

across the jurisdictions and industries. Considering this fact, International Accounting Standard Board (IASB) and US national standard-setter, the Financial Accounting Standards Board (FASB) initiated a joint project to develop a common revenue standard for IFRS and US GAAP.

IASB has issued IFRS 15 “*Revenue from Contract with Customers*” which will be applicable from accounting period commencing on or after 1st January 2018. The newly issued standard will replace IAS 11 (Construction Contracts), IAS 18 (Revenue), IFRIC 13 (Customer Loyalty Programmes), IFRIC 15 (Agreements for the Construction of Real Estate), IFRIC 18 (Transfers of Assets from Customers) and SIC-31 (Revenue—Barter Transactions Involving Advertising Services).

Ministry of Corporate Affairs (MCA) has already announced the roadmap for implementation of Ind-AS in February 2015 and India has opted for early adoption of revenue standard effective from 1st April, 2015. IFRS 15 will replace AS 7 (Construction Contracts), AS 9 (Revenue Recognition) and Guidance Notes issued by the ICAI.

Core principle of IFRS 15 is that revenue should be recognised for transferred goods or services for the consideration which the entity is entitled. Following steps need to be applied for revenue recognition -

- I. *Identify the contract with the customer*– A contract is an agreement between two or more parties which creates an enforceable right. The standard provides details for contract modification and combination of contracts.
- II. *Identify the performance obligation of the contract*– Performance obligation can be in the form of transfer of goods or services to the customer. All the relevant terms and conditions of the contract with the customer have to be analysed carefully to determine the point of time when performance obligation gets satisfied.
- III. *Determine the transaction price*- Transaction price is the amount of consideration in a contract to which an entity expects to be entitled in exchange for transferring promised goods or services to a customer. Transaction price can be fixed, variable, a combination of both or non-cash consideration. In case there is a financing element in the contract then

transaction price has to be adjusted for this factor. The standard provides detail guidance for all the situations.

- IV. *Allocate the transaction price to the performance obligations in the contract*– In case multiple goods or services are promised in a single contract (called as bundled contract), entire transaction price is allocated on the basis of relative stand-alone selling price of each good or service. Relative fair value method is prescribed by the standard for allocating the transaction price but residual value method is also permitted in certain circumstances. The standard provides guidance on allocation of discount or variable consideration to the distinct goods or services.
- V. *Recognise revenue when (or as) the entity satisfies a performance obligation*– An entity recognises revenue when it satisfies a performance obligation in the contract. The performance obligation is satisfied when the entity transfers the control of the promised goods or services. In case performance obligation is satisfied over a period of time then the entity can recognise revenue based on output method or input method provided the entity has a right to payment for performance completed till date. This is the significant change as compared to the prevailing accounting guidance where obligation is deemed to be satisfied when the entity transfers the risks and rewards to the customer.

Implementation of the new revenue standard would require numerous organisational and business changes. Significant changes as compared to current accounting practice are as below-

1. *Timing of revenue recognition*- Under AS9, the

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timing of revenue recognition from the sale of goods is based primarily on the transfer of risks and rewards. IFRS 15, instead, focuses on when control of those goods has been transferred to the customer. This difference may change the timing of revenue recognition as it may happen that the legal title of the goods remains with the seller but the necessary control to obtain economic benefit has been transferred to the customer. If the control of a good or service is transferred over a period then revenue shall be recognised over the period. This change may impact real estate companies in a big way.

2. **Different performance obligations under single contract**– In certain circumstances, recognition criteria are to be applied separately on identifiable components of the contract. This is going to impact industries like telecom, software development, infrastructure, etc. where long term contracts are entered.

Example- A Telecom Company launches a scheme in which it will provide free handsets to its customers and will charge a fixed monthly fee of ₹1,000 for 12 months. Company sells the same handset to other customers at ₹4,000 and monthly payment plan without handset is ₹800. Prevailing revenue recognition standards do not provide guidance on how to identify the components and how to allocate selling price and most of the telecom companies recognise service revenue and treat the cost of handset as cost of acquiring the customer. Under IFRS 15, the company has to identify the obligations under the contract i.e. to deliver the handset and provide network services for 12 months. Transaction price of ₹12,000 is allocated between these components (refer table below)-

Performance Obligation	Stand-alone selling price	% on total	Relative selling price	Timing of revenue recognition
Sale of handset	4,000	29.41	3,529	When handset is delivered.
Network services	9,600 (800 X 12)	70.59	8,471	Over the service period
Total	13,600	100	12,000	

The above transaction has been broken into two parts because the customer can get benefit from these two on their own and both of these are readily available in the market. Conversely, the recognition criteria are applied to two or more transactions together when these are linked in such a way that the commercial effect cannot be understood without reference to the series of transactions as a whole.

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The basic fundamental under IFRS is that every transaction has a value if the goods or services are distinct. Based on this principle, revenue recognition for some entities will change which provide certain goods/services as free (as nothing is accounted as free under IFRS). In such kind of transactions, relative fair value of goods/services offered is to be determined and it has to be deferred until these goods/services are delivered.

3. **Transactions containing financing element**- There are certain transactions which are technically sale of goods/services but the substance of the contract contain significant financing component. For example, A sells goods to B for ₹10,000 and at the same time it agrees to buy the same goods after a period of six months at ₹12,000. In this case, if on the basis of criteria mentioned in the standard it is concluded that the transaction contains significant financing component, then ₹2,000 will be treated as finance cost over six months period and no revenue will be recognised (assuming that the cash selling price in normal course is also ₹10,000).

4. **Contract modification**- A contract modification is a change in the scope or price (or both) of a contract that is approved by the parties to the contract. A contract modification can be either accounted as a separate contract or otherwise. A modification shall be accounted as separate contract if scope of the contract increases due to addition of promised goods/

services and the contract price increases by the amount which reflects the stand-alone price of additional promises made in the contract.

If the contract modification is not treated as a separate contract as described above and remaining goods or services to be delivered after modification of the contracts are different from goods/services already delivered then the amount of consideration shall be allocated to the remaining performance obligation. In case the remaining goods or services to be delivered after modification of the contracts are not distinct, then it shall be treated as part of the existing contract.

Contract modification has implications in certain industries, like telecommunication, where the customers frequently change the bill plan and an entity must determine whether the modification creates a new contract or whether it will be accounted for as part of the existing contract.

5. **Variable consideration**– Variable consideration can be in the form of discounts, rebates, refunds, price concessions, incentives, etc. and can also vary due to occurrence or non-occurrence of future events. Variable consideration may arise out of the contractual terms or customary business practices. For the purpose of accounting, an entity shall estimate the amount of variable consideration by using the probability techniques and historical data and recognise a refund liability. An entity shall reassess the variable consideration at each balance sheet period. Customer's right to return the goods is treated as variable consideration as per this standard and the entity has to ensure the expected return at each reporting period.
6. **Non cash consideration**– In case of barter transactions (or even when non cash consideration is received as part of entire transaction price), fair value of the non-cash consideration shall be taken as the transaction value. Fair value, in this, case shall be determined

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in accordance with IFRS 13. In case fair value of non-cash consideration can't be ascertained reasonably, then stand-alone selling price of the goods or services shall be taken as transaction price.

In some cases, customer contributes material, equipment, etc. to facilitate the fulfillment of the contract. The entity shall assess whether it obtains control of those contributed goods or services. If so, the entity shall account for the contributed goods or services as non-cash consideration received from the customer.

7. **Customer loyalty points**– Paragraph 70 to Paragraph 72 deal with this topic and cover the aspects which are currently dealt by IFRIC 13 and a common practice in retail industry. Consideration payable to customer includes cash amount that entity pays or expects to pay and includes credit or other items (like a coupon or voucher). In certain cases, customer has an option to acquire additional goods or services for free or at discount (like award credit or points). In such kind of situation, the customer in fact pays the entity an advance for future goods or services and revenue shall be recognised when these goods or services are transferred or option gets expired. The entity allocates the relative standalone transaction price of options from revenue and recognises the liability.
8. **Incremental cost for obtaining contract**– The incremental costs of obtaining a contract are those costs that an entity incurs to obtain a contract with a customer that it would not have incurred if the contract had not been obtained (like sales commission). An entity shall recognise the incremental costs of obtaining a contract with a customer as an asset if the entity expects to recover those costs. The recognised asset shall be amortised on a systematic basis that is consistent with the transfer to the customer of the goods or services to which the asset relates. Costs to obtain a contract that would have been incurred regardless of whether the contract was obtained shall be recognised as an expense when incurred, unless those costs are explicitly chargeable to the customer regardless of whether the contract is obtained.
9. **Right to return**– In some cases, entities transfer the control of the goods to the

customer and also grant the customer the right to return the product for various reasons (such as dissatisfaction with the product). The right to return can be in the form of full or partial refund, credit of amount that can be applied by the customer or exchange of the product. Following accounting treatment shall be done for the right to return given to the customer-

- i. Entity shall recognise the revenue for the transferred products in 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);
- ii. A refund liability shall be recognised; and
- iii. An asset (and corresponding adjustment to cost of sales) shall be recognised for entity's right to recover products from customers on settling the refund liability.

The refund liability and asset shall be measured at each balance sheet and asset shall be presented separately from the refund liability.

10. **Warranty**– Nature of warranty varies across industries and it can be either for the performance of the product or a service obligation may also be present in addition to the performance of the product. If the warranty includes service obligation along with the performance of the product, then the transaction price shall be allocated between product and service. In case cannot be accounted separately, the entity shall account for both of the warranties together as a single performance obligation.

If a customer has the option to purchase a warranty separately (for example, because the warranty is priced or negotiated separately), the warranty is a distinct service and the transaction price shall be allocated between product and warranty. If a customer does not have the option to purchase a warranty separately then an entity shall create a provision for warranty liability in accordance with IAS 37 *Provisions, Contingent Liabilities and Contingent Assets*.

11. **Non-refundable upfront fee**– In certain industries, the entity receives non-refundable upfront fee from the customer at the inception of the contract (like activation fee for telecom subscribers, membership fee for club, etc.). In most of the cases, non-refundable fee is in the nature of advance received from the customer

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for future goods and services and therefore, has to be recognised as revenue when those future goods and services are provided. The revenue recognition period would extend beyond the initial contractual period if the entity grants the customer the option to renew the contract and that option provides the customer with a material right.

In case the non-refundable fee is towards compensation for costs incurred in setting up a contract, then the entity shall assess whether costs incurred in setting up a contract have resulted in an asset. This is because costs of setup activities do not depict the transfer of services to the customer.

12. **Consideration payable to customer**– At times, customer incurs expenses on behalf of the company (say, distributor incurring advertisement expenses, display charges, etc. for the company's products) and claims reimbursement from the company. Currently, these expenses are charged as selling and advertisement expenses in the profit and loss account. Under IFRS 115, consideration payable to customer is accounted as deduction from revenue unless the payment is for a distinct good or service from the customer in which case an entity shall account for the purchase of the good or service in the same way that it accounts for other purchases from suppliers.

Conclusion

Implementation of the new revenue recognition standard will be challenging for many entities and they might need to change their revenue recognition policy. IFRS 15 is likely to present implementation challenges and the enterprises need to relook at their contractual terms. A robust internal control backed by strong IT environment is the key for successful migration towards the new revenue recognition regime. ■