Audit committee considerations for the new revenue standard

Audit committees have an important role to play overseeing the implementation of the new standard in their organisations.

What you need to know

- The new revenue recognition standard will be effective for all entities reporting under Ind AS from 1 April 2018.
- Entities reporting on a quarterly basis need to be ready with the implementation of the new revenue standard for the first quarter of FY2018-19.
- Audit committees will be now enquiring about implementation plans and the entity's ability to meet reporting deadline because some entities will be significantly affected.
- Entities should consider an impact assessment to determine the level of effort needed to implement the new standard.
- Ind AS 115 requires significant disclosures, which may require changes in the systems for compiling the details required for complying with those disclosures.

Highlights

The new revenue recognition standard, notified by the Ministry of Corporate Affairs (MCA), requires immediate action by audit committee members as well as management.

With very limited time available for implementation and significant change in revenue recognition, it is required for entities to immediately start assessing the impact, frame a detailed implementation plan and prepare for its adoption.

Audit committee members may wish to start discussing the implementation plans with the management. Audit committee members may wish to ask whether the entity is performing an assessment of the impact and how much effort will be required to implement the standard. Changes to processes, systems and controls might require considerably more effort. Audit committee members should also ask about the management's plan to communicate with investors and other stakeholders. This would include plans for disclosing the effects of new accounting standards that are issued but not yet effective, as required by Ind AS 8 Accounting Policies, Changes in Accounting Estimates and Errors in the annual financial statements for the year ended 31 March 2018.

Building a better working world

Background

The new standard will supersede the current revenue recognition requirements in Ind AS and will apply to all entities that enter into contracts to provide goods or services to customers (unless the contracts are in the scope of other Ind AS such as Ind AS 17 Leases). Ind AS 115 also addresses the measurement and recognition of gains and losses on the sale of certain non-financial assets, such as property, plant and equipment (PP&E) and intangibles.

Although Ind AS 115 is principles-based, consistent with current Ind AS, it is a significant change from the current revenue requirements. Entities will need to exercise more judgement and may make more estimates than they do today. The core principle in Ind AS 115 is that an entity recognises revenue at an amount that reflects the consideration to which the entity expects to be entitled in exchange for transferring goods or services to a customer.

Ind AS 115 is effective from 1 April 2018. Entities reporting on a quarterly basis need to implement the new revenue standard for first quarter of FY 2018-19. All entities will be required to apply the standard retrospectively, either using a 'full retrospective' or a 'modified retrospective' approach. The full retrospective approach, means that the standard is applied to all periods presented, while the modified retrospective approach, means the standard is applied only to the most current period presented in the financial statements. An entity recognises the cumulative effect of initially applying the standard as an adjustment to the opening balance of retained earnings (or other appropriate components of equity) at the beginning of the earliest period presented under the full retrospective approach or at the date of initial application under the modified retrospective approach. Ind AS 115 contains certain practical expedients to make it easier for entities to use a full retrospective approach.

Key considerations

Audit committees have an important role to play overseeing implementation of the new standard in their organisations. Understanding the implementation process may be a consideration for audit committees. Many entities will now be starting their assessment of the potential impact of the standard by ensuring that they identify the arrangements that are within its scope. For example, an entity may need to evaluate its relationships with counterparties to contracts to determine whether a vendor-customer relationship exists. This may not be the case for collaboration agreements where they are more akin to a partnership (i.e., the arrangement would be outside the scope of the Ind AS 115).

Existing revenue recognition policies will also need to be evaluated to determine whether any contracts that are within the scope of Ind AS 115 will be affected by the new requirements. For example, an entity that sells software may currently account for software contracts with multiple elements (or promises to a customer) as a single arrangement. Under the new standard, the entity may reach a different conclusion about which goods and services in an arrangement should be accounted for separately.

Because Ind AS 115 requires significantly more disclosures than current Ind AS, audit committee members may want to understand from management whether the entity has sufficient information to satisfy the new disclosure requirements or whether new systems, processes and controls must be implemented to gather such information and ensure its accuracy. Management will also have to consider whether changes to the entity's existing accounting policies are needed.

Audit committee members also may want to understand an entity's chosen transition method and how that will affect its implementation plans. For example, the standard requires entities that select the full retrospective approach to apply Ind AS 115 to each year presented in the financial statements. This will require entities to begin tracking revenue using the new standard earlier than the mandatory effective date. In addition, entities will need to consider if there are any requirements to present additional historical financial information outside the audited financial statements.

Questions to discuss with management

Audit committees should consider the following questions for management:

- What is the management's plan to assess the standard's impact on the entity?
- When is the impact assessment expected to be complete?
- What process has the entity implemented to monitor and consider interpretations/guidance by the regulators/ standard–setters in India and globally?
- What is the entity's plan for making the Ind AS 8 disclosures on the effect of new accounting standards?

After an entity evaluates the potential effect of Ind AS 115, it may need to develop a detailed project plan for implementation to address the issues discussed above and to establish responsibilities and deadlines. This may help to determine the accountability of the implementation team and allow management to identify gaps in resources.

Once the impact assessment is complete, audit committee members should consider the following questions:

- What is the anticipated effect on the entity's businesses, processes and financial reporting?
- How, and to what extent, will the accounting processes and controls be affected or need to be changed?
- What are the entity's plans for communicating with stakeholders?
- What is the planned transition method?
- What is the entity's time table to meet the deadline of implementation?
- Does the entity have sufficient resources for an effective implementation?
- How do the entity's impact assessment and plans benchmark against its competitors?

How we see it

Audit committees have an important role to play in overseeing the entity as it implements the new revenue recognition standard. By asking the right questions, audit committee members can help an entity stay on track and make a smooth transition.

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