Ind AS 115, *Revenue from Contract with Customers - Basic concepts*

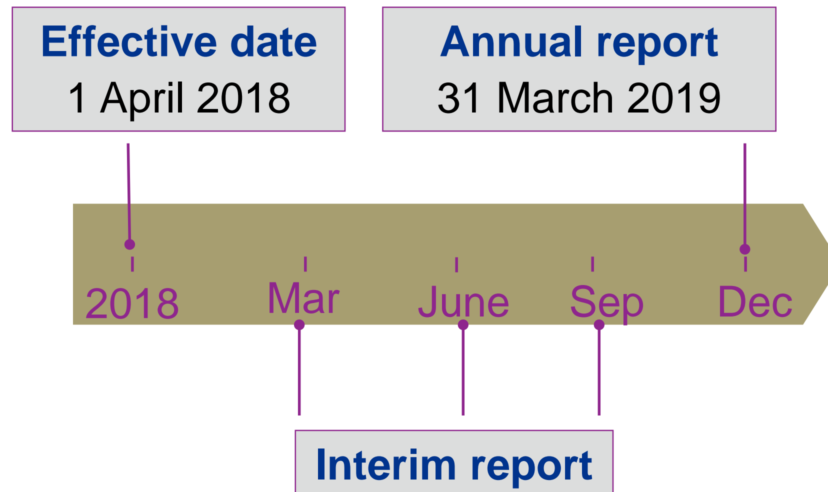
WIRC
June 2019

Why is This Important?

- Universally consistent standard
- The new revenue standard affects almost all entities.
- Ind AS 115 introduces a new framework for the analysis of revenue transactions.
- The impact will vary between entities.
- Your stakeholders/investors will want to understand the impact on your business.

Effective Date

- The Ministry of Corporate Affairs (MCA) on 28 March 2018, notified Ind AS 115, *Revenue from Contracts with Customers.*
- The new standard is effective for accounting periods beginning on or after 1 April 2018
- Early adoption is not permitted



Agenda

- ❑ Five Step Model
- ❑ Other Specific Matters
- ❑ Presentation and Disclosures
- ❑ Other Specific Matters
- ❑ Key Points to Remember

Introduction

Core principle

……is that an entity recognises ***revenue*** to depict the transfer of ***promised goods and services*** to customers in an amount that reflects the consideration to which the entity expects to be entitled ***in exchange*** for those goods or services.

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***".

Ind AS 115 applicability

Out of scope

Leases

Financial Service, *Insurance Contracts*

Rights or obligations that are in the scope of certain financial instruments guidance – e.g. derivative contracts

Non-monetary exchanges between entities in the same line of business that facilitate sales to customers other than the parties to the exchange.

In scope

Contract with a customer

Part of a contract

115

Other

Portfolio of contracts

Contract 1

Contract 2

Contract 3

Contract 4

The Five Step Model

1 Identify the contract with a customer

2 Identify the performance obligations

3 Determine the transaction price

4 Allocate the transaction price

5 Recognise revenue

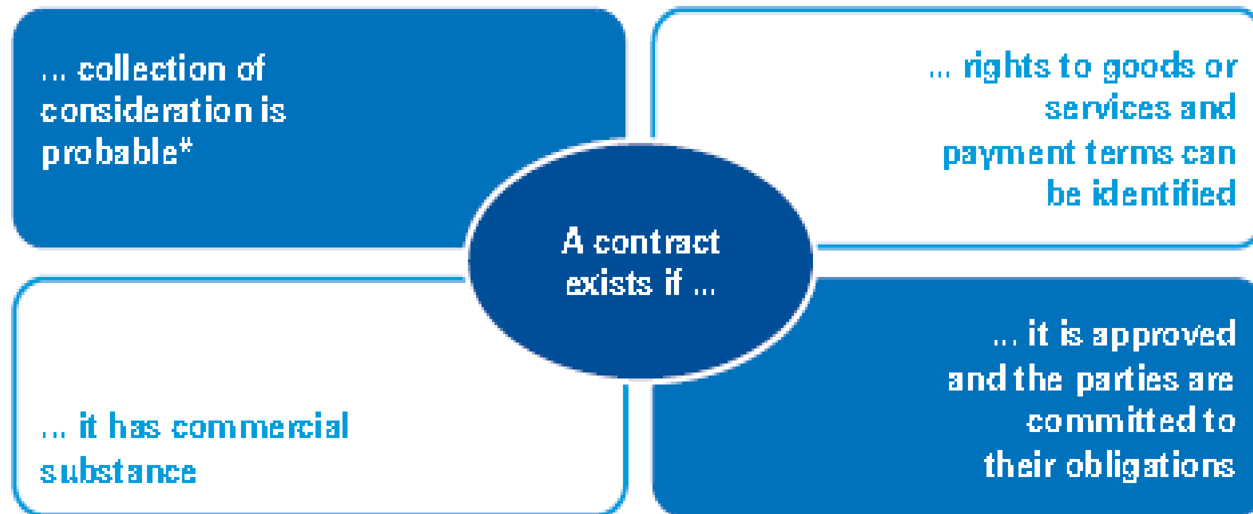
Identify the contract

STEP

1

- Ind AS 115 defines contract "as an agreement between two or more parties that creates enforceable rights and obligations", which can be written, oral or implied by customary business practices.

- A contract with customer needs to meet **all** of the following criteria:



Identify the contract

Question: Whether a 'contract' exist if an arrangement between the parties is not executed as a written document?

Key considerations

- A contract exists if rights and obligations are enforceable.
- Significant judgement may be required in some jurisdictions or for some arrangements to assess if a contract exists.
- An oral contract may constitute as an enforceable contract but key considerations to be factored in are:
  - Customary practices
  - Communications made by sales teams
  - Quotes
  - Purchase orders
  - Side agreement.

  The above assessment would depend on the facts and circumstances of each case.
- Consider involvement of the legal department while identifying a contract.

Identify the contract

STEP
1

Other considerations

- Assessment focus on enforceability and not form of the contract
- Collectability is a gating question and based on the amount an entity expects to receive
- Considerations received before concluding that a contract exists
- Combining contracts

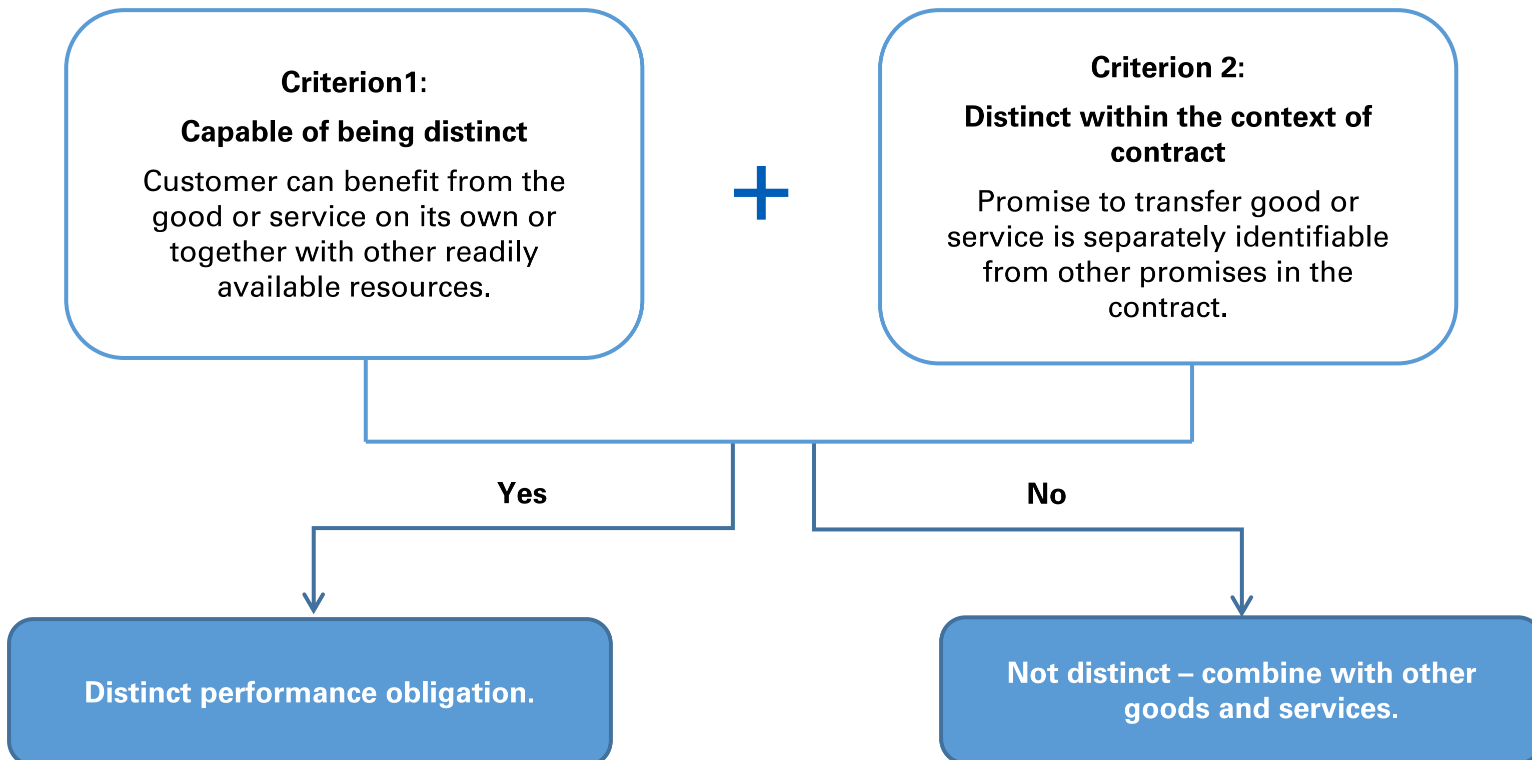
Identify performance obligations

STEP 2

Performance obligation

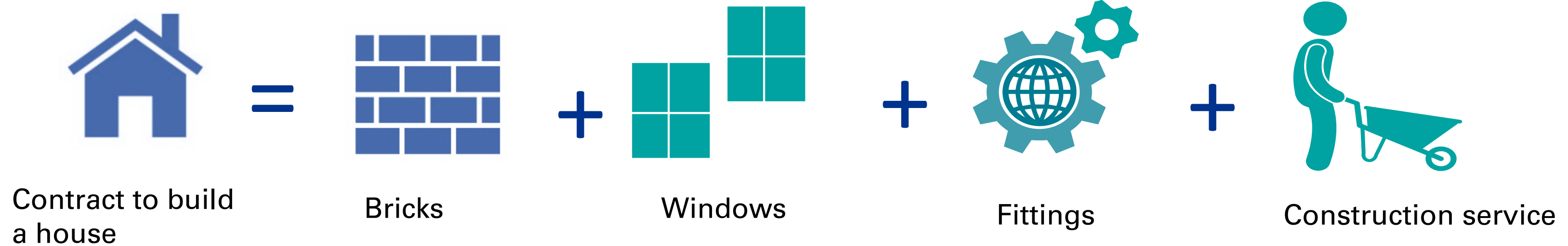
… is an implicit or explicit promise within a contract to transfer distinct goods or services to the customer.

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



Single performance obligation - Example

STEP
2



Do the goods and services individually meet the ‘performance obligation’ criteria?

Criterion 1 – Benefit on its own or with other resources

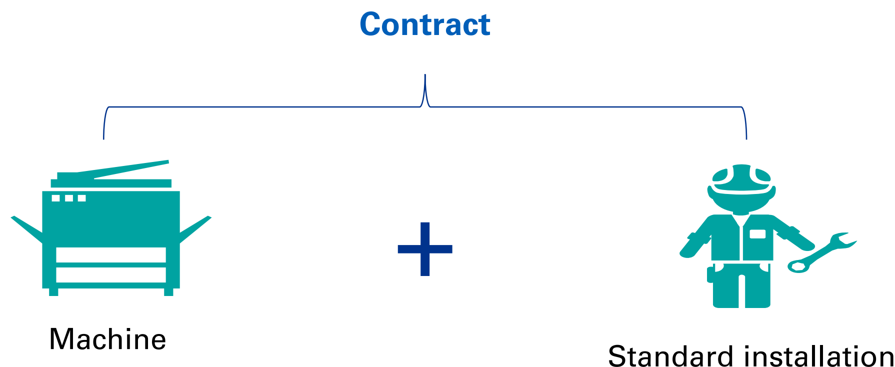
Each material could be used with another readily available item.

Criterion 2 – Good or service separately identifiable

Entity is providing a significant integration service.

Multiple performance obligation - Example

STEP
2



Installation services are also offered by third party providers.

Do the machine and the installation service meet the 'performance obligation' criteria?

Criterion 1 – Benefit on its own or with other resources	Criterion 2 – Good or service separately identifiable
Machine and installation can be used with other available resources. ✓	No significant integration service, installation is a standard service and installation and machine are not highly inter-related. ✓

Identify performance obligations

STEP
2

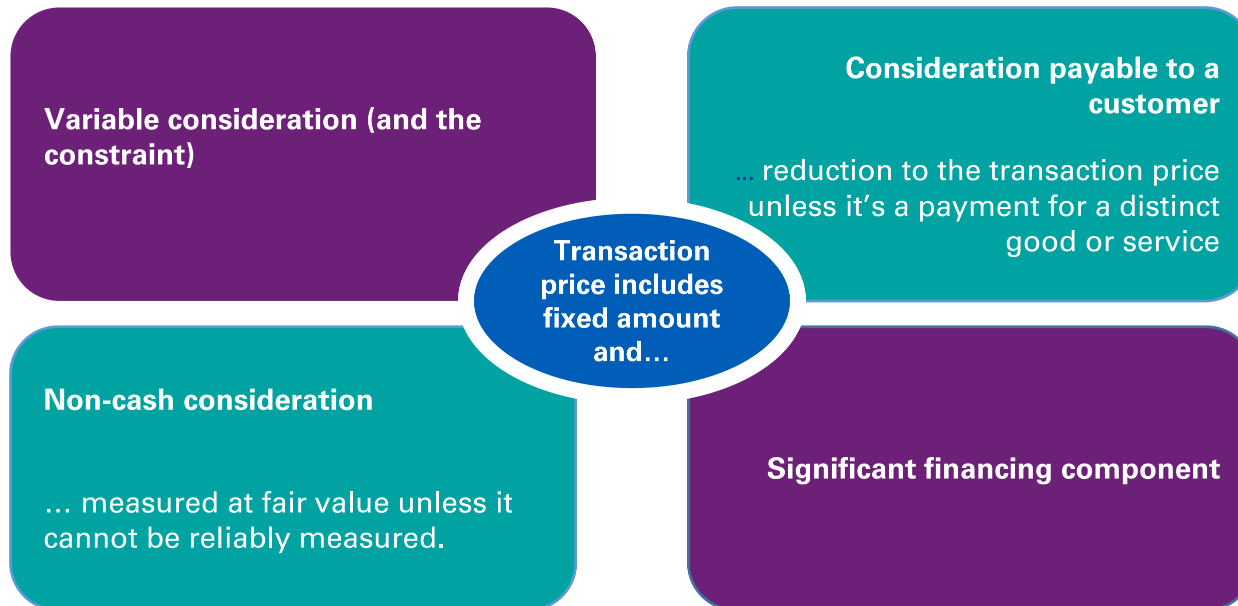
Other considerations

- Applying the indicators require judgement
- Potential change in practice from current guidance
- Accounting systems and process will need to be modified to allocate revenue to individual products and processes
- Set up activities are administrative tasks

Determine the transaction price

STEP
3

To determine the transaction price, an entity considers multiple factors:

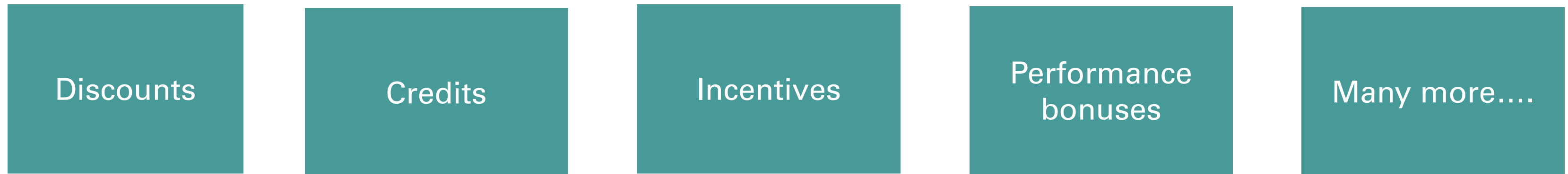


Key areas to be considered when determining transaction price: Variable consideration and existence of a significant financing component

Variable consideration

STEP 3

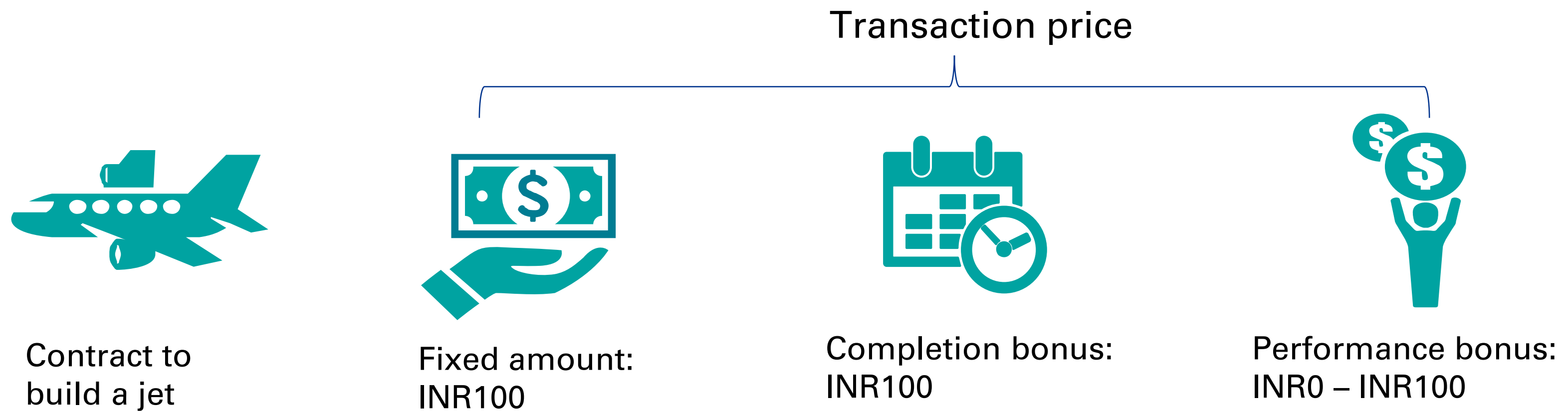
Variable consideration can be



Variable consideration is estimated using most appropriate method of either:

Estimating variable consideration

STEP 3



How would the entity estimate variable consideration?

Completion bonus

Most likely amount

Performance bonus

Expected value

Constraint on variable consideration

STEP 3

Estimate of variable consideration

Amount that is 'highly probable will ***not*** result in significant reversal'…

… included in transaction price

Qualitative assessment	• The likelihood of a reversal arising from an uncertain future event. • The magnitude of the reversal if the uncertain event occurs.

Significant financing component

STEP 3

Indicators of a significant financing component

- Transaction price compared to cash selling price.
- Period between payment and delivery.
- Other reasons for payment terms.

Discount rate

- Rate that would be used in separate financing transaction between the entity and customer.

Practical expedient

- No adjustment required if the period between performance and payment is 12 months or less.

Allocate the transaction price

STEP 4

Allocate based on relative stand-alone selling prices

Performance obligation 1

Performance obligation 2

Performance obligation 3

Determine stand-alone selling prices

Is observable price available?

Use observable price

Estimate price

Adjusted market assessment approach

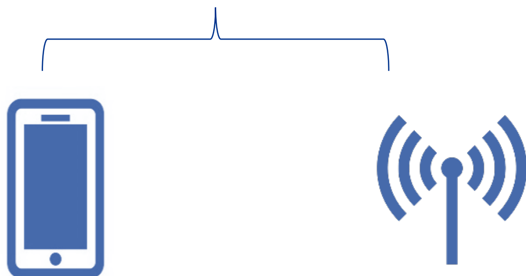
Expected cost plus a margin approach

Residual approach

Estimating the selling price

STEP 4

Two year contract – INR650



Phone

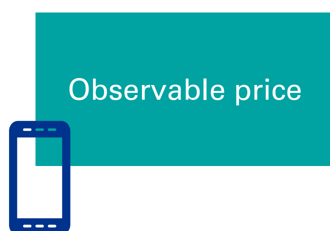
Data, calls and texts plan

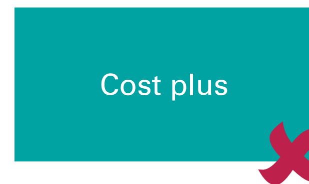
Entity sells phone and plan separately

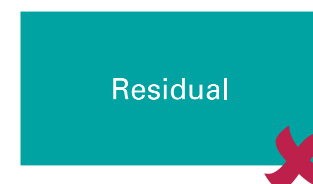
INR350

12 month plan for INR15 per month – INR360 (24XINR15)

Methods for estimating stand-alone selling price:







Transaction price allocated to phone = INR650 x (INR350/INR710) = INR320

Transaction price allocated to plan = INR650 x (INR360/INR710) = INR330

Performance obligations satisfied over time

STEP 5

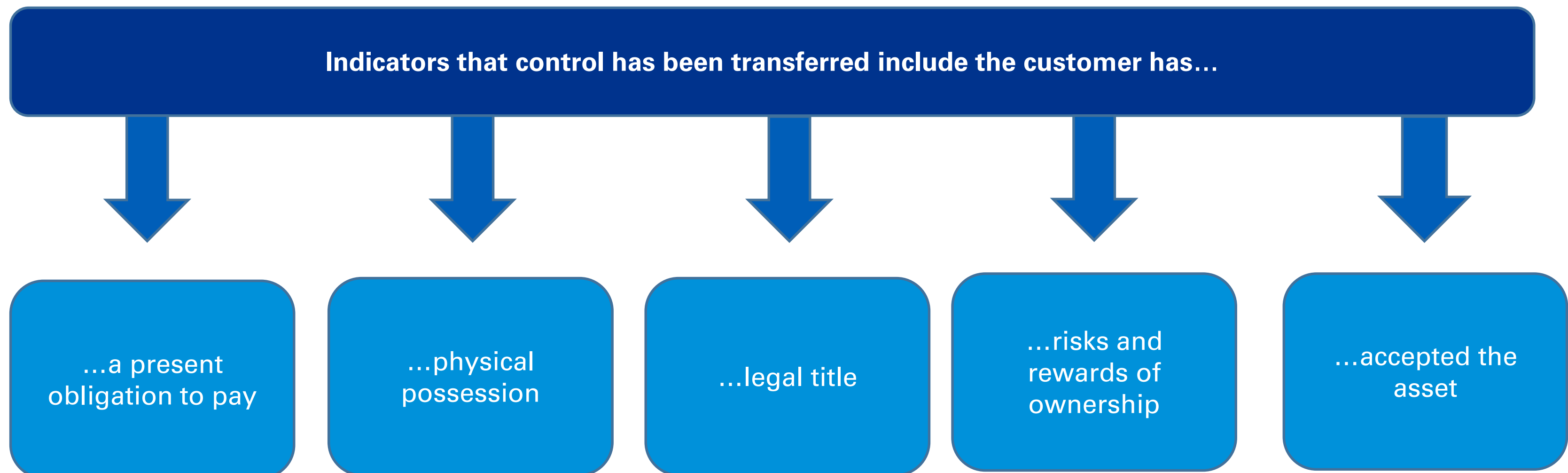
A performance obligation is satisfied over time if either:

1	Customer simultaneously receives and consumes the benefits as the entity performs.	Routine or recurring services.
2	Customer controls the asset as the entity creates or enhances it.	Asset built on customer's site.
3	The entity's performance does not create an asset with an alternate use and there is a right to payment for performance to date.	Asset built to order.

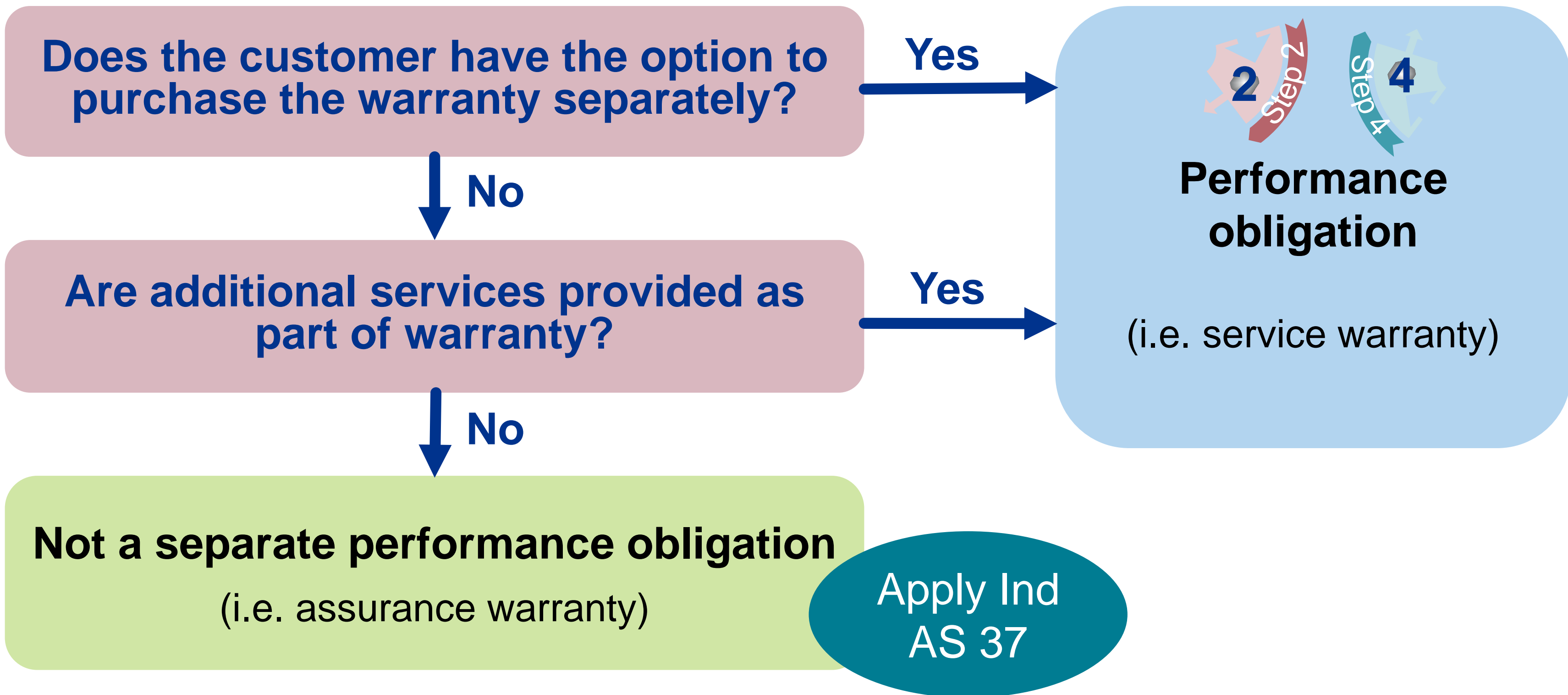
Performance obligations satisfied at a point in time

STEP 5

- Control refers to the customers ability to direct the use of, and obtain substantially all of the remaining benefits from an asset.
- Includes the ability to prevent other entities from directing the use of and obtaining the benefits from an asset
- Recognise revenue when customer obtains control of the promised asset.



Warranties



Factors to consider whether a warranty provides an additional service:		
Is it required by law?	Is it longer than customary?	What tasks are performed?

Contract Costs

Costs to obtain a contract

Capitalise incremental costs if:

- ✓ Incurred only as result of obtaining the contract
- ✓ Recovery is expected

e.g. sales commission

Costs to fulfil a contract

Capitalise fulfilment costs if:

- ✓ Directly related
- ✓ Generate or enhance resources
- ✓ Recovery is expected

Practical expedient

Amortisation period < 1 year?

Expense costs as incurred

Costs to Fulfil a Contract

Direct costs that are eligible for capitalisation if other criteria are met	Costs to be expensed when incurred
Direct labour (e.g. employee wages)	**General and administrative costs** – unless explicitly chargeable under the contract
Direct materials (e.g. supplies)	**Costs that relate to satisfied performance obligations**
Allocation of costs that relate directly to the contract (e.g. depreciation and amortisation)	**Costs of wasted materials, labour, or other contract costs**
Cost that are explicitly chargeable to the customer under the contract	**Costs that do not clearly relate to unsatisfied performance obligations**
Other costs that were incurred only because the entity entered into the contract (e.g., subcontractor costs)	

Presentation

Contract asset or contract liability is recognised when the:

- entity performs by transferring goods or services; or
- customer performs by paying consideration to entity.

Receivable

- Unconditional right to consideration
- Distinguished from contract assets

Capitalised contract costs

- Presented according to nature or function
- Separate presentation from contract assets

Disclosure

Objective: help users understand the nature, amount, timing and uncertainty of revenue and cash flows arising from contracts with customers

Contracts with customers	Significant judgements and changes in judgements
Disaggregation of revenue	Determining the timing of satisfaction of performance obligations
Changes in contract assets, liabilities and costs	Determining the transaction price
Performance obligations	Determining amounts allocated to performance obligations

Assets recognised from the costs to obtain or fulfil a contract

Transition Options

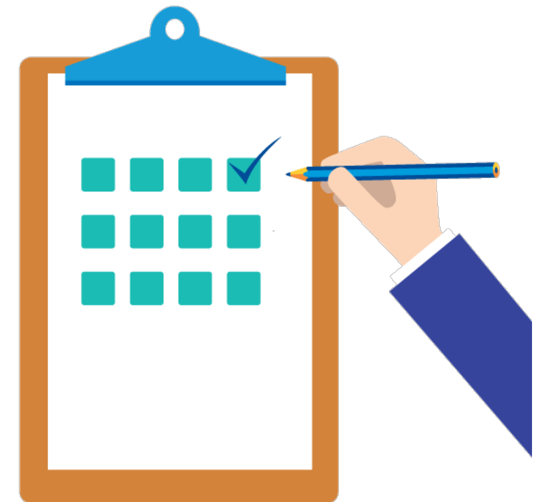
Approach	FY 2017-18	FY 2018-19	Date of equity adjustment
Full retrospective – no practical expedients	**Ind AS 115**	**Ind AS 115**	**1 April 2017**
Partial retrospective – practical expedients	**Mixed requirements**	**Ind AS 115**	**1 April 2017**
Cumulative effect	**Ind AS 11/ Ind AS 18**	**Ind AS 115**	**1 April 2018**

Differences from current Ind AS requirements

Current guidance (Ind AS 11/18)		New standard
Guidance contained in multiple standards and guidance notes.	→	Entire guidance contained in a single standard.
Limited guidance on identifying performance obligations in a contract.	→	Specific guidance on identifying performance obligations in a contract.
Guidance for recognising revenue over time may apply in different circumstances. (e.g. construction contracts, service arrangements)	→	Specific criteria provided to determine when a performance obligation is satisfied over time.
Revenue measured at the fair value of the consideration received or receivable.	→	Consideration measured as the amount the entity expects to be entitled to.

Key points to remember

- The revenue recognition model includes five steps.
- The best way to apply the model is to apply the model step by step.
- A contract may include one or more separate performance obligations.
- The transaction price is allocated to identified performance obligations using stand alone selling prices.
- The allocation is recognised as revenue either over time or at a point in time.



Q&A