PwC Reporting*InBrief*

Transitioning to Ind AS 115, Revenue from contracts with customers

In brief

The Companies (Indian Accounting Standards) Amendment Rules, 2018 issued by the Ministry of Corporate Affairs (MCA) notified Ind AS 115, *Revenue from Contracts with Customers*. Ind AS 115 is effective from reporting periods beginning on or after 1 April 2018 and is largely converged with IFRS 15, *Revenue from Contracts with Customers* issued by the International Accounting Standards Board (IASB).

In this InBrief, we discuss the transition options available with entities transitioning to Ind AS 115, suggested disclosures in the interim financial statements prepared as per Ind AS 34, *Interim Financial Reporting*/financial results prepared under SEBI (listing obligations and disclosure requirements) regulations, 2015 (the 'Regulations') on initial adoption of Ind AS 115 and share our insights thereon.

Let's talk

Ind AS 115 permits entities to apply one of the following methods:

Approach	Application	Comparatives
Full retrospective	The financial statements are presented as if Ind AS 115 had always been applied in accordance with Ind AS 8, *Accounting policies, changes in accounting estimates and errors.*	Comparatives (including the opening balance sheet) are restated.
Modified retrospective	Entities will recognise the cumulative effect of initially applying Ind AS 115 as an adjustment to the opening balance of equity at the date of initial application.	Comparatives are not restated and are presented using existing revenue standards (Ind AS 11, *Construction Contracts* and Ind AS 18, *Revenue*).

Irrespective of the transition approach elected, the 'date of initial application' is the start of the reporting period in which an entity first applies Ind AS 115 (i.e. 1 April 2018 for entities with years ending 31 March 2019).

The modified retrospective transition approach is intended to be simpler than full retrospective application; however, there are still challenges associated with that approach, including additional disclosure requirements in the year of adoption.

Acknowledging the potential difficulties in applying certain aspects of Ind AS 115 retrospectively, the standard has also provided certain practical expedients for election under both transition methods. We discuss these transition options and practical expedients in Section I of this publication.

Companies (Indian Accounting Standards) Amendment Rules, 2018 made consequential amendments to Ind AS 34 that require certain disclosures in an entity's interim financial statements on initial adoption of Ind AS 115. We also discuss the interim reporting disclosure requirements on initial adoption of Ind AS 115 in Section II of this publication.

In detail

Section I: Transition approaches and practical expedients

1. **Transition approaches**

   Application of full retrospective approach requires an entity to restate comparative information and record the cumulative impact of transition as at beginning of the earliest period presented i.e. 1 April 2017 for entities with years ending 31 March 2019. Entities adopting the full retrospective approach should also consider the requirement of Ind AS 1, *Presentation of Financial Statements* to present third balance sheet.

   If entities adopt Ind AS 115 using the modified retrospective method, the entities effectively apply existing standards (Ind AS 11 and Ind AS 18) during the comparative period. The cumulative effect of initially applying Ind AS 115 is recognised in the opening balance of equity at the date of initial application (i.e. 1 April 2018 for entities with a 31 March 2019 year-end).

> While the modified retrospective method allows an entity to avoid restating comparative numbers, entities adopting this method must disclose the amount by which each financial statement line item is affected in the current reporting period by the application of Ind AS 115 as compared to Ind AS 11 and Ind AS 18 and qualitative explanation of the reasons for significant changes (Ind AS 115 paragraph C8). These additional disclosures effectively require an entity to apply both Ind AS 115 and Ind AS 11 and Ind AS 18 in the year of initial application. Therefore, entities will need to consider a number of aspects when determining which approach to follow including configuration of accounting systems to capture information for both the accounting under Ind AS 115 and Ind AS 11 and Ind AS 18.

2. Practical expedients

Apart from certain disclosure related practical expedients, there are three main categories of practical expedients relating to – (1) completed contracts; (2) contract modifications; and (3) hindsight for variable consideration. While entities may choose one or more practical expedients, they must be applied consistently to all contracts where relevant. These expedients are summarised below:

#	Full retrospective approach	Modified retrospective approach
1	Completed contracts – (i) completed before the earliest period presented *and/or* (ii) those which begin and end within the same annual reporting period	Completed contracts – completed before the date of initial application
2	Contract modifications	Contract modifications
3	Hindsight for variable consideration	Not available

When applying certain Ind AS 115 practical expedients, it is essential to understand the term 'completed contracts'. A completed contract is a contract for which the entity has transferred all of the goods or services identified in accordance with Ind AS 11 and Ind AS 18.

In many situations, the term 'transferred' would mean 'delivered' within the context of contracts for the sale of goods and 'performed' within the context of contracts for rendering services and construction contracts. A completed contract is thus a contract in which the entity has fully performed its obligations in accordance with revenue recognition requirements of Ind AS 11 and Ind AS 18.

Let's evaluate whether the following contracts would meet the definition of completed contract assuming that the entity's year-end is 31 March 2019 and it has chosen to apply modified retrospective approach for the purpose of transition to Ind AS 115.

1. Entity A has transferred all of the goods on 30 June 2018.
   Response: The contract is not considered completed as the entity transferred all the goods on 30 June 2018 after the date of initial application.

2. Entity B has transferred all of the goods on 31 January 2018 but the customer retains right to return.
   Response: The contract is a completed contract as the entity has transferred all the goods before the date of initial application. The entity has fully performed its obligations by delivering the goods and therefore this meets the definition of a completed contract for transition purposes.

3. Entity C has transferred all of the goods on 31 March 2018 but the customer retains right to return. No revenue was recognised considering the significant uncertainty involved on acceptance of the goods by the customer.
   Response: The contract is a completed contract as the entity has transferred all the goods before the date of initial application. The entity has fully performed its obligations by delivering the goods and therefore this meets the definition of a completed contract for transition purposes.

Accordingly, determining whether a contract is complete for Ind AS 115 transitioning purposes, there is a need to assess whether there are any outstanding performance obligations. This has to be evaluated by applying the existing standards (Ind AS 11 and Ind AS 18) and not Ind AS 115.

(i) Completed contract expedient

(a) **Full retrospective method:**
An entity need not to restate any contracts that are completed (i) before the beginning of the comparative period and/or (ii) that begin and end in the same annual reporting period. If an entity with a 31 March 2019 year-end applies this expedient, it has to apply Ind AS 115 in comparative periods for (i) contracts not completed on or before 31 March 2017; and (ii) those contracts that begin in FY 2017-2018 and do not end on or before 31 March 2018.

(b) **Modified retrospective method:**
Under the modified retrospective method, an entity might elect the expedient for contracts that are completed before the date of initial application. That is, an entity with a 31 March 2019 year-end would need to apply Ind AS 115 only for contracts that are not completed on or before 31 March 2018.

Applying the above expedient might save some efforts and costs, particularly for entities which have many non-standard contracts. However, an entity also needs to consider whether applying this expedient might distort the trend analysis. This is particularly critical if an entity would change its revenue recognition pattern, for example, from recognising over time to point in time or the other way round.

(ii) Hindsight for variable consideration expedient

This expedient is only available for entities opting for full retrospective method and is not available when the modified retrospective method is opted. Ind AS 115 allows an entity to use the transaction price at the date the contract was completed rather than estimating variable consideration amounts in the comparative periods.

Example:

An entity enters into a construction contract with a customer in July 2016. Both parties agree that the project will be delivered by September 2017. The agreed contract price is 1 million INR, however, if the entity completes the construction 3 months ahead of schedule, it will be entitled to a bonus of 200,000 INR.

If the entity applies this practical expedient, it would apply the final transaction price that is known in September 2017 to recognise the revenue in FY 2016-2017 and FY 2017-2018. If the entity does not apply this practical expedient, it cannot use hindsight to determine the transaction price of the contract. Ind AS 115 requires management to estimate, and include in the transaction price at contract inception the amount of variable consideration to which it expects to be entitled.

(iii) Contract modification expedient

The last category of practical expedients is the contract modification expedient. This expedient is available for all entities regardless of whether they elect to use the full or modified retrospective approach.

Under the full retrospective approach, an entity that elects this practical expedient reflects the aggregate effect of all modifications that happened before the beginning of the earliest period presented instead of considering the effect of each modification separately, when:
(i) identifying the satisfied and unsatisfied performance obligations;
(ii) determining the transaction price; and
(iii) allocating the transaction price to the satisfied and unsatisfied performance obligations.

Under the modified retrospective method, an entity could elect to apply this expedient for all contract modifications that occur before the date of initial application or before the beginning of the earliest period presented.

EquipmentCo enters into a contract with Customer in December 2011 to sell Product A for 500,000 INR and a five-year service contract for 10,000 INR a year. In January 2012, Customer takes control of the Product A and the service contract commences. In 2015, EquipmentCo and Customer extend the service contract by an additional five years (for 10,000 INR a year) and, at the same time, add an additional piece of equipment, Product B, for 750,000 INR. Product B will be delivered in 2020.

Does EquipmentCo have to apply the modification guidance in the revenue standard to this contract when it adopts the Ind AS 115?

Analysis:

EquipmentCo can choose to apply the contract modifications practical expedient when it adopts the revenue standard. If EquipmentCo applies the practical expedient, it would allocate the total transaction price (1,350,000 INR) and allocate it to Product A, Product B, and the service contracts. Revenue allocated to Product B and the remaining unperformed services would be recognised as they are transferred to the customer.

(iv) Disclosure expedients and other considerations

- Under the full retrospective method, an entity is allowed to elect as a practical expedient to only present the adjusted amounts for each financial statement line item affected and earnings per share (if applicable) for the immediate preceding period (i.e. FY 2017-18 for entities with a 31 March 2019 year-end). If an entity does not opt for this practical expedient, it shall, as per paragraph 28 of Ind AS 8, present the information for current period and each prior period presented (i.e. FY 2018-19 and FY 2017-18 for entities with a 31 March 2019 year-end).
- The standard also allows those adopting full retrospective method not to comply with the requirements in paragraph 120 of Ind AS 115 to disclose the remaining performance obligations and related explanation of when the entity expects to recognise that amount as revenue, for all reporting periods presented before the date of initial application (i.e. before 1 April 2018 for entities with a 31 March 2019 year-end).
- Ind AS 115 requires entities to disclose any practical expedients which have been applied together with a qualitative assessment of the estimated effect as a result of applying each of those expedients, to the extent reasonably possible.

Section II: Disclosures in interim financial statements/financial results on initial adoption of Ind AS 115

Disclosure in the interim financial statements
Companies (Indian Accounting Standards) Amendment Rules, 2018 made consequential amendments to Ind AS 34 that require disclosure of:

- the recognition or reversal of an impairment loss from assets arising from contracts with customers, as an additional example of the events and transactions for which disclosures would be required if they are significant; and
- the 'disaggregation of revenue from contracts with customers' required by paragraphs 114 to 115 of Ind AS 115.

In addition to complying with these specific requirements in each interim report, entities should comply with paragraph 16A(a) of Ind AS 34, which requires a description of the nature and effect of any changes to their accounting policies and methods as compared with the most recent annual financial statements.

The extent of the disclosures will depend on an entity's circumstances. Entities need to apply judgement to determine the extent of the disclosure, taking into consideration, the significance of the changes. The extent of disclosures might vary depending on the effect on the financial statements of the initial adoption of Ind AS 115; disclosures might be less extensive where the impact is not qualitatively or quantitatively material.

The disclosures might include:

- a description of the nature and effect of the change resulting from the new accounting policies (this disclosure is required by paragraph 16A(a) of Ind AS 34);
- the key judgements made by management in applying Ind AS 115;
- details of the impact on the amounts presented in the interim financial statements, including earnings per share and the opening balance of retained earnings;
- the transition method selected, together with any transitional practical expedients applied. Entities that elect to apply the modified retrospective transition approach should consider whether the requirements of paragraph C8 of Ind AS 115 for annual financial statements could be used to explain the nature and effect of the change in accounting policy (refer section I above); and
- disclosures specific to the entity – entities should consider whether the requirements in paragraph 28 of Ind AS 8 (disclosures regarding change in accounting policy), which will be applicable for the annual financial statements, could be used to explain the nature and effect of the change in accounting policy when Ind AS 115 is first applied.

Entities should also consider whether any of the detailed disclosures required by Ind AS 115 in annual financial statements are useful to comply with the requirements of Ind AS 34, although these disclosures are not mandatory in interim reports.

Disclosure in the financial results prepared under the Regulations
The Regulations requires a listed entity to submit financial results with the stock exchange. The financial results shall be submitted in the format prescribed in Schedule III of the Companies Act, 2013 (excluding notes and detailed sub-classifications). Accordingly, these financial results are not an 'interim financial report' as defined in paragraph 4 of Ind AS 34. (Refer footnote 1 to Ind AS 34).

Schedule IV of the Regulations states that changes in accounting policies should be disclosed in accordance with Ind AS 8. In this regard, paragraph 28 of Ind AS 8 includes the disclosure requirements of change in accounting policy. Further, paragraph C4 and C8 of Ind AS 115 provides specific disclosure guidance depending on the transition method adopted by the entity.

Accordingly, basis above, following disclosures to be considered in the financial results to be submitted with the stock exchange under the Regulations, to the extent relevant:
1. description of the nature and effect of the change resulting from adoption of Ind AS 115;
2. the transition method selected together with any transitional practical expedients applied;
3. details of the quantitative impact on the financial results:
   (a) modified retrospective approach: how each financial statement line item of the current period presented in the financial results is affected as a result of applying Ind AS 115 (as compared to Ind AS 11 and Ind AS 18) along with a qualitative explanation of the reasons for significant changes;
   (b) full retrospective approach: each comparative period presented, to the extent practicable, the amount of the adjustment for each financial statement line item affected along with a qualitative explanation for any significant change between the previously reported results and restated comparatives; and
4. impact on earnings per share and the opening retained earnings, if presented.

Based on the facts and circumstances of each entity, the disclosures might be less extensive where the impact is not qualitatively or quantitatively material.

The takeaway

Transition options allow an entity to apply Ind AS 115 from different dates and therefore, to different population of contracts. Transition options can significantly impact the revenue reported in the financial statements. Entities need to carefully consider the potential effects of the transition options on their financial statements considering the needs of investors and users of financial statements.

Entities should select a practical expedient only after thorough assessment has been carried out. Entities should assess the impact of using the expedient on both the preparation of the financial information as well as communications with the stakeholders.

Lastly, the implication of selecting a transition option and practical expedient could also impact business processes, systems, controls and disclosures.

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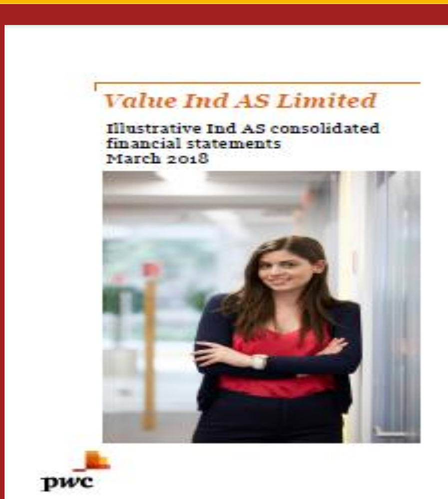

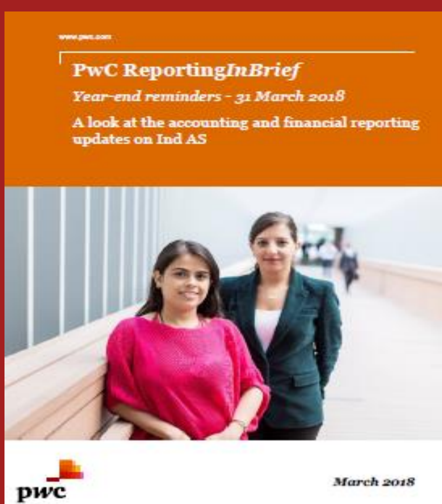

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