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THE 15th ANNUAL AOSSG MEETING

Joining hands in regional cooperation and the development of IFRS

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Issues in IFRS 15, Revenue from Contracts with Customers

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The Institute of Chartered Accountants of India

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Topics for discussion

- Issues in IFRS 15:

1) Determining the transaction price
2) Principal versus agent considerations

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1. Determining the Transaction Price

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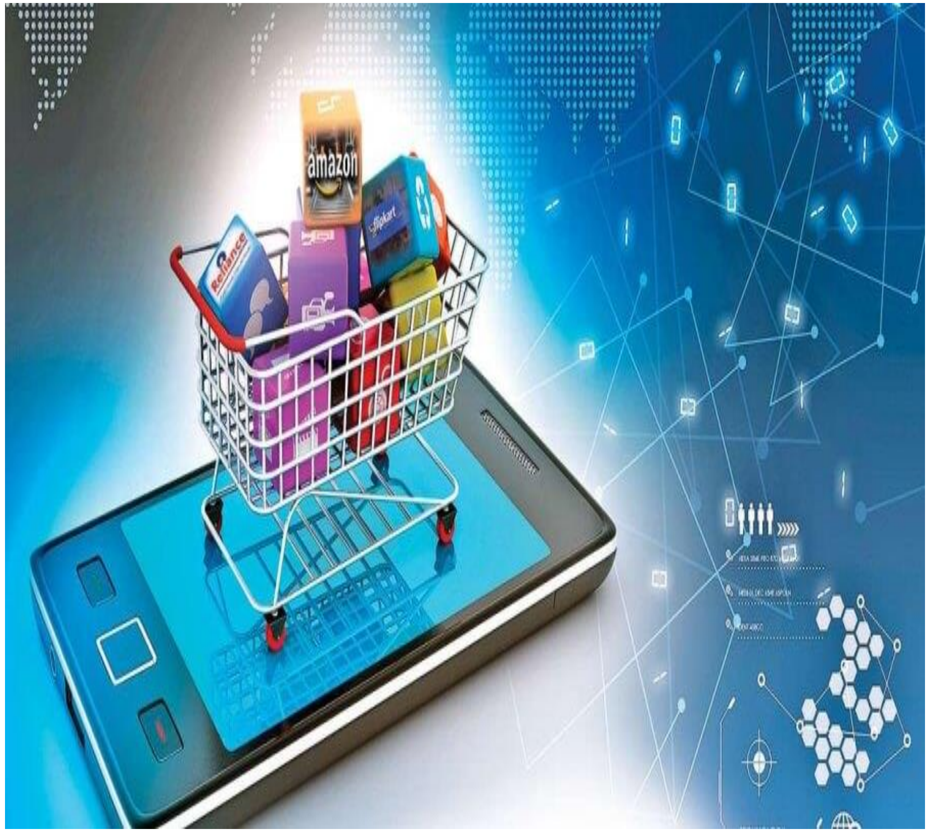
Issue 1(a) Accounting of marketing incentives paid to the end customers

Issues prevalent in entities providing an e-commerce platform for sale of goods/services or fintech companies providing wallet services:

Who are customers of the entity?

How to account for and present incentives given to customer?



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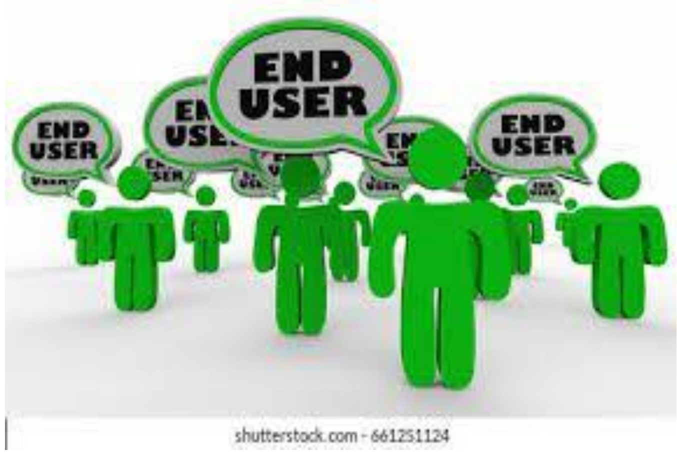
Issue 1(a) Accounting of marketing incentives paid to the end customers

Example 1:

Wallet Facility

A Ltd.

Cashback on availing certain services from the wallet



Purchases from Merchants

Merchant

% commission on transaction value

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Issue 1(a) Accounting of marketing incentives paid to the end customers

Issues:

1. Who is the customer for A Ltd.-merchant vendor or wallet user?

2. Whether the cashback offered to wallet user is promotional expense or shall be netted from the commission earned from the merchant vendor.

3. Would the response change if A Ltd. levied fee on the end user?

Issue 1(a) Accounting of marketing incentives paid to the end customers

Example 1: *Diversity in practice*

View 1:

- In the absence of any fee charged on the end user, only the merchant is the customer.

- Cashback should be considered as promotional expense rather than revenue adjustment.

View 2:

- An entity acting as an agent (i.e., arranging for another party to provide goods or services) should view both the merchant and the end user as its customers.
- Transactions are linked and the economic position of revenue earned by A Ltd. would be best represented by adjusting the cashback against the commission charged to the merchant.

Issue 1(a) Accounting of marketing incentives paid to the end customers

Example 2:

- An e-commerce company provides a platform for booking flights and/or hotels.
- Company charges commission from the airline company and/or hotel but in order to have a larger user base, it offers cash back to the end user.

Similar issues have been observed in such entities as well.

Issue 1(b) Negative Revenue: Cash Burning

Expense for promotion of business or reduction of revenue

- Aggressive strategy by start-ups to expand customer base
- Incentives in the form of cash backs to attract customers which are more than the commission earned by significant amount.
- Such strategies may be followed for an extended period/ on specific occasions/ for specific arrangements.

If such incentives are adjusted against revenue

- Negative revenue (either at aggregate level or at the entity level)
- Not a true and fair view of the state of revenue because from a business economic rationale, such incentives form part of promotional activity

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Issue 1(c) Revenue adjustment vs. Asset on account of cost of obtaining a contract

Example:

A Ltd., an IT company providing software development services, pays to customers for continuing with some of its existing vendor contracts for some (short) period (although services covered by such contracts are within the scope of contracts entered into by the IT company) in order to avoid penalty for pre-mature termination or transition/administrative convenience.

Issues:

- whether such amount is reduction of revenue or a cost of obtaining a contract (asset) would be helpful.
- Whether the frequency of payments will impact the accounting. Example, the amount is paid quarterly for 3 quarters rather than one-time payment.

Issue 1(d) Penalties

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Whether penalty is to be considered as variable consideration in all cases or the accounting treatment depends on the substance of the contract.

Paragraph B33 of IFRS 15 & Agenda Decision (AD) on 'Compensation for Delays or Cancellations issued in September 2019 : *Entity's obligation to pay compensation to a customer if its products cause harm/damage: Accounted for applying IAS 37 separately from its performance obligation*

AD applicable in a limited context and does not provide principle based guidance

Whether the penalty is a part of variable consideration or accounted for separately as per IAS 37.

IASB may consider providing clarification that penalty is part of variable consideration if the same was inherent in determination of transaction price.

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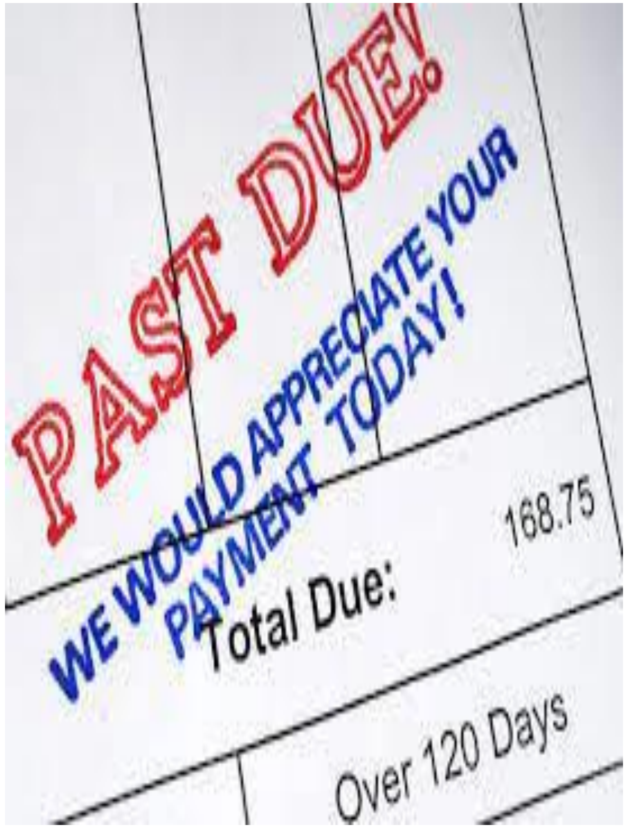
Issue 1(e) Delayed payment charges levied on customers

Charges may be directly linked with the passage of time and the quantum of the same depends on timing of payment by the customers.

Generally, such charges should be considered to be in the nature of financing component

Such charges could be in the nature of penalty where the intention of delay is not financing.



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2. Principal versus agent considerations

Issue:

Strict application of the indicators in paragraph B37 may not represent the substance of the contract or bring in complexities in the assessment.

Example: Retail and Commodity Industries

In arrangements entered into by a commodity entity where goods are shipped directly from the supplier to the customer, the assessment of control by the entity can be challenging since:

- Entity does not take physical possession of the asset.
- Entity may take legal title to the good only momentarily.
- Supplier transfers title and risks and rewards to the entity but these are simultaneously transferred to the customer – these pass on the entity only momentarily.

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Thank You

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