IFRS Notes

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The IASB proposes clarifications to the new revenue standard

KPMG

cutting through complexity

Introduction

In May 2014, the International Accounting Standards Board (IASB) and the Financial Accounting Standards Board (FASB), jointly issued a new revenue standard - IFRS 15, *Revenue from Contracts with Customers*, and Topic 606, *Revenue from Contracts with Customers.* After issuing the standard, the IASB and the FASB formed the Transition Resource Group (TRG) for revenue recognition to support the implementation of the standard. One of the objectives of the TRG is to inform the IASB and the FASB about any implementation issues which would help the Boards (IASB and FASB) determine what, if any, action should be undertaken to address those issues.

The TRG has met five times and discussed about 73 issues. Additionally, many stakeholders represented that the new revenue standard has far reaching impacts and that additional time is required to develop accounting policies, update information technology systems, and change processes and internal controls. Accordingly, on 22 July 2015, the IASB confirmed a one year deferral of the effective date of IFRS 15. This decision is consistent with that of the FASB's decision on 9 July 2015 for a one year deferral of the new revenue standard.

On 30 July 2015, the IASB published proposed clarifications (exposure draft (ED)) for public consultation with respect to the following topics:

- Identifying performance obligations
- Principal vs agent considerations
- Licencing, and
- Transitional relief.

The IASB expects these to be the only amendments to the IFRS 15 before entities are required to apply the new standard. The IASB's deadline for receiving comments is 28 October 2015.

In India, given that we are implementing the new revenue standard ahead of the global roll-out, companies should watch these updates closely. It is important that standard setters in India keep Ind AS 115, *Revenue from Contracts with Customers* in line with the changes proposed internationally. In the interim, due to the difference in the timeline for implementation it may happen that companies in India chase a moving target as far as changes to this important standard is concerned.

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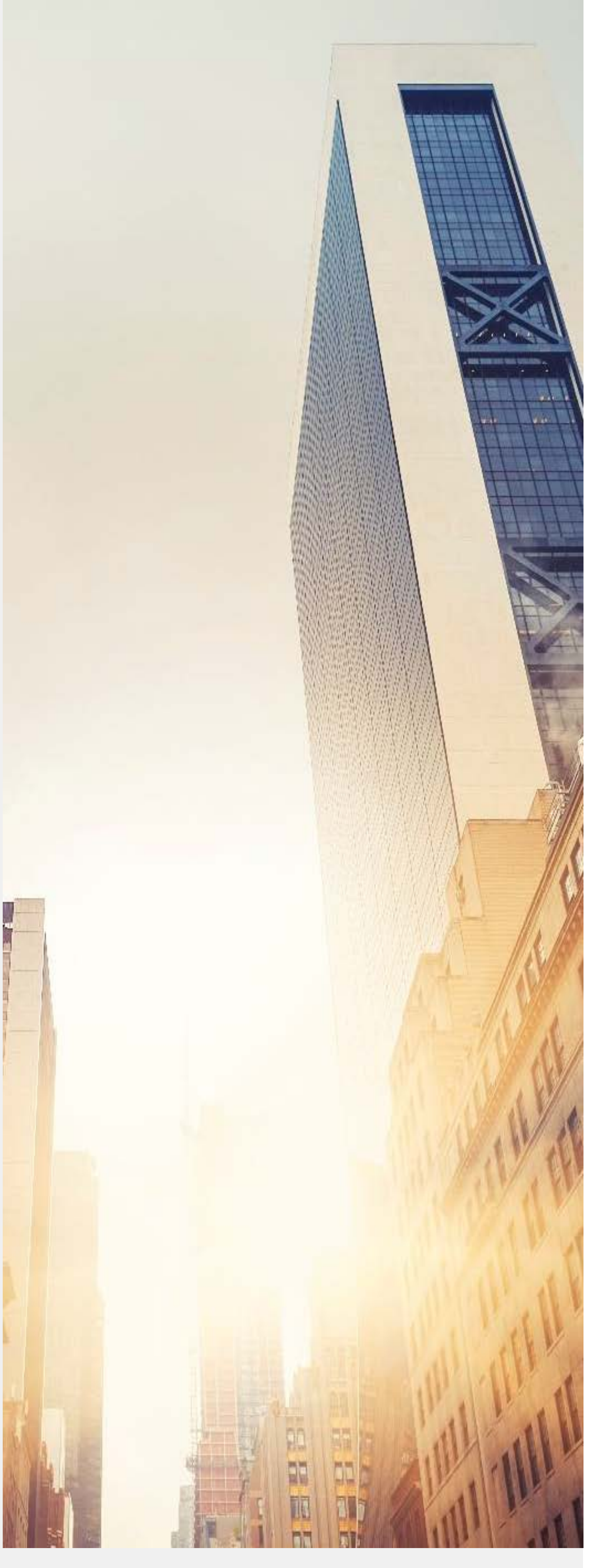

Evolution of IFRS 15

28 May 2014	22 July 2015	30 July 2015	28 October 2015	1 January 2018
IFRS 15 issued	Effective date revised to 2018	The IASB proposals issued	Comment deadline	Revised effective date of IFRS 15

(source: KPMG's presentation - New revenue standard - A clearer view of IFRS - 15 July 2015)

Background

The IASB has mentioned in its basis for conclusion that the substantial majority of the issues discussed by the TRG have been resolved without standard setting. However, on the following four key areas, the IASB has decided to propose clarifications:

a) Identifying performance obligations

b) Principal vs agent considerations

c) Licencing, and

d) Transitional relief.

This issue of IFRS Notes provides an overview of key clarifications proposed by the IASB to IFRS 15 and also highlights what the FASB is proposing to do in these areas.

I. Identifying performance obligations

Current requirements

At contract inception, an entity would need to identify each promise to deliver goods or services in a contract with a customer. Under IFRS 15, a promise constitutes a performance obligation, if the promised good or service is distinct. A good or service is distinct if it meets the following two criteria:

a) The customer can benefit from the good or service either on its own or together with other resources that are readily available to the customer, and

b) The entity's promise to transfer the good or service to the customer is separately identifiable from other promises in the contract.

Concerns

The concept of 'distinct' within the context of a contract is new. The TRG considered issues relating to the criterion regarding when a promised good or service is separately identifiable (i.e. distinct within the context of a contract) and supporting guidance given in the standard. The TRG informed the Boards about the potential diversity in stakeholders' understanding of what it means for a good or service to be highly dependent on, or highly interrelated with, other goods or services promised in the contract.

Proposed clarifications

The IASB proposes to add some new examples and to amend some of the existing examples that accompany IFRS 15 to clarify the application of the requirements on identifying performance obligations. The IASB would not amend other parts of the new standard.

The examples illustrate when goods or services in a contract are accounted for:

- As a bundle, single performance obligation
- Individually, separate performance obligations.

The new examples illustrate following cases:

- Installation services
- Multiple items
- Equipment and consumables.

FASB's proposals

The FASB is proposing more words and more new examples than the IASB, and the plans are to:

- Rearticulate the principle of when a good or service is separately identifiable in the context of the contract
- Redraft the existing indicators
- Specify that goods and services which are immaterial at the contract level can be ignored when identifying performance obligations
- Include a practical expedient for shipping and handling services.

II. Principal vs agent considerations

Current requirements

When another party, in addition to the entity, is involved in providing goods or services to a customer, IFRS 15 requires an entity to determine whether it is:

(a) the principal in the transaction (recognise revenue and costs gross), or

(b) the agent (recognise commission as revenue).

If the entity obtains control of the goods or services of another party before it transfers control to the customer, then the entity's performance obligation is to provide the goods or services itself. Therefore, the entity is acting as principal.

IFRS 15 provides a list of indicators for evaluating when an entity's performance obligation is not to provide the goods and services itself and the entity is therefore acting as an agent.

Concerns

The TRG discussed a number of issues regarding the guidance on principal vs agent in IFRS 15. Some stakeholders questioned whether control is always the basis for determining whether an entity is a principal or an agent, and how the control principle and the indicators in the standard work together. Questions were also raised on how to apply the control principle to contracts involving intangible goods or services.

Proposed clarifications

The IASB has decided to clarify the following aspects of the guidance on principal vs agent considerations:

- Relationship between control principle and related indicators in the standard
- Applying control to intangible goods or services.

Relationship between control principle and related indicators

The IASB proposes:

- To reframe the indicators of control as indicators of when an entity controls a specified good or service before transfer, rather than as indicators that an entity does not control the specified good or service before transfer.
- To add guidance to explain how each indicator supports the assessment of control as defined in IFRS 15.
- To remove the indicator relating to the form of the consideration.
- To clarify that the indicators are not an exhaustive list and merely support the assessment of control. They do not replace or override that assessment. Different indicators might provide more persuasive evidence to support the assessment of control in different scenarios.

Applying control to intangible goods or services

A new paragraph (paragraph B34A) has been proposed which requires an entity to identify the specified good or service before applying the control principle to that specified good or service. The proposed additional paragraph is expected to achieve the following:

- A better framework (i.e. clarify the thought process) to be applied when assessing whether an entity is a principal or an agent.
- To emphasise the importance of appropriately identifying the specified good or service (which could be a right to a good or service to be provided by another party) that will be transferred to the customer.
- To help clarify that the 'specified good or service' (i.e. the unit of account for the principal vs agent evaluation) is each distinct good or service (or distinct bundle of goods or services).
- To emphasise that control (as defined in paragraph 33 of IFRS 15) is the determining factor when assessing whether an entity is a principal or an agent.

FASB's proposals

It is expected that FASB's proposals would be similar to that of IASB's proposals.

III. Licencings

Current requirements

IFRS 15 provides specific application guidance 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 in Step 5 of the standard 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.

If the licence provides:

- A right to use the intellectual property as it exists at the time the licence is granted, then revenue is recognised at a point in time.
- A right to access the intellectual property as it exists throughout the licence period, then revenue is recognised over time.

A licence provides a right to access to the entity's intellectual property if:

- The contract requires, or the customer reasonably expects, that the entity will undertake activities that significantly affect the intellectual property to which the customer has rights
- The rights granted by the licence directly exposes the customer to any positive or negative effects of the entity's activities, and
- Those activities do not result in the transfer of a good or service to the customer as those activities occur.

If all the criteria are not met, then the licence provides a right to use the entity's intellectual property that is satisfied at a point in time.

Concerns

The TRG discussed issues relating to the application of the licences guidance in IFRS 15. The main issues discussed relates to determining the nature of the entity's promise in granting a licence of intellectual property.

Proposed clarifications

The IASB plans revised drafting to clarify the application guidance on licencing and new examples to improve the operability and understandability of the guidance. The proposal is expected to clarify whether revenue from a licence is recognised either:

- Upfront on the day the licence is granted, or
- Over time during the licence period.

Determining the nature of the entity's promise in granting a licence of intellectual property

The IASB proposes to provide additional guidance on when activities change the intellectual property to which the customer has rights. The core idea is to focus on the functionality of the licence, for example:

- Movies – recognise revenue upfront because functionality exists once the movie has been shot
- Brands – recognise revenue over time because the functionality changes constantly as the entity updates the brand.

Consideration in the form of sales-based or usage-based royalties

Current requirements

IFRS 15 includes an exception to the general requirement of estimating variable consideration. Under this, an entity recognises revenue for a sales-based or usage-based royalty promised in exchange for a licence of intellectual property when the later of the following events occurs:

- The customer's subsequent sales or usage occurs, and
- The satisfaction or partial satisfaction of the performance obligation to which some or all of the sales-based or usage-based royalty has been allocated.

Concern

The TRG's main concern was the scope and applicability of the sales-based and usage-based royalties exception.

Proposed clarifications

The IASB plans to clarify when and how to apply the exception. The proposal is to recognise sales and usage based royalties as the sales or usage occur if the royalty relates only to a licence of intellectual property, or the licence of intellectual property is the pre-dominant item to which the royalty relates.

Royalty that relates to more than one thing should be recognised either as an exception (sales-based or usage-based) or as per the requirements of variable consideration. This proposal clarifies that a royalty is either entirely inside or entirely outside the scope of the exception.

FASB's proposals

The FASB is proposing more new words and examples than the IASB such as:

- When to recognise revenue - new classification of all licences as either functional or symbolic
- Licences that are not distinct - clarification of when to apply the licences guidance
- Sales or usage-based royalties - similar to IASB's proposals
- Contractual restrictions - additional guidance and new examples.

IV. Transitional relief

Current requirements

IFRS 15 currently has three choices for transition:

- Full retrospective approach with no practical expedients – an entity would restate contracts at the start of the earliest presented comparative period.
- Partial retrospective approach with practical expedients – an entity would restate contracts at the start of the earliest period presented, except those covered by any practical expedients it has elected
- Cumulative effect approach – restate all contracts that were not completed under the existing revenue requirements at the start of the current period.

Proposals

The IASB is proposing two additional practical expedients on transition to IFRS 15:

- To permit an entity to use hindsight in (i) identifying the satisfied and unsatisfied performance obligations in a contract that has been modified before the beginning of the earliest period presented; and (ii) determining the transaction price.
- To permit an entity that elects to use the full retrospective approach, to not restate completed contracts at the beginning of the earliest period presented.

FASB's proposals

The FASB is likely to propose that on transition an entity could elect to use hindsight when determining the effects of contract modifications. However, the FASB is not expected to propose a practical expedient for completed contracts when applying the retrospective transition approach.

Impact

The IASB has issued clarifications instead of amending the main principles of the standard. The IASB considered the need to balance being responsive to issues raised to help entities implement IFRS 15 and the risk of creating a level of uncertainty about the standard to the extent that the IASB's actions might be disruptive to the implementation process while determining its response and clarifications.

The IASB expects that any further implementation issue are unlikely to lead to standard setting and is unlikely to propose any further amendments until after the post-implementation review of IFRS 15. It may be noted that the IASB is required to conduct a post-implementation review (PIR) of each new standard, about two to three years after it becomes effective. The clarifications discussed in the ED would be finalised by the IASB post receiving comments on this ED. Comment period ends on 28 October 2015.

Therefore, in some ways, Ind AS 115 which is based on IFRS 15 is a 'complete' standard and the key principles in the standard are unlikely to be amended by the IASB in the near term. The clarifications provided by the IASB may help in the consistent application of this standard in India.

Next steps

The IASB intends to consider the comments it receives on these proposals and decide whether to proceed with the amendments to IFRS 15. It expects to complete its redeliberations by the end of 2015.

The FASB is additionally proposing to provide clarifications in the areas of non-cash consideration, collectability and the presentation of sales tax.

Since Ind AS 115 is aligned with IFRS 15, the regulators in India such as the Ministry of Corporate Affairs (MCA) and the Institute of Chartered Accountants of India (ICAI) should keep a close watch on the recent developments by the IASB on IFRS 15.

Since India will be one of the first countries to adopt IFRS 15, Indian entities should assess the impact of the new revenue standard on their financial reporting earlier and accordingly modify their information technology systems, business processes and internal controls so that the information required for reporting and disclosure purposes is appropriately captured.

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KPMG in India's IFRS institute

KPMG in India is pleased to re-launch IFRS Institute - a web-based platform, which seeks to act as a wide-ranging site for information and updates on IFRS implementation in India.

The website provides information and resources to help board and audit committee members, executives, management, stakeholders and government representatives gain insight and access to thought leadership publications that are based on the evolving global financial reporting framework.

Voices on Reporting

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

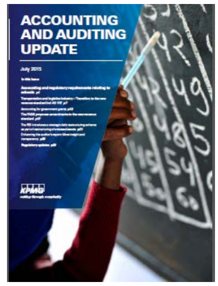
On 22 July 2015, we covered following topics:

I. Overview of Ind AS 110, *Consolidated Financial Statements* and Ind AS 27, *Separate Financial Statements*

II. Key differences between AS 21, *Consolidated Financial Statements* and Ind AS 110

III. Overview of key relaxations for private companies from certain provisions of the Companies Act, 2013.

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



July 2015

The July 2015 edition of the Accounting and Auditing Update highlights some of the key accounting and regulatory requirements relating to schools in India.

This month we examine how the transport and logistics sector is expected to be impacted by the new revenue recognition standard Ind AS 115, *Revenue from Contracts with Customers.*

We also analyse the impacts of Ind AS implementation in India with respect to government grants and highlight the corresponding requirements of Income Computation and Disclosure Standards applicable with effect from 1 April 2015.

Additionally, we discuss the amendments made to the guidance on licences and identifying performance obligations by the Financial Accounting Standards Board (FASB). We also highlight how the International Accounting Standards Board (IASB) plans to address these issues in the IFRS version of the standard.

Recently, the Reserve Bank of India (RBI) has allowed banks to undertake a Strategic Debt Restructuring (SDR) scheme by converting loan dues to equity shares. This month, we provide an overview of the guidelines issued by the RBI for effective implementation of the SDR.

Finally, in addition to our regular round up of regulatory updates, this edition also provides an overview of the new requirements on auditor's report issued by the International Auditing and Assurance Standards Board (IAASB).

MCA clarifications regarding circulation and filing of financial statements under the Companies Act, 2013

24 July 2015

The Ministry of Corporate Affairs (MCA) received representations from various stakeholders in relation to circulation and filing of financial statements under the Companies Act, 2013 (2013 Act). On 21 July 2015, the MCA issued a general circular no.11/2015, which provided clarifications with regard to the following provisions of the 2013 Act:

Section 101 – notice of meeting

Section 136 – right of member to copies of audited financial statements

Section 137 – copy of financial statements to be filed with the Registrar of Companies.

Our issue of First Notes provides an overview of the clarifications issued by the MCA.

Previous editions are available to download from: www.kpmg.com/in