IND AS 115

Revenue from contracts with customers

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Areas to be covered

1. Introduction
2. Scope
3. Revenue recognition (5 Core Principles)
4. Illustrations
5. Presentation & Disclosures

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Introduction

Ministry of Corporate Affairs (MCA) issued Companies (Indian Accounting Standards) Amendment Rules, 2018 ('Amendment Rules') via notification dated 28 March 2018 to further amend Companies (Indian Accounting Standards) Rules, 2015. Among other things, the amendment inserts a new revenue recognition standard Ind AS 115, Revenue from Contracts with Customers ('Ind AS 115'). Ind AS 115 is effective from accounting period beginning on or after 1 April, 2018 and

- Replaces Ind AS 18, Revenue and Ind AS 11, Construction Contracts
- Establishes a new control-based revenue recognition model
- Provides new and more detailed guidance on specific topics such as multiple element arrangements, variable consideration, warranties, principal versus agent considerations, consignment arrangements, bill-and hold arrangements and licensing, to name a few
- Expands and improves disclosures about revenue

Ind AS 115 is aligned to IFRS 15, Revenue from Contracts with Customers, issued by International Accounting Standards Board ('IASB'). IFRS 15, Revenue from Contracts with Customers, was jointly issued by IASB and FASB with mandatory effective date of 1 January 2018.

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A single model for revenue recognition

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

- In a manner that depicts the transfer of goods or services to customers
- At an amount that reflects the consideration the entity expects to be entitled to in exchange for those goods or services.

"IND AS 115 at a Glance"

Who is affected?	All entities that enter into contracts with customers with few exceptions.
What is the impact?	The timing and amount of revenue recognized may not change for simple contracts for a single deliverable, but most complex arrangements will be affected to some extent. Entities affected will need to reassess their revenue recognition policies and may need to revise them. IND AS 115 requires more and different Disclosures.
When are the changes effective?	Accounting periods beginning on or after 1 April 2018.

Scope

IND AS 115 applies to contracts with customers to provide goods or services. It does not apply to certain contracts within the scope of other IND AS s such as lease contracts, insurance contracts, financial instruments, guarantees other than product warranties, and non-monetary exchanges between entities in the same line of business to facilitate sales to customers or potential customers.

Scope of Ind AS 115

In Scope

Revenue from contracts with customers (subject to specific exceptions), including contracts for

1. Sales of goods
2. Rendering of services, including construction services
3. Licensing of intellectual property
4. Exchanges of non-monetary assets other than scoped-out exchanges

Not in scope

1. Non-contractual income e.g. fair value of agricultural produce recognized under Ind AS 41, Agriculture
2. Contracts within the scope of:
   i. IND AS 17, Leases
   ii. IND AS 104, Insurance Contracts
   iii. IND AS 109, Financial Instruments: Recognition and Measurement.
3. Contracts that are not with customers (e.g. some risk and benefit sharing contracts)
4. Non-monetary exchanges between entities in the same line of business to facilitate sales to customers

Core Principle that Require to Recognize Revenue

1. Identify the contract(s) with a customer
2. Identify the performance obligations
3. Determine the transaction price
4. Allocate the transaction price to the performance obligations
5. Recognize revenue when or as an entity satisfies performance obligations

Step 1: Identify the contract(s) with a customer

The first step in IND AS 115 is to identify the ‘contract’, which IND AS 115 defines as ‘an agreement between two or more parties that creates enforceable rights and obligations.’ A contract can be written, oral, or implied by an entity’s customary business practices.

In addition, the general IND AS 115 model applies only when or if:

- ✓ The contract has commercial substance
- ✓ The parties have approved the contract and are committed to perform their respective obligations
- ✓ The entity can identify
  - each party’s rights
  - the payment terms for the goods and services to be transferred
- ✓ It is probable the entity will collect the consideration.
- ✓ If a customer contract does not meet these criteria and an entity receives consideration from the customer, revenue is recognized only when either:
  - The entity’s performance is complete and substantially all of the consideration in the arrangement has been collected and is non-refundable, or
  - The contract has been terminated and the consideration received is non-refundable.

For purposes of IND AS 115, a contract does not exist if each party has a unilateral enforceable right to terminate a wholly unperformed contract without compensating the other party.

Example 1: Company X is in the business of buying and selling commercial property. It sells a property to Purchaser Y, this transaction is in the scope of the standard because Purchaser Y has entered into a contract to purchase an output of Company X's ordinary activities and is therefore considered a customer of Company Y. Conversely, if Company X was a manufacturing entity selling its corporate headquarters to Purchaser Y, then the transaction would not be a contract with a customer because selling real estate is not an ordinary activity of Company X.

Example 2:

Party A holds products available to ship to customers before the end of its current fiscal year. Party B places an order for the product, and A delivers the product before the end of its current fiscal year.

A generally enters into written sales agreements with this class of customer that requires the signatures of the authorized representatives of both parties. A prepares a written sales agreement, and its authorized representative sign the agreement before the end of the year. B does not sign the agreement before end of A's fiscal year. However, B's purchasing department has orally agreed to the purchase and started that it is highly likely that the contract will be signed in the first week of A's next fiscal year.

After consulting its legal counsel and obtaining a legal opinion, A determines that based on local laws and legal precedent in B's jurisdiction, B is legally obliged to pay for the products shipped to it under the agreement, even though B has not yet signed the agreement.

Therefore, A concludes that a **contract exists** and applies the general requirements of the new standard to sales made under the agreements up to the year-end.

Combining contracts

An entity is required to combine two or more contracts and account for them as a single contract if they are entered into at or near the same time and meet any one of the following criteria:

The contracts were negotiated as a package with one commercial objective.

or

The amount paid under one contract is dependent on the price or performance under another contract,

or

The goods or services to be transferred under the contracts constitute a single performance obligation.

Example 1: Combining Contract

Company A, a manufacturer of specialized equipment, enters into a contract with Customer B to manufacture and deliver a customized equipment for Rs 95,000. The total cost to Company A of designing, manufacturing, and delivering the equipment is estimated to be Rs 70,000. Two days later, Company A enters into another contract with Customer B to deliver four equipment parts that Customer B will use on the customized equipment in the future after the original parts deteriorate. The contract price per part is Rs 800; however, the cost of each part is estimated at Rs 900.

***Analysis**:* In the facts above, Company A enters into two contracts with the same party at about the same time (within two days), which indicates the need for further analysis. Upon further analysis, Company A determines that criterion A for combining contracts is met because the two contracts are negotiated as a bundle with one business objective. Therefore, Company A is required to combine the two contracts for revenue recognition purpose.

Contract modifications:

A contract modification arises when the parties approve a change in the scope and/or the price of a contract (e.g. a change order). The **accounting** for a contract modification **depends on whether the modification is deemed to be a separate contract or not**.

An entity accounts for a modification as a separate contract, if both:

The scope increases due to the addition of 'distinct' goods or services.

and

The price increase reflects the goods' or services' stand-alone selling prices under the circumstances of the modified contract.

In this case, only future revenue is impacted as the entity will continue to account for the pre-modification contract as before.

Example : Contract modification

A general contractor was awarded a contract to build a new school for Rs 100 million. After construction has started, the customer approves a modification for an additional gym to be built on the school grounds. Both the contractor and the customer agree to modify the contract to include the construction of the gym for a total price of Rs 105 million, to be completed within six months. Based on similar contracts, the general contractor would normally charge Rs 5.2 million to build the gym; however, the contractor expects to take advantage of various efficiencies at the job site, given that most of the equipment and labor resources necessary for the additional build-out are already on site. Accordingly, the Rs 5 million reflects the standalone selling price of the additional service to be provided at the date of the modification.

Analysis:

The modification for the build-out of an additional gym is considered to be a distinct service that increases the scope of the contract. The additional consideration (adjusted for the specific circumstances of this particular contract, regarding the available resources on site) is considered to be the standalone selling price. As such, the contract modification for the gym build-out is accounted for as a new and separate contract that does not impact the accounting for the existing contract, given that both required factors are met.

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Step 2: Identify the performance obligations:

How to Distinct Performance Obligation?

Customer can benefit either alone or with other readily available resources

+

Separately identifiable

Readily available resource = Sold separately or customer has already obtained

Significant integration services not provided

No significant customisation or modification

Not highly inter-dependent or inter- related

Definition of distinct goods or services

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

1) The customer can benefit from the good or service either on its own or together with other resources that are readily available to the customer (i.e. the good or service is capable of being distinct); and

2) The entity's promise to transfer the good or service to the customer is separately identifiable from other promises in the contract (i.e. the promise to transfer the good or service is distinct within the context of the contract)

If a promised good or service is not distinct, it should be combined with other promised goods or services until they become distinct together ('a bundle'). Such a bundle is then treated as a single performance obligation.

Examples of distinct goods or services

A telecommunication Company promises a free smartphone to each customer who subscribes for a premium telecommunications service. Additionally, it charges a one-off connection fee.

Free smartphone is a distinct good and constitutes a separate performance obligation for the telecommunications company. Connection fee is not a distinct service and does not constitute a separate performance obligation as it does not result in a transfer of goods or services to the customer.

WHAT IS PERFORMANCE OBLIGATION ?

In simple terms performance obligation is a "**Promise**" to deliver goods or services in lieu of payment (in advance or otherwise).

As per the guidance:

At the inception of a contract, an entity shall assess the promises made in the contract to a customer and shall identify them as performance obligations. These may include:

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

Example: Identifying the Performance Obligation:

Entity XYZ has contractually agreed to build a fence at the home of a customer. From an operational perspective, there are likely three stages to the contract:

- Purchase the timber, nails, concrete and other required building supplies
- Deliver the required building supplies to the customer's home, and
- Build the fence.

However, from the perspective of the customer, a completed fence has been promised. In addition:

- Entity XYZ performs a significant amount of work to integrate the goods (building materials) and services (building of the fence) provided under the contract;
- The **goods** (building materials) and **services** (building of the fence) are highly interrelated; and
- The service (building of the fence) provided by Entity XYZ significantly modifies the goods (building materials) promised in the contract.

Given the above there is only **one performance obligation** in the contract and that is the provision of a completed fence.

Example: Identifying the Performance Obligation:

Software Company entered into contract with customer to provide software license, Installation service and three year of post contract customer support.

The installation service is required entity to configure certain aspect of the software but don't significantly modify the software. These software doesn't require special knowledge and other sophisticated software technician could perform similar service. The software doesn't require the upgrade and technical support in order to remain function.

How many performance obligation ?

Analysis: There are three performance obligation.

1) Software license
2) Installation service
3) Customer Support

Assume same fact:

However the installation service require software Company to substantially customise the software by adding significant new functionality enabling the software to function with other computer system owned by the customer .

In this case , what will be the performance obligation?

In the above case , There will be two performance obligation

1) Software license + installation service (Because both are highly interdependent)
2) Customer Support

Step 3: Determine the transaction price :

Under IND AS 115, the ‘transaction price’ is defined as the amount of consideration an entity expects to be entitled to in exchange for the goods or services promised under a contract to a customer, excluding any amounts collected on behalf of third parties (for example Goods and Services Tax).

The transaction price is not adjusted for effects of the customer’s credit risk, but is adjusted if the entity (e.g. based on its customary business practices) has created a valid expectation that it will enforce its rights for only a portion of the contract price.

An entity must consider the effects of all the following factors when determining the transaction price:

1. Variable consideration
2. Constraint on variable consideration
3. Time value of money
4. Non-cash consideration
5. Consideration payable to the customer.

1. Variable consideration

The amount of consideration received under a contract might vary due to discounts, rebates, refunds, credits, price concessions, incentives, performance bonuses and similar items. IND AS 115’s guidance on variable consideration also applies if:

- The amount of promised consideration under a contract is contingent on the occurrence or non-occurrence of a future event (e.g. a fixed-price contract would be variable if the contract included a return right or a fixed amount is promised as a performance bonus on achievement of a specified milestone)

- The facts and circumstances at contract inception indicate that the entity intends to offer a price concession.

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

Variable consideration (continued)

To estimate the transaction price in a contract that includes variable consideration, an entity determines either:

- The expected value (the sum of probability-weighted amounts) or
- The most likely amount of consideration to be received, whichever better predicts the amount of consideration to which the entity will be entitled.

The expected value might be the appropriate estimate of the amount of variable consideration in situations where an entity has a large number of similar contracts.

The most likely amount might be appropriate in situations where a contract has only two possible outcomes (for example, a bonus for early delivery that either would be fully received or not at all).

An entity should use one method consistently to estimate the transaction price throughout the life of a contract.

Refund of a portion of Consideration

An entity that expects to refund a portion of the consideration to the customer would recognize a liability for the amount of consideration it reasonably expects to refund. The entity would update the refund liability each reporting period based on current facts and circumstances.

Variable consideration (continued)

As per IND AS -115, If you are not certain of receiving any variable consideration, you will consider it in your Transaction Price since inception. If you are not certain than you consider the assumption which is most probable. But in the next year probability of variable consideration may change and that time you should make addition / reduction of variable consideration as per circumstances.

Example: Mr Y gives one contract to Mr X to make the building for which consideration was as under :

If X complete the Building in 3 years consideration will be 50 lacs

But if X complete the building in two years only than consideration would be 60 Lacs (10 Lacs more),

But if X complete the building in two and Half year only than consideration would be 55 Lacs (5 Lacs more),

But if X complete the contract in more than three year that he has to penalty of Rs 5 lacs and consideration would be only 45 lacs

Analysis: In case of Multiple outcome we will compute probability on weighted average method and include in Contract Transaction Prices

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2. Constraint on variable consideration:

If the amount of consideration from a customer contract is variable, an entity is required to evaluate whether the cumulative amount of revenue recognized should be constrained. The objective of the constraint is for an entity to recognise revenue only to the extent that it is highly probable that there will not be a significant reversal (i.e. significant downward adjustment) when the uncertainty associated with the variable consideration subsequently resolves.

An entity should consider both the likelihood and the magnitude of the revenue reversal in making such assessment. **Factors that could increase the likelihood or the magnitude of a revenue reversal** include, but are not limited to the following:

- The amount of consideration is highly susceptible to factors outside the entity's influence
- The uncertainty is not expected to be resolved for a long time.
- The entity's experience with similar types of contracts is limited.
- 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.
- There are a large number and wide range of possible consideration amounts in the contract.

Sales-based or usage-based royalties

An exception to the general principles on variable consideration applies to revenue for a sales-based or usage-based royalty promised in exchange for a license of intellectual property.

Revenue is recognized only on the later of the following events occurs:

- When the customer makes the subsequent sales or use that triggers the royalty
- 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).

3. Time value of money/ Financing component:

Under IND AS 115, an entity must reflect the time value of money in its estimate of the transaction price if the contract includes a significant financing component.

The objective in adjusting the transaction price for the time value of money is to reflect an amount for the selling price as though the customer had paid cash for the goods or services when they were transferred.

3. Time value of money/ Financing component: (Continued)

To determine whether a financing component is significant, an entity considers several factors, including, but not limited to, the following:

- ❑ The difference, if any, between the promised consideration and the cash selling price
- ❑ The combined effect of:
  - the expected length of time between delivery of the goods or services and receipt of payment
  - the prevailing interest rates in the relevant market.

A contract may not have a significant financing component if:

- ❑ Advance payments have been made but the transfer of the good or service is at the customer's discretion
- ❑ The consideration is variable based on factors outside the vendor's and customer's control (e.g. a sales-based royalty)
- ❑ A difference between the promised consideration and the cash selling price arises for reasons other than financing such as protecting one of the parties from non-performance by the other (e.g. retentions).

Time value of Money (Recognizing Interest Expense/Revenue)

If a significant financing component exists, the amount of revenue recognized will differ from the amount of cash received from the customer:

- In transactions where payment is received in advance for the performance obligation, the selling entity will recognize interest expense until performance occurs.

- When payment is received after performance is completed, the selling entity will recognize less revenue than cash received because a portion of the consideration will be considered interest income.

As a practical expedient, an entity **can ignore** the impact of the time value of money on a contract if it expects, at contract inception, that the period between the delivery of goods or services and customer payment will be one year or less.

To adjust the amount of consideration for the time value of money, an entity applies the discount rate that would be used in a separate financing transaction between the entity and the customer at contract inception. That **rate reflects the credit risk of the party receiving financing** in the contract (i.e. the customer if payment is deferred and the vendor if payment is in advance).

An entity presents the effects of financing separately from revenue as interest expense or interest income in the statement of profit and loss.

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Example : Time Value of Money- Financing Customer

Let's assume that a Company provides consulting services today and agrees to an Rs 11,000 payment one year later. The Rs 11,000 represents:

- an amount for the services performed today, and
- interest to compensate the Company for waiting 365 days for the Rs 11,000

Under the accrual basis of Accounting and a time value of money of 10%, the service revenues that were earned today are Rs 10,000. The difference of Rs 1,000 will be reported as interest income over the 365 days that the Company waits for the Rs 11,000

4. Non-cash consideration

If a customer promises consideration in a form other than cash, an entity measures the non-cash consideration at fair value in determining the transaction price. This include arrangements in which the customer transfers control of goods or services (e.g. materials, equipment, labor) to facilitate the entity’s fulfilment of the contract.

If an entity is unable to reasonably measure the fair value of non-cash consideration, it indirectly measures the consideration by referring to the stand-alone selling price of the goods or services promised under the contract.

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5. Consideration payable to a customer

Consideration payable to a customer includes amounts that an entity pays or expects to pay to a customer in the form of cash or in-substance cash (for example, a coupon or voucher that can be applied against amounts owed to the entity or to other parties). An entity reduces the transaction price by the amount it owes to the customer, unless the consideration owed is in exchange for distinct goods or services transferred from the customer to the entity.

Is consideration payable to the customer for a distinct good or service?

No

Reduce the transaction price by the amount owed to the customer at later of:

- **Related revenue is recognized**
- **Consideration is paid or promised to customer**

Yes

Account for the purchase of distinct good or service similarly to purchases from suppliers

- **If consideration owed to the customer > fair value of goods/services: reduce transaction price by that excess**
- **If entity cannot estimate fair value of goods/services received from customer: reduce transaction price by total consideration owed to the customer**

Example 1- Consideration payable to a customer (Not distinct goods or services)

Entity enters into a contract with the customer with the exclusive supply of Paint for a 3 years period. Entity makes Rs 50,000 upfront payment to the customer which the customer will use to customized its Paints sprayers for the entity's product.

Entity determined the upfront payment is not in respect of distinct good or service. Therefore 50,000 is accounted for as a deduction from the contract price and entity estimates the Rs. 1,000,000 sales with customer over the 3 year period.

How are you going to allocate Rs. 50,000 that you received from your customer ?

If

1st Quarter: Entity sales is Rs.100,000

2nd Quarter sales is Rs. 125,000 and also Entity update the estimate of total sales to be Rs. 15,00,000.

Analysis :

As the cost of Rs. 50,000 made to the customer is not distinct therefore the cost of Rs. 50,000 will be deducted from the transaction price over the three year period.

1st Quarter: Entity sales for the 1st quarter is Rs. 100,000 (which is 10% of Total estimated sales)

Therefore entity will recognize sale of Rs. 95,000 (i.e. Rs. 100,000-5,000 (10% of Rs.50,000) for 1st quarter.

2nd Quarter : Entity sales is Rs.1,25,000 (total sales till the second Quarter is 2,25,000 which is 15% of Total estimated sales)
Further entity updates the estimate of total sales to be Rs. 15,00,000.
So the entity will recognize the sale of Rs. 122,500 (i.e. Rs. 125,000-2500**) for the 2nd quarter.

** Amount of advance to be adjusted with transaction price till the second Quarter is Rs. 7,500 (Rs.50,000 X 15%)
Amount of advance has been adjusted in previous Quarter is 5,000
So the difference of Rs 2500 should be adjusted in Q2

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Example 2- Consideration payable to a customer (distinct goods or services)

Mobile Company sells 1000 phones to retailer for Rs. 100,000. The contract includes an Advertising arrangement that required for Mobile Company to pay Rs. 100,000 towards a specific advertising promotion that the retailer will provide.

Retailer will provide the advertising on strategically located billboards and in local advertisement.

Mobile company could have elected to engage a third party to provide similar advertising service at a cost of Rs. 100,000.

How should Mobile Company account for the payment to Retailer for advertising?

Analysis Since the Mobile Company is getting the advertising service (distinct service) which would it have got by engaging third party and therefore the customer is now the supplier for something else and therefore it should not be reduced from the transaction price.

Step 4: Allocate the transaction price to the performance obligations

Under **Ind AS 115**, an entity allocates a contract's transaction price to each separate performance obligation within that contract on a relative stand-alone selling price basis at contract inception. Ind AS 115 defines a stand-alone selling price as 'the price at which an entity would sell a promised good or service separately to a customer.' The best evidence of the stand-alone selling price is the **observable price charged by the entity to similar customers and in similar circumstances**, **if available. If not, the stand-alone selling price is estimated using all reasonably available information** (including market conditions, entity-specific factors, and information about the customer or class of customer) maximizing the use of observable inputs

Adjusted market assessment Approach:
Involves evaluating the market in which the entity sells goods or services and estimating the price that customers in that market would pay for those goods or services. An entity might also consider price information from its competitors and adjust that information for the entity's particular costs and margins.

Expected cost plus margin approach:
An entity would forecast its expected costs to provide goods or services and add an appropriate margin

Residual approach :
Involves subtracting the sum of observable stand-alone selling prices for other goods and services promised under the contract from the total transaction price to arrive at an estimated selling price for a good or service.
This method is permitted only if the entity either:
- Sells the same good/service to different customers (at or near the same time) for a broad range of amounts; or
- Has not yet established price for the good/ service and the good/ service has not previously been sold on a stand-alone basis

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Allocating discounts and variable consideration

Discounts

If the sum of the stand-alone selling prices for the promised goods or services exceeds the contract's total consideration, an entity treats the excess as a discount to be allocated to the separate performance obligations on a relative stand- alone selling price basis. However, an entity would allocate a discount to only some of the performance obligations **only if it has observable evidence of the obligations to which the entire discount belongs**. Ind AS 115 sets out criteria that must be met to satisfy this requirement.

If a discount is allocated entirely to one or more, but not all, performance obligations in a contract, then Ind AS 115 requires an entity to allocate that discount before using a residual approach to estimate a stand-alone selling price for a good or service.

Variable Consideration

Variable consideration may be attributable to the entire contract or only to a specific part. Ind AS 115 requires that variable consideration is allocated entirely to a single performance obligation (or to a distinct good or service that forms part of a performance obligation) if and only if both of the following conditions have been met:

- The terms of the variable payment relate specifically to the entity's efforts towards, or outcome from, satisfying that performance obligation (or distinct good or service)
- The result of the allocation is consistent with the amount of consideration to which the entity expects to be entitled in exchange for the promised goods or services.

Changes in estimated transaction price:

If the estimated transaction price changes, an entity allocates the change to performance obligations on the same basis as at contract inception (subject to the specific guidance on contract modifications).

Amounts allocated to a satisfied performance obligation are recognized either as revenue or as a reduction in revenue in the period the change occurs.

Changes in the transaction price are allocated entirely to one performance obligation (or only some of the total performance obligations) using the same criteria applied to allocation of variable consideration to a single performance obligation.

Example: Allocation of Transaction price to performance obligation

An Entity enters into a contract with the customer to sell television, speaker and entertainment unit for a total of Rs.2,100. The television and speaker that delivered at the same time on a regular basis.
The Entity separately sale the television for Rs.1,700 and speakers for Rs. 300 and the entertainment unit for Rs. 300.

In addition, the Entity regularly sales the television and the speaker as a bundle for Rs. 1800, now in this case the customer purchase all the three for Rs. 2,100 receiving a discount of Rs.200 .

Now Rs.200 discount will be allocated to all the three performance obligations or How the amount of Transaction price will be allocated ?

Analysis: There is hard evidence that the discount is specifically provided on television and speakers. Therefore the discount of Rs.200 will be allocated to Television and speakers only.

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Step 5: Recognize revenue when or as an entity satisfies performance obligations

Under Ind AS 115, an entity recognizes revenue when or as it transfers promised goods or services to a customer. A 'transfer' occurs when the customer obtains control of the good or service.

A customer obtains control of an asset (good or service) when it can direct the use of and obtain substantially all the remaining benefits from it. 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 that can be obtained directly or indirectly from the asset in many ways, such as by:

1 Using the asset to produce goods or provide services (including public services);
2 Using the asset to enhance the value of other assets;
3 Using the asset to settle liabilities or reduce expenses;
4 Selling or exchanging the asset;
5 Pledging the asset to secure a loan; and
6 Holding the asset.

A key part of the model is the concept that for some performance obligations control is transferred over time while for others control transfers at a point in time.

Transfer over time or at a point in time

Transfer of control of good or service to customer → Over time
Transfer of control of good or service to customer → At a point in time

Control transferred over time

An entity determines at contract inception whether each performance obligation will be satisfied (that is, control will be transferred) over time or at a specific point in time.

Control is considered to be transferred over time if one of the following conditions exists:

1. The customer controls the asset as it is created or enhanced by the entity's performance under the contract. (For example: Entity is constructing equipment for the customer at his site and customer control the equipment as entity is constructing the equipment. Therefore the customer is controlling the "work in progress").
2. The customer **receives and consumes the benefits** of the entity's performance **as the entity performs**. A customer receives a benefit from the entity's performance as the entity performs if another entity does not have to substantially redo the work completed to date if it stepped in to complete the remaining obligation(s) under the contract.
3. The entity's performance creates or enhances an asset that has no alternative use to the entity, and the entity has the right to receive payment for work performed to date. An entity evaluates whether a promised asset has an alternative use to it at contract inception by considering whether it can readily redirect the partially completed asset to another customer throughout the production process.
4. The right to payment should be enforceable, and a vendor considers the contractual terms, as well as any legislation or legal precedent that could override those terms, in assessing the enforceability of that right.

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An entity recognizes over time revenue that is associated with a performance obligation that is satisfied over time by measuring its progress toward completion of that performance obligation. The objective of this measurement is to depict the pattern by which the entity transfers control of the goods or services to the customer.

IND AS 115 discusses two classes of methods that are appropriate for measuring an entity's progress toward completion of a performance obligation:

- **Output methods and**
- **Input methods**.

Output methods (revenue recognized by directly measuring the value of the goods and services transferred to date to the customer)

- Revenue could be recognized at amount invoiced only if this corresponds directly with the value of the goods or services transferred to date (practical expedient)
- The units produced or units delivered method could provide a reasonable proxy for the entity's performance provided any work-in-process or finished goods controlled by the customer are appropriately included in the measure of progress

- Surveys of performance to date, milestones reached or units produced

Input methods (revenue recognized based on the extent of efforts or inputs toward satisfying a performance obligation compared to the expected total efforts or inputs needed)

- It may be appropriate to recognize revenue on a straight- line basis if efforts/inputs are expended evenly over the performance period
- Ind AS 115 requires that if an entity selects an input method such as costs incurred it must adjust the measure of progress for any inputs that do not depict performance, for example costs incurred that:
  - Do not contribute to progress (e.g. wasted materials)
  - Are not proportionate to progress (e.g. some non- distinct goods procured from another supplier with limited involvement by the entity).

- Resources consumed, labor hours expended, costs incurred, machine hours used or time lapsed

Ability to reasonably measure progress

An entity recognizes revenue for a performance obligation satisfied over time only if it can reasonably measure its progress toward completion of that performance obligation. An entity is not able to reasonably measure its progress toward completion if it lacks reliable information that is required to apply an appropriate method of measurement.

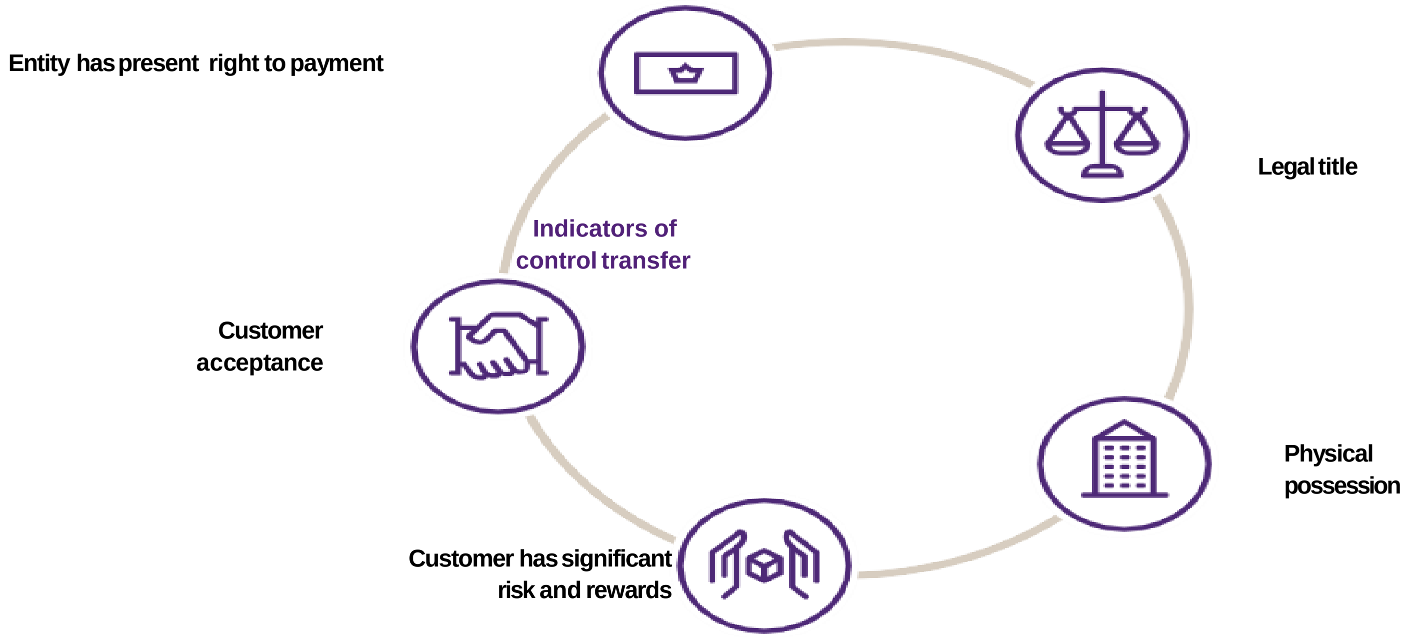
In some cases, such as during the early stages of a contract, an entity might not be able to reasonably measure its progress toward completion, but may still expect to recover its costs incurred in satisfying the performance obligation. An entity is then permitted to recognize revenue to the extent of costs incurred until it can reasonably measure its progress.

Control transferred at a point in time

In situations where control over an asset (goods or services) is transferred at a single point in time, an entity recognizes revenue by evaluating when the customer obtains control of the asset.

In performing the evaluation, an entity should **consider indicators of control**, including, but not limited to, the following:

Control indicators



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Incremental costs of obtaining a contract:

Under Ind AS 115, an entity capitalises the incremental costs of obtaining a contract if it expects to recover those costs. Incremental costs of obtaining a contract are costs that an entity would not have incurred if it had not obtained the contract (for example, some sales commissions).

Costs that an entity incurs regardless of whether it obtains a contract are expensed as incurred, unless the costs are explicitly chargeable to the customer regardless of whether the entity obtains the contract (for example tender costs).

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.

Example : Costs Related to obtaining a contract

Technology Company A incurred the following costs in order to obtain a three year contract with Customer B. Company A expects to recover all the costs incurred in order to obtain the contract. Company A should only capitalize the Rs 5,000 commission paid to its sales person.

Travel Costs to Deliver Bid Proposal	Rs 8,000
Commissions Paid to Salesperson	Rs 5,000
Total	Rs 13,000

Analysis: The costs related to the delivery of the bid on the contract do not qualify because those costs would have been incurred even if the Company did not ultimately obtain the contract. Company A should amortize the recognized asset over the three-year contract term.

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 for under other guidance, such as IND AS 2. An entity would reverse a previously recognized impairment loss when the impairment conditions no longer exist or have improved.

Principal versus agent (Gross versus net)

A Company is the principal and should report revenue on a gross basis if it controls the specified good or service before it is transferred to the customer. When another party is involved in providing goods or services to a customer, a Company that is a principal obtains control of any of the following:

- A good or another asset from the other party that it then transfers to the customer.
- A right to a service to be performed by the other party, which gives the Company the ability to direct that party to provide the service to the customer on the Company's behalf.
- A good or service from the other party that it then combines with other goods or services in providing the specific good or service to the customer (for example, if a Company provides a significant service of integrating the goods or services into the specified good or service for which the customer has contracted).

Conversely, a Company is an agent and should report revenue on a net basis if its obligation is to arrange for another party to provide goods or services (i.e., the Company does not control the specified good or service before it is transferred to the customer).

Indicators to assist Companies in determining whether it controls the good or service before it is transferred to the customer are:

- The Company is primarily responsible for fulfilling the promise.
- The Company has inventory risk.
- The Company has discretion in establishing the price.

In a single contract, a Company may act as a principal with respect to certain performance obligations and an agent with respect to others. Said differently, the principal versus agent assessment is at the performance obligation level, not at the contract level

Example: Principal versus agent

Bond.com is an online retailer platform that provides deals and coupons for customers. Various Companies offer their products and services on Bond.com and, based on contractual agreements, remit 10-30 percent of the sale price to Bond. Silva Company agrees to sell its chairs on Bond.com for Rs 200 (the chairs cost Silva Company Rs 100 to produce) and remit 10 percent of each sale to Bond. Customers buy the chairs on Bond.com using credit or debit cards, with payments going directly to Bond. Bond then arranges the shipping of the item from Silva’s warehouse to the customer (shipping paid for directly by Silva), and remits the sales price less 10 percent to Silva Company. At the end of the year, Bond had sold 1,000 chairs.

Is Bond the principal or agent in this transaction?

Analysis Bond is an agent in the transaction, as shown by an analysis of the three factors below.

- The entity is primarily responsible for fulfilling the promise to provide the specified good or service. Bond is not responsible for providing the chairs. Instead, it facilitates the sale of chairs from Silva Company to the end customers.
- The entity has inventory risk before or after the specified good or service has been transferred to a customer. Bond does not control the inventory before or after the transaction, nor does it lose money on unsold units.
- The entity has discretion in setting prices. Bond agrees to sell the chairs at the price Silva offers to customers through the website and cannot change that price.

None of these factors indicate that Bond would have control of the goods or services before they are transferred to the customer.

Since Bond Entity is an agent, it **will recognize net revenue of Rs. 20,000** [1,000 chairs * Rs 200 price * 10% commission].
Silva Company, being principal entity, will recognize gross revenue of Rs. 200,000, cost of goods sold of Rs. 100,000, and a commission expense for the amount remitted to Bond.

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Presentation and disclosure

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 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 good 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.

Disclosure

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

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 • Aggregate amount of transaction price allocated to remaining performance obligations at end of period*

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• Information about significant judgements	• Judgements impacting the expected timing of satisfying performance obligations • Methods used to recognise revenue for performance satisfied over time, and explanation • The transaction price and amounts allocated to performance obligations (e.g. estimating variable consideration and assessing if constrained and allocating to performance obligations) • Reconciliation of the amount of revenue recognized in the statement of profit and loss with the contracted price showing separately each of the adjustments made to the contract price specifying the nature and amount of each such adjustment separately (carve-out).
• Assets recognized from the costs to obtain or fulfil a contract	• Judgements made in determining costs capitalised • Amortisation method used • Closing balances by main category and amortisation expense

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Thank You!!