Ind AS 115 - New Rules for Revenue Recognition under Ind AS: An Analysis and Overview

Ind AS 115 is expected to impact revenue recognition of many companies across multiple sectors. The new revenue standard provides detailed guidance on areas such as multiple element arrangements, variable considerations, licensing of intellectual property, etc., which will help reduce scope for interpretation and improve disclosures about revenue recognition for users of financial statements. Under Ind AS 115, the focus has shifted from transfer of risk and rewards as required under Ind AS 18/Ind AS 11 to transfer of control over goods/services. The new revenue standard prescribes five-step model for determining timing and amount of revenue to be recognised by the entities. Read on to know more…

Background

The Ministry of Corporate Affairs (MCA) notified Ind AS 115, 'Revenue from Contracts with Customers', on 28th March 2018, with effective date of accounting periods beginning on or after 1st April 2018. Ind AS 115 replaces the existing revenue recognition standards under Ind AS namely Ind AS 11, 'Construction Contracts' and Ind AS 18, 'Revenue'. This new standard on revenue recognition is now a single standard under Ind AS providing for guidance on recognition of revenue for companies in any sector/industry.

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Ind AS 115 is expected to influence the revenue recognition in almost all companies in India, though the extent of impact could vary depending on the industry sector to which the Company

belongs and the current accounting practices of recognizing revenue.

Listed entities that are required to report their quarterly results are required to apply the requirements of this new standard in measurement and recognition revenue from its operations for the quarter ended June 30, 2018 and onwards.

What Has Changed under the New Revenue Recognition Standard?

Ind AS 115, 'Revenue from Contracts with Customers' has been issued to align with global standards on revenue recognition namely IFRS 15 and ASC 606 under IFRS and US GAAP respectively.

Key Differences between Ind AS 115 and the existing standard on Revenue - Ind AS 18/Ind AS 11 are as under:

Five Step Model of Revenue Recognition under Ind AS 115

Ind AS 115 prescribes five-step model for determining the timing (at a point in time or over time) and the amount of revenue to be recognised as the entity transfer control over goods and services to a customer.

The five steps model prescribed under the new revenue standard is as under:

Step 1	Identify Contract with Customer
Step 2	Identifying performance obligation
Step 3	Determine Transaction Price
Step 4	Allocating the transaction price to performance obligation
Step 5	Recognise revenue when (or as) a performance obligation is satisfied.

Sr. No.	Ind AS 18/Ind AS 11	Ind AS 115
1	Ind AS 18 and Ind AS 11 provided separate revenue recognition framework for supply of goods and services and for construction contracts.	Ind AS 115 prescribes a single comprehensive framework for recognition of revenue from sale of goods, services and from construction contracts. Based on the nature of performance obligations covered in the contract with customer, revenue can be recognised at a point in time or over a period of time as those performance obligation gets satisfied.
2.	Under Ind AS 18 and Ind AS 11, the focus was transfer of risk and rewards to enable entity to recognise revenue	Under Ind AS 115, revenue is recognised when control of a good or service transfers to a customer. Ind AS 115 focuses on transfer of control although risk and rewards continues to be an indicator of control. Control refers to the ability to direct the use of, obtain substantially all of the remaining benefits from goods/services and the ability to prevent other entities from directing the use of, and obtaining the benefits from those goods/services.
3.	Ind AS 18 and Ind AS 11 provided limited guidance on dealing with multiple performance obligations, variable consideration, customer options, repurchase arrangements, etc.	Ind AS 115 provides detailed guidance on multiple performance obligations, variable consideration, customer options, repurchase arrangements, etc. Detailed guidance on the above aspects may change the manner in which revenue is currently recognised.
4.	Ind AS 18/Ind AS 11 did not provide much guidance on revenue recognition from license of Intellectual property.	Appendix B to Ind AS 115 provides detailed guidance on recognition of revenue from license of intellectual property of an entity.

Understanding five-step model of Revenue Recognition

Steps	Guidance
Step 1 : Identify Contract with Customer	Under the Ind AS 115, entities can recognise revenue arising from contract with its customer. Contract need to create an enforceable rights and obligation between the two parties and can be written, oral or implied by an entity's customary business practices. A contract with customer would need to have following characteristics to meet the requirement of Ind AS 115 : a) Both the parties approve the contract and are committed to perform their part of obligations; b) Each party's rights regarding transfer of goods and services and payment terms are identified; c) The payment terms for the goods and services are identifiable. d) It is probable that the entity will collect the consideration for transfer of goods and services; and e) The arrangement has commercial substance.
Steps	**Guidance**
Step 2 : Identifying performance obligations	A performance obligation is a promise in a contract with a customer to transfer either: (a) a good or service (or a bundle of goods or services) that are distinct; or (b) a series of distinct goods or services that are substantially the same and have the same pattern of transfer to the customer (eg. cleaning services). A good or service might be distinct and thus a separate performance obligation, if below two criterias are met: • the customer can benefit from the good or service either on its own or together with other resources that are readily available, and • the good or service is not dependent on or interrelated with other items in the contract. Identifying performance obligation is a key step in recognition of revenue under Ind AS 115 as transaction price is allocated to each of the separate performance obligation (Step 4) and revenue is recognised as each of the each of identified performance obligation in the contract is satisfied (Step 5).
Step 3 : Determine Transaction Price	An entity need 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 an entity expects to be entitled in exchange for transferring promised goods or services to a customer. The consideration promised in a contract with a customer may include fixed amounts, variable amounts or both. An entity need to consider effects of the following components while determining transaction price :
	a) Variable Consideration: • An amount of consideration can vary because of discounts, rebates, refunds, credits, price concessions, incentives, performance bonuses, or other similar items. The promised consideration can also vary if an entity's entitlement to the consideration is contingent on the occurrence or non-occurrence of a future event. • If the consideration promised in a contract includes a variable amount, an entity shall estimate the amount of consideration to which the entity will be entitled in exchange for transferring the promised goods or services to a customer.

	b) Existence of significant financing component : • If the entity provides significant financing benefit to the customer, it shall adjust the transaction price for the effects of the time value of money. • The objective of the above adjustment for significant financing component is for an entity to recognise revenue at an amount that reflects the price that a customer would have paid for the promised goods or services either in cash or under normal credit terms as per industry practice. • As a practical expedient, an entity need not adjust the promised amount of consideration for the effects of a significant financing component if period of significant financing does not exceed one year.
Steps	**Guidance**
	c) Non Cash Consideration : • When the customer promises to pay consideration other than cash, the entity measures the non-cash consideration at fair value. • If the fair value of consideration cannot be reliably measured than the transaction price of promised goods and services is determined based on standalone selling price of those goods and/or services.
	d) Consideration payable to customer : • Any consideration payable (other than for purchase of distinct goods or services from a customer) to a customer or to customer's customer is required to be reduced from the transaction price and therefore revenue from sale of goods/services needs to be recorded net of such consideration payable to the customer.
Step 4: Allocating Transaction Price to separate performance obligation.	• At this step, entities are required to allocate the transaction price to each of the separate performance obligation identified at step 2 above based on relative standalone selling prices. • The stand-alone selling price is the price at which an entity would sell a promised good or service separately to a customer. The best evidence of a stand-alone selling price is the observable price of a good or service when the entity sells that good or service separately in similar circumstances and to similar customers.
Step 5: Recognise revenue when (or as) a performance obligation is satisfied.	• Under Ind AS 115, an entity shall recognise revenue when (or as) the entity satisfies a performance obligation by transferring promised good or service (i.e an asset) to a customer. An asset is transferred when (or as) the customer obtains control of that asset. • An entity transfers control of a good or service over time and, therefore recognises revenue over time, if one of the following criteria is met: a) the customer simultaneously receives and consumes the benefits provided by the entity's performance as the entity performs; b) the entity's performance creates or enhances an asset (for example, work in progress) that the customer controls as the asset is created or enhanced;or c) the entity's performance does not create an asset with an alternative use to the entity and the entity has an enforceable right to payment for performance completed to date. • For each performance obligation satisfied over time, an entity shall recognise revenue over time by measuring the progress towards complete satisfaction of that performance obligation using input method or output method based on nature of goods or services transferred to customer. • An entity shall determine at contract inception, whether it satisfies the performance obligation over time or at a point in time. If an entity does not satisfy a performance obligation over time, the performance obligation is satisfied at a point in time.

Impact on Presentation and Dislosures

Ind AS 115 prescribes more detailed disclosures as compared to Ind AS 18 and Ind AS 11 to enable the users of the financial statements to understand the nature, amount, timing and uncertainty of revenue and cashflows arising from contracts with customers. Ind AS 115 requires following qualitative and quantitative dislosures:

Broad heads of disclosures	Details of Disclosures
Customer with customers	a) Amount of revenue recognised from contracts with customers separately from its other sources of revenue ; b) amount of impairment losses recognised on any receivables/ contract assets which the entity shall disclose separately from impairment losses from other contracts.
Disaggregation of revenue	a) Amount of disaggregate revenue recognised from contracts with customers into categories based on the nature, amount, timing and uncertainty of revenue and cash flows
Contract balances	a) The amount of opening and closing balances of receivables, contract assets and contract liabilities from contracts with customers; b) revenue recognised in the reporting period that was included in the contract liability balance at the beginning of the period; and c) revenue recognised in the reporting period from performance obligations satisfied in previous periods (for example, due to changes in transaction price).

Transition Consideration

Appendix C to Ind AS 115 provides following four approaches in applying the new standard. An entity may choose to apply any one of the following approaches to apply the requirement of Ind AS 115:

a) **Full retrospective application:** The entity can apply the requirements of Ind AS 115 retrospectively for each prior reporting period presented in accordance with Ind AS 8, 'Accounting Policies, Changes in Accounting Estimates and Errors'. Accordingly, the entity shall adjust the opening balance of equity for the earliest prior period presented (i.e. adjust the retained earnings as at April 1, 2017) and the other comparative amounts disclosed for each prior period presented (i.e. restate the comparative figures of FY 2017 -2018) as if the requirements of Ind AS 115 had always been applied.

b) **Retrospective application with practical expedients :** An entity while applying the requirement of Ind AS 115 retrospectively may choose to apply certain practical expedients. Under this approach, an entity will comply all the requirement of full retrospective application (as stated above) except for certain practical expedients as summarised in 'Practical Expedient' section below.

c) **Cumulative catch up application :** Under this approach, the entity recognises the cumulative effect of initially applying this Standard as an adjustment to the opening balance of retained earnings/other component of equity of the accounting period that includes the date of initial application. Accordingly, an entity with March 31 year end shall recognise the cumulative effect of applying Ind AS 115 as an adjustment to its retained earning as at April 1, 2018.

d) **Cumulative catch up application with practical expedients :** An entity may choose to apply certain practical expedients while following cumulative catch up application approach. Under this approach, an entity will comply all the requirement of cumulative catch up application (as stated above) except for certain practical expedients as summarised in 'Practical Expedient' section below.

Practical Expedients

Ind AS 115 permits following practical expedients for each of transition method specified at para (b) and (d) above.

Sr. No.	Retrospective application	Cumulative catch up application
1.	Entity need not restate contracts which got completed within the same accounting period or at the beginning of earliest period presented (i.e. April 1, 2017 for entity with March 31 year end)	Entity need not restate contracts which got completed before the date of initial application (i.e. April 1, 2018 for entity with March 31 year end)
2.	Entity need not restate contracts which got modified at the beginning of earliest period presented (i.e. April 1, 2017 for entity with March 31 year end) for those contract modifications.	Entity need not restate contracts which got modified at the beginning of earliest period presented (i.e. April 1, 2017) or before the date of initial application (i.e. April 1, 2018) for those contract modifications.
3.	Entity may use the transaction price at the date the contract was completed rather than estimating variable consideration amounts in the comparative reporting periods.	Not available for this approach
4.	Exemption from certain disclosures for reporting period before date of initial application (i.e. April 1, 2018)	Not available for this approach

Entity will need to apply the expedients consistently to all contracts within all reporting periods presented and disclose the expedients used and estimated effect (qualitative assessment) of applying each of those expedients.

Which Sectors Will Get Impacted by Ind AS 115 ?

Revenue from operations is a key financial measure which is closely analysed by investors and analysts for most companies and Ind AS 115 accordingly impact almost all companies. Sectors which are most likely to get impacted by Ind AS 115 are summarised below :

Sectors	Key impacting areas
Real Estate	• Recognition of revenue over time is permitted if certain conditions are fulfilled. In other cases, revenue will need to be recognised at a point in time. • Recognition of revenue for bundled promises like sale of land, construction of flats, car parks, club membership and other ammenities. • Certain real estate development contracts may involve significant financing component and the entity would need to consider the impact of time value of money while determining the transaction price. • Accounting for variable consideration like awards or incentive payments, performance bonus, claims, liquidated damages and variation. In certain situations, Ind AS 115 may result in earlier recognition of revenue.
Sectors	**Key impacting areas**
Consumer and Industrial Products	• Accounting for option to acquire additional goods and services free of charge or at discounted prices. • Accounting for variable consideration like discounts, rebates, returns, price concessions, incentives, performance bonus, etc. • Accounting for incremental costs of obtaining a contract and costs to fulfill a contract.

Software & Technology	• Accounting for revenue from license of intellectual property (IP). Recognition of revenue could be different in situations where the licenses are distinct from other goods or services as compared to licenses that are not distinct from other goods or services. • Timing of recognition of revenue could be different where the license provides right to access IP as it exists throughout the license period as compared to right to use IP as it exists at a point in time at which the license is granted. • Identifying separate performance obligation like sale of hardware, softwares, installation services, upgrades and customer support, etc, allocation transaction price between these performance obligation and recognising revenue for separate performance obligations.

Summary

Notification of Ind AS 115 is a welcome move by MCA to align Indian Accounting Standard on revenue recognition to corresponding international accounting requirements under IFRS and US GAAP. The new standard would help in improving the comparability of revenue of Indian entities with its global peers in similar industries.

However, considering the effective date of April 1, 2018, companies, more particularly listed companies, would need to start early to assess the accounting and tax impact of the new standard on its financial results for current and comparative periods. Companies would also need to a) evaluate and determine their transition approach b) review and if required updated their existing revenue contracts terms and c) make changes to their IT systems and processes to capture the required information to meet the recognition, measurement and disclosure requirements of Ind AS 115. ■