Voices on Reporting
Transport, leisure and sports sector

12 December 2018

KPMG.com/in
Welcome

01 Series of knowledge sharing calls

02 Covering current and emerging reporting issues

03 Scheduled towards the end of each month

04 Look out for our Accounting and Auditing Update, IFRS Notes and First Notes publications
Ind AS 115 – Quick recap
Core principle of Ind AS 115, *Revenue from Contracts with Customers*

...is that an entity recognises *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.

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*”.

The new revenue standard is applicable to Indian companies following the Ind AS road map framework from 1 April 2018.
## Recap of the five-step model

<table>
<thead>
<tr>
<th>Step</th>
<th>Task Description</th>
</tr>
</thead>
<tbody>
<tr>
<td>1</td>
<td>Identify the contract with the customer (One or multiple)</td>
</tr>
<tr>
<td>2</td>
<td>Identify the performance obligations in the contract (One obligation or multiple)</td>
</tr>
<tr>
<td>3</td>
<td>Determine the transaction price (Total consideration for contract)</td>
</tr>
<tr>
<td>4</td>
<td>Allocate the transaction price to the performance obligation (Allocate to various performance obligations identified)</td>
</tr>
<tr>
<td>5</td>
<td>Recognise revenue (At a point-in-time or over-time)</td>
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</tbody>
</table>
Common industry issues
Step 1 - Identify the contract with the customer (modification of contracts)

Is the contract modification approved?
- Yes
  - Does it add distinct goods or services that are priced commensurate with their standalone selling prices?
    - Yes
      - Account for as a separate contract
    - No
      - Are the remaining goods or services distinct from those already transferred?
        - Yes
          - Account for as termination of existing contract and creation of a new contract
        - No
          - Account for as part of the original contract

No
- Do not account for contract modification until approved

Think about...

**Aviation**
- Up gradation charges
- Change of travel plan

**Hospitality**
- Ancillary services (business centre, travel support, etc.)
Step 2 - Identify the performance obligations in the contract

Do your agreements include elements that meet the new ‘distinct’ test to be accounted for separately?

A good or service is distinct if it is...

**Criterion 1:**
Capable of being distinct

**Criterion 2:**
Distinct within the context of the contract

Yes  Distinct – performance obligations

No  Not distinct – combine with other goods and services

Think about...

**Aviation**
- Air travel loyalty points and other vouchers
- Lounge access, seat assignment

**Hospitality**
- Non-refundable upfront membership fees
- Loyalty points

**Contract logistics**
- End to end turn-key projects

**Container freight station**
- Import related services
Step 3 - Determine the transaction price

If the contract price contains variable consideration, have you decided on the...

Estimation method and applied the

- Expected value
- or
- Most likely amount

Constraint

Could there be a significant revenue reversal?

Think about...

Railway
- Accounting of rebates

Shipping
- Demurrage claims

Contract logistics
- Performance incentives

Aviation
- Accounting of ticket breakages
Step 3 - Determine the transaction price (cont.)

Have you determined whether payments to customers should be netted against the revenue?

A payment to a customer that is not for a distinct good or service is netted against revenue...

At the later of when you...

- Recognise revenue for related goods or services, or
- Pay, or promise, the amount

Think about...

Leisure sector (online travel agents)

- Cash back to customers
Step 4 - Allocation of transaction price

How will you determine the stand-alone selling prices of your performance obligations and allocate the transaction price?

Is the price directly observable?

Yes

Use observable price

Adjusted market assessment approach

No

Estimate price

Expected cost plus margin approach

Residual approach (only in limited circumstances)

Think about...

Aviation
• Accounting of loyalty points

Leisure sector
• Accounting of free services provided in a package holiday

Hospitality
• Accounting of loyalty points
Step 5 – Timing of revenue recognition

Timing of revenue recognition

Revenue is recognised …

At the point in time when the customer obtains control

Or

Over time if specific criteria are met

Think about...

Shipping
• Revenue is recorded over time, given the customer simultaneously receives and consumes benefits

Freight forwarding (prepaid)
• On completion of the performance obligation

Hospitality
• Management fees for operating hotels.
• Non-refundable up-front membership fees

Aviation
• Customers’ unexercised rights (breakage)
Have you reassessed whether you are acting as a principal or as an agent?

Think about….

**Aviation**
- Interline billing
- Airport charges and taxes

**Contract logistics sector**
- Payment of freight cost, port handling and other statutory charges
- Statutory dues paid on behalf of customers

**Hospitality**
- Payment of other ancillary services – car hiring, tour guides, etc.
Significant financing components

Do deferred or advance payment terms in your contracts give rise to a significant financing component?

- **Interest expense**
- **Advance payment**
- **Interest income**
- **Deferred payment**

Performance date

**Practical expedient**
No need to recognise if period between payment and performance is less than one year.

Does not apply if the timing of performance is at the customer’s discretion.
Disclosure requirements
Disclosure requirements

Qualitative and quantitative disclosures

- Understand nature, amount, timing and uncertainty of revenue and cash flows
- Disaggregation of revenue
- Performance obligations
- Significant judgements
- Costs to obtain or fulfil a contract
- Contract balances
Preparing for the new leases standard (IFRS 16)
Lessees face major changes

All major leases on balance sheet

**Balance sheet**

- **Asset**
  - ‘Right-of-use’ of underlying asset

- **Liability**
  - Obligation to make lease payments

**Profit/Loss**

- **Lease expense**
  - Depreciation
  - + Interest
  - = Front-loaded total lease expense
Companies with operating leases will appear to be more asset-rich, but also more heavily indebted.

Balance sheet to be significantly grossed up

**Balance sheet**

<table>
<thead>
<tr>
<th>Asset</th>
<th>Liability</th>
</tr>
</thead>
</table>

**Profit/loss**

- **Depreciation**
- **Interest**
- Cash rental payments

Total lease expense is *front-loaded* even when cash rentals are constant.

**EBITDA** will improve

*EBITDA – Earnings Before Interest, Tax, Depreciation and Amortisation*
Impact on financial ratios

<table>
<thead>
<tr>
<th>Profit/loss</th>
<th>Balance sheet</th>
<th>Ratios</th>
</tr>
</thead>
<tbody>
<tr>
<td>EBITDA</td>
<td>Total assets</td>
<td>Gearing</td>
</tr>
<tr>
<td>*<em>EPS</em></td>
<td>Net assets</td>
<td>Interest cover</td>
</tr>
<tr>
<td>(in early years)</td>
<td></td>
<td>Asset turnover</td>
</tr>
</tbody>
</table>

*EPS – Earnings Per Share
Lease definition

The new on/off-balance sheet test for lessees – a key judgement area
IFRS 16 (cont.)

Lease definition – Control

The new definition increases focus on who controls the asset and may change which contracts are leases.

Think about…

Aviation
- Lease of aircrafts

Leisure sector
- Lease of land and building of hotels

Transport (rail and road)
- Lease of wagons/trailers/trucks
- Dedicated asset versus substitution rights
Lease definition – Exemptions

**Two major optional exemptions make the standard easier to apply**

- **Short term leases**: ≤ 12 months
- **Leases of low value items**: ≤ USD5,000 for example
IFRS 16 (cont.)

Measuring the lease liability

Lease liability = Present value of lease rentals + Present value of expected payments at end of lease

Think about…

Aviation
• Foreign currency debt
• Return/restoration costs

Leisure sector
• Long term debt
• Return/restoration costs

Transport (rail and road)
• Foreign currency debt
IFRS 16 (cont.)

Variable lease payments

Which variable lease payments are included in the lease liability?

- Payments based on an index or rate
  - Leisure
    - Revenue share arrangements
  - Transport (road)
    - Fuel inflation linked payments

- Payments based on turnover or usage
Lessor accounting remains similar to current practice…

but lacks consistency with new lessee accounting model

- Lease classification test: ✔
- Finance leases and operating leases: ✔
- Consistent accounting model for lessors and lessees: ✗
IFRS 16 essentially kills sale-and-leaseback as an off-balance sheet financing structure.

**Think about...**

**Aviation/Shipping**
- Sale and lease back of aircrafts or vessels
• Full retrospective: parallel systems for 2018.
• Modified retrospective approach: additional disclosure.
Things to think about now

Some questions to assess the impact on your company’s financial statements

- Which contracts are leases?
- Which transition options to choose?
- Database of all leases?
- Systems and processes in place?
- What about ratios and covenants?
### Links to previous recordings of VOR

<table>
<thead>
<tr>
<th>Month</th>
<th>Topics</th>
<th>Link</th>
</tr>
</thead>
<tbody>
<tr>
<td><strong>July 2018</strong></td>
<td>• Notification of sections of the Companies (Amendment) Act, 2017 and related rules under the Companies Act, 2013</td>
<td>Click <a href="#">here</a></td>
</tr>
<tr>
<td></td>
<td>• Amendments to SEBI Listing Regulations pursuant to Kotak Committee recommendations</td>
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<tr>
<td></td>
<td>• Ind AS Transition Facilitation Group (ITFG) clarification - Bulletin 15</td>
<td></td>
</tr>
<tr>
<td><strong>August 2018</strong></td>
<td>Ind AS 115 – Sector Series</td>
<td>Click <a href="#">here</a></td>
</tr>
<tr>
<td>(special session)</td>
<td>Automotive Sector</td>
<td></td>
</tr>
<tr>
<td><strong>September 2018</strong></td>
<td>Ind AS 115 – Sector Series</td>
<td>Click <a href="#">here</a></td>
</tr>
<tr>
<td>(special session)</td>
<td>Consumer and retail sector</td>
<td></td>
</tr>
<tr>
<td><strong>October 2018</strong></td>
<td>• Key clarifications on some Ind AS implementation issues provided in the Ind AS Transition Facilitation Group (ITFG) Bulletin 16.</td>
<td>Click <a href="#">here</a></td>
</tr>
<tr>
<td></td>
<td>• An overview of the key amendments in the SEBI (Issue of Capital and Disclosure Requirements) Regulations, 2018.</td>
<td></td>
</tr>
<tr>
<td></td>
<td>• Notification of certain important sections of the Companies (Amendment) Act, 2017 such as amendments related to managerial remuneration, financial statements and board’s report, Corporate Social Responsibility (CSR), etc.</td>
<td></td>
</tr>
<tr>
<td><strong>November 2018</strong></td>
<td>• Impact of Ind AS 103 and Ind AS 115 on technology sector</td>
<td>Click <a href="#">here</a></td>
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<td></td>
<td></td>
</tr>
</tbody>
</table>

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Our publications

Accounting and Auditing Update

First Notes

Coming up next

New issue of:
- Accounting and Auditing Update
- First Notes
- IFRS Notes

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