TOPIC 30

INDAS 115

REVENUE FROM CONTRACTS WITH CUSTOMERS

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Quote:- Look for something positive in every day,

even if some days you have to look a little harder.

What is the objective of INDAS 115?

INDAS 115 sets the principles to apply when reporting about:

- the nature;
- the amount;
- the timing; and
- the uncertainty

of revenue and cash flows from a contract with a customer.

Who is Customer?

If you have a contract with party other than a customer, then INDAS 115 does not apply.
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.
Sometimes, it's quite difficult to determine whether you deal with a customer or simply with a collaborating party (e.g. participation in an activity or process in which the parties to the contract share in the risks and benefits).

Non - Applicability:

There are some exclusions from INDAS - 115, namely:

- Leases (INDAS 17 or INDAS 16)
- Financial instruments and other rights and obligations within the scope of INDAS 109, INDAS 110, INDAS 111, INDAS 27, INDAS 28;
- Insurance contracts (INDAS 4) and
- Non-monetary exchanges between entities within the same business to facilitate sales. For example, this Standard would not apply to a contract between two oil companies that agree to an exchange of oil to fulfill demand from their customers in different specified locations on a timely basis.

Core Principle Of IndAS - 115

Ind AS 115 is based on a core principle that requires an entity to recognise revenue:

(a) In a manner that depicts the transfer of goods or services to customers

(b) At an amount that reflects the consideration the entity expects to be entitled to in exchange for those goods or services.

To achieve the core principle, an entity should apply the following Five-Step model

5 steps to recognize revenue under INDAS 115

(C. P. T. – A. R.)

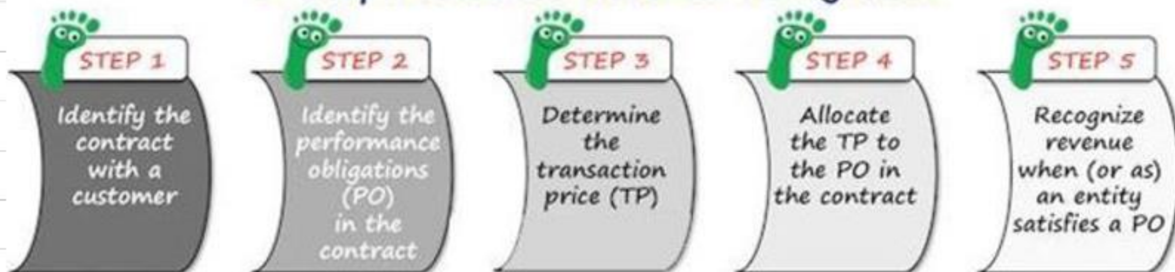
The main aim of INDAS 115 is to recognize revenue in a way that shows the transfer of goods/services promised to customers in an amount reflecting the expected consideration in return for those goods or services.

Well, because many situations are not straight forward and entities recognize revenues differently in these cases, for example:

- Buy 1+get 1 free;
- Buy monthly prepaid plan + get handset for free;
- Earn loyalty points and cash them out/receive free goods later on;
- Get bonuses for delivery on time; etc.

To make it systematic, INDAS 115 requires application of **5 step model for revenue recognition**.

The 5 steps are shown in the following picture:



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STEP - 1

IDENTIFY THE CONTRACT WITH THE CUSTOMER

A **contract** is an agreement between 2 parties that **creates enforceable rights and obligations**. Contracts can be written, oral, or implied by an entity's customary business practices. Enforceability is a matter of law, so an entity needs to consider the local relevant legal environment to make that determination.

You need to apply INDAS 115 to all contracts that have the following 5 Attributes:

1. Parties to the contract has **approved** it and are **committed** to perform;

This does not mean that the parties need to be committed to fulfill all of their respective rights and obligations in order for this criterion to be met.
For example, an entity may include a requirement in a contract for the customer to purchase a **minimum quantity** of goods each month, but the entity may have a history of not enforcing the requirement. In this example, the contract approval criterion can still be satisfied if evidence supports that the customer and the entity are both substantially committed to the contract.

2. Each party's **rights** to the goods/services transferred are identified;

I am going to teach u so my right is to collect fees and your rights are to attend my all lectures. I have identified the rights of mine and you.

3. The payment **terms** are identified;

How the payment will be made (online mode, in Cash or in Kind)?
What amount the customer is required to pay? (i.e. payment mode and amount)

4. The contract has a **commercial substance**; and

Suppose there is INTRA GROUP TRANSACTIONS at cost only then this transaction lacks commercial substance.
Without commercial substance, it is questionable whether an entity has entered into a transaction that has economic consequences.

5. It is **probable** that an entity will **collect the consideration** – here, you need to evaluate the customer's ability and intention to pay.

In determining whether collection is probable, the entity considers the customer's **ability and intention to pay** when amounts are due. In making the determination of customer's ability to pay, the credit risk was an important thing to determine if the contract is valid.

So, if the contract does not meet all 5 criteria, then we don't apply INDAS 115, but some other standard.

What if the step 1 is not passed, but the entity may still transfer goods or services to the customer and receive non-refundable consideration in exchange for those goods or services?

In that circumstance, the entity cannot recognise revenue for the non-refundable consideration received until either the Step 1 criteria are subsequently met, or one of the events outlined below 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 Combination

Contract combination happens when you need to account for **two or more contract with the same customer as for 1 contract and not separately** only when all following conditions are satisfied:

(a) The contracts are negotiated as a **package** with a single commercial objective;

(b) The amount of consideration paid in one contract **depends on the price or performance in the other contract**; or

(c) The goods or services promised in the contract are a **single performance obligation**.

Contract Modification

Contract modification is the change in the contract's scope, price or both. In other words, when you add certain goods or services, or you provide some additional discount, you are effectively dealing with the contract modification.

INDAS 115 sets different accounting methods for individual contract modification, depending on certain conditions.

Are both of the following true:-

- The scope of the contract increases because distinct promised goods or services are added to the contract
- The consideration increases by the standard alone selling price of the added goods or services.

Yes → Account for the modification as a separate contract

NO ↓

Are the remaining goods or services distinct from the goods or services transferred on or before the date of the contract modification?

Yes → Allocate the remaining transaction price not yet recognized to the outstanding performance obligation. In other words, treat as a termination of the old contract and the creation of a new contract

NO ↓

Are the remaining goods or services not distinct and , therefore, from part of a single performance obligation that is partially satisfied at the date of the contract modification?

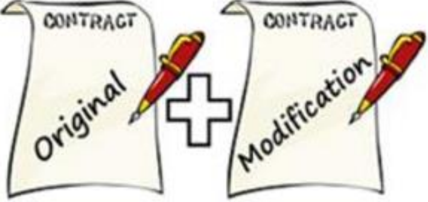
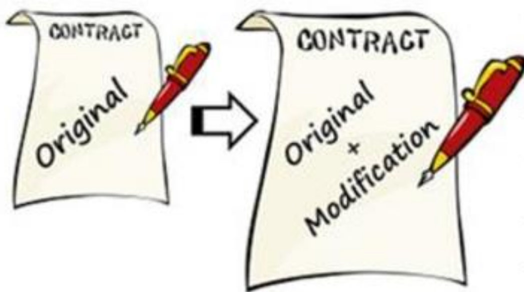
Yes → Account for the contract modification as if were a part of the existing contract- that is, the adjustment to revenue is made on a cumulative catch-up basis

NO ↓

Are some of the remaining goods or services distinct and other not distinct?

Yes → Follow the guidance above for distinct and non-distinct remaining goods or services

Contract modification

A separate contract	NOT a separate contract
	
✓ Additional goods/services distinct	✗ Additional goods/services NOT distinct, OR
✓ Consideration for add. goods/services reflects their stand-alone selling prices	✗ Consideration for add. goods/services DOES NOT reflect their stand-alone selling prices

Q413. ENFORCEABLE RIGHTS

A gymnasium enters into a contract with a new member to provide access to its gym for a 12-month period at Rs 4,500 per month. The member can cancel his or her membership without penalty after three months. Specify the contract term.

Solution

The enforceable rights and obligations of this contract are for three months, and therefore the contract term is three months.

Q414. COMBINATION OF CONTRACTS

Manufacturer of airplanes for the air force negotiates a contract to design and manufacture new fighter planes for a Kashmir air base. At the same meeting, the manufacturer enters into a separate contract to supply parts for existing planes at other bases. Would these contracts be combined?

Solution

Contracts were negotiated at the same time, but they appear to have separate commercial objectives. Manufacturing and supply contracts are not dependent on one another, and the planes and the parts are not a single performance obligation. Therefore, contracts for supply of fighter planes and supply of parts shall not be combined and instead, they shall be accounted separately.

Q415. MODIFICATION

An entity promises to sell 120 products to a customer for Rs 120,000 (Rs 1,000 per product). The products are transferred to the customer over a six-month period. The entity transfers control of each product at a point in time. After the entity has transferred control of 60 products to the customer, the contract is modified to require the delivery of an additional 30 products (a total of 150 identical products) to the customer at a price of Rs 950 per product which is the standalone selling price for such additional products at the time of placing this additional order. The additional 30 products were not included in the initial contract.

It is assumed that additional products are contracted for a price that reflects the stand-alone selling price.

Determine the accounting for the modified contract?

Solution

When the contract is modified, the price of the contract modification for the additional 30 products is an additional Rs 28,500 or Rs 950 per product. The pricing for the additional products reflects the stand-alone selling price of the products at the time of the contract modification and the additional products are distinct from the original products.

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Accordingly, the contract modification for the additional 30 products is, in effect, a new and separate contract for future products that does not affect the accounting for the existing contract and ₹ 950 per product for the 30 products in the new contract.

Q416: MODIFICATION

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 year for Rs 3,00,000 (Rs 1,00,00 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?

Answer:

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 standalone 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 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 relocate the remaining consideration to all the remaining service to be provided (i.e. the obligation 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.

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Q417 (Modification)

Growth Ltd enters into an arrangement with a customer for infrastructure outsourcing deal. Based on its experience, Growth Ltd determines that customising the infrastructure will take approximately 200 hours in total to complete the project and charges Rs 150 per hour. After incurring 100 hours of time, Growth Ltd and the customer agree to change an aspect of the project and increase the estimate of labour hours by 50 hours at the rate of Rs 100 per hour. Determine how contract modification will be accounted as per Ind AS 115?

Solution

Considering that the remaining goods or services are not distinct, the modification will be accounted for on a cumulative catch up basis, as given below:

Particulars	Hours	Rate (Rs)	Amount (Rs)
Initial contract amount	200	150	30,000
Modification in contract	50	100	5,000
Contract amount after modification	250	140*	35,000
Revenue to be recognised	100	140	14,000
Revenue already booked	100	150	15,000
Adjustment in revenue			(1,000)

*35,000/250 = 140

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STEP - 2

IDENTIFY THE PERFORMANCE OBLIGATIONS IN THE CONTRACT

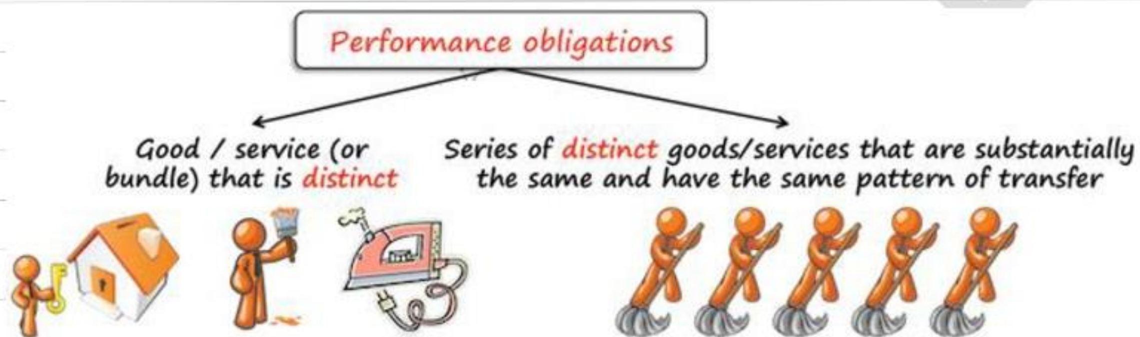
Identification of performance obligations requires high degree of judgment in cases where multiple goods or services are promised in a contract.

Also it needs to be determined whether those performance obligations should be accounted for separately or as in combination with other promised goods or services in the contract.

The timing of revenue recognition is based on satisfaction of performance obligations rather than the contract as a whole.

Performance obligation has been defined as a promise in a contract with a customer to transfer to the customer either:

- A single good or service, or their bundle that is distinct; or
- A series of distinct goods or services that are substantially the same and have the same pattern of transfer.



Performance obligations under a contract with the customer are not always explicit (e.g. written in the contract) or clearly mentioned in the contract, but there can be implied promises (e.g. implied by some customary practices) or performance obligation under the contract as well.

What is distinct?

Ind AS says that a good or a service is distinct if both of the following are met:

1. The good or service is capable of being distinct. It means that the customer can benefit from it either on its own or together with other available resources.
2. The good or service is distinct within the context of the contract. It means that the good or a service is separately identifiable from other promises in the contract.

Some Examples:

1. Developing & selling Software along with 1 year support services after the purchase. One year support services can also be provided individually - Yes support services are distint from Software development & selling.
2. Contract to build a house for customer and within the construction, we deliver everything: walls, roof, electricity installations etc.

   Each of these things meets the first criterion – it is capable of being distinct, because the customer can benefit from it on its own or with other available resources.

   For example: a roof.

   A customer cannot benefit from the roof on its own, but if the house is ready just without the roof, then yes, customer can buy the roof elsewhere and benefit from it.

   But, despite these items are capable of being distinct, they are NOT distinct in the context of the contract, because the contractor promised to deliver a combined output – a house.

An essential characteristic of a performance obligation is the word **"distinct". Simply said, distinct means separable, or separately identifiable,** and INDAS 115 sets criteria that you must assess in order to determine whether the performance obligation is distinct or not.

Also, if there's no transfer to customer, then there's no performance obligation. For example, imagine you construct a building for your client. Before you actually start, you build a small mobile toilet for your workers. As this will not be delivered to your customer, it is not a separate performance obligation.

Customer options for Additional Goods or Services

1. Retail and consumer products entities frequently give certain customers the option to purchase additional goods or services.
2. These options come in many forms, including sales incentives (e.g., coupons with a limited distribution, competitor price matching programs aimed at only some customers, gift cards issued by a retailer as a promotion) and customer award credits (e.g., loyalty or reward programs).
3. The standard states that when an entity grants a customer the option to acquire additional goods or services, **that option is only a separate performance obligation if it provides a material right to the customer.**

4. The right is material if it results in a discount that **the customer would not receive without entering into the contract** (e.g., a discount that exceeds the range of discounts typically given for those goods or services to that class of customer in that geographical area or market).
5. 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**.
6. If the discounted price in the option reflects the stand-alone selling price (separate from any existing relationship or contract), the entity is deemed to have made a marketing offer rather than having granted a material right.
7. In such 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.

Long Term Arrangements

- Entities frequently enter into arrangements to provide services on a long-term basis, such as maintenance services to be provided over a long period of time.
- For example, should a three-year maintenance agreement be considered a single performance obligation representing the entire contractual period, or should it be broken into smaller periods (daily, monthly or yearly)?
- It may be appropriate to treat a three-year services contract as three separate one-year performance obligations, if the contract can be renewed or cancelled by either party at discrete points in time (that is, at the end of each service year).

Q418 DISTINCT GOODS OR SERVICES

A construction services company enters into a contract with a customer to build a water purification plant. The company is responsible for all aspects of the plant including overall project management, engineering and design services, site preparation, physical construction of the plant, procurement of pumps and equipment for measuring and testing flow volumes and water quality, and the integration of all components.

Determine whether the company has a single or multiple performance obligations under the contract?

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Solution

Determining whether a good or service represents a performance obligation on its own or is required to be aggregated with other goods or services can have a significant impact on the timing of revenue recognition. In order to determine how many performance obligations are present in the contract, the company applies the guidance above. While the customer may be able to benefit from each promised good or service on its own (or together with other readily available resources), they do not appear to be separately identifiable within the context of the contract. That is, the promised goods and services are subject to significant integration, and as a result will be treated as a single performance obligation.

This is consistent with a view that the customer is primarily interested in acquiring a single asset (a water purification plant) rather than a collection of related components and services.

Q419

An entity provides broadband services to its customers along with voice call service. Customer buys modem from the entity. However, customer can also get the connection from the entity and modem from any other vendor. The installation activity requires limited effort and the cost involved is almost insignificant. It has various plans where it provides either broadband services or voice call services or both.

Are the performance obligations under the contract distinct?

Solution

Entity promises to customer to provide

- Broadband service
- Voice Call Service
- Modem

Entity's promise to provide goods and service is distinct if

- 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
- entity's promise to transfer the good or service to the customer is separately
- identifiable from other promises in the contract
- For broadband and voice call services –
- Broadband and voice services are separately identifiable from other promises as company has various plans to provide the two services separately. These two services are not dependent or interrelated. Also the customer can benefit on its own from the services received.

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For sale of modem-

- Customer can either buy product from entity or third party. No significant customisation or modification is required for selling product.
- Based on the evaluation we can say that there are three separate performance obligation:-
- Broadband service
- Voice Call Service
- Modem

Q420

An entity, a software developer, enters into a contract with a customer to transfer a software license, perform an installation service and provide unspecified software updates and technical support (online and telephone) for a two-year period. The entity sells the license, installation service and technical support separately. The installation service includes changing the web screen for each type of user (for example, marketing, inventory management and information technology). The installation service is routinely performed by other entities and does not significantly modify the software. The software remains functional without the updates and the technical support.

Determine how many performance obligations does the entity have?

Solution:-

The entity assesses the goods and services promised to the customer to determine which goods and services are distinct. The entity observes that the software is delivered before the other goods and services and remains functional without the updates and the technical support. Thus, the entity concludes that the customer can benefit from each of the goods and services either on their own or together with the other goods and services that are readily available.

The entity also considers the factors of Ind AS 115 and determines that the promise to transfer each good and service to the customer is separately identifiable from each of the other promises. In particular, the entity observes that the installation service does not significantly modify or customise the software itself and, as such, the software and the installation service are separate outputs promised by the entity instead of inputs used to produce a combined output.

On the basis of this assessment, the entity identifies four performance obligations in the contract for the following goods or services:

- The software license
- An installation service
- Software updates
- Technical support

Q421: Significant customization

The promised goods and services are the same as in the above Illustration, except that the contract specifies that, as part of the installation service, the software is to be substantially customised to add significant new functionality to enable the software to interface with other customised software applications used by the customer. The customised installation service can be provided by other entities.

Determine how many performance obligations does the entity have?

Solution

The entity assesses the goods and services promised to the customer to determine which goods and services are distinct. The entity observes that the terms of the contract result in a promise to provide a significant service of integrating the licensed software into the existing software system by performing a customised installation service as specified in the contract. In other words, the entity is using the license and the customised installation service as inputs to produce the combined output (i.e. a functional and integrated software system) specified in the contract. In addition, the software is significantly modified and customised by the service. Although the customised installation service can be provided by other entities, the entity determines that within the context of the contract, the promise to transfer the license is not separately identifiable from the customised installation service and, therefore, the criterion on the basis of the factors is not met. Thus, the software license and the customised installation service are not distinct.

The entity concludes that the software updates and technical support are distinct from the other promises in the contract. This is because the customer can benefit from the updates and technical support either on their own or together with the other goods and services that are readily available and because the promise to transfer the software updates and the technical support to the customer are separately identifiable from each of the other promises.

On the basis of this assessment, the entity identifies three performance obligations in the contract for the following goods or services:

a) customised installation service (that includes the software license);

b) software updates; and

c) Technical support.

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STEP - 3
DETERMINE THE TRANSACTION PRICE

Objective – To Predict the Total amount of Consideration to which the entity will be entitled from the Contract.

The **transaction price** is the amount of consideration than 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.

That's the definition from the standard and in other words, it's what you expect to **receive from your customer in return for your supplies.**

Attention – it's NOT always the price set in the contract. It is you expectation of what your receive.

It means that you need to **estimate the transaction price**. How?

First, you need to take the price stated in the contract as some basis (if applicable). Then, you need to take some items into account, such as:

- **Variable consideration** – are there some bonuses; discounts; rebates; credits; price concessions or incentives:, for example, performance bonus?
- **Constraining estimates in variable consideration** – you should include variable consideration (e.g. bonus) in the transaction price only when it's highly probable that a significant reversal in the amount of cumulative revenue recognised will not occur;
- **Significant financing component** – if your clients will pay you with delay, do the payments reflect the time value of money?
- **Non-cash consideration** – do you receive some non-cash items from your customer in return for your goods or services?
- **Consideration payable to a customer** – do you provide some vouchers or coupons to your customers?

Estimating the amount of variable consideration

An entity shall estimate an amount of variable consideration by using either of the following methods, depending on which method the entity expects to better predict the amount of consideration to which it will be entitled:

(a) **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.

(b) **The most likely amount** - the most likely amount is the single most likely amount in a range of possible consideration amounts (ie 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).

CASES	TREATMENT AS PER INDAS 115	REMARKS/EXAMPLES
Penalties	Where the penalty is inherent in determination of transaction price, it shall form part of variable consideration.	where an entity agrees to transfer control of a good or service in a contact with customer at the end of 30 days for ₹ 100,000 and if it exceeds 30 days, the entity is entitled to receive only ₹ 95,000, the reduction of ₹ 5,000 shall be regarded as variable consideration. In other cases, the transaction price shall be considered as fixed.
Refund Liabilities	An entity shall recognise a refund liability if the entity receives consideration from a customer and expects to refund some or all of that consideration to the customer.	The amount for which entity does not expect to be entitled.
Sale with Right of Return (other than consignment sale)	Recognise the following: (a) Revenue, for which entity is expected to be entitled (i.e. the amount which is not to be refunded) (b) A refund liability (c) An asset for its right	Exchanges by customers of one product for another of the same type, quality, condition and price (for example, one colour or size for another) are not considered returns for the purposes of applying this Standard.

	to recover products from customers on settling the refund liability.	
Service Type Warranties	Account this warranty as a separately performance obligation under IndAS 115 and allocate the transaction price to this PD also.	Customer has option to purchase separately or it provides something more i.e. some additional services beyond fixing the defeat.
Assurance type warranties (No additional services are provided)	Account for this warranty under IndAS 37	Is warranty required by Law? Yes This is assurance type warranty. Is this warranty for longer period than required by law? Yes It may be a Service Type Warranty.
Non Cash Consideration	Measure the consideration at Fair Value if possible. If Fair Value can-not be estimated reliably, then consideration is equal to the Stand alone selling price of goods & Services promised. **After contract inception if the fair value of non-cash consideration **varies because of its form,** then do not adjust the transaction price for any change in the fair value.	Example - Issuing shares or other equity instruments, or advertising or providing equipments.
Customer provided goods or services	The entity shall assess whether it obtains control of those contributed goods or	(for example, materials, equipment or labour)

	services. If so, the entity shall account for the contributed goods or services as non- cash consideration received from the customer.	
Consideration payable to customer against which entity receives distinct goods/services	Recognise purchase of goods/services separately, do not adjust revenue. If the consideration payable exceeds the fair value of goods/services received, the excess shall be reduced from transaction price.	
Consideration payable to Customer other than above (not in exchange of good/services)	Reduce it from Transaction Price	For Example - Cash Vouchers or Coupons

Q422.

An entity enters into a contract for the sale of Product A for Rs 1,000. As part of the contract, the entity gives the customer a 40% discount voucher for any future purchases up to Rs 1,000 in the next 30 days. The entity intends to offer a 10% discount on all sales during the next 30 days as part of a seasonal promotion. The 10% discount cannot be used in addition to the 40% discount voucher.

The entity believes there is 80% likelihood that a customer will redeem the voucher and on an average, a customer will purchase Rs. 500 of additional products.

Determine how many performance obligations does the entity have and their stand-alone

selling price and allocated transaction price?

Solution

Since all customers will receive a 10% discount on purchases during the next 30 days, the only additional discount that provides the customer with a material right is the incremental discount of 30% on the products purchased. The entity accounts for the promise to provide the incremental discount as a separate performance obligation in the contract for the sale of Product A.

The entity believes there is 80% likelihood that a customer will redeem the voucher and on an average, a customer will purchase Rs 500 of additional products. Consequently, the entity's estimated stand-alone selling price of the discount voucher is Rs 120 (Rs 500 average purchase price of additional products × 30% incremental discount × 80% likelihood of exercising the option). The stand-alone selling prices of Product A and the discount voucher and the resulting allocation of the Rs 1,000 transaction price are as follows:

Performance obligations	Stand-alone selling price
Product A	Rs 1000
Discount voucher	Rs 120
Total	Rs 1120

Performance obligations		Allocated transaction price (to nearest Rs 10)
Product A	(Rs 1000 ÷ Rs 1120 × Rs 1000)	Rs 890
Discount voucher	(Rs 120 ÷ Rs 1120 × Rs 1000)	Rs 110
Total		Rs 1000

The entity allocates Rs 890 to Product A and recognises revenue for Product A when control transfers. The entity allocates Rs 110 to the discount voucher and recognises revenue for the voucher when the customer redeems it for goods or services or when it expires.

Q423 – Right of return

An entity enters into 1,000 contracts with customers. Each contract includes the sale of one product for Rs 50 (1,000 total products × Rs 50 = Rs 50,000 total consideration). Cash is received when control of a product transfers. The entity's customary business practice is to allow a customer to return any unused product within 30 days and receive a full refund. The entity's cost of each product is Rs 30.

Since the contract allows a customer to return the products, the consideration received from the customer is variable. To estimate the variable consideration to which the entity will be entitled, the entity decides to use the expected value method (see paragraph 53(a) of Ind AS 115) because it is the method that the entity expects to better predict the amount of consideration to which it will be entitled. Using the expected value method, the entity estimates that 970 products will not be returned.

The entity estimates that the costs of recovering the products will be immaterial and expects that the returned products can be resold at a profit.

Determine the amount of revenue, refund liability and the asset to be recognised by the entity for the said contracts.

Solution

The entity also considers the requirements in paragraphs 56–58 of Ind AS 115 on constraining estimates of variable consideration to determine whether the estimated amount of variable consideration of Rs 48,500 (Rs 50 × 970 products not expected to be returned) can be included in the transaction price. The entity considers the factors in paragraph 57 of Ind AS 115 and determines that although the returns are outside the entity's influence, it has significant experience in estimating returns for this product and customer class. In addition, the uncertainty will be resolved within a short time frame (ie the 30-day return period). Thus, the entity concludes that it is highly probable that a significant reversal in the cumulative amount of revenue recognised (i.e. Rs 48,500) will not occur as the uncertainty is resolved (i.e. over the return period).

The entity estimates that the costs of recovering the products will be immaterial and expects that the returned products can be resold at a profit.

Upon transfer of control of the 1,000 products, the entity does not recognise revenue for the 30 products that it expects to be returned. Consequently, in accordance with paragraphs 55 and B21 of Ind AS 115, the entity recognises the following:

(a) revenue of Rs 48,500 (Rs 50 × 970 products not expected to be returned);

(b) a refund liability of Rs 1,500 (₹ 50 refund × 30 products expected to be returned); and

(c) An asset of Rs 900 (Rs 30 × 30 products for its right to recover products from customers on settling the refund liability).

COVID-19

Q424. Entitlement to non-cash consideration

An entity enters into a contract with a customer to provide a weekly service for one year. The contract is signed on 1st April 20X1 and work begins immediately. The entity concludes that the service is a single performance obligation. This is because the entity is providing a series of distinct services that are substantially the same and have the same pattern of transfer (the services transfer to the customer over time and use the same method to measure progress — that is, a time-based measure of progress).

In exchange for the service, the customer promises its 100 equity shares per week of service (a total of 5,200 shares for the contract). The terms in the contract require that the shares must be paid upon the successful completion of each week of service.

How should the entity decide the transaction price?

Solution

The entity measures its progress towards complete satisfaction of the performance obligation as each week of service is complete. To determine the transaction price (and the amount of revenue to be recognised), the entity has to measure the fair value of 100 shares that are received upon completion of each weekly service. The entity shall not reflect any subsequent changes in the fair value of the shares received (or receivable) in revenue.

Q425. Customer-provided goods or services

MS Limited is a manufacturer of cars. It has a supplier of steering systems – SK Limited. MS Limited places an order of 10,000 steering systems on SK Limited. It also agrees to pay Rs 25,000 per steering system and contributes tooling to be used in SK's production process.

The tooling has a fair value of Rs 2 crores at contract inception. SK Limited determines that each steering system represents a single performance obligation and that control of the steering system transfers to MS Limited upon delivery.

SK Limited may use the tooling for other projects and determines that it obtains control of the tooling. Determine the transaction price?

Solution

As a result, at contract inception, SK Limited includes the fair value of the tooling in the transaction price at contract inception, which it determines to be Rs 27 crores (Rs 25 crores for the steering systems and Rs 2 crores for the tooling).

Q426. Consideration payable to a customer

An entity that manufactures consumer goods enters into a one-year contract to sell goods to a customer that is a large global chain of retail stores. The customer commits to buy at least Rs 15 crores of products during the year. The contract also requires the entity to make a non-refundable payment of Rs 1.5 crores to the customer at the inception of the contract. The Rs 1.5 crores payment will compensate the customer for the changes it needs to make to its shelving to accommodate the entity's products. The entity does not obtain control of any rights to the customer's shelves. Determine the transaction price.

Solution

The entity considers the requirements in paragraphs 70 – 72 of Ind AS 115 and concludes that the payment to the customer is not in exchange for a distinct good or service that transfers to the entity. This is because the entity does not obtain control of any rights to the customer's shelves. Consequently, the entity determines that, in accordance with paragraph 70 of Ind AS 115, the Rs 1.5 crores payment is a reduction of the transaction price. The entity applies the requirements in paragraph 72 of Ind AS 115 and concludes that the consideration payable is accounted for as a reduction in the transaction price when the entity recognises revenue for the transfer of the goods. Consequently, as the entity transfers goods to the customer, the entity reduces the transaction price for each good by 10 per cent [(Rs 1.5 crores ÷ Rs 15 crores) x 100]. Therefore, in the first month in which the entity transfers goods to the customer, the entity recognises revenue of Rs 1.125 crores (Rs 1.25 crores invoiced amount less Rs 0.125 crore of consideration payable to the customer).

Q427. Estimating variable consideration

XYZ Limited enters into a contract with a customer to build a sophisticated machinery. The promise to transfer the asset is a performance obligation that is satisfied over time. The promised consideration is ₹ 2.5 crores, but that amount will be reduced or increased depending on the timing of completion of the asset. Specifically, for each day after 31 March 20X1 that the asset is incomplete, the promised consideration is reduced by ₹ 1 lakh. For each day before 31 March 20X1 that the asset is complete, the promised consideration increases by Rs 1 lakh.

In addition, upon completion of the asset, a third party will inspect the asset and assign a rating based on metrics that are defined in the contract. If the asset receives a specified rating, the entity will be entitled to an incentive bonus of Rs 15 lakhs.

Determine the transaction price.

COVID-19

Solution

In determining the transaction price, the entity prepares a separate estimate for each element of variable consideration to which the entity will be entitled using the estimation methods described in paragraph 53 of Ind AS 115:

a) The entity decides to use the expected value method to estimate the variable consideration associated with the daily penalty or incentive (i.e. ₹ 2.5 crores, plus or minus Rs 1 lakh per day). This is because it is the method that the entity expects to better predict the amount of consideration to which it will be entitled.

b) The entity decides to use the most likely amount to estimate the variable consideration associated with the incentive bonus. This is because there are only two possible outcomes (Rs 15 lakhs or Rs Nil) and it is the method that the entity expects to better predict the amount of consideration to which it will be entitled.

The entity considers the requirements in paragraphs 56–58 of Ind AS 115 (discussed below) on constraining estimates of variable consideration to determine whether the XYZ Limited should include some or its entire estimate of variable consideration in the transaction price.

Q428. Estimating variable consideration

AST Limited enters into a contract with a customer to build a manufacturing facility. The entity determines that the contract contains one performance obligation satisfied over time. Construction is scheduled to be completed by the end of the 36th month for an agreed-upon price of Rs 25 crores. The entity has the opportunity to earn a performance bonus for early completion as follows:

- 15 percent bonus of the contract price if completed by the 30th month (25% likelihood)
- 10 percent bonus if completed by the 32nd month (40% likelihood)
- 5 percent bonus if completed by the 34th month (15% likelihood)

In addition to the potential performance bonus for early completion, AST Limited is entitled to a quality bonus of Rs 2 crores if a health and safety inspector assigns the facility a gold star rating as defined by the agency in the terms of the contract. AST Limited concludes that it is 60% likely that it will receive the quality bonus.

Determine the transaction price.

Solution

In determining the transaction price, AST Limited separately estimates variable consideration for each element of variability ie the early completion bonus and the quality bonus.

AST Limited decides to use the expected value method to estimate the variable consideration associated with the early completion bonus because there is a range of possible outcomes

and the entity has experience with a large number of similar contracts that provide a reasonable basis to predict future outcomes. Therefore, the entity expects this method to best predict the amount of variable consideration associated with the early completion bonus. AST's best estimate of the early completion bonus is ₹ 2.13 crores, calculated as shown in the following table:

Bonus %	Amount of bonus (Rs in crores)	Probability	Probability-weighted amount (Rs in crores)
15%	3.75	25%	0.9375
10%	2.50	40%	1.00
5%	1.25	15%	0.1875
0%	-	20%	-
			2.125

AST Limited decides to use the most likely amount to estimate the variable consideration associated with the potential quality bonus because there are only two possible outcomes (Rs 2 crores or Rs Nil) and this method would best predict the amount of consideration associated with the quality bonus. AST Limited believes the most likely amount of the quality bonus is Rs 2 crores.

Q429. Volume discount incentive

HT Limited enters into a contract with a customer on 1 April 20X1 to sell Product X for Rs 1,000 per unit. If the customer purchases more than 100 units of Product A in a financial year, the contract specifies that the price per unit is retrospectively reduced to Rs 900 per unit. Consequently, the consideration in the contract is variable.

For the first quarter ended 30 June 20X1, the entity sells 10 units of Product A to the customer. The entity estimates that the customer's purchases will not exceed the 100 unit threshold required for the volume discount in the financial year. HT Limited determines that it has significant experience with this product and with the purchasing pattern of the customer. Thus, HT Limited concludes that it is highly probable that a significant reversal in the cumulative amount of revenue recognised (i.e. Rs 1,000 per unit) will not occur when the uncertainty is resolved (i.e. when the total amount of purchases is known).

Further, in May 20X1, the customer acquires another company and in the second quarter ended 30 September 20X1 the entity sells an additional 50 units of Product A to the customer. In the light of the new fact, the entity estimates that the customer's purchases will exceed the 100 unit threshold for the financial year and therefore it will be required to retrospectively reduce the price per unit to Rs 900. Determine the amount of revenue to be recognise by HT Ltd. for the quarter ended 30 June 20X1 and 30 September 20X1.

Solution

The entity recognises revenue of Rs 10,000 (10 units × Rs 1,000 per unit) for the quarter ended 30 June 20X1.

HT Limited recognises revenue of Rs 44,000 for the quarter ended 30 September 20X1. That amount is calculated from Rs 45,000 for the sale of 500 units (50 units × Rs 900 per unit) less the change in transaction price of Rs 1,000 (10 units × Rs 100 price reduction) for the reduction of revenue relating to units sold for the quarter ended 30 June 20X1.

Q430. Accounting for significant financing component

NKT Limited sells a product to a customer for Rs 121,000 that is payable 24 months after delivery. The customer obtains control of the product at contract inception. The contract permits the customer to return the product within 90 days. The product is new and the entity has no relevant historical evidence of product returns or other available market evidence.

The cash selling price of the product is Rs 100,000 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 entity's cost of the product is Rs 80,000. The contract includes an implicit interest rate of 10 per cent (i.e. the interest rate that over 24 months discounts the promised consideration of Rs 121,000 to the cash selling price of Rs 100,000). Analyse the above transaction with respect to its financing component.

Solution

The contract includes a significant financing component. This is evident from the difference between the amount of promised consideration of Rs 121,000 and the cash selling price of Rs 100,000 at the date that the goods are transferred to the customer.

The contract includes an implicit interest rate of 10 per cent (i.e. the interest rate that over 24 months discounts the promised consideration of Rs 121,000 to the cash selling price of Rs 100,000). The entity evaluates the rate and concludes that it is commensurate with the rate that would be reflected in a separate financing transaction between the entity and its customer at contract inception.

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

Q431. Determining the discount rate

VT Limited enters into a contract with a customer to sell equipment. Control of the equipment transfers to the customer when the contract is signed. The price stated in the contract is Rs 1 crore plus a 10% contractual rate of interest, payable in 60 monthly instalments of Rs 212,470. Determine the discounting rate and the transaction price when

Case A—Contractual discount rate reflects the rate in a separate financing transaction

Case B—Contractual discount rate does not reflect the rate in a separate financing transaction ie 14%.

Solution

Case A—Contractual discount rate reflects the rate in a separate financing transaction

In evaluating the discount rate in the contract that contains a significant financing component, VT Limited observes that the 10% contractual rate of interest reflects the rate that would be used in a separate financing transaction between the entity and its customer at contract inception (i.e. the contractual rate of interest of 10% reflects the credit characteristics of the customer).

The market terms of the financing mean that the cash selling price of the equipment is Rs 1 crore. This amount is recognised as revenue and as a loan receivable when control of the equipment transfers to the customer. The entity accounts for the receivable in accordance with Ind AS 109.

Case B—Contractual discount rate does not reflect the rate in a separate financing transaction

In evaluating the discount rate in the contract that contains a significant financing component, the entity observes that the 10% contractual rate of interest is significantly lower than the 14% interest rate that would be used in a separate financing transaction between the entity and its customer at contract inception (i.e. the contractual rate of interest of 10% does not reflect the credit characteristics of the customer). This suggests that the cash selling price is less than Rs 1 crore.

VT Limited determines the transaction price by adjusting the promised amount of consideration to reflect the contractual payments using the 14% interest rate that reflects the credit characteristics of the customer. Consequently, the entity determines that the transaction price is ₹ 9,131,346 (60 monthly payments of Rs 212,470 discounted at 14%). The entity recognises revenue and a loan receivable for that amount. The entity accounts for the loan receivable in accordance with Ind AS 109.

Q432. Advance payment

A computer hardware vendor enters into a three-year arrangement with a customer to provide support services. For customers with low credit ratings, the vendor requires the customer to pay for the entire arrangement in advance of the provision of service. Other customers pay over time. Analyse whether there is any significant financing component in the contract or not.

Solution

Due to this customer's credit rating, the customer pays in advance for the three-year term. Because there is no difference between the amount of promised consideration and the cash selling price (that is, the customer does not receive a discount for paying in advance), the vendor requires payment in advance only to protect against customer non-payment, and no other factors exist to suggest the arrangement contains a financing, the vendor concludes this contract does not provide the customer or the entity with a significant benefit of financing.

Student Notes :-

COVID -19

STEP - 4
Allocate the Transaction Price to the Performance Obligations

Once you have identified the contract's performace obligations and determined the transaction price, you need to split the transaction price and allocate it to the individual performance obligations.

The general rule is to do it ***based on their relative stand-alone selling prices***, but there are 2 exceptions when you allocate in a different way:

1. When allocating discounts, and
2. When allocating considerations with variable amounts.

How to identify Stand-alone Selling Price?

A ***stand-alone selling price*** is a price at which an entity would sell a promised good or a service separately to the customer (not in the bundle).

The best way to determine a stand-alone selling price is simply to ***take observable selling prices*** and if these are not available (for example entity does not sell the goods/services separately), then we need to ***estimate them***.

INDAS 115 suggest a few methods for estimating stand-alone selling prices -

ADJUSTED MARKET ASSESSMENT APPROACH	• Evaluate the Market • Estimate the Price that a Customer would be willing to pay for those goods/services • Entity may refer competitors' price for similar goods/services and adjusting with own Costs & Margin
EXPECTED COST PLUS MARKET APPROACH	• Forecast its expected costs of satisfying a performance obligation • Then add an appropriate margin for that Good or Service
RESIDUAL APPROACH	An Entity may estimate the stand alone selling price by reference to a) The total Transaction price, less b) The sum of the observable stand-alone selling prices of other goods or services promised in the contract

EXEPTION TO ALLOCATION BY REFERENCE TO STAND-ALONE SELLING PRICE:

(A) Allocation of a Discount

- A customer receives a discount for purchasing a bundle of goods or services
- Since the sum of the stand-alone selling prices of those promised goods or services in the contract exceeds the promised consideration in a contract
- The entity shall allocate a discount proportionately to all performance obligations in the contract.

(B) Allocation of variable consideration

Variable consideration may be attributable to

(1) The entire contract

For example, a contract may include two performance obligations: the construction of a building and the provision of services related to the ongoing maintenance of the property after construction. But a bonus for early completion may relate entirely to the construction of the building;

OR

(2) A specific part of the contract

For example, one or more, but not all, distinct goods or services promised in a series of distinct goods or services that forms part of a single performance obligation (for example, the consideration promised for the second year of a two-year cleaning service contract will increase on the basis of movements in a specified inflation index).

Q433. Allocating a discount

An entity regularly sells Products X, Y and Z individually, thereby establishing the following stand-alone selling prices:

Product	Stand-alone selling price
	Rs
Product X	50,000
Product Y	25,000
Product Z	45,000
Total	1,20,000

In addition, the entity regularly sells Products Y and Z together for Rs 50,000.

Case A—Allocating a discount to one or more performance obligations

The entity enters into a contract with a customer to sell Products X, Y and Z in exchange for Rs 100,000. The entity will satisfy the performance obligations for each of the products at different points in time; or Product Y and Z at same point of time. Determine the allocation of transaction price to Product Y and Z.

Case B—Residual approach is appropriate

The entity enters into a contract with a customer to sell Products X, Y and Z as described in Case A. The contract also includes a promise to transfer Product Alpha. Total consideration in the contract is Rs 130,000. The stand-alone selling price for Product Alpha is highly variable because the entity sells Product Alpha to different customers for a broad range of amounts (Rs 15,000 – Rs 45,000). Determine the stand-alone selling price of Products, X, Y, Z and Alpha using the residual approach.

Case C—Residual approach is inappropriate

The same facts as in Case B apply to Case C except the transaction price is Rs 1,05,000 instead of Rs 130,000.

Solution

Case A—Allocating a discount to one or more performance obligations

The contract includes a discount of Rs 20,000 on the overall transaction, which would be allocated proportionately to all three performance obligations when allocating the transaction price using the relative stand-alone selling price method.

However, because the entity regularly sells Products Y and Z together for ₹ 50,000 and Product X for Rs 50,000, it has evidence that the entire discount should be allocated to the promises to transfer Products Y and Z in accordance with paragraph 82 of Ind AS 115.

If the entity transfers control of Products Y and Z at the same point in time, then the entity could, as a practical matter, account for the transfer of those products as a single performance obligation. That is, the entity could allocate Rs 50,000 of the transaction price to the single performance obligation and recognise revenue of Rs 50,000 when Products Y and Z simultaneously transfer to the customer.

If the contract requires the entity to transfer control of Products Y and Z at different points in time, then the allocated amount of Rs 50,000 is individually allocated to the promises to transfer Product Y (stand-alone selling price of Rs 25,000) and Product Z (stand-alone selling price of Rs 45,000) as follows:

Product	Allocated transaction price	
	Rs	
Product Y	17,857	(Rs 25,000 ÷ Rs 70,000 total stand-alone selling price × Rs 50,000)
Product Z	32,143	(Rs 45,000 ÷ Rs 70,000 total stand-alone selling price × Rs 50,000)
Total	50,000	

Case B—Residual approach is appropriate

Before estimating the stand-alone selling price of Product Alpha using the residual approach, the entity determines whether any discount should be allocated to the other performance obligations in the contract.

As in Case A, because the entity regularly sells Products Y and Z together for Rs 50,000 and Product X for Rs 50,000, it has observable evidence that Rs 100,000 should be allocated to those three products and a Rs 20,000 discount should be allocated to the promises to transfer Products Y and Z in accordance with paragraph 82 of Ind AS 115.

Using the residual approach, the entity estimates the stand-alone selling price of Product Alpha to be Rs 30,000 as follows:

Product	Stand-alone selling price	Method
	Rs	
Product X	50,000	Directly observable
Products Y and Z	50,000	Directly observable with discount
Product Alpha	30,000	Residual approach
Total	130,000	

The entity observes that the resulting Rs 30,000 allocated to Product Alpha is within the range of its observable selling prices (Rs 15,000 – Rs 45,000).

Case C—Residual approach is inappropriate

The same facts as in Case B apply to Case C except the transaction price is Rs 105,000 instead of Rs 130,000. Consequently, the application of the residual approach would result in a stand-alone selling price of Rs 5,000 for Product Alpha (Rs 105,000 transaction price less Rs 100,000 allocated to Products X, Y and Z).

The entity concludes that Rs 5,000 would not faithfully depict the amount of consideration to which the entity expects to be entitled in exchange for satisfying its performance obligation to transfer Product Alpha, because Rs 5,000 does not approximate the stand-alone selling price of Product Alpha, which ranges from Rs 15,000 – Rs 45,000.
Consequently, the entity reviews its observable data, including sales and margin reports, to estimate the stand-alone selling price of Product Alpha using another suitable method. The entity allocates the transaction price of Rs 1,05,000 to Products X, Y, Z and Alpha using the relative stand-alone selling prices of those products in accordance with paragraphs 73–80 of Ind AS 115.

Q434. Allocating a change in transaction price

On 1 April 20X0, a consultant enters into an arrangement to provide due diligence, valuation, and software implementation services to a customer for Rs 2 crores. The consultant can earn Rs 20 lakhs bonus if it completes the software implementation by 30 September 20X0 or Rs 10 lakhs bonus if it completes the software implementation by 31 December 20X0.

The due diligence, valuation, and software implementation services are distinct and therefore are accounted for as separate performance obligations. The consultant allocates the transaction price, disregarding the potential bonus, on a relative stand-alone selling price basis as follows:

- Due diligence – Rs 80 lakhs
- Valuation – Rs 20 lakhs
- Software implementation – Rs 1 crore

At contract inception, the consultant believes it will complete the software implementation by 30 January 20X1. After considering the factors in Ind AS 115, the consultant cannot conclude that a significant reversal in the cumulative amount of revenue recognized would not occur when the uncertainty is resolved since the consultant lacks experience in completing similar projects. As a result, the consultant does not include the amount of the early completion bonus in its estimated transaction price at contract inception.

On 1 July 20X0, the consultant notes that the project has progressed better than expected and believes that implementation will be completed by 30 September 20X0 based on a revised forecast. As a result, the consultant updates its estimated transaction price to reflect a bonus of Rs 20 lakhs.

After reviewing its progress as of 1 July 20X0, the consultant determines that it is 100 percent complete in satisfying its performance obligations for due diligence and valuation and 60 percent complete in satisfying its performance obligation for software implementation.

Determine the transaction price.

Solution

On 1 July 20X0, the consultant allocates the bonus of Rs 20 lakhs to the software implementation performance obligation, for total consideration of Rs 1.2 crores allocated to that performance obligation, and adjusts the cumulative revenue to date for the software implementation services to Rs 72 lakhs (60 percent of Rs 1.2 crores).

Student Notes:-

COVID -19

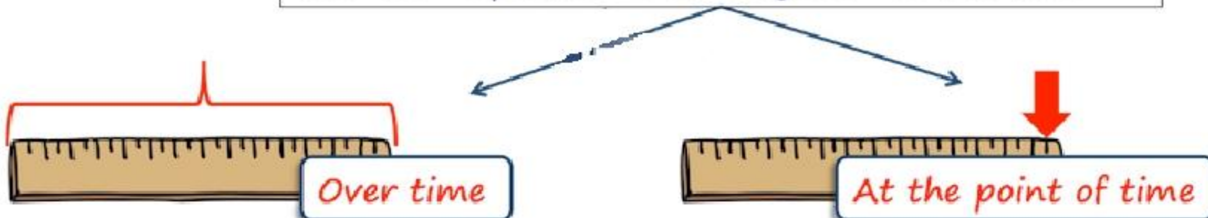
STEP - 5

RECOGNIZE REVENUE WHEN (OR AS) THE ENTITY SATISFIES A PERFORMANCE OBLIGATION

A performance obligation is satisfied (and revenue is recognized) when a ***promised good or service is transferred to a customer***. This happens when ***control*** is passed.

A performance obligation can be satisfied either:

- ***Over time*** – in this case, control is passed to the customer over some period of time (e.g. contract term); or
- ***At the point of time*** – in this case, control is retained by the supplier until it is transferred at some moment



Control of an asset means - The ability to prevent other entities from directing the use of, and obtaining the benefits from, an asset.

(A) Transfer of control over a period of time:

As Per 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 **any** of the following criteria is met:

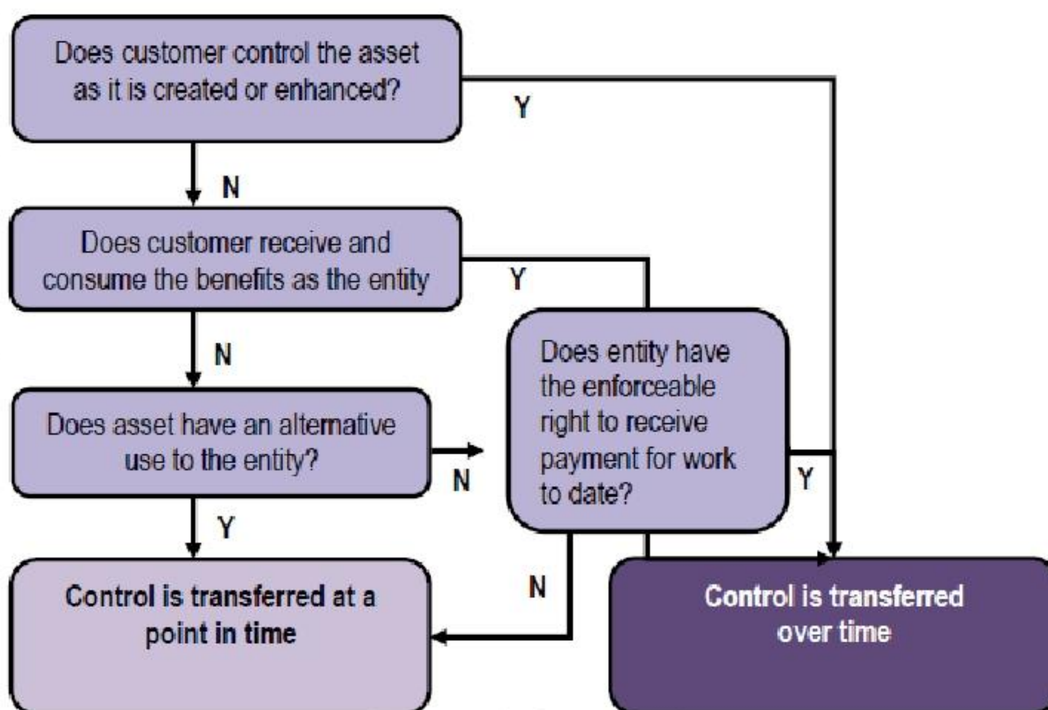
Criteria (a) – The customer simultaneously receives and consumes the benefits provided by the entity's performance as the entity performs;

Or

Criteria (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

Or

Criteria (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.*



Methods of measuring progress of a performance obligation satisfied over time

Output Methods	***Input 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.	*Recognise revenue on the basis of the* ***entity's efforts or inputs*** *to the satisfaction of a performance obligation.*
For Example: *Surveys of performance completed to date, appraisals of results achieved or Units Produced or delivered.*	***For Example:*** *Resources consumed labour hours expended, costs incurred, time elapsed or machine hours used*

(B) Transfer of control at a point in time:

Where a company does not meet any of the aforementioned criteria for recognising revenue over a period of time, then revenue shall be recognised at a point in time.

The following is an indicative list of indicators which may exist, to imply the point of time at which control of goods has been passed to the customer. This is not an exhaustive list and there may be more factors that may be considered to determine the point of time at which revenue shall be recognised:

INDICATORS	EVALUATIONS
The entity has a present right to payment	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.
The customer has a 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. 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.
The customer has 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 the asset. 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.
The customer has assumed significant risks & rewards of owning the asset	Transfer of risks & rewards for an asset may indicate that the customer has the ability to direct the use of and obtain substantially all of the benefits from the asset. 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.
The customer has accepted the asset	Customer acceptance clauses allow a customer to cancel a contract or require an entity to take remedial action if a good or service does not meet agreed-upon specifications. An entity shall consider such clauses when evaluating when a customer obtains control of a good or service. If an entity can objectively determine that control of a good or service has been transferred to the customer in accordance with the agreed-upon specifications in the contract, then customer acceptance is a formality that would not affect the entity's determination of when the customer has obtained control of the good or service. However, if an entity cannot objectively determine that the good or service provided to the customer is in accordance with the agreed-upon specifications in the contract, then the entity would not be able to conclude that the customer has obtained control until the entity receives the customer's acceptance.

Q435.

Space Ltd. enters into an arrangement with a government agency for construction of a space satellite. Although Space Ltd is in this business for building such satellites for various customers across the world, however the specifications for each satellite may vary based on technology that is incorporated in the satellite. In the event of termination, Company has right to enforce payment for work completed to date.

Evaluate if contract will qualify for satisfaction of performance obligation over a period of time.

Solution

While evaluating the pattern of transfer of control to the customer, the Company shall evaluate conditions laid in para 35 of Ind AS 115 as follows:

- Criterion (a) – whether the customer simultaneously receives and consumes the benefits: Customer can benefit only when the satellite is fully constructed and no benefits are consumed as its constructed. Hence, this criterion is not met.

- Criterion (b) – An asset created that customer controls: Per provided facts, the customer does not acquire control of the asset as its created.
- Criterion (c) – no alternate use to entity and right to seek payment:
  - The asset is being specifically created for the customer. The asset is customised to customer's requirements, such that any diversion for a different customer will require significant work. Therefore, the asset has practical limitation in being put to alternate use.
  - Further, Space Ltd.has a right to enforce payment if contract was early terminated, for reasons other than Space Ltd.'s failure to perform.

Therefore, criterion (c) is met and such performance obligation is said to be met over a period of time.

Q436. Uninstalled materials

Particulars	Amount (Rs)
Transaction price	50,00,000
Expected costs:	
(a) Elevators	15,00,000
(b) Other costs	25,00,000
Total	40,00,000

On 01 January 20X1, an entity contracts to renovate a building including the installation of new elevators. The entity estimates the following with respect to the contract:

The entity purchases the elevators and they are delivered to the site six months before they will be installed. The entity uses an input method based on cost to measure progress towards completion. The entity has incurred actual other costs of 500,000 by March 31, 20X1.
How will the Company recognize revenue, if performance obligation is met over a period of time?

Solution

Costs to be incurred comprise two major components – elevators and cost of construction service.

(a) The elevators are part of the overall construction project and are not a distinct performance obligation

(b) The cost of elevators is substantial to the overall project and are incurred well in advance.

(c) Upon delivery at site, customer acquires control of such elevators.

(d) And there is no modification done to the elevators, which the company only procures and delivers at site. Nevertheless, as part of materials used in overall construction project, the company is a principal in the transaction with the customer for such elevators also.

Therefore, applying the guidance on Input method –

- The measure of progress should be made based on percentage of costs incurred relative to the total budgeted costs.
- The cost of elevators should be excluded when measuring such progress and revenue for such elevators should be recognized to the extent of costs incurred.

The revenue to be recognized is measured as follows:

Particulars	Amount (Rs)
Transaction price	5,000,000
Costs incurred:	
(a) Cost of elevators	1,500,000
(b) Other costs	500,000
Measure of progress:	500,000 / 2,500,000 = 20%
Revenue to be recognised:	
(a) For costs incurred (other than elevators)	Total attributable revenue = 3,500,000 % of work completed = 20% Revenue to be recognised = 700,000
(b) Revenue for elevators	1,500,000 (equal to costs incurred)
Total revenue to be recognised	1,500,000 + 700,000 = 2,200,000

Therefore, for the year ended 31 March 20X1, the Company shall recognize revenue of ₹ 2,200,000 on the project.

Except for these 5 steps, INDAS 115 arranges a few other areas, such as...

Principal vs Agent Consideration

Indicators that an entity is a principal (and therefore controls the good or service before it is provided to a customer) include the following:

- *The entity is primarily responsible for fulfilling the contract. This typically includes responsibility for the acceptability of the specified good or service;*
- *The entity has inventory risk before the specified good or service has been transferred to a customer or after transfer of control to the customer (for example, if the customer has a right of return).*
- *The entity has discretion in establishing prices for the goods or services;*

When the entity is the principal in the arrangement, the revenue recognised is the gross amount to which the entity expects to be entitled.

When the entity is acting as an agent, the revenue recognised is the net amount i.e. the amount, entity is entitled to retain in return for its services under the contract. The entity's fee or commission may 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.

Q437.

An entity negotiates with major airlines to purchase tickets at reduced rates compared with the price of tickets sold directly by the airlines to the public. The entity agrees to buy a specific number of tickets and will pay for those tickets even if it is not able to resell them. The reduced rate paid by the entity for each ticket purchased is negotiated and agreed in advance. The entity determines the prices at which the airline tickets will be sold to its customers. The entity sells the tickets and collects the consideration from customers when the tickets are purchased; therefore, there is no credit risk. The entity also assists the customers in resolving complaints with the service provided by airlines. However, each airline is responsible for fulfilling obligations associated with the ticket, including remedies to a customer for dissatisfaction with the service.

Determine whether the entity is a principal or an agent.

Solution

To determine whether the entity's performance obligation is to provide the specified goods or services itself (i.e. the entity is a principal) or to arrange for another party to provide those goods or services (i.e. the entity is an agent), the entity considers the nature of its promise. The entity determines that its promise is to provide the customer with a ticket, which provides the right to fly on the specified flight or another flight if the specified flight is changed or cancelled. The entity considers the following indicators for assessment as principal or agent under the contract with the customers:

(a) The entity is primarily responsible for fulfilling the contract, which is providing the right to fly. However, the entity is not responsible for providing the flight itself, which will be provided by the airline.

(b) The entity has inventory risk for the tickets because they are purchased before they are sold to the entity's customers and the entity is exposed to any loss as a result of not being able to sell the tickets for more than the entity's cost.

(c) The entity has discretion in setting the sales prices for tickets to its customers.

The entity concludes that its promise is to provide a ticket (i.e. a right to fly) to the customer. On the basis of the indicators, the entity concludes that it controls the ticket before it is transferred to the customer. Thus, the entity concludes that it is a principal in the transaction and recognises revenue in the gross amount of consideration to which it is entitled in exchange for the tickets transferred.

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 OR similar asset.

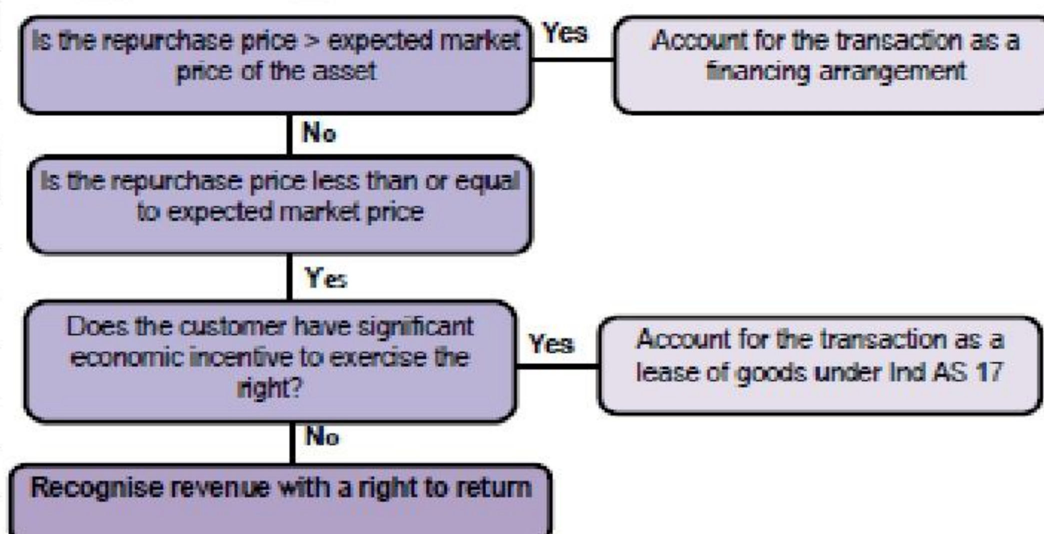
Repurchase agreement may be :

(a) A Put option - may has right to sell the asset

(b) A Call option or Forward option - Entity retains Control to repurchase

CALL OPTION OR FORWARD OPTION	PUT OPTION
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	**(A) PRICE LOWER THAN ORIGINAL SALE** If an entity has an obligation to repurchase the asset at the customer's request (a put option) at

though the customer may have physical possession of the asset. *Therefore this contrant shall be accounted by entity as either:* • *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; or* • *A financing arrangement, 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.*	*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, the entity shall account for the agreement as a lease in accordance with Ind AS 17* **(B) PRICE GREATER THAN ORIGINAL SALE** *If the repurchase price is equal to or greater than original selling price and more than the expected market value of the asset, the contract is in effect a financing arrangement.* *In this case, the entity shall account for the agreement as if it* ***were the sale of a product with a right of return****.*



Q438.

An entity enters into a contract with a customer for the sale of a tangible asset on 1 January 20X1 for ₹ 1 million. The contract includes a call option that gives the entity the right to repurchase the asset for Rs 1.1 million on or before December 31, 20X1.

How would the entity account for this transaction?

Solution

In the above case, where the entity has a right to call back the goods upto a certain date–

- The customer cannot be said to have acquired control, owing to the repurchase right with the seller entity
- Since the original selling price (Rs 1 million) is lower than the repurchase price (Rs 1.1 million), this is construed to be a financing arrangement and accounted as follows:
  (a) Amount received shall be recognized as 'liability'
  (b) Difference between sale price and repurchase price to be recognised as 'finance cost' and recognised over the repurchase term.

Q439.

An entity enters into a contract with a customer for the sale of a tangible asset on 1 January 20X1 for Rs 1,000,000. The contract includes a put option that gives the customer the right to sell the asset for Rs 900,000 on or before December 31, 20X1. The market price for such goods is expected to be Rs 750,000

How would the entity account for this transaction?

Solution

In the above case, where the entity has an obligation to buy back the goods upto a certain date–

- The entity shall evaluate if the customer has a significant economic incentive to return the goods. Since the repurchase price is significantly higher than market price, therefore, customer has a significant economic incentive to return the goods. There are no other factors which entity may affect this assessment.
- Therefore, company determines that 'control' of goods is not transferred to the customer till 31 December 20X1, ie, till the put option expires.
- Against payment of RS 1,000,000; the customer only has a right to use the asset and put it back to the entity for Rs 900,000. Therefore, this will be accounted as a lease transaction in which difference between original selling price (ie, Rs 1,000,000) and repurchase price (ie, Rs 900,000) shall be recognized as lease income over the period of lease.

- At the end of repurchase term, ie, 31 December 20X1, if the customer does not exercise such right, then the control of goods would be passed to the customer at that time and revenue shall be recognized for sale of goods for repurchase price (ie, Rs 900,000).

Bill-and-Hold

A bill-and-hold arrangement is a contract under which an entity bills a customer for a product but the entity 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 arrangements, the entity shall determine at which point does control transfer to the customer.

In some cases, 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). While in other cases, a customer may obtain control of a product even though that product remains in an entity's physical possession. In that case, the customer has the ability to direct the use of, and obtain substantially all of the remaining benefits from, the product even though it has decided not to exercise its right to take physical possession of that product. Consequently, the entity does not control the product. Instead, the entity provides custodial services to the customer over the customer's asset.

CONTRACT COSTS

INCREAMENTAL COSTS OF OBTAINING A CONTRACT (Also called Contract Acquisition Cost)	COSTS TO FULFILL A CONTRACT (Also called Contract Fulfillment Costs)
If such costs are **expected to be recovered** from the Customers then **recognise as an Asset** and Amortise. 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**. **Regardless of whether the contract is obtained**, Incremental costs, if incurred shall be recognised as an **Expense**. (Unless those cost are **explicitly chargeable to the customer** regardless of whether the contract is obtained) However, any incremental costs of obtaining the contract shall be recognised as an **expense if the amortisation period of the asset is one year or less.**	If costs incurred in fulfilling a contract with a customer are covered under another Standard (such as Ind AS 2 'Inventory', Ind AS 16 'Property, Plant, and Equipment' and Ind AS 38 'Intangible Assets'), an entity accounts for those costs in accordance with those Standards. If not, an entity **recognises an asset** for such costs, provided all of the criteria mentioned below are met: **(a)** the costs relate directly to a contract or to an anticipated contract that the entity can specifically identify (for example, costs of designing an asset to be transferred under a specific contract that has not yet been approved), including: (i) direct labour (ii) direct materials (iii) allocations that relate directly to the contract or contract activities (for example, contract management and supervision costs and depreciation of tools and equipment used in fulfilling the contract) (iv) costs that are explicitly chargeable to the customer (v) other costs that the entity incurs only because it entered into the contract (e.g. payments to subcontractors) **(b)** the costs generate or enhance resources of the entity that will be used to satisfy performance obligations in the future. **(c)** the entity expects to recover the costs, for e.g. through the expected margin.

	The following costs should be expensed as incurred: (a) general and administrative costs that are not explicitly chargeable to the customer (b) costs of wasted materials, labour, or other resources that were not reflected in the contract price (c) costs that relate to satisfied performance obligations

Cost	Capitalize or expense	Reason
Commission paid only upon successful signing of a contract	Capitalize	Assuming the entity expects to recover the cost, the commission is incremental since it would not have been paid if the parties decided not to enter into the arrangement just before signing.
Travel expenses for sales persons pitching a new client contract	Expense	Because the costs are incurred regardless of whether the new contract is won or lost, the entity expenses the costs, unless they are expressly reimbursable.
Legal fees for drafting terms of arrangement for parties to approve and sign	Expense	If the parties walk away during negotiations, the costs would still be incurred and therefore are not incremental costs of obtaining the contract.
Salaries for sales people working exclusively on obtaining new clients	Expense	The salaries are incurred regardless of whether contracts are won or lost and therefore are not incremental costs to obtain the contract.
Bonus based on quarterly sales target	Capitalize	Bonuses based solely on sales are incremental costs to obtain a contracts.
Commission paid to sales manager based on contracts obtained by the sales manager's local employees	Capitalize	The commissions are incremental costs that would not have been incurred had the entity not obtained the contract. Ind AS 115 does not differentiate costs based on the function or title of the employee that receives the commission.

AMORTISATION AND IMPAIRMENT OF COST

Under Ind AS 115, an entity amortises capitalised contract costs on a systematic basis consistent with the pattern of transferring the goods or services related to those costs.

If an entity identifies a significant change to the expected pattern of transfer, it updates its amortisation to reflect that change in estimate in accordance with Ind AS 8.

An entity recognises an impairment loss in earnings if the carrying amount of an asset exceeds the remaining amount of consideration that the entity expects to receive in connection with the related goods or services less any directly related contract costs yet to be recognised. When determining the amount of consideration it expects to receive, an entity ignores the constraint on variable consideration previously discussed, and adjusts for the effects of the customer's credit risk.

Before recognising an impairment loss under the revenue recognition guidance, an entity recognises impairment losses associated with assets related to the contract that are accounted in accordance with another Standard (for example, Ind AS 2, Ind AS 16 and Ind AS 38).
An entity would reverse a previously recognised impairment loss when the impairment conditions no longer exist or have improved. The increased carrying amount of the asset shall not exceed the amount that would have been determined (net of amortisation) if no impairment loss had been recognised previously.

Costs incurred in fulfilling a contract with a customer that are within the scope of another Standard, an entity shall account for those costs in accordance with those other Standards.

Q440.

Customer outsources its information technology data centre
Term = 5 years plus two 1-yr renewal options
Average customer relationship is 7 years
Entity spends Rs 400,000 designing and building the technology platform needed to accommodate out-sourcing contract:

Design service	Rs 50,000
Hardware	Rs 1,40,000
Software	Rs 1,00,000
Migration and testing of data center	Rs 1,10,000
Total	**Rs 4,00,000**

How should such costs be treated?

Solution

Design services	Rs 50,000	Assess under Ind AS 115. Any resulting asset would be amortised over 7 years (i.e. include renewals)
Hardware	Rs 140,000	Account for asset under Ind AS 16
Software	Rs 100,000	Account for asset under Ind AS 38
Migration and testing of data centre	Rs 110,000	Assess under Ind AS 115. Any resulting asset would be amortised over 7 years (i.e. include renewals)
TOTAL	Rs 400,000	

Q441. Amortisation

An entity enters into a service contract with a customer and incurs incremental costs to obtain the contract and costs to fulfil the contract. These costs are capitalised as assets in accordance with Ind AS 115. The initial term of the contract is five years but it can be renewed for subsequent one-year periods up to a maximum of 10 years. The average contract term for similar contracts entered into by entity is seven years.

Determine appropriate method of amortisation?

Solution

The most appropriate amortisation period is likely to be seven years (i.e. the initial term of five years plus two anticipated one year renewals) because that is the period over which the entity expects to provide services under the contract to which the capitalised costs relate.

SERVICE CONCESSION ARRANGEMENTS

About SCA	Service Concession Arrangement involves a private sector entity (an operator) constructing the infrastructure used to provide the public service or upgrading it (for example, by increasing its capacity) and operating and maintaining that infrastructure for a specified period of time. The operator is paid for its services over the period of the arrangement. Such an arrangement is often described as a 'build-operate-transfer', a 'rehabilitate-operate-transfer' or a 'public-to-private' service concession arrangement.
Treatment of Infrastructure Right for Operator	Infrastructure shall not be recognised as property, plant and equipment of the operator because the contractual service arrangement does not convey the right to control the use of the public service infrastructure

	to the operator.
How to recognise revenue in the books of Operator	Since the operator acts as a service provider, he shall recognise and measure revenue in accordance with Ind AS 115 for the services it performs. The nature of the consideration i.e. whether financial asset or intangible asset determines its subsequent accounting treatment. If the operator provides construction or upgrade services the consideration received or receivable by the operator shall be recognized at its fair value. The consideration may be rights to: (a) a financial asset, or (b) an intangible asset.
When Financial Asset?	The operator has an unconditional contractual right to receive cash or another financial asset from or at the direction of the grantor for the construction services and apply IndAS 109, 32 & 107 accordingly
When Intangible Assets?	The operator shall recognise an intangible asset to the extent that it receives a right (a licence) to charge users of the public service. A right to charge users of the public service is not an unconditional right to receive cash because the amounts are contingent on the extent that the public uses the service and apply IndAS 38 accordingly.

Q442.

A Ltd. is in the business of the infrastructure and has two divisions under the same; (I) Toll Roads and (II) Wind Power. The brief details of these business and underlying project details are as follows:

I. Bhilwara-Jabalpur Toll Project - The Company has commenced the construction of the project in the current year and has incurred total expenses aggregating to ₹ 50 crores as on 31st December, 20X1. Under IGAAP, the Company has 'recorded such expenses as Intangible Assets in the books of account. The brief details of the Concession Agreement are as follows:

- Total Expenses estimated to be incurred on the project ₹ 100 crores;
- Fair Value of the construction services is ₹ 110 crores;
- Total Cash Flow guaranteed by the Government under the concession agreement is ₹ 200 crores;
- Finance revenue over the period of operation phase is ₹ 15 crores:
- Other income relates to the services provided during the operation phase.

II. Kolhapur- Nagpur Expressway - The Company has also entered into another concession agreement with Government of Maharashtra in the current year. The construction cost for the said project will be ₹ 110 crores. The fair value of such construction cost is approximately ₹ 200 crores. The said concession agreement is Toll based project and the Company needs to collect the toll from the users of the expressway. Under IGAAP, UK Ltd. has recorded the expenses incurred on the said project as an Intangible Asset.

Required

(i) What would be the classification of Bhilwara-Jabalpur Toll Project as per applicable Ind AS? Give brief reasoning for your choice.

(ii) What would be the classification of Kolhapur-Nagpur Expressway Toll Project as per applicable Ind AS? Give brief reasoning for your choice.

(iii) Also, suggest suitable accounting treatment for preparation of financial statements as per Ind AS for the above 2 projects.

Solution

(i) Here the operator has a contractual right to receive cash from the grantor. The grantor has little, if any, discretion to avoid payment, usually because the agreement is enforceable by law. The operator has an unconditional right to receive cash if the grantor contractually guarantees to pay the operator. Hence, operator recognizes a financial asset to the extent it has a contractual right to receive cash.

(ii) Here the operator has a contractual right to charge users of the public services. A right to charge users of the public service is not an unconditional right to receive cash because the amounts are contingent on the extent that the public uses the service. Therefore, the operator shall recognise an intangible asset to the extent it receives a right (a licence) to charge users of the public service.

(iii) **Accounting treatment for preparation of financial statements**

Bhilwara-Jabalpur Toll Project

Journal Entries

	Particulars	Dr. (Rs in crores)	Cr. (Rs in crores)
During construction:			
1	Financial asset A/c Dr.	110	
To Construction revenue [To recognise revenue relating to construction services, to be settled in case]			110
2	Cost of construction (profit or loss) Dr.	100	
To Bank A/c (As and when incurred) [To recognise costs relating to construction services]			100
During the operation phase:			

3	Financial asset Dr.	15	
To Finance revenue (As and when received or due to receive) [To recognise interest income under the financial asset model]			15
4	Financial asset Dr.	75	
To Revenue [(200-110) – 15] [To recognise revenue relating to the operation phase]			75
5	Bank A/c Dr.	200	
To Financial asset [To recognise cash received from the grantor]			200

Kolhapur-Nagpur Expressway -Intangible asset

Journal Entries

Particulars		Dr. (Rs in crores)	Cr. (Rs in crores)
During construction:			
1	Cost of construction (profit or loss) Dr.	110	
To Bank A/c (As and when incurred) [To recognise costs relating to construction services]			110
To Bank A/c (As and when incurred) [To recognise costs relating to construction services]			110
2	Intangible asset Dr.	200	
To Revenue [To recognise revenue relating to construction services provided for non-cash consideration]			200
During the operation phase:			
3	Amortisation expense Dr.	200	
To Intangible asset (accumulated amortisation) [To recognise amortisation expense relating to the operation phase over the period of operation]			200
4	Bank A/c Dr.	?	
To Revenue [To recognise revenue relating to the operation phase]			?

Note: Amount in entry 4 is kept blank as no information in this regard is given in the question.

When and how to implement INDAS 115

Ind AS 115 is effective for annual reporting periods beginning on or after 1 April 2018.
Be careful, because you should present **comparative figures**, too – so in practice, you need to present the results for the periods starting on 1 January 2017, too.
As the requirements of INDAS 115 are very extensive and demanding, INDAS 115 permits 2 methods of adoption:

(a) **Full retrospective adoption** Under this approach, you need to apply INDAS 115 fully to all prior reporting periods, with some exceptions.

(b) **Modified retrospective adoption** Under this approach, comparative figures remain as they were reported under the previous standards and you recognize the cumulative effect of INDAS 115 adoption as a one-off adjustment to the opening equity at the initial application date.

INDAS 115 also prescribes some presentation rules, necessary disclosures and provides further guidance in the specific circumstances in the implementation guidance.

CARVE OUT IN IND AS 115 FROM IFRS 15

As per IFRS

IFRS 15 provides that all types of penalties which may be levied in the performance of a contract should be considered in the nature of variable consideration for recognising revenue.

Carve out

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.

Q443. (Exam – May19 – 5 Marks)

Orange Ltd. contracts to renovate a five star hotel cludIng the 5 installation of new elevators on 01.10.2017. Orange Ltd. estimates the transaction price of Rs 480 lakh. The expected cost of elevators is Rs 144 lakh and expected other cost is
Rs 240 lakh. Orange Ltd. purchases elevators and they are delivered to the site six months before they will be installed. Orange Ltd. uses an input method based on cost to measure progress towards completion. The entity has incurred actual other costs of Rs 48 lakh by 31.03.2018.

How much revenue will be recognised as per relevant Ind AS for the year ended 31 March, 2018, if performance obligation is met over a period of time?

Solution:

COVID-19

Student Notes:-

COVID-19

Student Notes:-

COVID-19