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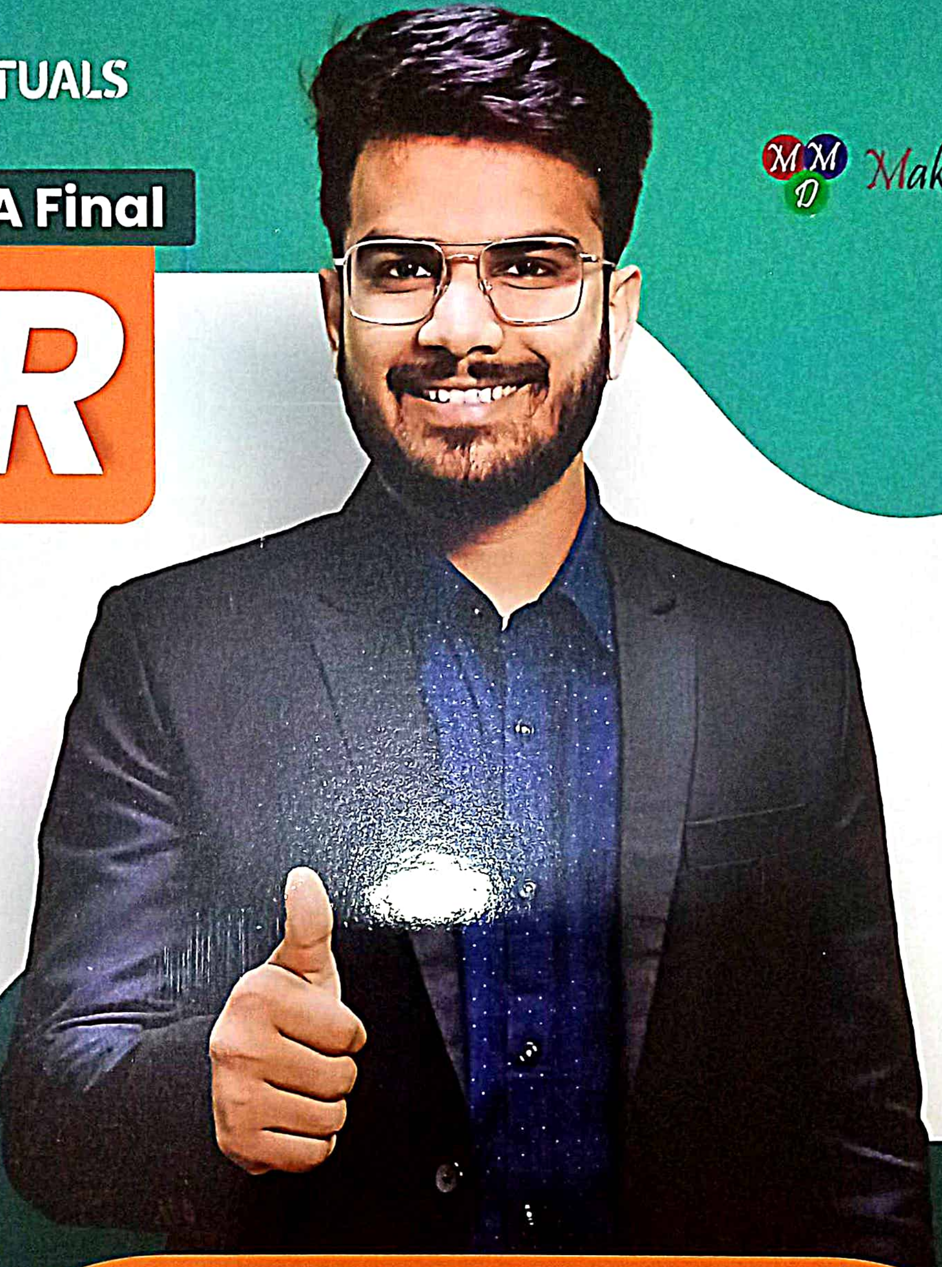

Financial Reporting

DIGEST QUESTION BANK

VOLUME - 4

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FINANCIAL REPORTING

IND AS 115 – REVENUE FROM CONTRACTS WITH CUSTOMERS

Illustration 1

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 it may not be able to collect the full amount from the customer.

Determine how New way will recognise this transaction?

Solution

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.

Illustration 2

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

Illustration 3

Contractor P enters into a manufacturing contract to produce 100 specialised CCTV Cameras for Customer Q for a fixed price of ₹ 1,000 per sensor. Customer Q can cancel the contract without a penalty after receiving 10 CCTV Cameras. Specify the contract units.

Solution

P determines that because there is no substantive compensation amount payable by Q on termination of the contract – i.e. no termination penalty in the contract – it is akin to a contract to produce 10 CCTV Cameras that gives Customer Q an option to purchase an additional 90 CCTV Cameras. Hence, contract is for 10 units.

Illustration 4

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

Would these contracts be combined?

Solution

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

Illustration 5

Software Company S enters into a contract to license its customer relationship management software to Customer B. Three days later, in a separate contract, S agrees to provide consulting services to significantly customise the licensed software to function in B's IT environment. B is unable to use the software until the customisation services are complete.

Would these contracts be combined?

Solution

S determines that the two contracts should be combined because they were entered into at nearly the same time with the same customer, and the goods or services in the contracts are a single performance obligation.

Illustration 6

Manufacturer M enters into a contract to manufacture and sell a cyber security system to Government-related Entity P. One week later, in a separate contract, M enters into a contract to sell the same system to Government-related Entity Q. Both entities are controlled by the same government. During the negotiations, M agrees to sell the systems at a deep discount if both P and Q purchases the security system.

Should these contracts be combined or separately accounted?

Solution

M concludes that the said two contracts should be combined because, among other things, P is a related party of Q, the contracts were entered into at nearly the same time and the contracts were negotiated as a single commercial package, which is clearly evident from the fact that discount is being offered if both the parties purchases the security system, thereby also making the consideration in one contract dependent on the other contract.

Illustration 7

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 of 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.

Illustration 8

On 1 April, 20X1, KLG 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, KLG 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?

Solution

The next six months of services are distinct from the services provided in the first six months before modification in contract.

Therefore, KLG Ltd. will account for the contract modification as if it were a termination of the existing contract and the creation of a new contract.

The consideration allocated to remaining performance obligation is ₹270,000, which is the sum of

- The consideration promised by the customer (including amounts already received from the customer) that was included in the estimate of the transaction price and had not yet been recognized as revenue. This amount is zero.
- The consideration promised as part of the contract modification is ₹270,000.

Illustration 9 – (MTP – Oct'21)

Growth Ltd enters into an arrangement with a customer for infrastructure outsourcing deal.

Based on its experience, Growth Ltd determines that customising the infrastructure will take approximately 200 hours in total to complete the project and charges ₹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? **(5 Marks)**

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 recognised	100	140	14,000
Revenue already booked	100	150	15,000
Adjustment in revenue			(1,000)

*35,000 / 250 = 140.

Illustration 10 – (MTP – April, 2021)

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

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

(4 Marks)

Solution

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

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

Illustration 11

An entity provides broadband services to its customers along with voice call service.

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

Are the performance obligations under the contract distinct?

Solution

Entity promises to customer to provide

- Broadband Service
- Voice Call 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 dependant 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 performanc e obligation: -

- Broadband Service
- Voice Call services

- Modem

Illustration 12

An entity enters into a contract to build a power plant for a customer. The entity will be responsible for the overall management of the project including services to be prov ided like engineering, site clearance, foundation, procurement, construction of the structure, piping and wiring, installation of equipment and finishing.

Determine how many performance obligations does the entity have?

Solution

Based on the discussion above it needs to be determined that the promised goods and services are capable of being distinct as per the principles of Ind AS 115. That is, whether the customer can benefit from the goods and services either on their own or together with other readily available resources. This is evidenced by the fact that the entity, or competitors of the entity, regularly sells many of these goods and services separately to other customers. In addition, the customer could generate economic benefit from the individual goods and services by using, consuming, selling or holding those goods or services.

However, the goods and services are not distinct within the context of the contract. That is, the entity's promise to transfer individual goods and services in the contract are not separately identifiable from other promises in the contract. This is evidenced by the fact that the entity provides a significant service of putting together the various inputs or goods and services into the power plant or the output for which the customer has contracted.

Since both the criteria has not met, the goods and services are not distinct. The entity accounts for all of the goods and services in the contract as a single performance obligation.

Illustration 13

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 fulfil the hotel management service rather than separate promises. The distinct service within the series is each time increment of performing the service.

Illustration 14

Entity A, a specialty construction firm, enters into a contract with Entity B to design and construct a multi-level shopping centre with a customer car parking facility located in sub-levels underneath the shopping centre. 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 obligations 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.