# The new revenue standard - an analysis of first quarter results

This article aims to:

- Provide a brief analysis on adoption of Ind AS 115, *Revenue from Contracts with Customers* based on first quarter results of BSE 100 companies and highlight key observations arising out of these results.

## Introduction and background to Ind AS 115

Revenue is one of the most important measures of performance for both preparers and users of financial statements. Revenue is generally used to measure and evaluate an entity's financial performance, and future prospects. Therefore, revenue recognition is considered as one of the crucial aspects examined by the investors, analysts and regulators.

The Ministry of Corporate Affairs (MCA), on 28 March 2018, notified Ind AS 115, *Revenue from Contracts with Customers* which is based on IFRS 15, *Revenue from Contracts with Customers*. The standard is effective for accounting periods beginning on or after 1 April 2018. Ind AS 115 provides a comprehensive framework for recognising revenue from contracts with customers and would apply to all revenue contracts with customers including construction contracts

The new standard replaces existing revenue recognition standards Ind AS 11, *Construction Contracts* and Ind AS 18, *Revenue* and revised guidance note of the Institute of Chartered Accountants of India (ICAI) on Accounting for Real Estate Transactions for Ind AS entities issued in 2016.

The core principle of the new standard is that revenue should be recognised when (or as) an entity transfers control of goods or services to a customer at the amount to which the entity expects to be entitled. To achieve the core principle, the new standard establishes a five-step model that entities would need to apply to determine when to recognise revenue, and at what amount.

## About the analysis

The quarterly results for 30 June 2018 are the first set of financial results that have been reported by the listed companies to present financial results with revenue recognition under Ind AS 115. The subsequent section presents an impact of Ind AS 115 on the first quarter results of the listed companies.

## Coverage of our analysis

Our impact assessment is based on BSE 100 companies which are among the first group of companies to report revenue under Ind AS 115 starting quarter ended 30 June 2018. Of the companies comprising the BSE 100 index, 10 companies are banks, 10 are finance companies including Non-Banking Financial Companies (NBFCs) and three companies follow different date of transition to Ind AS 115 due to financial year being other than 31 March. Therefore, our analysis is based on the results published by the remaining 77 companies (covered companies).

The impact of the transition to Ind AS 115 has been analysed by comparing the reported results of the covered companies for the quarter ended 30 June 2017 under Ind AS 11 and 18 with the restated results for the same quarter under Ind AS 115, that have been published as comparatives for the quarter ended 30 June 2018.

The analysis is based on consolidated financial results unless the consolidated financial results have not been published for the quarter ended 30 June 2018, in which case the separate financial results have been used. Of the covered companies, 46 companies have provided consolidated financial results, while 31 companies have provided separate financial results for the quarter ending 30 June 2018.

## Ind AS 115 transition impact

### Transitional provisions

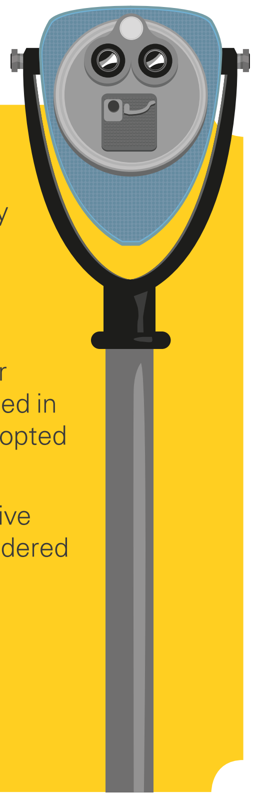
Ind AS 115 provides two methods of accounting i.e. the retrospective method (with or without one or more of four practical expedients) and the cumulative effect method (with or without one or more of four practical expedients). The requirements of each of these methods are summarised in the following diagram:

| Approach | Full retrospective (with optional practical expedients) | Cumulative effect (with optional practical expedients) |
|---|---|---|
| **Description** | Entities recognise the cumulative effect of applying the new standard at the start of the earliest period presented.<br><br>They can also elect to use one or more of the practical expedients available. The practical expedient help to simplify how contracts are restated or reduce the number of contracts to be restated.<br><br>For entities applying Ind AS, the expedients include an option to apply the new standard to only those contracts that are not considered completed contracts under previous/existing GAAP at the start of the earliest period presented. | Entities recognise the cumulative effect of applying the new standard at the date of initial application with no restatement of the comparative period presented in accordance with previous/existing GAAP.<br><br>An entity may choose to apply the new standard to all of its contracts or only those contracts that are not considered completed contracts at the date of initial application.<br><br>Entities may also elect to use the practical expedient available with respect to contract modifications to simplify their restatement of contracts.<br><br>Entities who elect this method are also required to disclose the quantitative effect and an explanation of the significant changes between the reported results under the new standard and those that would have been reported under previous/existing GAAP in the period of adoption. |
| **Application** | 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.* | The entities would recognise the cumulative effect of Ind AS 115 initially as an adjustment to the opening balance of equity at the date of initial application i.e. 1 April 2018. |
| **Comparatives** | Comparatives are required to be restated. | Comparatives would not be restated and would be presented under previous/existing GAAP. |

### The following chart represents transition options available to companies

| Approach | Period ending 31 March 2018 | Period ending 31 March 2019 | Date of equity adjustment |
|---|---|---|---|
| Full retrospective – no practical expedients | Ind AS 115 | Ind AS 115 | 1 April 2017 |
| Full 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 |

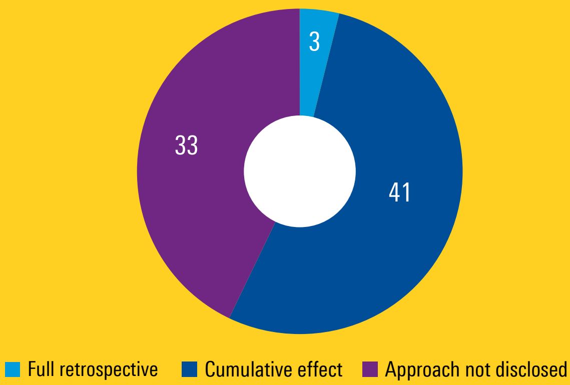
Source: Revenue Issues In-Depth, KPMG IFRG Limited's publication, May 2016



### Our observations

The following diagram represents the data on companies presenting their approach on transition to Ind AS 115.

**Approach to transition to Ind AS 115 (number of companies)**




Basis our analysis of the covered companies, we have observed that only three companies have followed the full retrospective approach. Out of the balance 74 companies, 41 companies (53 per cent) have adopted cumulative effect approach. However, about 43 per cent of the companies have not disclosed in their published results the approach adopted by them to transition to Ind AS 115.

The reason for adoption of the cumulative effect approach could be that it is considered to be a simpler approach than the full retrospective approach.

Source: KPMG in India analysis based on the primary data gathered from BSE 100 companies upto 14 August 2018)

## Impact of Ind AS 115 on revenue recognition

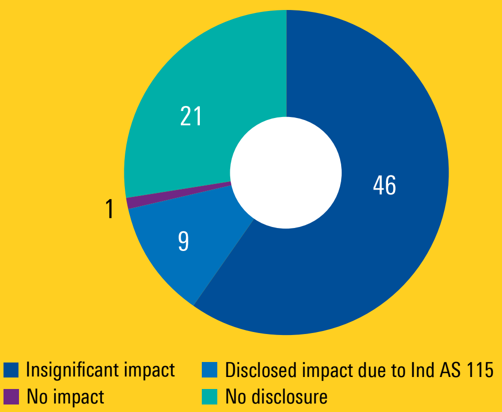
The new standard is expected to have far-reaching effects on how revenue from different contracts is recognised. The timing and amount of revenue that can be shown in each accounting period is likely to change. If it does, then performance against key performance indicators will also change. However, the impact of the new standard will vary by industry.

### Our observations

On analysing the financial results, we observed that a majority of companies, 46 companies out of 77 covered companies (60 per cent), have disclosed that adoption of Ind AS 115 does not have a significant impact on revenue. While 27 per cent of the companies have not provided any disclosure on the impact of Ind AS 115 on their revenue recognised.

The following chart represents the impact comparison as disclosed by companies

**Impact on revenue on adoption of Ind AS 115 (number of companies)**




Nine companies that have disclosed an impact on revenue belong to the sectors such as real estate, energy, metals, automotive, infrastructure, pharmaceuticals and other manufacturing.

Source: KPMG in India analysis based on the primary data gathered from BSE 100 companies upto 14 August 2018

## Disclosures in the quarterly financial results

Ind AS 115 contains extensive disclosure requirements as compared to those under the Ind AS 11 and 18. The objective of the disclosure requirements is that an entity should disclose sufficient information to enable users of the financial statements to understand the nature, amount, timing, and uncertainty of revenue and cash flows arising from contracts with customers.

The quarterly financial results of the listed companies are required to be submitted to stock exchange as per the formats for balance sheet and statement of profit and loss (excluding notes and detailed sub-classification) as prescribed in Schedule III to the Companies Act, 2013 (2013 Act). Further, Regulation 33 of the Securities Exchange Board of India (SEBI) Listing Regulations requires listed entities to make disclosures as specified in Part A of Schedule IV of the regulations. Schedule IV specifically requires entities to disclose changes in accounting policies in accordance with Ind AS 8.

Further, following disclosures would be considered to be relevant while submitting quarterly financial results:

- Description of the nature and effect of the change in revenue recognised due to adoption of Ind AS 115
- Transition method selected
- Quantitative impact of adoption of Ind AS 115 on the financial results.

### Our observations

Out of 77 covered companies, 21 companies have not provided any disclosure regarding adoption of Ind AS 115 (as mentioned earlier in the article). This disclosure may not have been provided by these companies as adoption of Ind AS 115 might not have been considered to have a significant impact on their financial results. Out of balance 56 companies only nine companies have presented detailed disclosure, on adoption of new standard.

These nine companies have provided the description of change in existing revenue recognition policies in current business subdivisions due to adoption of Ind AS 115. These companies have also provided disclosures regarding transition method adopted by them i.e. full retrospective method or the cumulative effect method along with notes to financial results. The disclosure also contains the quantitative disclosure on impact of Ind AS 115 on net worth, revenue or profits.

The balance 47 companies have only provided bare minimum disclosure relating to adoption of Ind AS 115.

## Conclusion

The transition to Ind AS 115 does not appear to have a significant effect on the financial results/disclosures as compared to the qualitative differences between Ind AS 115 and guidance under Ind AS 11 and Ind AS 18. This could be due to a combination of factors such as the transition approach adopted by the companies or that their existing revenue recognition policies are in line with requirements under Ind AS 115. Further, we would expect companies to provide some more disclosures relating to Ind AS 115 with their year-end financial results.