

**Educational Material on  
Indian Accounting Standard (Ind AS) 115,  
Revenue from Contracts with Customers**



**The Institute of Chartered Accountants of India**  
*(Set up by an Act of Parliament)*  
**New Delhi**

**Educational Material on**  
**Ind AS 115, *Revenue from Contracts***  
***with Customers***



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## Foreword

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The financial reporting has always been critical from the point of view of allocation of economic resources. Meaningful and transparent financial reporting serves an entity favourably in the long run since it establishes the credibility of an entity in the eyes of the investors, regulators and other users. Further, information about a particular entity is greatly useful if it can be compared with similar information about another entity. Comparability between entities and consistency in the application of methods over time increases the informational value of comparisons of relative economic opportunities or performance. In this era of globalisation, to address this issue of comparability across the globe and considering other factors, need for a single set of high quality accounting standards has been felt. This need has been taken care by the International Accounting Standards Board (IASB) by issuing International Financial Reporting Standards (IFRSs) which are increasingly being recognised as Global Financial Reporting Standards.

Keeping this in view, India has also decided to converge with IFRS. For this purpose, the Institute of Chartered Accountants of India (ICAI) is actively engaged in formulation of IFRS-converged Indian Accounting Standards (Ind ASs). Another very significant responsibility of the ICAI is getting the members and other stakeholders ready for proper implementation of these Standards, which is being discharged by the ICAI through its Ind AS Implementation Group. To accomplish its primary objective of providing guidance to members and other stakeholders for implementation of Ind AS, the Group formulates Educational Materials on Ind ASs.

An Educational Material contains summary of the respective Indian Accounting Standard and Frequently Asked Questions (FAQs) covering the issues which are expected to be encountered frequently while implementing the Standard. Accordingly, the Group has come out with the Educational Material on Ind AS 115, *Revenue from Contracts with Customers*.

I acknowledge the sincere efforts of CA. Nihar Niranjana Jambusaria, Convenor, Ind AS Implementation Group and CA. Dhinal Ashvinbhai Shah, Deputy Convenor, and all the members of the Ind AS Implementation Group for bringing out this Educational Material on an Indian Accounting Standard which deals with a very important aspect of the financial statements, i.e.,

revenue. I also congratulate CA. S. B. Zaware, Chairman and CA. M. P. Vijay Kumar, Vice-chairman of Accounting Standards Board of ICAI for their support. Since the subject is relevant for all the entities, I am confident that this Educational Material will be very useful for the members of the Institute and other concerned stakeholders in proper understanding and implementation of the Standard.

New Delhi  
August 02, 2018

**CA. Naveen N.D. Gupta**  
***President, ICAI***

## Preface

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In the era of globalised economies, Ind AS is a business imperative for Indian companies today. Ind AS converged with IFRS have put India at the centre stage of high quality and transparent financial reporting whose benefits far outweigh the challenges. These standards will facilitate better comparability and understanding of financial statements across all companies around the world and are the new benchmark of accounting excellence. In India, Ind AS has become a reality now as the era of Implementation of Ind AS has already begun in the country with Phase I companies which have published their financial statements prepared in accordance with Ind AS for financial year 2016-17. Phase II companies have also started publishing their financial statements in accordance with Ind AS.

The Institute of Chartered Accountants of India (ICAI) through its Ind AS Implementation Group is making every possible effort to ensure that these Standards are implemented in the same spirit in which these have been formulated. For this purpose, the Group is working to provide guidance to the members and other stakeholders by issuing Educational Materials on Ind AS, issuing timely clarifications on issues being faced by the members through Ind AS Technical Facilitation Group (ITFG) Clarification Bulletins, addressing queries through Support-desk for implementation of Ind AS, conducting Certificate Course on Ind AS, developing e-learning modules on Ind AS, workshops, seminars, awareness programmes on Ind AS and series of webcasts on Ind AS etc.

We are glad that the Group has brought out the Educational Material on Indian Accounting Standard (Ind AS) 115, *Revenue from Contracts with Customers*. The objective of Ind AS 115 is to establish the principles that an entity shall apply to report useful information to users of financial statements about the nature, amount, timing and uncertainty of revenue and cash flows arising from a contract with a customer. The core principle of Ind AS 115 is that an entity recognises revenue to depict the transfer of promised goods or 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. This Educational Material contains summary of Ind AS 115 discussing the key requirements of the Standard and the Frequently Asked Questions



(FAQs) covering the issues, which are expected to be encountered frequently while implementing this Standard.

We may mention that the views expressed in this publication are the views of the Ind AS Implementation Group and are not necessarily the views of the Council of the Institute. The purpose of this publication is to provide guidance for implementing this Ind AS effectively by explaining the principles enunciated in the Standard with the help of examples. However, while applying Ind AS in a practical situation, reference should be made to the full text of the Standards.

We would like to convey sincere gratitude to our Hon'ble President, CA. Naveen N D Gupta and Vice-President, CA. Prafulla Preme Sukh Chhajed for providing us this opportunity of bringing out implementation guidance on Ind AS in the form of Educational Materials. We sincerely appreciate the efforts put in by Co-convenor and members of the Group, CA. Sandip Khetan, CA. Archana Bhutani, CA. Anand Banka, CA. Gargi Ray, CA. Gopalakrishnan R, CA. Rohit Kumar Agarwala, CA. Sujit Mahato, CA Parveen Kumar, CA. M.M. Kawatra and CA. Mayur Gupta for preparing the draft of this Educational Material. We would also like to thank all the members of the Ind AS Implementation Group for their valuable & technical contributions in finalising this publication.

We sincerely appreciate CA. Geetanshu Bansal, Secretary, Ind AS Implementation Group and CA. Prachi Jain, Executive Officer for their technical and administrative support in bringing out this publication. We would also like to thank CA. Vidhyadhar Kulkarni, Head, Technical Directorate, for his guidance.

We are sure that this Educational Material will be of great help in understanding the provisions of Ind AS 115 and in their practical implementation.

**CA. Nihar Niranjana Jambusaria**  
**Convenor**  
**Ind AS Implementation Group**

**CA. Dhinal Ashvinbhai Shah**  
**Deputy Convenor**  
**Ind AS Implementation Group**

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# **Educational Material on Indian Accounting Standard (Ind AS) 115 *Revenue from Contracts with Customers***

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## **I. Summary**

### **Objective**

This standard establishes principles to report useful information about the nature, amount, timing and uncertainty of revenue and cash flows arising from a contract with a customer.

The core principle is that an entity shall recognise revenue to depict the transfer of promised goods or 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.

The standard specifies the accounting for an individual contract with a customer. However, as a practical expedient, an entity may apply this Standard to a portfolio of contracts (or performance obligations) with similar characteristics if the entity reasonably expects that the effects of applying the Standard to the portfolio would not differ materially from applying this Standard to the individual contracts (or performance obligations) within that portfolio.

### **Scope**

The standard applies to all contracts with customers, except the following:

- (a) lease contracts within the scope of Ind AS 17, *Leases*;
- (b) insurance contracts within the scope of Ind AS 104, *Insurance Contracts*;
- (c) financial instruments and other contractual rights or obligations within the scope of Ind AS 109, *Financial Instruments*, Ind AS 110, *Consolidated Financial Statements*, Ind AS 111, *Joint Arrangements*, Ind AS 27, *Separate Financial Statements* and Ind AS 28, *Investments in Associates and Joint Ventures*; and

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- (d) non-monetary exchanges between entities in the same line of business to facilitate sales to customers or potential customers. For example, this Standard would not apply to a contract between two oil companies that agree to an exchange of oil to fulfil demand from their customers in different specified locations on a timely basis.

Ind AS 115 applies only if the counterparty to a contract is a **customer**.

A **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.

A counterparty to the contract would not be a customer if, for example, the counterparty has contracted with the entity to participate in an activity or process in which the parties to the contract share in the risks and benefits that result from the activity or process (such as developing an asset in a collaboration arrangement) rather than to obtain the output of the entity's ordinary activities.

## **Recognition**

### **Identifying the contract**

An entity shall account for a contract with a customer only when all of the following criteria are met:

- (a) the parties to the contract have approved the contract (in writing, orally or in accordance with other customary business practices) and are committed to perform their respective obligations;
- (b) the entity can identify each party's rights regarding the goods or services to be transferred;
- (c) the entity can identify the payment terms for the goods or services to be transferred;
- (d) the contract has commercial substance (ie the risk, timing or amount of the entity's future cash flows is expected to change as a result of the contract); and
- (e) it is probable that the entity will collect the consideration to which it will be entitled in exchange for the goods or services that will be transferred to the customer. In evaluating whether collectability of an amount of consideration is probable, an entity shall consider only the

customer's ability and intention to pay that amount of consideration when it is due. The amount of consideration to which the entity will be entitled may be less than the price stated in the contract if the consideration is variable because the entity may offer the customer a price concession.

A contract is an agreement between two or more parties that creates enforceable rights and obligations. Enforceability is a matter of law. Contracts can be written, oral or implied by an entity's customary business practices. For the purpose of applying this Standard, a contract does not exist if each party to the contract has the unilateral enforceable right to terminate a wholly unperformed contract without compensating the other party (or parties).

If a contract meets the criteria (mentioned above) at contract inception, then an entity shall not reassess those criteria unless there is an indication of a significant change in facts and circumstances. If it does not meet the criteria, then an entity shall continue to assess the contract to determine whether the criteria are subsequently met.

When a contract does not meet the given criteria and an entity receives consideration from the customer, then it shall recognise the consideration received as revenue only when either of the following events has occurred:

- (a) the entity has no remaining obligations to transfer goods or services to the customer and all, or substantially all, of the consideration promised by the customer has been received by the entity and is non-refundable; or
- (b) the contract has been terminated and the consideration received from the customer is non-refundable.

### **Contract modification**

A contract modification is a change in the scope or price (or both) of a contract that is approved by the parties to the contract. It shall be accounted for as a separate contract if both of the following conditions are present:

- (a) the scope of the contract increases because of the addition of promised goods or services that are distinct; and
- (b) the price of the contract increases by an amount of consideration that reflects the entity's stand-alone selling prices of the additional

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promised goods or services and any appropriate adjustments to that price to reflect the circumstances of the particular contract.

If contract modification is not accounted for as a separate contract, then an entity shall account for the promised goods or services not yet transferred at the date of the contract modification (i.e. the remaining promised goods or services) in whichever of the following ways is applicable:

- (a) account for as if it were a termination of the existing contract and the creation of a new contract, if the remaining goods or services are distinct from the goods or services transferred. The amount of consideration to be allocated is the sum of:
  - (i) the consideration promised by the customer (including amounts already received from the customer) that was included in the estimate of the transaction price and that had not been recognised as revenue; and
  - (ii) the consideration promised as part of the contract modification.
- (b) account for as if it were a part of the existing contract if the remaining goods or services are not distinct and, therefore, form part of a single performance obligation that is partially satisfied at the date of the contract modification.
- (c) If the remaining goods or services are a combination of items (a) and (b), then the effects of the modification on the unsatisfied (including partially unsatisfied) performance obligations in the modified contract shall be accounted for in a manner that is consistent with the objectives of this paragraph.

### **Identifying performance obligations**

At contract inception, assess the goods or services promised and identify as a performance obligation each promise to transfer to the customer either:

- (a) a good or service (or a bundle of goods or services) that is distinct; or
- (b) a series of distinct goods or services that are substantially the same and that have the same pattern of transfer to the customer.

### **Distinct goods or services**

A good or service is distinct if both of the following criteria are met:

- (a) the customer can benefit from the good or service either on its own or together with other resources that are readily available to the customer (i.e. the good or service is capable of being distinct); and
- (b) the entity's promise to transfer the good or service to the customer is separately identifiable from other promises in the contract (i.e. the promise to transfer the good or service is distinct within the context of the contract).

### **Satisfaction of performance obligations**

An entity shall recognise revenue when (or as) the entity satisfies a performance obligation by transferring a promised good or service (i.e. an asset) to a customer. An asset is transferred when (or as) the customer obtains control of that asset.

For each performance obligation identified, determine at contract inception whether it satisfies the performance obligation over time or at a point in time. If an entity does not satisfy a performance obligation over time, the performance obligation is satisfied at a point in time.

### **Performance obligations satisfied over time**

A performance obligation is satisfied over time, if one of the following criteria is met:

- (a) the customer simultaneously receives and consumes the benefits provided by the entity's performance as the entity performs;
- (b) the entity's performance creates or enhances an asset (for example, work in progress) that the customer controls as the asset is created or enhanced; or
- (c) the entity's performance does not create an asset with an alternative use to the entity and the entity has an enforceable right to payment for performance completed to date.

For some types of performance obligations, assessment of (a) above would be straightforward. For other types, entity may not be able to readily identify whether a customer simultaneously receives and consumes the benefits from the entity's performance as the entity performs. In those circumstances, a



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performance obligation is satisfied over time if an entity determines that another entity would not need to substantially re-perform the work that the entity has completed to date if that other entity were to fulfil the remaining performance obligation to the customer.

In assessing whether an asset has an alternative use to an entity, an entity shall consider the effects of contractual restrictions and practical limitations on the entity's ability to readily direct that asset for another use, such as selling it to a different customer. A contractual restriction must be substantive i.e. a customer could enforce its rights to the promised asset if the entity sought to direct the asset for another use.

An entity has a right to payment for performance completed to date if it gets an amount that would compensate an entity for performance completed to date which is an amount that approximates the selling price of the goods or services transferred to date (for example, recovery of the costs incurred by an entity in satisfying the performance obligation plus a reasonable profit margin) rather than compensation for only the entity's potential loss of profit if the contract were to be terminated.

For each performance obligation satisfied over time recognise revenue over time by measuring the progress towards complete satisfaction of that performance obligation. Appropriate methods of measuring progress include output methods and input methods. In determining the appropriate method entity shall consider the nature of the good or service that the entity promised to transfer to the customer.

**Output methods** recognise revenue on the basis of direct measurements of the value to the customer of the goods or services transferred to date relative to the remaining goods or services promised under the contract.

**Input methods** recognise revenue on the basis of the entity's efforts or inputs to the satisfaction of a performance obligation (for example, resources consumed, labour hours expended, costs incurred, time elapsed or machine hours used) relative to the total expected inputs to the satisfaction of that performance obligation.

### **Measurement**

When (or as) a performance obligation is satisfied, recognise as revenue the amount of the transaction price (which excludes estimates of variable consideration that are constrained) that is allocated to that performance obligation.

## **Determining the transaction price**

Entity shall consider the terms of the contract and its customary business practices to determine the transaction price. The transaction price is the amount that the entity expects to be entitled to in exchange for transferring promised goods or services to a customer, excluding amounts collected on behalf of third parties (for example, some sales taxes). The consideration promised may include fixed amounts, variable amounts, or both.

### *Variable consideration*

If the consideration promised in a contract includes a variable amount, an entity shall estimate the amount of consideration to which the entity will be entitled in exchange for transferring the promised goods or services to a customer.

Estimate amount of variable consideration by using either of the following methods:

- The expected value—the expected value is the sum of probability-weighted amounts in a range of possible consideration amounts. An expected value may be an appropriate estimate of the amount of variable consideration if an entity has a large number of contracts with similar characteristics.
- The most likely amount—the most likely amount is the single most likely amount in a range of possible consideration amounts (i.e., the single most likely outcome of the contract). The most likely amount may be an appropriate estimate of the amount of variable consideration if the contract has only two possible outcomes (for example, an entity either achieves a performance bonus or does not).

At the end of each reporting period, an entity shall update the estimated transaction price including updating its assessment of whether an estimate of variable consideration is constrained.

### *The existence of a significant financing component in the contract*

In determining the transaction price, an entity shall adjust the promised amount of consideration for the effects of the time value of money if the timing of payments agreed to by the parties to the contract (either explicitly or implicitly) provides the customer or the entity with a significant benefit of financing the transfer of goods or services to the customer.

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### *Non-cash consideration*

Measure the non-cash consideration (or promise of non-cash consideration) at fair value. If cannot reasonably estimate the fair value of the non-cash consideration, then measure the consideration indirectly by reference to the stand-alone selling price of the goods or services promised to the customer (or class of customer) in exchange for the consideration.

### **Allocating the transaction price to performance obligations**

Allocate the transaction price to each performance obligation identified in the contract on a relative stand-alone selling price basis. To do so, an entity shall determine the stand-alone selling price at contract inception of the distinct good or service underlying each performance obligation in the contract and allocate the transaction price in proportion to those stand-alone selling prices.

The stand-alone selling price is the price at which an entity would sell a promised good or service separately to a customer. The best evidence is the observable price of a good or service when the entity sells that good or service separately in similar circumstances and to similar customers.

### **Allocation of a discount**

A customer receives a discount for purchasing a bundle of goods or services if the sum of the stand-alone selling prices of those promised goods or services in the contract exceeds the promised consideration in a contract.

An entity shall allocate a discount entirely to one or more, but not all, performance obligations in the contract if all of the following criteria are met:

- (a) the entity regularly sells each distinct good or service (or each bundle of distinct goods or services) in the contract on a stand-alone basis;
- (b) the entity also regularly sells on a stand-alone basis a bundle (or bundles) of some of those distinct goods or services at a discount to the stand-alone selling prices of the goods or services in each bundle; and
- (c) the discount attributable to each bundle of goods or services is substantially the same as the discount in the contract and an analysis of the goods or services in each bundle provides observable evidence

of the performance obligation (or performance obligations) to which the entire discount in the contract belongs.

### **Allocation of variable consideration**

Variable consideration may be attributable to the entire contract or to a specific part of the contract. Allocate a variable amount (and subsequent changes to that amount) entirely to a performance obligation or to a distinct good or service that forms part of a single performance obligation if both of the following criteria are met:

- (a) the terms of a variable payment relate specifically to the entity's efforts to satisfy the performance obligation or transfer the distinct good or service (or to a specific outcome from satisfying the performance obligation or transferring the distinct good or service); and
- (b) allocating the variable amount of consideration entirely to the performance obligation or the distinct good or service is consistent with the allocation objective in paragraph 73 when considering all of the performance obligations and payment terms in the contract.

### **Changes in the transaction price**

After contract inception, the transaction price can change for various reasons, including the resolution of uncertain events or other changes in circumstances that change the amount of consideration to which an entity expects to be entitled in exchange for the promised goods or services. An entity shall allocate to the performance obligations in the contract any subsequent changes in the transaction price on the same basis as at contract inception. Amounts allocated to a satisfied performance obligation shall be recognised as revenue, or as a reduction of revenue, in the period in which the transaction price changes.

### **Contract costs**

Recognise as an asset the incremental costs of obtaining a contract with a customer if the entity expects to recover those costs.

If the costs incurred in fulfilling a contract with a customer are not within the scope of another Standard (for example, Ind AS 2, *Inventories*, Ind AS 16, *Property, Plant and Equipment* or Ind AS 38, *Intangible Assets*), recognise an asset from the costs incurred to fulfil a contract only if those costs meet all of the following criteria:

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- (a) the costs relate directly to a contract or to an anticipated contract that the entity can specifically identify (for example, costs relating to services to be provided under renewal of an existing contract or costs of designing an asset to be transferred under a specific contract that has not yet been approved);
- (b) the costs generate or enhance resources of the entity that will be used in satisfying (or in continuing to satisfy) performance obligations in the future; and
- (c) the costs are expected to be recovered.

Asset recognised shall be amortised on a systematic basis that is consistent with the transfer to the customer of the goods or services to which the asset relates.

### **Presentation**

When either party to a contract has performed, an entity shall present the contract in the balance sheet as a contract asset or a contract liability, depending on the relationship between the entity's performance and the customer's payment. An entity shall present any unconditional rights to consideration separately as a receivable.

### **Sale with a right of return**

To account for the transfer of products with a right of return (and for some services that are provided subject to a refund), an entity shall recognise all of the following:

- revenue for the transferred products in the amount of consideration to which the entity expects to be entitled (therefore, revenue would not be recognised for the products expected to be returned);
- a refund liability; and
- an asset (and corresponding adjustment to cost of sales) for its right to recover products from customers on settling the refund liability.

An entity shall update the measurement of the refund liability at the end of each reporting period for changes in expectations about the amount of refunds. An entity shall recognise corresponding adjustments as revenue (or reductions of revenue).

An asset recognised for an entity's right to recover products shall initially be

measured by reference to the former carrying amount of the product (for example, inventory) less any expected costs to recover those products (including potential decreases in the value to the entity of returned products). At the end of each reporting period, an entity shall update the measurement of the asset arising from changes in expectations about products to be returned. It shall present the asset separately from the refund liability.

## **Warranties**

If customer has the option to purchase warranty separately, the warranty is a distinct service because the entity promises to provide the service to the customer in addition to the product that has the functionality described in the contract. In that case, entity shall account for the promised warranty as a performance obligation and allocate a portion of the transaction price to that performance obligation.

If a customer does not have the option to purchase a warranty separately, an entity shall account for the warranty in accordance with Ind AS 37, *Provisions, Contingent Liabilities and Contingent Assets*, unless it provides the customer with a service in addition to the assurance that the product complies with agreed-upon specifications. If that is the case, then, the promised service is a performance obligation. Entity shall allocate the transaction price to the product and the service.

If an entity promises both an assurance-type warranty and a service-type warranty but cannot reasonably account for them separately, the entity shall account for both of the warranties together as a single performance obligation.

A law that requires an entity to pay compensation if its products cause harm or damage does not give rise to a performance obligation. The entity shall account for such obligations in accordance with Ind AS 37.

## **Licensing**

A licence establishes a customer's rights to the intellectual property of an entity. Licences of intellectual property may include software and technology, motion pictures, music, franchise, patents trademarks etc. In addition to a promise to grant a licence (or licences) to a customer, an entity may also promise to transfer other goods or services to the customer.

When a contract includes a promise to grant a licence in addition to other

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promised goods or services, an entity identifies each of the performance obligations in the contract.

If promise to grant license is not distinct then account for the two as a single performance obligation. If the promise to grant the licence is distinct, then these are separate performance obligation and determine whether the licence transfers to a customer either at a point in time or over time.

### **Sales-based or usage-based royalties**

An entity shall recognise revenue for a sales-based or usage-based royalty promised in exchange for a licence of intellectual property only when (or as) the later of the following events occurs:

- the subsequent sale or usage occurs; and
- the performance obligation to which some or all of the sales-based or usage-based royalty has been allocated has been satisfied (or partially satisfied).

### **Repurchase agreements**

A repurchase agreement is a contract in which an entity sells an asset and also promises or has the option (either in the same contract or in another contract) to repurchase the asset. The repurchased asset may be the asset that was originally sold to the customer, an asset that is substantially the same as that asset, or another asset of which the asset that was originally sold is a component.

Repurchase agreements generally come in three forms viz. (i) an entity's obligation to repurchase the asset (a forward); (ii) an entity's right to repurchase the asset (a call option); and an entity's obligation to repurchase the asset at the customer's request (a put option).

### **Consignment arrangements**

When an entity delivers a product to another party (such as a dealer or a distributor) for sale to end customers, the entity shall evaluate whether that other party has obtained control of the product at that point in time. A product that has been delivered to another party may be held in a consignment arrangement if that other party has not obtained control of the product. Accordingly, an entity shall not recognise revenue upon delivery of a product to another party if the delivered product is held on consignment.

Indicators that an arrangement is a consignment arrangement include, but are not limited to, the following:

- the product is controlled by the entity until a specified event occurs, such as the sale of the product to a customer of the dealer or until a specified period expires;
- the entity is able to require the return of the product or transfer the product to a third party (such as another dealer); and
- the dealer does not have an unconditional obligation to pay for the product (although it might be required to pay a deposit).

### **Bill-and-hold arrangements**

A bill-and-hold arrangement is a contract under which an entity bills a customer for a product but retains physical possession of the product until it is transferred to the customer at a point in time in the future.

An entity shall determine when it has satisfied its performance obligation to transfer a product by evaluating when a customer obtains control of that product. For some contracts, control is transferred either when the product is delivered to the customer's site or when the product is shipped, depending on the terms of the contract (including delivery and shipping terms). However, for some contracts, a customer may obtain control of a product even though that product remains in an entity's physical possession.

For a customer to have obtained control of a product in a bill-and-hold arrangement, all of the following criteria must be met:

- (a) the reason for the bill-and-hold arrangement must be substantive (for example, the customer has requested the arrangement);
- (b) the product must be identified separately as belonging to the customer;
- (c) the product currently must be ready for physical transfer to the customer; and
- (d) the entity cannot have the ability to use the product or to direct it to another customer.

If an entity recognises revenue for the sale of a product on a bill-and-hold basis, the entity shall consider whether it has remaining performance obligations (for example, for custodial services).



## II Frequently Asked Questions

### General

#### Question 1

How is 'Revenue' different from 'Income'? What is the distinction between 'Income' and 'Equity'?

#### Response

Appendix A of Ind AS 115, *Revenue from Contracts with Customers*, defines 'Revenue' as income arising in the course of an entity's ordinary activities.

Income is defined in the Appendix A of Ind AS 115 as increases in economic benefits during the accounting period in the form of inflows or enhancements of assets or decreases of liabilities that result in an increase in equity, other than those relating to contributions from equity participants.

Thus, '*Income*' is a wider term as '*Revenue*' is income that arises in the course of ordinary activities of an entity, whereas Income encompasses revenue as well as gains which may not arise in the ordinary course of business.

Example: In case of a manufacturer of cement, the income from sale of cement is revenue. However, if the same entity sells its surplus land, the profit on sale of land is a gain and not revenue. However, its total income would comprise revenue from sale of cement as well as gain on sale of land.

It may be noted that changes in equity that relate to contributions from or distributions to owners are excluded from the definition of income and expenses. Paragraph 109 of Ind AS 1, *Presentation of Financial Statements*, provides that "Changes in an entity's equity between the beginning and the end of the reporting period reflect the increase or decrease in its net assets during the period. Except for changes resulting from transactions with owners in their capacity as owners (such as equity contributions, reacquisitions of the entity's own equity instruments and dividends) and transaction costs directly related to such transactions, the overall change in equity during a period represents the total amount of income and expense, including gains and losses, generated by the entity's activities during that period".

Accordingly, changes in total equity arise due to the following two reasons:

- (i) transactions with owners (like equity contributions, dividends etc.); and
- (ii) income/expense generated by the entity.

## Scope

### Question 2

Does Ind AS 115 apply to real estate developers?

### Response

Ind AS 18, *Revenue*, required that for real estate developers, revenue should be accounted for as per the 'Guidance Note on Accounting for Real Estate Transactions (for entities to whom Ind AS is applicable)'. However, pursuant to Ind AS 115 becoming effective, the said guidance note has been withdrawn and there is no scope exclusion for real estate developers in the standard.

Accordingly, the real estate developers will be required to apply Ind AS 115 for recognition of revenue from contracts with customers including determining whether the developer satisfies performance obligation and recognises revenue over time or at a point in time.

### Question 3

Whether revenue from extraction of mineral ores be accounted for as per Ind AS 115?

### Response

Ind AS 18 specifically scoped out revenue from the extraction of mineral ores. However, Ind AS 115 does not scope out revenue from the extraction of mineral ore, if it arises as a result of a contract with a customer.

As specified in paragraph 5 of Ind AS 115, the following are the only contracts that are explicitly outside the scope of the Standard:

- lease contracts within the scope of Ind AS 17, *Leases*;
- insurance contracts within the scope of Ind AS 104, *Insurance Contracts*;
- financial instruments and other contractual rights and obligations within the scope of Ind AS 109, *Financial Instruments*, Ind AS 110, *Consolidated Financial Statements*, Ind AS 111, *Joint Arrangements*, Ind AS 27, *Separate Financial Statements* and Ind AS 28, *Investments in Associates and Joint Ventures*; and
- non-monetary exchanges between entities in the same line of business to facilitate sales to customers or potential customers.

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Therefore, revenue from extraction of mineral ores will be covered under the scope of Ind AS 115 if the same is pursuant to a contract with the customer.

### **Question 4**

A Company is registered as an Export Oriented Unit (EOU) and exports all its manufactured products. As per the Foreign Trade Policy in India, Merchandise Exports from India Scheme ("MEIS"), the Company is eligible to claim 2% of its FOB value of exports as export incentives in the form of scrips w.e.f 1<sup>st</sup> April, 2015 which could be used for payment of custom duty against imports or could be sold in open market. Can the MEIS Incentive be treated as revenue?

### **Response**

Appendix A of Ind AS 115, *Revenue from Contracts with Customers*, defines 'Revenue' as income arising in the course of an entity's ordinary activities.

It may be noted that as per paragraph 3 of Ind AS 20, *Accounting for Government Grants and Disclosure of Government Assistance*, 'government grants' are assistance by government in the form of transfers of resources to an entity in return for past or future compliance with certain conditions relating to the operating activities of the entity. They exclude those forms of government assistance which cannot reasonably have a value placed upon them and transactions with government which cannot be distinguished from the normal trading transactions of the entity.

In the given case, the export incentive is in the nature of government grant and does not fall within the scope of Ind AS 115, as it is not revenue arising from contract with customer. Such export incentives are benefits given by the government to incentivise companies to export more products.

In accordance with above, while recognising the income arising from MEIS scheme, the Company should apply the provisions of Ind AS 20 and not Ind AS 115.

The presentation of such incentives shall be made in accordance with the relevant provisions of Ind AS 20 and Schedule III to the Companies Act, 2013

## Identification of Customer

### Question 5

Cybernet Ltd. provides internet-based advertising services to publishing companies. It purchases advertisement space on various websites from a selection of publishers as per the following scenarios:

- (i) It pre-purchases the advertisement space from the publishers before it finds advertisers for that space.
- (ii) It provides the service of matching the advertisers with the publishers.

In each of the above cases, which party will be identified as the customer?

### Response

Paragraph 6 of Ind AS 115 states that, “an entity shall apply this Standard to a contract, (other than a contract listed in paragraph 5), only if the counterparty to the contract is a customer. A 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. A counterparty to the contract would not be a customer if, for example, the counterparty has contracted with the entity to participate in an activity or process in which the parties to the contract share in the risks and benefits that result from the activity or process (such as developing an asset in a collaboration arrangement) rather than to obtain the output of the entity’s ordinary activities”.

Although the definition of customer refers to the ordinary activities, the term ‘ordinary activities’ is not specifically defined in Ind AS. The notion of ‘ordinary activities’ is derived from the definition of revenue which states revenue as income arising in the course of an entity’s ordinary activities. In many transactions, a customer is easily identifiable. However, in transactions involving multiple parties, it requires judgement to identify which counterparties are customers of the entity as it depends on specific terms and conditions of the underlying contracts. An entity is required to consider all relevant facts and circumstances, such as the purpose of the activities undertaken by the counterparty, to determine whether the counterparty is a customer. The identification of the performance obligations in a contract can also have a significant effect on the determination of which party is the entity’s customer.

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- (i) In Scenario 1, (it is assumed that the Cybernet Ltd. is acting as a principal in accordance with Ind AS 115), according to paragraph 6 above, where Cybernet Ltd. pre-purchases advertisement space on various websites from a selection of publishers, the companies (i.e., advertiser) to whom it will provide the advertising space will be identified as its customers.
- (ii) In Scenario 2, (it is assumed that the Cybernet Ltd. is acting as an agent of the publisher in accordance with Ind AS 115) Cybernet Ltd., does not provide any ad-targeting services or purchase the advertising space from the publishers before it finds advertisers for that space. It only provides the service of matching the ad placement for advertisers with the publishers. Accordingly, the publisher to whom Cybernet Ltd. is providing services will be identified as its customer.

## Non-Monetary Exchanges

### Question 6

Q TV released an advertisement in Deshabandhu, a vernacular daily. Instead of paying for the same, Q TV allowed Deshabandhu a free advertisement spot, which was duly utilised by Deshabandhu. How revenue for these non-monetary transactions in the area of advertising will be recognised and measured?

### Response

Paragraph 5(d) of Ind AS 115 excludes non-monetary exchanges between entities in the same line of business to facilitate sales to customers or potential customers. For example, this Standard would not apply to a contract between two oil companies that agree to an exchange of oil to fulfil demand from their customers in different specified locations on a timely basis.

In industries with homogenous products, it is common for entities in the same line of business to exchange products in order to sell them to customers or potential customers other than parties to exchange. The current scenario, on the contrary, will be covered under Ind AS 115 since the same is exchange of **dissimilar goods or services** because both of the entities deal in different mode of media, i.e., one is print media and another is electronic media and both parties are acting as customers and suppliers for each other. Further, in the current scenario, it seems it is for consumption by the said

parties and hence it does not fall under paragraph 5(d). It may also be noted that, even if it was to facilitate sales to customers or potential customers, it would not be scoped out since the parties are not in the same line of business.

As per paragraph 47 of Ind AS 115, “An entity shall consider the terms of the contract and its customary business practices to determine the transaction price. The transaction price is the amount of consideration to which an entity expects to be entitled in exchange for transferring promised goods or services to a customer, excluding amounts collected on behalf of third parties (for example, some sales taxes). The consideration promised in a contract with a customer may include fixed amounts, variable amounts, or both”.

Paragraph 66 of Ind AS 115 provides that to determine the transaction price for contracts in which a customer promises consideration in a form other than cash, an entity shall measure the non-cash consideration (or promise of non-cash consideration) at fair value.

In accordance with the above, QTV and Deshabandhu should measure the revenue promised in the form of non-cash consideration as per the above referred principles of Ind AS 115.

#### **Question 7**

A Ltd. and B Ltd. both are engaged in manufacturing of homogenous bottles. A Ltd. operates in northern, eastern and central parts of India. B Ltd. operates in western and southern parts of India. A Ltd. fulfils the demands of its customers based on western and southern India by using the bottles manufactured by B Ltd. Similarly, B Ltd. fulfils the demands of customer based on northern, eastern and central parts of India by delivering bottles manufactured by A Ltd. How A Ltd. and B Ltd. should recognise the revenue?

#### **Response**

Paragraph 5(d) of Ind AS 115 states that this standard shall not apply to non-monetary exchanges between entities in the same line of business to facilitate sales to customers or potential customers. For example, this Standard would not apply to a contract between two oil companies that agree to an exchange of oil to fulfil demand from their customers in different specified locations on a timely basis.

In industries with homogenous products, it is common for entities in the same

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line of business to exchange products in order to sell them to customers or potential customers other than parties to exchange.

It is to be noted that all contracts (including contract for non-monetary exchanges) should have commercial substance before an entity can apply the other requirements in the revenue recognition model prescribed in Ind AS 115.

In this case, the exchange of bottles qualifies as a non-monetary exchange between customers in the same line of business. Accordingly, A Ltd. and B Ltd. should not recognise any revenue on account of exchange of goods as Ind AS 115 will not apply to the contract.

### **Question 8**

Entities A Ltd. and B Ltd. are both engaged in the extraction and supply of natural gas to different parts of India. A Ltd. is located in western India while B Ltd. is located in Southern part of India. A Ltd. contracts to supply natural gas to a large corporate customer, XL Ltd., located in the South-eastern region of India, who is engaged in supply of natural gas to homes. B Ltd. on the other hand contracts to supply natural gas to YS Ltd. which is located closer to A Ltd. Consequently, A Ltd. purchases from B Ltd. to supply natural gas to YS Ltd. and B Ltd. purchases from A Ltd. to supply natural gas to XL Ltd. The price of natural gas for this transaction would be based on actual delivery date of gas by either party. Further, the parties would do a monthly calculation of supplies and receipts of gas and do a net settlement based on the prices calculated as above. In the said industry, price varies based on different product categories and also varies based on point of sale. How will this situation be treated under Ind AS 115?

### **Response**

Paragraph 5(d) of Ind AS 115 excludes non-monetary exchanges between entities in the same line of business to facilitate sales to customers or potential customers. For example, this Standard would not apply to a contract between two oil companies that agree to an exchange of oil to fulfil demand from their customers in different specified locations on a timely basis.

In industries with homogenous products, it is common for entities in the same line of business to exchange products in order to sell them to customers or potential customers other than parties to exchange.

It is to be noted that all contracts (including contract for non-monetary exchanges) should have commercial substance before an entity can apply the other requirements in the revenue recognition model prescribed in Ind AS 115.

In the above case, entities A Ltd. & B Ltd. operate in the same line of business and agree to supply the same units of natural gas to each other's customers due to ease of supplying in geographically closer areas. However, they calculate the price based on date of delivery and do a net settlement every month and hence, the contracts have commercial substance. Thus, the above stated situation does fall within the scope of Ind AS 115, even though the timing of transfer of goods or services may be different. Hence, A Ltd. will book revenue from sale of goods to B Ltd. and also book revenue from sale of goods to XL Ltd. A Ltd. will also recognise purchase of good from B Ltd. Similarly, B Ltd. will also record relevant corresponding accounting entries. A Ltd. and B Ltd. will also be required to give disclosures in accordance with Ind AS 115.

#### **Question 9**

A Ltd. a telecommunication company, entered into an agreement with B Ltd. which is engaged in generation and supply of power. The agreement provided that A Ltd. will provide 1,00,000 minutes of talk time to employees of B Ltd. in exchange for getting power equivalent to 20,000 units. A Ltd. normally charges Re.0.50 per minute and B Ltd. charges Rs.2.5 per unit. How should revenue be measured in this case?

#### **Response**

Paragraph 5(d) of Ind AS 115 excludes non-monetary exchanges between entities in the same line of business to facilitate sales to customers or potential customers. For example, this Standard would not apply to a contract between two oil companies that agree to an exchange of oil to fulfil demand from their customers in different specified locations on a timely basis.

However, the current scenario will be covered under Ind AS 115 since the same is exchange of dissimilar goods or services.

As per paragraph 47 of Ind AS 115, "an entity shall consider the terms of the contract and its customary business practices to determine the transaction price. The transaction price is the amount of consideration to which an entity expects to be entitled in exchange for transferring promised goods or



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services to a customer, excluding amounts collected on behalf of third parties (for example, some sales taxes). The consideration promised in a contract with a customer may include fixed amounts, variable amounts, or both”.

Paragraph 66 of Ind AS 115 provides that to determine the transaction price for contracts in which a customer promises consideration in a form other than cash, an entity shall measure the non-cash consideration (or promise of non-cash consideration) at fair value.

On the basis of the above, revenue recognised by A Ltd. will be the consideration in the form of power units that it expects to be entitled for talk-time sold, i.e. Rs.50,000 (20,000 units x Rs.2.5). The revenue recognised by B Ltd. will be the consideration in the form of talk time that it expects to be entitled for the power units sold, i.e., Rs.50,000 (1,00,000 minutes x Re. 0.50).

### **Identifying the Contract**

#### **Question 10**

Company A has a customer P which is undergoing restructuring due to issues related to liquidity. Company A has decided not to do any further business with P. P has informed Company A that it will get Letter of Credit from a nationalised bank against which the Company A can despatch goods. Company A has manufactured the goods exclusively for P, but the Letter of Credit has not yet been arranged because it is in process. When should Company A recognise the revenue?

#### **Response**

As per paragraph 9 of Ind AS 115, “An entity shall account for a contract with a customer that is within the scope of this Standard only when all of the following criteria are met:

- (a) the parties to the contract have approved the contract (in writing, orally or in accordance with other customary business practices) and are committed to perform their respective obligations;
- (b) the entity can identify each party’s rights regarding the goods or services to be transferred;
- (c) the entity can identify the payment terms for the goods or services to be transferred;
- (d) the contract has commercial substance (ie the risk, timing or amount

of the entity's future cash flows is expected to change as a result of the contract); and

- (e) it is probable that the entity will collect the consideration to which it will be entitled in exchange for the goods or services that will be transferred to the customer. In evaluating whether collectability of an amount of consideration is probable, an entity shall consider only the customer's ability and intention to pay that amount of consideration when it is due. The amount of consideration to which the entity will be entitled may be less than the price stated in the contract if the consideration is variable because the entity may offer the customer a price concession".

Paragraph 9(e) above, requires that for revenue to be recognised, it should be probable that the entity will collect the consideration to which it will be entitled in exchange for the goods or services that will be transferred to the customer. In the given case, as the customer has liquidity issues, the collection is not considered to be probable. Accordingly, till the time the Letter of Credit is arranged from a nationalised bank in favour of Company A, criterion as mentioned in paragraph 9(e) is not met. However, in case the Company A is able to demonstrate through any other mechanism that the above criteria would be fulfilled in its favour, then it may recognise the revenue in accordance with the principles of Ind AS 115 assuming all other conditions as stated in paragraph 9 are met.

Furthermore, in accordance with paragraph 14 of Ind AS 115, if a contract with a customer does not meet the criteria in paragraph 9, an entity shall continue to assess the contract to determine whether the criteria of paragraph 9 are subsequently met (or requirements of paragraph 15 are met). Hence, the company shall reassess whether the criteria under paragraph 9 are subsequently met.

#### **Question 11**

An entity G Ltd. enters into a contract with a customer P Ltd. for the sale of a machinery for Rs.20,00,000. P Ltd. intends to use the said machinery to start a food processing unit. The food processing industry is highly competitive and P Ltd. has very little experience in the said industry.

P Ltd. pays a non-refundable deposit of Rs.1,00,000 at inception of the contract and enters into a long-term financing agreement with G Ltd. for the remaining 95 per cent of the agreed consideration which it intends to pay

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primarily from income derived from its food processing unit as it lacks any other major source of income. The financing arrangement is provided on a non-recourse basis, which means that if P Ltd. defaults then G Ltd. can repossess the machinery but cannot seek further compensation from P Ltd., even if the full value of the amount owed is not recovered from the machinery. The cost of the machinery for G Ltd. is Rs.12,00,000. P Ltd. obtains control of the machinery at contract inception.

When should G Ltd. recognise revenue from sale of machinery to P Ltd. in accordance with paragraph 9 of Ind AS 115?

### **Response**

As per paragraph 9 of Ind AS 115, “An entity shall account for a contract with a customer that is within the scope of this Standard only when all of the following criteria are met:

- (a) the parties to the contract have approved the contract (in writing, orally or in accordance with other customary business practices) and are committed to perform their respective obligations;
- (b) the entity can identify each party’s rights regarding the goods or services to be transferred;
- (c) the entity can identify the payment terms for the goods or services to be transferred;
- (d) the contract has commercial substance (ie the risk, timing or amount of the entity’s future cash flows is expected to change as a result of the contract); and
- (e) it is probable that the entity will collect the consideration to which it will be entitled in exchange for the goods or services that will be transferred to the customer. In evaluating whether collectability of an amount of consideration is probable, an entity shall consider only the customer’s ability and intention to pay that amount of consideration when it is due. The amount of consideration to which the entity will be entitled may be less than the price stated in the contract if the consideration is variable because the entity may offer the customer a price concession”.

Paragraph 9(e) above, requires that for revenue to be recognised, it should be probable that the entity will collect the consideration to which it will be

entitled in exchange for the goods or services that will be transferred to the customer. In the given case, it is not probable that G Ltd. will collect the consideration to which it is entitled in exchange for the transfer of the machinery. P Ltd.'s ability to pay may be uncertain due to the following reasons:

- (a) P Ltd. intends to pay the remaining consideration (which has a significant balance) primarily from income derived from its food processing unit (which is a business involving significant risk because of high competition in the said industry and P Ltd.'s little experience);
- (b) P Ltd. lacks other income or assets that could be used to repay the balance consideration; and
- (c) P Ltd.'s liability is limited because the financing arrangement is provided on a non-recourse basis.

In accordance with the above, the criteria in paragraph 9 of Ind AS 115 are not met.

Further, paragraphs 15 and 16 of Ind AS 115, state as follows:

- “ 15 When a contract with a customer does not meet the criteria in paragraph 9 and an entity receives consideration from the customer, the entity shall recognise the consideration received as revenue only when either of the following events has occurred:
- (a) the entity has no remaining obligations to transfer goods or services to the customer and all, or substantially all, of the consideration promised by the customer has been received by the entity and is non-refundable; or
  - (b) the contract has been terminated and the consideration received from the customer is non-refundable.
- 16 An entity shall recognise the consideration received from a customer as a liability until one of the events in paragraph 15 occurs or until the criteria in paragraph 9 are subsequently met (see paragraph 14). Depending on the facts and circumstances relating to the contract, the liability recognised represents the entity's obligation to either transfer goods or services in the future or refund the consideration received. In either case, the liability shall be measured at the amount of consideration received from the customer.”

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In accordance with the above, in the given case G Ltd. should account for the non-refundable deposit of Rs.1,00,000 payment as a deposit liability as none of the events described in paragraph 15 have occurred—that is, neither the entity has received substantially all of the consideration nor it has terminated the contract. Consequently, in accordance with paragraph 16, G Ltd. will continue to account for the initial deposit as well as any future payments of principal and interest as a deposit liability until the criteria in paragraph 9 are met (i.e. the entity is able to conclude that it is probable that the entity will collect the consideration) or one of the events in paragraph 15 has occurred. Further, G Ltd. will continue to assess the contract in accordance with paragraph 14 to determine whether the criteria in paragraph 9 are subsequently met or whether the events in paragraph 15 of Ind AS 115 have occurred.

### **Question 12**

On March 01, 2017, P Ltd. agrees to sell 1,000 bath fittings to X Ltd. which are manufactured by using customised screws supplied by a specific vendor. The payment terms between P Ltd. and X Ltd. have not been decided as they are dependent on the price of the customised screws which is yet to be finalised. As a token of confirmation, P Ltd. received a non-refundable amount of Rs.1,000. How will this arrangement be treated under Ind AS 115 in the books of P Ltd., if P Ltd. is a principal in this transaction?

### **Response**

Paragraph 9 of Ind AS 115 states that, “an entity shall account for a contract with a customer that is within the scope of this Standard only when all of the following criteria are met:

- (a) the parties to the contract have approved the contract (in writing, orally or in accordance with other customary business practices) and are committed to perform their respective obligations;
- (b) the entity can identify each party’s rights regarding the goods or services to be transferred;
- (c) the entity can identify the payment terms for the goods or services to be transferred;
- (d) the contract has commercial substance (ie the risk, timing or amount of the entity’s future cash flows is expected to change as a result of the contract); and

- (e) it is probable that the entity will collect the consideration to which it will be entitled in exchange for the goods or services that will be transferred to the customer. In evaluating whether collectability of an amount of consideration is probable, an entity shall consider only the customer's ability and intention to pay that amount of consideration when it is due. The amount of consideration to which the entity will be entitled may be less than the price stated in the contract if the consideration is variable because the entity may offer the customer a price concession".

In accordance with the above, in the given case, since the payment terms are not identified yet, the said contract does not meet all of the criteria of paragraph 9.

Further, paragraphs 14 -16 of Ind AS 115 state as follows:

"14 If a contract with a customer does not meet the criteria in paragraph 9, an entity shall continue to assess the contract to determine whether the criteria in paragraph 9 are subsequently met.

15 When a contract with a customer does not meet the criteria in paragraph 9 and an entity receives consideration from the customer, the entity shall recognise the consideration received as revenue only when either of the following events has occurred:

- (a) the entity has no remaining obligations to transfer goods or services to the customer and all, or substantially all, of the consideration promised by the customer has been received by the entity and is non-refundable; or
- (b) the contract has been terminated and the consideration received from the customer is non-refundable.

16 An entity shall recognise the consideration received from a customer as a liability until one of the events in paragraph 15 occurs or until the criteria in paragraph 9 are subsequently met (see paragraph 14). Depending on the facts and circumstances relating to the contract, the liability recognised represents the entity's obligation to either transfer goods or services in the future or refund the consideration received. In either case, the liability shall be measured at the amount of consideration received from the customer."

In accordance with above, in the given case P Ltd. shall account for the non-

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refundable amount of Rs.1,000 as a liability as none of the events described in paragraph 15 have occurred—that is, neither the entity has received substantially all of the consideration nor it has terminated the contract. Consequently, in accordance with paragraph 16, P Ltd. will continue to account for the non-refundable amount as well as any future payments as a liability until the criteria in paragraph 9 are met (i.e. the payment terms are identified) or one of the events in paragraph 15 has occurred. Further, P Ltd. will continue to assess the contract in accordance with paragraph 14 to determine whether the criteria in paragraph 9 are subsequently met or whether the events in paragraph 15 of Ind AS 115 have occurred.

### **Question 13**

X Ltd. provides IT support services to its customers from a distant location. Customers call up the support team of X Ltd., who understand the client's requirement over the phone and provide necessary advice to the customer to resolve their issue. Before providing advice, the support team member will understand the client's problem and inform them about the price for the services to be provided. Once the problem is resolved, the customer will make the agreed payment to X Ltd. through online banking mode. X Ltd. considers that collection is probable and the oral contract is enforceable as per the laws applicable in the jurisdiction of X Ltd. In such a case, whether there is a valid contract in accordance with Ind AS 115?

### **Response**

As per paragraph 9 of Ind AS 115, "An entity shall account for a contract with a customer that is within the scope of this Standard only when all of the following criteria are met:

- (a) the parties to the contract have approved the contract (in writing, orally or in accordance with other customary business practices) and are committed to perform their respective obligations;
- (b) the entity can identify each party's rights regarding the goods or services to be transferred;
- (c) the entity can identify the payment terms for the goods or services to be transferred;
- (d) the contract has commercial substance (ie the risk, timing or amount of the entity's future cash flows is expected to change as a result of the contract); and
- (e) it is probable that the entity will collect the consideration to which it will

be entitled in exchange for the goods or services that will be transferred to the customer. In evaluating whether collectability of an amount of consideration is probable, an entity shall consider only the customer's ability and intention to pay that amount of consideration when it is due. The amount of consideration to which the entity will be entitled may be less than the price stated in the contract if the consideration is variable because the entity may offer the customer a price concession."

In accordance with the above, following is the assessment for the given case against each of the above criteria:

- (i) In the current case, the contract has been approved orally and X Ltd. will work to resolve the customer's problem and in return it will be eligible to receive the agreed price.
- (ii) Each party's rights can be clearly identified – The right of the customer is to receive the agreed service to resolve his problem while X Ltd. is eligible to receive the agreed price in case the problem is successfully resolved.
- (iii) Payment terms are identified – Since the customer has understanding that he will be required to pay the agreed amount through online banking mode, the payment amount and the method of payment are clearly identified.
- (iv) Contract has commercial substance – Since it involves the efforts and time of the support team of X Ltd. to resolve the customer's problem and in return they will become eligible to receive the agreed price which will impact the risk and timing of the expected cash flow, it can be said that there is commercial substance in the contract.
- (v) Collection is probable – As given in the facts X Ltd. considers that collection is probable.

Further, paragraph 10 of Ind AS 115 provides that a contract is an agreement between two or more parties that creates enforceable rights and obligations. Enforceability of the rights and obligations in a contract is a matter of law. Contracts can be written, oral or implied by an entity's customary business practices. The practices and processes for establishing contracts with customers vary across legal jurisdictions, industries and entities. In addition, they may vary within an entity (for example, they may depend on the class of customer or the nature of the promised goods or services). An entity shall



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consider those practices and processes in determining whether and when an agreement with a customer creates enforceable rights and obligations.

Based on the above assessment and since in the given case, the oral contract is enforceable as per the laws applicable in the jurisdiction, the contract satisfies all the criteria of paragraph 9, even though it is an oral contract. Accordingly, in the given case, there is a contract in accordance with Ind AS 115.

### **Combination of Contracts**

#### **Question 14**

Company A, a manufacturer of specialised construction equipment enters into a contract with Customer B to manufacture and deliver a customised boom lift for Rs.95,000. The total cost to Company A of designing, manufacturing and delivering the boom lift is estimated to be Rs.70,000. Two days later, Company A enters into another contract with Customer B to deliver four boom lift tyres that Customer B will use on the customised boom lift in the future after the original tyres deteriorate. The contract price per tyre is Rs.800, however, the cost of each tyre is estimated at Rs.900. Whether these two contracts should be treated as a single contract?

#### **Response**

As per paragraph 17 of Ind AS 115, “an entity shall combine two or more contracts entered into at or near the same time with the same customer (or related parties of the customer) and account for the contracts as a single contract if one or more of the following criteria are met:

- (a) the contracts are negotiated as a package with a single commercial objective;
- (b) the amount of consideration to be paid in one contract depends on the price or performance of the other contract; or
- (c) the goods or services promised in the contracts (or some goods or services promised in each of the contracts) are a single performance obligation in accordance with paragraphs 22–30”.

In the given case, Company A enters into two contracts with the same party at about the same time, i.e. within two days. In addition, the contracts should satisfy one or more of the criteria in paragraph 17 of Ind AS 115 for the contracts to be combined.

In the given case, criterion (a) of paragraph 17 for combining contracts is met because the two contracts are negotiated as a bundle with one business objective. The relationship between the consideration in the contracts (i.e., the price interdependence) is such that if those contracts were not combined, the amount of consideration allocated to the performance obligations in each contract might not faithfully depict the value of the goods or services transferred to the customer.

In other words, Company A would have incurred a loss of Rs.400 [(Rs.900 – Rs.800) x 4 = Rs.400] on the second contract, if it was not combined with the first contract. Considering that the contracts were entered into at about the same time, it seems that two contracts are negotiated as a package with a single commercial objective, i.e. the tyres have not been sold at a loss instead the consideration of Rs.95,000 stated for the boom lift includes a part of consideration for the tyres as well. Therefore, Company A should combine the two contracts for revenue recognition.

## **Contract Modifications**

### **Question 15**

Entity AB Ltd. enters into a three-year service contract with a customer CD Ltd. for Rs.4,50,000 (Rs.1,50,000 per year). The standalone selling price for one year of service at inception of the contract is Rs.1,50,000 per year. AB Ltd. accounts for the contract as a series of distinct services.

At the beginning of the third year, the parties agree to modify the contract as follows:

- (i) the fee for the third year is reduced to Rs.1,20,000; and
- (ii) CD Ltd. agrees to extend the contract for another three years for Rs.3,00,000 (Rs.1,00,000 per year).

The standalone selling price for one year of service at the time of modification is Rs.1,20,000. How should AB Ltd. account for the modification?

### **Response**

Paragraph 20 of Ind AS 115, *inter alia*, states that, “An entity shall account for a contract modification as a separate contract if **both** of the following conditions are present:

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- a) the scope of the contract increases because of the addition of promised goods or services that are distinct (in accordance with paragraphs 26–30); and
- b) the price of the contract increases by an amount of consideration that reflects the entity's *stand-alone selling prices* of the additional promised goods or services and any appropriate adjustments to that price to reflect the circumstances of the particular contract. For example, an entity may adjust the stand-alone selling price of an additional good or service for a discount that the customer receives, because it is not necessary for the entity to incur the selling-related costs that it would incur when selling a similar good or service to a new customer”.

In accordance with the above, it may be noted that a contract modification should be accounted for prospectively if the additional promised goods or services are distinct and the pricing for those goods or services reflects their stand-alone selling price.

In the given case, even though the remaining services to be provided are distinct, the modification should not be accounted for as a separate contract because the price of the contract did not increase by an amount of consideration that reflects the standalone selling price of the additional services. The modification would be accounted for, from the date of the modification, as if the existing arrangement was terminated and a new contract created (i.e. on a prospective basis) because the remaining services to be provided are distinct.

AB Ltd. should reallocate the remaining consideration to all of the remaining services to be provided (i.e. the obligations remaining from the original contract and the new obligations). AB Ltd. will recognise a total of Rs.4,20,000 (Rs.1,20,000 + Rs.3,00,000) over the remaining four-year service period (one year remaining under the original contract plus three additional years) or Rs.1,05,000 per year.

### **Question 16**

Bob Ltd., a construction company, enters into a contract on 15<sup>th</sup> April, 2017 to construct a commercial building for Lee Ltd. on the land owned by Lee Ltd. for a consideration of Rs.20,00,000. The expected cost of construction is Rs.14,00,000. As per the agreed terms, if the building is completed within 24 months, i.e. 14<sup>th</sup> April, 2019, then the Bob Ltd. is entitled for a performance bonus of Rs.4,00,000.

As at year ended March 2018, Bob Ltd. has satisfied 60 per cent of its performance obligation on the basis of costs incurred to date. In June 2018, Bob Ltd. and Lee Ltd. agreed to modify the contract by changing the floor plan of the building. As a result, the fixed consideration and expected costs increase by Rs.3,00,000 and Rs.2,40,000 respectively.

In addition, the allowable time for achieving the performance bonus of Rs.4,00,000 is extended by 6 months (i.e. from 24 months to 30 months) viz. 14<sup>th</sup> October 2019 from the original contract inception date.

How should Bob Ltd. account for this contract modification?

### **Response**

It is assumed that Bob Ltd. accounts for the promised bundle of goods and services as a single performance obligation satisfied over time in accordance with paragraph 35(b) of Ind AS 115 because the customer, Lee Ltd. controls the building during construction.

### **Year 1**

At the inception of the contract, for Bob Ltd:

	<b>Amount in Rs.</b>
Transaction Price	20,00,000
Expected costs	14,00,000
Expected profit (30%)	6,00,000

Paragraphs 56 and 57 of Ind AS 115 state as follows:

“56 An entity shall include in the transaction price some or all of an amount of variable consideration estimated in accordance with paragraph 53 only to the extent that it is highly probable that a significant reversal in the amount of cumulative revenue recognised will not occur when the uncertainty associated with the variable consideration is subsequently resolved.

57 In assessing whether it is highly probable that a significant reversal in the amount of cumulative revenue recognised will not occur once the uncertainty related to the variable consideration is subsequently resolved, an entity shall consider both the likelihood and the magnitude of the revenue reversal. Factors that could increase the likelihood or the magnitude of a revenue reversal include, but are not limited to, any of the

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following:

- (a) the amount of consideration is highly susceptible to factors outside the entity's influence. Those factors may include volatility in a market, the judgement or actions of third parties, weather conditions and a high risk of obsolescence of the promised good or service.
- (b) the uncertainty about the amount of consideration is not expected to be resolved for a long period of time.
- (c) the entity's experience (or other evidence) with similar types of contracts is limited, or that experience (or other evidence) has limited predictive value.
- (d) the entity has a practice of either offering a broad range of price concessions or changing the payment terms and conditions of similar contracts in similar circumstances.
- (e) the contract has a large number and broad range of possible consideration amounts."

In accordance with the above, in the given case, at contract inception Bob Ltd. will exclude the performance bonus of Rs.4,00,000 from the transaction price because it cannot be concluded that it is highly probable that a significant reversal in the amount of cumulative revenue recognised will not occur as the completion of the building is highly susceptible to factors outside the entity's influence, including weather and regulatory approvals.

As at the year end, March 2018, Bob Ltd. will reassess the variable consideration (i.e. performance bonus) and if it is concluded that the amount is still uncertain in accordance with paragraphs 56–58 of Ind AS 115, then the cumulative revenue and costs recognised for the year ended March 2018 will be as follows:

	<b>Amount in Rs.</b>
Revenue	12,00,000
Costs	8,40,000
Gross profit	3,60,000

### **Year 2**

In June 2018, Bob Ltd. and Lee Ltd. agreed to modify the contract by changing the floor plan of the building. As a result, the fixed consideration

and expected costs increase by Rs.3,00,000 and Rs.2,40,000 respectively.

Now, total potential consideration after the modification is Rs.27,00,000 (Rs.23,00,000 fixed consideration + Rs.4,00,000 performance bonus).

At the date of the modification, on the basis of its experience and the remaining work to be performed, which is primarily inside the building and not subject to weather conditions, if Bob Ltd. concludes that it is highly probable that including the performance bonus in the transaction price will not result in a significant reversal in the amount of cumulative revenue recognised in accordance with paragraph 56 of Ind AS 115 and includes Rs.4,00,000 in the transaction price.

In assessing the contract modification, the Bob Ltd. evaluates paragraph 27(b) of Ind AS 115 and if it concludes that the remaining goods and services to be provided using the modified contract are not distinct from the goods and services transferred on or before the date of contract modification, i.e., the contract remains a single performance obligation, then Bob Ltd. will account for the contract modification, as if it were part of the original contract (in accordance with paragraph 21(b) of Ind AS 115).

Bob Ltd. will update its measure of progress and estimates that it has satisfied 51.2 per cent of its performance obligation (Rs.8,40,000 actual costs incurred ÷ Rs.16,40,000 total expected costs).

Bob Ltd. will recognise additional revenue of Rs.1,82,400 [(51.2 per cent complete × Rs.27,00,000 modified transaction price) – Rs.12,00,000 revenue recognised to date] at the date of the modification as a cumulative catch-up adjustment.

## **Identifying performance obligations**

### **Question 17**

NJ Ltd. enters into a contract to build a house for a customer. NJ Ltd. is responsible for the overall management of the project and identifies various goods and services that are provided, including architectural design, site preparation, construction of the house, plumbing and electrical services and finish carpentry.

NJ Ltd. regularly enters into such contracts with customers to sell these goods and services individually to them.

How many performance obligations are in the contract?

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### Response

Paragraph 27 of Ind AS 115 states that, “A good or service that is promised to a customer is distinct if both of the following criteria are met:

- (a) the customer can benefit from the good or service either on its own or together with other resources that are readily available to the customer (i.e. the good or service is capable of being distinct); and
- (b) the entity’s promise to transfer the good or service to the customer is separately identifiable from other promises in the contract (i.e. the promise to transfer the good or service is distinct within the context of the contract)”.

In accordance with the above, in the given case, the promised goods and services are capable of being distinct because the customer could benefit from the goods or services either on their own or together with other readily available resources. The reason for the same is because NJ Ltd. regularly sells the goods or services separately to other customers and the customer could generate economic benefit from the individual goods and services by using, consuming or selling them.

Paragraph 29 of Ind AS 115, *inter-alia*, provides that in assessing whether an entity’s promises to transfer goods or services to the customer are separately identifiable in accordance with paragraph 27(b), the objective is to determine whether the nature of the promise, within the context of the contract, is to transfer each of those goods or services individually or, instead, to transfer a combined item or items to which the promised goods or services are inputs.

Accordingly, in the given case, the goods and services are not separately identifiable from other promises in the context of the contract (i.e., the promise to transfer the good or service is not distinct within the context of the contract) in accordance with paragraph 27(b) of Ind AS 115 (on the basis of the factors in paragraph 29 of Ind AS 115). NJ Ltd.’s overall promise in the contract is to transfer a combined item (the house) to which the individual goods or services are inputs. This conclusion is supported by the fact that NJ Ltd. provides a significant service of integrating the various goods and services into the house that the customer has contracted to purchase.

In accordance with the above, in the given case, the bundle of goods and services should be combined into a single performance obligation.

### **Question 18**

Company A is an auto component supplier and supplies auto parts to Original Equipment Manufacturer (OEM). It has received a contract to make a tooling for a total consideration of Rs.5,00,000. This tooling requires a design to be created and approved from the customer and then the process of manufacture of the tooling will begin. This process is completed in a short period of time, i.e., around one month. Whether designing and tooling are separate performance obligations?

### **Response**

Paragraph 29 of Ind AS 115 states that, "In assessing whether an entity's promises to transfer goods or services to the customer are separately identifiable in accordance with paragraph 27(b), the objective is to determine whether the nature of the promise, within the context of the contract, is to transfer each of those goods or services individually or, instead, to transfer a combined item or items to which the promised goods or services are inputs. Factors that indicate that two or more promises to transfer goods or services to a customer are not separately identifiable include, but are not limited to, the following:

- (a) the entity provides a significant service of integrating the goods or services with other goods or services promised in the contract into a bundle of goods or services that represent the combined output or outputs for which the customer has contracted. In other words, the entity is using the goods or services as inputs to produce or deliver the combined output or outputs specified by the customer. A combined output or outputs might include more than one phase, element or unit.
- (b) one or more of the goods or services significantly modifies or customises, or are significantly modified or customised by, one or more of the other goods or services promised in the contract.
- (c) the goods or services are highly interdependent or highly interrelated. In other words, each of the goods or services is significantly affected by one or more of the other goods or services in the contract. For example, in some cases, two or more goods or services are significantly affected by each other because the entity would not be able to fulfil its promise by transferring each of the goods or services independently".



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In the given case, if the design activity and the tooling activity are satisfying the above stated indicators, e.g., designing is highly interrelated with the tooling activity, i.e., the designing is complex and specialised such that the customer cannot derive any benefit from it independent of the tooling activity then both the activities would be considered as a single performance obligation.

However, if the design activity and the tooling activity are not highly interrelated, for e.g., the design activity is not complex and specialised, the company provides the designing services on a stand-alone basis and the customer can use the design to get the tooling manufactured by another vendor, the two can be treated as separate components.

### **Question 19**

A car company C Ltd. grants company X a license to use its name in a new nano car with solar technology and also promises to manufacture the car for X. Whether the license to use company's name a separate performance obligation?

### **Response**

Paragraph 27 of Ind AS 115 states that, "A good or service that is promised to a customer is distinct if both of the following criteria are met:

- (a) the customer can benefit from the good or service either on its own or together with other resources that are readily available to the customer (ie the good or service is capable of being distinct); and
- (b) the entity's promise to transfer the good or service to the customer is separately identifiable from other promises in the contract (ie the promise to transfer the good or service is distinct within the context of the contract)".

In accordance with the above, C Ltd. assesses that no other company can manufacture the car due to highly specialised nature of the nano-solar car manufacturing process. As a result the license cannot be separately purchased from the company. C Ltd. also determines that Company X cannot be benefitted from the licence without the manufacturing service, therefore, the criterion in paragraph 27(a) of Ind AS 115 is not met. Consequently, the licence and the manufacturing service are not distinct and C Ltd. accounts for the licence and the manufacturing service as a single performance obligation.

If however, C Ltd. is able to determine that the manufacturing process used for the car is not unique or specialised and other companies could also manufacture the car for Company X, then the criterion in paragraph 27(a) of Ind AS 115 is met because Company X can be benefitted from the licence together with readily available resources other than C Ltd.'s manufacturing service (because there are other entities that can provide the manufacturing service), and can benefit from the manufacturing service together with the licence transferred to it (Company X) at the start of the contract. Company X also considers whether it will be able to purchase the license separately without significantly affecting its ability to benefit from the license and that neither the license nor the manufacturing service is significantly modified by the other and C Ltd. is not providing services to integrate those items. In such case, C Ltd. shall conclude that its promise to grant the license and to provide the manufacturing service are distinct and there are two performance obligations:

- (i) License to use name
- (ii) Manufacturing of car

#### **Question 20**

A manufacturer enters into a contract with a customer to provide a series of similar customised goods in a large quantity that will be delivered consecutively over time. Based on the contract, the customer has legal title and controls the work in progress as the products are being manufactured. The manufacturer has determined an expected average cost for manufacturing the product and has also determined that using an input method based on costs (for this particular contract) is an appropriate method because it represents the manufacturer's performance when transferring control of the goods.

Whether this contract of a series of distinct goods can be considered as a single performance obligation?

#### **Response**

Paragraph 23 of Ind AS 115, states that, "a series of distinct goods or services has the same pattern of transfer to the customer if both of the following criteria are met:

- (a) each distinct good or service in the series that the entity promises to transfer to the customer would meet the criteria in paragraph 35 to be

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a performance obligation satisfied over time; and

- (b) in accordance with paragraphs 39–40, the same method would be used to measure the entity’s progress towards complete satisfaction of the performance obligation to transfer each distinct good or service in the series to the customer”.

In accordance with the above, this contract is determined to be for a series of distinct goods that are effectively one performance obligation because of the following:

- (a) The goods are similar in nature and are transferred consecutively over time.
- (b) The contract is satisfied over time because the customer has title to and controls the work in progress while the products are being manufactured and therefore meets the criterion for performance obligation satisfied over time.
- (c) The same method (i.e., cost to cost) is used to measure progress toward the satisfaction of the performance obligation of each individual product.

## **Determining the Transaction Price**

### **Question 21**

A car manufacturer sells a car at Rs.1,28,000 which includes GST of Rs.28,000. What is the amount to be recognised as revenue?

### **Response**

Section 9(1) of the Central Goods and Services Tax Act, 2017 provides that, *“Subject to the provisions of sub-section (2), there shall be levied a tax called the central goods and services tax (CGST) on all intra-state supplies of goods or services or both, except on the supply of alcoholic liquor for human consumption, on the value determined ..... and collected in such manner as may be prescribed and shall be paid by the taxable person”*. Similar provisions are also included for State Goods and Services Tax Act (SGST), Integrated Goods and Services Tax Act (IGST) and Union Territory Goods and Services Tax Act (UGST).

In accordance with the above, the incidence of GST (i.e. CGST/SGST/IGST/UGST) is on supply of goods or services and it is recovered from the

customer.

Paragraph 47 of Ind AS 115, *inter alia*, “an entity shall consider the terms of the contract and its customary business practices to determine the transaction price. The transaction price is the amount of consideration which an entity expects to be entitled in exchange for transferring promised goods or services to a customer, excluding amounts collected on behalf of third parties”.

Amounts collected on behalf of third parties such as sales taxes, goods and services taxes and value added taxes are not economic benefits which flow to the entity. Therefore, they are excluded from revenue.

As per paragraph 9.1.3 of the ‘Guidance Note on Division II - Ind AS Schedule III to the Companies Act, 2013’, indirect taxes such as Sales tax, Service tax etc. are generally collected from the customer on behalf of the government in majority of the cases. However, this may not hold true in all cases and it is possible that a company may be acting as principal rather than as an agent in collecting these taxes. Whether revenue should be presented gross or net of taxes should depend on whether the company is acting as a principal and hence, is responsible for paying tax on its own account or, whether it is acting as an agent, i.e. simply collecting and paying tax on behalf of the government authorities. If the entity is the principal, then revenue should also be grossed up for the tax billed to the customer and the tax payable should be shown as an expense. However, in cases, where a company collects such taxes only as an agent, revenue should be presented net of taxes.

Further, as per paragraph 9.1.6 of the said Guidance Note, under the GST regime, the collection of GST by an entity would not be an inflow on the entity’s own account but it shall be made on behalf of the government authorities. Accordingly, the revenue should be presented net of GST.

Therefore, in the present case, the revenue should be recognised at Rs.1,00,000.

#### **Question 22**

Can the amount of revenue recognised for a particular transaction in the financial statements be different from the amount of sales for the purposes of GST?

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### Response

Paragraph 47 of Ind AS 115, *inter alia*, states that, “the entity shall consider the terms of the contract and its customary business practices to determine the transaction price. The transaction price is the amount of consideration to which an entity expects to be entitled in exchange for transferring promised goods or services to a customer, excluding amounts collected on behalf of third parties”.

The value of a taxable supply is based on the principles as given in the relevant GST Act. For example, Section 15 of the Maharashtra Goods & Services Tax Act, 2017, provides what should be included or not included in the value of taxable supply.

In certain situations, it may be possible that the value determined for the purpose of GST is equal to the value determined for the purposes of financial reporting, but it is not necessary that these two values would always be same. For example, if there is a sale made with deferred consideration over five years for a value of say, Rs.1,00,000, the sale value for the purposes of GST could be Rs.1,00,000 but the revenue for the purposes of financial reporting would be the fair value after excluding the financing element for the deferred consideration.

### Question 23

A TV manufacturer sells TV sets to its dealers at the list price of Rs.10,000 per TV. If a dealer takes more than 8,000 sets during the contract period, then it is eligible for a discount of 5% on the list price retrospectively (i.e. for all sets purchased since the commencement of the agreement). The contract period starts in June and ends in May of each year. On the reporting date, i.e., March 31, 2018, a particular dealer has purchased 5,000 sets. Based on the past trends, it is expected that the total purchases to be made by dealer during the contract period up to May 2018 will be more than 8,000 sets. Should revenue be adjusted for the discount expected to be availed by such a dealer?

### Response

Paragraph 47 of Ind AS 115, *inter alia*, states that, “the entity shall consider the terms of the contract and its customary business practices to determine the transaction price. The transaction price is the amount of consideration to which an entity expects to be entitled in exchange for transferring promised goods or services to a customer, excluding amounts collected on behalf of

third parties”.

Paragraph 51 of Ind AS 115, *inter alia*, states that, “an amount of consideration can vary because of discounts, rebates, refunds, credits, price concessions, incentives, bonuses or other similar items”.

Further, paragraph 52 of Ind AS 115 states that, “the variability relating to the consideration promised by a customer may be explicitly stated in the contract. In addition to the terms of the contract, the promised consideration is variable if either of the following circumstances exists:

- (a) the customer has a valid expectation arising from an entity’s customary business practices, published policies or specific statements that the entity will accept an amount of consideration that is less than the price stated in the contract. That is, it is expected that the entity will offer a price concession. Depending on the jurisdiction, industry or customer this offer may be referred to as a discount, rebate, refund or credit.
- (b) other facts and circumstances indicate that the entity’s intention, when entering into the contract with the customer, is to offer a price concession to the customer”.

In addition to the above, the entity considers the requirements in paragraphs 56–58 of Ind AS 115 on constraining estimates of variable consideration, including the factors in paragraph 57 of Ind AS 115. The entity determines whether it has significant experience with this product and with the purchasing pattern of the entity and whether it is highly probable that a significant reversal in the amount of cumulative revenue recognised will not occur when the uncertainty associated with the variable consideration is subsequently resolved.

In the instant case, based on past trends and other available evidences, it is probable that the total purchases made by the dealer during the contract period up to May 2018 will exceed 8000 sets and thus, it is probable that a 5% discount will have to be allowed.

Therefore, the amount of revenue should be adjusted for the probable discount that may have to be allowed, as the economic benefits to that extent may not flow to the entity. Revenue should be adjusted for probable discount on sales made till March 31, 2018.

While estimating the amount of discount expected to be allowed, events

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occurring between the end of the reporting period and the date when the financial statements are approved for issuance should also be considered in accordance with the requirements of Ind AS 10, *Events after the Reporting Period*.

### **Question 24**

On 1<sup>st</sup> April, 2018, Entity X enters into a contract with Entity Y to sell mobile chargers for Rs.100 per charger. As per the terms of the contract, if Entity Y purchases more than 1,000 chargers till March 2019, the price per charger will be retrospectively reduced to Rs.90 per unit. Till September 2018, Entity X sold 95 chargers to Entity Y. Entity X estimates that Entity Y's purchases by March 2019 will not exceed the required threshold of 1,000 chargers.

In October 2018, Entity Y acquires another Entity C and from October to December 2018, the Entity X sells an additional 600 chargers to Entity Y. Due to these developments, the Entity X estimates that purchases of Entity Y will exceed the 1,000 chargers threshold for the period and therefore, it will be required to retrospectively reduce the price per charger to Rs.90. How should the revenue be recognised in such a situation?

### **Response**

Paragraph 56 of Ind AS 115 states that, "an entity shall include in the transaction price some or all of an amount of variable consideration estimated in accordance with paragraph 53 only to the extent that it is highly probable that a significant reversal in the amount of cumulative revenue recognised will not occur when the uncertainty associated with the variable consideration is subsequently resolved".

Further, paragraph 57 of Ind AS 115 state that, "In assessing whether it is highly probable that a significant reversal in the amount of cumulative revenue recognised will not occur once the uncertainty related to the variable consideration is subsequently resolved, an entity shall consider both the likelihood and the magnitude of the revenue reversal. Factors that could increase the likelihood or the magnitude of a revenue reversal include, but are not limited to, any of the following:

- (a) the amount of consideration is highly susceptible to factors outside the entity's influence. Those factors may include volatility in a market, the judgement or actions of third parties, weather conditions and a high risk of obsolescence of the promised good or service.

- (b) the uncertainty about the amount of consideration is not expected to be resolved for a long period of time.
- (c) the entity's experience (or other evidence) with similar types of contracts is limited, or that experience (or other evidence) has limited predictive value.
- (d) the entity has a practice of either offering a broad range of price concessions or changing the payment terms and conditions of similar contracts in similar circumstances.
- (e) the contract has a large number and broad range of possible consideration amounts”.

Entity X estimates that the consideration in the above contract is variable. Therefore, in accordance with paragraphs 56 and 57 of Ind AS 115, Entity X is required to consider the constraints in estimating variable consideration. Entity X determines that it has significant experience with this product and with the purchasing pattern of the Entity Y. Thus, if Entity X concludes that it is highly probable that a significant reversal in the cumulative amount of revenue recognised (i.e. Rs.100 per unit) will not occur when the uncertainty is resolved (i.e. when the total amount of purchases is known), then the Entity X will recognise revenue of Rs.9,500 (95 chargers × Rs.100 per charger) for the half year ended 30 September 2018.

Paragraphs 87 and 88 of Ind AS 115 state as follows:

- “87 After contract inception, the transaction price can change for various reasons, including the resolution of uncertain events or other changes in circumstances that change the amount of consideration to which an entity expects to be entitled in exchange for the promised goods or services.
- 88 An entity shall allocate to the performance obligations in the contract any subsequent changes in the transaction price on the same basis as at contract inception. Consequently, an entity shall not reallocate the transaction price to reflect changes in stand-alone selling prices after contract inception. Amounts allocated to a satisfied performance obligation shall be recognised as revenue, or as a reduction of revenue, in the period in which the transaction price changes.”

In accordance with the above, in the month of October 2018, due to change in circumstances on account of Entity Y acquiring Entity C and consequential



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increase in sale of chargers to Entity Y, Entity X estimates that Entity Y's purchases will exceed the 1,000 chargers threshold till March 2019 for the period and therefore, it will be required to retrospectively reduce the price per charger to Rs.90.

Consequently, the Entity X will recognise revenue of Rs.53,050 for the quarter ended December 2018 which is calculated as follows:

Particulars	Amount in Rs.
Sale of 600 chargers (600 chargers × Rs.90 per charger)	54,000
<b>Less:</b> Change in transaction price (95 chargers × Rs.10 price reduction) for the reduction of revenue relating to units sold till September 2018.	950
Revenue recognised for the quarter ended December 2018	53,050

### Question 25

Entity X is a dealer in electronic goods. Entity X has entered into a contract to sell a television to a customer for a consideration of Rs.1,00,000. The payment for the equipment is to be made after 2 years. The cash selling price of the product is Rs.80,000 which represents the amount that the customer would pay upon delivery for the same product sold under otherwise identical terms and conditions as at contract inception. The prevailing rate of interest is 12%. Should revenue be measured at Rs.1,00,000 or at Rs.80,000?

### Response

Paragraph 60 of Ind AS 115, *inter alia*, states that, "in determining the transaction price, an entity shall adjust the promised amount of consideration for the effects of the time value of money if the timing of payments agreed to by the parties to the contract (either explicitly or implicitly) provides the customer or the entity with a significant benefit of financing the transfer of goods or services to the customer".

Further, paragraph 61 of Ind AS 115, *inter alia*, states that, "an entity shall consider all relevant facts and circumstances in assessing whether a contract contains a financing component and whether that financing component is

significant to the contract, including both of the following:

- (a) the difference, if any, between the amount of promised consideration and the cash selling price of the promised goods or services; and
- (b) the combined effect of both of the following:
  - (i) the expected length of time between when the entity transfers the promised goods or services to the customer and when the customer pays for those goods or services; and
  - (ii) the prevailing interest rates in the relevant market”.

In accordance with the above, Entity X should assess whether the contract includes a significant financing component. In the given case, this is evident from the difference between the amount of promised consideration of Rs.1,00,000 and the cash selling price of Rs.80,000 at the date that the television are transferred to the customer. Furthermore, Entity X assesses that the contract includes an implicit interest rate of 12%, i.e. the interest rate that discounts the promised consideration of Rs.80,000 over 24 months.

Entity X concludes that the rate of 12% is commensurate with the rate in a separate financing transaction between Entity X and the customer. Entity is required to evaluate the probability that whether it will be able to collect the consideration to which it is entitled to in exchange for the television that will be transferred to the customer in accordance with the criterion of paragraph 9(c) of Ind AS 115 which is assumed to have been met in the given case.

Further, paragraph 65 of Ind AS 115, states that, “an entity shall present the effects of financing (interest revenue or interest expense) separately from revenue from contracts with customers in the statement of profit and loss. Interest revenue or interest expense is recognised only to the extent that a contract asset (or receivable) or a contract liability is recognised in accounting for a contract with a customer”.

Accordingly, on transfer of television to the customer, Entity X will recognise revenue with a corresponding receivable equal to the cash selling price of Rs.80,000.

Until Entity X receives the cash payment from the customer, interest revenue should be recognised in accordance with Ind AS 109. In determining the effective interest rate in accordance with Ind AS 109, the entity should consider the remaining contractual term.

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### Question 26

Entity A has entered into contract with Entity B to provide it a commitment regarding a term loan, which may be availed during the period of five years. A specified fee as per the contract is received by Entity A to provide the loan commitment to Entity B. How should Entity A account for such fees received to provide a loan commitment?

### Response

Loan commitments are primarily covered by Ind AS 109, *Financial Instruments*. As per paragraph 2.3 of Ind AS 109, the following loan commitments are within the scope of Ind AS 109:

- (a) loan commitments that the entity designates as financial liabilities at fair value through profit or loss. An entity that has a past practice of selling the assets resulting from its loan commitments shortly after origination shall apply this Standard to all its loan commitments in the same class.
- (b) loan commitments that can be settled net in cash or by delivering or issuing another financial instrument. These loan commitments are derivatives. A loan commitment is not regarded as settled net merely because the loan is paid out in instalments (for example, a mortgage construction loan that is paid out in instalments in line with the progress of construction).
- (c) commitments to provide a loan at a below-market interest rate.

For loan commitments not covered by Ind AS 109, revenue recognition will be as per Ind AS 115.

The recognition of fee for financial services depends on the purposes for which the fees are assessed and the basis of accounting for any associated financial instrument. The description of fees for financial services may not be indicative of the nature and substance of the services provided. Therefore, it is necessary to distinguish between fees that are an integral part of the effective interest rate of a financial instrument, fees that are earned as services are provided and fees that are earned on the execution of a significant act.

- (i) *Fees that are an integral part of the effective interest rate of a financial instrument.*

In case, it is probable that the Entity B will enter into a specific lending arrangement and the loan commitment is not within the scope of Ind AS 109, the commitment fee received is regarded as compensation for an ongoing involvement with the acquisition of a financial instrument and, together with the related transaction costs (as defined in Ind AS 109), is deferred and recognised as an adjustment to the effective interest rate. If the commitment expires without the entity making the loan, the fee is recognised as revenue on expiry. Loan commitments that are within the scope of Ind AS 109 are accounted for as derivatives and measured at fair value.

(ii) *Fees earned as services are provided.*

If it is unlikely that a specific lending arrangement will be entered into and the loan commitment is outside the scope of Ind AS 109, the commitment fee is recognised as revenue on a time proportion basis over the commitment period.

In cases, where a term loan is disbursed in tranches, to the extent there is evidence that it is probable that the undisbursed term loan will be drawn down in the future, the commitment fee is accounted for as a transaction cost under Ind AS 109, i.e., the fee is deferred and adjusted from the carrying value of the financial instrument when the draw down occurs and considered in the effective interest rate calculations.

## **Allocating the transaction price to performance obligations**

### **Question 27**

An entity, Moon Ltd. which manufactures auto components enters into a two year contract with a customer Venus Ltd., a car manufacturer. The total contract value is Rs.20,00,000. Additionally, Moon Ltd. agrees to pay Rs.4,00,000 to Venus Ltd. as compensation for storage facility which will require certain modifications to accommodate the components manufactured by Moon Ltd. The storage facility is controlled by Venus Ltd. and will be utilised exclusively to store goods received from Moon Ltd.

What will be the accounting treatment for the consideration payable to Venus Ltd.?

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### Response

Paragraphs 70 to 72 of Ind AS 115 deal with consideration payable to a customer.

Paragraph 70, *inter alia*, states that, “consideration payable to a customer includes cash amounts that an entity pays, or expects to pay, to the customer (or to other parties that purchase the entity’s goods or services from the customer). .....An entity shall account for consideration payable to a customer as a reduction of the transaction price and, therefore, of revenue unless the payment to the customer is in exchange for a distinct good or service (as described in paragraphs 26–30) that the customer transfers to the entity”.

In accordance with the above, in the given case, if Moon Ltd. concludes that the payment to the Venus Ltd. is not in exchange for a distinct good or service that it transfers to Venus Ltd. in view of the fact, that it does not obtain the control of storage facility of its customer (Venus Ltd.). Thus, Rs.4,00,000 would be a reduction from the transaction price.

Further, paragraph 72 of Ind AS 115 states that, “accordingly, if consideration payable to a customer is accounted for as a reduction of the transaction price, an entity shall recognise the reduction of revenue when (or as) the later of either of the following events occurs:

- (a) the entity recognises revenue for the transfer of the related goods or services to the customer; and
- (b) the entity pays or promises to pay the consideration (even if the payment is conditional on a future event). That promise might be implied by the entity’s customary business practices”.

Applying the above requirements of paragraph 72 of Ind AS 115, the reduction of revenue is recognised as and when transfer of the related goods or services to Venus Ltd. will occur. In the current scenario, the revenue is reduced proportionately, i.e. (Rs.4,00,000/ Rs.20,00,000). If in the first month, components worth Rs.5,00,000 are transferred, the revenue would be Rs.4,00,000 [Rs.5,00,000 - Rs.100,000 (i.e. 20% X Rs.500,000)].

### Question 28

A seller provides sales incentives to a customer when entering into a contract. Examples of such customer incentives include:

- Cash incentives
- Non-cash incentives in the three scenarios as described below:
  - Scenario 1: Loyalty points to purchase goods from the seller at a lower price;
  - Scenario 2: A coupon redeemable for free products from a third party; and
  - Scenario 3: Free goods or services that the seller normally sells or provides as part of its business (e.g., On purchase of two products, third product is free).

How should an entity account for cash and non-cash based sales incentives when entering into a contract for supply of goods or services?

### **Response**

#### *Cash Incentives*

Paragraph 70 of Ind AS 115, *inter-alia*, states that, “consideration payable to a customer includes cash amounts that an entity pays, or expects to pay, to the customer (or to other parties that purchase the entity’s goods or services from the customer). Consideration payable to a customer also includes credit or other items (for example, a coupon or voucher) that can be applied against amounts owed to the entity (or to other parties that purchase the entity’s goods or services from the customer). An entity shall account for consideration payable to a customer as a reduction of the transaction price and, therefore, of revenue unless the payment to the customer is in exchange for a distinct good or service (as described in paragraphs 26–30) that the customer transfers to the entity”.

Therefore, cash incentives (payments given to the customer) would be considered as a reduction in the transaction price and therefore in the measurement of revenue when the goods are delivered. Revenue would be recognised at a reduced amount taking into account such an incentive.

#### ***Non-Cash Incentives***

##### **Scenario 1**

Paragraph B40 of Ind AS 115, *inter alia*, states that, “if in a contract, an entity grants a customer the option to acquire additional goods or services, that option gives rise to a performance obligation in the contract only if the option provides a material right to the customer that it would not receive without

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entering into that contract (for example, a discount that is incremental to the range of discounts typically given for those goods or services to that class of customer in that geographical area or market). If the option provides a material right to the customer, the customer in effect pays the entity in advance for future goods or services and the entity recognises revenue when those future goods or services are transferred or when the option expires”.

In this case the customer does get a material right since he can purchase future additional goods at a discount. Thus, the customer in effect pays the entity in advance for future goods and the entity recognises revenue when the goods are transferred.

Therefore, for such non-cash incentives, a portion of the total consideration receivable is allocated to the incentive and is reduced from the revenue of initial sale. These incentives are recognised as revenue when the incentive is redeemed and the entity fulfils its obligations to supply the incentive.

### **Scenario 2**

In the given scenario, as the discount or free item is provided by a third-party, for such non-cash incentives, the portion of the total consideration receivable is to be allocated to the incentive.

Paragraph B34 provides that, “When another party is involved in providing goods or services to a customer, the entity shall determine whether the nature of its promise is a performance obligation to provide the specified goods or services itself (ie the entity is a principal) or to arrange for those goods or services to be provided by the other party (ie the entity is an agent). An entity determines whether it is a principal or an agent for each specified good or service promised to the customer. A specified good or service is a distinct good or service (or a distinct bundle of goods or services) to be provided to the customer (see paragraphs 27–30). If a contract with a customer includes more than one specified good or service, an entity could be a principal for some specified goods or services and an agent for others”.

Accordingly, an entity providing such incentives should assess whether it is acting as a principal or agent, to determine the ‘deliverable’ within the arrangement and the amount to allocate to that item.

Further, paragraphs B35B and B36 state as follows:

“B35B When (or as) an entity that is a principal satisfies a performance obligation, the entity recognises revenue in the gross amount of

consideration to which it expects to be entitled in exchange for the specified good or service transferred.

- B36 An entity is an agent if the entity's performance obligation is to arrange for the provision of the specified good or service by another party. An entity that is an agent does not control the specified good or service provided by another party before that good or service is transferred to the customer. When (or as) an entity that is an agent satisfies a performance obligation, the entity recognises revenue in the amount of any fee or commission to which it expects to be entitled in exchange for arranging for the specified goods or services to be provided by the other party. An entity's fee or commission might be the net amount of consideration that the entity retains after paying the other party the consideration received in exchange for the goods or services to be provided by that party."

In accordance with above, if an entity is -

*Acting as a principal:* If the entity has collected the consideration allocated to the points on its own account (i.e., as the principal in the transaction), the accounting treatment is the same as in scenario 1 above, that is, the entity allocates the consideration to all the elements of the transaction, including the free good or services it provides as an incentive to its customers and recognises revenue when those free goods or services are delivered/provided.

*Acting as an agent:* If the entity is collecting the consideration on behalf of the third party (i.e., as an agent for the third party), the entity measures revenue at the net amount it retains on its own account (the consideration allocated to the incentive less the amount paid to the third party supplying the incentive). The entity recognises the net revenue when it provides the incentive to the customer.

**Scenario 3:** An entity grants "free goods" to a customer as part of the sale transaction, which it sells separately as part of its operations. As per paragraph 73 of Ind AS 115, the transaction price is allocated to the each performance obligation. Further, paragraph 31 of Ind AS 115 requires that revenue from sale of goods or services shall be recognised when the entity satisfies a performance obligation by transferring a promised good or service to a customer.

Paragraph 22 of the Standard further provides that at the contract inception,



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an entity shall assess the goods or services promised in a contract with a customer and shall identify as a performance obligation each promise to transfer to the customer a good or service that is distinct and separately identifiable.

Accordingly, in the given scenario, an entity grants free goods to a customer as part of the sale transaction, which it sells separately as part of its operations, the transaction price is allocated to each separate identifiable promised good or service.

In the current transaction, the total consideration received will be allocated to all elements in the sale, including the free goods.

### **Question 29**

Prime Ltd. is a technology company and regularly sells Software S, Hardware H and Accessory A. The stand-alone selling prices for these items are stated below:

Software S – Rs.50,000

Hardware H – Rs.1,00,000 and

Accessory A – Rs.20,000.

Since the demand for Hardware H and Accessory A is low, Prime Ltd. sells H and A together at Rs.100,000. Prime Ltd. enters into a contract with Zeta Ltd. to sell all the three items for a consideration of Rs.1,50,000.

What will be the accounting treatment for the discount of Rs.20,000 in the financial statements of Prime Ltd., considering that the three items are three different performance obligations which are satisfied at different points in time?

### **Response**

Paragraph 82 of Ind AS 115 states that, “An entity shall allocate a discount entirely to one or more, but not all, performance obligations in the contract if all of the following criteria are met:

- (a) the entity regularly sells each distinct good or service (or each bundle of distinct goods or services) in the contract on a stand-alone basis;
- (b) the entity also regularly sells on a stand-alone basis a bundle (or bundles) of some of those distinct goods or services at a discount to the stand-alone selling prices of the goods or services in each bundle;

and

- (c) the discount attributable to each bundle of goods or services described in paragraph 82(b) is substantially the same as the discount in the contract and an analysis of the goods or services in each bundle provides observable evidence of the performance obligation (or performance obligations) to which the entire discount in the contract belongs”.

In the given case, the contract includes a discount of Rs.20,000 on the overall transaction, which should have been allocated proportionately to all three performance obligations when allocating the transaction price using the relative stand-alone selling price method (in accordance with paragraph 81 of Ind AS 115). However, as Prime Ltd. meets all the criteria specified in paragraph 82 above, i.e., it regularly sells Hardware H and Accessory A together for Rs.1,00,000 and Software S for Rs.50,000, accordingly, it is evident that the entire discount should be allocated to the promises to transfer Hardware H and Accessory A.

In the given case, since the contract requires the entity to transfer control of Hardware H and Accessory A at different points in time, then the allocated amount of Rs.1,00,000 should be individually allocated to the promises to transfer Hardware H (stand-alone selling price of Rs.1,00,000) and Accessory A (stand-alone selling price of Rs.20,000)

Product	Allocated transaction price (Rs.)
Hardware H	83,333 (1,00,000/ 120,000*100,000)
Accessory A	16,667 (20,000/120,000*100,000)
Total	1,00,0000

However, if Prime Ltd. would have transferred the control of Hardware H and Accessory A at the same point in time, then the Prime Ltd. could, as a practical matter, account for the transfer of those products as a single performance obligation. That is, Prime Ltd. could allocate Rs.1,00,000 of the transaction price to the single performance obligation and recognise revenue of Rs.1,00,000 when Hardware H and Accessory A simultaneously transfer to Zeta Ltd.

### Question 30

Entity Y enters into an agreement to sell hardware, professional services and

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maintenance services for Rs.2,00,000. Entity Y determines that each of the promised goods or services represents a separate performance obligation because the entity frequently sells professional services and maintenance services on a stand-alone basis. The stand-alone selling prices of professional services and maintenance services are Rs.25,000 and Rs.15,000 respectively. The Entity Y rarely sells the hardware on a stand-alone basis, so it estimates the stand-alone selling price at Rs.185,000 based on the hardware's underlying cost, the entity's targeted cost and the amount of margin the entity believes the market will bear (i.e., the expected cost plus a margin approach).

The contract price will include Rs.10,000 incentive, if professional services are provided within seven days of the delivery date of the hardware.

- (a) How will the transaction price be allocated to performance obligations?
- (b) What will be the accounting treatment for the incentive amount?

### **Response (a)**

Paragraph 76 of Ind AS 115 states that, "To allocate the transaction price to each performance obligation on a relative stand-alone selling price basis, an entity shall determine the stand-alone selling price at contract inception of the distinct good or service underlying each performance obligation in the contract and allocate the transaction price in proportion to those stand-alone selling prices".

In accordance with the above, Entity Y needs to allocate the transaction price to each performance obligation on the basis of stand-alone selling price. The stand-alone selling price is the price at which an entity would sell a promised good or service separately to a customer.

Further, paragraphs 77 and 78 of Ind AS 115 provide that the best evidence of the stand-alone selling price is the observable price. If the stand-alone selling price is not directly observable, then the entity needs to estimate the same considering the reasonably available information. In doing so, an entity shall maximise the use of observable inputs and apply estimation methods consistently in similar circumstances.

For the purpose of estimating the stand-alone selling price, paragraph 79 of Ind AS 115 provides various approaches. One of the approaches mentioned is expected cost plus margin approach in which an entity could forecast its expected costs of satisfying a performance obligation and then add an

appropriate margin for that good or service. Accordingly, the company needs to determine stand-alone selling prices for each of the performance obligation and the transaction price shall be allocated to each performance obligation in that ratio.

In the given case, since professional service and maintenance services are directly observable, the stand alone selling price for these obligations shall be considered as Rs.25,000 and Rs.15,000 respectively.

However, in case of hardware, the stand-alone selling price is not directly observable, Entity Y shall apply expected cost plus margin approach and consider Rs.1,85,000 as the stand alone selling price. Accordingly, Entity Y shall allocate the purchase consideration to the three performance obligations of hardware, professional services and maintenance services based on their stand-alone selling prices, i.e. in the ratio of Rs.1,85,000, Rs.25,000 and Rs.15,000 respectively.

**Response (b)** Paragraph 85 of Ind AS 115 provides that an entity shall allocate a variable amount entirely to a single performance obligation if both of the following criteria are met:

- (i) the terms of a variable payment relate specifically to the entity's efforts to satisfy the performance obligation; and
- (ii) allocating the variable amount of consideration entirely to the performance obligation is consistent with the allocation objective in paragraph 73 when considering all of the performance obligations and payment terms in the contract.

As per paragraph 73 of Ind AS 115, the objective when allocating the transaction price is for an entity to allocate the transaction price to each performance obligation in an amount that depicts the amount of consideration to which the entity expects to be entitled in exchange for transferring the promised goods or services to the customer.

Accordingly, in the current case, the incentive of Rs.10,000 that is receivable by Entity Y is entirely dependent on whether the professional services are provided within 7 days of the delivery of the hardware. Accordingly, the entire incentive of Rs.10,000 shall be allocated to professional services.

### **Question 31**

A Ltd. owns 20 resorts across India. Every customer who stays in any of the resorts owned by A Ltd. is entitled to get points on the basis of total amount

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paid by him. Under this scheme, 1 point is granted for every Rs.100 spent for stay in the resort. As per the past experience of A Ltd., the likelihood of exercise of the points is 100% and the stand alone price of each such point is Rs.5. Customer X spends Rs.10,000 in one of the resorts of A Ltd. and earns 100 points. What is the accounting treatment for the points granted by A Ltd.?

### **Response**

Paragraph B40 of Ind AS 115, *inter alia*, states that, “if in a contract, an entity grants a customer the option to acquire additional goods or services, that option gives rise to a separate performance obligation only if the option provides a material right to the customer that it would not receive without entering into that contract”.

Further, paragraph B41 states that, “If a customer has the option to acquire an additional good or service at a price that would reflect the stand-alone selling price for that good or service, that option does not provide the customer with a material right even if the option can be exercised only by entering into a previous contract. In those cases, the entity has made a marketing offer that it shall account for in accordance with this Standard only when the customer exercises the option to purchase the additional goods or services”.

In the given case, the customer does get a material right by way of a discount of Rs.500 for every 100 points that he would not receive without the previous stay in that resort. Thus, the customer in effect pays the entity in advance for future goods and the entity recognises revenue when the goods are transferred.

According to paragraph B42, paragraph 74 requires an entity to allocate the transaction price to performance obligations on a relative stand-alone selling price basis. If the stand alone selling price for a customer’s option to acquire additional goods or services is not directly observable, an entity shall estimate it on the basis of percentage discount the customer may obtain upon exercising the option and the likelihood of the option getting exercised.

In accordance with above, an entity shall account for award credit as a separate performance obligation of the sales transactions in which they are initially granted. The value of the consideration the entity expects to be entitled in respect of the initial sale shall be allocated between the award credits and the other components of the sale.

In the current case, the standalone selling price of the 100 points is Rs.500. A Ltd. should allocate the fair value of the consideration (i.e. Rs.10,000) between the points and the other components of the sale as Rs.476 ( $500/10,500 \times 10,000$ ) and Rs.9,524 ( $10,000/10,500 \times 10,000$ ) respectively in proportion of their standalone selling price. Since A Ltd. supplies the awards itself (i.e. it acts as a principal), it should recognise Rs.476 as revenue when points are redeemed.

### **Question 32**

Company A sells a photocopier machine for Rs.1,00,000 with a contractual understanding that it will also do maintenance for five years. In certain other transactions where the Company A has sold photocopier machines without maintenance, the value is Rs.80,000. If the maintenance contract is taken separately for 5 years, its value is Rs.30,000. How should the revenue be recognised in such a situation?

### **Response**

Paragraph 73 of Ind AS 115 provides that, “the objective when allocating the transaction price is for an entity to allocate the transaction price to each performance obligation (or distinct good or service) in an amount that depicts the amount of consideration to which the entity expects to be entitled in exchange for transferring the promised goods or services to the customer”.

In this case, there are two separately identifiable performance obligations one being a sale of a photocopier machine and second being maintenance contract for five years.

As per paragraph 76 of the Standard, to allocate the transaction price to each performance obligation on a relative stand-alone selling price basis, an entity shall determine the stand-alone selling price at contract inception of the distinct good or service underlying each performance obligation in the contract and allocate the transaction price in proportion to those stand-alone selling prices.

For recognition of revenue, relative stand-alone selling price of the individual components may be taken and the consideration allocated in proportion of relative fair values, i.e. 80,000:30,000. Hence, the sale of photocopier machine should be recognised at Rs.72,727 ( $Rs.1,00,000 \times 8/11$ ) when all other conditions for sale of photocopier machine are fulfilled and the revenue from maintenance services of Rs.27,273 ( $100,000 \times 3/11$ ) should be the service revenue recognised over a period of five years as per its stage of

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completion.

It may also be noted that the Company A should also consider financing element in this transaction.

### **Recognise revenue when performance obligation is satisfied**

#### **Question 33**

- (a) Does raising an invoice means that control has been transferred to the buyer?
- (b) Does transfer of legal title means control has been transferred?

#### **Response**

Paragraph 31 of Ind AS 115 states that, “An entity shall recognise revenue when (or as) the entity satisfies a performance obligation by transferring a promised good or service (ie an asset) to a customer. An asset is transferred when (or as) the customer obtains control of that asset.”

Paragraph 33 of Ind AS 115, “Goods and services are assets, even if only momentarily, when they are received and used (as in the case of many services). Control of an asset refers to the ability to direct the use of, and obtain substantially all of the remaining benefits from, the asset. Control includes the ability to prevent other entities from directing the use of, and obtaining the benefits from, an asset. The benefits of an asset are the potential cash flows (inflows or savings in outflows) that can be obtained directly or indirectly in many ways, such as by:

- (a) using the asset to produce goods or provide services (including public services);
- (b) using the asset to enhance the value of other assets;
- (c) using the asset to settle liabilities or reduce expenses;
- (d) selling or exchanging the asset;
- (e) pledging the asset to secure a loan; and
- (f) holding the asset”.

Apart from paragraphs 31–34, an entity should consider indicators of the transfer of control, which include, but are not limited to, the following:

- The entity has a present right to payment. When the entity has a right to payment, this frequently indicates that control has passed to the customer.
- The customer has legal title to the asset.
- The entity has transferred physical possession of the asset. This factor should be evaluated in light of other arrangements or contractual stipulations, e.g., consignment goods.
- The customer has the significant risks and rewards of ownership of the asset. This is an area that requires judgment. For example, if an entity has sold goods but retains responsibility for delivery to the customer, then the entity likely retains control. However, entities should determine if some risks of ownership of the asset could be separate performance obligations, such as an additional obligation to provide maintenance services for products that have been delivered. Such risks should be accounted for separately, and would not impact the determination of transfer of control.
- The customer has accepted the asset.
  - a) Raising an invoice is just a commercial arrangement and does not necessarily indicate that control has been transferred. It is important to assess the terms of the contract with the customer and determine if the control has been transferred. For example, as regards shipping terms, factors such as who will bear the loss in case the goods are destroyed, risk of loss in transit, the rights of the unpaid seller, etc. will have to be considered in each case of sale. Thus, where keeping in view the facts and circumstances of each case, it is established that the control of the goods is not transferred at the time of raising an invoice, revenue in respect thereof should not be recognised at the time of invoicing.
  - b) Paragraph 38(b) of Ind AS 115 states that legal title may indicate which party to a contract has the ability to direct the use of and obtain substantially all of the remaining benefits from an asset or to restrict the access of other entities to those benefits. Therefore, transfer of legal title of an asset may indicate that the customer has obtained control of the asset. However, it is not a conclusive factor on its own. The assessment of transfer of



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control should be made based on an overall consideration of all the relevant factors including risks and rewards. If the legal title has been transferred (say for compliance purposes or as required by applicable laws) but most of the significant risks and rewards are still with the seller, it would not be supportive of transfer of control.

There can be situations where the legal title is transferred to help the customer take a loan, but with the understanding that if the product does not run trouble free for three months it will be returned back. In a situation like this, the entity will have to refer to the guidance on sale with a right to return.

The reverse can also be true. An entity may also retain legal title solely as protection against the customer's failure to pay, those rights of the entity would not preclude the customer from obtaining control of an asset.

For instance, in certain cases, contracts may contain terms in which the transfer of legal title may happen once the last instalment is paid. In such a case, if the control has been transferred, then revenue can be recognised even if legal title is not transferred.

### **Question 34**

Entity A enters into a contract with Customer B to manufacture and install a product. These products need significant amount of installation to make them operational and the installation will be done by the Entity A. Entity A despatches these goods to Customer B to be installed later and raises an invoice of Rs.8,00,000 for these goods as at March 31, 2018. The standalone value of the product is Rs.7,00,000 and installation is Rs.2,00,000. Assuming the installation is completed by June 2018, when should the revenue be recognised?

### **Response**

Paragraph 22 of Ind AS 115 states that, "at contract inception, an entity shall assess the goods or services promised in a contract with a customer and shall identify as a performance obligation each promise to transfer to the customer either:

- (a) a good or service (or a bundle of goods or services) that is distinct; or

- (b) a series of distinct goods or services that are substantially the same and that have the same pattern of transfer to the customer”.

Paragraph 27 further states that, “a good or service promised to a customer is distinct if both of the following criteria are met:

- (a) the customer can benefit from the good or service either on its own or together with other resources that are readily available to the customer (i.e. goods or services that are capable of being distinct); and
- (b) the entity’s promise to transfer the good or service to the customer is separately identifiable from other promises in the contract (ie the promise to transfer the good or service is distinct within the context of the contract).”

Further, paragraph 29 of Ind AS 115 states that, “in assessing whether an entity’s promises to transfer goods or services to the customer are separately identifiable in accordance with paragraph 27(b), the objective is to determine whether the nature of the promise, within the context of the contract, is to transfer each of those goods or services individually or, instead, to transfer a combined item or items to which the promised goods or services are inputs”.

In the given case, it needs to be ascertained whether installation is complex and whether company A offers manufacturing and installation services in combination or separately to its customers.

In case the company offers these services in combination, and the customer cannot benefit from the installation services on its own or together with other readily available resources (for instance, only company A can install the product because of its complicated nature), then there is only one performance obligation. Additionally, the entity must also establish whether it satisfies the performance obligation at a point in time or over time, to satisfy conditions in paragraphs 35 and 36 of the Standard. Assuming the product cannot be used before installation and the customer cannot obtain the benefits of using the product before installation (i.e. the money received will have to be returned unless the installation of the product is successful), performance obligation is satisfied at a point in time when installation is completed. Additionally, paragraph 31 of Ind AS 115 requires revenue from sale of goods to be recognised when the control of goods has passed to the customer. Paragraph 33 of the Standard states that control of an asset includes the ability to prevent other entities from directing the use of, and obtaining the benefits from, an asset.

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Thus, in such a case, revenue of Rs.8,00,000 will be recognised when installation is complete, i.e., in June 2018.

On the other hand, if the company offers these services individually and the customer can benefit from the good or service either on its own or together with other resources that are readily available to the customer, then there are two performance obligations:

- (i) Sale of the product; and
- (ii) Installation of the product

Rs.8,00,000 would be allocated to goods and installation services respectively in accordance with paragraph 76 of Ind AS 115 as per their stand-alone selling prices i.e. Rs.7,00,000 and Rs.2,00,000 respectively.

Accordingly, the revenue from goods to be recorded for the year ended March 31, 2018 is Rs.6,22,222.22 ( $800000 \times 700000/900000$ ) and for installation services during the period ended June 30, 2018 is Rs.177,777.78.

### **Question 35**

Company A enters into a contract to manufacture a turbine for Customer. The turbine is designed and manufactured to Customer's specifications. Company A could redirect the turbine to another customer, but only if Company A incurs significant cost to reconfigure the turbine. Assume the following additional facts:

- (a) The contract contains one performance obligation as the goods and services to be provided are not distinct.
- (b) Customer is obligated to pay Company A an amount equal to the costs incurred plus an agreed profit margin if it cancels the contract.

How should Company A recognise revenue from this contract?

### **Response**

Paragraph 35 of Ind AS 115 states that, "an entity transfers control of a good or service over time and, therefore, satisfies a performance obligation and recognises revenue over time, if one of the following criteria is met:

- (a) the customer simultaneously receives and consumes the benefits provided by the entity's performance as the entity performs;
- (b) the entity's performance creates or enhances an asset (for example,

work in progress) that the customer controls as the asset is created or enhanced; or

- (c) the entity's performance does not create an asset with an alternative use to the entity and the entity has an enforceable right to payment for performance completed to date.

In accordance with the above, in the given case the Company A should consider whether the turbine in its completed state will have an alternative use to the entity. Although the contract does not preclude the entity from directing the completed turbine to another customer, Company A will have to incur significant costs to reconfigure the turbine to direct it to another customer. Consequently, the asset, i.e. the turbine has no alternative use to Company A because the customer-specific design of the turbine limits the Company A's practical ability to readily direct the turbine to another customer in accordance with paragraphs 36 and B6–B8 of Ind AS 115. Further, as per paragraphs 37 and B9–B13 of Ind AS 115, the Company A also has a right to payment for performance completed to date.

Accordingly, the criteria under paragraph 35(c) are met for a performance obligation satisfied over time. Hence, Company A can recognise revenue over time as it builds the turbine, provided it is able to fulfil all other conditions of paragraph 9.

### **Question 36**

A publication company, O Ltd., enters into a contract with a content development company, X Ltd. O Ltd. will get the right for the content developed by X Ltd. to be used in a book published by O Ltd. and in exchange, X Ltd. will receive a sales-based royalty of 10% of the monthly book sales and a non-refundable upfront fee of Rs.1,00,000. When should X Ltd. recognise revenue?

### **Response**

The content development company, X Ltd., has single performance obligations, i.e. the promise to grant the right to the content.

As per paragraph B58 of Ind AS 115, the nature of an entity's promise in granting a license is a promise to provide a right to access its intellectual property if all of the following criteria are met:

- (a) the contract requires, or the customer reasonably expects, that the

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entity will undertake activities that significantly affect the intellectual property to which the customer has rights;

- (b) the rights granted by the licence directly expose the customer to any positive or negative effects of the entity's activities identified in paragraph B58(a); and
- (c) those activities do not result in the transfer of a good or a service to the customer as those activities occur.

Further paragraph B61 states that, "If the criteria in paragraph B58 are not met, the nature of an entity's promise is to provide a right to use the entity's intellectual property as that intellectual property exists (in terms of form and functionality) at the point in time at which the licence is granted to the customer. This means that the customer can direct the use of, and obtain substantially all of the remaining benefits from, the licence at the point in time at which the licence transfers. An entity shall account for the promise to provide a right to use the entity's intellectual property as a performance obligation satisfied at a point in time. An entity shall apply paragraph 38 to determine the point in time at which the licence transfers to the customer. However, revenue cannot be recognised for a licence that provides a right to use the entity's intellectual property before the beginning of the period during which the customer is able to use and benefit from the licence. For example, if a software licence period begins before an entity provides (or otherwise makes available) to the customer a code that enables the customer to immediately use the software, the entity would not recognise revenue before that code has been provided (or otherwise made available)."

In accordance with above, in the given case, because the criteria in paragraph B58 are not met, the company concludes that promise to transfer the license is a performance obligation satisfied at a point in time. Hence, Rs.1,00,000 shall be recognised on transfer of right to O Ltd.

Further, as per paragraph B63, the company shall recognise revenue for sales based royalty promised in exchange for a license only when the later of the following take place:

- (i) the subsequent sale occurs and
- (ii) performance obligation to which some or all of the sales-based royalty has been allocated has been satisfied.

Hence, the sales-based royalty income shall be recognised when sales of the

book occurs.

### **Question 37**

Company A is a manufacturer of auto parts. It entered into a contract with an automobile Company B to make tooling. The tooling is for the part of a new model which Company B is launching. Company A estimated the cost of Rs.50,000 for making the tooling and it quoted the price of Rs.75,000 to Company B. The Company B has incurred a lot of losses and requests Company A to help it tide over the current situation.

As per the terms of agreement, Company B will pay Company A Rs.52,000 immediately on delivery and the balance Rs.23,000 will be paid only if the model is successful and at least 2,000 units would be sold per month for a continuous period of six months. As at March 31, 2018, the Company A has made the tooling and sold to Company B. What is the amount of revenue that can be recognised by Company A as at the year ended March 31, 2018?

### **Response**

Paragraph 9 of Ind AS 115 requires that one of the conditions for an entity to account for a contract with a customer to be within the scope of this Standard is that it is probable that the entity will collect the consideration to which it will be entitled in exchange for the goods or services that will be transferred to the customer. In evaluating whether collectability of an amount of consideration is probable, an entity shall consider only the customer's ability and intention to pay that amount of consideration when it is due.

Further as per paragraph 33, revenue shall be recognised when control of goods is transferred to the other party.

Paragraph 51, *inter alia*, states that, "the promised consideration can also vary if an entity's entitlement to the consideration is contingent on the occurrence or non-occurrence of a future event. For example, an amount of consideration would be variable if either a product was sold with a right of return or a fixed amount is promised as a performance bonus on achievement of a specified milestone".

In accordance with the above, in this case, Company A should recognise the amount of revenue only to the extent of Rs.52,000 as at March 31, 2018, assuming all the conditions of paragraph 9 are met. In this case, considering that the part is for a new model and that sale of cars is beyond the control of Company B, the balance amount of Rs.23,000 which is linked to future sale

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of product should be recognised after the completion of six months of continuous sale of 2000 units per month.

### **Recognise revenue as and when entity satisfies each performance obligation**

#### **Question 38**

An operator offers a subscriber a finite number of call minutes for a fixed amount per month with the option of rolling over any unused minutes to the following month. At the end of the month, the subscriber has some unused minutes to roll over to the next month. The subscriber can use the unused minutes for the following two months, after which they expire. The operator has a history of enforcing expiry dates. How does a telecommunication operator account for unused minutes that a subscriber holds?

#### **Response**

As per paragraph 35 of Ind AS 115, “An entity transfers control of a good or service over time and, therefore, satisfies a performance obligation and recognises revenue over time, if one of the following criteria is met:

- (a) the customer simultaneously receives and consumes the benefits provided by the entity’s performance as the entity performs (see paragraphs B3–B4);
- (b) the entity’s performance creates or enhances an asset (for example, work in progress) that the customer controls as the asset is created or enhanced (see paragraph B5); or
- (c) the entity’s performance does not create an asset with an alternative use to the entity (see paragraph 36) and the entity has an enforceable right to payment for performance completed to date (see paragraph 37)”.

In accordance with the above, revenue is recognised in the accounting period in which the services are rendered, which in this case would be when the contracted call minutes are provided (i.e., the allocation is to minutes and not periods). The operator recognises revenue when the minutes are used. The operator recognises any unused minutes at the end of each month as contract liability.

Paragraphs B44 and B46 of Ind AS 115 state that:

“B44 In accordance with paragraph 106, upon receipt of a prepayment from a customer, an entity shall recognise a contract liability in the amount of the prepayment for its performance obligation to transfer, or to stand ready to transfer, goods or services in the future. An entity shall derecognise that contract liability (and recognise revenue) when it transfers those goods or services and, therefore, satisfies its performance obligation.

B46 If an entity expects to be entitled to a breakage amount in a contract liability, the entity shall recognise the expected breakage amount as revenue in proportion to the pattern of rights exercised by the customer. If an entity does not expect to be entitled to a breakage amount, the entity shall recognise the expected breakage amount as revenue when the likelihood of the customer exercising its remaining rights becomes remote. To determine whether an entity expects to be entitled to a breakage amount, the entity shall consider the requirements in paragraphs 56–58 on constraining estimates of variable consideration.”

In some instances, the operator has reliable and robust evidence that shows that the customer will not use a portion of those minutes before the expiration of the validity period. Hence, in accordance with paragraph B46 stated above, if an entity expects to be entitled to a breakage amount in a contract liability, the entity shall recognise the expected breakage amount as revenue in proportion to the pattern of rights exercised by the customer. Accordingly, in that case, the operator could consider a revenue recognition policy that considers the probability of unused minutes at the end of the validity period into the computation of the revenue per minute used by the subscriber. This results in allocating a higher fixed amount of revenue per minute used.

When the validity period expires, the operator recognises any remaining balance of unused minutes as revenue immediately, since the obligation of the operator to provide the contractual call minutes is extinguished.

### **Question 39**

A telecommunication company B Ltd. enters into contracts with a customer for providing broadband data services. These contracts are generally for one year and are renewed automatically after one year. These contracts are cancellable by any party at any point in time without any penalty for future unperformed services/obligations. Over what period will the revenue be



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recognised?

### **Response**

Paragraph 11 of Ind AS 115 states that, “some contracts with customers may have no fixed duration and can be terminated or modified by either party at any time. Other contracts may automatically renew on a periodic basis that is specified in the contract. An entity shall apply this standard to the duration of the contract (ie the contractual period) in which parties have present enforceable rights and obligations”.

Further, as per paragraph 12 of Ind AS 115, “for the purpose of applying this Standard, a contract does not exist if each party to the contract has the unilateral enforceable right to terminate a wholly unperformed contract without compensating the other party (or parties). A contract is wholly unperformed if both of the following criteria are met:

- (a) the entity has not yet transferred any promised goods or services to the customer; and
- (b) the entity has not yet received, and is not yet entitled to receive, any consideration in exchange for promised goods or services”.

In accordance with the above, in the given scenario, since there are no contractual terms, the telecommunication company B shall recognise revenue as and when services are provided, i.e., only for satisfied performance obligations.

### **Question 40**

The price payable under certain metal concentrate purchase or sale contracts is determined by reference to prices quoted in an organised market (e.g., LME) as follows:

- The title to the commodity passes to the buyer on delivery. At this time, a provisional invoice is generated based on the market price at the date of sale (either spot or the average spot price over the previous 1–3 weeks). 90% of the provisional invoice will be settled within a short period.
- The remaining 10% (plus or minus any adjustment on 100% of the value of the sale for movements in price from the spot price at the date of sale and the final price at the end of the specified period, plus any minor volume adjustments resulting from the final assay) is settled 2-4

months after the date of the sale.

- The final invoice is based on the market price at the time of invoicing (this can be the spot price at the date of final invoicing, or an average spot price over a prescribed quotation period between the date of the delivery and the final invoice).

The commercial rationale behind this pricing mechanism is to cover the purchaser, e.g., a smelter, from exposure to price risk from the point the inventory is received by the smelter, to the date the smelter expects to ultimately sell the final product (which is typically around 2-4 months, being the time the smelter takes to treat and refine the concentrate). This is to enable the smelter to operate as nearly as possible, as a pure tolling/refining operation. Such contracts may be cancellable without penalty prior to delivery. Economically, the purchaser locks-in the price and transfers any price risk to the seller.

For purposes of this fact pattern, it is assumed that the non-financial contract is not within the scope of Ind AS 109, *Financial Instruments*.

Considering that the seller retains price risk on commodity contracts for a specified period after the sale has occurred (i.e., after delivery), whether the entity would be able to recognise revenue on the date of delivery?

*(It may be noted that the response does not address aspect of embedded derivative, if any, in the transaction.)*

### **Response**

As per paragraph 33 of Ind AS 115, "Goods and services are assets, even if only momentarily, when they are received and used (as in the case of many services). Control of an asset refers to the ability to direct the use of, and obtain substantially all of the remaining benefits from, the asset. Control includes the ability to prevent other entities from directing the use of, and obtaining the benefits from, an asset. The benefits of an asset are the potential cash flows (inflows or savings in outflows) that can be obtained directly or indirectly in many ways, such as by:

- (a) using the asset to produce goods or provide services (including public services);
- (b) using the asset to enhance the value of other assets;
- (c) using the asset to settle liabilities or reduce expenses;

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- (d) selling or exchanging the asset;
- (e) pledging the asset to secure a loan; and
- (f) holding the asset.”

In accordance with above, it is appropriate for the seller to recognise revenue on the delivery of the commodity because the control of the same has been transferred to the customer since the customer can use or obtain all the benefits from these goods. The variability in the price would be considered as an embedded derivative, if any, which will be dealt with as per Ind AS 109, *Financial Instruments*.

### **Question 41**

XYZ Ltd. a knowledge management company, entered into an agreement with ABC, an educational institute, to formulate some study material on a particular subject for a total consideration of Rs.10,00,000. The contract terms stipulated that XYZ Ltd. has to complete the contract before March 31, 2018, and in the event of failure to complete the same within the stipulated time, it will be reimbursed only 75% of the cost incurred by it. XYZ Ltd. could complete only 85% of the assignment till March 31, 2018. Till that date XYZ Ltd. has incurred cost of Rs.4,00,000 and has sought an extension of time but it is not sure whether the extension will be granted or not? How and when XYZ Ltd. should recognise revenue? Ignore the element of onerous contract.

### **Response**

Paragraph 35 of Ind AS 115 states that, “An entity transfers control of a good or service over time and, therefore, satisfies a performance obligation and recognises revenue over time, if one of the following criteria is met:

- (a) the customer simultaneously receives and consumes the benefits provided by the entity’s performance as the entity performs (see paragraphs B3–B4);
- (b) the entity’s performance creates or enhances an asset (for example, work in progress) that the customer controls as the asset is created or enhanced (see paragraph B5); or
- (c) the entity’s performance does not create an asset with an alternative use to the entity (see paragraph 36) and the entity has an enforceable right to payment for performance completed to date (see paragraph 37)”.

Paragraph 37, *inter alia*, states that, “An entity shall consider the terms of the contract, as well as any laws that apply to the contract, when evaluating whether it has an enforceable right to payment for performance completed to date in accordance with paragraph 35(c)”.

Further, paragraph 44 of Ind AS 115 states that, “an entity shall recognise revenue for a performance obligation satisfied over time if the entity can reasonably measure its progress towards complete satisfaction of the performance obligation. An entity would not be able to reasonably measure its progress towards complete satisfaction of a performance obligation if it lacks reliable information....”

Paragraph 45 further explains that in some cases an entity may not be able to reasonably measure the outcome of a performance obligation, but the entity expects to recover the costs incurred in satisfying the performance obligation. In those circumstances, the entity shall recognise revenue only to the extent of the costs incurred until such time that it can reasonably measure the outcome of the performance obligation.

In the present case, the outcome of the contract cannot be measured reliably, but it is certain that XYZ Ltd. can recover the 75% of the cost incurred as per terms of the agreement. Accordingly, XYZ Ltd. can recognise 75% of the cost incurred as revenue, i.e., Rs.3,00,000 (4,00,000 x 75/100).

#### **Question 42**

Supernet Ltd. is into a business of providing fibre connectivity to homes. It lays the fibre from the nearest point of connection of telecom companies to the housing societies where each house can obtain data connectivity. It charges a non-refundable upfront charge of Rs.300 per subscriber and a monthly charge of Rs.1,000 per subscriber. The upfront charges are one-time costs of laying the cable to home, charges of the agency which does the outsourced work, administrative set-up costs etc. How should Supernet Ltd. recognise the upfront charges? Based on the past experience of the company, it estimates that the expected life of customer is 3 years.

#### **Response**

As per paragraph 39 of Ind AS 115, for each performance obligation satisfied over time in accordance with paragraphs 35–37, the entity shall recognise revenue over time by measuring the progress towards complete satisfaction of that performance obligation. Under this method, revenue is recognised in

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the accounting period in which the services are rendered.

Paragraphs B48-B49 of Ind AS 115, *inter alia*, state that, “In some contracts, an entity charges a customer a non-refundable upfront fee at or near contract inception..... To identify performance obligations in such contracts, an entity shall assess whether the fee relates to the transfer of a promised good or service. In many cases, even though a non-refundable upfront fee relates to an activity that the entity is required to undertake at or near contract inception to fulfil the contract, that activity does not result in the transfer of a promised good or service to the customer (see paragraph 25). Instead, the upfront fee is an advance payment for future goods or services and, therefore, would be recognised as revenue when those future goods or services are provided....”.

The upfront charges are one-time charges and these charges are for services that will be provided over the period of contract of the customer.

Thus, in this case the amount of Rs.300 would be amortised as revenue over the period of 3 years. The difference between the amount received and the revenue would be shown as a contract liability.

### **Question 43**

A Ltd. is a manufacturer of automobile parts and it has entered into a contract with a customer. As at March 31, 2018, Rs.1,00,000 worth of goods were sold of which Rs.60,000 had reached the customers factory by March 31, 2018 and Rs.40,000 reached the customers factory by April 10, 2018. What is the amount of revenue that can be recognised by A Ltd. as at year ended March 31, 2018 in the following cases?

- (a) The delivery terms are CIF (cost, insurance and freight) i.e., the legal title passes to the customer when the goods are handed over to the transporter. A third-party transporter contracted by A Ltd. is used to deliver the goods. The customer does not have physical possession of the goods during transit, but has legal title at shipment and therefore, can redirect the goods to another party while still in transit. The customer can hypothecate the goods while in transit (since it has the title documents). The manufacturer is prohibited from selling the goods to another customer while in transit.
- (b) The delivery terms are CIF (cost, insurance and freight i.e. the legal title passes to the customer when the goods are handed over to the

transporter. A third-party transporter, contracted by A Ltd. is used to deliver the goods. Customer has no nexus or privity of contract with the transporter. A Ltd. has past business practice of providing replacements to the customer at no additional cost if the goods are damaged during transit. Customer cannot redirect goods or take their possession before delivery or hypothecate the goods while in transit (since title documents are with transporter). There is no correlation of amount paid to the transporter and amount charged to customer.

### **Response**

Paragraph 31 of Ind AS 115 states that, “An entity shall recognise revenue when (or as) the entity satisfies a performance obligation by transferring a promised good or service (ie an asset) to a customer. An asset is transferred when (or as) the customer obtains control of that asset”.

Paragraph 33 of Ind AS 115, states that, “Goods and services are assets, even if only momentarily, when they are received and used (as in the case of many services). Control of an asset refers to the ability to direct the use of, and obtain substantially all of the remaining benefits from, the asset. Control includes the ability to prevent other entities from directing the use of, and obtaining the benefits from, an asset. The benefits of an asset are the potential cash flows (inflows or savings in outflows) that can be obtained directly or indirectly in many ways, such as by:

- (a) using the asset to produce goods or provide services (including public services);
- (b) using the asset to enhance the value of other assets;
- (c) using the asset to settle liabilities or reduce expenses;
- (d) selling or exchanging the asset;
- (e) pledging the asset to secure a loan; and
- (f) holding the asset.”

Further, as per paragraph 38, an entity shall consider indicators of the transfer of control, which include, but are not limited to, the following:

- (a) The entity has a present right to payment for the asset—if a customer is presently obliged to pay for an asset, then that may indicate that the customer has obtained the ability to direct the use of, and obtain substantially all of the remaining benefits from, the asset in exchange.

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- (b) The customer has legal title to the asset—legal title may indicate which party to a contract has the ability to direct the use of, and obtain substantially all of the remaining benefits from, an asset or to restrict the access of other entities to those benefits. Therefore, the transfer of legal title of an asset may indicate that the customer has obtained control of the asset. If an entity retains legal title solely as protection against the customer's failure to pay, those rights of the entity would not preclude the customer from obtaining control of an asset.
- (c) The entity has transferred physical possession of the asset—the customer's physical possession of an asset may indicate that the customer has the ability to direct the use of, and obtain substantially all of the remaining benefits from, the asset or to restrict the access of other entities to those benefits. However, physical possession may not coincide with control of an asset. For example, in some repurchase agreements and in some consignment arrangements, a customer or consignee may have physical possession of an asset that the entity controls. Conversely, in some bill-and-hold arrangements, the entity may have physical possession of an asset that the customer controls. Paragraphs B64–B76, B77–B78 and B79–B82 provide guidance on accounting for repurchase agreements, consignment arrangements and bill-and-hold arrangements, respectively.
- (d) The customer has the significant risks and rewards of ownership of the asset—the transfer of the significant risks and rewards of ownership of an asset to the customer may indicate that the customer has obtained the ability to direct the use of, and obtain substantially all of the remaining benefits from, the asset. However, when evaluating the risks and rewards of ownership of a promised asset, an entity shall exclude any risks that give rise to a separate performance obligation in addition to the performance obligation to transfer the asset. For example, an entity may have transferred control of an asset to a customer but not yet satisfied an additional performance obligation to provide maintenance services related to the transferred asset.
- (e) The customer has accepted the asset—the customer's acceptance of an asset may indicate that it has obtained the ability to direct the use of, and obtain substantially all of the remaining benefits from, the asset. To evaluate the effect of a contractual customer acceptance clause on when control of an asset is transferred, an entity shall

consider the guidance in paragraphs B83–B86.

On the basis of the above, the question when the transfer of control takes place depends on particular facts and circumstances of the case, including the terms of the contract, express and/or implied, and the conduct of the parties. Various factors should be considered for ascertaining the timing of passing of control of the product. For example, factors like, who bears the risk of damage during transit, whether the goods produced are substantially complete, whether the company can sell the goods to another party or pledge the same after handing over of the goods to the carrier, etc., will have to be taken into account in determining the timing of transfer of control of the product.

If, based on the consideration of the above factors, it is concluded that the control is transferred to customer on transfer of goods to the transporter, the contract will have two performance obligations. First to deliver the products to the customer and second to arrange forwarding and freight of the goods (now belonging to the customer) at the behest of the customer (the transporter would be the agent of the customer). In such a case the composite consideration would be divided into two components, i.e., for goods supplied and for freight services rendered. This seems to be the case in scenario (a).

If on the other hand, control is transferred to the customer only on receipt/acceptance of goods by him, the composite price will be recognised as revenue at that time (viz., on the fulfilment of the promise to deliver the goods to the customer at his godown). The forwarding and freight cost incurred by the company would be recognised as fulfilment cost for supply of the goods. In scenario (b), control seems to be transferred to the customer only on receipt/acceptance of goods by him.

In case of scenario (a) where shipping and handling is a separate performance obligation, it should also be considered whether the entity is the principal for the shipping service or is an agent for arranging such services.

Accordingly, revenue should be recognised as soon as control has passed on to the buyer and other conditions as stipulated in paragraph 31 in this case in, combination with paragraphs B79-B81 of Ind AS 115 have been fulfilled.



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### Question 44

Entity A, a large payroll processing firm enters into a contract with Entity B to provide monthly payroll processing services. The term of the contract is for one year. Entity B promises to pay Rs.1,00,000 per month for the service. How should revenue be recognised?

### Response

Paragraph 22 of Ind AS 115 states that, “at contract inception, an entity shall assess the goods or services promised in a contract with a customer and shall identify as a performance obligation each promise to transfer to the customer either:

- (a) a good or service (or a bundle of goods or services) that is distinct; or
- (b) a series of distinct goods or services that are substantially the same and that have the same pattern of transfer to the customer”.

Further, paragraph 23(a) states that, “a series of distinct goods or services has the same pattern of transfer to the customer if both of the following criteria are met:

- (a) each distinct good or service in the series that the entity promises to transfer to the customer would meet the criteria in paragraph 35 to be a performance obligation satisfied over time.
- (b) in accordance with paragraphs 39–40, the same method would be used to measure the entity’s progress towards complete satisfaction of the performance obligation to transfer each distinct good or service in the series to the customer.”

Further, paragraph 35(a) of the Standard states that, “an entity transfers control of a good or service over time and, therefore, satisfies a performance obligation and recognises revenue over time, if the customer simultaneously receives and consumes the benefits provided by the entity’s performance as the entity performs.”

In accordance with paragraphs 22(b) and 23 of Ind AS 115, the promised payroll processing services are accounted for as single performance obligation. Entity B simultaneously receives and consumes the benefits of the Entity A performance in processing each payroll transaction as and when each transaction is processed. Entity A therefore, concludes that the performance obligation is satisfied over time in accordance with paragraph

35(a) of Ind AS 115. Entity A therefore recognises revenue over time by measuring its progress towards complete satisfaction of that performance obligation. Consequently, Entity A concludes that a time-based measure is the best measure of progress towards complete satisfaction of the performance obligation over time and hence, it recognises revenue on a straight-line basis throughout the year at Rs.1,00,000 per month.

#### **Question 45**

Company X enters into an agreement on January 1, 2018 with a customer for renovation of hospital and install new air-conditioners for total consideration of Rs.50,00,000. The promised renovation service, including the installation of new air-conditioners is a single performance obligation satisfied over time. Total expected costs are Rs.40,00,000 including Rs.10,00,000 for the air-conditioners. Company X determines that it acts as a principal in accordance with paragraphs B34-B38 of Ind AS 115 because it obtains control of the air conditioners before they are transferred to the customer. The customer obtains control of the air conditioners when they are delivered to the hospital premises.

Company X uses an input method based on costs incurred to measure its progress towards complete satisfaction of the performance obligation.

As at March 31, 2018, other costs incurred excluding the air conditioners are Rs.6,00,000.

Whether Company X should include cost of the air conditioners in measure of its progress of performance obligation? How should revenue be recognised for the year ended March 2018?

#### **Response**

Paragraph B19 of Ind AS 115 *inter alia*, states that, “an entity shall exclude from an input method the effects of any inputs that, in accordance with the objective of measuring progress in paragraph 39, do not depict the entity’s performance in transferring control of goods or services to the customer”.

In accordance with the above, Company X assesses whether the costs incurred to procure the air conditioners are proportionate to the entity’s progress in satisfying the performance obligation. The costs incurred to procure the air conditioners (Rs.10,00,000) are significant relative to the total costs to completely satisfy the performance obligation (Rs.40,00,000). Also, Company X is not involved in manufacturing or designing the air

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conditioners.

Company X concludes that including the costs to procure the air conditioners in the measure of progress would overstate the extent of the entity's performance. Consequently, in accordance with paragraph B19 of Ind AS 115, the entity adjusts its measure of progress to exclude the costs to procure the air conditioners from the measure of costs incurred and from the transaction price. The entity recognises revenue for the transfer of the air conditioners at an amount equal to the costs to procure the air conditioners (i.e., at a zero margin).

Company X assesses that as at March 2018, the performance is 20 per cent complete (i.e., Rs.6,00,000/Rs.30,00,000). Consequently, Company X recognises the following-

### As at March 31, 2018

	Amount in Rs.
Revenue	18,00,000
Cost of goods sold	16,00,000
Profit	2,00,000

Revenue recognised is calculated as (20 per cent × Rs.40,00,000) + Rs.10,00,000.

(Rs.40,00,000 = Rs.50,00,000 transaction price – Rs.10,00,000 costs of air conditioners.)

Cost of goods sold is Rs.6,00,000 of costs incurred + Rs.10,00,000 costs of air conditioners.

## Contract Assets

### Question 46

Whether a 'contract asset' as defined in Ind AS 115 is a 'financial instrument'?

### Response

Ind AS 115 defines a 'contract asset' as, "An entity's right to consideration in exchange for goods or services that the entity has transferred to a **customer** when that right is conditioned on something other than the passage of time

(for example, the entity's future performance).”

When an entity performs first by satisfying a performance obligation before a customer performs by paying the consideration, the entity has a contract asset—a right to consideration from the customer in exchange for goods or services transferred to the customer.

In many cases, that contract asset is an unconditional right to consideration—a **receivable**—because only the passage of time is required before payment of that consideration is due. However, in other cases, an entity satisfies a performance obligation but does not have an unconditional right to consideration, for example, because it first needs to satisfy another performance obligation in the contract.

When an entity satisfies a performance obligation but does not have an unconditional right to consideration, an entity should recognise a contract asset in accordance with Ind AS 115. Making the distinction between a contract asset and a receivable is important because doing so provides users of financial statements with relevant information about the risks associated with the entity's rights in a contract. That is because although both would be subject to credit risk, a contract asset is also subject to other risks, for example, performance risk.

As per Ind AS 32, a *financial instrument* is defined as any contract that gives rise to a financial asset of one entity and a financial liability or equity instrument of another entity. Further, a *financial asset* includes a contractual right to receive cash or another financial asset from another entity; or to exchange financial assets or financial liabilities with another entity under conditions that are potentially favourable to the entity. However, as mentioned above, a contract asset is a right that is conditioned on something other than the passage of time. Hence, a contract asset is **not** a financial instrument.

Additionally, paragraph 2.1(j) of Ind AS 109, *Financial Instruments*, scopes out rights and obligations within the scope of Ind AS 115 that are financial instruments, except for those that Ind AS 115 specifies are accounted for in accordance with Ind AS 109. The example of this is paragraph 107 of Ind AS 115, which specifies that “an entity shall assess a contract asset for impairment in accordance with Ind AS 109. An impairment of a contract asset shall be measured, presented and disclosed on the same basis as a financial asset that is within the scope of Ind AS 109.”

## Right to return

### Question 47

A Ltd. is a manufacturer of garments and sells garments to certain retailers with a right to return in case the retailer is not satisfied with the quality of garments. Full amount is refunded to retailer provided that garments are undamaged. Based on past experience, at the end of the year, it is expected that 5% of goods sold during the year will be returned by the retailers in the next financial year. The gross margin on sale of garments is 10%. How should revenue be recognised by A Ltd.?

### Response

Regarding sale with a right of return, paragraph B20 of Ind AS 115 provides that, “in some contracts, an entity transfer control of a product to a customer and also grant the customer the right to return the product for various reasons (such as dissatisfaction with the product) and receive any combination of the following:

- (a) a full or partial refund of any consideration paid;
- (b) a credit that can be applied against amounts owed, or that will be owed, to the entity; and
- (c) another product in exchange”.

Further, paragraph B20AA states that, “In some contracts, an entity transfers control of a product to a customer with an unconditional right of return. In such cases, the recognition of revenue shall be as per the substance of the arrangement. Where the substance is that of a consignment sale, the entity shall account for such a contract as per the provisions of paragraph B77 of this Appendix. In other cases, the accounting for contracts with customers shall be as per paragraphs B21-B27”.

When an entity delivers goods to another party such as a dealer or distributor for sale to end customers, the entity shall evaluate whether that other party has obtained control of the product at that point in time. According to paragraph B77 of the standard, a product that has been delivered to another party may be held in a consignment arrangement if that other party has not obtained control of the product. Accordingly, the entity shall not recognise revenue upon delivery of a product that is held on consignment.

Paragraph B21 of Ind AS 115, *inter alia*, states that, “To account for the

transfer of products with a right of return, an entity shall recognise all of the following:

- (a) revenue for the transferred products in the amount of consideration to which the entity expects to be entitled (therefore, revenue would not be recognised for the products expected to be returned);
- (b) a refund liability; and
- (c) an asset (and corresponding adjustment to cost of sales) for its right to recover products from customers on settling the refund liability”.

In accordance with the above, in the present case, A Ltd. should recognise revenue only for 95% of the goods based on past experience and a refund liability will be recognised for the balance 5%. A Ltd. will also recognise an asset equal to the amount reflecting the 5% goods expected to be returned adjusting it for any impairment in value, if any, i.e., the asset will be measured by reference to its carrying value (example inventory) less any expected costs to recover those products including potential decreases in the value to the entity of the returned product in accordance with paragraph B25 of Ind AS 115.

## **Bill-and-hold Arrangements**

### **Question 48**

Company A has an agreement to supply certain goods to Company B which has to be supplied by March 15, 2018. Company A manufactures the goods, but prior to its despatch on March 15, 2018, it receives intimation from Company B that the project has been delayed for a month and they will be unable to pick up the goods on agreed time. Hence, Company B requests Company A to store the goods on its behalf. Company A cannot use the goods itself or direct them to another customer. Company B has already made the payment and has the legal title of the goods. Company B has inspected and accepted the goods.

When should revenue be recognised by Company A?

### **Response**

Paragraphs B79 to B82 of Ind AS 115 deal with bill-and-hold arrangements.

Paragraph B79 of Ind AS 115 states that, “A bill-and-hold arrangement is a contract under which an entity bills a customer for a product but the entity

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retains physical possession of the product until it is transferred to the customer at a point in time in the future. For example, a customer may request an entity to enter into such a contract because of the customer's lack of available space for the product or because of delays in the customer's production schedules".

In such cases, the revenue is recognised when the buyer takes the title, provided:

- (a) it is probable that delivery will be made.
- (b) the item is on hand, identified and ready for delivery to the buyer at the time the sale is recognised.
- (c) the buyer specifically acknowledges the deferred delivery instructions; and
- (d) the usual payment terms apply.

Paragraph B80 of Ind AS 115 specifies that an entity shall recognise revenue when the customer obtains control of the asset.

Further, paragraph B81 of Ind AS 115, *inter alia*, states that, "for a customer to have obtained control of a product in a bill-and-hold arrangement, all of the following criteria must be met:

- (a) the reason for the bill-and-hold arrangement must be substantive (for example, the customer has requested the arrangement);
- (b) the product must be identified separately as belonging to the customer;
- (c) the product currently must be ready for physical transfer to the customer; and
- (d) the entity cannot have the ability to use the product or to direct it to another customer".

Company A should assess the indicators in paragraph 38 of Ind AS 115 to determine the point in time at which control of goods transfers to Company B, noting that the Company A has received payment, the Company B has legal title to the goods and inspected and accepted the goods. In addition, if Company A concludes that all of the criteria in paragraph B81 of Ind AS 115 are met, which is necessary for it to recognise revenue in a bill-and-hold arrangement, the Company A shall recognise revenue for the goods on 31

March , 2018 when control transfers to Company B.

Further, as per paragraph B82 of Ind AS 115, “if an entity recognises revenue for the sale of a product on a bill-and-hold basis, the entity shall consider whether it has remaining performance obligations (for example, for custodial services) in accordance with paragraphs 22–30 to which the entity shall allocate a portion of the transaction price in accordance with paragraphs 73–86”.

Accordingly, in the given case, Company A shall assess whether it has remaining performance obligations (for example, for custodial services) in which case Company A shall allocate a portion of the transaction price and recognise revenue for custodial service over time.

## **Engineering and construction – Retention Money on long term contracts**

### **Question 49**

X Limited enters into a contract for the construction of a hotel that includes scheduled milestone payments for the performance by X Limited throughout the contract term of five years. The performance obligation will be satisfied over time and the milestone payments are scheduled to coincide with X Limited’s expected performance. The contract provides that a specified percentage of each milestone payment is to be withheld (i.e., retained) by the customer throughout the arrangement and paid to X Limited only when the building is complete. This amount is withheld by the customer purely for the purpose of protecting itself from non-performance of X Limited. Whether the amount withheld shall be considered for the assessment of financing component under Ind AS 115?

### **Response**

Paragraph 62(c) of Ind AS 115, *inter alia*, states that, “notwithstanding the assessment in paragraph 61, a contract with a customer would not have a significant financing component if the difference between the promised consideration and the cash selling price of the good or service (as described in paragraph 61) arises for reasons other than the provision of finance to either the customer or the entity, and the difference between those amounts is proportional to the reason for the difference. For example, the payment terms might provide the entity or the customer with protection from the other party failing to adequately complete some or all of its obligations under the



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contract”.

In accordance with the above, if the contract requires amounts to be retained for reasons other than the provision of finance then the Company may conclude that the contract with the customer does not involve any financing element. Since in the current case, the withholding of a specified percentage of each milestone payment is intended to protect the customer from X Limited failing to adequately complete its obligations under the contract, it may be concluded that the contract does not include a significant financing component.

### Question 50

Neo Ltd. enters into a contract with a sport apparel brand to purchase sports equipment at lower rates compared with the price of the same equipment sold directly by the brands in the retail market. The entity agrees to buy a specific number of equipment and must pay for that equipment regardless of whether it is able to resell them. The reduced rate paid by the entity for each equipment purchased is negotiated and agreed in advance.

Neo Ltd. determines the selling prices at which it will sell the equipment to its customers. Neo Ltd. is obliged to pay the brand for that right regardless of whether it is able to obtain a customer to resell the equipment to or whether it can obtain a favourable price for the equipment.

Whether the Neo Ltd. is providing the specified goods or services as a principal or acting as an agent?

### Response

Paragraph B35A of Ind AS 115, *inter alia*, states that, “When another party is involved in providing goods or services to a customer, an entity that is a principal obtains control of a good or another asset from the other party that it then transfers to the customer”.

In the given case, if Neo Ltd. concludes that with each equipment that it commits to purchase from the sport brand, it obtains control of a right to use the equipment that Neo Ltd. itself then transfers to one of its customers. Consequently, Neo Ltd. determines that the specified good or service to be provided to its customer is a right that it controls. Neo Ltd. further observes that no other goods or services are promised to the customer.

Neo Ltd. further assesses that it controls the right to each equipment before

the specified rights are being transferred to one of its customer's because it has the ability to direct the use of that right by deciding whether to use the equipment to fulfil a contract with a customer and, if so, which contract it will fulfil. Further, Neo Ltd. can resell the equipment or obtain all of the proceeds from the sale or, alternatively, use the equipment itself. Thus, Neo Ltd. also has the ability to obtain the remaining benefits from that right.

Further, Neo Ltd. considers the indicators in paragraphs B37(b)–(c) of Ind AS 115 and determines that it controls each specified right before it is transferred to the customer. Neo Ltd. has inventory risk with respect to the equipment because it committed itself to obtain the equipment from the brand before obtaining a contract with a customer to purchase the equipment. This is because Neo Ltd. is obliged to pay the brands for that right regardless of whether it is able to obtain a customer to resell the equipment to or whether it can obtain a favourable price for the equipment. Neo Ltd. also establishes the price that the customer will pay for the specified equipment.

Hence, in the given case Neo Ltd. concludes that it is a principal in the transactions with customers and it recognises revenue in the gross amount of consideration to which it is entitled in exchange for the equipment transferred to the customers.

## **Repurchase agreements**

### **Question 51**

- (a) An entity enters into a contract with a customer for the sale of equipment for Rs.5 crores on 4<sup>th</sup> April, 2018. The contract includes a call option that gives the entity a right to repurchase the equipment for Rs.5.3 crores on or before 31<sup>st</sup> March, 2019. How will this transaction be treated under Ind AS 115?
- (b) An entity enters into a contract with a customer for the sale of an equipment for Rs.5 crores on 4<sup>th</sup> April, 2018. The contract includes a put option that creates an obligation for the entity to repurchase the equipment at the customer's request for Rs.4.8 crores on or before 31<sup>st</sup> March, 2019. The market price is expected to be Rs.4.5 crores. How will this transaction be treated under Ind AS 115?

### **Response**

- (a) Paragraph B66 of Ind AS 115, *inter alia* states that, "if an entity has an

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obligation or a right (a forward or a call option), to repurchase the asset, the customer does not obtain control of the asset because the customer is limited in its ability to direct the use of, and obtain substantially all of the remaining benefits from, the asset even though the customer may have physical possession of the asset. Consequently, the entity shall account for the contract as either of the following:

- (i) a lease in accordance with Ind AS 17, *Leases*, if the entity can or must repurchase the asset for an amount that is less than the original selling price of the asset, unless the contract is part of a sale and leaseback transaction; or
- (ii) a financing arrangement in accordance with paragraph B68 if the entity can or must repurchase the asset for an amount that is equal to or more than the original selling price of the asset”.

Accordingly, as per paragraph B66(b), if the repurchase price of the asset is greater than the original selling price of the asset, it constitutes a financing arrangement.

Thus, the entity should continue to recognise the asset and also recognise a financial liability for any consideration received from the customer. The difference between the amount received from the customer and the amount of consideration to be paid to the customer (i.e., Rs.30,00,000 in this case) shall be treated as interest expense.

- (b) Paragraph B70 of Ind AS 115 states that, “If an entity has an obligation to repurchase the asset at the customer’s request (a put option) at a price that is lower than the original selling price of the asset, the entity shall consider at contract inception whether the customer has a significant economic incentive to exercise that right. The customer’s exercising of that right results in the customer effectively paying the entity consideration for the right to use a specified asset for a period of time. Therefore, if the customer has a significant economic incentive to exercise that right, the entity shall account for the agreement as a lease in accordance with Ind AS 17, unless the contract is part of a sale and leaseback transaction.”

In accordance with paragraph B70-B76, at the inception of the contract, the entity assesses whether the customer has a significant economic incentive to exercise the put option, to determine the

accounting for the transfer of the asset. In the given case, as the repurchase price is significantly greater than the expected market value, the entity concludes that the customer has a significant economic incentive to exercise its right, i.e., the put option. The entity determines there are no other relevant factors to consider when assessing whether the customer has a significant economic incentive to exercise the put option. Consequently, the entity concludes that control of the asset does not transfer to the customer, because the customer is limited in its ability to direct the use of, and obtain substantially all of the remaining benefits from, the asset.

Accordingly, the entity accounts for the transaction as a lease in accordance with Ind AS 17, *Leases*.

### **Asset Management Company - Variable consideration - Constraint**

#### **Question 52**

On April 1, 2018, AMC, an Asset Management Company contracts with Customer B to provide portfolio management services for all three years. AMC will receive fees based on performance of the Net Asset Value (NAV). The same will be computed by reducing the average market return from the actual fund's return at the end of the three year term. In addition to this there will be an upfront non-refundable management fees levied on the customer.

State the accounting treatment for the fees based on performance as per Ind AS 115 for the period of the contract.

#### **Response**

The performance based fees is variable consideration. Ind AS 115 prohibits the recognition of variable consideration as revenue until it is highly probable that a significant reversal of the cumulative amount of revenue recognised will not occur upon the resolution of the uncertainty. The performance-based fee depends on the market and, therefore, is highly susceptible to factors outside the AMC's influence. AMC would be required to assess as per paragraph 57 of Ind AS 115 whether the factors exist which indicate that there may be significant reversal of revenue.

Thus, AMC will recognise revenue, only if, a significant reversal of the cumulative amount of revenue is not highly probable. If fair value of the

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remaining assets in the fund is significantly in excess of the threshold at which the AMC would earn a performance based fees, then it may be one of the factors which will indicate that significant reversal will not occur.

As per paragraph 39 of Ind AS 115, the entity shall recognise revenue over time by measuring the progress towards complete satisfaction of that performance obligation in accordance with paragraphs 35-37 of the Standard. Under this method, revenue is recognised in the accounting period in which the services are rendered.

Further, paragraphs B48-B49 of the Standard, *inter alia*, state that, “In some contracts, an entity charges a customer a non-refundable upfront fee at or near contract inception..... To identify performance obligations in such contracts, an entity shall assess whether the fee relates to the transfer of a promised good or service. In many cases, even though a non-refundable upfront fee relates to an activity that the entity is required to undertake at or near contract inception to fulfil the contract, that activity does not result in the transfer of a promised good or service to the customer (see paragraph 25). Instead, the upfront fee is an advance payment for future goods or services and, therefore, would be recognised as revenue when those future goods or services are provided...”.

The upfront charges are for services that will be provided in each year of contract of the customer.

Thus, in this case the amount of upfront management fee would be recognised as revenue over the period of the contract. In addition, the annual management fee will be recognised in each year based on performance of the fund.

## **Consignment Assignment**

### **Question 53**

Company A is into the business of manufacturing seasonal item such as Diwali gift baskets, Christmas ornaments, Halloween items etc. Company A enters into a consignment agreement with Retailer R assuring the retailer that whatever is not sold will be taken back by the Company A. The right to determine the selling price and the risk of non-payment by the customer is with Company A.

When should revenue be recorded by Company A?

## **Response**

Paragraph B77 of Ind AS 115 states that, “When an entity delivers a product to another party (such as a dealer or a distributor) for sale to end customers, the entity shall evaluate whether that other party has obtained control of the product at that point in time. A product that has been delivered to another party may be held in a consignment arrangement if that other party has not obtained control of the product. Accordingly, an entity shall not recognise revenue upon delivery of a product to another party if the delivered product is held on consignment”.

Further, paragraph B78 of Ind AS 115 states that, “Indicators that an arrangement is a consignment arrangement include, but are not limited to, the following:

- (a) the product is controlled by the entity until a specified event occurs, such as the sale of the product to a customer of the dealer or until a specified period expires;
- (b) the entity is able to require the return of the product or transfer the product to a third party (such as another dealer); and
- (c) the dealer does not have an unconditional obligation to pay for the product (although it might be required to pay a deposit).

In the current scenario, retailer R does not obtain the control of goods in accordance with paragraphs 33, B77-B78 of Ind AS 115.

In accordance with above, since the goods will be returned to Company A, if they remain unsold and the right to determine the selling price and the credit risk is entirely borne by it, the revenue will be recognised by Company A only when the goods are sold to the final customer

## **Presentation & Disclosure**

### **Question 54**

An entity enters into a contract with its customer to provide certain payroll processing services. The contract has a five-year non-cancellable term. The payroll processing service is provided once a month and the customer pays a monthly amount of Rs.5,00,000 for the same.

As per the requirements of Ind AS 115, what information in each contract is to be included in the disclosure of the transaction price allocated to the

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remaining performance obligations at each reporting period?

### **Response**

Paragraphs 120 and 121 of Ind AS 115 state that-

“120 An entity shall disclose the following information about its remaining performance obligations:

- (a) the aggregate amount of the transaction price allocated to the performance obligations that are unsatisfied (or partially unsatisfied) as of the end of the reporting period; and
- (b) an explanation of when the entity expects to recognise as revenue the amount disclosed in accordance with paragraph 120(a), which the entity shall disclose in either of the following ways:
  - (i) on a quantitative basis using the time bands that would be most appropriate for the duration of the remaining performance obligations; or
  - (ii) by using qualitative information.

121 As a practical expedient, an entity need not disclose the information in paragraph 120 for a performance obligation if either of the following conditions is met:

- (a) the performance obligation is part of a contract that has an original expected duration of one year or less; or
- (b) the entity recognises revenue from the satisfaction of the performance obligation in accordance with paragraph B16.”

Further, paragraph B16 of Ind AS 115 states that, “as a practical expedient, if an entity has a right to consideration from a customer in an amount that corresponds directly with the value to the customer of the entity’s performance completed to date (for example, a service contract in which an entity bills a fixed amount for each hour of service provided), the entity may recognise revenue in the amount to which the entity has a right to invoice”.

Since, in the given case, the entity has a right to invoice the customer in the amount that corresponds directly with the value of the entity’s performance completed to date, no disclosure is necessary in relation to the remaining performance obligation, if the entity elects to apply the practical expedient in

paragraph 121(b) stated above.

**Question 55**

Will an entity's disaggregated revenue disclosure always be at the same level as its segment disclosures?

**Response**

Paragraphs 114 and 115 of Ind AS 115 state that-

“114 An entity shall disaggregate revenue recognised from contracts with customers into categories that depict how the nature, amount, timing and uncertainty of revenue and cash flows are affected by economic factors. An entity shall apply the guidance in paragraphs B87–B89 when selecting the categories to use to disaggregate revenue.

115 In addition, an entity shall disclose sufficient information to enable users of financial statements to understand the relationship between the disclosure of disaggregated revenue (in accordance with paragraph 114) and revenue information that is disclosed for each reportable segment, if the entity applies Ind AS 108, *Operating Segments*.”

The above paragraphs require entities to explain the relationship between the disaggregated revenue required by Ind AS 115 and the information required by Ind AS 108. Management should not assume that the two disclosures will be disaggregated at the same level. More disaggregation might be needed in the revenue footnote, for example, because Ind AS 108 permits aggregation in certain situations. Ind AS 115 does not have similar aggregation criteria. However, if management concludes that the disaggregation level is the same in both standards and segment revenue is measured on the same basis as required by Ind AS 115, then the segment disclosure would not be required to be repeated in the revenue footnote.

Paragraph B89 provides that, “examples of categories that might be appropriate include, but are not limited to, all of the following:

- (a) type of good or service (for example, major product lines);
- (b) geographical region (for example, country or region);
- (c) market or type of customer (for example, government and non-government customers);



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- (d) type of contract (for example, fixed-price and time-and-materials contracts);
- (e) contract duration (for example, short-term and long-term contracts);
- (f) timing of transfer of goods or services (for example, revenue from goods or services transferred to customers at a point in time and revenue from goods or services transferred over time); and
- (g) sales channels (for example, goods sold directly to consumers and goods sold through intermediaries)."

The following table illustrates the disaggregation disclosure by primary geographical market, major product line and timing of revenue recognition, including a reconciliation of how the disaggregated revenue ties in with the consumer products, transportation and energy segments, in accordance with paragraph 115 of Ind AS 115.

	<b>Consumer Durables</b>	<b>Engineering Goods</b>	<b>Telecom</b>	<b>Automobile</b>	<b>Total</b>
<b>Primary geographical markets</b>	Rs. (crores)	Rs. (crores)	Rs. (crores)	Rs. (crores)	Rs. (crores)
Europe	500	800	900	400	2,600
America	800	1,500	1,900	500	4,700
Australia	200	300	500	100	1,100
India	400	600	800	500	2,300
	1,900	3,200	4,100	1,500	10,700
<b>Major Goods /Service lines</b>					
Electronic appliances	1900				1900
Machines		2,000			2,000
Leased Lines			4,100		4,100
Solar Panels		1,200			1,200
Motorcycles				1,500	1,500
	1,900	3,200	4,100	1,500	10,700
<b>Timing of Revenue</b>					

Recognition					
Goods transferred at point in time	1900	2000		1500	5,400
Service transferred over time		1200	4100		5,300
	1,900	3,200	4,100	1,500	10,700

### Question 56

A manufacturer enters into a contract to deliver a product to customer for Rs.5,00,000. Customer pays a deposit of Rs.2,00,000 with the remainder due upon delivery (delivery will occur three weeks later and a significant financing component does not exist). Revenue will be recognised upon delivery as that is when control of the product transfers to the customer.

How should the manufacturer present the advance payment prior to delivery in financial statements?

### Response

Paragraph B44 of Ind AS 115, states that, "In accordance with paragraph 106, upon receipt of a prepayment from a customer, an entity shall recognise a contract liability in the amount of the prepayment for its performance obligation to transfer, or to stand ready to transfer, goods or services in the future. An entity shall derecognise that contract liability (and recognise revenue) when it transfers those goods or services and, therefore, satisfies its performance obligation."

Rs.2,00,000 deposit was received in advance of delivery, so manufacturer should recognise a contract liability under Ind AS 115 as against advance from customers under Ind AS 18, *Revenue* for that amount.

Cash	Rs.2,00,000
Contract Liability	Rs.2,00,000

The contract liability will be reversed and recognised as revenue (along with the Rs.3,00,000 remaining balance) upon delivery of the product.

Contract Liability	Rs.2,00,000
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Cash	Rs.3,00,000
Revenue	Rs.5,00,000

### Cost of obtaining contracts

#### Question 57

- (a) Company A is a telecommunication company that pays discretionary annual bonus to its employees of the sales department based on annual sales target, EBITDA target and employees' ratings. Will the annual bonus be incremental cost of obtaining contracts and hence eligible for capitalisation?
- (b) Company X provides consultancy services to its customers. It has won a contract through a tender process and incurs following costs to obtain the contract:

External legal fees for due diligence	Rs. 15,00,000
Travel cost to deliver proposal	Rs. 25,00,000
Commissions to sales employees	Rs. 10,00,000
Total cost incurred	Rs. 50,00,000

#### Response

Paragraph 91 of Ind AS 115 states that, "An entity shall recognise as an asset the incremental costs of obtaining a contract with a customer if the entity expects to recover those costs".

Further, paragraph 92 of Ind AS 115 states that, "The incremental costs of obtaining a contract are those costs that an entity incurs to obtain a contract with a customer that it would not have incurred if the contract had not been obtained (for example, a sales commission)".

- (a) In accordance with the above paragraphs, the entity does not recognise an asset for the annual bonuses paid to sales employees because the bonuses are not incremental cost to obtain a contract. The amounts are discretionary and are based on other factors, including the EBITDA of the

entity and the employees' performance. The bonuses are not directly attributable to identifiable contracts.

- (b) In accordance with above paragraphs, the commissions payable to sales employees are an incremental cost to obtain the contract, because they are payable only upon successfully obtaining the contract. Company X therefore recognises an asset for the sales commissions of Rs.10,00,000, subject to recoverability.

Company X would have incurred legal fees and travel costs regardless of whether the contract was obtained. Therefore, in accordance with paragraph 93 of Ind AS 115, those costs are recognised as expenses when incurred, unless they are within the scope of another Standard, in which case, the relevant provisions of that Standard apply.

#### **Question 58**

Entity B pays 10% sales commission to its salesperson on each contract that he or she obtains. In addition, the following employees of the entity receive sales commissions on each signed contract negotiated by the salesperson: 3% to the manager and 1% to the regional manager. How will these costs be treated in accordance with Ind AS 115?

#### **Response**

Paragraph 91 of Ind AS 115 states that, "An entity shall recognise as an asset the incremental costs of obtaining a contract with a customer if the entity expects to recover those costs."

Further, as per paragraph 92 of Ind AS 115, The incremental costs of obtaining a contract are those costs that an entity incurs to obtain a contract with a customer that it would not have incurred if the contract had not been obtained (for example, a sales commission).

To determine whether a cost is incremental, an entity should consider whether it would incur the cost if the customer (or the entity) decides, just as the parties are about to sign the contract, that it will not enter into the contract. If the costs would have been incurred even if the contract is not executed, the costs are not incremental to obtaining that contract. For example, salaries and benefits of sales employees that are incurred regardless of whether a contract is obtained are not incremental costs.

In the given case, all of the commissions are incremental because the commissions would not have been incurred if the contract had not been

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obtained. Ind AS 115 does not distinguish between commissions paid to the employee(s) based on the function or the title of the employee(s) that receives a commission. It is the entity that decides which employee(s) are entitled to a commission as a result of obtaining a contract.

### **Cost of fulfilling contracts**

#### **Question 59**

Company B incurs heavy expenditure during financial year ended March 31, 2018, amounting to Rs.5 crores for training of technical personnel on a new technology to implement the same for its customers. This training cost is for both existing and future contract with customers. Will this training expense be eligible for recognition as an asset as per Ind AS 115?

#### **Response**

Paragraph 95 of Ind AS 115 states that, "If the costs incurred in fulfilling a contract with a customer are not within the scope of another Standard (for example, Ind AS 2, *Inventories*, Ind AS 16, *Property, Plant and Equipment* or Ind AS 38, *Intangible Assets*), an entity shall recognise an asset from the costs incurred to fulfil a contract only if those costs meet all of the following criteria:

- (a) the costs relate directly to a contract or to an anticipated contract that the entity can specifically identify (for example, costs relating to services to be provided under renewal of an existing contract or costs of designing an asset to be transferred under a specific contract that has not yet been approved);
- (b) the costs generate or enhance resources of the entity that will be used in satisfying (or in continuing to satisfy) performance obligations in the future; and
- (c) the costs are expected to be recovered."

Further, paragraph 97(d) provides that, "costs that relate directly to a contract (or a specific anticipated contract) include costs that are explicitly chargeable to the customer under the contract".

In accordance with above, the training expenditure can be recognised as an asset if explicitly chargeable to the customer under the contract. In the above case, since the training expenditure cannot be explicitly charged to a

customer, it does not qualify for recognition as an asset.

## **Transition Requirements**

### **Question 60**

A Ltd. is an Indian software service company. It has adopted Ind AS 115 from April 1, 2018. A Ltd. adopts the standard using the modified retrospective approach. A Ltd. enters into arrangements to provide a software licence, professional services and post-delivery support service. As at April 1, 2018, A Ltd. has existing contracts which were accounted for previously under Ind AS 18, *Revenue*. As a result, it recognised fees from the development of its software by reference to the stage of completion of the development, which included the completion of post-delivery support services. Therefore, A Ltd. treated the development of software and post-delivery support service as a single performance obligation. However, had A Ltd. done an assessment of this contract under Ind AS 115, it would have identified three performance obligations – software license, professional services and post-delivery support services. How should A Ltd. recognise revenue from April 1, 2018 under Ind AS 115 for contracts previously accounted for Ind AS 18, assuming it decides to use the modified retrospective approach to transition to Ind AS 115?

### **Response**

Ind AS 115 provides detailed requirements for determining whether promised goods and services are distinct performance obligations. Therefore, A Ltd. may reach a different conclusion under Ind AS 115 than it did under Ind AS 18 regarding the number of deliverables.

As a result, A Ltd.'s analysis of contracts in progress as of April 1, 2018 may result in the identification of different distinct performance obligations from those it previously used for revenue recognition. As part of this assessment, the entity would need to allocate the estimated transaction price, based on the relative stand-alone selling price method (or any other appropriate method) to the newly identified distinct performance obligations. The entity would compare the revenue recognised for each arrangement, from contract inception to 31 March, 2018, to the amount that would have been recognised, if A Ltd. had applied Ind AS 115 since contract inception. The difference between those two amounts would be accounted for as a cumulative catch-up adjustment and recognised as at 1 April, 2018 in opening retained earnings. From April 1, 2018 onwards, revenue recognised would be in

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accordance with the principles of Ind AS 115.

### **Question 61**

M Ltd. has adopted Ind AS 115 from April 1, 2018. M Ltd. entered into an 18 month contract with B Ltd. to provide marketing services on January 1, 2018. The consideration includes a fixed amount of Rs.15,00,000 plus an additional amount of Rs.5,00,000, if certain service levels are achieved by May 2018 and Rs.3,00,000 if they are achieved by June 2018.

Till March 2018, M Ltd. followed Ind AS 18 in accounting for the above contract. Under Ind AS 18, service provider M Ltd. recognised revenue on a straight line basis over the contract term. M Ltd. determines service level at each reporting period and assessed whether the additional consideration was earned. On the date of the contract inception, the additional consideration amount was not recorded, rather M Ltd. determined that the variable amount should not be recognised until the date on which the service levels were met, and therefore did not recognise it at March 31, 2018.

What should be the difference in accounting for revenue under Ind AS 115? How should revenue be recognised on transition to Ind AS 115?

### **Response**

Under Ind AS 115, M Ltd. determines that the contract consisted of a single performance obligation that is satisfied over time. The contractual terms indicates that revenue will continue to be recognised on a straight line basis over the contract term. In determining the transaction price, M Ltd. considers the approach that will best predict the amount of consideration that it will ultimately be entitled to, and determines that the most likely amount method is the appropriate approach.

As per Ind AS 115, the variable consideration is estimated at Rs.3,00,000 at the inception date, using the most likely amount method. The entity determines that, at the inception date, Rs.3,00,000 would have been included in the transaction price, because it was probable that it would not have been subject to a significant reversal in the future. M Ltd. re-evaluates the estimate of variable consideration at each reporting period, and determines that there were no changes in the estimate. Monthly revenue would, therefore, be  $\text{Rs.}18,00,000/18 = \text{Rs.}1,00,000$  [ $\text{Rs.}15,00,000 + \text{Rs.}3,00,000 = \text{Rs.}18,00,000$ ]

M Ltd. records an adjustment to opening retained earnings at April 1, 2018 to reflect the difference between revenue recognised under Ind AS 18 and what

would have been recognised under Ind AS 115 at that date.

<b>Particulars</b>	<b>April 1, 2018</b>
Revenue under Ind AS 18	Rs.2,50,000 [Rs.15,00,000/18x3]
Revenue under Ind AS 115	Rs.3,00,000 [(Rs.15,00,000+Rs.3,00,000)/18x3]
Adjustments in Opening Retained Earnings	Rs.50,000

## **Industry-specific**

### **IT Sector**

#### **Question 62**

X Ltd. licenses software product S to a Customer Y on a perpetual basis along with specified implementation services. The implementation services consist of developing basic interfaces, loading/installing the software and running test data. Product S can be used by the customer upon basic installation without any significant customisation or X Ltd. providing the specified implementation services.

Further, there are other experienced providers of implementation services for Product S and has a history of successfully providing services of this nature to the satisfaction of customers. The services do not carry any significant degree of risk or unique acceptance criteria.

Whether Software license can be considered as a distinct performance obligation or would it be bundled along with the implementation services?

#### **Response**

As per paragraph 27 of the Ind AS 115, "a good or service that is promised to a customer is distinct if both of the following criteria are met:

- (a) the customer can benefit from the good or service either on its own or together with other resources that are readily available to the customer (i.e. the good or service is capable of being distinct); and
- (b) the entity's promise to transfer the good or service to the customer is separately identifiable from other promises in the contract (i.e. the promise to transfer the good or service is distinct within the context of the contract)".



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X Ltd. assesses the goods and services promised to the customer to determine which goods and services are distinct, and it concludes that the criteria in paragraph 27 of Ind AS 115 are met for each of the software and the implementation service.

X Ltd. concludes that the criterion in paragraph 27(a) of Ind AS 115 is met because the customer Y can benefit from the software together with readily available resources other than the entity X's implementation service (because there are other entities that can provide the implementation service), and can benefit from the implementation service together with the software transferred to the customer.

X Ltd. also concludes that its promises to grant the licence and to provide the implementation services are separately identifiable (i.e., the criterion in paragraph 27(b) of Ind AS 115 is met). The entity concludes that the software license and implementation services are not inputs to a combined item in this contract on the basis of the principle and the factors in paragraph 29 of Ind AS 115. In reaching this conclusion, X Ltd. considers that the customer Y could separately avail the implementation services without significantly affecting its ability to benefit from the licence.

In this case, Product S is fully functional to its off-the-shelf specifications as soon as it is installed in customer's IT environment. It means that the customer is able to benefit from the software either on its own (if its own personnel could install the Product S) or together with implementation services that are readily available from numerous alternate service providers.

In accordance with the above, X Ltd. concludes that the software license to Product S and the implementation services are each capable of being distinct.

The Entity X applies paragraphs 31–38 of Ind AS 115 to determine whether the performance obligation (i.e., the bundle of the software licence and the implementation services) is a performance obligation satisfied at a point in time or over time.

Paragraphs 31 and 32 of Ind AS 115 state that-

“31 An entity shall recognise revenue when (or as) the entity satisfies a performance obligation by transferring a promised good or service (ie an asset) to a customer. An asset is transferred when (or as) the customer obtains control of that asset.”

- 32 For each performance obligation identified in accordance with paragraphs 22–30, an entity shall determine at contract inception whether it satisfies the performance obligation over time (in accordance with paragraphs 35-37) or satisfies the performance obligation at a point in time (in accordance with paragraphs 38). If an entity does not satisfy a performance obligation over time, the performance obligation is satisfied at a point in time.”

Further, paragraph 35 of Ind AS 115 states that, “An entity transfers control of a good or service over time and, therefore, satisfies a performance obligation and recognises revenue over time, if one of the following criteria is met:

- (a) the customer simultaneously receives and consumes the benefits provided by the entity’s performance as the entity performs (see paragraphs B3-B4);
- (b) the entity’s performance creates or enhances an asset (for example, work in progress) that the customer controls as the asset is created or enhanced (see paragraph B5); or
- (c) the entity’s performance does not create an asset with an alternative use to the entity (see paragraph 36) and the entity has an enforceable right to payment for performance completed to date (see paragraph 37).

Accordingly, as per paragraph 31 of Ind AS 115, revenue arising out on licensing of Product S should be recognised at the point in time when the customer obtains control of software license, i.e., immediately on transfer of right to use. Furthermore, in accordance with paragraph 35, revenue attributed to implementation services should be recognised over time by selecting an appropriate measure of progress towards satisfaction of the performance obligation.

### **Question 63**

Entity A licenses customer relationship management software to a client B. In addition, Entity A promises to provide customisation services to significantly customise the software as per the client’s requirement.

Whether software license can be considered as a distinct performance obligation or would it be bundled along with the customisation services in the following scenarios?

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**Scenario I** – Client B has floated a single request for proposal (RFP) for procurement of the software and customisation services. The client's requirement is to receive a completely customised solution.

**Scenario II** – Client B has floated separate RFP's for the procurement of software and customisation services. There are third party service providers providing the customisation services. Also, license contract is non-cancellable and payments are non-refundable.

### **Response**

As per paragraph 27 of Ind AS 115, "a good or service that is promised to a customer is distinct if both of the following criteria are met:

- (a) the customer can benefit from the good or service either on its own or together with other resources that are readily available to the customer (ie the good or service is capable of being distinct); and
- (b) the entity's promise to transfer the good or service to the customer is separately identifiable from other promises in the contract (ie the promise to transfer the good or service is distinct within the context of the contract)."

### **Scenario I**

The Entity A assesses the goods and services promised to the customer to determine which goods and services are distinct in accordance with paragraph 27 of Ind AS 115. The Entity A determines that the criterion in paragraph 27(b) of Ind AS 115 is not met as in this case the entity is providing a significant service of integrating the goods and services (the license and the customisation services) for which the client has contracted. Hence, in accordance with paragraph 27, the software is not a distinct performance obligation in the context of the contract. Entity A would account for the license and customisation services together as one performance obligation.

The entity applies paragraphs 31–38 of Ind AS 115 to assess whether the performance obligation (i.e., the bundle of the licence and the customisation services) is a performance obligation satisfied at a point in time or over time.

## **Scenario II**

The Entity A assesses the goods and services promised to the client B to determine which goods and services are distinct in accordance with paragraph 27 of Ind AS 115.

Entity A concludes that the criterion in paragraph 27(a) of Ind AS 115 is met because the client B can benefit from the software together with readily available resources other than the Entity A's customisation service (because there are other entities that can provide the customisation service), and can benefit from the customisation service together with the software transferred to the client.

Entity A also concludes that its promises to grant the licence and to provide the customisation services are separately identifiable (i.e., the criterion in paragraph 27(b) of Ind AS 115 is met). The entity concludes that the software license and customisation services are not inputs to a combined item in this contract on the basis of the principle and the factors in paragraph 29 of Ind AS 115. In reaching this conclusion, Entity A considers that the client B has floated a separate RFP for license of software and customisation service. The contract for customisation service of the product could have been awarded to a third party. The client can benefit from the license by taking the customisation service from a third party that is readily available.

The license contract is non-cancellable and non-refundable, which indicate that the license fee is not contingent upon the performance of customisation services.

In accordance with the above, Entity A concludes that the software license and the customisation services are each capable of being distinct. Hence, the license element qualifies as a separate performance obligation.

The Entity A applies paragraphs 31–38 of Ind AS 115 to assess whether the performance obligation (i.e., the bundle of the licence and the customisation services) is a performance obligation satisfied at a point in time or over time.

Accordingly, as per paragraph 31 of Ind AS 115, the revenue arising from such sale of license should be recorded at the point in time when the client obtains control of software i.e., immediately on transfer of right to use.

Further, in accordance with paragraph 35, the revenue from the customisation services shall be recognised over time by selecting an appropriate measure of progress towards satisfaction of the performance

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obligation.

### Question 64

A Ltd. is a software-as-a-service (SaaS) provider of tax preparation software, i.e., A Ltd. provides software-as-a-service, and does not license its software. The customers do not have an option to take the software on premise.

A Ltd. charges a one-time set up fee of Rs.1,00,000 which is non-refundable and a monthly access charge of Rs.25,000. The initial hosting period is 3 years. The basic configuration takes 3 months and the customer can access the system once the configuration is completed.

How would A Ltd. account for the revenue?

### Response

As per paragraph 27 of Ind AS 115, “a good or service that is promised to a customer is distinct if both of the following criteria are met:

- (a) the customer can benefit from the good or service either on its own or together with other resources that are readily available to the customer (ie the good or service is capable of being distinct); and
- (b) the entity’s promise to transfer the good or service to the customer is separately identifiable from other promises in the contract (ie the promise to transfer the good or service is distinct within the context of the contract)”.

A Ltd. assesses the goods and services promised to the customer to determine which goods and services are distinct in accordance with paragraph 27 of Ind AS 115. A Ltd. determines that the criterion in paragraph 27(b) of Ind AS 115 is not met as in this case, A Ltd. provides set up services which do not provide any separately identifiable benefit to the customer. Thus, the set up services and the initial hosting services is considered as one single performance obligation. Hence, in accordance with paragraph 27, the software is not a distinct performance obligation in the context of the contract. A Ltd. would account for the set up service and initial hosting services together as one performance obligation.

A Ltd. applies paragraphs 31–38 of Ind AS 115 to assess whether the performance obligation (i.e., the bundle of the set up services and the hosting services) is a performance obligation satisfied at a point in time or over time. In accordance with the requirements of these paragraphs, the

revenue for such hosting arrangement should be recognised from the time the customer can access the system. The set up fees which is paid upfront should be taken over a straight line basis over the initial hosting period of 3 years and the monthly access charge of Rs.25,000 will be recognised per month.

**Question 65**

XYZ Ltd. developed a software Product A. A customer enters into a three-year contract with XYZ Ltd. to access the software (Product A) in a hosting arrangement. The standalone selling price of Product A is Rs.5,00,000. The monthly fee for hosting the software is Rs.25,000.

The following are the additional facts:

- (a) The Customer has the enforceable right under the contract to take possession of the software Product A at any time for no additional fee and, if it does so, will no longer be required to pay Rs.25,000 monthly fee for the hosting services.
- (b) If Customer takes possession of Product A, it loses the right to future unspecified updates, upgrades and enhancements. However, the Product is updated infrequently and updates are typically minor in nature and not integral to maintaining the utility of Product.
- (c) The incremental costs of electing to take possession of the software Product A from XYZ Ltd. would not be significant in comparison to the hosting service fees it would avoid.

Whether the license be considered as a distinct performance obligation from that of the hosting contract?

Will the answer be different in situations where the upgrades and new features are integral to the overall functionality of the Product A?

**Response**

As per paragraph 27 of Ind AS 115, “a good or service that is promised to a customer is distinct if both of the following criteria are met:

- (a) the customer can benefit from the good or service either on its own or together with other resources that are readily available to the customer (ie the good or service is capable of being distinct); and
- (b) the entity’s promise to transfer the good or service to the customer is

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separately identifiable from other promises in the contract (ie the promise to transfer the good or service is distinct within the context of the contract)".

It may be noted that the contracts that include a licence require an assessment of the promises in the contract and the criteria for identifying performance obligations in accordance with the above paragraph. This would include an assessment of whether the customer can benefit from the licence on its own or together with other resources that are readily available as per the criterion in paragraph 27(a) of Ind AS 115 and whether the licence is separately identifiable from other goods or services in the contract as stated in paragraph 27(b) of Ind AS 115.

In the current case, Entity XYZ Ltd. concludes that the criterion in paragraph 27(a) of Ind AS 115 is met because the Customer has the contractual right to take possession of Product A at any time, and can do so without incurring a significant penalty and without significant diminution in the utility of the product.

Further, Entity XYZ Ltd. also concludes that the criterion in paragraph 27(b) of Ind AS 115 is also met as the customer can take control of the license and benefit on its own without the hosting service and the license can be recognised separately from the hosting arrangement.

In accordance with above, as both the criteria of paragraph 27 are met, Entity XYZ Ltd. concludes that the software license and the hosting services are each capable of being distinct. Hence, they qualify as separate performance obligations.

### ***In situations where the upgrades and new features are integral to the overall functionality of the Product A***

In many cases, where the customer can benefit from the licence only with another good or service that is also promised (explicitly or implicitly) in the contract; the licence is not separately identifiable from other goods or services in the contract. This may occur when:

- (a) a licence forms a component of a tangible good and is integral to the good's functionality—software (i.e., a licence) is often included in tangible goods (for example, a gaming console) and in most cases, significantly affects how that good functions. In those cases, the customer cannot benefit from the licence on its own (see paragraph

27(a) of Ind AS 115) because the licence is integrated into the good (see paragraph 29(a) of Ind AS 115); that is, the licence is an input to produce that good, which is an output.

- (b) a license that the customer can benefit from only in conjunction with a related service — this may occur when an entity provides a service, such as in some hosting or storage services, that enables the customer to use a license, such as software, only by accessing the entity's infrastructure. In those cases, the customer does not take control of the license and, therefore, cannot benefit from (or use) the license on its own (see paragraph 27(a) of Ind AS 115) without the hosting service. In addition, the use of the license is highly dependent on, or highly interrelated with, the hosting service (see paragraph 29(c) of Ind AS 115).

Accordingly, in situations where the customer's right to receive one or more specified upgrades or unspecified updates or upgrades are considered integral to maintaining the utility of the software, and forfeiture of its right to receive integral updates or upgrades by taking possession of the software, would incur a significant diminution in utility and value of the software the customer in essence receives 'software-as-a-service' (SaaS).

XYZ Ltd. assesses the goods and services promised to the customer to determine which goods and services are distinct in accordance with paragraph 27 of Ind AS 115. XYZ Ltd. determines that the criterion in paragraph 27(b) of Ind AS 115 is not met as in this case, the customer's right to receive one or more specified upgrades or unspecified updates or upgrades are considered integral to maintaining the utility of the software, i.e., these are not distinct within the context of the contract. Thus, the set up services and the initial hosting services is considered as one single performance obligation. Hence, in accordance with paragraph 27, the software is not a distinct performance obligation in the context of the contract. XYZ Ltd. would account for such contracts as one performance obligation.

In this case XYZ Ltd. applies paragraphs 31–38 of Ind AS 115 to assess whether the performance obligation is a performance obligation satisfied at a point in time or over time. In accordance with the requirements of these paragraphs, the revenue shall be recognised over time by selecting an appropriate measure of progress towards satisfaction of the performance



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obligation.

### Question 66

B Ltd. provides a hosted software solution to customers for which customers pay a fixed monthly fee. Customer enters into a contract to use the software on 'software-as-a-service' (SaaS) model for three years. Customers are not permitted to take possession of the software.

As part of the contract, B Ltd. agrees to provide a variety of services to the customer prior to using the SaaS. These services include training Customer's personnel, converting and migrating Customer's data from its current on-premise solution to B Ltd.'s hosted environment, and building an interface to permit the hosted application to supply data to Customer's on-premise general ledger system.

Each of these services has value to the customer on a standalone basis. Most of these services need not be re-performed if, the hosting provider is changed.

B Ltd. regularly sells SaaS separately without the additional services. There are third-party consultants that provide each of the services requested by Customer.

Whether the SaaS software and the other services are distinct performance obligations?

### Response

Paragraph 27 of Ind AS 115 states that, "a good or service that is promised to a customer is distinct if both of the following criteria are met:

- (a) the customer can benefit from the good or service either on its own or together with other resources that are readily available to the customer (ie the good or service is capable of being distinct); and
- (b) the entity's promise to transfer the good or service to the customer is separately identifiable from other promises in the contract (ie the promise to transfer the good or service is distinct within the context of the contract)".

B Ltd. assesses the goods and services promised to the customer to determine which goods and services are distinct, and it concludes that the criteria in paragraph 27 of Ind AS 115 are met for each of the software and

the implementation service.

B Ltd. concludes that the criterion in paragraph 27(a) of Ind AS 115 is met because the customer can benefit from the SaaS together with readily available resources other than the Entity B's additional other services (because there are other entities that can provide such services), and can benefit from the additional service together with the SaaS.

B Ltd. also concludes that its promises for SaaS and to provide the additional services are separately identifiable (i.e., the criterion in paragraph 27(b) of Ind AS 115 is met). The entity concludes that the SaaS and additional services are not inputs to a combined item in this contract on the basis of the principle and the factors in paragraph 29 of Ind AS 115. In reaching this conclusion, B Ltd. considers that the customer could separately avail the additional services without significantly affecting its ability to benefit from the SaaS.

As in the current scenario, the services performed by B Ltd. are not essential for the performance of the SaaS solution as B Ltd. sells SaaS separately to other customer and there are other consultants who could provide these services to the customer.

In accordance with the above, as the services have standalone value to the customer and need not be re-performed, if the hosting vendor is changed, B Ltd. concludes that its promises to provide each of the services and the SaaS are distinct performance obligations.

In this case B Ltd. applies paragraphs 31–38 of Ind AS 115 to assess whether the performance obligation is a performance obligation satisfied at a point in time or over time. In accordance with the requirements of these paragraphs, the revenue from the SaaS is taken over the initial hosting period once the customer's access is enabled to the SaaS environment. Revenue for the other services shall be recognised over time by selecting an appropriate measure of progress towards satisfaction of the performance obligation.

#### **Question 67**

An entity Polo Ltd. grants a customer a three-year term license to anti-virus software and promises to provide the customer with when-and-if available updates to that software during the license period. Polo Ltd. frequently provides updates that are critical to the continued utility of the software.

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Without the updates, the customer's ability to benefit from the software would decline significantly during the three-year arrangement.

Whether the anti-virus software and updates be distinct performance obligations?

### **Response**

Paragraph 27 of Ind AS 115 states that, "a good or service that is promised to a customer is distinct if both of the following criteria are met:

- (a) the customer can benefit from the good or service either on its own or together with other resources that are readily available to the customer (ie the good or service is capable of being distinct); and
- (b) the entity's promise to transfer the good or service to the customer is separately identifiable from other promises in the contract (ie the promise to transfer the good or service is distinct within the context of the contract)".

Polo Ltd. assesses the goods and services promised to the customer to determine which goods and services are distinct in accordance with paragraph 27 of Ind AS 115. Polo Ltd. determines that the customer can benefit from (a) the licence on its own without the updates; and (b) the updates together with the initial licence. Although, the benefit that the customer can derive from the licence on its own (i.e., without the updates) is limited because the updates are integral to the customer's ability to continue to use the license for anti-virus software in an industry in which updates are required rapidly, the licence can be used in a way that generates some economic benefits. Therefore, the criterion in paragraph 27(a) of Ind AS 115 is met for the licence and the updates.

The fact that the benefit that the customer can derive from the licence on its own (i.e., without the updates) is limited (because the updates are integral to the customer's ability to continue to use the software in the rapidly changing technological environment) is also considered in assessing whether the criterion in paragraph 27(b) of Ind AS 115 is met. Because the benefit that the customer could obtain from the software over the three-year term without the updates would be significantly limited, the Polo Ltd.'s promises to grant the licence to software and to provide the expected updates are, in effect, inputs that together fulfil a single promise to deliver a combined item to the customer. That is, the nature of the Polo Ltd.'s promise in the contract is to

provide ongoing access to the Polo Ltd.'s anti-virus software for the three-year term of the contract. The promises within that combined item (i.e., to grant the licence and to provide when-and-if-available updates) are, therefore, not separately identifiable in accordance with the criterion in paragraph 27(b) of Ind AS 115.

The updates significantly modify the functionality of the software (that is, they permit the software to protect the customer from a significant number of additional viruses that the software did not protect against previously) and are integral to maintaining the utility of the software license to the customer. Consequently, the license and updates fulfil a single promise to the customer in the contract. Hence, the entity concludes that its promises to transfer the software license and to provide the updates, when-and-if available, are not separately identifiable because the license and the updates are, in effect, inputs to a combined item (anti-virus protection) in the contract.

The nature of the combined good and service that Polo Ltd. promised to transfer to the customer is ongoing access to the entity's intellectual property related to the design and production processes for the three-year term of the contract. On the basis of this conclusion, the entity applies paragraphs 31–38 of Ind AS 115 to determine whether single the performance obligation is satisfied at a point in time or over time. The entity concludes that because the customer simultaneously receives and consumes the benefits of the entity's performance as it occurs, the performance obligation is satisfied over time in accordance with paragraph 35(a) of Ind AS 115.

### **Question 68**

An entity enters into a service contract to manage a customer's information technology data centre for five years. The entity pays the sales representative a sales commission of Rs.10,000 to obtain the contract.

How would this amount of sales commission be account for by the entity?

### **Response**

Paragraphs 91 and 92 of Ind AS 115 state that-

“91 An entity shall recognise as an asset the incremental costs of obtaining a contract with a customer if the entity expects to recover those costs.

92 The incremental costs of obtaining a contract are those costs that an

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entity incurs to obtain a contract with a customer that it would not have incurred if the contract had not been obtained (for example, a sales commission).”

In accordance with paragraphs 91–92 of Ind AS 115, the entity recognises an asset for Rs.10,000 incremental costs of obtaining the contract for the sales commission because the entity expects to recover those costs through future fees for the services to be provided. Further, the said amount is not discretionary and is not based on any other factor. The entity amortises the asset over five years because the asset relates to the services transferred to the customer during the contract term of five years.

### **Question 69**

X Ltd. enters into a four-year contract with a customer to provide Quality Assurance Services. Before the Quality Assurance can begin, X Ltd. is required to procure a third party tool which would enable it to deliver services seamlessly. For the testing tool, X Ltd. charges the customer Rs.6,00,000 which is included in the overall transaction price that is allocated to the performance obligation to provide Quality Assurance services. X Ltd. pays the vendor a cost of Rs.5,00,000 to develop the tool.

How will X Ltd. account for the cost of the tool?

### **Response**

Paragraph 95 of Ind AS 115 states that, “If the costs incurred in fulfilling a contract with a customer are not within the scope of another Standard (for example, Ind AS 2, *Inventories*, Ind AS 16, *Property, Plant and Equipment* or Ind AS 38, *Intangible Assets*), an entity shall recognise an asset from the costs incurred to fulfil a contract only if those costs meet all of the following criteria:

- (a) the costs relate directly to a contract or to an anticipated contract that the entity can specifically identify (for example, costs relating to services to be provided under renewal of an existing contract or costs of designing an asset to be transferred under a specific contract that has not yet been approved);
- (b) the costs generate or enhance resources of the entity that will be used in satisfying (or in continuing to satisfy) performance obligations in the future; and

(c) the costs are expected to be recovered”.

In the given case, the third party tool satisfies all of the above criteria defined in the standard and hence the fulfilment costs of Rs.5,00,000 can be capitalised and amortised on a systematic basis that is consistent with the transfer of the underlying services to which the asset relates, i.e., in this case over the quality assurance services.

## **Real Estate**

### **Scope and definition**

#### **Identification of contract**

##### **Question 70**

Lex Developer enters into a contract for sale of a building to Bigbricks for Rs. 9,00,00,000. Bigbricks pays a non-refundable deposit of Rs.4,50,000 and enters into a long-term, non-recourse financing agreement with Lex Developer (i.e., if Bigbricks defaults, Lex developer can repossess the property but cannot seek further compensation even if the property does not cover the full value of the amount owed) for the remaining 95% of the sales price. Bigbricks intends to open a restaurant in the building and expects to repay the loan using income derived from its restaurant business. Bigbricks business faces significant risks due to high competition in the area where the building is located and it also has only limited experience in the restaurant industry. It does not have any other income or assets that could be used to repay the loan. Bigbricks obtains control of the building at contract inception. Considering the above facts, whether a contract exists as per the requirements of Ind AS 115?

##### **Response**

As per paragraph 9 of Ind AS 115, a contract exists for the purposes of applying the standard only if all of the following criteria are met:

- (a) the collection of the consideration is probable;
- (b) the rights to goods and services and payment terms can be identified;
- (c) the contract has commercial substance; and
- (d) the contract is approved and the parties are committed to their obligations.

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If any of the criteria are not met, a contract does not exist and, generally, no revenue is recognised until the above criteria are met (or when either of the events specified in paragraph 15 of Ind AS 115 have occurred).

Generally, one of the most important gating questions in assessment for real estate developers is collectability of consideration considering the uncertainty inherent in real estate developments and that such contracts can be subject to conditions outside the developer's control, both during the construction phase and subsequently – e.g., economic conditions that result in increases or decreases in property prices. The entity needs to assess the collectability of the consideration at the initial stage and evaluate whether it is probable that the economic benefits associated with the transaction will flow to the entity. In making the collectability assessment, an entity considers the customer's ability and intention (which includes assessing its credit worthiness) to pay the consideration when it falls due. All relevant facts and circumstances are considered – for example:

- (a) the buyer's rights to cancel the contract for no penalty;
- (b) any prior experience with the buyer;
- (c) historical data on buyers with similar characteristics;
- (d) the importance of the property to the buyer's operations;
- (e) contractual terms (e.g., small down payment without sufficient collateral);
- (f) funding arrangements of buyer and
- (g) whether the seller is providing non-recourse finance (i.e., seller only has a right to the property in the event of default) to the buyer.

In the given facts and circumstances, it appears that it may not be probable that Lex Developer will collect the consideration to which it is entitled in exchange for the transfer of the building. This is because the customer's ability and intention to pay may be in doubt because of the following factors:

- The liability of Bigbricks under the loan is limited because the loan by Lex Developer is on a non-recourse basis;
- Bigbricks lacks other sources of income or assets that could be used to repay the loan and
- The repayment of loan (representing a significant balance) is intended

to be met primarily from the income derived from the restaurant business but the business is one which faces significant risk because of high competition and lack of prior experience of Bigbricks

Thus, the requirements of paragraph 9 of Ind AS 115 are not satisfied. Accordingly, a contract does not exist.

It should be noted that collectability is a continuous assessment and thus, if there are any changes in the facts and the circumstances leading to significant changes in the ability of the customer to honour its obligations under the contract, the entity needs to re-assess the appropriateness of revenue recognition.

Because the criteria in paragraph 9 of Ind AS 115 are not met, the entity applies paragraphs 15–16 of Ind AS 115 to determine the accounting for the non-refundable deposit of Rs.4,50,000. The entity observes that none of the events described in paragraph 15 have occurred—that is, the entity has neither received substantially all of the consideration nor it has terminated the contract. Consequently, in accordance with paragraph 16, the entity accounts for the non-refundable payment of Rs.4,50,000 as a deposit liability. The entity continues to account for the initial deposit, as well as any future payments of principal and interest, as a deposit liability, until such time that the entity concludes that the criteria in paragraph 9 are met (i.e., the entity is able to conclude that it is probable that the entity will collect the consideration) or one of the events in paragraph 15 has occurred. The entity continues to assess the contract in accordance with paragraph 14 to determine whether the criteria in paragraph 9 are subsequently met or whether the events in paragraph 15 of Ind AS 115 have occurred. Lex Developer should also provide appropriate disclosures as per Ind AS 115.

### **Identifying performance obligation**

#### **Question 71**

ABC Ltd. enters into a contract to design and build a mall for XYZ Ltd. ABC Ltd. is responsible for the overall management of the project and identifies various promised goods and services, including engineering, site clearance, foundation, procurement, construction of the structure, piping and wiring, installation of equipment and finishing. Do these goods and services meet the requirements of separate performance obligation in a single contract?



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### **Response**

Paragraph 22 of Ind AS 115 provides that at contract inception, an entity evaluates the promised goods or services to determine which goods or services (or bundle of goods or services) are distinct and therefore constitute a performance obligation.

A performance obligation is a promise in a contract to transfer to the customer either:

- a good or service (or a bundle of goods or services) that is distinct; and
- series of distinct goods or services that are substantially the same and that have the same pattern of transfer to the customer.

Paragraph 27 of Ind AS 115 provides that, a good or service in a contract is distinct if both the following criteria are satisfied:

- (i) Criterion 1: Capable of being distinct - The customer can benefit from the good or service either on its own or together with other resources that are readily available to the customer; and
- (ii) Criterion 2: Distinct within the context of the contract - The entity's promise to transfer the good or service to the customer is separately identifiable from other promises in the contract.

Each performance obligation is required to be accounted for separately.

In the present case, many of the goods and services to be provided meet criterion 1 (capable of being distinct). This is because the customer could benefit from the goods or services on their own - each construction material is sold separately by numerous suppliers or could be resold for more than scrap value by the customer - or together with other readily available resources such as additional materials or the services of another contractor. However, based on the current facts and circumstances, criterion 2 (distinct within the context of the contract) is not met because it provides a significant service of integrating the goods and services to produce the output (i.e., the mall) for which the customer has contracted.

Accordingly, since criterion 2 is not met, ABC Ltd. should account for the contract as a single performance obligation.

**Question 72**

XYZ Ltd. is in the business of providing mall management services and enters into a contract with PQR Ltd., owner of the mall, for management of the mall for a fixed price of Rs.10,00,000 per month and providing the leasing services at 2-months lease rent for leasing of each of the shop space within the mall. Mall management services involve smooth functioning of the mall operations including maintenance thereof as per the desired standards to maintain targeted inflow of visitors. Leasing services include maintaining a track of empty shops, identifying the tenants, negotiating the leasing terms with them and renting the shops throughout the year.

Whether mall management services and leasing services can be considered as a single performance obligation or should they be considered as separate performance obligations? Assume that the stated consideration for the services represents their stand-alone selling price.

**Response**

Paragraph 22 of Ind AS 115 provides that at contract inception, an entity evaluates the promised goods or services to determine which goods or services (or bundle of goods or services) are distinct and therefore constitute a performance obligation.

A performance obligation is a promise in a contract to transfer to the customer either:

- a good or service (or a bundle of goods or services) that is distinct; and
- series of distinct goods or services that are substantially the same and that have the same pattern of transfer to the customer.

Paragraph 27 of Ind AS 115 provides that, a good or service in a contract is distinct if both the following criteria are satisfied:

- (i) Criterion 1: Capable of being distinct - The customer can benefit from the good or service either on its own or together with other resources that are readily available to the customer; and
- (ii) Criterion 2: Distinct within the context of the contract - The entity's promise to transfer the good or service to the customer is separately identifiable from other promises in the contract.

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Each performance obligation is required to be accounted for separately.

In the present case, XYZ Ltd. should evaluate each of the above components of the contract to identify whether separate performance obligations are present. It should also consider the underlying activities that comprise each of the services to determine whether they meet the criteria to be accounted for as a single performance obligation or whether there are several performance obligations i.e., whether the leasing services are distinct from the management services (i.e., the leasing and management services are not combined to form a single performance obligation).

Considering the facts and circumstances, both services are capable of being distinct and are distinct in the context of the contract because XYZ Ltd. does not provide a significant service of integrating the services; neither service significantly modifies or customises the other service; and the services are not highly dependent on, or highly interrelated with each other. The activities that are necessary to perform the day-to-day management of the property are independent of those that are required to negotiate and execute leases with tenants. Accordingly, XYZ Ltd. should account for the management services and leasing services separately and should not combine the performance obligation.

### **Question 73**

A property sale contract includes the following:

- (a) Common areas
- (b) Construction services and building material
- (c) Property management services
- (d) Golf membership
- (e) Car park
- (f) Land entitlement

Whether they could be considered as separate performance obligations as per the requirements of Ind AS 115?

### **Response**

Paragraph 22 of Ind AS 115 provides that at contract inception, an entity evaluates the promised goods or services to determine which goods or services (or bundle of goods or services) are distinct and therefore constitute

a performance obligation.

A performance obligation is a promise in a contract to transfer to the customer either:

- a good or service (or a bundle of goods or services) that is distinct; and
- series of distinct goods or services that are substantially the same and that have the same pattern of transfer to the customer.

As per paragraph 27 of Ind AS 115, a good or service that is promised to a customer is distinct if both of the following criteria are met:

- (a) the customer can benefit from the good or service either on its own or together with other resources that are readily available to the customer (i.e. the good or service is capable of being distinct); and
- (b) the entity's promise to transfer the good or service to the customer is separately identifiable from other promises in the contract (i.e. the promise to transfer the good or service is distinct within the context of the contract).

Each performance obligation is required to be accounted for separately.

Based on the above guidance, the following table discusses whether the common goods and services in property sale contract should be considered as separate performance obligation or not:

<b>Goods/Service</b>	<b>Whether a separate performance obligation (PO) or not</b>	<b>Reason</b>
Common areas	Unlikely to be separate PO	Common areas are unlikely to be a separate performance obligation because the interests received in common areas are typically undivided interests that are not separable from the property itself. However, if the common areas were sold separately by the developer, then they could be considered as a separate performance obligation provided that it is

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		distinct in the context of the contract.
Construction services and building materials	Unlikely to be separate PO	Construction services and building materials can meet the first criterion as they are items that can be used in conjunction with other readily available goods or services. However, the developer would be considered to be providing a significant integration service as it is bringing together all the separate elements to deliver a completed building.
Property management services and Golf membership	Likely to be separate PO	Property management services and golf membership are likely to be separate performance obligations as they may be used in isolation or with the property already acquired, i.e., management services can be used with the property. These types of services are not significantly customised, integrated with, or dependent on the property. This is because there is no change in their function with or without the property. Also, a property management service could be undertaken by a third party.
Car park Land entitlement	Analysis required	Items such as car parks and land entitlements generally meet the first criterion – i.e., capable of being distinct – as the buyer benefits from them on their own.  Whether the second criterion is met depends on the facts and circumstances. For example, if the land entitlement can be sold separately or pledged as security as a separate item, it may indicate that it is not highly dependent on, or integrated with, other rights received in the contract.  In an apartment scenario, the customer can receive an undivided interest in the

		land on which the apartment block sits. This type of right is generally considered as highly inter-related with the apartment itself.*
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\* However, if title to the land is transferred to the buyer separately – for example in a single party development – then the separately identifiable criterion may be met.

The above is only a general discussion. The facts and circumstances of each contract should be carefully considered to determine the performance obligations.

### **Determination of transaction price**

#### **Question 74**

A real estate developer has launched a 20:80 scheme for the sale of units to the customers, i.e., 20 percent of the total consideration is to be paid upfront by the customer and the balance 80 percent is to be paid on possession. Presuming that the contract qualifies for the recognition of revenue over a period of time as per paragraph 35 of Ind AS 115, how should the transaction price be measured?

#### **Response**

Paragraph 60 of Ind AS 115, *inter alia*, states that, “In determining the transaction price, an entity shall adjust the promised amount of consideration for the effects of the time value of money if the timing of payments agreed to by the parties to the contract (either explicitly or implicitly) provides the customer or the entity with a significant benefit of financing the transfer of goods or services to the customer”.

The objective when adjusting the promised amount of consideration for a significant financing component is to recognise revenue at an amount that reflects what the cash selling price of the promised good or service would have been if the customer had paid cash at the same time as control of that good or service transferred to the customer.

A significant financing component may exist when the receipt of consideration does not match the timing of the transfer of goods or services to the customer (i.e., the consideration is either prepaid or is paid after the services are provided). A significant financing component may exist

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regardless of whether the promise of financing is explicitly stated in the contract or implied by the payment terms agreed to by the parties to the contract.

However, as per paragraph 62(c) of Ind AS 115, a contract with a customer would not have significant financing components if, the difference between the promised consideration and the cash selling price of the good or service (as described in paragraph 61) arises for reasons other than the provision of finance to either the customer or the entity, and the difference between those amounts is proportional to the reason for the difference. For example, the payment terms might provide the entity or the customer with protection from the other party failing to adequately complete some or all of its obligations under the contract.

Further, paragraph 63 provides a practical expedient as per which an entity need not adjust the promised amount of consideration for the effects of a significant financing component if the entity expects, at contract inception, that the period between when the entity transfers a promised good or service to a customer and when the customer pays for that good or service will be one year or less.

Basis above guidance, in a scheme like 20:80 or disproportionate payments over the project duration *vis-à-vis* revenue earned, the developer will need to separate the financing component, if it is significant, from the consideration to determine the transaction price.

The transaction price is determined by discounting the amount of promised consideration. The discount rate should reflect the credit characteristics of the party receiving the credit (as well as any collateral or security provided by the customer or the entity, including assets transferred in the contract). In other words, the developer should use the discount rate that it would use if it were to enter into a separate financing transaction with the customer at contract inception. Developer may be able to determine that rate by identifying the rate that discounts the nominal amount of the promised consideration to the price that the customer would pay in cash for the goods or services when (or as) they transfer to the customer. Further, after contract inception, developer should not update the discount rate for changes in interest rates or other circumstances (such as a change in the assessment of the customer's credit risk).

Subject to the practical expedient, the developer should present the effects

of financing i.e., interest revenue which relates to 80% (being deferred consideration) and interest expense which relates to 20% (being advanced amount received) of total consideration, separately from revenue from contracts with customers in the statement of profit and loss. Interest revenue or interest expense is recognised only to the extent that a contract asset (or receivable) or a contract liability is recognised in accounting for a contract with a customer.

**Question 75**

X Ltd. enters into a contract for the construction of a building on the Y's land which is considered as single performance obligation. Control passes to Y from X Ltd. over the period of contract. The contract terms indicate specific dates on which Y is required to make certain payments which do not necessarily coincide with the performance by X Ltd. The following milestones are established:

Month of payment	Payment	Months in which related construction activity is performed
1	Rs.10 crores	0-6
5	Rs.50 crores	7-13
13	Rs.20 crores	14-18

The contract is set up as such so that the X Ltd. has the necessary funds to cover the cost of construction. Y makes advance payment to X Ltd. considering the above payment schedule.

Whether the consideration will include significant financing component?

**Response**

Paragraph 60 of Ind AS 115, *inter alia*, states that, "In determining the transaction price, an entity shall adjust the promised amount of consideration for the effects of the time value of money if the timing of payments agreed to by the parties to the contract (either explicitly or implicitly) provides the customer or the entity with a significant benefit of financing the transfer of goods or services to the customer".

The objective when adjusting the promised amount of consideration for a



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significant financing component is to recognise revenue at an amount that reflects what the cash selling price of the promised good or service would have been if the customer had paid cash at the same time as control of that good or service transferred to the customer.

A significant financing component may exist when the receipt of consideration does not match the timing of the transfer of goods or services to the customer (i.e., the consideration is prepaid or is paid after the services are provided). A significant financing component may exist regardless of whether the promise of financing is explicitly stated in the contract or implied by the payment terms agreed to by the parties to the contract.

As per paragraph 62(c) of Ind AS 115, a contract with a customer would not have a significant financing component if the difference between the promised consideration and the cash selling price of the good or service (as described in paragraph 61) arises for reasons other than the provision of finance to either the customer or the entity, and the difference between those amounts is proportional to the reason for the difference. For example, the payment terms might provide the entity or the customer with protection from the other party failing to adequately complete some or all of its obligations under the contract.

Entities are not required to adjust the transaction price for the financing component if it is not significant to the contract. Further, as a practical expedient, an entity is not required to adjust the transaction price for the effects of a significant financing component if, at contract inception, the entity expects the period between customer payment and the transfer of goods or services to be one year or less.

Considering the above guidance, management will need to consider whether a financing component does exist taking into consideration paragraph 62 of Ind AS 115. If there is a financing component, it needs to be further assessed whether it is significant. For this, the management will need to consider the time period between payment and the completion of the related performance where X Ltd. is performing over time rather than at a specific point in time to assess whether there is a significant financing component taking into account the 12-month practical expedient offered by the standard. For example, X Ltd. may receive payment in month 5 but would perform over the period between month 7 to month 13, and thus there may not be a 12-month period between the date of payment and the associated performance.

## Revenue recognition

### Question 76

P Ltd. is developing a multi-unit residential complex. A customer enters into a binding sales contract with P Ltd. for a specified unit that is under construction. Each unit has a similar floor plan and is of a similar size, but other attributes of the units are different (for example, the location of the unit within the complex).

The customer pays a deposit (10%) upon entering into the contract and promises to make progress payments during construction of the unit. The deposit is refundable, only if, the entity fails to complete construction of the unit in accordance with the contract. P Ltd. retains legal title to the real estate unit construction is complete. The customer can resell or pledge the right as the real estate unit is being constructed. P Ltd. cannot direct the unit to another customer as per terms of the contract. In addition, the customer does not have the right to terminate the contract unless P Ltd. fails to perform as promised.

How revenue should be recognised for such a contract under Ind AS 115 in the following scenarios:

#### Scenario A:

**If the customer defaults on its obligations by failing to make the promised progress payments as and when they are due, the entity would have a right to all of the consideration promised in the contract, if it completes the construction of the unit. The courts have previously upheld similar rights that entitle developers to require the customer to perform, subject to the entity meeting its obligations under the contract.**

#### Response to Scenario A:

As per paragraph 31 of Ind AS 115, an entity recognises revenue when (or as) it satisfies a performance obligation by transferring a promised good or service (i.e. an asset) to a customer. An entity 'transfers' a good or service to a customer when (or as) the customer obtains control of that asset. Control may be transferred either at a point in time or over time.

Further, paragraph 35 of Ind AS 115, states that, "an entity transfers control of a good or service over time and, therefore, satisfies a performance

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obligation and recognises revenue over time if one of the following criteria is met:

- (a) the customer simultaneously receives and consumes the benefits provided by the entity's performance as the entity performs (see paragraphs B3–B4);
- (b) the entity's performance creates or enhances an asset (for example, work in progress) that the customer controls as the asset is created or enhanced (see paragraph B5); or
- (c) the entity's performance does not create an asset with an alternative use to the entity (see paragraph 36) and the entity has an enforceable right to payment for performance completed to date (see paragraph 37)".

Revenue is recognised at a point in time if it does not meet the above criteria.

As mentioned above, paragraph 35 gives three criteria for recognition of revenue over a period of time. In the given fact pattern, revenue recognition has been evaluated considering the criteria under paragraph 35(c).

Paragraph 35(c)

P cannot change or substitute the real estate unit specified in the contract with the customer, and thus the customer could enforce its rights to the unit if the entity sought to direct the asset for another use. Accordingly, the contractual restriction is substantive and the real estate unit does not have an alternative use to P.

P also has a right to payment for performance completed to date in accordance with paragraphs 37 and B9-B15. This is because if the customer were to default on its obligations, P would have an enforceable right to all of the consideration promised under the contract if it continues to perform as promised. Therefore, the terms of the contract and the legal precedent indicate that there is a right to payment for performance completed to date.

Consequently, the criteria in paragraph 35(c) are met, and P has a performance obligation that it satisfies over time. To recognise revenue for that performance obligation satisfied over time, P should measure its progress toward complete satisfaction of its performance obligation in accordance with paragraphs 39-45 and paragraph B14-B19.

**Scenario B: If the customer defaults on the contract before completion of the unit, P Ltd. only has the right to retain the deposit.**

**Response to Scenario B:**

As discussed above, the entity applies paragraph 35(c) to determine whether its promise to construct and transfer the unit to the customer is a performance obligation satisfied over time. The real estate unit does not have an alternative use to P. However, P does not have an enforceable right to payment for performance completed to date - until construction of the unit is complete, P only has a right to the deposit paid by the customer. Because P does not have a right to payment for work completed to date, P's performance obligation is not a performance obligation satisfied over time in accordance with paragraph 35(c). Instead, P accounts for the sale of the unit as a performance obligation satisfied at a point in time in accordance with paragraph 38.

**Scenario C: In the event of a default by the customer, P Ltd. shall serve the customer with a notice period to perform/pay. Either P Ltd. can require the customer to perform as required under the contract or the entity can cancel the contract in exchange for the asset under construction and be entitled to a penalty of a proportion of the contract price. In case of such cancellation, the P Ltd. shall be entitled to sell the unit to any other person if the customer does not fulfil his obligation within the notice period given by P Ltd.**

**Response to Scenario C:** Notwithstanding that P Ltd. could cancel the contract (in which case the customer's obligation to P Ltd. would be limited to transferring control of the partially completed asset to it and paying the penalty prescribed), P Ltd. has a right to payment for performance completed to date because it could also choose to enforce its rights to proportionate payment under the contract. Consequently, the criterion in paragraph 35(c) of Ind AS 115 is met and the entity has a performance obligation that it satisfies over time. The fact that P Ltd. may choose to cancel the contract in the event the customer defaults on its obligations would not affect that assessment, provided that P Ltd.'s rights to require the customer to continue to perform as required under the contract (i.e., pay the promised consideration) are enforceable.

The above scenarios are only illustrative. The facts and circumstances of each contract would need to be carefully assessed to determine whether or

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not revenue can be recognised over time. Apart from the terms of the contract, the entity also needs to understand the practices in the legal jurisdiction to assess the enforceability of its right to payment (where available). In India, for instance, an entity needs to assess contractual terms and requirements of Real Estate (Regulation and Development) Act, 2016 (RERA), related Rules, whether courts have previously upheld rights that entitle developers to require the customer to perform, subject to the entity meeting its obligations under the contract, to determine that whether entity has an enforceable right to payment.

### **Measuring progress**

#### **Question 77**

Developer D acquires land on which it will construct an apartment block and market individual units for sale to residential customers. During the construction phase, D sells an apartment to a customer for Rs.10,00,000. The estimated total cost of the apartment is Rs.8,00,000 comprising Rs. 4,00,000 for the land and Rs.4,00,000 for construction cost. At the reporting date, construction of the apartment is 25% complete. Assuming that, under local property law, the sales contract is enforceable and includes a single performance obligation that is satisfied over time under paragraph 35(c), how should developer D measure progress of revenue as per Ind AS 115?

#### **Response**

As per paragraph 39 of Ind AS 115, where the performance is satisfied over a period of time, an entity should recognise revenue over time by measuring the progress towards complete satisfaction of that performance obligation. Appropriate methods of measuring progress include output methods and input methods. Ind AS 115 requires an entity to select a method that is consistent with the objective of depicting its performance. The method should be applied consistently over the period of time. In the given case, Company D is measuring progress using output method as per which construction is 25% complete.

In the given case, land does not contribute to measure of progress and should be considered as a fulfilment cost. Revenue should be recognised as per the stage of completion and the land should be amortised over the construction period to cost of sales.

Thus, considering that construction of the apartment is 25% complete,

Company D should recognise revenue equal to 25% of the transaction price (Rs.10,00,000). Thus, revenue to be recognised is Rs.2,50,000 (i.e., 25% x Rs.10,00,000).

With regards to measuring progress, the requirements of paragraphs 44-45 of Ind AS 115 should be noted:

“44 An entity shall recognise revenue for a performance obligation satisfied over time only if the entity can reasonably measure its progress towards complete satisfaction of the performance obligation. An entity would not be able to reasonably measure its progress towards complete satisfaction of a performance obligation if it lacks reliable information that would be required to apply an appropriate method of measuring progress.

45 In some circumstances (for example, in the early stages of a contract), an entity may not be able to reasonably measure the outcome of a performance obligation, but the entity expects to recover the costs incurred in satisfying the performance obligation. In those circumstances, the entity shall recognise revenue only to the extent of the costs incurred until such time that it can reasonably measure the outcome of the performance obligation.”

Thus, an entity recognises revenue over time only if it can reasonably measure its progress toward complete satisfaction of the performance obligation. However, an entity may not be able to measure its progress if reliable information required to apply an appropriate method is not available. If the entity cannot reasonably measure the outcome but expects to recover the costs incurred in satisfying the performance obligation, then it recognises revenue to the extent of the costs incurred. Some of the considerations that may be relevant for assessing whether a reasonable measure of progress can be made may include the following:

- (a) critical approvals - whether all critical approval necessary for commencement of the project have been obtained;
- (b) stage of completion of the project - whether the stage of completion of the project has reached a reasonable level of development (e.g., expenditure incurred on construction and development costs is more than 25% of the construction and development costs);
- (c) agreements with buyers e.g., 25% of the saleable project area is secured by contracts or agreements with buyers;
- (d) contract consideration realised e.g., 10% of the contract consideration

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as per the agreements of sale or any other legally enforceable documents are realised at the reporting date in respect of each of the contracts and it is reasonable to expect that the parties to such contracts will comply with the payment terms as defined in the contracts.

In the given case, it was assumed that a reasonable measure of progress can be made. However, based on facts and circumstances of a particular contract, the entity should assess whether or not it can reasonably measure the outcome.

The above discussion is relevant only for those contracts where it is concluded that revenue can be recognised over time.

### **Question 78**

A developer is constructing a multi-storied apartment building. All apartments have been sold off-plan (i.e., before construction commenced). The ground floor units are completed in March 2017, however the top floor apartments are completed in September 2018. Apartments cannot be occupied until such time that the entire building is complete, and the safety inspection, which is required by the relevant regulations, has been performed.

Assume that there is only one performance obligation (i.e., the apartment) and the criteria for recognising revenue over time have been met because the apartments have no alternate use and the developer has a right to payment. How should the developer recognise revenue from the sale of the apartments?

### **Response**

The developer has sold each apartment to a different customer. Each individual apartment is a separate contract that includes a performance obligation that is satisfied over time. The developer would account for each contract separately; however, practically, the progress towards completion for each apartment could be calculated by reference to the stage of completion of the multi-storeyed apartment building as a whole.

However, if the developer had not sold all the apartments off-plan before construction commenced, revenue would not be recognised on unsold apartments and costs associated with unsold apartments would be recorded as inventory.

## Appendix I

*Note: The purpose of this Appendix is only to bring out the major differences, if any, between Indian Accounting Standard (Ind AS) 115, Revenue from Contracts with Customers and the corresponding International Financial Reporting Standard (IFRS) 15, Revenue from Contracts with Customers, issued by the International Accounting Standards Board.*

### **Major differences between Ind AS 115, Revenue from Contracts with Customers and IFRS 15, Revenue from Contracts with Customers**

- (i) IFRS 15 provides that penalties which may be levied in the performance of a contract should be considered in the nature of variable consideration for recognising revenue. Ind AS 115 has been amended to provide that penalties shall be accounted for as per the substance of the contract. Where the penalty is inherent in determination of transaction price, it shall form part of variable consideration, otherwise the same should not be considered for determining the consideration and the transaction price shall be considered as fixed. Paragraph 51AA has been inserted to explain the accounting treatment of 'penalties'
- (ii) Paragraph 109AA has been inserted in Ind AS 115 to require an entity to present separately the amount of excise duty included in the revenue recognised in the statement of profit and loss.
- (iii) Paragraph 126AA in Ind AS 115 has been inserted to present reconciliation of the amount of revenue recognised in the statement of profit and loss with the contracted price showing separately each of the adjustments made to the contract price specifying the nature and amount of each such adjustment separately.
- (iv) In Appendix B 'Application Guidance' of Ind AS 115, paragraph B20AA has been inserted to explain the accounting treatment in case of transfers of control of a product to a customer with an unconditional right of return.



## Appendix II

*Note: The purpose of this Appendix is only to bring out the major differences, if any, between Indian Accounting Standard (Ind AS) 115, Revenue from Contracts with Customers and the Accounting Standard (AS) 9, Revenue Recognition and AS 7, Construction contracts.*

### **Major differences between Ind AS 115, Revenue from Contracts with Customers and AS 9, Revenue Recognition and AS 7, Construction Contracts**

- (i) Ind AS 115 gives a framework of revenue recognition within a standard. It specifies the core principle for revenue recognition which requires the 'revenue to depict the transfer of promised goods or 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'. AS 7 and AS 9 do not provide any such overarching principle to fall upon in case of doubt.
- (ii) Ind AS 115 gives comprehensive guidance on how to recognise and measure multiple elements within a contract with customer. AS 7 and AS 9 do not provide comprehensive guidance on this aspect.
- (iii) AS 7 covers only revenue from construction contracts which is measured at consideration received/receivable. AS 9 deals only with recognition of revenue from sale of goods, rendering of services, interest, royalties and dividends. On the other hand, Ind AS 115 comprehensively deals with all types of performance obligation contract with customer. However, it does not deal with revenue from 'interest' and 'dividend' which is covered in financial instruments standard.
- (iv) As per AS 9, Revenue is the gross inflow of cash, receivables or other consideration arising in the course of the ordinary activities. Revenue is measured by the charges made to customers or clients for goods supplied and services rendered to them and by the charges and rewards arising from the use of resources by them. As per AS 7, revenue from construction contracts is measured at consideration received/receivable and to be recognised as revenue as construction progresses, if certain conditions are met. As per Ind AS 115, revenue is measured at transaction price, i.e., the amount of consideration to

which an entity expects to be entitled in exchange for transferring promised goods or services to a customer, excluding amounts collected on behalf of third parties.

- (v) As per AS 9, revenue is recognised when significant risks and rewards of ownership is transferred to the buyer. As per AS 7, revenue is recognised when the outcome of a construction contract can be estimated reliably, contract revenue should be recognised by reference to the stage of completion of the contract activity at the reporting date. As per Ind AS 115, revenue is recognised when the control is transferred to the customer.
- (vi) Ind AS 115 provides guidance on recognition of costs to obtain and fulfil a contract, as asset, whereas AS 7 and AS 9 do not deal with such capitalisation of costs.
- (vii) Ind AS 115 gives guidance on service concession arrangements and disclosures thereof. Existing standard does not provide such guidance.
- (viii) Ind AS 115 contains detailed disclosure requirements as compared to AS 9 and AS 7.