to business processes, procedures and controls?
- Would Ind AS 115 numbers form an appropriate basis for management reward or would the company need to maintain management reporting on a different basis internally?
- How does this change interact with the upcoming changes to lease accounting?
- Consider concessions that could be requested to gain competitive advantage in procurement when re-negotiating contracts with suppliers (given that a company's costs represent suppliers' revenue)?
- Which Key Performance Indicators (KPIs) may be affected in unexpected ways?
- Are there sufficient resources to deliver in time frame needed to implement Ind AS 115?

Sources:

- Ind AS 115, *Revenue from Contracts with Customers* notified by MCA.
- First Impressions: IFRS 15 Revenue, KPMG IFRG Limited's publication, April 2016.
- Revenue – Issues In-Depth, KPMG IFRG Limited's publication, May 2016.
- IFRS 15 – Beware of changes to your top line and KPIs!, KPMG IFRG Limited's publication, August 2017.

KPMG in India

Ahmedabad
Commerce House V, 9th Floor,
902 & 903, Near Vodafone House,
Corporate Road,
Prahlad Nagar,
Ahmedabad – 380 051.
Tel: +91 79 4040 2200
Fax: +91 79 4040 2244

Bengaluru
Maruthi Info-Tech Centre,
11-12/1, Inner Ring Road,
Koramangala,
Bengaluru – 560 071.
Tel: +91 80 3980 6000
Fax: +91 80 3980 6999

Chandigarh
SCO 22-23 (Ist Floor),
Sector 8C, Madhya Marg,
Chandigarh – 160 009.
Tel: +91 172 393 5777/781
Fax: +91 172 393 5780

Chennai
KRM Tower, Ground Floor,
No 1, Harrington Road
Chetpet, Chennai – 600 031
Tel: +91 44 3914 5000
Fax: +91 44 3914 5999

Gurugram
Building No.10, 8th Floor
DLF Cyber City, Phase II,
Gurugram, Haryana – 122 002,
Tel: +91 124 307 4000.
Fax: +91 124 254 9101

Hyderabad
Salarpuria Knowledge City,
ORWELL, 6th Floor, Unit 3,
Phase III, Sy No. 83/1, Plot No 2,
Serilingampally Mandal,
Raidurg Ranga Reddy District,
Hyderabad, Telangana – 500081
Tel: +91 40 6111 6000
Fax: +91 40 6111 6799

Jaipur
Regus Radiant Centres Pvt Ltd.,
Level 6, Jaipur Centre Mall,
B2 By pass Tonk Road
Jaipur, Rajasthan, 302018.
Tel: +91 141 – 7103224

Kochi
Syama Business Center
3rd Floor, NH By Pass Road,
Vytilla, Kochi – 682019
Tel: +91 484 302 7000
Fax: +91 484 302 7001

Kolkata
Unit No. 603 – 604,
6th Floor, Tower – 1,
Godrej Waterside,
Sector – V, Salt Lake,
Kolkata – 700 091.
Tel: +91 33 4403 4000
Fax: +91 33 4403 4199

Mumbai
Lodha Excelus, Apollo Mills,
N. M. Joshi Marg,
Mahalaxmi, Mumbai – 400 011.
Tel: +91 22 3989 6000
Fax: +91 22 3983 6000

Noida
Unit No. 501, 5th Floor,
Advant Navis Business park,
Tower-B, Plot# 7, Sector 142,
Expressway Noida,
Gautam Budh Nagar,
Noida – 201305.
Tel: +91 0120 386 8000
Fax: +91 0120 386 8999

Pune
9th floor, Business Plaza,
Westin Hotel Campus, 36/3-B,
Koregaon Park Annex,
Mundhwa Road,
Ghorpadi, Pune – 411001.
Tel: +91 20 6747 7000
Fax: +91 20 6747 7100

Vadodara
iPlex India Private Limited,
1st floor office space, No. 1004,
Vadodara Hyper, Dr. V S Marg,
Alkapuri, Vadodara – 390 007.
Tel: +91 0265 235 1085/
232 2607/232 2672

You can reach out to us for feedback and questions at:
in-fmkpmgifrsinst@kpmg.com

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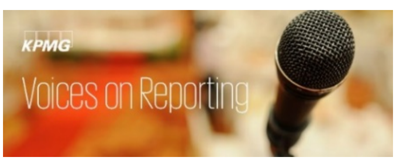
Voices on Reporting

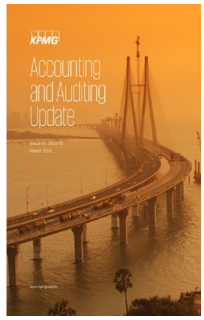


KPMG in India is pleased to present Voices on Reporting – a series of knowledge sharing calls to discuss current and emerging issues relating to financial reporting.

In our recent session of Voices on Reporting webinar on 4 April 2018, we covered key financial reporting and regulatory matters that are expected to be relevant for stakeholders for the quarter ended 31 March 2018.

Click here to access the audio recording (mp3) and presentation (pdf).

Missed an issue of our Accounting and Auditing Update or First Notes



Issue no. 20/2018 – March 2018

In this edition of Accounting and Auditing Update (AAU), we highlight the significant areas where revenue recognition under real estate and construction sector is expected to change due to implementation of Ind AS 115, *Revenue from Contracts with Customers*. This standard is applicable to Indian companies covered in the Ind AS road map from 1 April 2018.

The article on SA 701, *Communicating Key Audit Matters in the Independent Auditor's Report* aims to explain significant changes expected in the auditor's report due to communication of key audit matters. The SA would be applicable to listed companies and certain other companies from 1 April 2018.

The publication carries an article securitisation transactions which describes with the help of an illustrative whether a certain securitisation transaction would meet the criteria for derecognition of a financial instrument and application of control definition on such special purpose entities or trusts.

This publication also cast lens on accounting for income taxes. The article covers two practical scenarios:

- accounting for income taxes in any interim period
- accounting for deferred taxes in a business combination.

Our publication also carries a regular synopsis of some recent regulatory updates in India and internationally.

SEBI relaxes norms governing schemes of arrangements by listed entities

18 January 2018

The listed entities that desire to undertake a scheme of arrangement or are involved in a scheme of arrangement need to follow the regulations laid down by the Securities and Exchange Board of India (SEBI). On 10 March 2017, SEBI issued a circular number CFD/DIL3/CIR/ 2017/21 which laid down a revised regulatory framework for schemes of arrangements by listed entities and relaxation under Rule 19(7) of the Securities Contract (Regulation) Rules, 1957.

The SEBI received representations to improve the existing framework governing schemes of arrangements.

Additionally, SEBI wanted to expedite the processing of draft schemes and prevent misuse of schemes to bypass regulatory requirements. Therefore, on 3 January 2018, SEBI issued a circular number CFD/DIL3/ CIR/2018/2 (the circular) to make certain amendments to the circular dated 10 March 2017.

The recent circular is applicable from the date of its issue i.e. 3 January 2018. In this issue of First Notes, we have provided an overview of the key amendments/ relaxations given in the circular.

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