Ind AS 115
Revenue form Contracts with Customers

CONCEPT 1: OBJECTIVE

The objective of the standard is to establish principles regarding revenue recognition – it includes

- Nature, amount, timing and uncertainty of revenue recognitions; and
- Cash flows arising from a contract with a customer.

This Standard specifies the accounting for **an individual contract** with a customer.
An entity can apply this for a portfolio of contracts when

- Contracts have similar characteristics; and

CONCEPT 2: SCOPE

This Standard **applies to ALL CONTRACTS** with customers, except the following.

(a) Revenue from lease contracts (discussed in Ind AS 17- Leases);

(b) Revenue from Insurance contracts which are covered by Ind AS 104 – Insurance Contracts;

(c) Financial instruments and other contractual rights or obligations within the scope of Ind AS 109, Financial Instruments, Ind AS 110, consolidated Financial Statements, Ind AS 111, Joint Arrangements, Ind AS 27, Separate Financial Statement and Ind AS 28, Investments in Associated and Joint Ventures; and

(d) Non- monetary exchanges between entities in the **same line of business** to facilitate sale to customers or potential customers.

For example, this Standard would not apply to a contract between two oil companies that agree to an **exchange of oil** (Exchanging same items is **not called as barter)** to fulfill demand from their customers in different specified locations on a timely basis. As the items exchanged are same, there is no commercial substance – hence it will not treated as transaction.

Example

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

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

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

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

CONCEPT 3: DEFINITIONS

This standard is applicable ONLY to the contracts with customers. It means if it is a contract with **other hen** customer- this standard is NOT applicable and the entity needs to refer other relevant standard for those transactions.

Let us understand what are meanings of contracts & customers.

What is a contract?

Contract is an **agreement** between two or more parties that **creates ENFORMCEALBE rights and obligations.** The contract can be **written, oral or as per other customary business practices.**

Enforceability of the rights and obligations in a contract is matter of law.

Who is a customer?

A Party that has **contracted** (entered into an agreement) with an entity **to obtain goods or services for consideration** These goods or services are an output of the entity's **ordinary activities.**

Management needs to identify whether the counterparty to the contract is customer, since contract that are not with customer are outside the scope of the revenue standard.

Based on this, Dividends- counterparty is not customer (it is shareholder) (Dealt by Ind AS 109), Contributions/ Donations and increase in far value of biological assets (Ind AS 41), investment property (Ind AS 40), etc. are scoped OUT of this standard.

What is Income?

Income is increaser in inflows or enhancements of assets **or** decreases of liabilities that **result in an increase in equity,** other than those relating to contributions from equity participants. (Refer chapter – Framework for detailed discussion)

This definition is broad – It includes all kinds of income I.e. Profit on sale of Property, Plant and equipment (PPE), Profit on sale on investments , revaluation gain, extinguishment of debt, revenue from sale of goods or services etc, it includes profit and gains. It includes realised and unrealised.

What is Revenue?

Revenue is an income arising in the course of an entity's ordinary activities:

It is **subset of income.** It arises from **sale of goods or rendering of services** as part of an entity's ongoing **major on central activities** i.e. ordinary activities. Transactions that do not arise in the course of an entity's ordinary activities do not result in revenue. For example, from the disposal of the entity's PPE are not included in revenue.

EXAMPLE

A car dealer makes one of the cars as test drive car (demonstration cars') These cars are used for more than one year and then sold as used cars The dealership sells new and used cars. Whether the sale of test drive car is considered as revenue **or** gain from sale of PPE?

Suggested answer

The car dealership is in the business of selling new and used cars. The sale of demonstration cars is therefore revenue, since selling used cars is part of the dealership's ordinary activities.

When a car is classified as test drive car - it should be classified as PPE as its cost. It should be depreciated as usual as per Ind AS 16. When the management intends to sell it in the ordinary course of business, the same car should be reclassified as inventory i.e. it should be reclassified as its carrying amount. The sale of such car should be recongised as Revenue i.e. sale of goods –as the Car dealer's primary business is selling new and used cars. Say if the entity decides to sell its used "Laptop – PPE – It cannot be treated as revenue as sale of laptops is not its ordinary activity.

CONCEPT 4: RECOGNITION & MEASUREMENT

The entire recognition process can be divided into **five steps.** Those are.

Step 1: Identifying the contracts with the customer;

Step 2: Identify the separate performance obligations;

Step 3: Determine the transaction Price;

Step 4: Allocate the transaction price to the performance obligation;

Step 5: Recognise revenue when performance obligation is satisfied.

Learning each step is very important. Read slowly and revise it a t least once before going to the next step

Step 1: Identifying the contracts with the customer;

This Standard is applicable only when a contract meets ALL the following condition:

1. The contract has been approved by the parties to the contract **and** are **committed** to perform the obligations:

2. The entity can **identify each party's rights** regarding the goods or services to be transferred;
3. The entity can **identify the payment terms;**
4. The contract has **commercial substance** (i.e. the <u>risk,</u> <u>timing</u> or <u>amount</u> of the entity s future cash flows is <u>expected to change</u> as a result of the contract); and
5. It is **probable** that entity **will collect the consideration** due. For determining collectability, consider the ability and intention of the customer when it becomes due.

<u>QUESTION 1 (Collection of Consideration)</u>

New way limited decides to enter a new market that is currently experiencing economic difficulty and expects that in future economy will improve. New way enters into an arrangement with a customer in the new region for networking products for promised consideration of ₹ 1,250,000. At contract inception, New way expects that is may be able to collect the full amount from the customer,

Determine how New way will recognise this transaction?

<u>Solution</u>

Assuming the contract meets the other criteria covered within the scope of the model in Ind AS 115, New way need to assesses whether collectability is probable.

In making this assessment, New way considers whether the customer has the ability and intent to pay the estimated transaction price, which may be an amount less than the contract price.

QUESTION 2 (ENFORCEABLE RIGHTS)

A company provides free trial services for two months to encourage the customers for non-cancellable paid services for a year. Does it need to recognise revenue during the free period?

Solution

No. As per the conditions. parties should approve the contract and they should be committed to perform their respective obligations. During the free trial period the parties are not committed, hence the entity should not recognise the revenue during this period if the customer signs a non-cancellable agreement for 12 months.

QUESTION 3 (ENFORCEABLE RIGHTS)

Continuation to the above concept capsule

If customer sings the agreement one month before expiring free trial. Can the entity recognize revenue for 13 months?

Suggested answer

No, Revenue will be recognized still for 12 months.

COMBINATION OF CONTRACT

An entity shall combine two or more contracts entered into **at** or **near the same time** with the same **customer** (or related parties of the customer) and account for the contracts as a single contract if one or more of the following criteria are met:

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

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

(c) The goods or services promises in the contracts (or some goods or services promises in each of the contracts) are a single performance obligation discusses below.

QUESTION 4 (COMBINATION OF CONTRACT)

Government of Andhra Pradesh invited tenders for construction of roads in five routes. All five routes are to be awarded to one contractor as a package price. Tender should be submitted with estimations of all routes. Rama Constructions Ltd got the contract. Can we combine these contracts as a single contract and account for?

solution

Based on the given information, it can be understood that it is negotiated as a single package and contractor doesn't have an option to select the routes. So the company should select the entire contract based on overall profit margin. Hence it is appropriate to treat all five routes as single construction contract for accounting purposes. Submission of estimations for each route does not change the single commercial objective.

QUESTION 5 (COMBINATION OF CONTRACTS)

Mr. Bhargav is a construction contractor undertakes constructions of Villas. He undertook a contract to construct 25 villas from a real estate company, Each villa is different in its specifications, hence has separate proposal of each unit to be constructed and subject to separate negotiations. He was able to identify the costs and revenue attributable to each unit. Should he each unit as a separate contract **or** consider all villas as a single contract for accounting revenue under Ind AS 115?

Suggested answer

As per Ind AS 115, contracts shall be combined if the contracts satisfy any one more conditions discussed above.

In the given case,-

(a) the contracts are not negotiated as a package;

(b) Consideration of one contract is no dependent on performance or price of another;

(c) each one has a separate performance obligations.

As none of the conditions are satisfied – the entity cannot combine the contracts.

QUESTION 6 (COMBINATION OF CONTRACTS)

Manufacture 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 manufacture 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.

DURATION OF CONTRACT

QUESTION 7 (TERMINATION OF CONTRACT)

A gymnasium enters into a contract with a new member to provide access to its gym for a 12-month period at ₹ 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 obligation of this contract are for three months, and therefore the contract term is three months.

QUESTION 8 (TERMINATION OF CONTRACTS)

A party has unilateral right to terminate the entire wholly unperformed contract. Will it be considered as contract as per Ind AS 115.

Solution

The standard considers that there is NO contract when the parties have the right to terminate the unperformed contract. A contract is wholly unperformed if both of the following criteria are met:

(a) the entity has not yet transferred any promised goods or services to the customer; and

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

QUESTION 9 (TERMINATION OF CONTRACT)

A maintenance service provider enters into a contract with a customer to provide monthly services for a three- year period. Customer can terminate the contract at the end of any month for any reason without compensating other party (that is, there is no penalty for terminating the contract early.) What is the contract term in this case?

Solution

The contract should be treated as a month-to-month contract the three-year stated term. It means contract period is one month. The parties do not have enforceable rights and obligations beyond the month.

QUESTION 10 (TERMINATION OF CONTRACT)

Continuation to the above concept capsule
If the contract can be terminated only by paying penalty ? What would be contract period?

Solution
The answer depends on the substantive i.e. materiality of the penalty amount. If it is a substantive amount, it automatically creates enforceable rights and obligation for the three years of the contract. Then contract period is 3 years. If the penalty amount is nominal – it will be treated as month on month contract as discusses in the above concept capsule.

MODIFICATIONS

A contract modification is **Change in the scope or price** (or both) of a contract that is **(approved)** by the parties to the contract.

A modification should be approved by the parties in writing, by oral agreement or implied by customary business practices. If the modification is not approved, the entity should account only the existing contract as per this Ind AS.

Such modification may be accounted as a separate contract or modification to the existing contract. This depends on the facts and circumstances of each case.

An entity shall account for a **contract modification as a separate contract,** if both the conditions are satisfied

a) Modification leads to addition of goods or services which **distinct** from existing contract; and
b) It is priced at their **stand alone selling prices;**

What is "Stand alone selling price"?
It is a price at which an entity would sell a promised good or service separately to a customer. **For example,** an entity might provide a discount to a **recurring customer** that is would not provide to new customers. The objective is to determine whether the pricing reflects the amount that the entity would have negotiated independent of other existing contracts.

If the goods or services are prices at a discount to the stand-alone selling price, management will need to evaluate the reason for the discount, because this might be an indicator the new contract is modification of the existing contract.

QUESTION 11 (MODIFICATION OF CONTRACTS)

An entity promises to sell 120 products to a customer for ₹ 120,000 (₹ 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 ₹ 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 ₹ 28,500 or ₹ 950 per product. The pricing for the additional products reflects the stand-alone selling price or the products at the time of the contract modification and the additional products are distinct from the original products.

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.

QUESTION 12 (MODIFICATION OF CONTRACTS)

On 1 April, 20X1, KLC Ltd. enters into a contract with Mr. K to provide

- A machine for ₹ 2.5 million
- One year of maintenance services for ₹ 55,000 per month

On 1 October 20X1, KLC Ltd. and Mr. K agree to modify the contract to reduce the amount of services from ₹ 55,000 per month to 45,000 per month.
Determine the effect of change in the contract?

QUESTION 13(MODIFICATION OF CONTRACTS)

Growth Ltd enters into an arrangement with a customer for infrastructure outsourcing deal. Based on its experience, Growth Ltd determines that customizing the infrastructure will take approximately 200 hours in total to complete the project and charges ₹ 150 per hour. After incurring 100 hours of time Growth Ltd and the customer agree to change an aspect of the project and increases the estimate of labour hours by 50 hours at the rate of ₹ 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 (₹)	Amount(₹)
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 recognized	100	140	14,000
Revenue already booked	100	150	15,000
Adjustment in revenue			(1,000)

*35,000/250=140

QUESTION 14 (MODIFICATIONS)

Anju Ltd. Provides accounting services. It enters into a 3-year service with customer for ₹ 6,00,000 (Rs.2,00,000 per year) is the SSP for the service at inception, At the end of the second year the parties agree to modify the contract as follows: (1) the fees for the third year is reduced by ₹ 90,000 and (2) the contract is extended for another 3 year of ₹ 7,50,000 per year(₹ 2,50,000 per year). The SSP of the services at the of modification is ₹ 2,30,000. How should this modification be accounted for?

Solution

The modification is accounted for prospectively; as if the existing arrangement is terminated and a new contract is entered into Anju Ltd. should reallocated the remaining services to be provided. Anju Ltd. will recognise a total of ₹ 8,60,000 (₹,7,50,000+ ₹,1,10,000)over the remaining 4 years' service period (One year remaining under the original contract plus three additional years), or ₹ 2,15,000 per year.

QUESTION 15

Anju Ltd. provides accounting services. It enters into a 2-year service contract with customer for ₹ 6,00,000 (₹ 3,00,000 per year) is the SSP for the service at inception AT the end first year, both the parties agree that the fees should be ₹ 3,50,000 per year for the years because the volumes were much larger than larger than expected. How should this modification be accounted for?

solution

In the given case, services are not distinct and only transaction price is increasing – Hence the entity should recognise ₹ 50,000 as cumulative catch up adjustment i.e. recorded immediately, as soon as the modification is approved by the customer.

Step 2: Identifying the PERFORMING OBLIGATION

Question: What is performance obligation?

Answer: Performance obligation **is promise in a contract** to transfer to the customer either:

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

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

Once the contract has been identified, an entity needs to evaluate the terms and customary business practices to identify the promised goods or services which need to be accounted as performance obligation.

Question: When should performance obligation be identified?

Answer: At contract **inception itself-** an entity should identify what are the goods or services to be delivered as per the contract.

Question: When can we say goods or services are distinct?

Answer: Goods or services that are promised to a customer are distinct if both conditions are met:

(a) the **customer can benefit** from the good or service either on its own or together with other resources that are readily available to the customer; and

(b) the entity's promise to transfer the good or service to the customer is separately identifiable other promises in the contract.

Example: In case of IT Hardware Company sells printers and laptops that compatible with each other and compatible with other laptops and printers available in the market. The company would consider the printer and laptop as separate performance obligation under the contract, as it can sell the laptop and the printer independently.

QUESTION 16

A software developer enters into a contract with a customer to transfer a software license, perform installation and provide software updated and technical support for five years. He sells the license, installation, updates and technical support separately to other customers. How many performance obligations exist in this contract?

Suggested answer

As understood, a contract may have one or more performance obligations. Performance obligation is a promise to transfer a distinct goods services to the customer.

Goods or services are distinct if they are separately identifiable and customer can get benefit from the goods or service with on its own or together with other resources that the customer has.

In the given case, goods are separately identifiable because the developer is selling separately to other customers. Delivery of software is different from installation, updates and support and it works without updates and technical support. So we can say that the customer gets the benefit from each goods or services on its own.

On this basis, we can conclude this contract has the four following performance obligations:

- Software license;
- Installation service;
- Software updates;
- Technical support.

QUESTION 17

Continuation to the above concept capsule

What would be your answer if installation services are critical to produce customized software required by the customer?

Suggested answer

In that situation, there are only performance obligations i.e. software and installation services will be treated as one performance obligation as the installation services significantly modify and customize the software.

QUESTION 18

A customer approaches a contractor to design and build a house for him. For this purpose, the contractor will have to provide different services such as designing, site preparation, electrical, plumbing, civil work and carpentry. The contractor also provides these services individually to other customers also. So what are the performance obligations in the contract?

Suggested answer

In the given context, all the components will be treated as one single performance obligation because the contractor provides a significant service of integrating the various goods and services into a home. The customer has contracted to purchase the home rather than the individual services that make up the home. Another way of looking at this is, when goods or services are highly dependent or interrelated with each other, they would constitute a single performance obligation.

QUESTION 19

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 single or multiple performance obligations under the contract?

Solution

Determining whether a good or service represents a performance obligation or its own or is required to 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 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 or related components and services.

QUESTION 20

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 services or both.
Are the performance obligations under the contract distinct?

Solution

Entity promises to customer to provide

- ❖ Broadband Service
- ❖ Voice Call services
- ❖ Modem

Entity's promise to provide goods and services 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.

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 services
- Modem

QUESTION 21

Could the series requirement apply to hotel management services where day to day activities vary, involve employee management, procurement, accounting, etc?

Solution

The series guidance requires each distinct good or service to be “substantially the same” Management should evaluate this requirement based on the nature of its promise to customer For example, a promise to provide hotel management services for a specified contract term may meet the series criteria. This is because the entity is providing the same service of “hotel management” each period, even though some on underlying activities may vary each day. The underlying activities for e.g. reservation services, property maintenance services are activities to fulfill the hotel management service rather than separate promises. The distinct service within the series is each time increment of performing the service.

QUESTION 22

Entity A, a specialty construction firm, enters into a contract with Entity B to design and construct a multi-level shopping center with a customer car parking facility located in sub-levels underneath the shopping center. Entity B solicited bids from multiple firms on both phases of the project- design and construction.

The design and construction of the shopping Centre and parking facility involves multiple goods and services from architectural consultation and engineering through procurement and installation of all of the materials. Several of these goods and services could be

considered separate performance obligation because Entity A frequently sells the services, such as architectural consulting and engineering services, as well as standalone construction services based on third party design, separately. Entity A may require to continually alter the design of the shopping Centre and parking facility during construction as well as continually assess the propriety of the materials initially selected for the project.

Determine how many performance obligations does the entity A have?

Solution

Entity A analyses that is will be required to continually alter the design of the shopping center and parking facility during construction as well as continually assess the propriety of the materials initially selected for the project. Therefore, the design and construction phases are highly dependent on one another (i.e., the two phases are highly interrelated). Entity A also determines that significant Customisation and modification of the design and construction services is required in order to fulfill the performance obligation under the contract. As such, Entity A concludes that design and construction services will be bundled and accounted for as one performance obligation.

Step 3: Identifying the TRANSACTION PRICE

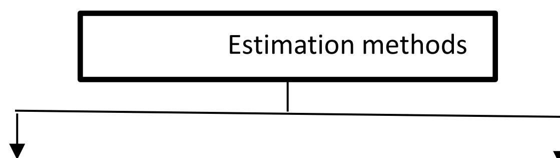
"The Transaction price is the amount of consideration to which an entity expects to be entitled in exchange for transferring promised goods or services to a customer, excluding amounts collected on behalf of third parties (for example, GST etc.)"

The transaction price may be effected by the following reasons:

1. Variable consideration
2. Significant finance component
3. Non cash consideration
4. Consideration payable to customer

The standard says estimate the variable consideration should be estimated. How to estimate? Is there any method suggested?

Yes. There are two method suggested by the standard:



The Expected Value	The Most likely amount
It is a sum of **probability – weighted average** amounts in rage of possible consideration amounts.	It is the **single most likely amount** in a range of possible consideration amount (i.e. the single most likely outcome of the contract)
When con this be used? Only if an entity has a large number of contracts with similar characteristics;	When the contract has **only two possible outcomes** (e.g. entity either achieve a performance bonus or does not)

There is **no free choice** to the entity is using either method; the method selected should be used consistently. A single contract may have more than one variable consideration – In this case, entity can use expected value method for one variable consideration and most likely amount method for other variable consideration.

In estimating the variable consideration, the entity should <u>use all available information</u> i.e. historical, current and forecast. The information should be similar to the information which is used at the time of bid and proposal process for establishing the prices.

Constraining estimates of variable consideration

Variable consideration is included in the transaction price ONLY IF it is highly probable that the amount will not result in a significant revenue reversal of cumulative recognised when the uncertainty associated with the variable e consideration is subsequently resolved (*i.e. it is highly probable that is will not be reversed).* For this purpose, entity should consider both the likelihood and magnitude of the revenue reversal.

In some contracts, penalties are specified. In such cased, 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 For example, where an entity agrees to transfer control of a good or service in a contract with customer at the end of 30 days for ₹ 1,00,000 and if it exceeds 30 days, the entity is entitled to receive only ₹ 95,000 the reduction on ₹ 5,000 shall be regarded as variable consideration. In other cases, the transaction price shall be considered as fixed.

Reassessment of variable consideration

At the end of each reporting period, an entity shall update the estimate transaction price (*including updating constraints*) to represent faithfully the circumstance present at the end of the reporting period and the changes in circumstances during the reporting period.

Let us discuss few variable consideration estimation basis in the following table:

Variable consideration	**Estimation basis**
Volume discounts	These are incentives to encourage additional purchases and customer loyalty. This is generally given to a customer to purchase a specified amount of goods or services, after which the price is either reduced prospectively for additional goods or services purchased in the future OR retrospectively reduced for all purchases during the specific period. Retrospective value discounts included the variable consideration as the transaction price for the current purchases are not known till the uncertainty of discount is resolved Management should use experience and other information to make a reasonable *Estimate. Sometimes, it may be difficult to estimate. Based of the estimation, at least a* **Minimum price per unit** should be **included** in the estimated transaction price at the inception of the contract.
Price concessions	Price concessions are adjustment to the initial contract and provided for a variety of reasons. For Example, a vendor might accept a lover payment than the amount contractually due form a customer, to encourage the customer pay for previous purchase and continue making future purchases. Price concessions are also sometime provided where a customer has experienced some level of dissatisfaction with that good or service

	(other than items covered by warranty) Management should **assets the likelihood of offering price** concession. An entity that expects to provide a price concession or practice of doing so, **should reduce the transaction price** to reflect the consideration to which is expects to be entitled after the concession is provided.
Prompt payment discounts (Cash discounts)	Customer purchases frequently include a discount of early payment For example, an entity might offer a 2% discount if an invoice is paid within 10 days of receipt. A portion of the Consideration is variable in this situation, because there is uncertainty as to whether the customer will pay the invoice within the discount period. Management need to **make an estimate of the consideration** that is expect to be entitled to as a result of offering this incentive. Experience with similar customers and similar transactions should be considered in determining the number of customers that are expected to receive the discount.
Variable consideration	**Estimation basis**
Rebate- Cash receipt in the future when achieved the target purchases	Customers typically pay full for goods or services at contract inception and then receive a cash rebate in the future. This cash rebate is often tied to an aggregate level of purchases. Management needs to consider the volume of expected sales and expected rebated in such cases to determine the revenue to be recognises n each, sale. The consideration is variable in these situations, because it is based on the value of eligible transactions. Is should only include amounts in the transaction price for arrangements with rebates if it is highly probable that a significant reversal in the amount if cumulative revenue reasonably will not occur if estimates of rebates change. Where management cannot reasonable estimate the amount of rebates that customers are expected to earn, it still need to consider whether there is a minimum amount of

	variable consideration that should not be constrained.
Price based on a Formula	A contract could include variable consideration if pricing is based on a formula or a contractual rate per unit of outputs and there is an undefined quantity of outputs The Transaction price is variable because is based on an unknown number of outputs. For example, a hotel is management entity enters into an arrangement to manage properties on behalf of a customer for a 5 - year period Contract consideration is based on a defined percentage of daily receipts the consideration is variable for this contract as it will be calculated based on daily receipts. The promise to the customer is to provide management services for the terms of the contract; therefore, the contract contains a variable fee as opposed to an option to make future purchases.
Price protection and price matching	Price protection clauses allow a customer to obtain a refund if the seller reduces the product' price to any other customers during a specified period. *Say one customer bought at ₹ 100 per unit and subsequently due any reason the product price is reduced to ₹ 90 during the year. In this case, if the customer has price protection he gets back ₹ 10.* Price matching provisions require an entity to refund a portion of the transaction price if a competitor lowers its price on a similar product. In this case, if the market price of the item. i.e. even competitor reduces the price to ₹ 90, the entity should pay ₹ 10 to the customer. In Addition some arrangements allow for price protection only on the goods that remain in a customer's inventory. It means this rule is applicable to the unsold stock of the customer. Both of these provisions create a possibility of subsequent adjustments to the stated transaction price. Management needs to estimate the number of units to which the price protection guarantee

	applies in such cases, to determine the transaction price, as the reimbursement does not apply to unit already sold by the customer.
Non-cash consideration	• Non-cash consideration should be measured at FAIR VALUE • If the entity cannot reasonably measure – Stand alone selling price of goods or services is the value of non-cash consideration; • If non- cash consideration varies for reasons other than only the form of it apply the constraining requirements; • If customer gives goods or services like materials' equipment of labour- Assess whether entity obtains controls over it -If Yes, recognise revenue.

Time value of money/significant financing component/deferred credit period

Normally credit period in many industries is 1 to 6 months (max.) If an entity is providing a credit period for a longer period (Say more than one year) i.e. called as deferred period It is apparent that invoice amount includes inters element (that means there is a financing arrangement between the parties). That interest should be separated (deducted) from the transactions price and recognised in the statement of P&L as expense.

- If there is a significant financing component in the contact, it should be considered whether it is explicitly mentioned in the agreement or it is implicit;
- In determining the interest element the entity should consider the following:
  - Difference between promised consideration and Cash selling price; and
  - Combined effect of the deferred period & interest rates prevailing in the market.

What rate should be used for discounting?

Ans: the entity should use the rate that reflects the credit characteristics of the party and any collateral or security provided by the customer or the entity, including assets transferred in the contract. The rate can be determined by identifying **the rate that discounts** the nominal amount of the promised consideration to Cash selling price i.e. IRR between the promised consideration and cash price (effective rate of return).

After contract inception, an entity **shall not update the discount rate** for changes in interest rates on other circumstances (such as a change in the assessment of the customer's credit risk).

As a practical expedient, an entity **NEED NOT apply** this concept if the deferred is less than or equal to a year.

Consideration payable to a customer/customer loyalty programs

Consideration payable to a customer includes

- Cash amount e.g. cash back offers;
- A credit or other items e.g. a coupon or voucher;

Consideration payable to a should be **reduced from the transaction price unless**

The entity received a distinct goods or services from the customer.

If the consideration payable to a customer include a variable amount, an entity shall estimate the transaction price (including considering the constraints);

Payments made by an entity to its customer's customer are assessed and accounted for the same as those paid directly to the entity's customer.

If the consideration paid to a customer for supplying a distinct goods of services to the entity?

If it is paid for a distinct good or service from the customer account for the purchase in the same way that is accounts for other purchases from suppliers.

If the amount of consideration payable to the customer **exceeds** the fair value of the distinct good or service received from the customer, then such an excess amount should be reduced from the transaction price.

When (timing) to recognise the reduction in transaction price?

Ans: Recognise the reduction of revenue at the **later** of the following events occur (whoever is later)

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

<u>QUESTION 23 – Estimating variable consideration</u>

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 ₹ 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 entitled to an incentive bonus of ₹ 15 lakhs.

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 daily penalty or incentive (i.e. ₹ 2.5 cores, plus or minus ₹ Lakh per day). This is because it is the method that entity expects to better predict the amount of consideration to which it will 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 (₹ 15 lakhs or ₹ Nil) and it is the method that the entity expects to better predict the amount of consideration to which it will be entitled.

QUESTION 24- 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 ₹ 25 cores.

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 ₹ 2 crores if 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 is 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 i.e. 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 contract 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 (₹ in crores)**	**Probability**	**Probability-weighted Amount(₹ 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 (₹2 crores or ₹ Nil) and this method would best predict the amount of consideration associated with the equality bonus. AST Limited believes the most likely amount of the equality bonus is ₹ 2 crores.

QUESTION 25- Volume discount incentive

HT Limited enters into a contract with a customer on 1 April 20X1 to sell product X for ₹ 1,000 per unit. If customer purchases more than 100 units of product A in financial year, the contract specifies that price per unit is retrospectively reduced to ₹ 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. ₹ 1,000 per unit) will not occur when the uncertainty is resolved (i.e. when the total amount of purchase is known).

Further, in May 20X1, the customer acquires another company and in the second quarter ended 30 September 20X1 the entity sell s 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₹ 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 ₹ 10,000 (10 units x₹ 1,000 per unit) for the quarter ended 30 June 20X1.

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

QUESTION 26- Measurement of variable consideration

An entity has a fixed fee contract for ₹ 1 million to develop a product that meets specified performance criteria. Estimated cost to complete the contract is ₹ 950,000. The entity will transfer control of the product over five years, and the entity uses the cost-to cost input

method to measure progress on the contract. An incentive award is available if the product meets the following weight criteria:

Weight (kg)	Award % of fixed fee	Incentive fee
951 or greater	0%	-
701-950	10%	₹ 100,000
700 or less	25%	₹ 250,000

The entity has extensive experience creating products that meet the specific performance criteria. Based on its experience, the entity has identified five engineering alternative that will achieve the 10 percent incentive and two that will achieve the 25 percent incentive. In this case, the entity determined that it has 95 percent confident that it will achieve the 10 percent incentive and 20 percent confidence that it will achieve the 25 percent incentive.

Based on this analysis, the entity believes 10 percent to be the most likely amount when estimating the transaction price. Therefore, the entity include only the 10 percent award in the transaction price when calculating revenue because the entity has concluded it is probable that a significant reversal in the amount of cumulative revenue recognised will not occur when the uncertainty associated with the variable consideration is subsequently resolved due to its 95 percent confidence in achieving the 10 percent award.

The entity reassesses its production status quarterly to determine whether is on track to meet the criteria for the incentive award. At the end of the year four, it becomes apparent that this contract will fully achieve the weight-based criterion. Therefore, the entity revises its estimate of variable consideration to include the entire 25 percent incentive fee in I the year four because, at this point, is probable that a significant reversal in the amount of cumulative revenue recognised will not occur including the entire variable consideration in the transaction price.

Evaluate the impact of changes invariable consideration when cost incurred is as follows:

Year	₹
1	50,000
2	1,75,000
3	4,00,000
4	2,75,000
5	50,000

Solution

[Note: For simplification purposes, the table calculates revenue for the year independently based on costs incurred during the year divided by total expected cost, with the assumption that expected costs do not change.]

Fixed consideration	A	1,000,000				
Estimated costs to complete*	B	950,000				
		Year 1	Year 2	Year 3	Year 4	Year 5
Total estimated variable	C	100,000	1,00,000	100,000	250,000	250,000
Consideration						
Fixed revenue	D=A x H/B	52,632	184,211	421,053	289,474	52,632
Variable revenue	E= C x H/B	5,263	18,421	42,105	72,368	13,158
Cumulative revenue adjustment	F (See below)	-	-	-	99,370	-
Total revenue	G = D + E+ F	57,895	202,632	463,158	461,212	65,790
Costs	H	50,000	175,000	400,000	275,000	50,000
Operating profit	I = G – H	7,895	27,632	63,158	186,212	15,790
Margin (rounded off)	J = I/G	14%	14%	14%	14%	24%

- For simplicity, it is assumed three is no change to the estimated costs to complete throughout the contract period.

- In practice, under the cost-to cost measure of progress, total revenue for each period is determined by multiplying the total transaction price (fixed and variable) by the ratio of cumulative cost incurred total estimated costs to complete, less revenue recognised to date.

Calculation of cumulative catch-up adjustment:			
Updated variable consideration	L		250,000
Percent complete in Year 4: (rounded off)	M=N/O		95%
Cumulative costs through year 4	N	900,000	
Estimated costs to complete	O	950,000	
Cumulative variable revenue through Year 4:	P		138,130
Cumulative catch up adjustment	F = L x M – P		99,370

QUESTION 27 – Right of return

An entity enters into 1,000 contracts with customers. Each contract includes the sale of one product for ₹50 (1,000 total products x ₹ 50 = ₹ 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. The entity's cost of each product is ₹30.

The entity applies the requirement in Ind AS 115 to the portfolio of 1,000 contracts because it reasonably expects that, in accordance with paragraph 4, the effects on the financial statements from applying these requirements to the portfolio would not differ materially from applying the requirements to the individual contracts within the portfolio. 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 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 estimates amount of variable consideration of ₹ 48,500 (₹ 50 x 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 (i.e. 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. ₹ 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 profit.

Upon transfer of control of the 1,000 products, the entity 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 ₹ 48,500 (₹ 50 x 970 products not expected to be returned);

(b) a refund liability of ₹ 1,500 (₹ 50 refund x 30 products expected to be retuned); and

(c) an assets of ₹ 900 (₹ 30 x 30 products for its right to recover products from customers on setting the refund liability).

QUESTION 28 – Financing component: significant or insignificant?

A commercial airplane component supplier enters into a contract with a customer for promised consideration of ₹ 7,000,000. Based on an evaluation of the facts and circumstances, the supplier concluded that ₹ 140,000 represented a insignificant financing component because of an advance payment received in excess of a year before the transfer of control of the product.

State whether company needs to make any adjustment in determining the transaction price.

What if the advance payment was larger and received further in advance, such that the entity concluded that ₹ 1,400,000 represented the financing component based on an analysis of the facts and circumstances.

Solution

The entity may conclude that ₹ 140,000, or 2 percent of the contract price, is not significant, and the entity may not need to adjust the consideration in determining the transaction price.

However, when the advance payment was larger and received further in advance such that the entity may conclude that ₹ 1,400,000 represents the financing component based on an analysis of the fact and circumstances. In such a case, the entity may conclude that ₹ 1,400,000, or 20 percent of the contract price, is significant, and the entity should adjust the consideration promised in determining the transaction price.

Note: In this illustration, the entity's conclusion that 2 percent of the transaction price was not significant and 20 percent was significant is a judgment based on the entity's facts and circumstances. An entity may a different conclusion on its facts and circumstances.

QUESTION 29 – Accounting for significant financing component

NKT Limited sells a product to a customer for ₹ 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 ₹ 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 ₹ 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 ₹ 121,000 to the cash selling price of ₹ 100,000). Analyse the above transaction with respect to its financing component.

Solution

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

The contract includes an implicit rate of 10 per cent (i.e. the interest rate that over 24 months discounts the promised consideration of ₹ 121,000 to the cash selling price of ₹ 100,000). The entity evaluates the rate concludes that 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.

QUESTION 30 – 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 ₹ 1 crore plus a 10% contractual rate of interest, payable in 60 monthly instalments of ₹212,470

Determine the discounting rate the transaction price when

Case A- Contractual discount rate reflects the rate in separate financing transaction

Case B – Contractual discount rate does not reflect the rate in a separate financing transaction i.e. 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 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 ₹ 1 crore. This amount is recognised as revenue and as a loan recevable when control of the equipment transfers to the customer. The entity account for the receivable in accordance with Ind AS 109.

Case B- Contractual discount rate does 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 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 ₹ 1

VT Limited determines the transaction price by adjusting the promised amount of consideration to reflect the contractual payments using the 14% interest rate reflects the credit characteristics of the customer. Consequently, the entity

determines that transaction price is ₹ 9,131,346 (60 monthly payments of ₹ 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.

QUESTION 31 – Advance payment and assessment of discount rate

ST Limited enters into a contract with a customer to sell an asset. Control of the asset will transfer to the customer in two years (i.e. the performance obligation will be satisfied at a point in time). The contract includes two alternative payment options:

(1) Payment of ₹ 5,000 in two years when the customer obtains control of the asset or

(2) Payment of ₹ 4,000 when the contract is signed. The customer elects to pay ₹ 4,000 when the contract is signed.

ST Limited concludes that the contract contains a significant financing component because of the length of time between when the customer pays for the asset and when the entity transfers the asset to the customer, as well as the prevailing interest rates in the market. The interest rate implicit in the transaction is 11.8 per cent, which is the interest rate necessary to make the alternative payment options economically equivalent. However, the entity determines that, the rate that should be used in adjusting the promised consideration is 6% which is the entity's incremental borrowing rate.

Pass journal entries showing how the entity would account for the significant financing component

Solution

Journal Entries showing accounting for the significant financing component:

(a) Recognise a contract liability for the ₹ 4,000 payment received at contract inception:

Cash	Dr.	₹ 4,000	
To Contract liability			₹ 4,000

(b) During the two years from contract inception until the transfer of the asset, the entity adjusts the promises amount of consideration and accretes the contract liability by recognising interest on ₹ 4,000 at 6% for two years:

Interest expense	Dr.	₹ 494*	
To Contract liability			₹ 494

₹ 494 = ₹ 4,000 contract liability x (6% interest per year for two years).

(c) Recognise revenue for the transfer of the asset.

Contract liability	Dr.	₹ 4,494	
To Revenue			₹ 4,494

QUESTION 32- Withheld payments on a long- term contract

ABC Limited enters into a contract for the construction of a power plant that includes scheduled milestone payments for the performance by ABC Limited throughout the contract term of three years. The performance obligation will be satisfied over time and the milestone payments are scheduled to coincide with the expected performance by ABC Limited. The contract provides that a specified percentage of each milestone payment is to be withheld as retention money by the customer throughout the arrangement and paid the entity the building is complete.

Analyse whether the contract contains any financing component.

Solution

ABC Limited concludes that the contract does not include a significant financing component since the milestone payments coincide with its performance and the contract requires amounts to be retained for reasons other than the provision of finance. The withholding of a specified percentage of each milestone payment is intended to protect the customer from the contractor failing to adequately complete its obligations under contract.

QUESTION 33 – 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 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.

QUESTION 34 sales based royalty

A software vendor enters into a contract with a customer to provide a license solely in exchange for a sales- based royalty.

Analyse whether there is any significant financing component in the contract or not.

Solution

Although the payment will be made in arrears, because the total consideration varies based on the occurrence or non-occurrence of a future event that is not within the control of the customer or the entity, the software vendor concludes the contract does provide the customer or the entity with a significant benefit or financing.

QUESTION 35 – Payment in arrears

An EPC contractor enters into a two-year contract to develop customised machine for a customer. The contractor concludes that goods and services in this contract constitute a single performance obligation.

Based on the terms of the contract, the contactor determines that is transfers control over, time, and recognised revenue based on an input method best reflecting the transfer of control to the customer. The customer agree to provide the contractor monthly progress payments, with the final 25 percent payment (holdback payment) due upon contract completion. As a result of the holdback payment, there is a gap between when control transfers and when consideration is received, creating a financing component.

Solution

There is no difference between the amount of promised consideration and the cash selling price (that is, the customer did not pay a premium a portion of the consideration in arrears). The payment terms included a holdback payment only to ensure successful completion of the project, and no other factors exist to suggest the arrangement contains a financing. Hence, the contractor this does not provide the customer or the contractor with a significant benefit of financing.

QUESTION 36 – Payment in arrears

Company Z is a developer and manufacture of defence systems that is primarily a Tier-II suppler of parts and integrated systems to original equipment manufacturers (OEMs) in the commercial markets. Company Z enters into a contract with Company X for the development and delivery of 5,000 highly technical, specialised missiles for use in one Company X's platforms.

As a part of the contract, Company X has agreed to pay Company Z for their cost plus an award fee up to ₹ 100 crores. The consideration will be paid by the customer related to costs incurred near the time Company Z incurs such cost. However, the ₹ 100 crores award fee is awarded upon successful completion of the development and test fire of a missile to occur in 16 months from the contract is executed.

The contract specifies Company Z will earn up to ₹ 100 crores based on Company X's assessment of Company Z's ability to develop and manufacture a missile that achieves multiple factors, including final weight, velocity, and accuracy. Partial award fees may be awarded based on a pre-determined scale based on their success.

Assume Company Z has assessed the under Ind AS 115 and determined the award fee represents variable consideration Based of their assessment, Company Z has estimated a total of ₹ 80 crores in the transaction price related to the variable consideration pursuant to guidance within Ind AS 115. Further, the entity has concluded it should recognised revenue over time for a single performance obligation using a cost-to cost input method.

Analyse whether there is any significant financing component in the contract or not.

Solution

The intention of the parties in negotiating the award fee upon completion of the test fire, and based on the results of that test fire, was to provide incentive to Company Z to producer high functioning missiles that achieved successful scoring from Company X.

Therefore, it was determined the contract does not contain a significant financing component, and Company Z should not adjust the transaction price.

As per Ind AS 115. 63, as practical expedient, an entity need not adjust the promised amount of consideration for the effects of significant financing component if the entity expects, at contract inception, that the period between;

(a) When the entity transfers a promised good or service to a customer and

(b) When the customer pays for the good or service Will be one year or less.

QUESTION 37- Applying practical expedient

Company H enters into a two-year contract to develop customised software for Company C. Company H concludes that goods and services in this contract constitute a single performance obligation.

Based on the terms of the contract, Company H determines that is transfers control over time,. And recognised revenue based on an input method best reflecting the transfer of control to company C.

Company C agrees to provide Company H monthly progress payments. Based on the expectation of the timing of costs to be incurred, Company H concludes that progress payments are being made such that the timing between the transfer of control and payment is never expected to exceed one year.

Analyse whether there is any significant financing component in the contract or not.

Solution

Company H concludes it will not need to further whether a significant financing component is present and does adjust the promised consideration in determining the transaction price, as they applying the practical expedient under In AS 115.

As per Ind AS 115.65 an entity shall present the effects of financing (interest revenue or interest expenses) separately from revenue from contracts with customers in the statement of profit and loss. Interest revenue or interest

expense is recognises only to the extent that a contract asset (or receivable) or a contract liability is recognised in accounting for a contract with a customer.

QUESTION 38 – 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 signal 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 par week of service a (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.

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 not reflect any subsequent changes in the fair value of the shares received (or receivable) in revenue.

QUESTION 39 – Fair of non-cash consideration varies for reasons other than the form of the consideration

RT Limited enters into a contract to build an office building for AT Limited over an 18- month period. AT Limited agrees to pay the construction entity ₹ 350 crores for the project. RT Limited will receive a bonus of 10 lakhs equity shares of AT Limited if is completes construction of the office building within one year. Assume a fair value of ₹ 100 per share at contract inception.

Determine the transaction price.

Solution

The ultimate value of nay shares the might receive could change for two reasons:

1) The entity earns or does not earn the shares and
2) The fair value per share may change during the contract term.

When determining the transaction price, the entity would reflect changes in the number of shares to be earned. However, the entity would not reflect changes in the fair value per share. Said another way, the share price of ₹ 100 is used to value the potential bonus throughout the life of the contract.

As a result, if the entity earns the bonus, its revenue would be ₹ 350 crores plus 10 lakhs equity shares at ₹ 100 per share for total consideration of ₹ 360 crores.

QUESTION 40 – *Customer provided goods or services*

MS Limited is a manufacture of It has supplier of steering systems – SK Limited. MS Limited places an order of 10,000 steering systems on SK Limited. It also agrees to pay ₹ 25,000 per steering system and contributes tooling to be used in SK's production process.
The tooling has a fair value of ₹ 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 ₹ 27 crores (₹ 25 crores for the steering systems and ₹ 2 cores for the tooling).

QUESTION 41 – *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 ₹ 15 crores of products during the year. The contract also requires the entity to make a non-refundable payment of ₹ 1.5 crores to the customer at the inception of the contract. The ₹ 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 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 ₹ 1.5 crores payment is a reduction of the transaction price. The entity apples the requirement 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 foreach good by 10 per cent [(₹ 1.5 crores ÷ ₹ 15crores)] Therefore in the first month in which the entity transfers goods to the customer, the entity recognises revenue of ₹ 1.125 cores (₹ 1.25 Crores invoiced amount less ₹ 0.125 crore of consideration payable to the customer).

QUESTION 42 (DISCOUNT)

A seller offers a cash discount for immediate or prompt payment (i.e. earlier than required under the normal credit terms). A sale is made for ₹ 100 with the balance due within 90 days. If the customer pays within 30 days, the customer will receive a 10% discount on the total invoice. The seller sells a large volume of similar items on these credit terms (i.e. this transaction is part of a portfolio of similar items). How should the seller account for this early payment incentive- if discount is taken by 40% of transactions.

SOLUTION

In the circumstances described, revenue is ₹ 100 if the discount is not taken and ₹ 90 if the discount is taken, As a result, the amount of consideration to which the entity will entitled is variable.

Under Ind AS 115, if the consideration promised in a contract includes a variable amount, an entity should estimate the amount of variable consideration to which it will be entitled by (1) using either the expected value or the most likely amount method (whichever method the entity expects would better predict the amount of consideration to which it will be entitled), and then (2) considering the effect of the constraint.

Therefore, the seller should recognises revenue **net of the amount of cash discount** expected to be taken, measured as described in the precious paragraph.

Expected value will be calculate as follows (₹ 100x 60%) + (₹ 90 X 40) = ₹ 96

QUESTION 43 (CONTINUATION WITH Q.42)

Continuation to the above concept capsule

What if the proportion of transactions for which the discount is taken varies significantly which will result in the recognition of less revenue. Based on historical, although the term average is 40% there is grate variability from month to month and that the proportion of transactions for which the discount is taken is frequently as high as 70% (but never higher than). How to account revenue under these circumstances?

SOLUTION

In Such a scenario, the seller might conclude that only 30% of the variable consideration should be included, because inclusion of a higher amount might result in significant revenue reversal. In that case, the amount of revenue recognised would be restricted to the following (conservative)

(₹100 x30) + (₹ 90 x70%) = ₹ 93

QUESTION 44 (CONSIDERATION PAID TO CUSTOMER)

Lubes Ltd. Sells lubes in containers to its customer, which in this case is the distributor, These containers carry a cash coupon, which is placed inside the container. The cash coupons are received by the ultimate customer, which for example, is either the grange or mechanic that actually opens the lube container. The ultimate customer is reimbursed by Lubes Ltd. A batch of containers was sold to distributors at ₹ 5,20,000. These containers carried cash of coupons of ₹ 20,000 what is the transaction price in this case?

SOLUTION

Transaction price will be ₹ 5,20,000 – 20,000 = ₹ 5,00,000. As per the standard, it does not matter whether incentive is provided to the customer (distributor) of customer's (mechanic or garage).Both will have impact of reducing the transaction price.

QUESTION 45 (NON CASH CONSIDERATION)

A Ltd., A telecommunication company, entered into an agreement with B Ltd. Which is engaged in generation supply of power, the agreement provide that A Ltd. Will provide

1,00,000 minutes talk time free to employees of B Ltd. In exchange for getting free power equivalent to 20,000 units. A of Ltd. normally charges ₹ 0.50 per minute and B Ltd. charges ₹ 3 per unit. How to measure revenue of A Ltd. And B Ltd.?

SOLUTION

As per Ind AS 115, when non-cash consideration is received Revenue should be measured at Fair value of goods/services received/ adjusted by any cash equivalents transferred;

In the given case, as power per unit rate is clearly available, sales should be recorded at ₹ 60,000 (i.e. 20,000 units x ₹ 3 per unit) in the books of A Ltd. Revenue in the books of B Ltd. Would be ₹ 50,000 (i.e. 1,00,000 units x ₹ 0.5.per minute);

QUESTION 46 (NON CASH CONSIDERATION)

X Ltd. A dealer of garments, got the renovation of one shop carried out by Y Ltd. In turn, it gave 100 T – Shirts and ₹ 3,000 to Y Ltd. As full payment of the renovation work. Y Ltd. would normally charge ₹ 15,000 for the work done. X Ltd. Usually sells T – Shirts at ₹ 120 each. How both X Ltd. Y Ltd. Will account for the above transactions?

SOLUTION

X Ltd. Books;

It received service (non-cash consideration) in exchange of goods, In this case, the revenue is measured at the fair value of the goods or services received, adjust by the amount of any cash or cash equivalents transferred.

The fair value of service received is ₹ 15,000 (i.e. the amount that Y Ltd. normally charge for the same work) and also X Ltd. Has transferred cash of ₹ 3,000 to Y Led. So X Ltd. Will recognise revenue from sale of goods (T-shirts) as 12,000 (₹ 15,000 – ₹ 3,000).

If assume renovation work is capitalised-

PPE a/c Dr 15,000

To Sales a/c 12,000

To Cash a/c 3,000

Y Ltd. Books:

It will recognise revenue (from renovation activities) as ₹ 15,000 (₹ 120 x 100) + 3,000]

QUESTION 47 (FINANCING COMPONENT)

X Ltd. Is engaged in manufacturing and selling of designer furniture. It sells goods extended credit On 1st April, 2018, it sold furniture for ₹ 48,40,000 to a customer, the payment against which was receivable **after 24 months**. He sells the same furniture at ₹ 40,00,000 to other customer who pays cash on the date of sale. How will X Ltd. Recognise revenue for the above transaction?

SOLUTION

In the give case, the credit period is a deferred credit period. There is significant financing component involved and not mentioned explicitly in the contract. The entity should account for the time value of money as interest income.

Interest element = Promised consideration – cash selling price = ₹ 48,40,000 – ₹ 40,00,000= ₹ 8,40,000.

Internal rate of rerun between ₹ 48,40,000 & ₹ 40,00,000 is 10% The interest revenue should be accounted for using the same rate.

The following journal entry should be recoded

Date	Journal entry	Debit	Credit
1st April 2018	Customer A/c……………Dr To Sales (Revenue) A/c (Being revenue is recognised at fair value)	40,00,000	40,00,000

Date	Journal entry	Debit	Credit
31st Mar 2019	Customer A/c………….Dr. To Interest Income A/c (Being finance income is recognised at effective Rate i.e. ₹ 40,00,000 x 10%)	4,00,000	4,00,000
31st Mar 2020	Customer A/c………..Dr. To Interest Income A/c	4,40,000	4,40,000

	(Being finance income is recognised at effective Rate i.e. ₹ 44,00,00 x 10%)		

Receivable amount as at 31st March 2020 = ₹ 40,00,000 ₹ 4,00,000 + 4,40,000 ₹ 48,40,000

31st Mar 2020	Cash A/c………Dr. To Customer (Being receipt of consideration is accounted)	₹ 48,40,000	₹ 48,40,000

Note: If customer paid advance consideration and the timing of the transfer of those goods or services is at the discretion of the customer –the entity should not consider any interest revenue in this case.

Step 4: ALLOCATION OF TRANSACTION PRICE

QUESTION 48 – Allocation methodology

An entity enters into a contract with a customer to sell products A, B and C in exchange for ₹ 10,000. The entity will satisfy the performance obligations for each of the products at different points in time. The entity regularly sells Product A separately and therefore the stand- alone selling price is directly observable. The stand- alone selling prices of Products of Products B and are not directly observable.

Because the stand-and selling prices for Products B and C are not directly observable, the entity must estimate them. To estimate the stand- alone selling prices, the entity uses the adjusted market assessment approach for Product B and the expected cost plus a margin approach for Product C. In making those estimates, the entity maximises the use of observable inputs.

The entity estimates the stand-alone selling prices as follows:

Product	Stand – alone selling price	Method
	₹	
Product A	5,000	Directly observable
Product B	2,500	Adjusted market assessment approach
Product C	7,500	Expected cost plus a margin approach
Total	15,000	

Determine the transaction price allocated to each product.

Solution

The customer receives a discount for purchasing the bundle of goods because the sum of the stand – alone selling prices (₹ 15,000) exceeds the promised consideration (₹ 10,000) the entity considers that there is no observable evidence about the performance obligation to which the entire discount belongs. The discount is allocated proportionately across products A, B and C. The discount, and therefore the transaction price, is allocated as follows:

Product	**Allocated transaction price (to nearest ₹ 100)**	
	₹	
Product A	3,300	(₹ 5,000 ÷ ₹ 15,000 ₹ 10,000)
Product B	1,700	(₹ 2,500 ÷ ₹15,000 x ₹ 10,000)
Product C	5,000	(₹ 7,500 ÷ ₹ 15,000 x ₹ 10,000)
Total	10,000	

QUESTION 49 (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**
	₹
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 ₹ 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 ₹ 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 ₹ 130,000. The stand-alone selling price for Product Alpha is highly variable because the entity sells Products Alpha to different customers for a broad range of amounts (₹ 15,000 - ₹ 45,000). Determine the stand-alone selling price of Products, X, Y, Z and Alpha using the residual approach.

Solution:

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

The contract includes a discount of ₹ 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 ₹ 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 contract requires the entity to transfer control of Products Y and Z together, then the allocated amount of ₹ 50,000 is individually allocated to the promises to transfer Product Y (stand-alone selling price of ₹ 25,000) and Product Z (stand-alone selling price of ₹ 45,000) as follows:

Product	Allocated transaction price	
	₹	
Product Y	17,857	(₹ 25,000 ÷ ₹ 70,000 total stand-alone selling price * ₹ 50,000)
Product Z	32,143	(₹ 45,000 ÷ ₹ 70,000 total stand-alone selling price × ₹ 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 ₹ 50,000 and Product X for ₹ 50,000, it has observable evidence that ₹ 100,000 should be allocated to

those three product and a ₹ 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 estimated the stand-alone selling price of Product Alpha to be ₹ 30,000 as follows:

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

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

QUESTION 50– Allocating of variable consideration

An entity enters into a contract with a customer for two intellectual property licences (Licences A and B), which the entity determines to represent two performance obligation each satisfied at a point in time. The stand-alone selling prices of Licences A and B are ₹ 1,600,000 and ₹ 2,000,000, respectively. The entity transfers Licence B at inception of the contract and transfers Licence A one month later.

The price stated in the contract for Licence A is a fixed amount of ₹ 1,600,000 and for Licence B the consideration is three per cent of the customer's future sales of products that use Licence B. For purposes of allocation, the entity estimates its sales-bases royalties (i.e. the variable consideration) to be ₹ 2,000,000. Allocate the transaction price.

Solution;

To allocate the transaction price, the entity considers the criteria in paragraph 85 and concludes that the variable consideration (i.e. the sales-based royalties) should be allocated entirely to Licence B. The entity concludes that the criteria are met for the following reasons:

(a) The variable payment related specifically to an outcome from the performance obligation to transfer Licence B (i.e. the customer's subsequent sales of products that use License B).

(b) Allocating the expected royalty amounts of ₹ 2,000,000 entirely to Licence B is consistent with the allocation objective in paragraph 73 of Ind AS 115. This is because the entity's estimate of the amount of sales-based royalties (₹ 2,000,000) approximates the stand-alone selling price of Licence B and the fixed amount of ₹ 1,600,000 approximates the stand-alone selling price of Licence A. The entity allocated ₹ 1,600,000 to Licence A. This is because, based on an assessment of the facts and circumstances relating to both licences, allocating to Licence B some of the fixed consideration in addition to all of the variable consideration would not meet the allocation objective in paragraph 73 of Ind As 115.

QUESTION 51 – Allocating a change in transaction price

On 1 April 20X0, a consultant enters into a n arrangement to provide due diligence, valuation, and software implementation services to a customer for ₹ 2 crores. The consultant can earn ₹ 20 lakhs bonus if it completes the software implementation by 30 September 20X0 or ₹ 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 - ₹ 80 lakhs
- Valuation - ₹ 20 lakhs
- Software implementation - ₹ 1 crore

At contract inception, the consultant believes it will complete the software implementation by 30 January 20X1. After considering the factors in Ins 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 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 ₹ 20 lakhs.

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

Determine the transaction price.

Solution;

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

Step 5: SATISFYING THE PERFORMANCE OBLIGATION

QUESTION 52

Minitek Ltd. Is a payroll processing Company? Minitek Ltd. enters into a contract to provide monthly payroll processing services to ABC limited for one year. Determine how entity will recognise revenue?

Solution

Payroll processing is a single performance obligation. On a monthly basis, as Microtek Ltd carries out the payroll processing-

- The customer, i.e. ABC Limited simultaneously receives and consumes the benefits of the entity's performance in processing each payroll transaction
- Further, once the services have been performed for a particular month, in case of termination of the agreement before maturity and contract is transferred to another entity, then such new entity will not need to re-perform the services for expired months.

Therefore, it satisfied the first criterion, i.e. services completed on a monthly basis are consumed by the entity at the same time and hence, revenue shall be recognised over the period of time.

QUESTION 53

T&L Limited ('T&L') is a logistics company that provides inland and sea transportation services. A customer – Horizon Limited ('Horzon') enters into a contract with T&L for transportation of its goods from India to Srilanka through sea. The voyage is expected to take 20 days Mumbai to Colombo. T&L is responsible for shipping the goods from Mumbai port to Combo port.

Whether T&L's performance obligation is met over period of time?

Solution

T&L has a single performance to ship the goods form one port to another. The following factors are critical for assessing how services performed by T&L are consumed by the customer-

- As the voyage is performed, the service undertaken by T&L is progressing such that no other entity will need to re-perform the service till so far as the voyage has been performed, if T&L was to deliver only part-way.
- The customer is directly benefiting from the performance of the voyage as & when it progresses.

Therefore, such performance obligation is said to be met over a period of time.

QUESTION 54

AFS Ltd. Is a risk advisory firm and enters into a contract with a company WBC Ltd provide audit service that results in AFS issuing an audit opinion of the Company. The professional opinion relates to facts and circumstances that are specific to the company. If the Company was to terminate the consulting contract for reasons other than the entity's failure to perform as promised, the contract requires the Company to compensate the risk advisory firm for its costs incurred plus a 15 per cent margin the 15 per cent margin approximates the profit margin that the entity earns from similar contracts.

Whether risk advisory firm's performance obligation is met over period of time?

Solution

AFS has a single performance to provide an opinion on the professional audit services proposed to be provided under the contract with the customer. Evaluating the criterion for recognising revenue over a period of time or at a point in time, Ind AS 115 requires one of the following criterion to be met-

- Criterion (a) – whether the customer simultaneously receives and consumes the benefits from services provided by AFS: Company shall benefit only when the audit opinion is

provided upon completion. And in case the contract was to be terminated, and other frim engaged to perform similar services will have to substantially re-perform.

Hence, this criterion is not met.

- Criterion (b) – An asset created that customer controls: This is service contract and no asset created, over which customer acquires control.
- Criterion (C)- no alternate use to entity and right to seek payment:

  - ❖ The services provided by AFS are specific to the company WBC and do not have any alternate use to AFS
  - ❖ Further, AFS has a right to enforce payment if contract was early terminated, for reasons other than AFS's failure to perform. And the profit margin approximates what entity otherwise earns.

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

QUESTION 55

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 condition laid in para 35 of Ind AS 115 as follows:

- Criterion (a) whether the customer simultaneously 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 in not met.
- Criterion (b) – An asset created that customer controls: per provided facts, the customer does not acquire control

- 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 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.

QUESTION 56: Uninstalled materials

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:

Particulars	Amount (₹)
Transaction price	5,000,000
Expected costs:	
(a) Elevators	1,500,000
(b) Other costs	2,500,000
Total	4,000,000

The entity purchases the elevators and they are delivered to the 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 recognise 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 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 cots incurred relative to the budgeted costs.

- The cost of elevators should be excluded when measuring such progress and revenue for such elevators should be recognised to the extent of costs incurred.
The revenue to be recognised is measured as follows:

Particulars	Amount (₹)
Transaction Price	5,000,000
Costs incurred:	
(a) Cost of elevators	1,500,000
(b) Other costs	5,00,000
Measure of progress:	5,00,000/2,500,000 = 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 + 7,00,000 = 2,200,000

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

CONCEPT 5: VARIOUS SITUATIONS

QUESTION 57 (REPURCHASE AGREEMENT)

An entity enters into a contact 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 ₹ 1.1 million on or before December 31,20X1.

How would the entity account for this transaction?

Solution

In the above, 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 (₹ 1 million) is lower than the repurchase price (₹ 1.1 million,) this is construed to be a financing arrangements and accounted as follows:
  (a) Amount received shall be recognised as 'liability'
  (b) Difference between sale price and repurchase price to be recognised as finance cost and recognised over the repurchase term.

QUESTION 58 (REPURCHASE AGREEMENT)

An entity enters into a contract with a customer for the sale of a tangible asset on 1 January 20X1 for ₹ 1,000,000. The contract includes a put option that gives the customer the right to sell the asset for ₹ 9,00,000 on or before December 31, 20X1. The market price for such goods is expected to be ₹ 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 up to 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, i.e. Till the put option expires

- Against payment of ₹ 1,000,000 the customer only has a right to use the asset and put it back to the entity for 900,000. Therefore, this will be accounted as a lease transaction in which difference between original selling price (i.e. ₹ 1,000,000) and repurchase price (i.e. ₹ 900,000) shall be recognised as lease income over the period of lease.

QUESTION 59 (BILL & HOLD)

An entity enters into a contract with a customer on 1 April 20X1 for the sale of a machine and spare parts. The manufacturing lead time for the machine and spare parts is two years. Upon completion of manufacturing, the entity demonstrates that the machine and spare parts meet the agreed-upon specifications in the contract. The promises to transfer the machine and spare parts are distinct and result in two performance obligations that each will be satisfied at a point in time. On 31 March 20X3, the customer pays for the machine and spare parts, but only takes physical possession of the machine. Although the customer inspects and accept the spare part, the customer requires that the spare parts be stored at the entity's warehouse because of its close proximity to the customer's factory. The customer has legal title to the spare parts and the parts can be identified as belonging to the customer. Furthermore, the entity stores the spare parts in a separate section of its warehouse and the parts are ready for immediate shipment at the customer's request. The entity expects to hold the spare parts for two to four years and the entity does not have the ability to use the spare parts or direct them to another customer.

How will the Company recognise revenue for sale of machine and spare parts? Is there any other performance obligation attached to this sale of goods?

Solution

In the fats provided above, the entity has made sale of two goods- machine and space parts, whose control is transferred at a point in time. Additionally, company agrees to the spare parts for the customer for a period or 2-4 years, which is a separate performance obligation therefore, total transaction price shall be divided amongst 3 performance obligations-

(i) Sale of machinery
(ii) Sale of spare parts
(iii) Custodial services for storing spare parts.

Recognition of revenue for each of the three performance obligations shall occur as follows:

- Sale of machinery: Machine has been sold to the customer and physical possession as well as legal – title passed to the customer on 31 March 20X3. Accordingly, revenue for sale of machinery shall be recognised on 31 March 20X3.

- Sale of spare parts: the customer has made payment for the spare parts and legal title has been passed to specifically identified goods, but such spares continue to be physically held by the entity In this regard, the company shall evaluate if revenue can be recognised on bill-n hold basis if all below criteria are met:

(a) The reason for the bill and – hold arrangement must be substantive (for example, the customer has requested the arrangement);	The customer has specifically requested for entity to store goods in their warehouse, owing to close proximity to customer's factory
(b) The product must be identified separately as belonging to the customer;	The spare parts have been specifically identified and inspected by the customer
(c) The entity cannot have the ability to use the product or to direct it to another customer	Spares have been segregated and cannot be redirected to any other customer.

Therefore, all conditions of bill-and-hold are met hence, company can recognise revenue for sale of spare parts on 31 march 20X3.

- Custodial services; Such services shall be given for a period of 2 to 4 years form 31 March 20X3. Where services are given uniformly and customer receives & consumes benefits simultaneously, revenue for such service shall be recognised on a straight line basis over a period of time.

QUESTION 60 (CONTRACT COST)

Customer outsources its information technology data center

Term= 5 years plus two 1yr renewal options

Average customer relationship is 7 years

Entity spends ₹ 4,00,000. designing and building the technology platform needed to accommodate out- sourcing contract:

Design services	₹ 50,000
Hardware	₹ 140,000
Software	₹ 100,000
Migration and testing of data centre	₹ 110,000
Total	**₹ 400,000**

How should such costs be treated?

Solution

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

QUESTION 61 (Amortisation)

An entity enters into a service contract with a customer and incurs incremental cost to obtain the contact 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 buy it can be renewed for subsequent one- year periods up to a maximum of 10 years. The average contract term of similar contracts entered into 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 serviced under the contract to which the capitalised costs relate.

QUESTION 62 (SERVICE CONCESSION ARRANGEMENTS)

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 book 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 phases is ₹ 15 crores:
- Other income relates to the services provide 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 ₹ 100 crores. The fair value of such construction cost in 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 IGGAP, UK Ltd. has recorded the expenses incurred on the said project as an Intangible Assets.

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.

QUESTION 63 (CONSIGNMENT AGREEMENT)

Manufacture M enters into a 60-day consignment contract to ship 1,000 dresses to Retailer A's Stores. Retailer A is obligated to pay Manufacture M ₹ 20 per dress when the dress is sold to an end customer.

During the consignment period, Manufacture M has contractual right to require Retailer A to either return the dresses or transfer them to another retailer. Manufacture M is also required to accept the return of the inventory. State when the control is transferred.

<u>Solution</u>

Manufacture M determines the control has been transferred to Retailer A on delivery, for the following reasons:

(a) Retailer A does not have an unconditional obligation to pay for the dresses until they have been sold to an end customer;

(b) Manufacturer M is able to require that the dresses be transferred to another retailer at any time before Retailer A sells them to an end customer; and

(c) Manufacturer M is able to require the return of the dresses or transfer them to another retailer.

Manufacturer M determines that control of the dresses transfers when they are sold to an end customer i.e. when retailer A has an unconditional obligation to pay Manufacturer M and can no longer return or otherwise transfer the dresses.
Manufacturer M recognizes revenue as the dressers are sold to the end customer.

QUESTION 64 (UPFRONT FEES)

Customer buy a new data connection from, the telecom entity. It pays one-time registration and activation fees at the time of purchase of new connection.
The customer will be charged based on the usage of the data services of the connection on monthly basis.
Are the performance obligations under the contract distinct?

Solution

By selling a new connection, the entity promises to supply data services to customer. Customer will not be able to benefit from just buying a data card and data services form third party. The activity of registering and activating connection is not a service to customer and therefore does not represent satisfaction of performance obligation.

Entity's obligation is to provide data service and hence activation is not separate performance obligation.

EXTRA QUESTIONS FOR SELF READING ON IND AS 115

QUESTION 65 (ALLOCATION OF TRANSACTION PRICE)

An entity sells boats for ₹ 30,000 each. The entity also provides mooring facilities for ₹ 5,000 per annum. The entity sells these goods and services separately. If a purchaser of a boat contracts to buy mooring facilities for a year there is a discount on the whole package. Thus the 'package' costs ₹ 32,500. How should revenue be recognized?

Suggested answer

AS per the standard, transaction price should be allocated between the performance obligations in the ratio of SSPs.

In the given contract, there are two performance obligations i.e. sale of boats and mooring facility.

SSP is very clearly observable in the given question. Hence the transaction price of ₹ 32,500 should be allocated in the ratio of ₹30,000 :₹ 5,000

Sale value of boats = ₹ 27,857 (₹ 32,500 × 35,000/₹35,000); and

Sale value of mooring facility = ₹ 4,643 (₹ 32,500 × ₹ 5,000/₹35,000).

The revenue recognized on the sale (₹28,857) of the boat should, therefore, be recognized on delivery of the boat. The revenue recognized for the mooring facilities is ₹ 4,643, which will be recognized evenly over the year for which the mooring facility is provided.

QUESTION 66

Continuation to the above question

Assume an entity X generally sells the boats in range between ₹ 29,000 and ₹ 32,500.

The entity enters into a contract to sell a boat and one year of mooring services to a customer. The stated contract prices for the boat and the mooring services are ₹ 31,000 and ₹ 1,500 respectively?

How should entity X allocate the total transaction price of ₹ 32,500 to each performance obligation?

Suggested answer

The contract price for the boat (₹ 31,000) **falls within the range** entity X established for stand-alone selling price: therefore, entity X **could use the stated contract price** for the boat as the stand-alone selling price in the allocation.

Boat : ₹ 27,986 (₹ 32,500 × (₹ 31,000/₹ 36,000))

Mooring services :₹ 4,514 (₹ 32,500 × (₹ 5,000/₹ 36,000))

QUESTION 67

Continuation to the above question

What is the contract price of the boat did not fall within the range like ₹ 28,000?

Suggested answer

Entity X would need to determine a price within the range to use as the stand-alone price of the boat in the allocation, such as the midpoint. Entity X should apply a consistent method for determining the price within the range to use the stand-alone selling price.

QUESTION 68

A seller enters into a contract with a customer to sell products A.B and C for a total transaction price of ₹ 1,00,000. The seller regularly sells product A for ₹ 25,000 and product B for ₹ 45,000 on a stand-alone basis. Product C is a new product that has not been sold previously, has no established price and is not sold by competitors in the market. Products A and B are not regularly sold together at a discounted price. Product C is delivered on 1st March, and products A and B are delivered on 1st April.

How should the seller determine the stand-alone selling price of product C?

Suggested answer

The seller can use the residual approach to estimate to stand-alone selling price of product C, because the seller has not previously sold or established a price for product C.

Prior to using the residual approach, the seller should assess whether any other observable data exists to estimate the stand-alone selling price.

For example, although product C is a new product, the seller might be able to estimate a stand-alone selling price through other methods, such as using expected cost plus a margin.

The seller has observable evidence that products A and B sell for ₹ 25,000 and ₹ 45,000 respectively, for a total of ₹ 70,000. The residual approach results in an estimates stand-alone selling price of ₹ 30,000 for Product C (₹ 100,000 total transaction price less ₹ 70,000).

QUESTION 69 (RIGHT TO RETURN)

ABC Ltd. Sole 10,000 @ ₹ 1,000 limited on customary terms of right to return within a month without any penalty. On the basis of past experience, ABC Ltd. assesses that 10% refund is expected but it will be able to sale the returned goods at a profit. Cost of goods is ₹ 700 per unit. Suppose 1,000 units are returned within the specified time and customer gets replacement. Show necessary accounting entries.

Suggested answer

As discussed above. The entity should recognise revenue to the extent it expects to be entitled, a refund liability and an asset & corresponding adjustment to cost of sales – this is because the entity has right to recover the product.

Date	Particulars	Dr. ₹	Cr. ₹
At the time of sale	Bank a/c……….Dr To Sales a/c To Refund liability (90% of the revenue recognized on the basis of expected value method of the amount of variable consideration and 10% is recognised as refund liability)	1,00,00,000	 90,00,000 10,00,000
At the time of sale	Stock on sale or return a/c……..Dr To Stock of finished goods (Inventories with the customer are recognised and respect of goods expected to be refunded at cost i.e. 1,000 units x 700)	7,00,000	 7,00,000
After the goods are replaced by entity	Refund liability a/c……………. Dr. To Sale of goods a/c (Revenue recognised after the replacement of the returned goods- 1000 units and refund liability is extinguished)	10,00,000	 10,00,000
After the goods are replaced by entity	Stock of finished goods a/c…….Dr To Stock on sale or return a/c (Entries in respect of stock goods with the customer reversed after return of goods by customer)	7,00,000	 7,00,000

QUESTION 70 (FINANCING COMPONENT IN ADVANCE PAYMENT)

On 1st jan, ABC Ltd enters into a non- cancellable contract with TVC Ltd for the sale of an excavator for ₹ 3.50,000. The excavator will be delivered to TVC Ltd on 1st April. The

contract required TVC Ltd to pay ₹ 3,50,000 in advance on 1st Feb and TVC Ltd makes the payment on 1st March. Prepare the journal entries that would be used by ABC Ltd to account for this contract.

Suggested answer

Date	Particulars		Debit	Credit
1st Feb	Receivable To contracts liability (Being ABC Ltd recognises receivable because it has an unconditional rights to the consideration (i.e. the contract is non-cancellable)	Dr	3,50,000	3,50,000
1st March	Cash To receivable (Being TVC makes the payment ABC recognise the cash collection)	DR	3,50,000	3,50,000
1st April	Contract liability To revenue (Being ABC recognises revenue when excavator is delivered to TVC)	DR	3,50,000	3,50,000