CHAPTER 9

INDIAN ACCOUNTING STANDARD 115: REVENUE FROM CONTRACTS WITH CUSTOMERS



LEARNING OUTCOMES

After studying this chapter, you will be able to:

- Appreciate the scope and definition of the standard.
- Identify the contract.
- Comprehend the criteria for revenue recognition.
- Gain knowledge on accounting treatment of various aspects like combination of contracts, contract modifications etc.
- Identify performance obligations and when the performance obligation is satisfied.
- Determine the transaction price and allocate the performance obligation to transaction price.
- Allocate discount to various performance obligations in determining their transaction price.
- Account for the changes in the transaction price.
- Account for variable considerations while determining the transaction price.
- Deal with contract costs.
- Comply with the Presentation and disclosure requirements of the standard.

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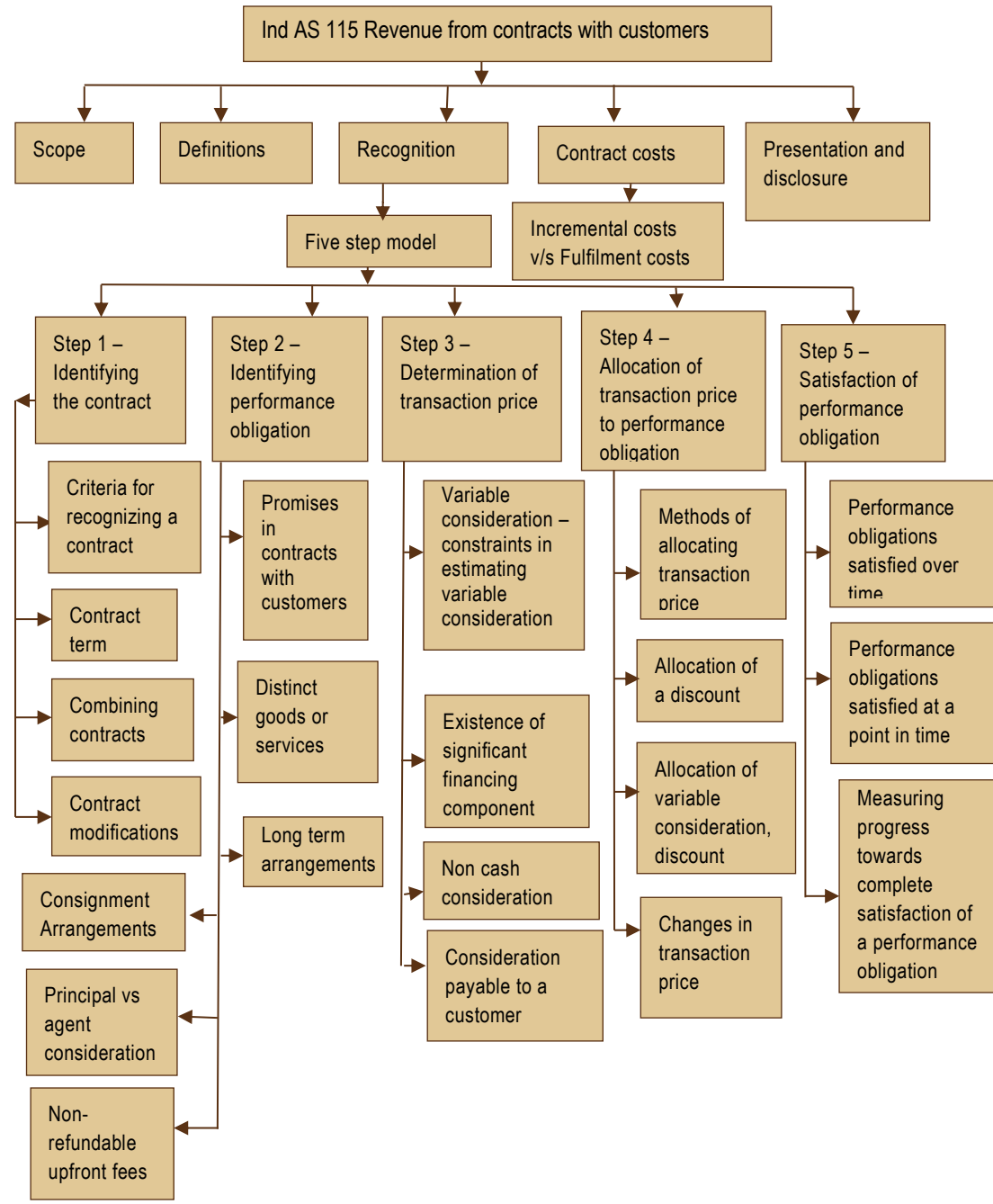
CHAPTER OVERVIEW



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

The core principle is that an entity shall recognize revenue to depict the transfer of promised goods or services to customers in an amount that reflects the consideration to which the entity expects to be entitled in exchange for those goods or services.

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

1. SCOPE

Ind AS 115 applies to all contracts with customers to provide goods or services that are outputs of the entity's ordinary course of business in exchange for consideration, unless specifically excluded from the scope of the new guidance, as described below.

An entity shall apply this Standard to all contracts with customers, except the following:

(a) lease contracts within the scope of Ind AS 116, Leases;

(b) contracts within the scope of Ind AS 117, Insurance Contracts. However, an entity may choose to apply this Standard to insurance contracts that have as their primary purpose the provision of services for a fixed fee in accordance with Ind AS 117

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

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

This standard is applicable only if the counterparty to the contract is a customer. A customer is a party that has contracted with an entity to obtain goods or services that are an output of the entity's ordinary activities in exchange for a consideration.

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

A contract with a customer may be partially within the scope of Ind AS 115 and partially within the scope of other Ind AS. In such cases, the following steps should be followed to identify how it should be split between Ind AS 115 and other Ind AS:

(i) If the other Ind AS specifies how to separate and/or measure a portion of the contract, then that guidance should be applied first. The amounts measured under other Ind AS should be excluded from the transaction price that is allocated to performance obligations under Ind AS 115.

(ii) If the other Ind AS does not stipulate how to separate and/or measure a portion of the contract, then Ind AS 115 would be used to separate and/or measure that portion of the contract (refer discussion relating to Step 4 - Allocation of transaction price to performance obligation).

Ind AS 115 also specifies the accounting for the incremental costs of obtaining a contract with a customer and for the costs incurred to fulfil a contract with a customer if those costs are not within the scope of another Standard (see section related to Contract Costs). An entity shall apply those paragraphs only to the costs incurred that relate to a contract with a customer (or part of that contract) that is within the scope of this Standard.

2. DEFINITIONS

Contract	An agreement between two or more parties that creates enforceable rights and obligations.
Contract asset	An entity's right to consideration in exchange for goods or services that the entity has transferred to a **customer** when that right is conditioned on something other than the passage of time (for example, the entity's future performance).
Contract liability	An entity's obligation to transfer goods or services to a **customer** for which the entity has received consideration (or the amount is due) from the customer.

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Customer	A party that has contracted with an entity to obtain goods or services that are an output of the entity's ordinary activities in exchange for a consideration.
Income	Increases in economic benefits during the accounting period in the form of inflows or enhancements of assets or decreases of liabilities that result in an increase in equity, other than those relating to contributions from equity participants.
Performance obligation	A promise in a **contract** with a **customer** 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.
Revenue	**Income** arising in the course of an entity's ordinary activities.
Stand-alone selling price (of goods or service)	The price at which an entity would sell a promised goods or service separately to a **customer**.
Transaction price (for a contract with a customer)	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.

3. OVERVIEW

After more than a decade of work, the International Accounting Standards Board (IASB) and Financial Accounting Standards Board (FASB) had published their largely converged standards on revenue recognition in May, 2014. The IASB issued IFRS 15 Revenue from Contracts with Customers and FASB issued ASU 2014-09 with the same name.

In convergence with IFRS, the Ministry of Corporate Affairs (MCA) issued Ind AS 115, Revenue from Contracts with Customers vide its notification dated 28th March, 20X2.

Ind AS 115 supersedes and replaces Ind AS 11 and Ind AS 18.

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

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

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

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To achieve the core principle, an entity should apply the following five-step model:

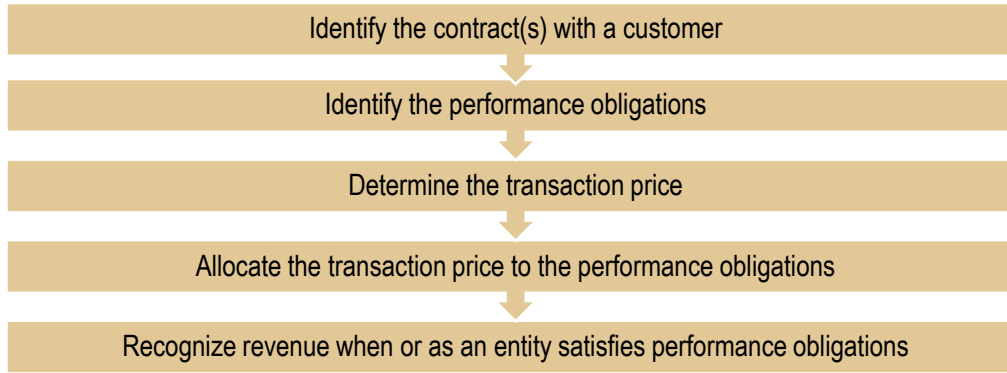
Step 1: Identify the contract with the customer.

Step 2: Identify the performance obligations in the contract.

Step 3: Determine the transaction price.

Step 4: Allocate the transaction price to the performance obligations in the contract.

Step 5: Recognize revenue when (or as) the entity satisfies its performance obligations.



Each of these steps, and some other related guidance, is discussed in details below.

Entities will need to exercise judgement when considering the terms of the contract(s) and all of the facts and circumstances, including implied contract terms. Entities will also have to apply the requirements of the standard consistently to contracts with similar characteristics and in similar circumstances.

4. TRANSITION

Ind AS 115 is effective for annual reporting periods beginning on or after 1st April, 20X2.

Entities are required to apply the new revenue standard using either of the following two approaches:

(a) Full retrospective approach: apply retrospectively to each prior period presented in accordance with Ind AS 8, subject to some practical expedients mentioned in the standard or

(b) Modified retrospective approach: apply retrospectively with the cumulative effect of initial application recognized at the date of initial application

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When applying the full retrospective method, an entity shall restate all prior periods presented in accordance with Ind AS 8. This results in comparative statements in which all periods are presented as if Ind AS 115 had been in effect since the beginning of the earliest period presented.

When applying modified retrospective approach, an entity does not restate prior periods presented and the cumulative effect of initial application is recognized in the opening retained earnings of the first year of application of Ind AS 115.

5. STEP 1: IDENTIFYING THE CONTRACT

As the guidance in Ind AS 115 applies only to contracts with customers, the first step in the model is to identify such contracts.

A contract is an agreement between two or more parties that creates enforceable rights and obligations. Enforceability of the rights and obligations in a contract is a matter of law. Contracts can be written, oral, or implied by an entity's customary business practices. The practices and processes for establishing contracts with customers vary across legal jurisdictions, industries, and entities. In addition, they may vary within an entity (for example, they may depend on the class of customer or the nature of the promised goods or services). An entity shall consider those practices and processes in determining whether and when an agreement with a customer creates enforceable rights and obligations. For example, if an entity has an established practice of starting performance based on oral agreements with its customers, it may determine that such oral agreements meet the definition of a contract. As a result, an entity may need to account for a contract as soon as performance begins, rather than delay revenue recognition until the arrangement is documented in a signed contract.

The guidance in Ind AS makes it clear that the rights and obligations in a contract must be "enforceable" in order for an entity to apply the five-step revenue model. Enforceability is a matter of law, so an entity needs to consider the local relevant legal environment to make that determination. That said, while the contract must be legally enforceable, oral or implied promises may give rise to performance obligations in the contract.

5.1 Criteria for recognizing a contract

Step 1 serves as a 'gateway' through which an entity must pass before proceeding to the later steps of the model. In other words, if at the inception of an arrangement, an entity concludes that the criteria below are not met, it should not apply Step 2 to 5 of the model until it determines that the Step 1 criteria are subsequently met. When a contract meets the five criteria and 'passes'

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Step 1, the entity will not reassess the Step 1 criteria unless there is an indication of a significant change in facts and circumstances.

Ind AS 115 requires an entity to account for a contract with a customer that is within the scope of the model in this standard only when **all** the following criteria are met:

(a) The parties have approved (in writing, orally or in accordance with other customary business practices) the contract and are committed to perform their contractual obligations

(b) The entity can identify each party's rights regarding the goods or services to be transferred

(c) The entity can identify the payment terms for the goods or services to be transferred

(d) The contract has commercial substance (i.e. the risk, timing or amount of the entity's future cash flows is expected to change as a result of the contract), and

(e) It is probable that the entity will collect substantially all of the consideration to which it expects to be entitled in exchange for the goods or services that will be transferred to the customer.

If the arrangement does not meet the five criteria at inception, an accounting contract, for purposes of applying Ind AS 115, does not exist, and the entity should continue to reassess whether the five criteria are subsequently met. For example, if a customer's ability to pay the consideration deteriorates significantly, an entity would reassess whether it is probable that the entity will collect the consideration to which it will be entitled in exchange for the remaining goods or services that will be transferred to the customer.

A contract may not pass Step 1, but the entity may still transfer goods or services to the customer and receive non-refundable consideration in exchange for those goods or services. In that circumstance, the entity cannot recognize revenue for the non-refundable consideration received until either the Step 1 criteria are subsequently met, or one of the events outlined below has occurred:

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

(b) The contract has been terminated, and the consideration received from the customer is non-refundable.

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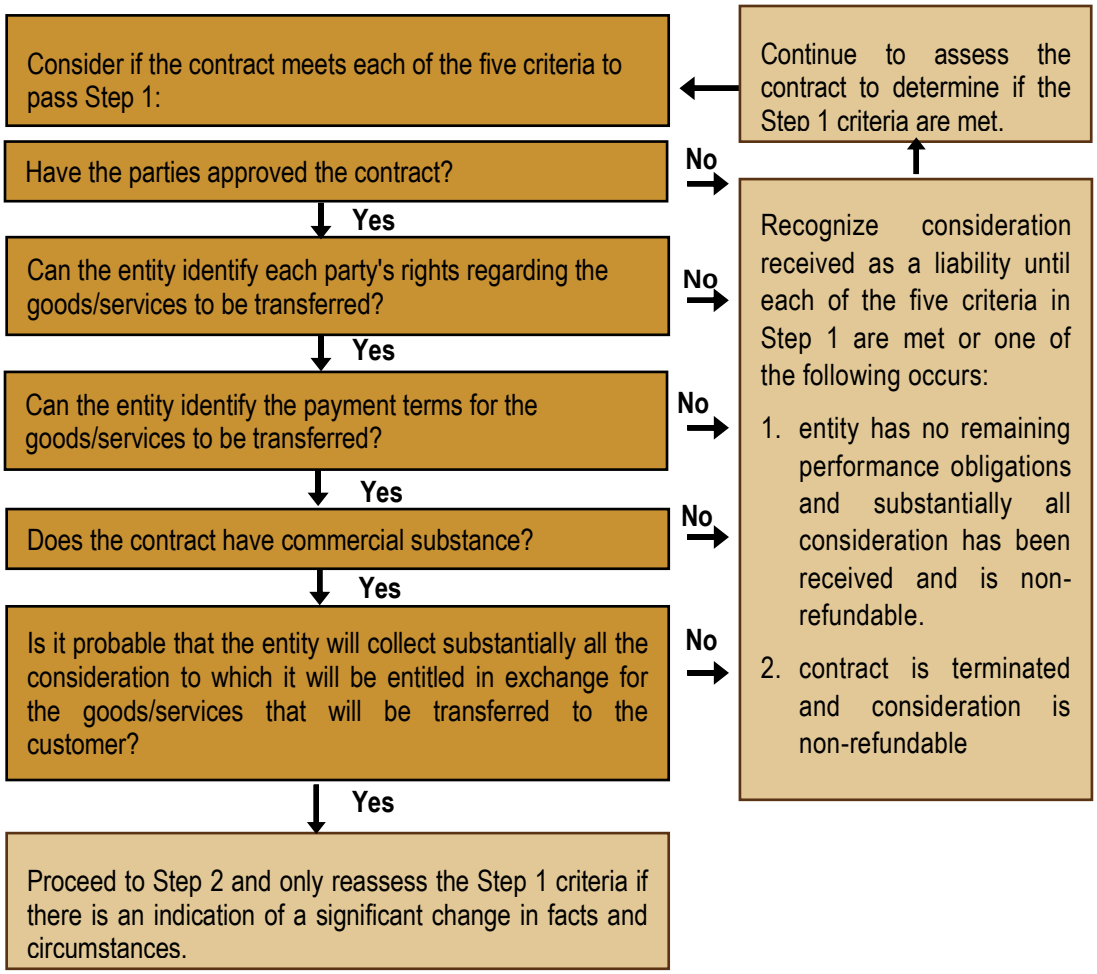

Each of the criteria mentioned above are discussed in more detail below:

5.1.1 Criteria 1: The parties have approved the contract and are committed to perform

To pass Step 1, the parties must approve the contract. This approval may be written, oral, or implied, as long as the parties intend to be bound by the terms and conditions of the contract. The form of the contract (i.e. oral, written or implied) is not determinative, in assessing whether the parties have approved the contract. Instead, an entity must consider all relevant facts and circumstances when assessing whether the parties intend to be bound by the terms and conditions of the contract. In some cases, the parties to an oral or implied contract may have the intent to fulfil their respective obligations. However, in other cases, a written contract may be required before an entity can conclude that the parties have approved the arrangement.

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In addition to approving the contract, the entity must also be able to conclude that both parties are committed to performing their respective obligations under the contract. This does not mean that the parties need to be committed to fulfil all of their respective rights and obligations in order for this criterion to be met. For example, an entity may include a requirement in a contract for the customer to purchase a minimum quantity of goods each month, but the entity may have a history of not enforcing the requirement. In this example, the contract approval criterion can still be satisfied if evidence supports that the customer and the entity are both substantially committed to the contract. Termination clauses are also an important consideration when determining whether both parties are committed to perform under a contract and, consequently, whether a contract exists. See 5.3.1 below for further discussion of termination clauses and how they affect contract duration.

5.1.2 Criteria 2: The entity can identify each party's rights

An entity must be able to identify its rights, as well as the rights of all other parties to the contract. An entity cannot assess the transfer of goods or services if it cannot identify each party's rights regarding those goods or services.

5.1.3 Criteria 3: The entity can identify the payment terms for the goods or services

An entity must also be able to identify the payment terms for the promised goods or services within the contract. Identifying the payment terms does not require that the transaction price be fixed or stated in the contract with the customer. As long as there is an enforceable right to payment (i.e. enforceability as a matter of law) and the contract contains sufficient information to enable the entity to estimate the transaction price, the contract would meet this criterion. The entity cannot determine how much it will receive in exchange for the promised goods or services (the "transaction price" in Step 3 of the model) if it cannot identify the contractual payment terms.

5.1.4 Criteria 4: The contract has commercial substance

A contract has commercial substance if the risk, timing, or amount of the entity's cash flows is expected to change as a result of the contract. In other words, the contract must have economic consequences. This criterion was added to prevent entities from transferring goods or services back and forth to each other for little or no consideration to artificially inflate their revenue. This criterion is applicable for both monetary and non-monetary transactions, because without commercial substance, it is questionable whether an entity has entered into a transaction that has economic consequences. Determining whether a contract has commercial substance for the purposes of Ind AS 115 may require significant judgement. In all situations, the entity must be able to demonstrate that a substantive business purpose exists, considering the nature and structure of its transactions.

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5.1.5. Criteria 5: It is probable the entity will collect substantially all of the consideration

To pass Step 1, an entity must determine that it is probable that it will collect substantially all of the consideration to which it will be entitled under the contract in exchange for goods or services that it will transfer to the customer. This criterion is also referred to as the 'collectability assessment'. In determining whether collection is probable, the entity considers the customer's ability and intention to pay considering all relevant facts and circumstances, including past experiences with that customer or customer class. In making the determination of customer's ability to pay, the credit risk was an important thing to determine if the contract is valid. However, customer's credit risk should not affect the measurement or presentation of revenue. The standard requires an entity to evaluate at contract inception (and when significant facts and circumstances change) whether it is probable that it will collect the consideration to which it will be entitled in exchange for the goods or services that will be transferred to a customer. For purposes of this analysis, the meaning of the term 'probable' means 'more likely than not'. If it is not probable that the entity will collect amounts to which it is entitled, the model in Ind AS 115 is not applied to the contract until the concerns about collectability have been resolved.

Illustration 1

New Way Ltd. decides to enter a new market that is currently experiencing economic difficulty and expects that in future the economy will improve. New Way Ltd. 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 Ltd. expects that it may not be able to collect the full amount from the customer.

Determine how New Way Ltd. will recognize this transaction?

Solution

Assuming the contract meets the other criteria covered within the scope of the model in Ind AS 115, New Way Ltd. need to assess whether collection is probable.

In making this assessment, New Way Ltd. 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.

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5.2 Contracts that do not pass Step 1: Reassessing the Step 1 criteria

When an entity determines that a contract passes Step 1, it should not reassess contract existence unless there is an indication of a significant change in facts and circumstances.

For example, if the customer's ability to pay significantly deteriorates, an entity would have to reassess whether it is probable that the entity will collect the consideration to which it is entitled in exchange for transferring the remaining goods and services under the contract. The updated assessment is prospective in nature and would not change the conclusions associated with goods and services already transferred. That is, an entity would not reverse any receivables, revenue or contract assets already recognized under the contract.

However, the revenue related to the remaining goods or services yet to be transferred is impacted.

5.3 Contract term

An entity applies Ind AS 115 to the contractual period over which the parties to the contract have present enforceable rights and obligations.

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

5.3.1 Termination provisions

Some contracts can be terminated by either party at any time while others may only be terminated by one party. The contract does not exist if each party to a contract has the unilateral enforceable right to terminate a wholly unperformed contract without paying a termination penalty. A 'wholly unperformed' contract means that the entity has not yet performed and is not entitled to any consideration.

In some situations, only the customer has the ability to terminate the contract without penalty. In those situations, the contract term for accounting purposes may be shorter than that stated in the contract.

However, a substantive termination penalty payable by a customer to the entity is evidence of enforceable rights and obligations of both parties throughout the period covered by the termination penalty. For example, consider a four-year service contract in which the customer has the right to cancel without cause at the end of each year, but for which the customer would incur a termination

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penalty that decreases each year and is determined to be substantive. Then, this arrangement would be treated as a four-year contract only and contract term should not be assessed less than four years unless the entity has past experience of having such contracts terminated by this customer or class of customer which may demand assessment of the contract term based on previous trend or experience.

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.

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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 additional 90 CCTV cameras. Hence, contract is for 10 units.

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5.4 Combining contracts

An entity should combine two or more contracts and account for them as a single contract in certain circumstances because the substance of the individual contracts cannot be understood without considering the entire arrangement. This evaluation takes place at contract inception.

Two or more contracts may need to be accounted for as a single contract if they are entered into at or near the same time with the same customer (or with related parties of the customer), and if one of the following conditions exists:

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

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

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

Note: Entities will need to apply judgement to determine whether contracts are entered into at or near the same time because the standard does not provide a bright line for making this assessment.

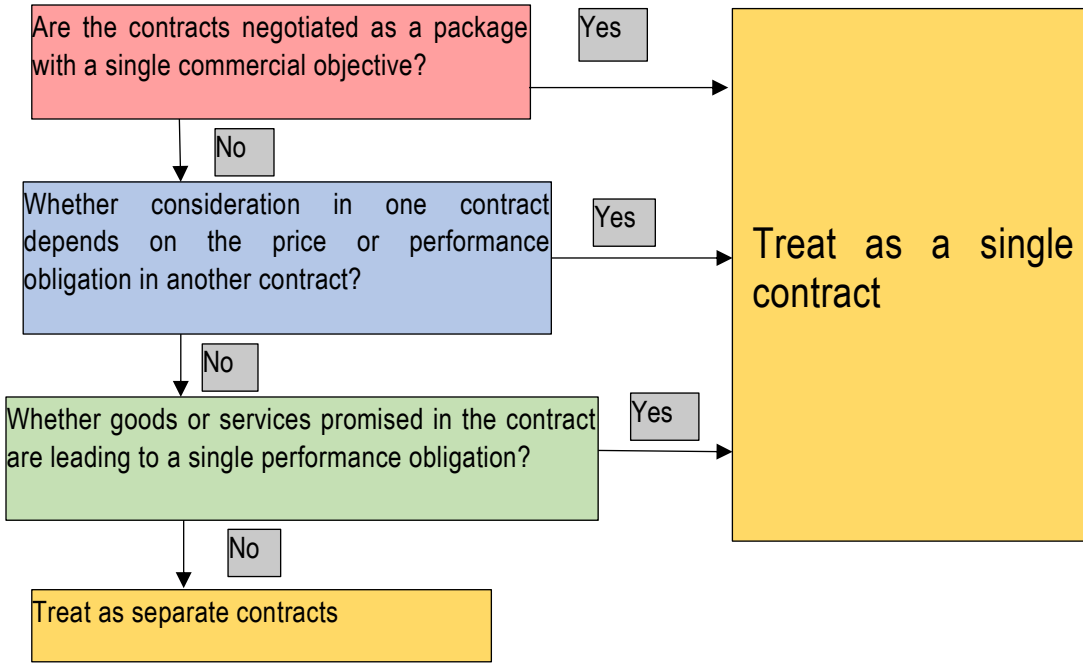

Illustration 4

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.

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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 purchase the security system, thereby also making the consideration in one contract dependent on the other contract.

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5.5 Contract Modifications

Modifications that change the terms of a contract are common in many industries, including manufacturing, telecommunications, defence, and construction. Depending upon the industry or jurisdiction, the modification may be better known as a change order, a variation, or an amendment.

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The modification guidance under Ind AS 115 requires an entity to

(a) Identify if a contract has been modified.

(b) Determine if the modification results in a separate contract, a termination of the existing contract and the creation of a new contract, or a continuation of the existing contract.

(c) Account for the contract modification accordingly.

5.5.1 Identifying a modification

A contract modification exists if three conditions are met:

(a) There is a change in the scope, price, or both in a contract.

(b) That change is approved by both the entity and the customer.

(c) The change is enforceable.

Similar to the criterion discussed above, the approval of a contract modification may be written, oral, or implied by customary business practice.

Contract modifications may take many forms and the following list includes some common examples:

(a) Partially terminating the contract

(b) Extending the contract term with or without a corresponding increase in price

(c) Adding new goods and/or services to the contract, with or without a corresponding change in price

(d) Reducing the contract price without a change in goods or services promised

5.5.2 Accounting for the modification

Once an entity determines that a contract with a customer has been modified, it needs to determine whether the modification should be accounted for as a separate contract as discussed above. If the modification is not accounted for as a separate contract, it will be accounted for in one of the following three ways:

(a) As a termination of the old contract and the creation of a new contract

(b) By making a cumulative catch-up adjustment to the original contract

(c) A combination of the two

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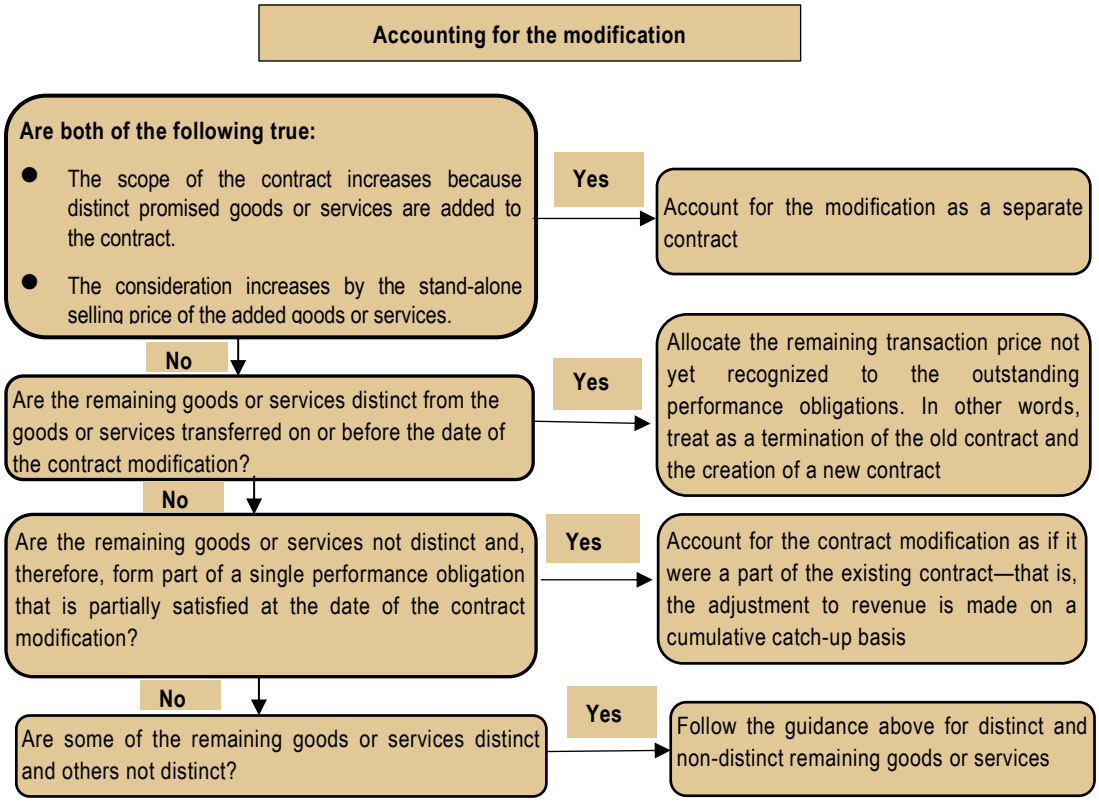

5.5.2.1 Modifications that constitute separate contracts

An entity accounts for a contract modification as a separate contract if the modification both

(1) increases the scope of the work promised under the original contract by adding new promised goods or services that are considered distinct, and

(2) the increase in the contract price reflects the stand-alone selling price of the additional goods or services. An entity determines if the additional promised goods or services are distinct using the guidance in Section 6.1.

The logic behind this guidance is that there is no economic difference between the entity entering into a separate contract or modifying an existing contract for the additional goods or services.

When assessing whether the transaction price increases by an amount of consideration that reflects the stand-alone selling prices of the additional goods or services, an entity is allowed to adjust the stand-alone selling price for costs that it does not incur because it is contracting with a repeat customer. Therefore, if the stand-alone selling price in the original contract is ₹ 10 per unit, a modification that adds units for ₹ 9.50 per unit might reflect a stand-alone selling price of the additional units. For example, the selling effort and administration costs might be much lower

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when incremental units are added, in contrast to the effort and cost of the original quantity. The entity needs to exercise judgment to make that determination.

If a modification adds a distinct goods or service to a series of distinct goods or services that is accounted for as a single performance obligation, the modification is accounted for as a separate contract as long as the transaction price increases by the stand-alone selling price for those added goods or services.

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.

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5.5.2.2 Modifications that do not constitute separate contracts

If a contract modification is not accounted for as a separate contract, the guidance provides the following three methods to account for the modification:

(a) First, account for the modification prospectively as long as the goods or services to be provided after the modification are distinct from the goods or services that were already provided to the customer. The logic behind this guidance is that accounting for these

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types of modifications on a cumulative catch-up basis could be complex and may not faithfully depict the economics of the modification since the modification is negotiated based on facts and circumstances that exist after the original contract's inception.

Illustration 8

On 1st 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 1st 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?

Solution

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

Therefore, KLC 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 i.e. ₹ 270,000.

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(b) Second, when the remaining goods or services are not distinct and are part of a single performance obligation that is partially satisfied, the entity recognizes the effect of the modification on a cumulative catch-up basis. This is the case in many construction contracts where a modification does not result in the transfer of additional distinct goods or services.

Illustration 9

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

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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 increase the estimate of labour hours by 50 hours at the rate of ₹ 100 per hour.

Determine how contract modification will be accounted for 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

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(c) Third, there may be cases where the remaining goods or services provided after a modification are a combination of both distinct and non-distinct goods or services. In this case, the entity accounts for those remaining goods or services that are distinct on a prospective basis and for those goods and services that are not distinct on a cumulative catch-up basis.

6. STEP 2: IDENTIFYING PERFORMANCE OBLIGATIONS

Under the five-step model of Ind AS 115, the second step in accounting for a contract with a customer is identifying the performance obligations. Identifying performance obligations is a crucial process in the five-step model. Performance obligations are considered as unit of account for the purposes of applying the revenue standard. Identification of performance obligations requires high degree of judgment in cases where multiple goods or services are promised in a

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

The concept of performance obligations is a cornerstone of the Ind AS 115 revenue recognition model. The timing of revenue recognition is based on satisfaction of performance obligations rather than the contract as a whole. This area is sometimes referred to as 'multiple element arrangements'.

6.1 Criteria for identifying performance obligation

At contract inception, an entity shall assess

(a) the goods or services promised in a contract with a customer and

(b) shall identify performance obligation under each promise to be transferred to the customer.

A contract with a customer generally states explicitly, the goods or services that an entity promises to transfer to the customer. However, the performance obligations identified in a contract with the customer may not be limited to the goods or services that are explicitly stated in that contract. This is because a contract with a customer may also include promises that are implied by an entity's customary business practices, published policies or specific statements if, at the time of entering into the contract, those promises to create a valid expectation of the customer that the entity will transfer goods or service to the customer. Therefore, performance obligations under a contract with the customer are not always explicit or clearly mentioned in the contract, but there can be implied promises or performance obligation under the contract as well.

Promises under the contract can be explicit or implicit if the same creates a valid expectation by the customer that the entity will provide those goods or service based on the customary business practices, published policies, or specific statements. Some of the examples of promised goods or services include:

Promise	Example
• Sale of manufactured goods	• A manufacturing entity sells inventory
• Resale of goods purchased	• A retail entity sells purchased merchandise
• Resale of rights to goods or services purchased by an entity	• A hospitality entity that purchased a concert ticket resells the ticket, acting as principal

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• Performing tasks	• A professional services entity provides consulting services
• Providing goods or services to customers on stand-by basis i.e. as and when required	• A manufacturing entity provides maintenance services on machines sold to a customer when the customer decides it wants the services performed
• Construction of an asset for the customers	• A contractor builds a hospital
• Use or access to intellectual property rights of the entity	• An entity grants a license to use its trade name
• Right to purchase additional goods or services to the customer in the future	• A retailer grants a customer an option to buy three items and to receive 60 percent off of a fourth item at a later date

An entity, a manufacturer, sells a product to a distributor (i.e. its customer) who will then resell it to an end customer.

I Explicit promise of service

- The entity promises to the distributor to provide maintenance services for no additional consideration or free of cost to any party that purchases the product from the distributor. The entity in turn appoints the distributor and pays the distributor to provide the maintenance services on company's behalf to the customer for an agreed payment. In case no one avails those services, the company is not required to pay anything to the distributor.
- Under this contract promise to provide maintenance services in the future will be considered as a performance obligation. The entity has promised to provide maintenance services regardless of whether the entity, the distributor, or a third party provides the service.

II Implicit promise of service

- The entity has historically provided maintenance services for no additional consideration (i.e. 'free') to end customers that purchase the entity's product from the distributor. The entity does not explicitly promise maintenance services during negotiations with the distributor and the final contract between the entity and the distributor does not specify terms or conditions for those services.

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- However, on the basis of its customary business practice, the entity determines at contract inception that it has made an implicit promise to provide maintenance services as part of the negotiated exchange with the distributor. That is, the entity's past practices of providing these services create valid expectations of the entity's customers (i.e. the distributor and end customers).

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

(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. Performance obligations do not include activities that an entity must undertake to fulfil a contract unless those activities transfer the goods or service to a customer. For example, a service provider may need to perform various administrative tasks to set up a contract. The performance of those tasks does not transfer a service to the customer as the tasks are performed. Therefore, those setup activities are not a performance obligation.

A. Distinct performance obligations

A goods or service that is promised to a customer is distinct if both of the following criteria are met:

Two-step model to identify which goods or services are distinct	
Step 1 - Focus on whether the good or service is **capable of being distinct**	**Step 2** - Focus on whether the good or service is **distinct in the context of the contract**
Customer can benefit from the individual good or service on its own **Or;** Customer can use good or service with other readily available resources	The good or service is not integrated with, highly dependent on, highly interrelated with, or significantly modifying or customising other promised goods or services in the contract

Each of the criteria mentioned above are discussed in more detail below:

6.1.1 Customer can benefit either on a stand-alone basis or with other readily available resources

The customer can benefit from the goods or service either on its own or with other resources readily available to them. A readily available resource is a goods or service that is sold separately (by the entity or by another entity) or that the customer has already obtained from the entity or from other transactions or events.

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A customer can benefit from a goods or service if the goods or service could be used, consumed, sold for an amount that is greater than its scrap value or otherwise held in a way that generates economic benefits.

Sometimes, a customer can benefit from a goods or service only with other readily available resources. A readily available resource is a goods or service that is sold separately (by the entity or another entity) or a resource that the customer has already obtained from the entity (including goods or services that the entity will have already transferred to the customer under the contract) or from other transactions or events. Various factors may provide evidence that the customer can benefit from a goods or service either on its own or in conjunction with other readily available resources.

For e.g, the fact that the entity regularly sells a goods or service on its own is an indicator that the goods or service is capable of being distinct.

6.1.2 Separately identifiable from other promises in the contract

Factors that indicate that an entity's promise to transfer a goods or service to a customer is separately identifiable include, but are not limited to, the following:

6.1.2.1 Significant integration service

It indicates that two or more promises to transfer goods or services are not separately identifiable from other goods or services in the contract if the entity provides significant integration services. Stated differently, the entity is using the goods or services as inputs to produce the combined output promised in the contract. When an entity provides a significant service of integrating a goods or service with other goods or services in a contract, the bundle of integrated goods or services represents a combined output or outputs. In other words, when an entity provides a significant integration service, the risk of transferring individual goods or services is inseparable from the bundle of integrated goods or services because a substantial part of an entity's promise to the customer is to make sure the individual goods or services are incorporated into the combined output or outputs.

For example, construction contracts in which a contractor provides an integration (or contract management) service to manage and coordinate the various construction tasks and to assume the risks associated with the integration of those tasks. An integration service provided by the contractor often includes coordinating the activities performed by any subcontractors and making sure the quality of the work performed is in compliance with the contract specifications and that the individual goods or services are appropriately integrated into the combined item that the customer has contracted to receive.

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6.1.2.2 Significant modification or customization

It indicates that one or more of the goods or services significantly modifies or customises, or are significantly modified or customised by, one or more of the other goods or services promised in the contract.

In some industries, such as the software industry, the notion of inseparable risks is more clearly illustrated by assessing whether one goods or service significantly modifies or customizes another goods or service in the contract. In this case, the goods or services are used as inputs and are being assembled together to create a combined output — a customized product.

Example 1

An entity promises to provide a customer with software that it will significantly customise to make the software function with the customer's existing infrastructure. Based on its facts and circumstances, the entity determines that it is providing the customer with a fully integrated system and that the customisation service requires it to significantly modify the software in such a way that the risks of providing it and the customisation service are inseparable (i.e. the software and customisation service are not separately identifiable).

6.1.2.3 Highly interdependent or highly interrelated

It indicates that two or more promises to transfer goods or services are not separately identifiable from other goods or services in the contract if the goods or services are highly interdependent or highly interrelated.

Sometimes it may be unclear whether the entity provides an integration service or whether the goods or services are significantly modified or customized; yet the individual goods or services are not separately identifiable from other goods or services because they are highly dependent on, or highly interrelated with, other promised goods or services in the contract.

The principle in evaluating whether promises are "distinct within the context of the contract" is to consider the level of integration, interrelation, or interdependence among promises to transfer goods or services. As a result, the entity must evaluate whether two or more promised goods or services significantly affect the other and are therefore highly interdependent or highly interrelated with other promised goods or services in the contract. An entity does not simply evaluate whether one item depends on another. There must be a two-way dependency. In other words, instead of concluding that an undelivered item would never be obtained by a customer absent the delivered item in the contract, the entity would consider whether the undelivered item and the delivered item each significantly affect the other and therefore are highly interdependent or highly interrelated.

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Illustration 10

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?

Solution

Determining whether a goods 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 goods 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.

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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?

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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 goods 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 goods 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 performance obligation: -

- Broadband Service
- Voice Call services
- Modem

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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 provided 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?

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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 have 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.

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B. Promise to transfer a series of distinct goods or services that are substantially the same and have the same pattern of transfer:

There might be cases, where distinct goods or services are provided continuously over a period of time. For e.g. security services, or bookkeeping services. This will be considered as single performance obligation if the consumption of those services by the customers is symmetrical.

A series of distinct goods or services has the same pattern of transfer to the customer if both of the following criteria are met:

(a) each distinct goods or service in the series that the entity promises to transfer to the customer would meet the criteria to be a performance obligation satisfied over time; and

(b) the same method would be used to measure the entity's progress towards complete satisfaction of the performance obligation to transfer each distinct goods or service in the series to the customer.

If a series of distinct goods or services meets the criteria in paragraph 22(b) and paragraph 23 of Ind AS 115 (the series requirement), an entity is required to treat that series as a single performance obligation (i.e. it is not optional). Cleaning services, transaction processing services and delivering electricity to customers are some examples that meet the series requirement.

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It is important to note that, even if, the underlying activities an entity performs to satisfy a promise vary significantly throughout the day and from day to day, that fact, by itself, does not mean the distinct goods or services are not substantially the same.

Example 2

A vendor enters into a 5-year contract with a customer to provide continuous access to its system and to process all transactions on behalf of the customer. The customer is obligated to use the vendor's system, but the ultimate quantity of transactions is unknown. The vendor concludes that the customer simultaneously receives and consumes the benefits as it performs.

If the vendor concludes that the nature of its promise is to provide continuous access to its system, rather than process a particular quantity of transactions, it might conclude that there is a single performance obligation to stand ready to process as many transactions as the customer requires. If that is the case, it would be reasonable to conclude that there are multiple distinct time increments of the service. Each day of access to the service provided to the customer could be considered substantially the same since the customer is deriving a consistent benefit from the access each day, even if a different number of transactions are processed each day.

If the vendor concludes that the nature of the promise is the processing of each transaction, then each transaction processed could be considered substantially the same even if there are multiple types of transactions that generate different payments. Furthermore, each transaction processed could be a distinct service because the customer could benefit from each transaction on its own and each transaction could be separately identifiable. Accordingly, it would be reasonable for an entity to conclude that this contract meets the series' requirement.

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 goods 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.

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6.2 Multiple Element Arrangements/ Goods and services that are not distinct

Once an entity determines whether the goods and services would be distinct based on their individual characteristics, the entity then has to consider if the manner in which the goods and services have been bundled in an arrangement would require the entity to account for two or more goods or services as one performance obligation. This determination would be required regardless of whether or not those goods and services were determined to be distinct on their own.

If the goods or services are not considered as distinct, those goods or services are combined with other goods or services under the contract till the time the entity identifies a bundle of distinct goods or services.

This combination would result in accounting of multiple goods or services in the contract as a single performance obligation. This could also result in an entity combining a goods or service that is not considered distinct with another goods or service that, on its own, would have met the criteria to be considered distinct. An entity may end up accounting for all the goods or services promised in a contract as a single performance obligation if the entire bundle of promised goods and services is the only distinct performance obligation identified.

It is important to note that the assessment of whether a goods or service is distinct must consider the specific contract with a customer. That is, an entity cannot assume that a particular goods or service is distinct (or not distinct) in all instances. The manner in which promised goods and services are bundled within a contract can affect the conclusion of whether a goods or service is distinct. Entities may treat the same goods and services differently, depending on how those goods and services are bundled within a contract.

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 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

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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 it will be required 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. 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 fulfil the performance obligation under the contract. As such, Entity A concludes that the design and construction services will be bundled and accounted for as one performance obligation.

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Illustration 15

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

Determine how many performance obligations does the entity have?

Solution

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

The entity also considers the factors of Ind AS 115 and determines that the promise to transfer each goods and service to the customer is separately identifiable from each of the other promises. In particular, the entity observes that the installation service does not significantly modify or

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customise the software itself and, as such, the software and the installation service are separate outputs promised by the entity instead of inputs used to produce a combined output.

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

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

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Illustration 16 : Significant customisation

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

Determine how many performance obligations does the entity have?

Solution

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

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

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and because the promise to transfer the software updates and the technical support to the customer are separately identifiable from each of the other promises.

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

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

b) software updates; and

c) technical support.

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Illustration 17

Telco T Ltd. enters into a two-year contract for internet services with Customer C. C also buys a modem and a router from T Ltd. and obtains title to the equipment. T Ltd. does not require customers to purchase its modems and routers and will provide internet services to customers using other equipment that is compatible with T Ltd.'s network. There is a secondary market in which modems and routers can be bought or sold for amounts greater than scrap value.

Determine how many performance obligations does the entity T Ltd. have?

Solution

T Ltd. concludes that the modem and router are each distinct and that the arrangement includes three performance obligations (the modem, the router and the internet services) based on the following evaluation:

Criterion 1: Capable of being distinct

- C can benefit from the modem and router on their own because they can be resold for more than scrap value.
- C can benefit from the internet services in conjunction with readily available resources – i.e. either the modem and router are already delivered at the time of contract set- up, they could be bought from alternative retail vendors or the internet service could be used with different equipment.

Criterion 2: Distinct within the context of the contract

- T Ltd. does not provide a significant integration service.
- The modem, router and internet services do not modify or customise one another.

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- C could benefit from the internet services using routers and modems that are not sold by T Ltd. Therefore, the modem, router and internet services are not highly dependent on or highly inter-related with each other.

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Illustration 18

V Ltd. grants Customer C a three-year licence for anti-virus software. Under the contract, V Ltd. promises to provide C with when-and-if-available updates to that software during the licence period. The updates are critical to the continued use of the anti-virus software.

Determine how many performance obligations does the entity have?

Solution

V Ltd. concludes that the licence and the updates are not distinct because the updates are critical to the continued use of the anti-virus during the licence period. C can benefit from the updates together with the licence transferred when the contract is signed.

Therefore, V Ltd. concludes that the licence and the updates are not separately identifiable because the software and the service are inputs into a combined item in the contract − i.e. the nature of V Ltd.'s promise is to provide continuous anti-virus protection for the term of the contract. Therefore, V Ltd. accounts for the licence and the updates as a single performance obligation.

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Illustration 19

Media Company P Ltd. offers magazine subscriptions to customers. When customers subscribe, they receive a printed copy of the magazine each month and access to the magazine's online content.

Determine how many performance obligations does the entity have?

Solution

P evaluates whether the promises to provide printed copies and online access are separate performance obligations. P determines that the arrangement includes two performance obligations for the following reasons:

- The printed copies and online access are both capable of being distinct because the customer could use them on their own.

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- The printed copies and online access are distinct within the context of the contract because they are different formats, so they do not significantly customise or modify each other, nor is there any transformative relationship into a single output.

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Illustration 20-Implied promise to reseller's customers

Software Company K Ltd. enters into a contract with reseller D, which then sells software products to end users. K Ltd. has a customary business practice of providing free telephone support to end users without involving the reseller, and both reseller and the customer expect K Ltd. to continue to provide this support.

Determine how many performance obligations does the entity K Ltd. have?

Solution

In evaluating whether the telephone support is a separate performance obligation, K Ltd. notes that the promise to provide telephone support free of charge to end users is considered a service that meets the definition of a performance obligation when control of the software product transfers to D. As a result, K Ltd. accounts for the telephone support as a separate performance obligation in the transaction with D.

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Illustration 21-Implied performance obligation

Carmaker N Ltd. has a historical practice of offering free maintenance services – e.g. oil changes and tyre rotation – for two years to the end customers of dealers who buy its vehicles. However, the two years' free maintenance is not explicitly stated in the contract with its dealers, but it is typically stated in N's advertisements for the vehicles.

Determine how many performance obligations does the entity have?

Solution

The maintenance is treated as a separate performance obligation in the sale of the vehicle to the dealer. Revenue from the sale of the vehicle is recognized when control of the vehicle is transferred to the dealer. Revenue from the maintenance services is recognized separately as and when the maintenance services are provided to the retail customer.

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6.3 Customer options for additional goods or services

Retail and consumer products entities frequently give certain customers the option to purchase additional goods or services. These options come in many forms, including sales incentives (e.g., coupons with a limited distribution, competitor price matching programs aimed at only some customers, gift cards issued by a retailer as a promotion) and customer award credits (e.g., loyalty or reward programs).

The standard states that when an entity grants a customer the option to acquire additional goods or services, that option is only a separate performance obligation if it provides a material right to the customer. The right is material if it results in a discount that the customer would not receive without entering into the contract (e.g., a discount that exceeds the range of discounts typically given for those goods or services to that class of customer in that geographical area or market).

If the option provides a material right to the customer, the customer in effect pays the entity in advance for future goods or services and the entity recognizes revenue when those future goods or services are transferred or when the option expires.

If the discounted price in the option reflects the stand-alone selling price (separate from any existing relationship or contract), the entity is deemed to have made a marketing offer rather than having granted a material right.

In such cases, the entity has made a marketing offer that it shall account for in accordance with this Standard only when the customer exercises the option to purchase the additional goods or services.

This standard requires an entity to allocate the transaction price to performance obligations on a relative stand-alone selling price basis. If the stand-alone selling price for a customer's option to acquire additional goods or services is not directly observable, an entity shall estimate it. That estimate shall reflect the discount that the customer would obtain when exercising the option, adjusted for both of the following:

(a) any discount that the customer could receive without exercising the option; and

(b) the likelihood that the option will be exercised.

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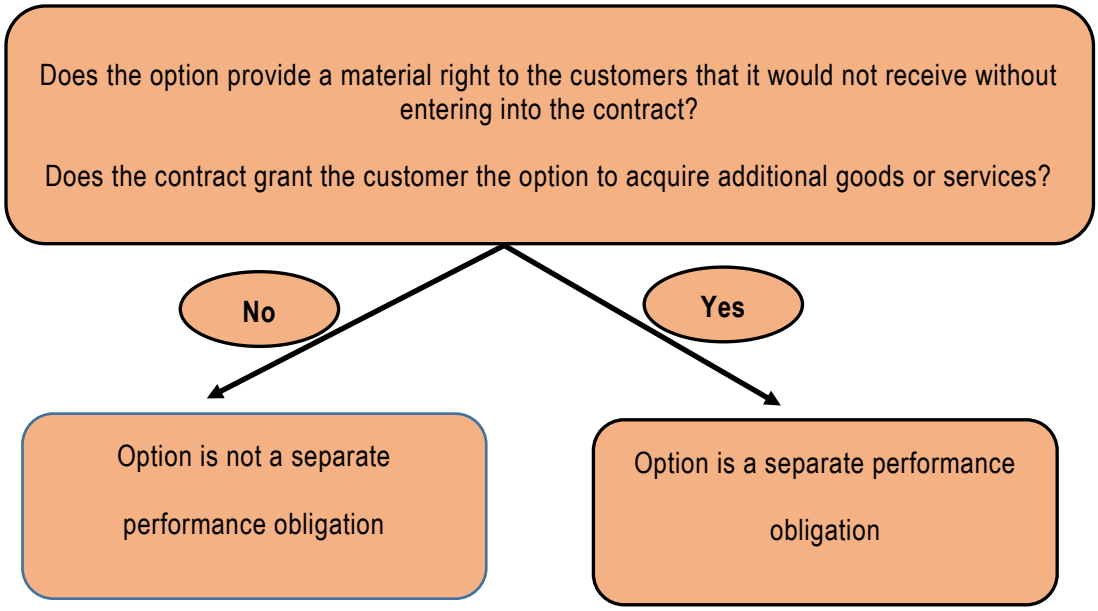

Illustration 22

Entity sells gym memberships for ₹ 7,500 per year to 100 customers, with an option to renew at a discount in 2nd and 3rd years at ₹ 6,000 per year. Entity estimates an annual attrition rate of 50% each year.

Determine the amount of revenue to be recognized in the first year and the amount of contract liability against the option given to the customer for renewing the membership at discount.

Solution

Allocated price per unit (year) is calculated as follows:

Total estimated memberships is 175 members (Year 1 = 100; Year 2 = 50; Year 3 = 25) = 175

Total consideration is ₹ 12,00,000 {(100 x 7,500) + (50 x 6,000) + (25 x 6,000)}

Allocated price per membership is ₹ 6,857 approx. (12,00,000 / 175)

Based on above, it is to be noted that although entity has collected ₹ 7,500 but revenue can be recognized at ₹ 6,857 approx. per membership and remaining ₹ 643 should be recorded as contract liability against option given to customer for renewing their membership at discount.

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Illustration 23

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

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

Determine how many performance obligations does the entity have and their stand-alone selling price and allocated transaction price.

Solution

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

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

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

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

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

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6.4 Long term arrangements

Entities frequently enter into arrangements to provide services on a long-term basis, such as maintenance services to be provided over a long period of time.

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

The entity would separately account for its rights and obligations for each period in which the contract cannot be cancelled by either party.

In long-term service agreements when the consideration is fixed, the accounting generally will not change regardless of whether a single performance obligation or multiple performance obligations are identified.

Illustration 24

A cable company provides television services for a fixed rate fee of ₹ 800 per month for a period of 3 years. Cable services is satisfied overtime because customer consumes and receives benefit from services as it is provided i.e. customer generally benefits each day that they have access to cable service.

Determine how many performance obligations does the cable company have?

Solution

Cable company determines that each increment of its services e.g. day or month, is a distinct performance obligation because customer benefits from that period of services on its own. Additionally, each increment of service is separately identifiable from those preceding and following it i.e. one service period does not significantly affect, modify or customise another. Therefore, it can be concluded that its contract with customer is a single performance obligation to provide three years of cable service because each of the distinct increments of service is satisfied over time. Also, cable company uses the same measure of progress to recognize revenue on its cable television service regardless of the contract's time period.

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6.5 Consignment Arrangements

Entities frequently deliver inventory on a consignment basis to other parties (e.g. distributor, dealer). By shipping on a consignment basis, consignors are able to achieve better sales by moving them closer to the end-customer. However, they do so without selling the goods to the intermediary (consignee). A consignment agreement is an agreement between a consignee and consignor for the storage, transfer, sale or resale and use of the goods. The consignee may take goods from the consignment stock for use or resale subject to payment to the consignor agreeably to the terms bargained in the consignment agreement. Entities frequently deliver inventory on a consignment basis to other parties (e.g., distributor, dealer).

The following indicators have been provided to evaluate whether the arrangement is a consignment arrangement:

(a) the product is controlled by the entity until a specified event occurs, such as the sale of the product to a customer of the dealer or until a specified period expires;

(b) the entity is able to require the return of the product or transfer the product to a third party (such as another dealer); and

(c) the dealer does not have an unconditional obligation to pay for the product (although it might be required to pay a deposit).

Entities entering into a consignment arrangement must determine the nature of the performance obligation (i.e., whether the obligation is to transfer the inventory to the consignee or to transfer the inventory to the end customer). This determination is based on whether control of the inventory has passed to the consignee upon delivery. In case of consignment arrangement, a consignor will not relinquish control of consignment inventory until the inventory is sold to the consumer or on the expiry of an agreed period. Consignees does not have an obligation to pay, until the goods are sold to the ultimate or end consumer. As a result, revenue generally would not be recognized for consignment arrangements when the goods are delivered to the consignee because control has been not yet transferred. Revenue is recognized when the entity has transferred control of the goods to the consignor or the end consumer. A consignment sale differs from a sale with a right of return. The customer has control of the goods in a sale with right of return and can decide whether to put the goods back to the seller. In case of consignment sales, the consignee does not have the control over the goods.

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Illustration 25

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

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

Solution

Manufacturer M determines that control has not 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 dresses are sold to the end customer.

*****

6.6 Principal vs agent consideration

Some contracts result in an entity's customer receiving goods or services from another entity that is not a direct party to the contract with the customer. The standard states that when other parties are involved in providing goods or services to an entity's customer, the entity must determine whether its performance obligation is to provide the goods or service itself (i.e., the entity is a principal) or to arrange for another party to provide the goods or service (i.e., the entity is an agent). The determination of whether the entity is acting as a principal, or an agent affects the amount of revenue the entity recognizes. That is,

- when the entity is the principal in the arrangement, the revenue recognized is the gross amount to which the entity expects to be entitled.

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- when the entity is acting as an agent, the revenue recognized is the net amount i.e. the amount, entity is entitled to retain in return for its services under the contract. The entity's fee or commission may be the net amount of consideration that the entity retains after paying the other party the consideration received in exchange for the goods or services to be provided by that party.

A principal's performance obligations in an arrangement differ from an agent's performance obligations. For example, if an entity obtains control of the goods or services of another party before it transfers those goods or services to the customer, the entity's performance obligation may be to provide the goods or services itself. Hence, the entity likely is acting as a principal and would recognize revenue in the gross amount to which it is entitled. An entity that obtains legal title of a product only momentarily before legal title is transferred to the customer is not necessarily acting as a principal. In contrast, an agent facilitates the sale of goods or services to the customer in exchange for a fee or commission and generally does not control the goods or services for any length of time. Therefore, the agent's performance obligation is to arrange for another party to provide the goods or services to the customer. Since the identification of the principal in a contract is not always clear, Ind AS 115 provides indicators that a performance obligation involves an agency relationship.

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

(a) the entity is primarily responsible for fulfilling the contract. This typically includes responsibility for the acceptability of the specified goods or service;

(b) the entity has inventory risk before the specified good or service has been transferred to a customer or after transfer of control to the customer (for example, if the customer has a right of return).

(c) the entity has discretion in establishing prices for the goods or services.

After an entity identifies its promise and determines whether it is the principal or the agent, the entity recognizes revenue when it satisfies that performance obligation. In some contracts in which the entity is the agent, control of the goods or services promised by the agent might transfer before the customer receives the goods or services from the principal.

For example, an entity might satisfy its promise to provide customers with loyalty points when those points are transferred to the customer if:

(a) The entity's promise is to provide loyalty points to customers when the customer purchases goods or services from the entity

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(b) The points entitle the customers to future discounted purchases with another party (i.e., the points represent a material right to a future discount)

(c) The entity determines that it is an agent (i.e., its promise is to arrange for the customers to be provided with points) and the entity does not control those points before they are transferred to the customer.

In contrast, if the points entitle the customers to future goods or services to be provided by the entity, the entity may conclude it is not an agent. This is because the entity's promise is to provide those future goods or services.

Therefore, the entity controls both the points and the future goods or services before they are transferred to the customer. In these cases, the entity's performance obligation may only be satisfied when the future goods or services are provided.

In other cases, the points may entitle customers to choose between future goods or services provided by either the entity or another party. In this situation, the nature of the entity's performance obligation may not be known until the customer makes its choice. That is, until the customer has chosen the goods or services to be provided (and, therefore, whether the entity or the third party will provide those goods or services), the entity is obliged to stand ready to deliver goods or services. Therefore, the entity may not satisfy its performance obligation until it either delivers the goods or services or is no longer obliged to stand ready. If the customer subsequently chooses the goods or services from another party, the entity would need to consider whether it was acting as an agent. If so, it would recognize revenue, but only for the fee or commission that the entity receives in return for providing the services to the customer and the third party.

Following illustrations explain the application of the principal versus agent application guidance:

Illustration 26

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

The entity also assists the customers in resolving complaints with the service provided by airlines. However, each airline is responsible for fulfilling obligations associated with the ticket, including remedies to a customer for dissatisfaction with the service.

Determine whether the entity is a principal or an agent.

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Solution

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

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

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

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

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

*****

Illustration 27

Company D Ltd. provides advertising services to customers. D Ltd. enters into a sub-contract with a multinational online video sharing company, F Ltd. Under the sub-contract, F Ltd. places all of D Ltd.'s customers' adverts.

D Ltd. notes the following:

– *D Ltd. works directly with customers to understand their advertising needs before placing adverts.*

– *D Ltd. is responsible for ensuring that the advert meets the customer's needs after the advert is placed.*

– *D Ltd. directs F Ltd. over which advert to place and when to place it.*

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– *D Ltd. does not bear inventory risk because there is no minimum purchase requirement with F Ltd.*

– *D Ltd. does not have discretion in setting the price because fees are charged based on F Ltd.'s scheduled rates.*

D is Principal or an agent?

Solution

D Ltd. is primarily responsible for fulfilling the promise to provide advertising services. Although F Ltd. delivers the placement service, D Ltd. works directly with customers to ensure that the services are performed to their requirements. Even though D Ltd. does not bear inventory risk and does not have discretion in setting the price, it controls the advertising services before they are provided to the customer. Therefore, D Ltd. is the principal in this case.

*****

6.7 Non-refundable upfront fees

In some contracts, an entity charges the customer a non-refundable upfront fee. Examples include joining fees in health club membership, activation fees for telecom services, setup fees in certain service contracts and initial fees or joining fees in some supply contracts with the distributors or customers.

To identify performance obligations in such contracts, an entity shall assess whether the fee relates to an activity that the entity is required to undertake at the inception of the contract, or that activity does not result in the transfer of a promised goods or service to the customer.

In many cases, even though a non-refundable upfront fee relates to an activity that the entity is required to undertake at or near contract inception to fulfil the contract, that activity does not result in the transfer of a promised goods or service to the customer. Instead, the upfront fee is an advance payment for future goods and services and, therefore, would be recognized as revenue when those future goods and services are provided.

If the non-refundable upfront fee relates to a goods or service, the entity shall evaluate whether to account for the goods or services as a separate performance obligation. An entity may charge a non-refundable fee as a part of compensation of costs incurred in setting up a contract (or other administrative tasks). If those setup activities do not satisfy performance obligation, the entity shall disregard those activities (and related costs) when measuring progress. That is because the costs of setup activities do not depict transfer of services to customer.

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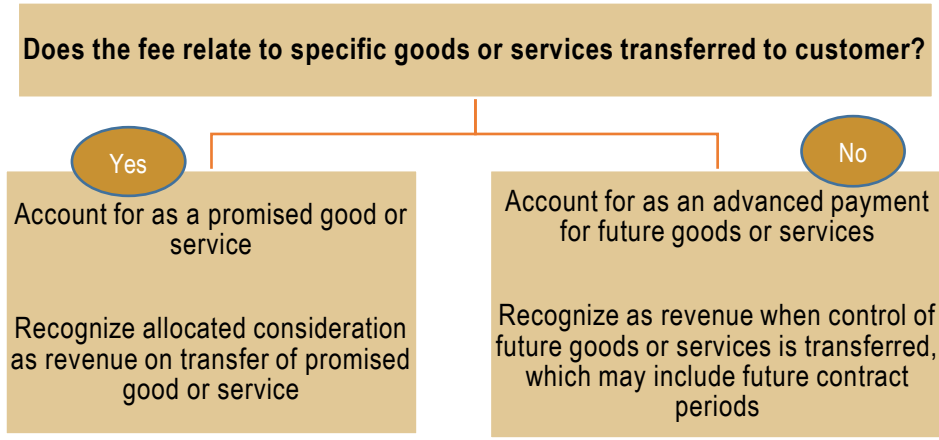

Illustration 28

A 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 from 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 a separate performance obligation.

*****

7. STEP 3: DETERMINING THE TRANSACTION PRICE

Measurement

"When (or as) a performance obligation is satisfied, an entity shall recognize as revenue the amount of the transaction price (which excludes estimates of variable consideration that are constrained in accordance with paragraphs 56 – 58) that is allocated to that performance obligation."

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After identifying the contract in Step 1 and the performance obligations in Step 2, an entity next applies Step 3 to **determine the transaction price** of the contract. The objective of Step 3 is to predict the total amount of consideration to which the entity will be entitled from the contract.

What is the transaction price?

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

The consideration promised in a contract with a customer may include fixed amounts, variable amounts, or both. Further, an entity shall consider the terms of the contract and its customary business practices to determine the transaction price.

For the purpose of determining the transaction price, an entity shall assume that the goods or services will be transferred to the customer as promised in accordance with the existing contract and that the contract will not be cancelled, renewed or modified.

The nature, timing and amount of consideration promised by a customer affect the estimate of the transaction price. When determining the transaction price, an entity shall consider the effects of all of the following:

Transaction Price

Variable consideration (and the constraint)

An entity estimates the amount of variable consideration to which it expects to be entitled, considering the risk of reversal of revenue in making the estimate

Significant financing component

For contracts with a significant financing component, an entity adjusts the promised amount of consideration to reflect the time value of money

Non-cash consideration

Non-cash consideration is measured at fair value, if that can be reasonably estimated.

If not, then an entity uses the stand-alone selling price of the goods or service that was promised in exchange for non-cash consideration

Consideration payable to a customer

An entity needs to determine whether consideration payable to a customer represents a reduction of the transaction price, a payment for a distinct good or service, or a combination of the two.

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Comparison with AS 7 and AS 9

Neither AS 7 nor AS 9 has any specific mention about significant financing component in a transaction price.

7.1 Variable consideration

What is variable consideration?

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

Examples of variable consideration

"An amount of consideration can vary because of discounts, rebates, refunds, credits, price concessions, incentives, performance bonuses, or other similar items. The promised consideration can also vary if an entity's entitlement to the consideration is contingent on the occurrence or non-occurrence of a future event. For example, an amount of consideration would be variable if either a product was sold with a right of return, or a fixed amount is promised as a performance bonus on achievement of a specified milestone."

Variable consideration may be fixed in amount, but the entity's right to receive that consideration is contingent on a future outcome. For example, the amount of a performance bonus might be fixed, but because the entity is not entitled to that bonus until a performance target is met, the outcome is uncertain and therefore the amount is considered variable. Items such as discounts, rebates, refunds, rights of return, early settlement discounts, credits, price concessions, incentives, performance bonuses, penalties or similar items may result in variable consideration.

The variability relating to the consideration promised by a customer **may be explicitly stated** in the contract. In addition to the terms of the contract, the promised consideration is variable if either of the following circumstances exists:

(a) the customer has a **valid expectation arising from an entity's customary business practices**, published policies or specific statements that the entity will accept an amount of consideration that is less than the price stated in the contract. That is, it is expected that the entity will offer a price concession. Depending on the jurisdiction, industry or customer this offer may be referred to as a discount, rebate, refund or credit.

(b) other facts and circumstances indicate that the **entity's intention**, when entering into the contract with the customer, is to offer a price concession to the customer.

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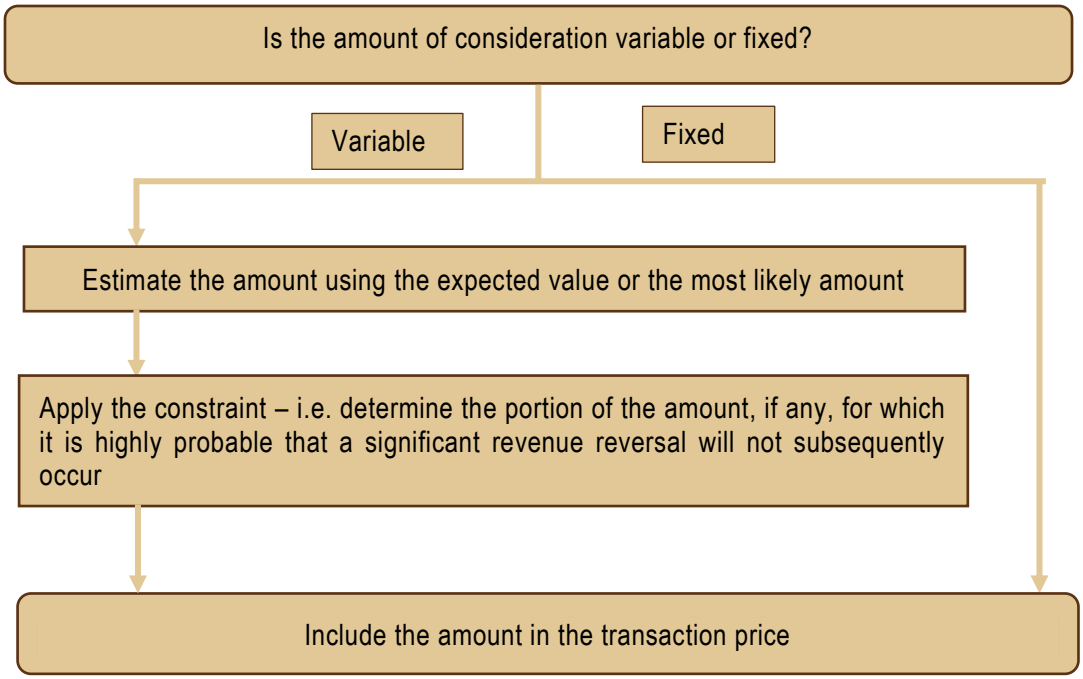

7.1.1 Penalties

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.

Example 3

Where an entity agrees to transfer control of a goods or service in a contract with customer at the end of 30 days for ₹ 100,000 and if it exceeds 30 days, the entity is entitled to receive only ₹ 95,000, the reduction of ₹ 5,000 shall be regarded as variable consideration. In other cases, the transaction price shall be considered as fixed at ₹ 95,000.

7.1.2 Estimating the amount of variable consideration

As per Ind AS 115.53, an entity shall estimate an amount of variable consideration by using either of the following methods, depending on which method the entity expects to better predict the amount of consideration to which it will be entitled:

(a) **The expected value** - the expected value is the sum of probability-weighted amounts in a range of possible consideration amounts. An expected value may be an appropriate estimate of the amount of variable consideration if an entity has a large number of contracts with similar characteristics.

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(b) **The most likely amount** - the most likely amount is the single most likely amount in a range of possible consideration amounts (ie the single most likely outcome of the contract). The most likely amount may be an appropriate estimate of the amount of variable consideration if the contract has only two possible outcomes (for example, an entity either achieves a performance bonus or does not).

An entity is required to choose between the expected value method and the most likely amount method. The choice is based on the method which better predicts the amount of consideration to be entitled. **That is, the method selected is not meant to be a 'free choice'**. Rather, an entity selects the method that is best suited, based on the specific facts and circumstances of the contract.

An entity shall apply one method consistently throughout the contract when estimating the effect of an uncertainty on an amount of variable consideration to which the entity will be entitled. An entity shall consider all the information that is reasonably available to the entity and shall identify a reasonable number of possible consideration amounts.

A contract may contain different types of variable consideration. It may be appropriate for an entity to use different methods (i.e. expected value or most likely amount) for estimating different types of variable consideration within a single contract.

Illustration 29 : Estimating variable consideration

XYZ Limited enters into a contract with a customer to build sophisticated machinery. The promise to transfer the asset is a performance obligation that is satisfied over time. The promised consideration is ₹ 2.5 crore, but that amount will be reduced or increased depending on the timing of completion of the asset. Specifically, for each day after 31st March, 20X1 that the asset is incomplete, the promised consideration is reduced by ₹ 1 lakh. For each day before 31st 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 be entitled to an incentive bonus of ₹ 15 lakh.

Determine the transaction price.

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:

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

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

*****

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

Illustration 30 : 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 crore.

The entity has the opportunity to earn a performance bonus for early completion as follows:

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

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

Determine the transaction price.

Solution

In determining the transaction price, AST Limited separately estimates variable consideration for each element of variability 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

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

Bonus %	Amount of bonus (₹ in crore)	Probability	Probability-weighted amount (₹ in crore)
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 crore or Nil) and this method would best predict the amount of consideration associated with the quality bonus. AST Limited believes the most likely amount of the quality bonus is ₹ 2 crore.

Accordingly, the transaction price would be

₹ 25 crore + ₹ 2.125 crore + ₹ 2 crore = ₹ 29.125 crore.

*****

As per para 54 of Ind AS 115, an entity shall apply one method consistently throughout the contract when estimating the effect of an uncertainty on an amount of variable consideration to which the entity will be entitled. In addition, an entity shall consider all the information (historical, current and forecast) that is reasonably available to the entity and shall identify a reasonable number of possible consideration amounts. The information that an entity uses to estimate the amount of variable consideration would typically be similar to the information that the entity's management uses during the bid-and-proposal process and in establishing prices for promised goods or services.

7.1.3 Refund liabilities

An entity shall recognize a refund liability if the entity receives consideration from a customer and expects to refund some or all of that consideration to the customer. A refund liability is measured at the amount of consideration received (or receivable) for which the entity does not expect to be entitled (i.e. amounts not included in the transaction price). The refund liability (and corresponding

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change in the transaction price and, therefore, the *contract liability*) shall be updated at the end of each reporting period for changes in circumstances.

While the most common form of refund liabilities may be related to sales with a right of return, the refund liability requirements also apply when an entity expects that it will need to refund consideration received due to poor customer satisfaction with a service provided (i.e. there was no goods delivered or returned) and/or if an entity expects to have to provide retrospective price reductions to a customer (e.g. if a customer reaches a certain threshold of purchases, the unit price will be retrospectively adjusted).

7.1.4 Constraining estimates of variable consideration

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

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

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

(b) the uncertainty about the amount of consideration is not expected to be resolved for a long period of time.

(c) the entity's experience (or other evidence) with similar types of contracts is limited, or that experience (or other evidence) has limited predictive value.

(d) the entity has a practice of either offering a broad range of price concessions or changing the payment terms and conditions of similar contracts in similar circumstances.

(e) the contract has a large number and broad range of possible consideration amounts.

7.1.5 Reassessment of variable consideration

At the end of each reporting period, an entity shall update the estimated transaction price (including updating its assessment of whether an estimate of variable consideration is constrained) to represent faithfully the circumstances present at the end of the reporting period and the changes in circumstances during the reporting period. The entity shall account for changes in the transaction price in accordance with paragraphs 87 – 90 of Ind AS 115.

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Comparison with AS 7 and AS 9

AS 7 and AS 9 both are silent on a situation where revenue should be reversed as specified in Ind AS 115.

Illustration 31 : Volume discount incentive

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

For the first quarter ended 30th 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 recognized (i.e. ₹ 1,000 per unit) will not occur when the uncertainty is resolved (i.e. when the total amount of purchases is known).

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

Determine the amount of revenue to be recognize by HT Ltd. for the quarter ended 30th June, 20X1 and 30th September, 20X1.

Solution

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

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

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Illustration 32 : 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 ₹ 9,50,000. 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 alternatives 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 confidence 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 includes 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 recognized 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 it is on the 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 the year four because, at this point, it is probable that a significant reversal in the amount of cumulative revenue recognized will not occur when including the entire variable consideration in the transaction price.

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

Year	₹
1	50,000
2	1,75,000

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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 costs, with the assumption that total 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 amount	C	100,000	100,000	100,000	250,000	250,000
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)	—	—	—	98,683	—
Total revenue	G=D+E+F	57,895	202,632	463,158	460,527	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	185,527	15,790
Margin (rounded off)	J=I/G	14%	14%	14%	40%	24%

* For simplicity, it is assumed there 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 to total estimated costs to complete, less revenue recognized to date.

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Calculation of cumulative catch-up adjustment:			
Updated variable consideration	L		250,000
Percent complete in Year 4: (rounded off)	M=N/O		94.736%
Cumulative costs through Year 4	N	900,000	
Estimated costs to complete	O	950,000	
Cumulative variable revenue through Year 4:	P		138,157
Cumulative catch-up adjustment	F= (L x M)–P		98,683

*****

Illustration 33 : Management fees subject to the constraint

On 1st April, 20X1, an entity enters into a contract with a client to provide asset management services for five years. The entity receives a two per cent quarterly management fee based on the client's assets under management at the end of each quarter. At 31st March, 20X2, the client's assets under management are ₹ 100 crore. In addition, the entity receives a performance-based incentive fee of 20 per cent of the fund's return in excess of the return of an observable market index over the five-year period. Consequently, both the management fee and the performance fee in the contract are variable considerations.

Analyse the revenue to be recognized on 31st March, 20X2.

Solution

The entity accounts for the services as a single performance obligation because it 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).

The entity observes that the promised consideration is dependent on the market and thus is highly susceptible to factors outside the entity's influence. In addition, the incentive fee has a large number and a broad range of possible consideration amounts. The entity also observes that although it has experience with similar contracts, that experience is of little predictive value in determining the future performance of the market. Therefore, at contract inception, the entity cannot conclude that it is highly probable that a significant reversal in the cumulative amount of revenue recognized would not occur if the entity included its estimate of the management fee or the incentive fee in the transaction price.

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At each reporting date, the entity updates its estimate of the transaction price. Consequently, at the end of each quarter, the entity concludes that it can include in the transaction price the actual amount of the quarterly management fee because the uncertainty is resolved. However, the entity concludes that it cannot include its estimate of the incentive fee in the transaction price at those dates. This is because there has not been a change in its assessment from contract inception — the variability of the fee based on the market index indicates that the entity cannot conclude that it is highly probable that a significant reversal in the cumulative amount of revenue recognized would not occur if the entity included its estimate of the incentive fee in the transaction price.

At 31st March, 20X2, the client's assets under management are ₹ 100 crore. Therefore, the resulting quarterly management fee and the transaction price is ₹ 2 crore.

At the end of each quarter, the entity allocates the quarterly management fee to the distinct services provided during the quarter. This is because the fee relates specifically to the entity's efforts to transfer the services for that quarter, which are distinct from the services provided in other quarters.

Consequently, the entity recognizes ₹ 2 crore as revenue for the quarter ended 31st March, 20X2.

*****

7.1.6 Sale with a right of return

In some contracts, an entity transfers control of a product to a customer (refer Step 5) and also grants the customer the right to return the product for various reasons (such as dissatisfaction with the product) and receive any combination of the following:

(a) a full or partial refund of any consideration paid;

(b) a credit that can be applied against amounts owed, or that will be owed, to the entity; and

(c) another product in exchange.

In some contracts, an entity transfers control of a product to a customer with an unconditional right of return. In such cases, the recognition of revenue shall be as per the substance of the arrangement. Where the substance is that of a consignment sale, the entity shall account for such a contract as per the provisions of Ind AS 115's application guidance related to consignment sales (refer paragraph B77 and B78 of Application Guidance to Ind AS 115). In other cases, the accounting for contracts with customers shall be as per provisions laid out below.

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

(a) revenue for the transferred products in the amount of consideration to which the entity expects to be entitled (therefore, revenue would not be recognized for the products expected to be returned);

(b) a refund liability; and

(c) an asset (and corresponding adjustment to cost of sales) for its right to recover products from customers on settling the refund liability.

An entity's promise to stand ready to accept a returned product during the return period shall not be accounted for as a performance obligation in addition to the obligation to provide a refund.

An entity shall apply the requirements in paragraphs 47 – 72 (including the requirements for constraining estimates of variable consideration in paragraphs 56 – 58) to determine the amount of consideration to which the entity expects to be entitled (i.e. excluding the products expected to be returned). For any amounts received (or receivable) for which an entity does not expect to be entitled, the entity shall not recognize revenue when it transfers products to customers but shall recognize those amounts received (or receivable) as a refund liability. Subsequently, at the end of each reporting period, the entity shall update its assessment of amounts for which it expects to be entitled in exchange for the transferred products and make a corresponding change to the transaction price and, therefore, in the amount of revenue recognized.

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

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

Exchanges by customers of one product for another of the same type, quality, condition and price (for example, one colour or size for another) are not considered returns for the purposes of applying this Standard.

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Accounting for restocking fees for goods that are expected to be returned

Entities sometimes charge customers a 'restocking fee' when a product is returned. This fee may be levied by entities to compensate them for the costs of repackaging, shipping and/or reselling the item at a lower price to another customer.

Restocking fees for goods that are expected to be returned would be included in the estimate of the transaction price at contract inception and recorded as revenue when (or as) control of the goods transfers.

Example 4

An entity enters into a contract with a customer to sell 10 units of a product for ₹ 100 per unit. The customer has the right to return the product, but if it does so, it will be charged a 3% restocking fee (or ₹ 3 per returned unit). The entity estimates that 10% of the sold units will be returned. Upon transfer of control of the 10 units, the entity will recognize revenue of ₹ 903 [(9 units not expected to be returned x ₹ 100 selling price) + (1 unit expected to be returned x ₹ 3 restocking fee per unit)]. A refund liability of ₹ 97 will also be recorded [1 unit expected to be returned x (₹ 100 selling price – ₹ 3 restocking fee)].

Contracts in which a customer may return a defective product in exchange for a functioning product shall be evaluated in accordance with the guidance on warranties given below.

Illustration 34 : Right of return

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

The entity applies the requirements 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 be returned.

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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 recognized by the entity for the said contracts.

Solution

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

Upon transfer of control of the 1,000 products, the entity does not recognize 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 recognizes the following:

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

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

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

*****

7.1.7 Warranties

It is common for an entity to provide (in accordance with the contract, the law or the entity's customary business practices) a warranty in connection with the sale of a product (whether a goods or service). The nature of a warranty can vary significantly across industries and contracts. Some warranties provide a customer with **assurance** that the related product will function as the parties intended because it complies with agreed-upon specifications. Other warranties provide the customer with a **service** in addition to the assurance that the product complies with agreed-upon specifications.

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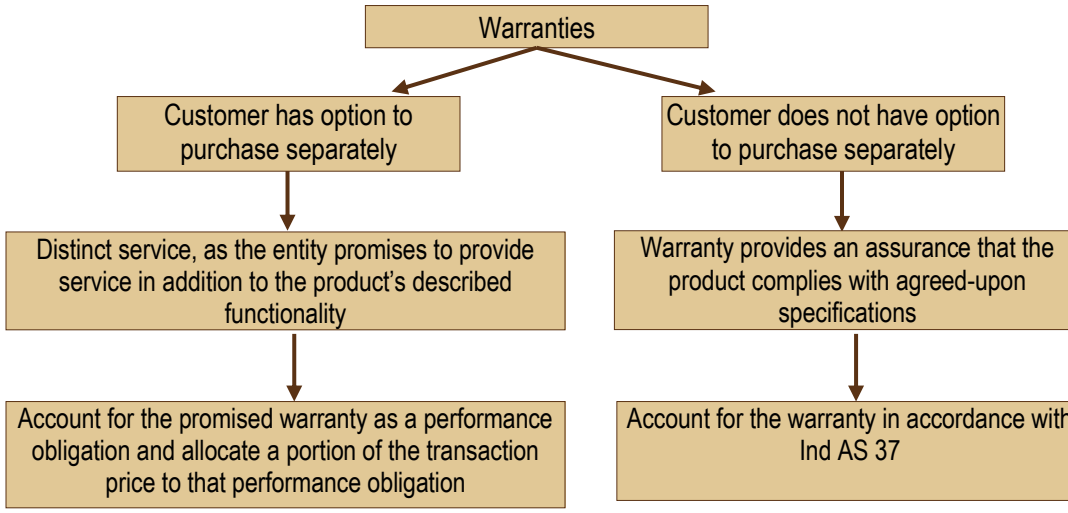
The flowchart below summarises the accounting treatment for the two broad types of warranties:



In assessing whether a warranty provides a customer with a service in addition to the assurance that the product complies with agreed-upon specifications, an entity shall consider factors such as:

(a) Whether the warranty is required by law — if the entity is required by law to provide a warranty, the existence of that law indicates that the promised warranty is not a performance obligation because such requirements typically exist to protect customers from the risk of purchasing defective products.

(b) The length of the warranty coverage period — the longer the coverage period, the more likely it is that the promised warranty is a performance obligation because it is more likely to provide a service in addition to the assurance that the product complies with agreed-upon specifications.

(c) The nature of the tasks that the entity promises to perform — if it is necessary for an entity to perform specified tasks to provide the assurance that a product complies with agreed-upon specifications (for example, a return shipping service for a defective product), then those tasks likely do not give rise to a performance obligation.

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

A law that requires an entity to pay compensation if its products cause harm or damage does not give rise to a performance obligation. For example, a manufacturer might sell products in a jurisdiction in which the law holds the manufacturer liable for any damages (for example, to

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personal property) that might be caused by a consumer using a product for its intended purpose. Similarly, an entity's promise to indemnify the customer for liabilities and damages arising from claims of patent, copyright, trademark or other infringement by the entity's products does not give rise to a performance obligation. The entity shall account for such obligations in accordance with Ind AS 37.

Comparison with AS 7 and AS 9

Ind AS 115 deals with warrantees in two specific ways as discussed above. However, as per AS 9 only a general provision for warrantees is sufficient without revenue reversal or recognition of a contractual liability.

Illustration 35 : Warranty

An entity manufactures and sells computers that include an assurance-type warranty for the first 90 days. The entity offers an optional 'extended coverage' plan under which it will repair or replace any defective part for three years from the expiration of the assurance-type warranty. Since the optional 'extended coverage' plan is sold separately, the entity determines that the three years of extended coverage represent a separate performance obligation (i.e. a service-type warranty). The total transaction price for the sale of a computer and the extended warranty is ₹ 36,000. The entity determines that the stand-alone selling prices of the computer and the extended warranty are ₹ 32,000 and ₹ 4,000, respectively. The inventory value of the computer is ₹ 14,400. Furthermore, the entity estimates that, based on its experience, it will incur ₹ 2,000 in costs to repair defects that arise within the 90-day coverage period for the assurance-type warranty.

Pass required journal entries.

Solution

The entity will record the following journal entries:

		₹	₹
Cash / Trade receivables	Dr.	36,000	
Warranty expense	Dr.	2,000	
To Accrued warranty costs (assurance-type warranty)			2,000
To Contract liability (service-type warranty)			4,000
To Revenue			32,000
(To record revenue and contract liabilities related to warranties)			

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Cost of goods sold	Dr.	14,400	
To Inventory			14,400
(To derecognize inventory and recognize cost of goods sold)			

The entity derecognizes the accrued warranty liability associated with the assurance-type warranty as actual warranty costs are incurred during the first 90 days after the customer receives the computer. The entity recognizes the contract liability associated with the service-type warranty as revenue during the contract warranty period and recognizes the costs associated with providing the service-type warranty as they are incurred. The entity had to determine whether the repair costs incurred are applied against the warranty reserve already established for claims that occur during the first 90 days or recognized as an expense as incurred.

The net effect of the accounting treatment can be seen as follows:

Accounting point	Treatment under Ind AS 115	Treatment as per AS 9
How warranty is accounted	Expense and liability effect created at the inception of contract with customer	Provision is made on past experience based on a certain percentage of total revenue to give effect to subsequent warranty costs, say 5% of revenue.
Accounting treatment	Total cash inflow ₹ 36,000 Warranty expense ₹ 2000 Accrued warranty cost ₹ 2,000 Contract liability (for future service cost) ₹ 4000 Actual revenue ₹ 32,000	Total cash inflow ₹ 36,000 Provision for warranty (at 5% of transaction price) ₹ 1800 Contract liability – None Actual revenue ₹ 34,200

*****

Illustration 36 : Warranty

Entity sells 100 ultra-life batteries for ₹ 2,000 each and provides the customer with a five-year guarantee that the batteries will withstand the elements and continue to perform to specifications. The entity, which normally provides a one-year guarantee to customer purchasing ultra-life batteries, determines that from the years 2 to 5 represent a separate performance obligation. The entity determines that ₹ 1,70,000 of the ₹ 2,00,000 transaction price should be allocated to the batteries and ₹ 30,000 to the service warranty (based on estimated stand-alone selling prices and a relative selling price allocation). The entity's normal one-year warranty cost is ₹ 100 per battery.

Pass required journal entries.

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Solution

The entity will record the following journal entries:

Upon delivery of the batteries, the entity records the following entry:

Cash/Receivables	Dr.	2,00,000	
To Revenue			1,70,000
To Contract liability (service warranty)			30,000
Warranty expense	Dr.	10,000	
To Accrued warranty costs (assurance warranty)			10,000

The contract liability is recognized as revenue over the service warranty period (years 2 - 5). The costs of providing the service warranty are recognized as incurred. The assurance warranty obligation is used / derecognized as defective units are replaced / repaired during the initial year of the warranty. Upon expiration of the assurance warranty period, any remaining assurance warranty obligation is reversed.

7.1.8 Sales-based or usage-based royalties

As per Ind AS 115.B63, notwithstanding the requirements of Ind AS 115 related to constraining estimate of variable consideration (discussed above), an entity shall recognize revenue for a sales-based or usage-based royalty promised in exchange for a licence of intellectual property only when (or as) the later of the following events occurs:

(a) the subsequent sale or usage occurs; and

(b) the performance obligation to which some or all of the sales-based or usage-based royalty has been allocated has been satisfied (or partially satisfied).

As per Ind AS 115.B63A, the accounting requirements for a sales-based or usage-based royalty discussed above apply when the royalty relates only to a licence of intellectual property or when a licence of intellectual property is the predominant item to which the royalty relates (for example, the licence of intellectual property may be the predominant item to which the royalty relates when the entity has a reasonable expectation that the customer would ascribe significantly more value to the licence than to the other goods or services to which the royalty relates).

As per Ind AS 115.B63B, when the requirement in paragraph B63A is met, revenue from a sales-based or usage-based royalty shall be recognized wholly in accordance with paragraph B63. When the requirement in paragraph B63A is not met, the requirements on variable consideration discussed earlier apply to the sales-based or usage-based royalty.

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7.2 Significant financing component

In determining the transaction price, an entity shall adjust the promised amount of consideration for the effects of the time value of money if the timing of payments agreed to by the parties to the contract (either explicitly or implicitly) provides the customer or the entity with a significant benefit of financing the transfer of goods or services to the customer. Either party may benefit from financing — that is, the customer may pay before the entity performs its obligation (a customer loan to the entity) or the customer may pay after the entity performs its obligation (a loan by the entity to the customer). In those circumstances, the contract contains a significant financing component.

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

The objective when adjusting the promised amount of consideration for a significant financing component is for an entity to recognize revenue at an amount that reflects the price that a customer would have paid for the promised goods or services if the customer had paid cash for those goods or services when (or as) they transfer to the customer (ie the cash selling price).

An entity shall consider all relevant facts and circumstances in assessing whether a contract contains a financing component and whether that financing component is significant to the contract, including **both** of the following:

(a) the difference, if any, between the amount of promised consideration and the cash selling price of the promised goods or services; and

(b) the combined effect of both of the following:

  (i) the expected length of time between when the entity transfers the promised goods or services to the customer and when the customer pays for those goods or services; and

  (ii) the prevailing interest rates in the relevant market.

To meet the objective stated above, when adjusting the promised amount of consideration for a significant financing component, an entity shall use the discount rate that would be reflected in a separate financing transaction between the entity and its customer at contract inception. That rate would reflect the credit characteristics of the party receiving financing in the contract, as well as any collateral or security provided by the customer or the entity, including assets transferred in the contract.

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An entity may be able to determine that rate by identifying the rate that discounts the nominal amount of the promised consideration to the price that the customer would pay in cash for the goods or services when (or as) they transfer to the customer. After contract inception, an entity shall not update the discount rate for changes in interest rates or other circumstances (such as a change in the assessment of the customer's credit risk).

An entity considers the significance of a financing component only at a contract level and not whether the financing is material at a portfolio level. In other words, if the combined effects for a portfolio of similar contracts were material to the entity as a whole, but if the effects of the financing component were not material to the individual contract, such financing component shall not be considered significant and shall not be separately accounted for.

As mentioned above, when a significant financing component exists in a contract, the transaction price is adjusted so that the amount recognized as revenue is the 'cash selling price' of the underlying goods or services at the time of transfer. Essentially, a contract with a customer that has a significant financing component would be separated into a revenue component (for the notional cash sales price) and a loan component (for the effect of the deferred or advance payment terms). Consequently, the accounting for accounts receivable arising from a contract that has a significant financing component should be comparable to the accounting for a loan with the same features.

The amount allocated to the significant financing component would have to be presented separately from revenue recognized from contracts with customers. The financing component is recognized as interest expense (when the customer pays in advance) or interest income (when the customer pays in arrears). The interest income or expense is recognized over the financing period using the effective interest method described in Ind AS 109. The standard notes that interest is only recognized to the extent that a contract asset, contract liability or receivable is recognized in accordance with Ind AS 115. An entity may present interest income as revenue only when interest income represents income from an entity's ordinary activities.

Illustration 37 : Financing component: significant or insignificant?

A commercial airplane component supplier enters into a contract with a customer for a promised consideration of ₹ 70,00,000. Based on an evaluation of the facts and circumstances, the supplier concluded that ₹ 1,40,000 represented an 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 ₹ 14,00,000 represented the financing component based on an analysis of the facts and circumstances.

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Solution

The entity may conclude that ₹ 1,40,000, or 2% of the contract price, is not significant, and the entity may not need to adjust the consideration promised in determining the transaction price.

However, when the advance payment was larger and received further in advance, such that the entity may conclude that ₹ 14,00,000 represents the financing component based on an analysis of the facts and circumstances. In such a case, the entity may conclude that ₹ 14,00,000, or 20% 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% was significant is a judgment based on the entity's facts and circumstances. An entity may reach a different conclusion based on its facts and circumstances.

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Illustration 38 : Accounting for significant financing component

NKT Limited sells a product to a customer for ₹ 1,21,000 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 ₹ 1,00,000 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% (i.e. the interest rate that over 24 months discounts the promised consideration of ₹ 1,21,000 to the cash selling price of ₹ 1,00,000). Analyse the above transaction with respect to its financing component.

Solution

The contract includes a significant financing component. This is evident from the difference between the amount of promised consideration of ₹ 1,21,000 and the cash selling price of ₹ 1,00,000 at the date that the goods are transferred to the customer.

The contract includes an implicit interest rate of 10% (i.e. the interest rate that over 24 months discounts the promised consideration of ₹ 1,21,000 to the cash selling price of ₹ 1,00,000). The entity evaluates the rate and concludes that it is commensurate with the rate that would be reflected in a separate financing transaction between the entity and its customer at contract inception.

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Until the entity receives the cash payment from the customer, interest revenue would be recognized 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.

Comparison with AS 9

Point of accounting	Treatment under Ind AS 115	Treatment under AS 9
Cash selling price ₹ 1,00,000 Promised selling price of ₹ 1,21,000	Transaction price will be bifurcated as ₹ 1,00,000 and ₹ 21,000. ₹ 1,00,000 will be recognised as revenue and ₹ 21,000 shall be treated as interest income being a price difference due to financing arrangement involved in the transaction	Transaction price of ₹ 1,21,000 shall be treated as revenue once the risk and rewards are transferred to the customer. Here, there is no requirement to dissect the transaction price to look for multiple element arrangement like financing component.
Revenue recognized	₹ 1,00,000	₹ 1,21,000
Other income (interest)	₹ 21,000 over 2 years as per Ind AS 109	No interest income is recognized.

*****

Illustration 39 : 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 ₹ 2,12,470.

Determine the discounting rate and the transaction price when -

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

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

Solution

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

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

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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 recognized as revenue and as a loan receivable when control of the equipment transfers to the customer. The entity accounts for the receivable in accordance with Ind AS 109.

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

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

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

*****

Illustration 40 : 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 two 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.

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Solution

Journal Entries showing accounting for the significant financing component:

(a) Recognize 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 promised amount of consideration and accretes the contract liability by recognizing interest on ₹ 4,000 at 6% for two years:

Interest expense	Dr.	₹ 494*	
To Contract liability			₹ 494
* ₹ 494 = ₹ 4,000 contract liability × (6% interest per year for two years).			

(c) Recognize revenue for the transfer of the asset:

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

*****

Ind AS 115.62 contains an overriding provision, which specifies that, a contract with a customer would not have a significant financing component if any of the following factors exist:

(a) the **customer paid for the goods or services in advance** and the timing of the transfer of those goods or services is at the discretion of the customer. For example, consider a prepaid card for mobile phone services, wherein the customer has the discretion to avail mobile services within a certain band of time.

(b) a **substantial amount of the consideration promised by the customer is variable** and the amount or **timing** of that consideration varies on the basis of the occurrence or non-occurrence of a future event that is **not substantially within the control of the customer or the entity** (for example, if the consideration is a sales-based royalty).

(c) the difference between the promised consideration and the cash selling price of the goods or service arises for **reasons other than the provision of finance to either the customer or the entity**, and the difference between those amounts is proportional to the reason for the difference. For example, the payment terms might provide the entity or the customer with protection from the other party failing to adequately complete some or all of its obligations under the contract.

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Illustration 41 : 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 to the entity only when 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 the contract.

*****

Illustration 42 : Advance payment

XYZ Limited, a personal computer (PC) manufacturer, enters into a contract with a customer to provide global PC support and repair coverage for three years along with its PC. The customer purchases this support service at the time of buying the product. Consideration for the service is an additional ₹ 3,000. Customers electing to buy this service must pay for it upfront (i.e. a monthly payment option is not available).

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

Solution

To determine whether there is a significant financing component in the contract, the entity considers the nature of the service being offered and the purpose of the payment terms. The entity charges a single upfront amount, not with the primary purpose of obtaining financing from the customer but, instead, to maximise profitability, taking into consideration the risks associated with providing the service. Specifically, if customers could pay monthly, they would be less likely to renew and the population of customers that continue to use the support service in the later years may become smaller and less diverse over time (i.e. customers that choose to renew historically are those that make greater use of the service, thereby increasing the entity's costs). In addition, customers tend to use services more if they pay monthly rather than making an upfront

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payment. Finally, the entity would incur higher administration costs such as the costs related to administering renewals and collection of monthly payments.

In assessing whether or not the contract contains a significant financing component, XYZ Limited determines that the payment terms were structured primarily for reasons other than the provision of finance to the entity. XYZ Limited charges a single upfront amount for the services because other payment terms (such as a monthly payment plan) would affect the nature of the risks it assumes to provide the service and may make it uneconomical to provide the service. As a result of its analysis, XYZ Limited concludes that there is not a significant financing component.

*****

Illustration 43 : 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 overtime.

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

Solution

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

*****

Illustration 44 : 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 not provide the customer or the entity with a significant benefit of financing.

*****

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Illustration 45 : Payment in arrears

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

Based on the terms of the contract, the contractor determines that it transfers control over time, and recognizes revenue based on an input method best reflecting the transfer of control to the customer. The customer agrees 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.

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

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 for paying 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 concludes this contract does not provide the customer or the contractor with a significant benefit of financing.

*****

Illustration 46 : Payment in arrears

Company Z is a developer and manufacturer of defence systems that is primarily a Tier-II supplier 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, specialized missiles for use in one of 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 crore. The consideration will be paid by the customer related to costs incurred near the time Company Z incurs such costs. However, the ₹ 100 crore award fee is awarded upon successful completion of the development and test fire of a missile to occur in 16 months from the time the contract is executed.

The contract specifies Company Z will earn up to ₹ 100 crore 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.

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Partial award fees may be awarded based on a pre-determined scale based on their success.

Assume Company Z has assessed the contract under Ind AS 115 and determined the award fee represents variable consideration. Based on their assessment, Company Z has estimated a total of ₹ 80 crore in the transaction price related to the variable consideration pursuant to guidance within Ind AS 115. Further, the entity has concluded it should recognize 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

Company Z will transfer control over time beginning shortly after the contract is executed but will not receive the cash consideration related to the award fee component from Company X for more than one year in the future. Hence, Company Z should assess whether the award fee represents a significant financing component.

The intention of the parties in negotiating the award fee due upon completion of the test fire, and based on the results of that test fire, was to provide incentive to Company Z to produce 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 a practical expedient, an entity need not adjust the promised amount of consideration for the effects of a significant financing component if the entity expects, at contract inception, that the period between:

(a) when the entity transfers a promised goods or service to a customer and

(b) when the customer pays for that goods or service

will be one year or less.

Illustration 47 : Applying practical expedient

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

Based on the terms of the contract, Company H determines that it transfers control over time, and recognizes revenue based on an input method best reflecting the transfer of control to

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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 assess whether a significant financing component is present and does not adjust the promised consideration in determining the transaction price, as they are applying the practical expedient under Ind AS 115.

As per Ind AS 115.65, an entity shall present the effects of financing (interest revenue or interest expense) separately from revenue from contracts with customers in the statement of profit and loss. Interest revenue or interest expense is recognized only to the extent that a contract asset (or receivable) or a contract liability is recognized in accounting for a contract with a customer.

*****

7.3 Non-cash consideration

Sometimes a customer promises to pay for a goods or service in a form other than cash, such as shares of common stock or other equity instruments, advertising, or equipment.

To determine the transaction price for contracts in which a customer promises consideration in a form other than cash, an entity shall:

- In the first instance, measure the non-cash consideration (or promise of non-cash consideration) at fair value.
- And, if it cannot reasonably estimate the fair value of the non-cash consideration, it shall measure the consideration indirectly by reference to the stand-alone selling price of the goods or services promised to the customer (or a class of customers) in exchange for the consideration.

The fair value of non-cash consideration may change both because of the form of consideration (e.g. a change in the price of a share an entity is entitled to receive from a customer) and for reasons other than the form of consideration (e.g. a change in the exercise price of a share option because of the entity's performance).

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7.3.1 Subsequent measurement of non-cash consideration

- If the fair value of the non-cash consideration varies after contract inception because of its form (for example, a change in the price of a share to which an entity is entitled to receive from a customer), the entity does not adjust the transaction price for any changes in the fair value of the consideration.

Illustration 48 : Entitlement to non-cash consideration

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

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

How should the entity decide the transaction price?

Solution

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

*****

- If the fair value of the non-cash consideration promised by a customer varies for reasons other than only the form of the consideration (for example, the fair value could vary because of the entity's performance), the entity is required to apply the guidance on variable consideration and the constraint when determining the transaction price.

Illustration 49 : Fair value 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 crore for the project. RT Limited will receive a bonus of 10 lakh equity shares of AT Limited if it

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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 any shares the entity 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 crore plus 10 lakh equity shares at ₹ 100 per share for total consideration of ₹ 360 crore.

*****

Illustration 50 : Non-cash consideration - Free advertising

Production Company Y sells a television show to Television Company X. The consideration under the arrangement is a fixed amount of ₹ 1,000 and 100 advertising slots. Y determines that the stand-alone selling price of the show would be ₹ 1,500. Based on market rates, Y determines that the fair value of the advertising slots is ₹ 600.

Determine the transaction price.

Solution

Y determines that the transaction price is ₹ 1,600, comprising of ₹ 1,000 fixed amount plus the fair value of the advertising slots i.e. ₹ 600.

If the fair value of the advertising slots could not be reasonably estimated, then the transaction price would be ₹ 1,500 i.e. Y would use the stand-alone selling price of the goods or services promised for the non-cash consideration.

*****

7.3.2 Customer-provided goods or services

If a customer contributes goods or services (for example, materials, equipment or labour) to facilitate an entity's fulfilment of the contract, the entity shall assess whether it obtains control of those contributed goods or services. If so, the entity shall account for the contributed goods or services as non-cash consideration received from the customer.

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Illustration 51 : Customer-provided goods or services

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

The tooling has a fair value of ₹ 2 crore 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, SK Limited includes the fair value of the tooling in the transaction price at contract inception, which it determines to be ₹ 27 crore (₹ 25 crore for the steering systems and ₹ 2 crore for the tooling).

*****

7.4 Consideration payable to a customer

The rationale behind the accounting provisions related to "consideration payable to a customer" is that an entity should not overstate its revenue by amounts given to customers in a contract that it will receive back through the purchase of its goods or services.

Consideration payable to a customer includes cash amounts that an entity pays, or expects to pay, to the customer (or to other parties that purchase the entity's goods or services from the customer). Consideration payable to a customer also includes credit or other items (for example, a coupon or voucher) that can be applied against amounts owed to the entity (or to other parties that purchase the entity's goods or services from the customer).

The key to appropriately accounting for consideration payable to a customer is determining whether the payment is made in exchange for a distinct goods or service:

- When the entity receives a goods or service from the customer, it applies the guidance in Step 2 in identifying its performance obligations to determine if that goods or service is distinct.

  When an entity concludes that the consideration paid to a customer is in exchange for a distinct goods or service, it accounts for the distinct goods or service as it would any other

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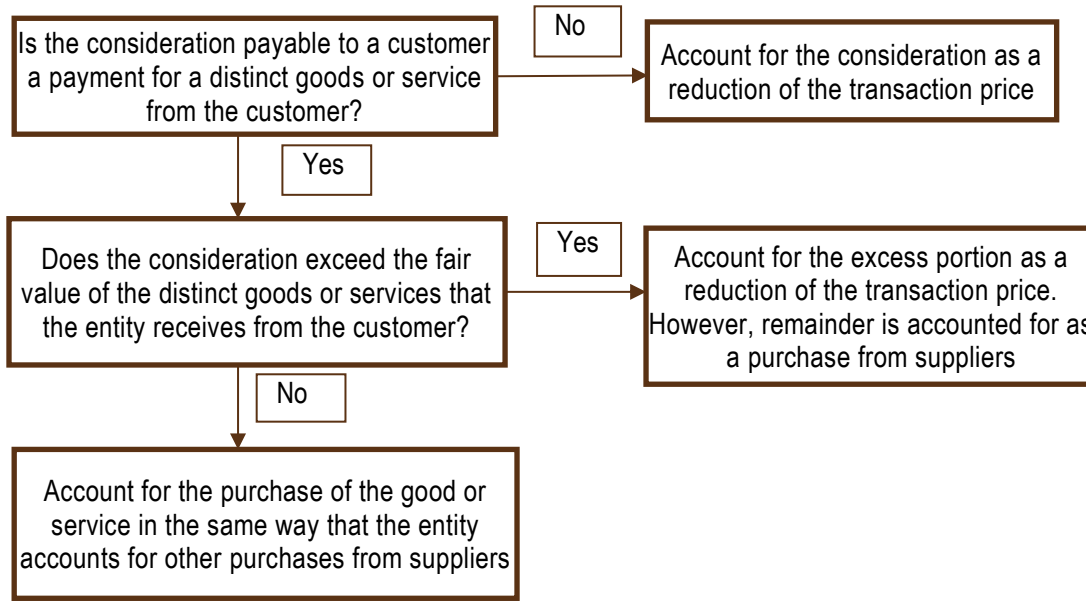
purchase from a supplier, as long as the consideration paid does not exceed the fair value of the goods or services received. When the consideration exceeds the fair value of the distinct goods or services received, any excess is accounted for as a reduction in the transaction price. If the entity cannot reasonably estimate the fair value of the goods or service received from the customer, it shall account for all of the consideration payable to the customer as a reduction of the transaction price.

- If, on the other hand, the entity concludes that the consideration paid to the customer is not in exchange for a distinct goods or service, the entity would reduce the transaction price by the amount it pays or owes the customer.

The below diagram summarises the guidance above:



If the consideration payable to a customer includes a variable amount, an entity shall estimate the transaction price (including assessing whether the estimate of variable consideration is constrained) in accordance with accounting guidance on "variable consideration" discussed earlier.

As per Ind AS 115.72, if consideration payable to a customer is accounted for as a reduction of the transaction price, an entity shall recognize the reduction of revenue when (or as) the later of either of the following events occurs:

(a) the entity recognizes revenue for the transfer of the related goods or services to the customer; and

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(b) the entity pays or promises to pay the consideration (even if the payment is conditional on a future event). That promise might be implied by the entity's customary business practices.

Consideration paid or payable to a customer can take many different forms. Therefore, entities will have to carefully evaluate each transaction to determine the appropriate treatment of such amounts. Some common examples of consideration paid to a customer are given below:

1. **Slotting fees –** Manufacturers of consumer products commonly pay retailers fees to have their goods displayed prominently on store shelves. Those shelves can be physical (i.e. in a building where the store is located) or virtual (i.e. they represent space in an internet reseller's online catalogue). Generally, such fees do not provide a distinct goods or service to the manufacturer and are treated as a reduction of the transaction price.

Example 5

A producer entity sells energy drinks to a retailer, a convenience store. Producer also pays Retailer a fee to ensure that its products receive prominent placement on store shelves, to attract the customer's eyeballs so that chances of sales of its products are higher. The fee is negotiated as part of the contract for sale of the energy drinks. In this case, Producer should reduce the transaction price for the sale of the energy drinks by the amount of slotting fees paid to Retailer. Producer does not receive a goods or service that is distinct in exchange for the payment to Retailer.

2. **Co-operative advertising arrangements –** In some arrangements, a vendor agrees to reimburse a reseller for a portion of costs incurred by the reseller to advertise the vendor's products. The determination of whether the payment from the vendor is in exchange for a distinct goods or service at fair value will depend on a careful analysis of the facts and circumstances of the contract.

Example 6

Mobile-Co sells 1,000 phones to Retailer for ₹ 10,00,000. The contract includes an advertising arrangement that requires Mobile-Co to pay ₹ 1,00,000 toward a specific advertising promotion that Retailer will provide. The retailer will provide the advertising on strategically located billboards and in local advertisements. Mobile-Co could have elected to engage a third party to provide similar advertising services at a cost of ₹ 1,00,000. In this case, Mobile-Co should account for the payment to Retailer consistent with other purchases of advertising services. The payment from Mobile-Co to the Retailer is consideration for a distinct service provided by Retailer and reflects fair value. The advertising is distinct because Mobile-Co could have engaged a third party who is not its

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customer to perform similar services. The transaction price is ₹ 10,00,000 and is not affected by the payment made by Retailer for the sale of the phones. However, it is to be noted here that, if price paid to retailer for this service is not the fair value of such advertising services, then any excess paid to retailer over the fair value of said services should be reduced from transaction price.

3. **Price protection –** A vendor may agree to reimburse a retailer up to a specified amount for shortfalls in the sales price received by the retailer for the vendor's products over a specified period of time. Normally such fees do not provide a distinct goods or service to the manufacturer and are treated as a reduction of the transaction price.

Illustration 52 : 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 crore of products during the year. The contract also requires the entity to make a non-refundable payment of ₹ 1.5 crore to the customer at the inception of the contract. The ₹ 1.5 crore payment will compensate the customer for the changes it needs to make to its shelving to accommodate the entity's products. The entity does not obtain control of any rights to the customer's shelves.

Determine the transaction price.

Solution

The entity considers the requirements in paragraphs 70 – 72 of Ind AS 115 and concludes that the payment to the customer is not in exchange for a distinct goods 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 crore payment is a reduction of the transaction price.

The entity applies the requirements in paragraph 72 of Ind AS 115 and concludes that the consideration payable is accounted for as a reduction in the transaction price when the entity recognizes revenue for the transfer of the goods. Consequently, as the entity transfers goods to the customer, the entity reduces the transaction price for each goods by 10 per cent [(₹ 1.5 crore ÷ ₹ 15 crore) x 100]. Therefore, in the first month in which the entity transfers goods to the customer, the entity recognizes revenue of ₹ 1.125 crore (₹ 1.25 crore invoiced amount less ₹ 0.125 crore of consideration payable to the customer).

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Illustration 53 : Credits to a new customer

Customer C is in the middle of a two-year contract with Telco B Ltd., its current wireless service provider, and would be required to pay an early termination penalty if it terminated the contract today. If C cancels the existing contract with B Ltd. and signs a two-year contract with Telco D Ltd. for ₹ 800 per month, then D Ltd. promises at contract inception to give C a one-time credit of ₹ 2,000 (referred to as a 'port-in credit'). The amount of the port-in credit does not depend on the volume of service subsequently purchased by C during the two-year contract.

Determine the transaction price.

Solution

D Ltd. determines that it should account for the port-in credit as consideration payable to a customer. This is because the credit will be applied against amounts owing to D Ltd. Since, D Ltd. does not receive any distinct goods or services in exchange for this credit, it will account for it as a reduction in the transaction price ₹ 17,200 [(₹ 800 x 24 month) – ₹ 2,000]. D Ltd. will recognize the reduction in the transaction price as the promised goods or services are transferred.

*****

8. STEP 4: ALLOCATING THE TRANSACTION PRICE TO PERFORMANCE OBLIGATIONS

Allocation objective- While allocating the transaction price, the objective of the entity should be to allocate the transaction price to each performance obligation (or distinct goods or service) in an amount that depicts the amount of consideration to which the entity expects to be entitled in exchange for transferring the promised goods or services to the customer.

To meet the above allocation objective, an entity shall allocate the transaction price to each performance obligation identified in the contract on a relative stand-alone selling price basis as per the standard, except for allocating discounts and for allocating consideration that includes variable amounts.

Simply put, there are two exceptions to the general allocation guidance:

- allocating discounts, and
- allocating variable consideration

Under these exceptions, an entity allocates a disproportionate amount of the transaction price to specific performance obligations based on evidence that suggests the discount or variable consideration relates to those specific performance obligations.

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8.1 Determining stand-alone selling price

To allocate the transaction price on a relative stand-alone selling price basis, an entity must first determine the stand-alone selling price of the distinct goods or service underlying each performance obligation. The stand-alone selling price is the price at which an entity would sell a promised goods or service separately to a customer.

The best evidence of a stand-alone selling price is - **the observable price of a goods or service when the entity sells that goods or service separately in similar circumstances and to similar customers.**

An entity shall determine the stand-alone selling price at contract inception of the distinct goods or service underlying each performance obligation in the contract and allocate the transaction price in proportion to those stand-alone selling prices, to allocate the transaction price to each performance obligation on a relative stand-alone selling price basis. Stand-alone selling prices are determined at contract inception and are not updated to reflect changes between contract inception and when performance is complete. Furthermore, if the contract is modified and that modification is treated as a termination of the existing contract and the creation of a new contract (see 5.5.2 above), the entity would update its estimate of the stand-alone selling price at the time of the modification. If the contract is modified and the modification is treated as a separate contract (see 5.5.2.1 above), the accounting for the original contact would not be affected (and the stand-alone selling prices of the underlying goods and services would not be updated), but the stand-alone selling prices of the distinct goods or services of the new, separate contract would have to be determined at the time of the modification.

A contractually stated price or a list price for a goods or service **may be (but shall not be presumed to be)** the stand-alone selling price of that goods or service.

If a stand-alone selling price is not directly observable, for example, the entity does not sell the goods or service separately, an entity shall estimate the stand-alone selling price at an amount that would result in the allocation of the transaction price meeting the allocation objective in paragraph 73 above. When estimating a stand-alone selling price, an entity shall consider all information (including market conditions, entity-specific factors and information about the customer or class of customer) that is reasonably available to the entity. In doing so, an entity shall maximise the use of observable inputs and apply estimation methods consistently in similar circumstances.

Evaluating the evidence related to estimating a stand-alone selling price may require significant judgment.

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An entity should establish policies and procedures for estimating stand-alone selling price and apply those policies and procedures consistently to similar performance obligations. As a best practice, an entity should document its evaluation of the market conditions and entity-specific factors considered in estimating each stand-alone selling price, including factors that it considers to be irrelevant and the reasons why.

Suitable methods for estimating the stand-alone selling price of a goods or service include, but are not limited to, the following:

(a) **Adjusted market assessment approach**—an entity could evaluate the market in which it sells goods or services and estimate the price that a customer in that market would be willing to pay for those goods or services. That approach might also include referring to prices from the entity's competitors for similar goods or services and adjusting those prices as necessary to reflect the entity's costs and margins. Applying this approach will likely be convenient when an entity has sold the goods or service for a period of time (such that it has data about customer demand), or a competitor offers similar goods or services that the entity can use as a basis for its analysis. However, applying this approach would be difficult when an entity is selling entirely new goods or service because in that case it may be difficult to anticipate market demand.

(b) **Expected cost plus a margin approach**—an entity could forecast its expected costs of satisfying a performance obligation and then add an appropriate margin for that goods or service. When determining which costs to include in the selling price analysis, an entity should develop and consistently apply a methodology that considers direct and indirect costs, as well as other relevant costs considered in its normal pricing practices, such as research and development costs. Determining the margin to use when applying a cost-plus-a-margin approach requires significant judgment, particularly when the entity is not planning to separately sell a product or service. Furthermore, using an expected cost-plus-margin approach may not be appropriate in many circumstances, such as when direct fulfillment costs are not easily identifiable or when costs are not a significant input in setting the price for the goods or services.

(c) **Residual approach**—an entity may estimate the stand-alone selling price by reference to (1) the total transaction price, less (2) the sum of the observable stand-alone selling prices of other goods or services promised in the contract.

However, an entity may use a residual approach to estimate the stand-alone selling price of a goods or service only if one of the following criteria is met:

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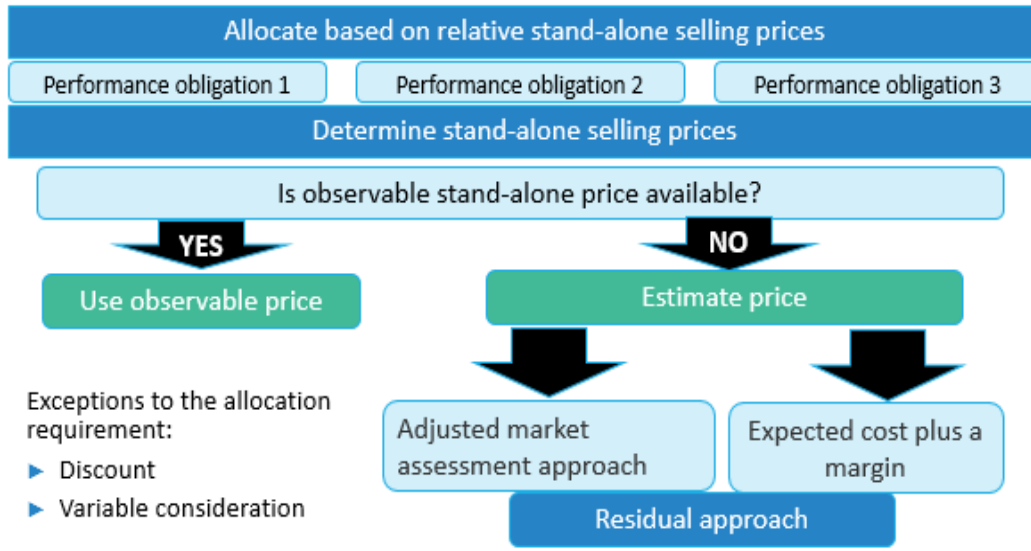
(i) the entity sells the same goods or service to different customers (at or near the same time) for a broad range of amounts (ie the selling price is highly variable because a representative stand-alone selling price is not discernible from past transactions or other observable evidence); or

(ii) the entity has not yet established a price for that goods or service and the goods or service has not previously been sold on a stand-alone basis (ie the selling price is uncertain).

An entity shall allocate the discount before using the residual approach to estimate the stand-alone selling price of a goods or service where the discount is allocated entirely to one or more performance obligations in the contract.

A combination of methods may need to be used to estimate the stand-alone selling prices of the goods or services promised in the contract if two or more of those goods or services have highly variable or uncertain stand-alone selling prices. For example, an entity may use a residual approach to estimate the aggregate stand-alone selling price for those promised goods or services with highly variable or uncertain stand-alone selling prices and then use another method to estimate the stand-alone selling prices of the individual goods or services relative to that estimated aggregate stand-alone selling price determined by the residual approach. When an entity uses a combination of methods to estimate the stand-alone selling price of each promised goods or service in the contract, the entity shall evaluate whether allocating the transaction price at those estimated stand-alone selling prices would be consistent with the allocation objective in paragraph 73 and the requirements for estimating stand-alone selling prices.

Below chart summarises the above concept:



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8.1.1 Allocation of a discount

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

Unless an entity has observable evidence (if (c) criteria below are fulfilled) that the entire discount relates to only one or more, but not all, performance obligations in a contract, the entity shall allocate a discount proportionately to all performance obligations in the contract. The proportionate allocation of the discount in those circumstances is a consequence of the entity allocating the transaction price to each performance obligation on the basis of the relative stand-alone selling prices of the underlying distinct goods or services (as discussed earlier).

When to allocate discount to 'less than all' performance obligations?

As per Ind AS 115.82, an entity shall allocate a discount entirely to one or more, but not all, performance obligations in the contract **if all of the following criteria are met**:

(a) the entity regularly sells each distinct goods or service (or each bundle of distinct goods or services) in the contract on a stand-alone basis;

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

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

Note: As a **first step**, always allocate the discount entirely to one or more performance obligations in the contract (if applicable), and then as a **second step**, use the residual approach to estimate the stand-alone selling price of a goods or service.

Illustration 54 : 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 B and C are not directly observable.

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Because the stand-alone 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 × ₹ 10,000)
Product C	5,000	(₹ 7,500 ÷ ₹ 15,000 × ₹ 10,000)
Total	10,000	

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Illustration 55 : 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

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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 Product 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.

Case C—Residual approach is inappropriate

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

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 of ₹ 20,000 should be allocated to the promises to transfer Products Y and Z in accordance with paragraph 82 of Ind AS 115.

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

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If the contract requires the entity to transfer control of Products Y and Z at different points in time, 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 ₹ 1,00,000 should be allocated to those three products 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 estimates 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
Products Y and Z	50,000	Directly observable with discount
Product Alpha	30,000	Residual approach
Total	130,000	

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

Case C—Residual approach is inappropriate

The same facts as in Case B apply to Case C except the transaction price is ₹ 1,05,000 instead of ₹ 1,30,000. Consequently, the application of the residual approach would result in a stand-alone selling price of ₹ 5,000 for Product Alpha (₹ 105,000 transaction price less ₹ 1,00,000 allocated to Products X, Y and Z).

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The entity concludes that ₹ 5,000 would not faithfully depict the amount of consideration to which the entity expects to be entitled in exchange for satisfying its performance obligation to transfer Product Alpha, because ₹ 5,000 does not approximate the stand-alone selling price of Product Alpha, which ranges from ₹ 15,000 – ₹ 45,000.

Consequently, the entity reviews its observable data, including sales and margin reports, to estimate the stand-alone selling price of Product Alpha using another suitable method. The entity allocates the transaction price of ₹ 1,05,000 to Products X, Y, Z and Alpha using the relative stand-alone selling prices of those products in accordance with paragraphs 73–80 of Ind AS 115.

*****

8.1.2 Allocation of variable consideration

Variable consideration may be attributable to (1) the entire contract or (2) a specific part of the contract, such as either of the following:

(a) one or more, but not all, performance obligations in the contract. For example, a contract may include two performance obligations: the construction of a building and the provision of services related to the ongoing maintenance of the property after construction. But a bonus for early completion may relate entirely to the construction of the building; or

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

How to allocate variable consideration?

In accordance with Ind AS 115.85, an entity shall allocate a variable amount (and subsequent changes to that amount) entirely to a performance obligation or to a distinct goods or service that forms part of a single performance obligation **if both of the following criteria are met**:

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

The general principles of allocation of transaction price shall be applied to allocate the remaining amount of the transaction price that does not meet the criteria in paragraph 85 above.

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Illustration 56 : Allocation 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 obligations each satisfied at a point in time. The stand-alone selling prices of Licences A and B are ₹ 16,00,000 and ₹ 20,00,000, respectively. The entity transfers Licence B at inception of the contract and transfers Licence A one month later.

Case A—Variable consideration allocated entirely to one performance obligation

The price stated in the contract for Licence A is a fixed amount of ₹ 16,00,000 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-based royalties (ie the variable consideration) to be ₹ 20,00,000. Allocate the transaction price.

Case B — Variable consideration allocated on the basis of stand-alone selling prices

The price stated in the contract for Licence A is a fixed amount of ₹ 6,00,000 and for Licence B the consideration is five per cent of the customer's future sales of products that use Licence B. The entity's estimate of the sales-based royalties (ie the variable consideration) is ₹ 30,00,000. Here, Licence A is transferred 3 months later. The royalty due from the customer's first month of sale is ₹ 4,00,000.

Allocate the transaction price and determine the revenue to be recognized for each licence and the contract liability, if any.

Solution

Case A—Variable consideration allocated entirely to one performance obligation

To allocate the transaction price, the entity considers the criteria in paragraph 85 and concludes that the variable consideration (ie 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 relates specifically to an outcome from the performance obligation to transfer Licence B (ie the customer's subsequent sales of products that use Licence B).

(b) allocating the expected royalty amounts of ₹ 20,00,000 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 (₹ 20,00,000) approximates the stand-alone selling price of Licence B and the fixed amount of ₹ 16,00,000 approximates the stand-alone selling price of Licence A. The entity allocates ₹ 16,00,000 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.

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The entity transfers Licence B at inception of the contract and transfers Licence A one month later. Upon the transfer of Licence B, the entity does not recognize revenue because the consideration allocated to Licence B is in the form of a sales-based royalty. Therefore, the entity recognizes revenue for the sales-based royalty when those subsequent sales occur.

When Licence A is transferred, the entity recognizes as revenue the ₹ 16,00,000 allocated to Licence A.

Case B—Variable consideration allocated on the basis of stand-alone selling prices

To allocate the transaction price, the entity applies the criteria in paragraph 85 of Ind AS 115 to determine whether to allocate the variable consideration (ie the sales-based royalties) entirely to Licence B.

In applying the criteria, the entity concludes that even though the variable payments relate specifically to an outcome from the performance obligation to transfer Licence B (ie the customer's subsequent sales of products that use Licence B), allocating the variable consideration entirely to Licence B would be inconsistent with the principle for allocating the transaction price. Allocating ₹ 6,00,000 to Licence A and ₹ 30,00,000 to Licence B does not reflect a reasonable allocation of the transaction price on the basis of the stand-alone selling prices of Licences A and B of ₹ 16,00,000 and ₹ 20,00,000, respectively. Consequently, the entity applies the general allocation requirements of Ind AS 115.

The entity allocates the transaction price of ₹ 6,00,000 to Licences A and B on the basis of relative stand-alone selling prices of ₹ 16,00,000 and ₹ 20,00,000, respectively. The entity also allocates the consideration related to the sales-based royalty on a relative stand-alone selling price basis. However, when an entity licenses intellectual property in which the consideration is in the form of a sales-based royalty, the entity cannot recognize revenue until the later of the following events: the subsequent sales occur or the performance obligation is satisfied (or partially satisfied).

Licence B is transferred to the customer at the inception of the contract and Licence A is transferred three months later. When Licence B is transferred, the entity recognizes as revenue ₹ 3,33,333 [(₹ 20,00,000 ÷ ₹ 36,00,000) x ₹ 6,00,000] allocated to Licence B. When Licence A is transferred, the entity recognizes as revenue ₹ 2,66,667 [(₹ 16,00,000 ÷ ₹ 36,00,000) x ₹ 6,00,000] allocated to Licence A.

In the first month, the royalty due from the customer's first month of sales is ₹ 4,00,000. Consequently, the entity recognizes as revenue ₹ 2,22,222 (₹ 20,00,000 ÷ ₹ 36,00,000 x ₹ 4,00,000) allocated to Licence B (which has been transferred to the customer and is therefore a satisfied performance obligation). The entity recognizes a contract liability for the ₹ 1,77,778 (₹ 16,00,000 ÷ ₹ 36,00,000 x ₹ 4,00,000) allocated to Licence A. This is because although the subsequent sale by the entity's customer has occurred, the performance obligation to which the royalty has been allocated has not been satisfied.

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8.2 Changes in the transaction price

After contract inception, the transaction price can change for various reasons, including the resolution of uncertain events or other changes in circumstances that change the amount of consideration to which an entity expects to be entitled in exchange for the promised goods or services.

The following principles should be noted:

- An entity shall allocate to the performance obligations in the contract any subsequent changes in the transaction price on the same basis as at contract inception. **Consequently, an entity shall not reallocate the transaction price to reflect changes in stand-alone selling prices after contract inception.**
- Amounts allocated to a satisfied performance obligation shall be recognized as revenue, or as a reduction of revenue, in the period in which the transaction price changes.

When reallocating consideration because of a change in the transaction price, the entity continues to allocate the variable amount entirely to a performance obligation or to a distinct goods or service that forms part of a single performance obligation if the criteria in Ind AS 115.85 (as discussed above) continue to be met.

If the change in transaction price is the result of a contract modification, the entity should follow the contract modification guidance.

However, when the transaction price changes after a modification, the entity should allocate the change in transaction price to the performance obligations identified before the modification if both:

- The change in the transaction price is attributable to variable consideration promised prior to the modification.
- The modification is accounted for as a termination of the old contract and the creation of a new contract.

An entity allocates all other changes in the transaction price to performance obligations under the modified contract (i.e. the performance obligations that were unsatisfied or partially satisfied immediately after the modification) as long as the modification was not accounted for as a separate contract.

Changes in the transaction price should be allocated entirely to one or more, but not all, distinct goods or services promised in a series that forms part of a single performance obligation if the criteria for allocating variable consideration are met.

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Comparison with AS 7 and AS 9

Subsequent changes in transaction price are not specifically dealt with either AS 7 or AS 9 unlike in Ind AS 115.

Illustration 57 : Allocating a change in transaction price

On 1st April, 20X0, a consultant enters into an arrangement to provide due diligence, valuation, and software implementation services to a customer for ₹ 2 crore. The consultant can earn ₹ 20 lakh bonus if it completes the software implementation by 30th September, 20X0 or ₹ 10 lakh bonus if it completes the software implementation by 31st 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 lakh*
- *Valuation – ₹ 20 lakh*
- *Software implementation – ₹ 1 crore*

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

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

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

Determine the transaction price.

Solution

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

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Illustration 58 : Discretionary credit

Telco G Ltd. grants a one-time credit of ₹ 50 to a customer in Month 14 of a two-year contract. The credit is discretionary and is granted as a commercial gesture, not in response to prior service issues (often referred to as a 'retention credit'). The contract includes a subsidised handset and a voice and data plan. G Ltd. does not regularly provide these credits and therefore customers do not expect them to be granted.

How this will be accounted for under Ind AS 115?

Solution

G Ltd. concludes that this is a change in the transaction price and not a variable consideration. Since, the credit does not relate to a satisfied performance obligation, the change in transaction price resulting from the credit is accounted for as a contract modification and recognized over the remaining term of the contract. If, in this example, rather than providing a one-time credit, G Ltd. granted a discount of ₹ 5 per month for the remaining contract term, then also G Ltd. would conclude that it was a change in the transaction price. It would apply the contract modification guidance and recognize the credit over the remaining term of the contract.

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9. STEP 5: SATISFYING PERFORMANCE OBLIGATION

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

In other words, the transfer of 'control' is the key determinant under Ind AS 115. Decision making on how 'control' will be transferred to the customer is done at the inception of transaction.

Following is a diagrammatic presentation of the aforesaid guidance:



Therefore, the key questions that need to be answered at contract inception to determine if the seller has satisfied its performance obligation are –

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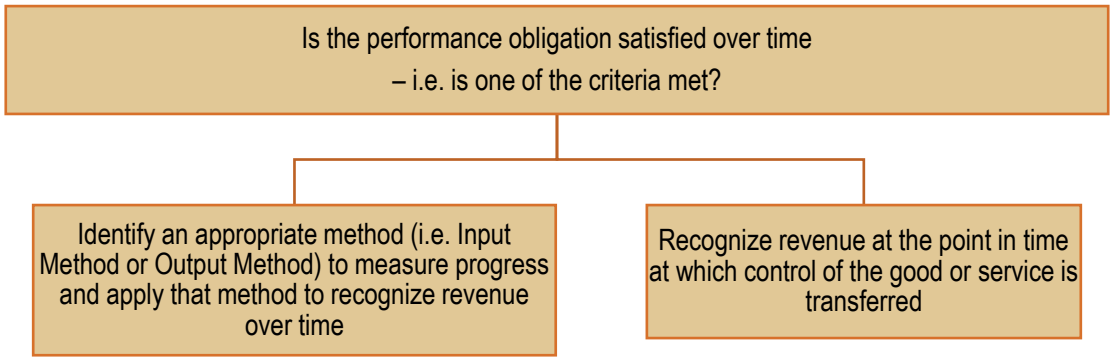
- Establish **what does transfer of control mean** in the context of the arrangement between the parties?
- Does the customer acquire **control over a period of time or at a point in time**?



9.1 What does transfer of control mean?

Control is…	
the ability	– The customer has a present right
to direct the use of	– The right enables it to: - deploy the asset in its activities - allow another entity to deploy the asset in its activities - prevent another entity from deploying the asset
and obtain the remaining benefits from	– The right also enables it to obtain potential cash flows directly or indirectly – e.g. through: - use of the asset - consumption of the asset - sale or exchange of the asset - pledging the asset - holding the asset
… an asset	

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- ***Control*** of an asset refers to –

  (i) the **ability to direct the use** of, and obtain substantially all of the remaining benefits from, the asset.

  (ii) Control includes the ability to prevent other entities from directing the use of, and obtaining the benefits from, an asset.

- The benefits of an asset are the potential cash flows (inflows or savings in outflows) that can be obtained directly or indirectly in many ways, such as by:

  (a) using the asset to produce goods or provide services (including public services);

  (b) using the asset to enhance the value of other assets;

  (c) using the asset to settle liabilities or reduce expenses;

  (d) selling or exchanging the asset;

  (e) pledging the asset to secure a loan; and

  (f) holding the asset.

- In addition, an entity shall consider indicators of the transfer of control, which include, but are not limited to, the following:

  (a) The entity has a present right to payment for the asset;

  (b) The customer has legal title to the asset;

  (c) The entity has transferred physical possession of the asset;

  (d) The customer has the significant risks and rewards of ownership of the asset;

  (e) The customer has accepted the asset.

The standard indicates that an entity must determine, at contract inception, whether it will transfer control of a promised goods or service over time. If an entity does not satisfy a performance obligation over time, the performance obligation is satisfied at a point in time.

To help entities determine whether control transfers over time (rather than at a point in time), the standard states below guidance:

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9.2 Does the customer acquire control over a period of time or at a point in time?

9.2.1 Transfer of control over a period of time:

Per para 35 of Ind AS 115, an entity transfers control of a goods or service over time and, therefore, satisfies a performance obligation and recognizes revenue over time, if **any** of the following criteria is met:

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

Or

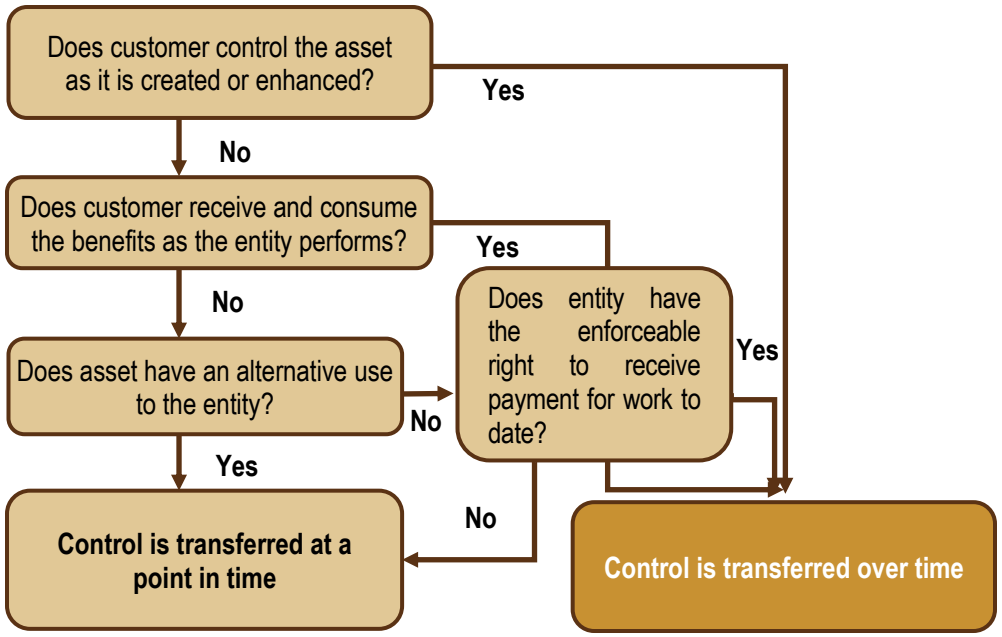
Criteria (b) – the entity's performance creates or enhances an asset (for example, work in progress) that the customer controls as the asset is created or enhanced; or

Or

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

Following diagram below depicts if the control is transferred over a period of time.

- If any of the criteria are met, then revenue is recognized over a period of time.
- If none of the criteria are met, then revenue is recognized at a point in time.



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In this regard, it is important to understand how each of the above criteria are evaluated –

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

This criterion is ordinarily applied in situations in which the benefits of seller's performance are immediately consumed by the customer, for eg.: routine or recurring services in which the consumer consumes the benefits immediately as the services are performed, which means that the customer obtains control of seller entity's output as soon as the entity performs.

Hence, in such situations, entity's performance is said to be performed over a period of time.

Illustration 59

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 recognize the revenue?

Solution

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

- The customer, ie, 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 satisfies the first criterion, ie, services completed on a monthly basis are consumed by the entity at the same time and hence, revenue shall be recognized over the period of time.

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For certain performance obligations, an entity may not be able to readily identify whether a customer simultaneously receives and consumes the benefits from the entity's performance as the entity performs. In such cases, a performance obligation is satisfied over time if an entity determines that another entity would not need to substantially re-perform the work that the entity has completed to date if that other entity were to fulfil the remaining performance obligation to the customer.

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In making such determination, an entity shall make both of the following assumptions:

(a) disregard potential contractual restrictions or practical limitations that otherwise would prevent the entity from transferring the remaining performance obligation to another entity; and

(b) presume that another entity fulfilling the remainder of the performance obligation would not have the benefit of any work in progress.

Illustration 60

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

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

Solution

T&L has a single performance to ship the goods from 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 benefitting from the performance of the voyage as & when it progresses.

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

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Criteria (b) – the entity's performance creates or enhances an asset (for example, work in progress) that the customer controls as the asset is created or enhanced. Refer guidance on "control" given at the beginning of this section.

- In such cases, the customer ordinarily obtains control of the asset whose work is in progress and therefore, the entity carrying out the work can recognize revenue over a period of time.
- Ordinarily, this criterion is applied to the following type of contracts with customers:

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(a) Construction contracts, wherein the contractor engages to construct a specific asset for the customer on customer's land;

(b) Contracts with the government, wherein the government agency is ordinarily entitled to any work in process performed by the service provider.

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

Where a customer does not meet either criterion (a) or criterion (b), the seller entity evaluates the third and last criterion to determine if performance obligation is satisfied over a period of time.

- This criterion refers to situations in which an asset is created at customer's discretion, which the seller is restricted from using for any other purpose and at the same time, the seller entity reserves a right to seek payment for work in process. Therefore, this criterion is met if two factors exist simultaneously –

(i) The asset so created does not have an alternate use to the entity; and

(ii) Seller entity has a legally enforceable right to payment for performance completed to date.

Asset has no alternate use to Seller entity	This evaluation is done at contract inception and involves consideration of following factors – ❖ For the asset created - Seller is restricted contractually from readily directing the asset for another use during its creation or enhancement; or ❖ The seller is limited practically from readily directing the asset in it completed state for another use.

And

Legally enforceable right to payment for work completed	❖ An entity has a right to payment at all times that at least compensates for performance completed to date, i.e, an amount that approximates selling price of goods which is equal to cost of goods plus a reasonable profit margin ❖ Legally enforceable right comes from operation of law or legal precedent that could supplement or override contractual terms. This may be affected if company's customary business practice is to not enforce payment if customer defaults, etc.

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Let's take a closer look at each of the above-mentioned factors.

❖ **Asset does not have alternate use to the seller entity:**

This evaluation is carried out at inception of transaction and is not reassessed unless the contract is substantially modified. In doing this assessment, the entity shall consider the practical limitations and/ or contractual restrictions in redirecting the asset for another use, like selling to another customer.

- A ***contractual restriction*** referred to above must be substantive, ie, a customer should be able to enforce its right to the asset if at any time the seller tries to redirect the asset to another customer. Therefore, if any customer's right to an asset is inter-changeable with other equivalent assets, then the right is not substantive to restrict the seller entity from redirecting the use of the asset.
- A ***practical limitation*** exists when the seller entity would require incurring significant economic losses to direct the asset for another use, such that the seller is practically limited from doing so. This may occur, for example, if the costs of rework of the asset are significant to direct for another use, or a significant loss would occur upon selling the asset to another customer, etc.

❖ **Right to payment for performance completed to date**

- An entity has a right to payment for performance completed to date if the entity would be entitled to an amount that at least compensates the entity for its performance completed to date in the event that the customer or another party terminates the contract for reasons other than the entity's failure to perform as promised.
- Such a right to enforce payment should result in **compensation for the costs incurred by the entity for work completed to date, plus a reasonable profit margin**. A meagre compensation for potential loss of profit, if the contract was to be terminated does not tantamount to legally enforceable right for work completed to date.
- Compensation for a reasonable profit margin need not equal the profit margin expected if the contract was fulfilled as promised, but an entity should be entitled to compensation for either of the following amounts:

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(a) a proportion of the expected profit margin in the contract that reasonably reflects the extent of the entity's performance under the contract before termination by the customer (or another party); or

(b) a reasonable return on the entity's cost of capital for similar contracts (or the entity's typical operating margin for similar contracts) if the contract-specific margin is higher than the return the entity usually generates from similar contracts.

- Sometimes, the right of the entity need not be a present unconditional right. Entity may have a right to seek payment only upon achievement of specific milestones or upon completion of entire performance obligation. In such case, entity would need to determine if it has a right to enforce payment, in case the contract was to be terminated prior to completion, for reasons other than company's failure to perform.
- Also, sometimes termination clauses in an agreement may not provide the customer with right to cancel or terminate. In such cases, if the customer seeks cancellation, the entity may still have a right to complete performance and seek payment for work carried out.
- Alternatively, if the contract provides for right to demand payment as work progresses, but customer may have a right to refund if he proposes to terminate the contract before completion. In such cases, entity cannot be said to have a right to enforce payment for work completed to date.

Illustration 61

AFS Ltd. is a risk advisory firm and enters into a contract with a company – WBC Ltd to provide audit services that results in AFS issuing an audit opinion to 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?

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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 recognizing revenue over a period of time or at a point in time, Ind AS 115 requires one of the following criteria 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. Further, in case the contract was to be terminated, any other firm 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 the contract was early terminated, for reasons other than AFS's failure to perform. And the profit margin approximates what the entity otherwise earns.

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

*****

Illustration 62

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

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

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Solution

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

- Criterion (a) – whether the customer simultaneously receives and consumes the benefits: Customer can benefit only when the satellite is fully constructed, and no benefits are consumed as its constructed. Hence, this criterion is not met.
- Criterion (b) – An asset created that customer controls: Per provided facts, the customer does not acquire control of the asset as its created.
- Criterion (c) – no alternate use to entity and right to seek payment:
  - ❖ The asset is being specifically created for the customer. The asset is customised to customer's requirements, such that any diversion for a different customer will require significant work. Therefore, the asset has practical limitation in being put to alternate use.
  - ❖ Further, Space Ltd. has a right to enforce payment if the contract was terminated early, for reasons other then 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.

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Illustration 63

ABC enters into a contract with a customer to build an item of equipment. The customer pays 10% advance and then 80% in instalments of 10% each over the period of construction with balance 10% payable at the end of construction period. The payments are non-refundable unless the company fails to perform as per the contract. Further, if the customer terminates the contract, then entity is entitled to retain payments made. The company will have no further right to compensation from the customer.

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

Solution

The Company shall evaluate conditions laid in para 35 of Ind AS 115 as follows:

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

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- Criterion (b) – An asset created that customer controls: As per provided facts, the customer does not acquire control of the asset as it is created.
- Criterion (c) – no alternate use to entity and right to seek payment:
  - ❖ The customer has specific right over the asset and company does not have right to divert it for any alternate use. In other words, there is contractual restriction to use the asset for any alternate purpose.
  - ❖ In the event of early termination, Company has a right to retain any payments made by the customer. However, such payments need not necessarily compensate the selling price of the partially constructed asset, if the customer was to stop making payments.

  Therefore, Company does not have a legally enforceable right to payment for work completed to date and the criterion under para 35 is not satisfied. Thus, revenue cannot be recognized over a period of time.

*****

All above discussed three criteria can be summarized in below table:

	Criterion	Example
1.	The customer simultaneously receives and consumes the benefits provided by the entity's performance as the entity performs	Routine or recurring services – e.g. cleaning services, Routine transaction processing services, Hotel management services.
2.	The entity's performance creates or enhances an asset that the customer controls as the asset is created or enhanced	Building an asset on a customer's site
3.	The entity's performance does not create an asset with an alternative use to the entity and the entity has an enforceable right to payment for performance completed to date	Building a specialized/highly customized asset that only the customer can use or building an asset according to a customer's specifications

When an entity has determined that a performance obligation is satisfied over time, the standard requires the entity to select a single revenue recognition method for the relevant performance obligation. The objective is to faithfully depict an entity's performance in transferring control of goods or services promised to a customer (i.e. the satisfaction of an entity's performance obligation). The standard provides two methods for recognizing revenue on contracts involving the transfer of goods and services over time: input methods and output methods.

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Methods of measuring progress of a performance obligation satisfied over time

Output Methods	Input Methods
Recognize revenue based on direct measurements of the value to the customer of the goods or services transferred to date relative to the remaining goods or services promised under the contract.	Recognize revenue based on the **entity's efforts or inputs** to the satisfaction of a performance obligation.
For Example: Surveys of performance completed to date, appraisals of results achieved	**For Example**: Resources consumed labour hours expended, costs incurred, time elapsed or machine hours used

A. Output methods:

- Output methods recognize revenue on the basis of direct measurements of the value, to the customer, of the goods or services transferred to date relative to the remaining goods or services promised under the contract. Output methods include methods such as surveys of performance completed to date, appraisals of results achieved, milestones reached, time elapsed and units produced or units delivered. Output method is selected if it would faithfully depict the entity's performance towards complete satisfaction of the performance obligation. It may not be useful in depicting the entity's performance if it would fail to measure some of the goods or services for which control has transferred to the customer. For example, output methods based on units produced or units delivered would not faithfully depict an entity's performance in satisfying a performance obligation if, at the end of the reporting period, the entity's performance has produced work in progress or finished goods controlled by the customer that are not included in the measurement of the output.

- **As a practical expedient** – if a company has a right to consideration from a customer in an amount which corresponds directly with the value billed to the customer of the entity's performance completed to date, then company may recognize revenue for the amount to which the entity has a right to invoice. For eg.: a service contract in which entity bills a fixed amount for each hour of service provided, etc.

B. Input methods:

- Input methods recognize revenue on the basis of the entity's efforts or inputs to the satisfaction of a performance obligation (e.g. resources consumed, labour hours

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expended, costs incurred, time elapsed or machine hours used) relative to the total expected inputs to the satisfaction of that performance obligation. If the entity's efforts or inputs are expended evenly throughout the performance period, it may be appropriate for the entity to recognize revenue on a straight-line basis.

- While applying input method, a careful consideration should be given for events that do not depict a direct relationship between entity's inputs and transfer of control of goods or services. For example, when cost-based input method is used, an adjustment may be required in the following cases –

  (a) When any cost incurred does not contribute to an entity's progress in satisfying performance obligation – any excess costs incurred owing to entity's inefficiencies that were not reflected in the price of the contract must be ignored for measuring progress of work. For eg: cost of wasted materials, labour or other resources, etc.

  (b) When cost incurred is not proportionate to entity's progress in satisfying its performance obligation. In such cases, the best reflection is to adjust the input method to recognize revenue only to the extent of costs incurred. Such recognition of revenue to the extent of costs incurred is appropriate, if at contract inception, all the following conditions exist:

    (i) The goods do not represent a distinct performance obligation;

    (ii) Customer is expected to obtain control of the goods significantly before receiving the services;

    (iii) Cost of such goods is significant relative to the total expected costs to complete the performance obligation; and

    (iv) The entity procures the goods from a third party and does not significantly involve in designing / manufacturing the goods (even if the entity is a principal in the arrangement between the entity and end customer).

An entity shall apply a single method of measuring progress for each performance obligation satisfied over time, and the entity shall apply that method consistently to similar performance obligations and in similar circumstances. At the end of each reporting period, an entity shall remeasure its progress towards complete satisfaction of a performance obligation satisfied over time.

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As circumstances change over time, an entity shall update its measure of progress to reflect any changes in the outcome of the performance obligation. Such changes to an entity's measure of progress shall be accounted for as a change in accounting estimate in accordance with Ind AS 8, Accounting Policies, Changes in Accounting Estimates and Errors.

*****

Illustration 64 : Measuring progress on straight line basis

An entity, an owner and manager of health clubs, enters into a contract with a customer for one year of access to any of its health clubs. The customer has unlimited use of the health clubs and promises to pay CU100 per month. The entity's promise to the customer is to provide a service of making the health clubs available for the customer to use as and when the customer wishes.

Evaluate if contract will qualify for satisfaction of performance obligation over a period of time. If yes, how should an entity measure its progress of service provided?

Solution

The entity shall determine if revenue should be recognized over a period of time by evaluating the conditions laid in para 35 of Ind AS 115.

- Applying the first criterion of para 35 to establish if the customer simultaneously receives and consumes the benefits, as the entity provides service – The health club provides access to services uniformly through the year. The extent to which the customer uses the health clubs does not affect the amount of the remaining goods and services to which the customer is entitled. The customer therefore simultaneously receives and consumes the benefits of the entity's performance as it performs by making the health clubs available.
- Consequently, the entity's performance obligation is satisfied over time.
- Once the pattern of satisfying performance obligation is defined, the Company then determines how progress should be measured. The services are uniformly provided to the customer through the year. Therefore, the best measure of progress is to recognize revenue on a straight-line basis over the year.

*****

Illustration 65 : Uninstalled materials

On 1st 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:

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

The entity purchases the elevators, and they are delivered to the site six months before they will be installed. The entity uses an input method based on cost to measure progress towards completion of the contract. The entity has incurred actual other costs of 5,00,000 by 31st March, 20X1.

How will the Company recognize revenue for the year ended 31st March, 20X1, 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, the customer acquires control of such elevators.

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

Therefore, applying the guidance on Input method –

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

The revenue to be recognized is measured as follows:

Particulars	**Amount (₹)**
Transaction price	50,00,000
Costs incurred:	

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(a) Cost of elevators	15,00,000
(b) Other costs	5,00,000
Measure of progress:	5,00,000 / 25,00,000 = 20%
Revenue to be recognized:	
(a) For costs incurred (other than elevators)	Total attributable revenue = 35,00,000 % of work completed = 20% Revenue to be recognized = 7,00,000
(b) Revenue for elevators	15,00,000 (equal to costs incurred)
Total revenue to be recognized	15,00,000 + 7,00,000 = 22,00,000

Therefore, for the year ended 31st March, 20X1, the Company shall recognize revenue of ₹ 22,00,000 on the project.

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Other considerations in measuring progress of work:

Stand-Ready Obligations

When the nature of an entity's performance obligation is to stand ready to provide goods or services, it may be appropriate to utilize a time-based measure of progress.

- When the pattern of benefit and the entity's efforts to fulfill the contract are not even throughout the contract period, a time-based method of measuring progress may not be appropriate.
- On the other hand, when an entity expects the customer will receive and consume the benefits of the entity's promise equally throughout the contract period, or if the entity does not know and cannot reasonably estimate how and when the customer will request performance, then a straight-line revenue attribution resulting from a time-based measure of progress may be appropriate.

9.2.2 Transfer of control at a point in time:

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

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

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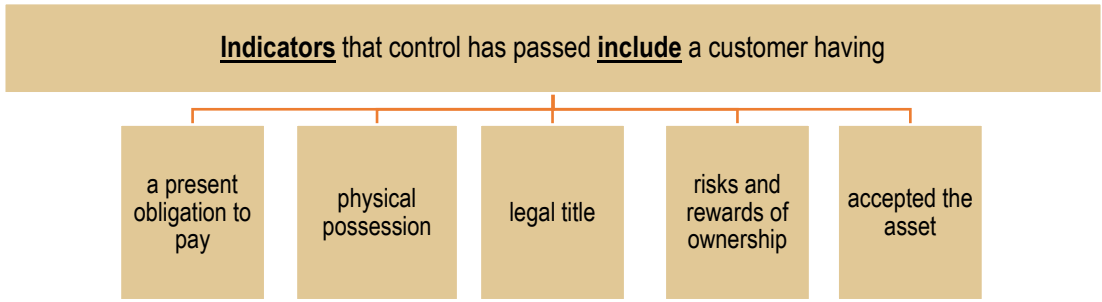

Indicator	Evaluation
The entity has a present right to payment	If a customer is presently obliged to pay for an asset, then that may indicate that the customer has obtained the ability to direct the use of, and obtain substantially all of the remaining benefits from, the asset in exchange.
The customer has a legal title to the asset	- Legal title may indicate which party to a contract has the ability to direct the use of, and obtain substantially all of the remaining benefits from, an asset or to restrict the access of other entities to those benefits. - If an entity retains legal title solely as protection against the customer's failure to pay, those rights of the entity would not preclude the customer from obtaining control of an asset.
The customer has physical possession of the asset	- The customer's physical possession of an asset may indicate that the customer has the ability to direct the use of the asset. - However, physical possession may not coincide with control of an asset. For example, in some repurchase agreements and in some consignment arrangements, a customer or consignee may have physical possession of an asset that the entity controls.
The customer has assumed significant risks & rewards of owning the asset	- Transfer of risks & rewards for an asset may indicate that the customer has the ability to direct the use of and obtain substantially all of the benefits from the asset. - When evaluating the risks and rewards of ownership of a promised asset, an entity shall exclude any risks that give rise to a separate performance obligation in addition to the performance obligation to transfer the asset. For example, an entity may have transferred control of an asset to a customer but not yet satisfied an additional performance obligation to provide maintenance services related to the transferred asset.

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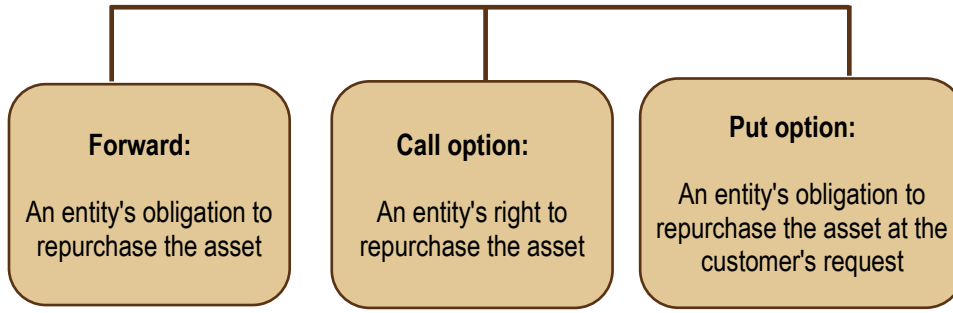
The customer has accepted the asset	- Customer acceptance clauses allow a customer to cancel a contract or require an entity to take remedial action if a goods or service does not meet agreed-upon specifications. - An entity shall consider such clauses to evaluate when a customer obtains control of a goods or service. - If an entity can objectively determine that control of a goods or service has been transferred to the customer in accordance with the agreed-upon specifications in the contract, then customer acceptance is a formality that would not affect the entity's determination of when the customer has obtained control of the goods or service. - However, if an entity cannot objectively determine that the goods or service provided to the customer is in accordance with the agreed-upon specifications in the contract, then the entity would not be able to conclude that the customer has obtained control until the entity receives the customer's acceptance.

9.3 Repurchase agreements

When a company determines the timing of transfer of control, it is important to take into consideration any repurchase agreements that may have been executed by the Company.

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

Repurchase agreements generally come in three forms:



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A. Forward or call option:

- If an entity has an obligation or a right to repurchase the asset (a forward or a call option), a customer does not obtain control of the asset because the customer is limited in its ability to direct the use of, and obtain substantially all of the remaining benefits from, the asset even though the customer may have physical possession of the asset.

  Consequently, the entity shall account for the contract as either of the following:

  (a) a lease in accordance with Ind AS 116, Leases, if the entity can or must repurchase the asset for an amount that is less than the original selling price of the asset, unless the contract is part of a sale and leaseback transaction. If the contract is part of a sale and leaseback transaction, the entity shall continue to recognize the asset and shall recognize financial liability for any consideration received from the customer. The entity shall account for the financial liability in accordance with Ind AS 109; or

  (b) a financing arrangement, if the entity can or must repurchase the asset for an amount that is equal to or more than the original selling price of the asset.

- When comparing the repurchase price with the selling price, an entity shall consider the time value of money.

- If the repurchase agreement is a financing arrangement, the entity shall continue to recognize the asset and also recognize a financial liability for any consideration received from the customer.

- The entity shall recognize the difference between the amount of consideration received from the customer and the amount of consideration to be paid to the customer as interest and, if applicable, as processing or holding costs (for example, insurance).

- If the option lapses unexercised, an entity shall derecognize the liability and recognize revenue.

B. Put option

- If an entity has an obligation to repurchase the asset at the customer's request (a put option) at a price that is lower than the original selling price of the asset, the

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entity shall consider at contract inception whether the customer has a significant economic incentive to exercise that right. The customer's exercising of that right results in the customer effectively paying the entity consideration for the right to use a specified asset for a period of time. Therefore, the entity shall account for the agreement as a lease in accordance with Ind AS 116, unless the contract is part of a sale and leaseback transaction. If the contract is part of a sale and leaseback transaction, the entity shall continue to recognize the asset and shall recognize a financial liability for any consideration received from the customer. The entity shall account for the financial liability in accordance with Ind AS 109.

- To determine whether a customer has a significant economic incentive to exercise its right, an entity shall consider various factors, including the relationship of the repurchase price to the expected market value of the asset at the date of the repurchase and the amount of time until the right expires. For example, if the repurchase price is expected to significantly exceed the market value of the asset, this may indicate that the customer has a significant economic incentive to exercise the put option and hence the customer is expected to ultimately return the asset to the entity.
- If the repurchase price is equal to or greater than original selling price and more than the expected market value of the asset, the contract is in effect a financing arrangement.
- If the repurchase price of the asset is equal to or greater than the original selling price and is less than or equal to the expected market value of the asset, and the customer does not have a significant economic incentive to exercise its right, then the entity shall account for the agreement as if it were the sale of a product with a right of return.
- If the customer does not have a significant economic incentive to exercise its right at a price that is lower than the original selling price of the asset, the entity shall account for the agreement as if it were the sale of a product with a right of return.
- The following decision tree may be useful to account for the arrangement –

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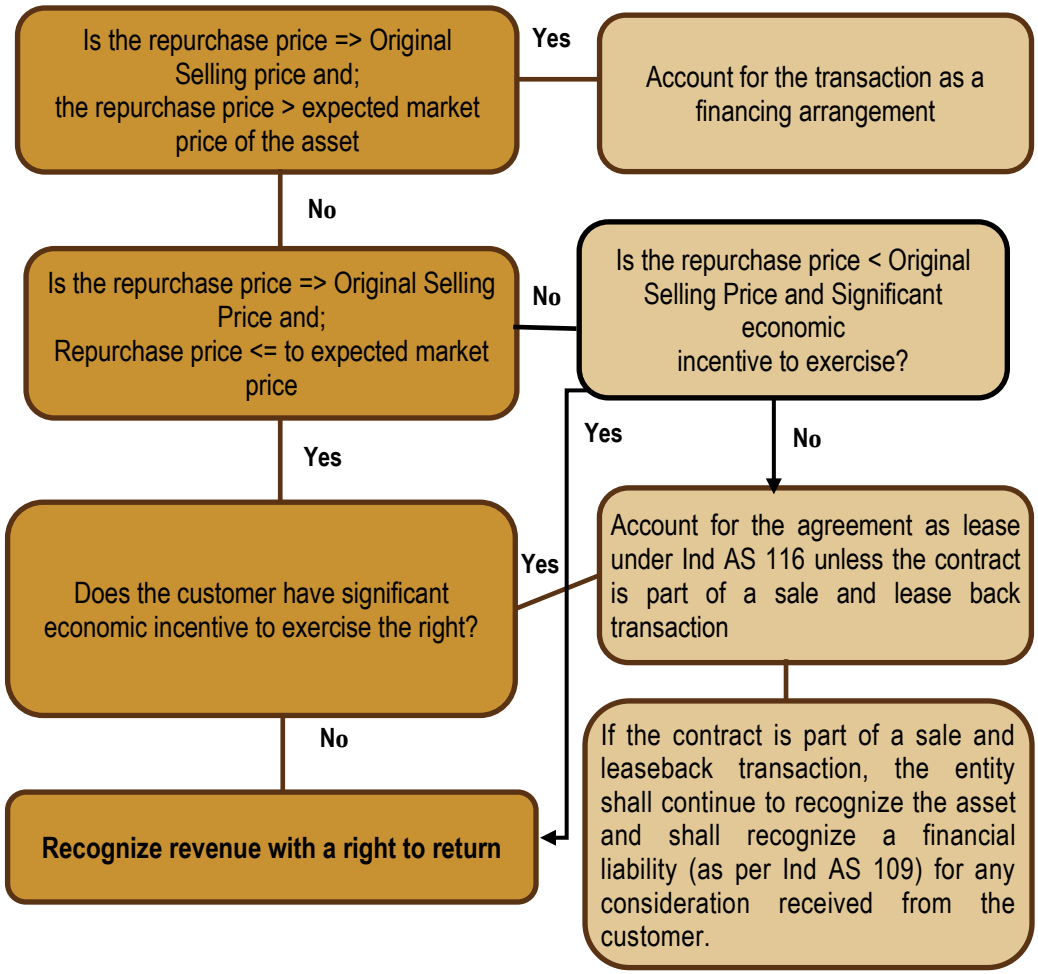

- When comparing the repurchase price with the selling price, an entity shall consider the time value of money.
- If the option lapses unexercised, an entity shall derecognize the liability and recognize revenue.

Illustration 66

An entity enters into a contract with a customer for the sale of a tangible asset on 1st 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 31st December, 20X1.

How would the entity account for this transaction?

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Solution

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

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

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Illustration 67

An entity enters into a contract with a customer for the sale of a tangible asset on 1st January, 20X1 for ₹ 10,00,000. The contract includes a put option that gives the customer the right to sell the asset for ₹ 9,00,000 on or before 31st December, 20X1. The market price for such goods is expected to be ₹ 7,50,000

How would the entity account for this transaction?

Solution

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

- The entity shall evaluate if the customer has a significant economic incentive to return the goods. Since the repurchase price is significantly higher than market price, therefore, customer has a significant economic incentive to return the goods. There are no other factors which may affect this assessment.
- Therefore, company determines that 'control' of goods is not transferred to the customer till 31st December, 20X1, ie, till the put option expires.
- Against payment of ₹ 10,00,000; the customer only has a right to use the asset and put it back to the entity for ₹ 9,00,000. Therefore, this will be accounted as a lease transaction in which difference between original selling price (ie, ₹ 10,00,000) and repurchase price (ie, ₹ 9,00,000) shall be recognized as lease income over the period of lease.
- At the end of repurchase term, ie, 31st December, 20X1, if the customer does not exercise such right, then the control of goods would be passed to the customer at that time and revenue shall be recognized for sale of goods for repurchase price (ie, ₹ 9,00,000).

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9.4 Bill-and-hold

- A bill-and-hold arrangement is a contract under which an entity bills a customer for a product but the entity retains physical possession of the product until it is transferred to the customer at a point in time in the future. For example, a customer may request an entity to enter into such a contract because of the customer's lack of available space for the product or because of delays in the customer's production schedules.

- In such arrangements, the entity shall determine at which point does control transfer to the customer.

  In some cases, control is transferred either when the product is delivered to the customer's site or when the product is shipped, depending on the terms of the contract (including delivery and shipping terms). While in other cases, a customer may obtain control of a product even though that product remains in an entity's physical possession. In that case, the customer has the ability to direct the use of, and obtain substantially all of the remaining benefits from, the product even though it has decided not to exercise its right to take physical possession of that product. Consequently, the entity does not control the product. Instead, the entity provides custodial services to the customer over the customer's asset

- In addition, the indicators defined earlier in this chapter for establishing transfer of control, **all the following criteria must be met**:

  (a) the reason for the bill-and-hold arrangement must be substantive (for example, the customer has requested the arrangement);

  (b) the product must be identified separately as belonging to the customer;

  (c) the product currently must be ready for physical transfer to the customer; and

  (d) the entity cannot have the ability to use the product or to direct it to another customer.

- Where an entity recognizes revenue on bill & hold basis, the entity shall determine if it has any additional performance obligations forming part of the transaction price, which would need to be segregated and accounted separately, when such performance obligations are met. (for eg.: custodial services for goods held, extended warranty, etc.) For identification of performance obligations, refer step 2 – identifying performance obligations.

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Illustration 68

An entity enters into a contract with a customer on 1st 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 31st March, 20X3, the customer pays for the machine and spare parts, but only takes physical possession of the machine. Although the customer inspects and accepts the spare parts, the customer requests 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 recognize revenue for sale of machine and spare parts? Is there any other performance obligation attached to this sale of goods?

Solution

In the facts 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 hold the spare parts for the customer for a period of 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 31st March, 20X3. Accordingly, revenue for sale of machinery shall be recognized on 31st 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

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physically held by the entity. In this regard, the company shall evaluate if revenue can be recognized on bill-and-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 product currently must be ready for physical transfer to the customer; and	The spares are identified and segregated, therefore, ready for delivery.
(d) 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 and hence, company can recognize revenue for sale of spare parts on 31st March, 20X3.

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

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9.5 Licences of intellectual property

Ind AS 115 provides application guidance specific to the recognition of revenue for licences of intellectual property, which differs from the recognition model for other promised goods and services.

Considering the fact that licences include a wide range of features and economic characteristics, an entity will need to evaluate the nature of its promise to grant a licence of intellectual property in order to determine whether the promise is satisfied (and revenue is recognized) over time or at a point in time.

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A licence will either provide:

- a right to access the entity's intellectual property throughout the licence period, which results in revenue that is recognized over time; or
- a right to use the entity's intellectual property as it exists at the point in time in which the licence is granted, which results in revenue that is recognized at a point in time.

The standard states that licences of intellectual property establish a customer's rights to the intellectual property of an entity and may include licences for any of the following: software and technology, media and entertainment (e.g. motion pictures and music), franchises, patents, trademarks and copyrights.

9.5.1 Right to access

A licence that provides an entity with the right to access intellectual property is satisfied over time 'because the customer simultaneously receives and consumes the benefit from the entity's performance as the performance occurs', including the related activities undertaken by entity. This conclusion is based on the determination that when a licence is subject to change (and the customer is exposed to the positive or negative effects of that change), the customer is not able to fully gain control over the licence of intellectual property at any given point in time, but rather gains control over the licence period.

Example 7

Pogo has created a popular television show called "Chhota Bheem". Pogo grants a three-year license to Toy Manufacturer for use of the character "Chhota Bheem" on its toys. As per the contract, Pogo will continue to produce the show, popularize the character, carry out marketing activities. Toy Manufacturer produces and sells "Chhota Bheem" toys. In this case, the license provides access to Pogo's Intellectual Property (IP). Pogo will undertake activities that significantly affect the IP by production and marketing of the show, development of the characters. Toy manufacturer is directly exposed to any positive or negative effects by Pogo's activities ie. how the show is received by kids and their parents. These activities are not separate performance obligations as they do not transfer a goods or service to Toy Manufacturer separate from the license. Hence, Pogo will recognize revenue over time.

9.5.2 Right to use

In contrast, when the licence represents a right to use the intellectual property as it exists at a specific point in time, the customer gains control over that intellectual property at the beginning of the period for which it has the right to use the intellectual property. This timing may differ from when the licence was granted.

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Illustration 69

An entity, a music record label, licenses to a customer a 1975 recording of a classical symphony by a noted orchestra. The customer, a consumer products company, has the right to use the recorded symphony in all commercials, including television, radio and online advertisements for two years in Country A. In exchange for providing the licence, the entity receives fixed consideration of ₹ 50,000 per month. The contract does not include any other goods or services to be provided by the entity. The contract is non-cancellable.

Determine how the revenue will be recognized?

Solution

The entity assesses the goods and services promised to the customer to determine which goods and services are distinct in accordance with paragraph 27 of Ind AS 115. The entity concludes that its only performance obligation is to grant the licence. The entity does not have any contractual or implied obligations to change the licensed recording. The licensed recording has significant stand-alone functionality (i.e. the ability to be played) and, therefore, the ability of the customer to obtain the benefits of the recording is not substantially derived from the entity's ongoing activities. The entity therefore determines that the contract does not require, and the customer does not reasonably expect, the entity to undertake activities that significantly affect the licensed recording. Consequently, the entity concludes that the nature of its promise in transferring the licence is to provide the customer with a right to use the entity's intellectual property as it exists at the point in time that it is granted. Therefore, the promise to grant the licence is a performance obligation satisfied at a point in time. The entity recognizes all of the revenue at the point in time when the customer can direct the use of, and obtain substantially all of the remaining benefits from, the licensed intellectual property.

*****

Access to the IP (over time)

1. The entity is required (by the contract) or reasonably expected (by the customer) **to undertake activities that significantly affect the licensed IP**
2. The licence **exposes the customer to any effects** of the entity's activities
3. The **entity's activities are not a performance obligation** under the contract

All criteria must be met

Right to use the IP (at a point in time)

- **If all 3 criteria for access (over time) are not met**, the nature of the entity's promise is to provide a right to use the IP as the IP exists at the point in time the licence is granted to the customer
- Effectively, this means the customer is able to direct the use of and obtain all remaining benefits from the licensed IP when granted (i.e., the IP is static)

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Illustration 70 : Assessing the nature of a software licence with unspecified upgrades

Software Company X licenses its software application to Customer Y. Under the agreement, X will provide updates or upgrades on a when-and-if-available basis; Y can choose whether to install them. Y expects that X will undertake no other activities that will change the functionality of the software.

Determine the nature of license.

Solution

Based on the facts given in question it can be concluded that, although the updates and upgrades will change the functionality of the software, they are not activities considered in determining the nature of the entity's promise in granting the licence. The activities of X to provide updates or upgrades are not considered because they transfer a promised goods or service to Y – i.e. updates or upgrades are distinct from the licence. Therefore, the software licence provides a right to use the IP that is satisfied at a point in time.

*****

Illustration 71 : Assessing the nature of a film licence and the effect of marketing activities

Film Studio C grants a licence to Customer D to show a completed film. C plans to undertake significant marketing activities that it expects will affect box office receipts for the film. The marketing activities will not change the functionality of the film, but they could affect its value.

Determine the nature of license.

Solution

C would probably conclude that the licence provides a right to use its IP and, therefore, is transferred at a point in time. There is no expectation that C will undertake activities to change the form or functionality of the film. Because the IP has significant stand-alone functionality, C's marketing activities do not significantly affect D's ability to obtain benefit from the film, nor do they affect the IP available to D.

*****

Illustration 72 : Assessing the nature of a team name and logo

Sports Team D enters into a three-year agreement to license its team name and logo to Apparel Maker M. The licence permits M to use the team name and logo on its products, including display

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products, and in its advertising or marketing materials.

(i) Determine the nature of license in the above case.

(ii) Modifying above facts that, Sports Team D has not played games in many years and the licensor is Brand Collector B, an entity that acquires IP (Intellectual Property) such as old team or brand names and logos from defunct entities or those in financial distress. B's business model is to license the IP or obtain settlements from entities that use the IP without permission, without undertaking any ongoing activities to promote or support the IP.

Would the answer be different in this situation?

Solution

(i) The nature of D's promise in this contract is to provide M with the right to access the sports team's IP and, accordingly, revenue from the licence will be recognized over time. In reaching this conclusion, D considers all of the following facts:

- M reasonably expects D to continue to undertake activities that support and maintain the value of the team name and logo by continuing to play games and field a competitive team throughout the licence period. These activities significantly affect the IP's ability to provide benefit to M because the value of the team name and logo is substantially derived from, or dependent on, those ongoing activities.
- The activities directly expose M to positive or negative effects (i.e. whether D plays games and fields a competitive team will have a direct effect on how successful M is in selling its products featuring the team's name and logo).
- D's ongoing activities do not result in the transfer of a goods or a service to M as they occur (i.e. the team playing games does not transfer a goods or service to M).

(ii) Based on B's customary business practices, Apparel Maker M probably does not reasonably expect B to undertake any activities to change the form of the IP or to support or maintain the IP. Therefore, B would probably conclude that the nature of its promise is to provide M with a right to use its IP as it exists at the point in time at which the licence is granted.

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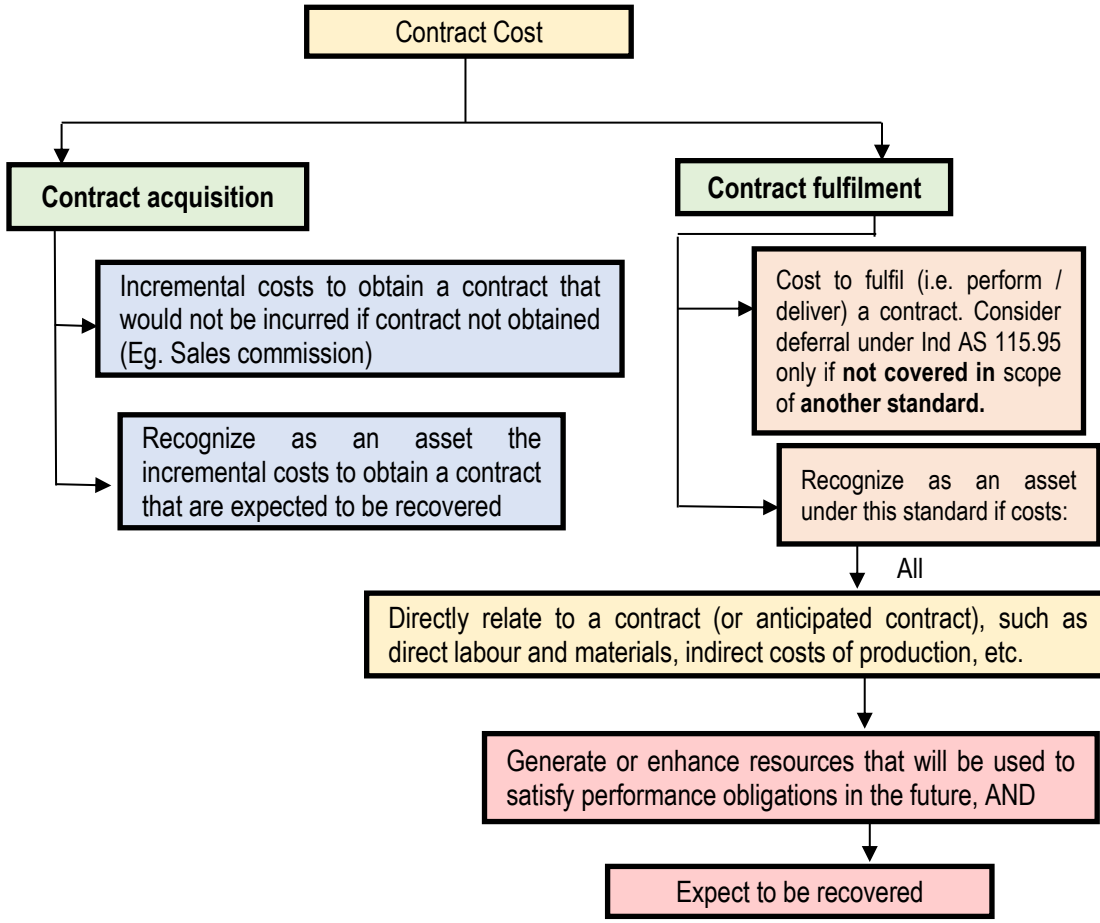
10. CONTRACT COSTS



10.1 Costs to obtain a contract (contract acquisition costs)

Entities may incur various costs to obtain or acquire a contract with a customer, including, but not limited to, legal fees, advertising expenses, travel expenses, and salespersons' salaries and commissions.

Incremental costs of obtaining a contract are those costs that an entity incurs to obtain a contract with a customer that it would not have incurred if the contract had not been obtained (for example, a sales commission).

Once an entity has determined that costs incurred relate to a specific contract with a customer, it should then determine if the costs meet the conditions for capitalisation. Incremental costs to

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obtain a contract that an entity expects to recover should be capitalised, while costs to obtain a contract that do not qualify for capitalisation should be expensed as incurred.

The test to determine if a cost is incremental is to ask whether the entity would have incurred the cost had one or both of the parties decided to walk away just before signing the arrangement. In this context, any legal costs (for example, to draft or negotiate the contract) or salaries for salespeople would be incurred regardless of whether the contract is finalized. Therefore, these costs are not incremental. On the other hand, a commission paid only upon the successful signing of the contract would be incremental and should be capitalized.

As a practical expedient, Ind AS 115 allows an entity to expense the incremental costs of obtaining a contract as incurred if the amortisation period of the asset that the entity would have otherwise recognized is one year or less.

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

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Comparison with AS 7 and AS 9

Contract acquisition cost is not specifically dealt with in either in AS 7 or AS 9. Let's take an illustration to understand the treatment in AS 7 / AS 9 and how it is different from Ind AS:

Example 8

A software company has agreed to pay a special commission of 1% of the contract value to a sales consultant who has agreed to work based on the successful bidding of the proposal to a customer. In case the contract is not signed by the company and the customer, for whatever reason, then there is no commission to be paid to the sales consultant.

The contract value is ₹ 1 crore over 3 years and the company has signed the contract with the customer after successful bidding with the help of the sales consultant.

In this context, the accounting differences will be as follows:

Particulars	Treatment under Ind AS 115	Treatment under AS 9
1st year of operations - Contract acquisition cost of ₹ 1 crore	• Amortization as expense of the year ₹ 33.33 lakhs • Contract asset ₹ 66.67 lakhs	Expense of ₹ 1 crore as sales commission
2nd year of operations - Contract acquisition cost of ₹ 1 crore	• Amortization as expense of the year ₹ 33.33 lakhs • Contract asset ₹ 33.34 lakhs	No accounting treatment
3rd year of operations - Contract acquisition cost of ₹ 1 crore	• Amortization as expense of the year ₹ 33.34 lakhs • Contract asset of nil	No accounting treatment

10.2 Costs to fulfil a contract (contract fulfilment costs)

If costs incurred in fulfilling a contract with a customer are covered under another Standard (such as Ind AS 2 'Inventories' and Ind AS 16 'Property, Plant, and Equipment'), an entity accounts for those costs in accordance with those Standards. If not, an entity recognizes an asset for such costs, provided all of the criteria mentioned below are met:

(a) the costs relate directly to a contract or to an anticipated contract that the entity can specifically identify (for example, costs relating to services to be provided under renewal of an existing contract or costs of designing an asset to be transferred under a specific contract that has not yet been approved), including:

(i) direct labour

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(ii) direct materials

(iii) allocations that relate directly to the contract or contract activities (for example, contract management and supervision costs and depreciation of tools and equipment and right-of-use assets used in fulfilling the contract)

(iv) costs that are explicitly chargeable to the customer

(v) other costs that the entity incurs only because it entered into the contract (e.g. payments to subcontractors)

(b) the costs generate or enhance resources of the entity that will be used to satisfy performance obligations in the future

(c) the entity expects to recover the costs, for e.g. through the expected margin

The following costs should be expensed as incurred:

(a) general and administrative costs that are not explicitly chargeable to the customer

(b) costs of wasted materials, labour, or other resources that were not reflected in the contract price

(c) costs that relate to satisfied performance obligations

(d) costs related to remaining performance obligations that cannot be distinguished from costs related to satisfied performance obligations.

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

Illustration 73

Customer outsources its information technology data centre

Term = 5 years plus two 1-yr 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	*₹ 1,40,000*
Software	*₹ 1,00,000*
Migration and testing of data centre	*₹ 1,10,000*
TOTAL	***₹ 4,00,000***

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Solution

Design services	₹ 50,000	Assess under Ind AS 115. Any resulting asset would be amortised over 7 years (i.e. include renewals)
Hardware	₹ 1,40,000	Account for asset under Ind AS 16
Software	₹ 1,00,000	Account for asset under Ind AS 38
Migration and testing of data centre	₹ 1,10,000	Assess under Ind AS 115. Any resulting asset would be amortised over 7 years (i.e. include renewals)
TOTAL	**₹ 4,00,000**	

*****

10.3 Amortisation and impairment

Under Ind AS 115, an entity amortises capitalised contract costs on a systematic basis consistent with the pattern of transferring the goods or services related to those costs. If an entity identifies a significant change to the expected pattern of transfer, it updates its amortisation to reflect that change in estimate in accordance with Ind AS 8.

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

Before recognizing an impairment loss under the revenue recognition guidance, an entity recognizes impairment losses associated with assets related to the contract that are accounted in accordance with another Standard (for example, Ind AS 2, Ind AS 16 and Ind AS 38).

An entity would reverse a previously recognized impairment loss when the impairment conditions no longer exist or have improved. The increased carrying amount of the asset shall not exceed the amount that would have been determined (net of amortisation) if no impairment loss had been recognized previously.

Illustration 74 : Amortisation

An entity enters into a service contract with a customer and incurs incremental costs to obtain the contract and costs to fulfil the contract. These costs are capitalised as assets in accordance with

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Ind AS 115. The initial term of the contract is five years but it can be renewed for subsequent one-year periods up to a maximum of 10 years. The average contract term for similar contracts entered into by entity is seven years.

Determine appropriate method of amortisation?

Solution

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

*****

11. PRESENTATION & DISCLOSURE

11.1 Presentation

Under Ind AS 115, an entity presents a contract in its balance sheet as a contract liability, a contract asset, or a receivable, depending on the relationship between the entity's performance and the customer's payment at the reporting date. An entity shall present any unconditional rights to consideration separately as a receivable.

An entity presents a contract as a contract liability if the customer has paid consideration, or if payment is due as of the reporting date but the entity has not yet satisfied a performance obligation by transferring a goods or service. Conversely, if the entity has transferred goods or services as of the reporting date but the customer has not yet paid, the entity recognizes either a contract asset or a receivable. An entity recognizes a contract asset if it's right to consideration is conditioned on something other than the passage of time; otherwise, an entity recognizes a receivable.

A receivable is an entity's right to consideration that is unconditional. A right to consideration is unconditional if only the passage of time is required before payment of that consideration is due. An entity shall account for a receivable in accordance with Ind AS 109. Upon initial recognition of a receivable from a contract with a customer, any difference between the measurement of the receivable in accordance with Ind AS 109 and the corresponding amount of revenue recognized shall be presented as an expense.

An entity shall also present separately the amount of excise duty included in the revenue recognized in the statement of profit and loss. This is an additional requirement inserted due to the Indian context in Ind AS 115.

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11.2 Disclosure

Ind AS 115 requires many new disclosures about contracts with customers. The following table provides a summary:

Disclosures	
Disclosure area	**Summary of requirements**
General	• revenue recognized from contracts with customers, separately from its other sources of revenue • impairment losses on receivables or contract assets
Disaggregation of revenue	• categories that depict the nature, amount, timing, and uncertainty of revenue and cash flows • sufficient information to enable users of financial statements to understand the relationship with revenue information disclosed for reportable segments under Ind AS 108 'Operating Segments'
Information about contract balances	• including opening and closing balances of contract assets, contract liabilities, and receivables (if not separately presented) • revenue recognized in the period that was included in contract liabilities at the beginning of the period and revenue from performance obligations (wholly or partly) satisfied in prior periods • explanation of relationship between timing of satisfying performance obligations and payment • explanation of significant changes in the balances of contract assets and liabilities
Information about performance obligations	• when the entity typically satisfies performance obligations • significant payment terms • nature of goods and services • obligations for returns, refunds and similar obligations • types of warranties and related obligations
Transaction price allocated to the remaining performance obligations	• transaction price allocated to the performance obligations that are unsatisfied and an explanation of when the entity expects to recognize such revenue.

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Timing of satisfaction of performance obligations	• performance obligations that an entity satisfies over time:
	  ○ methods used to recognize revenue
	  ○ why the methods used provide a faithful depiction
	• performance obligations satisfied at a point in time:
	  ○ judgements made in evaluating when a customer obtains control

Information about significant judgements	• judgements impacting the expected timing of satisfying performance obligations transaction price and amounts allocated to performance obligations (e.g. estimating variable consideration and assessing if constrained and allocating to performance obligations).
Transaction price and amount allocated to performance obligations	• determining transaction price, estimating variable consideration, adjusting the consideration for the effects of the time value of money and measuring non-cash consideration • estimate of variable consideration is constrained • measuring obligations for returns, refunds and other similar obligations • allocating the transaction price, discounts and variable consideration to a specific part of the contract • reconcile the amount of revenue recognized in the statement of profit and loss with the contracted price
Assets recognized from the costs to obtain or fulfil a contract	• judgements made in determining costs amount of the costs incurred • to obtain or fulfil a contract with a customer • amortisation method used • closing balances by main category and amortisation expense
Practical expedients	• practical expedient elected by an entity in either paragraph 63 (about the existence of a significant financing component) or paragraph 94 (about the incremental costs of obtaining a contract)

12. SERVICE CONCESSION ARRANGEMENTS

12.1 About Arrangement

- Service Concession Arrangement involves a private sector entity (an operator) constructing the infrastructure used to provide the public service or upgrading it (for example, by increasing its capacity) and operating and maintaining that infrastructure for

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a specified period of time. The operator is paid for its services over the period of the arrangement. The arrangement is governed by a contract that sets out performance standards, mechanisms for adjusting prices, and arrangements for arbitrating disputes.

- Such an arrangement is often described as a 'build-operate-transfer', a 'rehabilitate-operate-transfer' or a 'public-to-private' service concession arrangement.

Infrastructure for public services—such as roads, bridges, tunnels, prisons, hospitals, airports, water distribution facilities, energy supply and telecommunication networks—has traditionally been constructed, operated and maintained by the public sector and financed through public budget appropriation.

- A feature of these service arrangements is the public service nature of the obligation undertaken by the operator.
- Public policy is for the services related to the infrastructure to be provided to the public, irrespective of the identity of the party that operates the services. The service arrangement contractually obliges the operator to provide the services to the public on behalf of the public sector entity. Other common features are:

(a) the party that grants the service arrangement (the grantor) is a public sector entity, including a governmental body, or a private sector entity to which the responsibility for the service has been devolved.

(b) the operator is responsible for at least some of the management of the infrastructure and related services and does not merely act as an agent on behalf of the grantor.

(c) the contract sets the initial prices to be levied by the operator and regulates price revisions over the period of the service arrangement.

(d) the operator is obliged to hand over the infrastructure to the grantor in a specified condition at the end of the period of the arrangement, for little or no incremental consideration, irrespective of which party initially financed it.

12.2 Accounting Principles

12.2.1 Treatment of the operator's rights over the infrastructure

- Infrastructure shall not be recognized as property, plant and equipment of the operator because the contractual service arrangement does not convey the right to control the use

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of the public service infrastructure to the operator.

- The operator has access to operate the infrastructure to provide the public service on behalf of the grantor in accordance with the terms specified in the contract.

12.2.2 Recognition and measurement

- Since the operator acts as a service provider, he shall recognize and measure revenue in accordance with Ind AS 115 for the services it performs. The operator constructs or upgrades infrastructure (construction or upgrade services) used to provide a public service and operates and maintains that infrastructure (operation services) for a specified period of time.
- If the operator performs more than one service (ie construction or upgrade services and operation services) under a single contract or arrangement, consideration received or receivable shall be allocated by reference to the relative fair values of the services delivered, when the amounts are separately identifiable.
- The nature of the consideration i.e. whether financial asset or intangible asset determines its subsequent accounting treatment.
- The operator shall account for revenue and costs relating to construction or upgrade services.
- The operator shall account for revenue and costs relating to operation services in accordance with Ind AS 115.

12.2.3 Consideration given by the grantor to the operator

- If the operator provides construction or upgrade services, the consideration received or receivable by the operator shall be recognized at its fair value. The consideration may be rights to:

  (a) a financial asset, or

  (b) an intangible asset.

- The operator shall recognize a financial asset to the extent that
  - it has an unconditional contractual right to receive cash or another financial asset from or at the direction of the grantor for the construction services; the grantor has

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little, if any, discretion to avoid payment, usually because the agreement is enforceable by law.

- it has an unconditional right to receive cash if the grantor contractually guarantees to pay the operator (a) specified or determinable amounts or (b) the shortfall, if any, between amounts received from users of the public service and specified or determinable amounts, even if payment is contingent on the operator ensuring that the infrastructure meets specified quality or efficiency requirements.

- The operator shall recognize an intangible asset to the extent that it receives a right (a licence) to charge users of the public service. A right to charge users of the public service is not an unconditional right to receive cash because the amounts are contingent on the extent that the public uses the service.
- If the operator is paid for the construction services partly by a financial asset and partly by an intangible asset it is necessary to account separately for each component of the operator's consideration. The consideration received or receivable for both components shall be recognized initially at the fair value of the consideration received or receivable.

12.2.4 Contractual obligations to restore the infrastructure to a specified level of serviceability

The operator may have contractual obligations it must fulfil as a condition of its licence, like to maintain or restore infrastructure, except for any upgrade element, which shall be recognized and measured in accordance with Ind AS 37, ie at the best estimate of the expenditure that would be required to settle the present obligation at the end of the reporting period.

12.2.5 Borrowing costs incurred by the operator

- Borrowing costs attributable to the arrangement shall be recognized as an expense in the period in which they are incurred unless the operator has a contractual right to receive an intangible asset (a right to charge users of the public service).
- If the operator does not have a contractual right to receive an intangible asset, borrowing costs attributable to the arrangement shall be capitalised during the construction phase of the arrangement.

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12.2.6 Financial asset

- For recognition of financial asset, Ind AS 32, Ind AS 107 and Ind AS 109 shall be applied. The amount due from or at the direction of the grantor is accounted at:

  (a) amortised cost;

  (b) fair value through other comprehensive income; or

  (c) fair value through profit or loss.

- If the amount due from the grantor is measured at amortised cost or fair value through other comprehensive income, Ind AS 109 requires interest calculated using the effective interest method to be recognized in profit or loss.

12.2.7 Intangible asset

For recognition and measurement of intangible asset, one has to apply Ind AS 38 for guidance on measuring intangible assets acquired in exchange for a non-monetary asset or assets or a combination of monetary and non-monetary assets.

Comparison with AS 7 and AS 9

Service concession arrangements are specifically dealt with in detail unlike with AS 9 or AS 7. Also, there's a specific mention about recognition of financial asset or intangible asset as per Ind AS 115 which is not mentioned in either AS 7 or AS 9.

12.2.8 Items provided to the operator by the grantor

- Infrastructure items to which the operator is given access by the grantor for the purposes of the service arrangement are not recognized as property, plant and equipment of the operator.

- The grantor may also provide other items to the operator that the operator can keep or deal with as it wishes. If such assets form part of the consideration payable by the grantor for the services, they are not government grants as defined in Ind AS 20. They are recognized as assets of the operator, measured at fair value on initial recognition.

- The operator shall recognize a liability in respect of unfulfilled obligations it has assumed in exchange for the assets.

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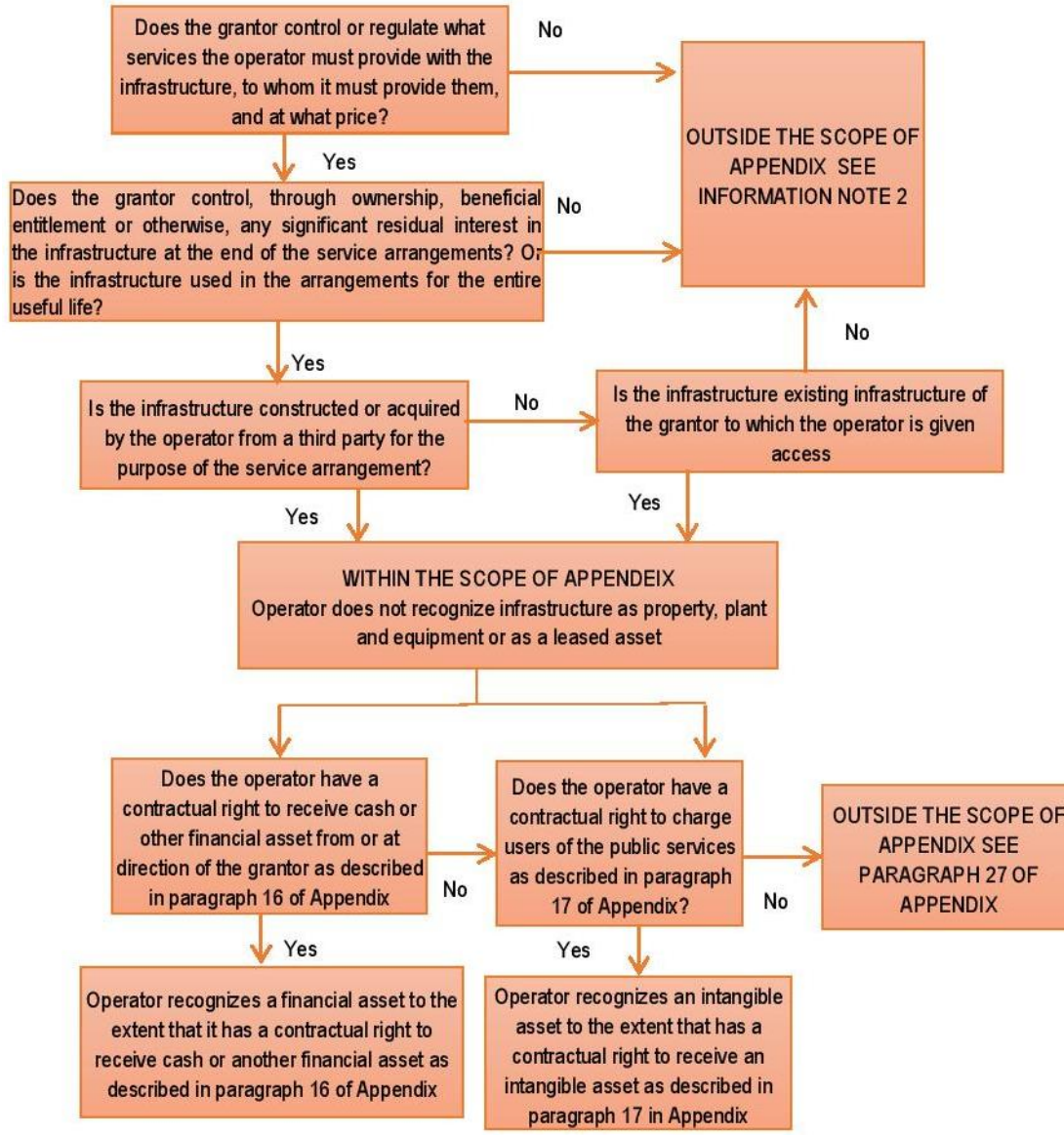
Information note 1

Accounting framework for public-to-private service arrangements



12.3 Service Concession Arrangements: Disclosures

- All aspects of a service concession arrangement shall be considered in determining the appropriate disclosures in the notes. An operator and a grantor shall disclose the following in each period:

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(a) a description of the arrangement;

(b) significant terms of the arrangement that may affect the amount, timing and certainty of future cash flows (eg the period of the concession, re-pricing dates and the basis upon which re-pricing or re-negotiation is determined);

(c) the nature and extent (eg quantity, time period or amount as appropriate) of:

(i) rights to use specified assets;

(ii) obligations to provide or rights to expect provision of services;

(iii) obligations to acquire or build items of property, plant and equipment;

(iv) obligations to deliver or rights to receive specified assets at the end of the concession period;

(v) renewal and termination options; and

(vi) other rights and obligations (eg major overhauls);

(d) changes in the arrangement occurring during the period; and

(e) how the service arrangement has been classified.

- An operator shall disclose the amount of revenue and profits or losses recognized in the period on exchanging construction services for a financial asset or an intangible asset.
- The disclosures required in accordance with paragraph 6 of this Appendix shall be provided individually for each service concession arrangement or in aggregate for each class of service concession arrangements. A class is a grouping of service concession arrangements involving services of a similar nature (eg toll collections, telecommunications and water treatment services).

Illustration 75

A Ltd. is in the business of infrastructure and has two divisions; (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 crore as on 31st December, 20X1. Under IGAAP, the Company has 'recorded such expenses as Intangible Assets in the books of account. The brief details of the Concession Agreement are as follows:

- *Total Expenses estimated to be incurred on the project ₹ 100 crore;*

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- *Fair Value of the construction services is ₹ 110 crore;*
- *Total Cash Flow guaranteed by the Government under the concession agreement is ₹ 200 crore;*
- *Finance revenue over the period of operation phase is ₹ 15 crore:*
- *Other income relates to the services provided during the operation phase.*

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

Required

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

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

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

Solution

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

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

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(iii) Accounting treatment for preparation of financial statements

Bhilwara-Jabalpur Toll Project

Journal Entries

	Particulars		Dr. (₹ in crore)	Cr. (₹ in crore)
	During construction:			
1	Financial asset A/c	Dr.	110	
	To Construction revenue			110
	[To recognize revenue relating to construction services, to be settled in case]			
2	Cost of construction (profit or loss)	Dr.	100	
	To Bank A/c (As and when incurred)			100
	[To recognize costs relating to construction services]			
	During the operation phase:			
3	Financial asset	Dr.	15	
	To Finance revenue (As and when received or due to receive)			15
	[To recognize interest income under the financial asset model]			
4	Financial asset	Dr.	75	
	To Revenue [(200-110) – 15]			75
	[To recognize revenue relating to the operation phase]			
5	Bank A/c	Dr.	200	
	To Financial asset			200
	[To recognize cash received from the grantor]			

Kolhapur-Nagpur Expressway -Intangible asset

Journal Entries

	Particulars		Dr. (₹ in crore)	Cr. (₹ in crore)
	During construction:			
1	Cost of construction (profit or loss)	Dr.	110	
	To Bank A/c (As and when incurred)			110
	[To recognize costs relating to construction services]			

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2	Intangible asset	Dr.	200	
	To Revenue			200
	[To recognize revenue relating to construction services provided for non-cash consideration]			
	During the operation phase:			
3	Amortisation expense	Dr.	200	
	To Intangible asset (accumulated amortisation)			200
	[To recognize amortisation expense relating to the operation phase over the period of operation]			
4	Bank A/c	Dr.	?	
	To Revenue			?
	[To recognize revenue relating to the operation phase]			

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

*****

13. EXTRACTS OF FINANCIAL STATEMENTS OF LISTED ENTITY

Following is the extract from the financial statements of the listed entity 'Hindustan Unilever Limited' for the financial year 2021-2022 with respect to 'Revenue from Contract with Customers' and its accounting policy thereon.

(All amounts in ₹ crores, unless otherwise stated)

Particulars	Note	Year ended 31st March, 2022	Year ended 31st March, 2021
INCOME			
Revenue from operations	25	52,446	47,028
Other income	26	258	410
TOTAL INCOME		52,704	47,438

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NOTE 25 REVENUE FROM OPERATIONS

Sale of products:

Revenue from sale of goods is recognised when control of the products being sold is transferred to our customer and when there are no longer any unfulfilled obligations. The performance obligations in our contracts are fulfilled at the time of dispatch, delivery or upon formal customer acceptance depending on customer terms.

Revenue is measured on the basis of contracted price, after deduction of any trade discounts, volume rebates and any taxes or duties collected on behalf of the Government such as goods and services tax, etc. Accumulated experience is used to estimate the provision for such discounts and rebates. Revenue is only recognised to the extent that it is highly probable a significant reversal will not occur.

Our customers have the contractual right to return goods only when authorised by the Group. An estimate is made of goods that will be returned and a liability is recognised for this amount using a best estimate based on accumulated experience.

Sale of services:

Income from Group owned salon is recognised when services are rendered.

Display income is recorded as per the term of the contract entered with the respective franchisee / parties.

Revenue from services are measured at fair value of the consideration received or receivable, after deduction of any sort of discounts and any taxes or duties collected on behalf of the government such as goods and services tax.

Income from services rendered:

Income from services rendered is recognised based on agreements/arrangements with the customers as the service is performed and there are no unfulfilled obligations.

Commission income on consignment sales:

Commission income on consignment sales (Consignment selling agency fees) is charged for rendering of services and for the use of the Group's sales and distribution network. Such revenue is recognised in the accounting period in which the services are rendered in accordance with the agreement with the parties.

Government grants:

The Group is entitled to 'Scheme of budgetary support' under Goods and Service Tax Regime in respect of eligible manufacturing units located in specified regions. Such grants are measured at amount receivable from the Government and are recognised as other operating revenue when there is a reasonable assurance that the Group will comply with all necessary conditions attached to that.

The Group has received approval under the Production Linked Incentive Scheme (PLI) of the Government of India for specific product categories. Incentive under the scheme is subject to meeting certain committed investments and defined incremental sales threshold. Such grants are recognised as other operating revenue when there is a reasonable assurance that the Group will comply with all necessary conditions attached to that.

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Income from such grants is recognised on a systematic basis over the periods to which they relate.

	Year ended 31st March, 2022	Year ended 31st March, 2021
Sale of products	51,472	46,269
Sale of services	76	52
Other operating revenue*		
Income from services rendered	294	222
Commission income on consignment sales	315	264
Government grants (GST budgetary support and Production linked incentives) #	140	108
Others (including scrap sales, rentals, etc)	149	113
Total	**52,446**	**47,028**

Previous period figures have been re-classified from Others for better presentation

Reconciliation of Revenue from sale of products & services with the contracted price

	Year ended 31st March, 2022	Year ended 31st March, 2021
Contracted Price	57,340	51,955
Less: Trade discounts, volume rebates, etc	(5,792)	(5,634)
Sale of products and Services	**51,548**	**46,321**

* There is no material adjustment made to contract price for revenue recognised as other operating revenue.

NOTE 26 OTHER INCOME

Interest income is recognised using the effective interest rate (EIR) method. Dividend income on investments is recognised when the right to receive dividend is established. Refer Note 38 on financial instruments for policy on measurement at fair value through profit or loss.

	Year ended 31st March, 2022	Year ended 31st March, 2021
Interest income on		
Bank deposits	102	216
Current investments	80	6
Others (including interest on Income tax refunds)	16	124
Dividend income from		
Non-current investments	1	1
Fair value gain/(loss)		
Investments measured at fair value through profit or loss*	59	63
Total	**258**	**410**

*Includes realised gain on sale of investment of ₹52 crores (31st March, 2021: ₹52 crores).

(Source: Annual Report 2021-2022 – Hindustan Unilever Limited)

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14. SIGNIFICANT DIFFERENCES IN IND AS 115 *VIS-À-VIS* AS 7 AND AS 9

S. No.	Particular	Ind AS 115	AS 7 and AS 9
1.	*Framework of Revenue Recognition*	Ind AS 115 gives a framework of revenue recognition within a standard. It specifies the core principle for revenue recognition which requires the 'revenue to depict the transfer of promised goods or services to customers in an amount that reflects the consideration to which the entity expects to be entitled in exchange for those goods or services'.	AS 7 and AS 9 do not provide any such overarching principle to fall upon in case of doubt. There is no emphasis on performance obligation under the contract with customer.
2.	*Comprehensive Guidance on Recognition and Measurement of Multiple Elements within a Contract with Customer:*	Ind AS 115 gives comprehensive guidance on how to recognize and measure multiple elements within a contract with customer.	AS 7 and AS 9 do not provide comprehensive guidance on this aspect.
3.	*Coverage*	Ind AS 115 comprehensively deals with all types of performance obligation contracts with customers. However, it does not deal with revenue from 'interest' and 'dividend' which are covered in financial instruments standard.	AS 7 covers only revenue from construction contracts which is measured at consideration received / receivable. AS 9 deals only with recognition of revenue from sale of goods, rendering of services, interest, royalties and dividends.
4.	*Measurement of Revenue*	As per Ind AS 115, revenue is measured at transaction price, i.e., the amount of consideration to	As per AS 9, Revenue is the gross inflow of cash, receivables or other

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		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.	considerations arising in the course of the ordinary activities. Revenue is measured by the charges made to customers or clients for goods supplied and services rendered to them and by the charges and rewards arising from the use of resources by them. As per AS 7, revenue from construction contracts is measured at consideration received / receivable and to be recognized as revenue as construction progresses if certain conditions are met.
5.	*Recognition of Revenue*	As per Ind AS 115, revenue is recognized when the control is transferred to the customer. It introduces a 5-step model for revenue recognition.	As per AS 9, revenue is recognized when significant risks and rewards of ownership is transferred to the buyer. As per AS 7, revenue is recognized when the outcome of a construction contract can be estimated reliably, contract revenue should be recognized by reference to the stage of completion of the contract activity at the reporting date.
6.	*Multiple element or linked transactions*	Ind AS 115 gives comprehensive guidance on how to recognize and measure multiple elements / performance obligations within a contract with customer.	AS 7 and AS 9 provide no specific guidance for multiple element or linked transactions.

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7.	*Capitalisation of Costs*	Ind AS 115 provides guidance on recognition of costs to obtain and fulfil a contract, as asset.	AS 7 and AS 9 do not deal with such capitalisation of costs.
8.	*Guidance on combining contracts and variable and contingent consideration*	Ind AS 115 provides guidance on combining contracts entered into at or near the same time with the same customer (or related parties of the customer), guidance on treatment of variable and contingent consideration.	AS 7 and AS 9 do not deal with such aspects.
9.	Adjustment for time value of money	As per Ind AS 115, transaction price is adjusted for the effect of time value of money when a significant financing component exists.	As per AS 9, revenue is not adjusted for time value of money.
10.	*Guidance on Service Concession Arrangements*	Ind AS 115 gives guidance on service concession arrangements and disclosures thereof.	AS does not provide such guidance.
11.	*Disclosure Requirements*	Ind AS 115 contains detailed disclosure requirements.	Less disclosure requirements are prescribed in AS.

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TEST YOUR KNOWLEDGE

Questions

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

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

3. Company X enters into an agreement on 1st January, 20X1 with a customer for renovation of hospital and install new air-conditioners for total consideration of ₹ 50,00,000. The promised renovation service, including the installation of new air-conditioners is a single performance obligation satisfied over time. Total expected costs are ₹ 40,00,000 including ₹ 10,00,000 for the air conditioners.

   Company X determines that it acts as a principal in accordance with paragraphs B34-B38 of Ind AS 115 because it obtains control of the air conditioners before they are transferred to the customer. The customer obtains control of the air conditioners when they are delivered to the hospital premises.

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

   As at 31st March, 20X1, other costs incurred excluding the air conditioners are ₹ 6,00,000.

   Whether Company X should include cost of the air conditioners in measure of its progress of performance obligation? How should revenue be recognized for the year ended March 20X1?

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

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P Ltd. pays a non-refundable deposit of ₹ 1,00,000 at inception of the contract and enters into a long-term financing agreement with G Ltd. for the remaining 95 per cent of the agreed consideration which it intends to pay primarily from income derived from its food processing unit as it lacks any other major source of income. The financing arrangement is provided on a non-recourse basis, which means that if P Ltd. defaults then G Ltd. can repossess the machinery but cannot seek further compensation from P Ltd., even if the full value of the amount owed is not recovered from the machinery. The cost of the machinery for G Ltd. is ₹ 12,00,000. P Ltd. obtains control of the machinery at contract inception.

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

5. Entity I sells a piece of machinery to the customer for ₹ 2 million, payable in 90 days. Entity I is aware at contract inception that the customer might not pay the full contract price. Entity I estimates that the customer will pay atleast ₹ 1.75 million, which is sufficient to cover entity I's cost of sales (₹ 1.5 million) and which entity I is willing to accept because it wants to grow its presence in this market. Entity I has granted similar price concessions in comparable contracts. Entity I concludes that it is highly probable that it will collect ₹ 1.75 million, and such amount is not constrained under the variable consideration guidance.

What is the transaction price in this arrangement?

6. On 1st January 20X8, entity J enters into a one-year contract with a customer to deliver water treatment chemicals. The contract stipulates that the price per container will be adjusted retroactively once the customer reaches certain sales volume, defined, as follows:

Price per container	Cumulative sales volume
₹ 100	1 - 1,000,000 containers
₹ 90	1,000,001 - 3,000,000 containers
₹ 85	3,000,001 containers and above

Volume is determined based on sales during the calendar year. There are no minimum purchase requirements. Entity J estimates that the total sales volume for the year will be 2.8 million containers, based on its experience with similar contracts and forecasted sales to the customer.

Entity J sells 700,000 containers to the customer during the first quarter ended 31st March 20X8 for a contract price of ₹ 100 per container.

How should entity J determine the transaction price?

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7. Entity K sells electric razors to retailers for ₹ 50 per unit. A rebate coupon is included inside the electric razor package that can be redeemed by the end consumers for ₹ 10 per unit.

Entity K estimates that 20% to 25% of eligible rebates will be redeemed, based on its experience with similar programmes and rebate redemption rates available in the market for similar programmes. Entity K concludes that the transaction price should incorporate an assumption of 25% rebate redemption, as this is the amount for which it is highly probable that a significant reversal of cumulative revenue will not occur if estimates of the rebates change.

How should entity K determine the transaction price?

Answers

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

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

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

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

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

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

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

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

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

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

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

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

In accordance with the above, Company X assesses whether the costs incurred to procure the air conditioners are proportionate to the entity's progress in satisfying the performance obligation. The costs incurred to procure the air conditioners (₹ 10,00,000) are significant

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relative to the total costs to completely satisfy the performance obligation (₹ 40,00,000). Also, Company X is not involved in manufacturing or designing the air conditioners.

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

Company X assesses that as at March, 20X1, the performance is 20 per cent complete (i.e., ₹ 6,00,000 / ₹ 30,00,000). Consequently, Company X recognizes the following-

As at 31st March, 20X1

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

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

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

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

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

(a) the parties to the contract have approved the contract (in writing, orally or in accordance with other customary business practices) and are committed to perform their respective obligations;

(b) the entity can identify each party's rights regarding the goods or services to be transferred;

(c) the entity can identify the payment terms for the goods or services to be transferred;

(d) the contract has commercial substance (ie the risk, timing or amount of the entity's future cash flows is expected to change as a result of the contract); and

(e) it is probable that the entity will collect the consideration to which it will be entitled in exchange for the goods or services that will be transferred to the customer. In evaluating whether collectability of an amount of consideration is probable, an entity shall consider only the customer's ability and intention to pay that amount of

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consideration when it is due. The amount of consideration to which the entity will be entitled may be less than the price stated in the contract if the consideration is variable because the entity may offer the customer a price concession".

Paragraph 9(e) above, requires that for revenue to be recognized, it should be probable that the entity will collect the consideration to which it will be entitled in exchange for the goods or services that will be transferred to the customer. In the given case, it is not probable that G Ltd. will collect the consideration to which it is entitled in exchange for the transfer of the machinery. P Ltd.'s ability to pay may be uncertain due to the following reasons:

(a) P Ltd. intends to pay the remaining consideration (which has a significant balance) primarily from income derived from its food processing unit (which is a business involving significant risk because of high competition in the said industry and P Ltd.'s little experience);

(b) P Ltd. lacks sources of other income or assets that could be used to repay the balance consideration; and

(c) P Ltd.'s liability is limited because the financing arrangement is provided on a non-recourse basis.

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

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

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

(b) the contract has been terminated and the consideration received from the customer is non-refundable.

Para 16 states that an entity shall recognize the consideration received from a customer as a liability until one of the events in paragraph 15 occurs or until the criteria in paragraph 9 are subsequently met. Depending on the facts and circumstances relating to the contract, the liability recognized represents the entity's obligation to either transfer goods or services in the future or refund the consideration received. In either case, the liability shall be measured at the amount of consideration received from the customer.

In accordance with the above, in the given case G Ltd. should account for the non-refundable deposit of ₹ 1,00,000 payment as a deposit liability as none of the events described in paragraph 15 have occurred—that is, neither the entity has received

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substantially all of the consideration, nor it has terminated the contract. Consequently, in accordance with paragraph 16, G Ltd. will continue to account for the initial deposit as well as any future payments of principal and interest as a deposit liability until the criteria in paragraph 9 are met (i.e. the entity is able to conclude that it is probable that the entity will collect the consideration) or one of the events in paragraph 15 has occurred. Further, G Ltd. will continue to assess the contract in accordance with paragraph 14 to determine whether the criteria in paragraph 9 are subsequently met or whether the events in paragraph 15 of Ind AS 115 have occurred.

5. Entity I is likely to provide a price concession and accept an amount less than ₹ 2 million in exchange for the machinery. The consideration is therefore variable. The transaction price in this arrangement is ₹ 1.75 million, as this is the amount which entity I expects to receive after providing the concession and it is not constrained under the variable consideration guidance. Entity I can also conclude that the collectability threshold is met for ₹ 1.75 million and therefore contract exists.

6. The transaction price is ₹ 90 per container based on entity J's estimate of total sales volume for the year, since the estimated cumulative sales volume of 2.8 million containers would result in a price per container of ₹ 90. Entity J concludes that based on a transaction price of ₹ 90 per container, it is highly probable that a significant reversal in the amount of cumulative revenue recognized will not occur when the uncertainty is resolved. Revenue is therefore recognized at a selling price of ₹ 90 per container as each container is sold. Entity J will recognize a liability for cash received in excess of the transaction price for the first 1 million containers sold at ₹ 100 per container (that is, ₹ 10 per container) until the cumulative sales volume is reached for the next pricing tier and the price is retroactively reduced.

For the quarter ended 31st March, 20X8, entity J recognizes revenue of ₹ 63 million (700,000 containers x ₹ 90) and a liability of ₹ 7 million [700,000 containers x (₹ 100 - ₹ 90)].

Entity J will update its estimate of the total sales volume at each reporting date until the uncertainty is resolved.

7. Entity K records sales to the retailer at a transaction price of ₹ 47.50 (₹ 50 less 25% of ₹ 10). The difference between the per unit cash selling price to the retailers and the transaction price is recorded as a liability for cash consideration expected to be paid to the end customer. Entity K will update its estimate of the rebate and the transaction price at each reporting date if estimates of redemption rates change.

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