



IFRS Notes

**The MCA issues notification on
revenue standards**

Ind AS 11 and Ind AS 18

April 2016

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Introduction

The Ministry of Corporate Affairs (MCA) through its notification dated 16 February 2015 issued 39 Indian Accounting Standards (Ind AS) which are converged with the International Financial Reporting Standards (IFRS). Through this notification, the IFRS converged standards are expected to bridge the significant gaps that exist in the current accounting guidance in India. Amongst those notified by MCA is Ind AS 115, *Revenue from Contracts with Customers*, which is based on IFRS 15, *Revenue from Contracts with Customers*.

IFRS 15 was issued in May 2014 as a result of a joint project of the International Accounting Standards Board (IASB) and the Financial Accounting Standards Board (FASB). Post issuance, 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 to 2018.

The initial plan of the regulators in India such as MCA and the Institute of Chartered Accountants of India (ICAI) was to implement the new revenue standard ahead of global roll-out. However, post the deferral of IFRS 15 to 2018, the ICAI in October 2015 proposed a deferral of Ind AS 115. This has been confirmed by MCA through its notification issued on 30 March 2016. Consequently, MCA has issued the following Ind AS:

- Ind AS 11, *Construction Contracts* along with the appendices corresponding to IFRIC 12, *Service Concession Arrangements*, SIC-29, *Service Concession Arrangements: Disclosures* (collectively called 'Ind AS on construction contract')
- Ind AS 18, *Revenue*, along with the appendices corresponding to IFRIC 13, *Customer Loyalty Programmes*, IFRIC 18, *Transfers of Assets from Customers*, SIC-31 *Revenue- Barter Transactions Involving Advertising Services* (collectively called 'Ind AS on revenue') and
- Consequential amendments.



"The notification of Ind AS 11 and 18 by the MCA provides clarity on the revenue recognition provisions that will apply to companies that are transitioning to Ind AS in 2016-17. This also ensures that companies will have sufficient time to prepare for the adoption of the new revenue standard, Ind AS 115, and also learn from the global experience on its implementation"

Sai Venkateshwaran

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Overview

The Ind AS comprises following topics:

Name of the Ind AS	Topics covered
Ind AS 11, <i>Construction Contracts</i>	<ul style="list-style-type: none"> • Accounting for construction contracts in the financial statements of contractors • Service concession arrangements • Service concession arrangements: Disclosures
Ind AS 18, <i>Revenue</i>	<ul style="list-style-type: none"> • Accounting for revenue arising from the following transactions and events: <ul style="list-style-type: none"> - Sale of goods - Rendering of services - Use of others entity assets yielding interest and royalties. • Revenue – Barter Transactions Involving Advertising Services • Customer Loyalty Programmes • Transfers of Assets from Customers

(Source: MCA Notification dated 30 March 2016)

Overview

The principles in these Ind AS are based on IAS 11, *Construction Contracts* and IAS 18, *Revenue*.

The overall approach of the standards is as follows:

- Revenue is recognised only if it is probable that future economic benefits will flow to the entity and that those benefits can be measured reliably.
- Revenue recognition does not require cash consideration. However, when goods or services exchanged are similar in nature and value, the transaction will not generate revenue.
- When an arrangement includes more than one component, it may be necessary to account for the revenue attributable to each component separately.
- When two or more transactions are linked such that the individual transactions have no commercial effect on their own, they are analysed as one arrangement.

Sale of goods

- Revenue from sale of goods is recognised when:
 - The entity transfers significant risks and rewards of ownership to the buyer
 - It no longer retains control or has continuing involvement in the goods.

Construction contracts

- Contract revenue is recognised with reference to the stage of completion of the contract activity, if the contract costs and the stage of contract completion can be measured reliably.
- Use of the completed contract method is not permitted.

Service contracts

- Revenue from service contracts would be recognised in the period during which the service would be rendered, generally under the percentage of completion method.

Gross vs net presentation

- Revenues comprise the gross inflows of economic benefits received by an entity on its own account.
- In an agency relationship, amounts collected on behalf of a principal are not recognised as revenue by an agent.

Measurement

- Revenue is measured at the fair value of the consideration received or receivable, taking into account any trade discounts, volume rebates or cash discounts.
- If a transaction includes a financing element, then revenue is measured by discounting all future cash receipts at an imputed rate of interest.

Key changes from the current Indian GAAP

Sale of goods

- Under the current principles, apart from the general criteria, revenue is recognised either on transfer of property in the goods or transfer of significant risks and rewards of ownership. Under Ind AS, revenue would be recognised only on the transfer of significant risks and rewards as well as effective control associated with the ownership of the goods. In many cases, the transfer of significant risks and rewards of ownership may correspond to the transfer of the legal title or physical delivery. However, in some cases transfer of risks and rewards could occur at a point which is different from the transfer of the legal title or the passing of possession, or might be on a continuous basis rather than at a point in time. This aspect is expected to give rise to practical differences in the application of the Ind AS on revenue.
- Shipment terms are a key consideration in determining the point at which the risks and rewards of ownership are transferred from the seller to the buyer, and revenue is recognised. For example, shipment terms under Cost Insurance Freight (CIF) would require analysis of several facts and circumstances to assess when risks and rewards of ownership transfer.

Multiple element arrangements

- A contract may include multiple components (for example, when goods are sold with subsequent support or maintenance services provided for no additional charge). Currently, there is no specific guidance on multiple element transactions under Indian GAAP.
- The ICAI has issued a *Technical Guide on Accounting Issues in the Retail Sector* in 2012, which states that a deferment model of revenue recognition is the preferred accounting treatment for multiple element transactions involving customer loyalty programmes. However, in practice, many companies currently account for multiple element arrangements in accordance with the legal form of the transaction based on prices stated in the contract for individual deliverables.
- Under Ind AS on revenue, when an arrangement includes more than one component, it is necessary to account for the revenue attributable to each component

- separately. Separation would generally be considered if the conditions mentioned below are present:
 - The component has a standalone value to the customer (for example, if the component is sold on a standalone basis by any vendor or the customer could resell it) and
 - The fair value of the component can be measured reliably.
- It is possible that specific components described in the contract with the customer and prices attributed to such components, may not be the appropriate basis for identifying separate components of revenue and allocating the total sale consideration.
- Ind AS on revenue requires separation of the different components and that revenue is to be recognised for different components when the revenue recognition criteria are fulfilled.

Linked transactions

- Ind AS requires linking transactions when the individual transactions have no commercial meaning on their own, and occurrence of one is dependent on the occurrence of the other. In such cases, transactions are evaluated on a combined basis.
- For example, supply or service transactions may involve charging a non-refundable initial fee along with subsequent periodic payments for future products or services. The initial fees may, in substance, be wholly or partly an advance for future products or services, or the ongoing rights or services being provided are essential to the customers receiving the expected benefit of the upfront payment. In these cases, the upfront fee and the continuing performance obligation related to the services to be provided should be assessed on a combined basis. Accordingly, upfront fees, even if non-refundable, may need to be deferred and recognised systematically over the periods that future services are performed, as compared with the current practice of upfront recognition. Examples of such upfront fees include loan origination fees charged by banks and Non-Banking Financial Companies (NBFCs), or activation fees charged by telecommunication companies.

Key changes from the current Indian GAAP

The following factors may indicate that the transactions are linked:

- Transactions are entered into at the same time or as part of a continuous sequence and in contemplation of one another
- Transactions, in substance, form a single arrangement that achieves or is designed to achieve an overall commercial effect
- One or more of the transactions, considered on their own, do not make commercial sense, but they do, when considered together and
- Occurrence of one transaction is dependent on the other transaction occurring.

Discounts and incentive schemes

- Currently, cash discounts and certain customer incentives are often reported as a separate expenditure in the statement of profit and loss. Further, in certain cases, these are recognised only when specified thresholds are met with.
- Under Ind AS, revenue is measured at the fair value of the consideration received or receivable taking into account the amount of any trade discounts and volume rebates allowed by an entity.
- Sales arrangements may include various rebates or discounts payable by sellers to their customers. For example, if a customer purchases a certain value or quantity of goods, a refund of a specified percentage may be granted; or if the customer makes payment for the goods within the credit period, a deduction for early payment based on a specified interest rate may be granted (cash discounts). If it is probable that such a rebate or discount would be granted, and the amount can be measured reliably, then Ind AS requires the rebate or discount to be considered as a reduction of revenue when the sales are recognised.
- Application Ind AS on revenue may therefore result in the acceleration of accruals and reclassification of certain 'costs' as a reduction from revenues.

Customer loyalty programmes

- Under Indian GAAP, the *Technical Guide on Accounting Issues in the Retail Sector* (guide) provides guidance on customer loyalty programmes. It mentions that currently in India both the 'deferment model' and 'provision model' are prevalent. The deferment model is based on IFRIC 13, *Customer Loyalty Programmes* and is similar to the guidance in Ind AS. In this model when an entity grants loyalty points with the purchase of a passenger ticket, the loyalty points are separated from the passenger ticket and accounted for as a separate performance obligation (multiple element transactions). Under the provision model, the sale is treated as a single element transaction and revenue is recognised for the entire transaction at the time of the initial sale. However, since further cost is expected to be incurred with regard to the obligation to provide free/discounted goods or services, a provision is recognised towards the cost of such free/discounted goods or services as marketing expense at the time of initial sale.
- According to the guide, the deferment model being a more refined one is preferred, though it does involve performing complex computations to arrive at the fair value of the award credits/obligations to be fulfilled in the future. In case, reliable data is not available or the estimation of fair value of the award credits presents significant difficulties, the provision model may be used. In practice, many airlines and other entities with similar programmes, recognise a provision on an estimated incremental cost basis at the time of recognising the sale.
- Under Ind AS, award credits and other loyalty programmes are considered as a separate component of the initial sale transaction. The fair value of the award credits/points is estimated and separated from the initial sale. Such income is deferred and is recognised subsequently when the award credits/points are utilised.

Extended credit

- Currently, revenue is recognised at the contractual value of the consideration receivable. Ind AS requires the measurement of revenue at the fair value of the consideration receivable.

Key changes from the current Indian GAAP

- If an entity offers an extended credit period to customers, revenue is recognised at the present value of the future cash inflows. Interest income is recognised over the credit period for the difference between the revenue and the stated transaction value.

Barter transactions

- Currently, there is no overall guidance on accounting for barter transactions. Accordingly, practise in this area varies.
- Under Ind AS, accounting for barter transactions would depend upon the nature of goods or services being exchanged. When dissimilar goods or services are exchanged, revenue is generally recognised based on the fair value of the goods or services received. However, if the goods or services exchanged are similar, no revenues and costs are separately recognised.
- This may result in recognition of transactions that were previously not recognised (for example, certain advertising barter transactions); and non-recognition of transactions that are currently being recognised (for example, certain oil barter transactions).

Sales of real estate

- Accounting in the real estate industry is challenging. The industry is characterised by various forms of complex arrangements, such as, agreements to sell, flat-buyer agreements, joint development agreements and space-sharing agreements. Therefore, revenue recognition requires significant application of judgement in this context.
- Currently, the ICAI's Guidance Note on *Accounting for Real Estate Transactions (Revised 2012)* (guidance note) requires the application of the percentage of completion method for recognising revenue on transactions and activities of the real estate sector that have the same economic substance as construction contracts.
- Ind AS 18 does not provide guidance on revenue from real estate transactions. Instead, they state that revenue would be recognised by real estate developers in accordance with a Guidance Note that is expected to be issued by the ICAI on this subject. We expect that this new Guidance Note would retain the application of the percentage of completion method for revenue recognition.

- Under IFRS, in IFRIC 15 *Agreement for Construction of Real Estate*, requires revenue from real estate arrangements to generally be recognised on the completion of construction (i.e. on transfer of possession of the property). The percentage of the completion method is used only when specific criteria in terms of continuous transfer of control, and managerial involvement in under construction property are met with. Since IFRIC 15 has not been included in Ind AS on construction contracts, the difference between current Indian GAAP and IFRS will remain till the time Ind AS 115 becomes applicable.

Transfers of assets from customers

- Under Indian GAAP, there is no specific guidance on transfers of Property, Plant and Equipment (PPE) or cash to acquire such PPE (customer contributions). This has led to significant divergence in practice. Some entities recognise customer contributions received at a cost of 'nil' or at an amount other than the fair value, whereas some entities in the power industry have deferred amounts billed to customers for establishing a connection to a network, over the useful life of the asset contributed by such customers.
- Ind AS on revenue now provides guidance on accounting for customer contributions by entities that receive such contributions to provide the customer with initial or ongoing access to supply of goods or services, or both. Although the power and utility industry is one such example, other industries and arrangements may also be affected by this guidance. These include telecommunication companies, and car manufacturers supply and outsourcing arrangements.
- Under Ind AS, an entity that has received a customer contribution would recognise it as an asset if it meets the definition of, and recognition criteria for, an asset. While determining whether the definition of an asset is met with, the receiving entity assesses which party controls that item. On initial recognition, the cost of the asset is measured at its fair value.

Key changes from the current Indian GAAP

- A corresponding amount of revenue would be recognised by the receiving entity as the related performance obligations are satisfied. For example, if the only performance obligation is establishing a connection to a network, then the revenue would be recognised when the connection is established. If the performance obligation requires an ongoing supply of goods and services, then the related revenue is recognised over the term of the agreement (if specified), or over a period no longer than the useful life of the asset.
- Cash contributions that are to be used only to acquire or construct an item of PPE, in order to connect the customer to a network or provide the customer with ongoing access to a supply of goods or services, would also be recognised as revenue. The constructed or acquired asset would be recognised at cost, if it meets the definition of an asset.
- Ind AS provides specific guidance for public-to-private service concession arrangements in which:
 - The public sector entity controls or regulates the services provided with the infrastructure and their prices and
 - Controls any significant residual interest in the infrastructure.
- If applicable, the operator would not recognise the infrastructure as its PPE. Instead, it recognises it as either a financial asset or an intangible asset, or both, at fair value as compensation for any construction service that it provides to the grantor. This represents a significant accounting change for such entities and would need careful analysis at the time of application.

Service concession arrangements

- Service concession arrangements are arrangements between a public sector entity (grantor) and a private sector company (operator) for construction of infrastructure assets, in which the grantor controls or regulates the services provided with the infrastructure, their price, and any significant residual interest in the infrastructure. This public-to-private model has gained popularity in the recent past, especially in the context of developing toll roads, bridges, airports and power generation, amongst others.
- There is no specific accounting guidance currently applicable to service concession agreements. The ICAI in 2008 had proposed a draft Guidance Note on Accounting for Service Concession Arrangements but a final version was not issued thereafter. In July 2014, the ICAI had issued an ED on Accounting for Service Concession Arrangements by Concessionaire which is still not notified. As a consequence, practise in this area varies significantly and divergent accounting treatments are being followed in India with many operators recognising the infrastructure as PPE on their balance sheet.

Gross vs net presentation

- Currently, excise duty is reduced from gross revenues to report revenues on a net basis. Generally, other indirect taxes such as sales tax are also reduced from revenues.
- Ind AS requires revenue to only include the gross inflows of economic benefits received by a company for its own account. Collections from customers in the nature of taxes and duties that are pass-through in nature and where the company is acting only as an agent of the government or another third party are not included in revenue. However, excise duty collected, which is a duty on manufacture and a primary obligation of the manufacturer, is considered as revenue with the corresponding payments to the government considered as expenditure. On the other hand, value added tax or service tax, where the entity is acting as an agent of the government, is not considered as a part of revenue and is accounted as a 'pass through' in the balance sheet.

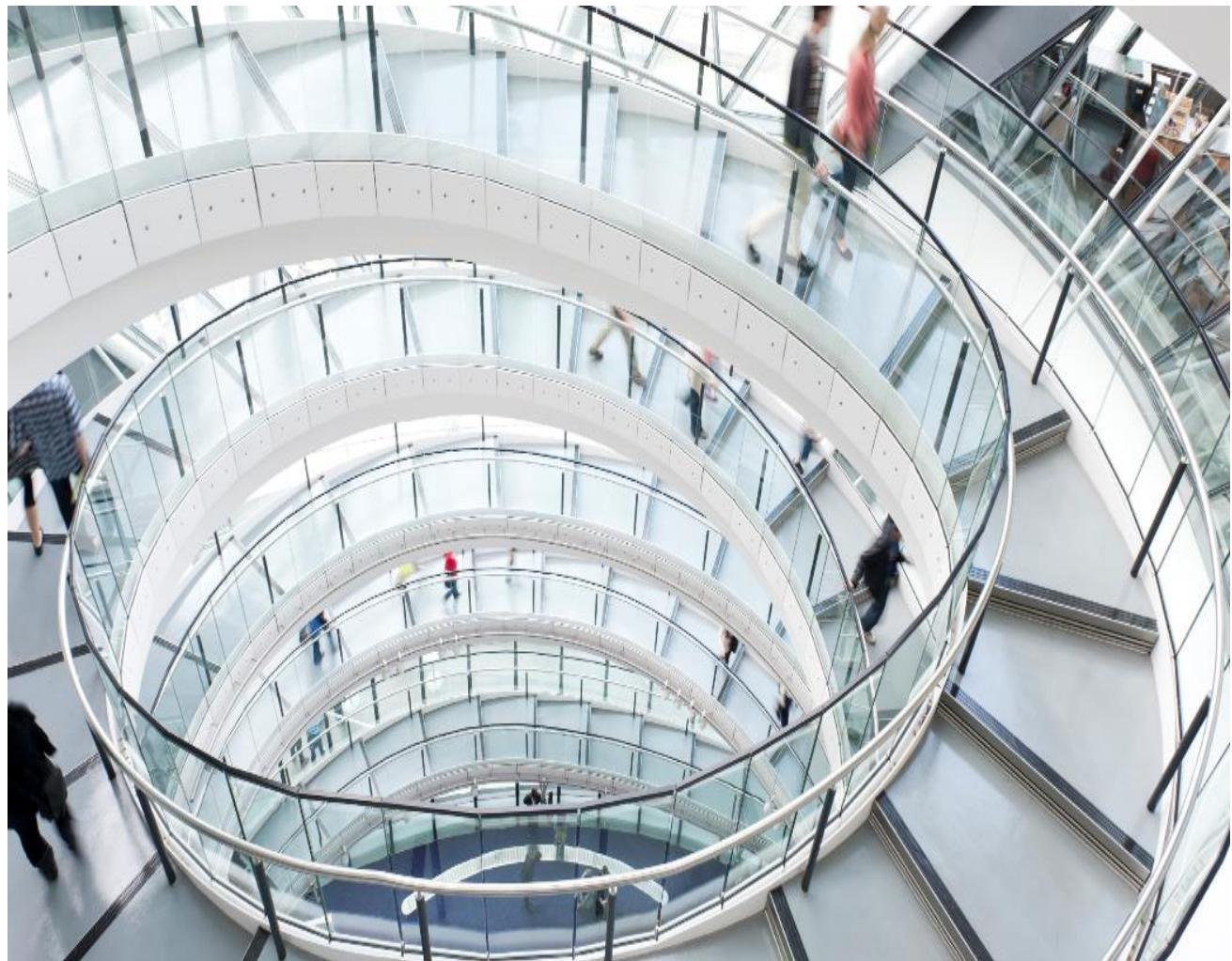
Consequential amendments to other Ind ASs

Issue of Ind AS 11 and Ind AS 18 give rise to consequential amendments to the other Ind AS and those affected Ind ASs are as follows:

- Ind AS 101, *First time adoption of Indian Accounting Standards*
- Ind AS 103, *Business Combinations*
- Ind AS 104, *Insurance Contracts*
- Ind AS 107, *Financial Instruments: Disclosures*
- Ind AS 109, *Financial Instruments*
- Ind AS 1, *Presentation of Financial Statements*
- Ind AS 2, *Inventories*

Next steps

Revenue is an important performance measure for many Indian companies and there is very limited time for transition to Ind AS 11 and Ind AS 18. This requires careful evaluation and determination of accounting policies. Eventually, entities shall be required to transition to Ind AS 115, *Revenue from Contracts with Customers*. Therefore, we recommend that when companies formulate their transition plan for 1 April 2016, they should also commence planning for Ind AS 115 (which is likely to be a significant transition) in order to be well prepared.



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Voices on Reporting



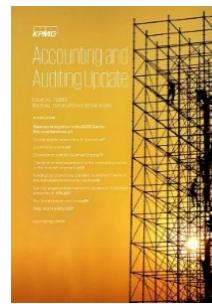
KPMG in India is pleased to present Voices on Reporting – a monthly series of knowledge sharing calls to discuss current and emerging issues relating to financial reporting.

In our next call, on 5 April 2016, we will cover key financial reporting and regulatory matters that are expected to be relevant for stakeholders as they approach the quarter ending 31 March 2016.

Our call will include updates from the Ministry of Corporate Affairs (MCA), the Securities and Exchange Board of India (SEBI), the Reserve Bank of India (RBI), the Institute of Chartered Accountants of India (ICAI), the Insurance Regulatory and Development Authority of India (IRDA), etc.

Our Voices on Reporting conference call will be held on Tuesday, 5 April 2016 between 04:00 – 05:00 PM.

Missed an issue of Accounting and Auditing Update or First Notes



The March 2015 edition of the Accounting and Auditing Update focusses on the Building, Construction and Real Estate (BCRE) sector and highlights key matters relating to accounting, financial reporting and regulatory areas relevant to this sector.

In this publication, we highlight current Indian GAAP guidance on revenue recognition by the sector and the guidance under IFRS. The Institute of Chartered Accountants of India is expected to issue a guidance note to provide direction on the accounting of the revenue recognition from the sale of real estate under Ind AS and we have highlighted potential challenges due to adoption of Ind AS.

The publication features an interaction with Mr. Govinder Singh, International Business Head and Ex-Chief Financial Officer, Tata Housing Development Company Limited, and explores some key accounting, reporting and other topical matters relevant to the industry.

The publication also carries number of other accounting issues in detail relevant to this sector.

Additionally, our publication carries a regular synopsis of regulatory updates



The proposed Companies (Amendment) Bill, 2016

1 April 2016

Based on the recommendations of the CLC report, on 16 March 2016, the government proposed the Companies (Amendment) Bill 2016, (the Bill) on issues arising on account of implementation of the Companies Act, 2013 (2013 Act) in the Lok Sabha to amend the 2013 Act. The Bill considered the suggestions made by the CLC as well as the comments received from the stakeholders and ministries/departments.

The recommendations cover significant areas of the 2013 Act, including definitions, raising of capital, accounts and audit, Corporate Social Responsibility (CSR), managerial remuneration, companies incorporated outside India and offences/penalties.

This issue of First Notes summarises key recommendations of the Bill.

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

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