Ind AS 115
Revenue from Contracts with Customers

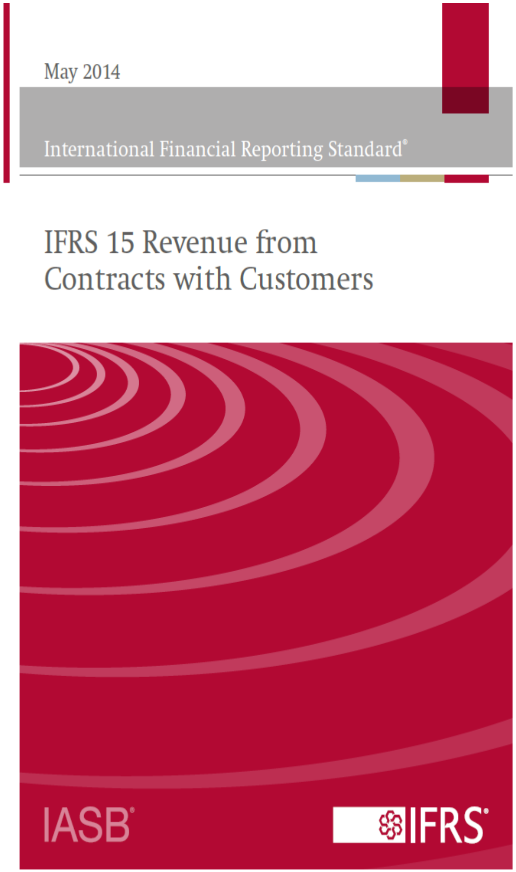
By CA. Parag V. Kulkarni

Agenda

- Core principles and scope
- Recognition and measurement (framework for recognising revenue – five-step model)
- Contract costs
- Presentation and disclosure
- Effective date and transition
- Application guidance

Ind AS 115

Reasons for issuing IFRS 15



- Previous revenue recognition requirements provided limited guidance and were difficult to apply to complex transactions
- The IASB's objective in issuing IFRS 15 was to develop a new Standard for recognising revenue to:
    - Remove inconsistencies and weaknesses in previous revenue requirements
    - Provide a more robust framework for addressing revenue issues
    - Improve comparability of revenue recognition practices across entities, industries, jurisdictions and capital markets
    - Provide improved disclosures

Link to the *Conceptual Framework*

Fundamental qualitative characteristics	Faithful representation	• Ind AS 115 provides a better depiction of entities' revenue performance
Enhancing qualitative characteristics	Comparability	• Ind AS 115 results in greater comparability and consistency in reported revenue from contracts with customers
	Understandability	• Ind AS 115 requires enhanced disclosures that will improve the understandability of revenue

Ind AS 115 – objective and core principle

Objective

- To establish the principles that an entity shall apply to report useful information to users of financial statements about the nature, amount, timing and uncertainty of revenue and cash flows arising from a contract with a customer

Core principle

- Recognise 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

Ind AS 115 – recognising revenue

When?

- Recognise revenue when the entity satisfies performance obligations by transferring goods or services to the customer

How?

- The transaction price is allocated to the goods or services transferred to the customer, ie the performance obligations

Scope

Ind AS 115 applies to all contracts with customers except:

- Lease contracts (Ind AS 116 Leases)
- Insurance contracts (Ind AS 104 Insurance Contracts)
- Financial instruments and other contractual rights or obligations within the scope of Ind AS 109, Ind AS 110, Ind AS 27 & Ind AS 28
- Non-monetary exchanges between entities in the same line of business to facilitate sales to customers or potential customers

Partially in scope

Is the contract partially within the scope of Ind AS 115 and partially within the scope of another Standard(s) (Ind AS 17, Ind AS 104, Ind AS 110, Ind AS 111, Ind AS 27, Ind AS 28)?

Yes

Does the other Standard(s) specify how to separate and/or initially measure one or more parts of the contract?

Yes

Apply the separation and/or the measurement requirements in the other Standard(s)

Exclude from transaction price amount of part(s) initially measured in accordance with the other Standard(s)

No

Apply Ind AS 115 to separate and/or initially measure the part(s) of the contract

Which contracts does Ind AS 115 apply to?

An entity shall apply Ind AS 115 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 contract is an agreement between two or more parties that creates enforceable rights and obligations

Ind AS 115 specifies the accounting for an individual contract → may apply the Standard to a portfolio of contracts if effect would not differ materially

Recognition and measurement

Framework for recognising revenue – five-step model

The five-step revenue recognition model

Step 1
- Identify the contract(s) with a customer

Step 2
- Identify the performance obligation(s) in the contract

Step 3
- Determine the transaction price

Step 4
- Allocate the transaction price to the performance obligations in the contract

Step 5
- Recognise revenue when (or as) the entity satisfies a performance obligation

Step 1 – Identify the contract
Contract criteria (para 9)

Contracts with customers must meet ALL of these criteria

- The contract is approved and the parties are committed to their obligations
- The entity can identify each party's rights and payment terms
- The contract has commercial substance
- Collection of consideration is probable

If each party has the unilateral enforceable right to terminate a wholly unperformed contract without compensating the other party (or parties) → no contract for the purposes of Ind AS 115

Step 1 – Identify the contract
If contract does not meet para 9 Ind AS 115 criteria

Contract with the customer does not meet the criteria in Ind AS 115 para 9

↓

Entity receives consideration from the customer

↓

Are there no remaining obligations to transfer goods or services to the customer and has all, or substantially all, of the consideration promised by the customer been received and is it non-refundable?

Yes → Recognise revenue

No ↓

Has the contract been terminated and is the consideration received from the customer non-refundable?

Yes → Recognise revenue

No ↓

Recognise a liability at the amount of consideration received

Step 1 – Identify the contract
Combination of contracts

Contracts entered into at or near the same time with the same customer – is one or more of the following criteria met?

? Negotiated as a package with a single commercial objective

? Linked consideration

? Goods or services promised form a single performance obligation

Step 1 – Identify the contract
Contract modifications

Definition → a change in the scope or price (or both) of a contract that is approved by the parties to the contract

Is contract modification approved?

No → Continue to apply Ind AS 115 to existing contract until contract modification is approved

Yes → Does it add distinct goods or services at stand-alone selling prices?

Yes → Account as a separate contract

No → Are remaining goods or services distinct from those already transferred?

Yes → Account for as termination of existing contract and creation of new contract

No → Account for as part of original contract – cumulative catch-up adjustment

Step 2 – Identify the performance obligations

A **performance obligation** is a promise in a contract with a customer to transfer a distinct good or service (or bundle of goods or services), or a series of substantially similar distinct goods or services with the same pattern of transfer to the customer

Some examples of promised goods or services:

- sale of goods produced by an entity (eg inventory of a manufacturer)
- resale of goods purchased by an entity (eg merchandise of a retailer)
- resale of rights to goods or services purchased by an entity (eg a ticket resold by an entity acting as a principal)
- performing a contractually agreed-upon task for the customer (eg cleaning services)
- providing a service of standing ready to provide goods or services (eg unspecified updates to software that are provided on a when-and-if-available basis)
- arranging for another party to transfer goods or services to a customer (eg acting as an agent of another party)
- constructing, managing or developing an asset on behalf of a customer
- granting a licence
- granting an option to purchase additional goods or services if it gives the customer a material right

Step 2 – Identify the performance obligations *Distinct good or service*

1. Customer can benefit from good or service (ie capable of being distinct);

- On its own; or
- Together with other readily available goods or services (including goods or services previously acquired from entity)

And

2. Promised good or service is separable from other promises (ie distinct in the context of the contract)

- No significant service of integrating the good or service
- Good or service does not significantly modify or customise another good or service in the contract
- Good or service is not highly dependent on or highly interrelated with other goods or services

Step 2 – Identify the performance obligations
Series of distinct goods or services

Each distinct good or service in the series is a performance obligation satisfied over time

+

The same method would be used to measure progress towards satisfaction of the performance obligation to transfer each distinct good or service in the series

=

Series = single performance obligation

Step 3 – Determine the transaction price

Transaction price is the amount of consideration to which entity expects to be entitled in exchange for goods or services

Variable consideration

- Amount of consideration can vary because of discounts, rebates, refunds, credits, price concessions, incentives, performance bonuses etc
- Estimate using Expected Value or Most Likely Amount but 'Constrained' (next slide)
- Exception for licences of intellectual property

Existence of significant financing component

- Adjust consideration if timing provides customer or entity with significant benefit of financing
- Practical expedient – no adjustment if the period between consideration and transfer of good and service is one year or less

Non-cash consideration

- Measure at fair value
- If fair value cannot be estimated, measure consideration indirectly by reference to stand-alone selling price of the goods or services transferred

Step 3 – Determining the transaction price
Constraining estimates of variable consideration

Include estimate of variable consideration in the transaction price only to extent it is *highly probable a significant reversal of revenue will not occur* when uncertainty is resolved

- Entity's expectations of revenue reversal assessed using indicators, eg
- – Factors outside entity's influence (market, 3rd-party actions etc)
- – Length of time before uncertainty resolved
- – Entity's level of experience with similar types of contracts

Exception for licences of intellectual property with a sales-based or usage-based royalty

- Refer to Application Guidance, effectively only recognise variable consideration as revenue when entitled to royalty

Step 3 – Determining the transaction price

No financing component

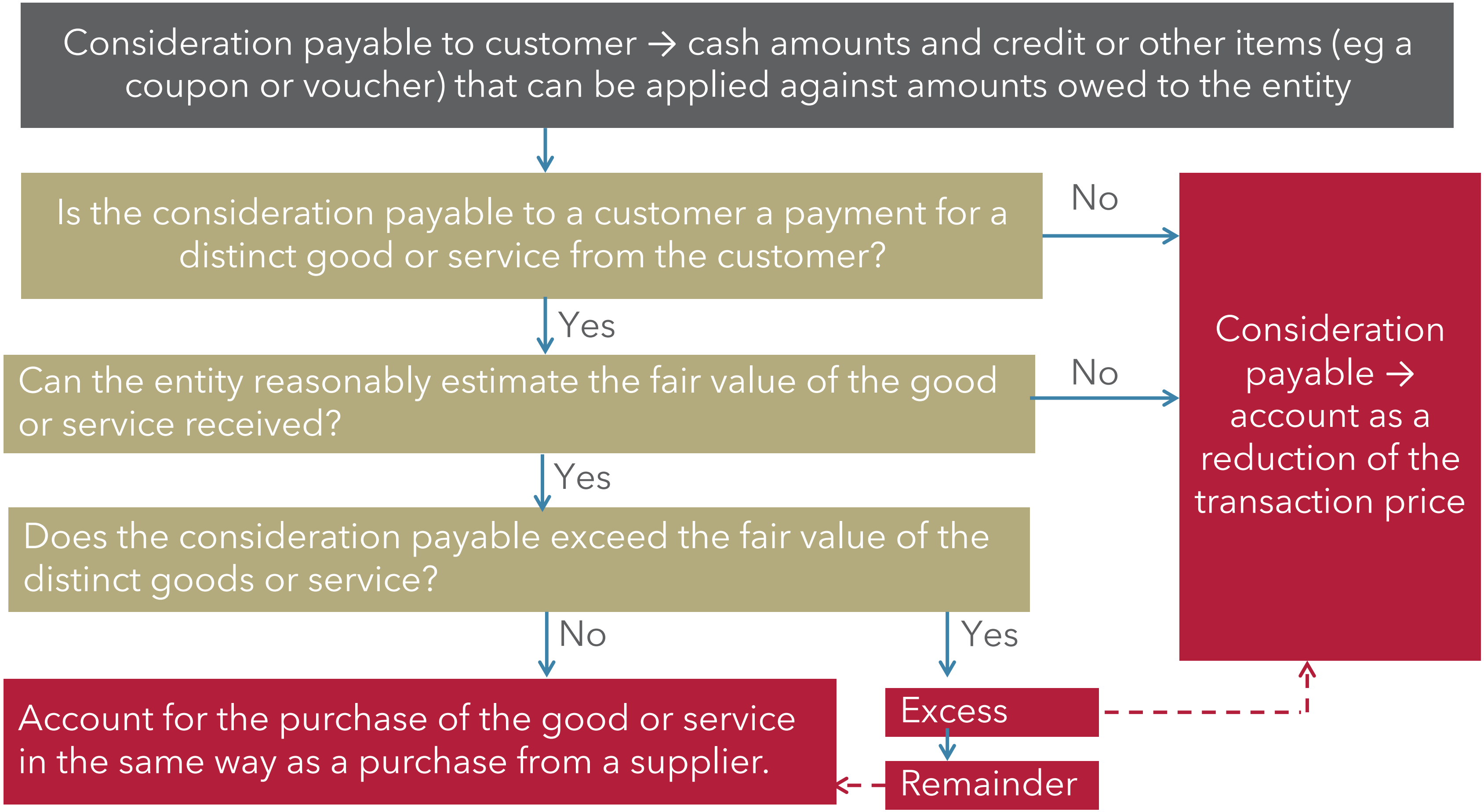
There is no significant financing component if any of the following factors exist:

- The customer paid for the goods or services in advance and the timing of the transfer of those goods or services is at the discretion of the customer.
- The amount or timing of that consideration varies on the basis of the occurrence or non-occurrence of a future event that is not substantially within the control of the customer or the entity, eg if the consideration is a sales-based royalty.
- The difference between the promised consideration and the cash selling price of the good or service….arises for reasons other than the provision of finance to either the customer or the entity, and the difference between those amounts is proportional to the reason for the difference.

Step 3 – Determining the transaction price
Discount rate in financing component

- Use the discount rate that would be reflected in a separate financing transaction between the entity and its customer at contract inception. Reflects:
  - Credit characteristics of the customer
  - Any collateral or security
- Discount rate is not updated after contract inception eg for changes in interest rates or customer's credit risk.

Step 3 – Determining the transaction price
Consideration payable to customer



Step 4 – Allocating the transaction price to performance obligations

Allocation based on stand-alone selling prices

- Allocate transaction price to separate performance obligations based on **relative** stand-alone selling price → where stand-alone selling price is not directly observable: estimate the amount using one of the following approaches:

Adjusted market assessment approach	• Evaluate the market in which goods or services are sold and estimate the price that customers in the market would be willing to pay
Expected cost plus a margin approach	• Forecast the expected costs of satisfying a performance obligation and then add an appropriate margin for that good or service
Residual approach (limited applicability)	• The total transaction price less the sum of the observable stand-alone selling prices of other goods or services promised in the contract

Step 4 – Allocating the transaction price to performance obligations
Allocation of discounts

Discount

- Allocate discount proportionately to all performance obligations (POs) in the contract, except when they relate to one or more but not all specific POs
- Allocate a discount entirely to one or more, but not all, POs if ALL of the following criteria are met:
  - the entity regularly sells each distinct good or service on a stand-alone basis;
  - the entity also regularly sells on a stand-alone basis a bundle (or bundles) of some of those distinct goods or services at a discount; and the discount attributable to each bundle is substantially the same as the discount in the contract and an analysis of the goods or services in each bundle provides observable evidence of the PO or POs to which the entire discount in the contract belongs.
- <u>An entity allocates a discount to one or more POs before using the residual approach to estimate the stand-alone selling price</u>

Step 4 – Allocating the transaction price to performance obligations
Allocation of variable consideration

Warning! This is a complex area!

Variable consideration

- Allocate variable consideration to one performance obligation (PO) or a distinct part of a PO if both these criteria are met:
  - The terms of the variable payment relate specifically to satisfying this PO etc
  - This allocation would faithfully depict the consideration entity expects for transferring these goods or services to the customer
- Allocate the remaining amount of the transaction price using the general allocation rules based on stand-alone selling prices and the allocation rules for discounts

Step 5 – Recognition of revenue

- Revenue is recognised when (or as) an entity satisfies a performance obligation by transferring a promised good or service (ie an asset) to a customer.
- An asset is transferred when (or as) the customer obtains control of that asset
- Control → ability to direct the use of, and obtain substantially all of the remaining benefits from, the good or service
- Benefits can be obtained directly or indirectly by:
  - Using the asset to produce goods or provide services
  - Using the asset to enhance the value of other assets
  - Using the asset to settle liabilities or reduce expenses
  - Selling or exchanging the asset
  - Pledging the asset to secure a loan
  - Holding the asset

Step 5 – Recognition of revenue *(continued)*

Recognise revenue over time

- The customer simultaneously receives and consumes the benefits provided by the entity's performance as the entity performs

or

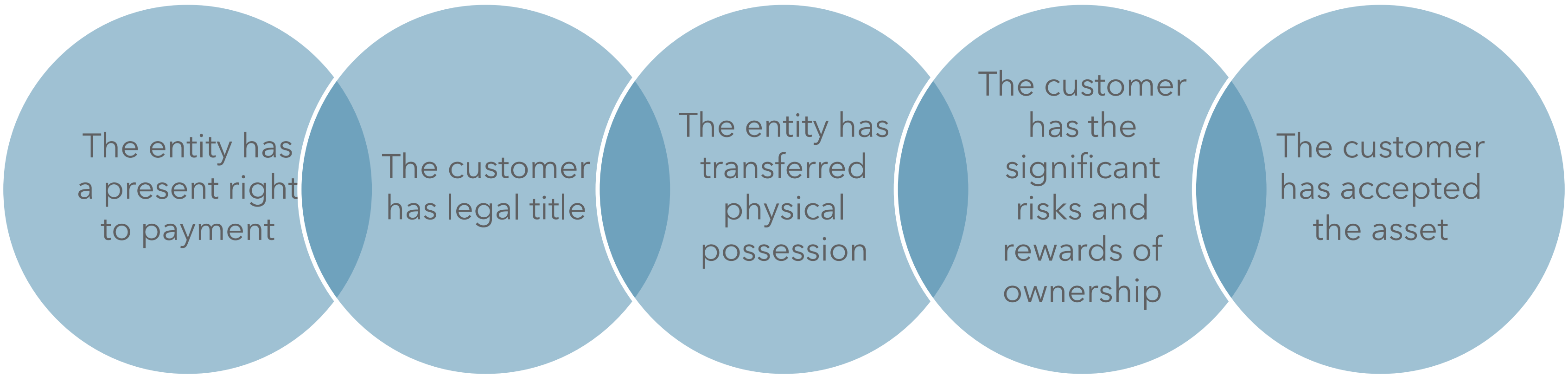
- The entity's performance creates or enhances an asset that the customer controls as the asset is created or enhanced

or

- 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

Step 5 – Recognition of revenue *(continued)*

- If not over time, then point in time….
- Recognise revenue when control transfers
- Indicators of the transfer of control of a good or service include:



Step 5 – Recognition of revenue
Methods of measuring progress

- Objective: to depict performance in transferring control of goods or services to the customer.

Method	Description	Examples	Advantage	Disadvantage
Output	• Based on the value of the goods delivered relative to those undelivered	• Surveys of performance to date • Appraisals of results achieved • Milestones reached • Units produced or delivered	• Probably most faithful depiction of entity's performance	• May not be directly observable • Information may be expensive to obtain
Input	• Based on the entity's efforts or inputs towards satisfying the performance obligation relative to the total expected inputs	• Resources consumed • Costs incurred • Labour hours • Machine hours	• Can recognise revenue on straight-line basis if inputs expended evenly	• May not be a direct relationship between inputs and transfer of control

THANKS