

Ind AS 115: Revenue from Contracts with Customers

Section A – Practical & Relevant Theory Questions

Determination of Transaction Price

Question 1

Construction Company C enters into a contract with Customer E to build an asset. Depending on when the asset is completed, C will receive either ₹ 1,10,000 or ₹ 1,30,000.

Outcome	Consideration (₹)	Probability
Project completes on time	1,30,000	90%
Project is delayed	1,10,000	10%

Determine the transaction price.

Answer

Because there are only two possible outcomes under the contract, C determines that using the **most likely amount** provides the best prediction of the amount of consideration to which it will be entitled. C estimates the **transaction price to be ₹ 1,30,000**, which is the single most likely amount.

Question 2

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.

Answer

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

AST Limited decides to use the **expected value method to estimate** the variable consideration associated with the **early completion bonus** because there is a range of possible outcomes and the entity has experience with a large number of similar 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 ₹ 2.125 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

Question 3

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 completes construction of the office building within one year. Assume a fair value of ₹ 100 per share at contract inception.

Determine the transaction price if entity estimates to earn bonus.

Answer

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

- (i) the entity earns or does not earn the shares and
- (ii) 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**.

Question 4

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.

Answer

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.

Question 5

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.

Answer

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

Question 6

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? Determine transaction price for A Ltd. and B Ltd.

Answer

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 non-cash consideration) at fair value.

On the basis of the above, **revenue recognised 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 recognised 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).

Question 7

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.

Answer

The entity considers the requirements in paragraphs 70-72 of Ind AS 115 and concludes that the payment to the customer is not in exchange for a distinct good or service that transfers to the entity. This is because the entity does not obtain control of any rights to the customer's shelves. Consequently, the entity determines that, in accordance with paragraph 70 of Ind AS 115, the **₹ 1.5 crore payment is a reduction of the transaction price**. So, **transaction price is ₹ 13.5 crore** [₹ 15 crore – ₹ 1.5 crore].

Question 8

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.

Answer

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 recognise the reduction in the transaction price as the promised goods or services are transferred.

Question 9

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?

Answer

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 liability for cash consideration expected to be paid to 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.

Question 10

A manufacturer enters into a contract to sell goods to a retailer for ₹ 1,000. The manufacturer also offers price protection, whereby it will reimburse the retailer for any difference between the sale price and the lowest price offered to any customer during the following six months. This clause is consistent with other price protection clauses offered in the past, and the manufacturer believes that it has experience which is predictive for this contract.

Management expects that it will offer a price decrease of 5% during the price protection period. Management concludes that it is highly probable that a significant reversal of cumulative revenue will not occur if estimates change.

How should the manufacturer determine the transaction price?

Answer

The **transaction price is ₹ 950**, because the expected reimbursement is ₹ 50. The expected payment to the retailer is reflected in the transaction price at contract inception, as that is the amount of consideration to which the manufacturer expects to be entitled after the price protection. The manufacturer will recognise a liability for the difference between the invoice price and the transaction price, as this represents the cash that it expects to refund to the retailer. The manufacturer will update its estimate of expected reimbursement at each reporting date until the uncertainty is resolved.

Question 11

Electronics Manufacturer M sells 1,000 televisions to Retailer R for ₹ 50,00,000 (₹ 5,000 per television). M provides price protection to R by agreeing to reimburse R for the difference between this price and the lowest price that it offers for that television during the following six months. Based on M's extensive experience with similar arrangements, it estimates the following outcomes.

Price reduction in next six months (₹)	Probability
0	70%
₹ 500	20%
₹ 1,000	10%

Determine the transaction price.

Answer

After considering all relevant facts and circumstances, M determines that the expected value method provides the best prediction of the amount of consideration to which it will be entitled. As a result, it estimates the transaction price to be ₹ 4,800 per television, i.e., (₹ 5,000 x 70%) + (₹ 4,500 x 20%) + (₹ 4,000 x 10%).

Allocation of Transaction Price**Question 12**

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.

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.

Answer

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 (₹)	
Product A	3,333	[(₹ 5,000 ÷ ₹ 15,000) x ₹ 10,000]
Product B	1,667	[(₹ 2,500 ÷ ₹ 15,000) x ₹ 10,000]
Product C	5,000	[(₹ 7,500 ÷ ₹ 15,000) x ₹ 10,000]
Total	10,000	

Question 13

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

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

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

Case A

The entity enters into a contract with a customer to sell Products X, Y and Z in exchange for ₹ 1,00,000. The entity will satisfy 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

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 ₹ 1,30,000. 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

The same facts as in Case B apply to Case C except the transaction price is ₹ 1,05,000 instead of ₹ 1,30,000. Discuss how the transaction price should be allocated.

Answer**Case A: Allocating a discount to one or more performance obligations**

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

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

If the 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 and recognise revenue of ₹ 50,000 when Products Y and Z simultaneously transfer to the customer.

If the contract requires the entity to transfer control of Products Y and Z at different points in time, then the allocated amount of ₹ 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	$[(₹ 25,000 \div ₹ 70,000 \text{ total stand-alone selling price}) \times ₹ 50,000]$
Product Z	32,143	$[(₹ 45,000 \div ₹ 70,000 \text{ total stand-alone selling price}) \times ₹ 50,000]$
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	1,30,000	

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 (₹ 1,05,000 transaction price less ₹ 1,00,000 allocated to Products X, Y and Z).

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.

Recognition of Revenue

Question 14

Prime Ltd. is a technology company and regularly sells Software S, Hardware H and Accessory A. The stand-alone selling prices for these items are stated below:

Software S - ₹ 50,000

Hardware H - ₹ 1,00,000 and

Accessory A - ₹ 20,000

Since the demand for Hardware H and Accessory A is low, Prime Ltd. sells H and A together at ₹ 1,00,000. Prime Ltd. enters into a contract with Zeta Ltd. to sell all the three items for a consideration of ₹ 1,50,000.

What will be the accounting treatment for the discount in the financial statements of Prime Ltd.,

considering that the three items are three different performance obligations which are satisfied at different points in time? Further, what will be the accounting treatment if Prime Ltd. would have transferred the control of Hardware H and Accessory A at the same point in time.

Answer

Paragraph 82 of Ind AS 115 states that, “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 good 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 paragraph 82(b) 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”.

In the given case, the contract includes a discount of ₹ 20,000 on the overall transaction, which should have been allocated proportionately to all three performance obligations when allocating the transaction price using the relative stand-alone selling price method (in accordance with paragraph 81 of Ind AS 115). However, as Prime Ltd. meets all the criteria specified in paragraph 82 above, i.e., it regularly sells Hardware H and Accessory A together for ₹ 1,00,000 and Software S for ₹ 50,000, accordingly, it is evident that the entire discount should be allocated to the promises to transfer Hardware H and Accessory A.

In the given case, since the contract requires the entity to **transfer control** of Hardware H and Accessory A **at different points in time**, then the allocated amount of ₹ 1,00,000 should be individually allocated to the promises to transfer Hardware H (stand-alone selling price of ₹ 1,00,000) and Accessory A (stand-alone selling price of ₹ 20,000)

Product	Allocated transaction price (₹)	
Hardware H	83,333	$[(₹ 1,00,000 / ₹ 1,20,000) \times ₹ 1,00,000]$
Accessory A	16,667	$[(₹ 20,000 / ₹ 1,20,000) \times ₹ 1,00,000]$
Total	1,00,000	

However, if Prime Ltd. would have **transferred the control of Hardware H and Accessory A at the same point in time**, then the Prime Ltd. could, as a practical matter, account for the transfer of those products as a single performance obligation. That is, Prime Ltd. could allocate ₹ 1,00,000 of the transaction price to the single performance obligation and **recognise revenue of ₹ 1,00,000 when Hardware H and Accessory A simultaneously transfer to Zeta Ltd.**

Question 15

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 percent complete in satisfying its performance obligations for due diligence and valuation and 60 percent complete in satisfying its performance obligation for software implementation.

Determine the transaction price of software implementation. Also determine revenue to be recognised till 1st July 20X0 for the software implementation services.

Answer

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 percent of ₹ 1.2 crore).

Question 16

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:

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?

Answer

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

- (a) The elevators are part of the overall construction project and are not a distinct performance obligation
- (b) The cost of elevators is substantial to the overall project and are incurred well in advance.
- (c) Upon delivery at site, customer acquires control of such elevators.
- (d) And there is no modification done to the elevators, which the company only procures and delivers at site. Nevertheless, as part of materials used in overall construction project, the company is a principal in the transaction with the customer for such elevators also.

Therefore, applying the guidance on Input method

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

The revenue to be recognized is measured as follows:

Particulars	Amount (₹)
Transaction price	50,00,000
Costs incurred:	
(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 recognised:	
(a) For costs incurred (other than elevators)	Total attributable revenue = 35,00,000 % of work completed = 20% Revenue to be recognised = 7,00,000
(b) Revenue for elevators	15,00,000 (equal to costs incurred)
Total revenue to be recognised	$7,00,000 + 15,00,000 = 22,00,000$

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

Question 17

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 recognised for the year ended March 20X1?

Answer

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 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 recognises 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 percent complete** (i.e., ₹ 6,00,000/₹ 30,00,000). Consequently, Company X **recognises the revenue of ₹ 18,00,000** which is calculated as (20 percent x ₹ 40,00,000) + ₹ 10,00,000

Question 18

Nivaan Limited commenced work on two long-term contracts during the financial year ended on 31st March, 20X2.

The first contract with A & Co. commences on 1st June, 20X1 and had a total sales value of ₹ 40 lakh. It was envisaged that the contract would run for two years and that the total expected costs would be ₹ 32 lakh. On 31st March, 20X2, Nivaan Limited revised its estimate of the total expected cost to ₹ 34 lakh on the basis of the additional rectification cost of ₹ 2 lakh incurred on the contract during the current financial year. An independent surveyor has estimated at 31st March, 20X2 that the contract is 30% complete. Nivaan Limited has made payment of costs incurred upto 31st March, 20X2 of ₹ 16 lakh and has received payments on account of ₹ 13 lakh.

The second contract with B & Co. commenced on 1st September, 20X1 and was for 18 months. The total sales value of contract was ₹ 30 lakh and the total expected cost is ₹ 24 lakh. Payments on account already received were ₹ 9.50 lakh and total payment made for costs incurred to date were ₹ 8 lakh. Nivaan Limited has insisted on a large deposit from B & Co. because the companies had not traded together prior to the contract. The independent surveyor estimated that on 31st March, 20X2 the contract was 20% complete.

The two contracts meet the requirement of Ind AS 115 ‘Revenue from Contracts with Customers’ to recognize revenue over time as the performance obligations are satisfied over time.

The company also has several other contracts of between twelve and eighteen months in duration. Some of these contracts fall into two accounting period and were not completed as at 31st March, 20X2.

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In absence of any financial data relating to the other contracts, you are advised to ignore these other contracts while preparing the financial statements of the company for the year ended 31st March, 20X2. Prepare financial statement extracts for Nivaan Limited in respect of the two construction contracts for the year ending 31st March, 20X2.

Answer**(a) Extracts of Balance Sheet of Nivaan Ltd. as on 31st March, 20X2**

	₹ in lakh
Current Assets	
Contract Assets - Work in progress (Prepaid expense) (Refer W.N. 3)	9.0
Current Liabilities	
Contract Liabilities (Advance from customers) (Refer W.N. 2)	4.5

(b) Extracts of Statement of Profit and Loss of Nivaan Ltd. as on 31st March, 20X2

	₹ in lakh
Revenue from contracts (Refer W.N. 1)	18
Cost of Revenue (Refer W.N. 1)	(15)
Net Profit on Contracts (Refer W.N. 1)	3

Working Notes:**1. Calculation of total revenue, expenses and profit or loss on contract for the year ₹ in lakh**

	A & Co.	B & Co.	Total
Revenue from contracts	(40 × 30%) = 12	(30 × 20%) = 6	18
Less: Expenses due for the year	(34 × 30%) = 10.2	(24 × 20%) = 4.8	15
Profit or loss on contract	1.8	1.2	3

2. Calculation of amount due from/(to) customers ₹ in lakh

	A & Co.	B & Co.	Total
Billing on the basis of revenue recognised in the books	12	6	18
Less: Payments received from the customers	(13)	(9.5)	(22.5)
Advance received from the customers	1	3.5	4.5

3. Work in Progress recognised as part of contract asset at the end of the year ₹ in lakh

	A & Co.	B & Co.	Total
Total actual cost payment during the year	16	8	24
Less: Cost recognised in books for the year 31.3.20X2	(10.2)	(4.8)	(15)
Work in progress recognised at the end of the year	5.8	3.2	9.0

Question 19

An entity has a fixed fee contract for ₹ 10,00,000 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:

Ind AS 115: Revenue from Contracts with Customers

Weight (kg)	Award % of fixed fee	Incentive fee
951 or greater	0%	-
701-950	10%	₹ 1,00,000
700 or less	25%	₹ 2,50,000

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% incentive and two that will achieve the 25% incentive. In this case, the entity determined that it has 95% confidence that it will achieve the 10% incentive and 5% confidence that it will achieve the 25% incentive. Based on this analysis, the entity believes 10% to be the most likely amount when estimating the transaction price. Therefore, the entity includes only the 10% 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% confidence in achieving the 10% award.

The entity reassesses its production status quarterly to determine whether it is on track to meet the criteria for the incentive award. At the end of the year four, it becomes apparent that this contract will fully achieve the weight-based criterion. Therefore, the entity revises its estimate of variable consideration to include the entire 25% 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
3	4,00,000
4	2,75,000
5	50,000

Calculate yearly Revenue, Operating Profit and Margin (%).

Answer

Calculation of yearly Revenue, Operating Profit and Margin (%):

Fixed consideration (A)	10,00,000					
Estimated costs to complete (B)	9,50,000					
	Year 1	Year 2	Year 3	Year 4	Year 5	
Total estimated variable consideration (C)	1,00,000	1,00,000	1,00,000	2,50,000	2,50,000	
Fixed revenue (D = A x H/B)	52,600	1,84,200	4,21,100	2,89,500	52,600	
Variable revenue (E = C x H/B)	5,260	18,420	42,110	72,375	13,150	
Cumulative adjustment (see below) (F)	-	-	-	98,685	-	
Total revenue (G = D + E + F)	57,860	2,02,620	4,63,210	4,60,560	65,750	
Costs (H)	50,000	1,75,000	4,00,000	2,75,000	50,000	
Operating profit (I = G - H)	7,860	27,620	63,210	1,85,560	15,750	
Margin (J = I/G)	13.58%	13.63%	13.65%	40.29%	23.95%	

Calculation of cumulative catch-up adjustment:

Updated variable consideration	(L)		2,50,000
Cumulative costs through Year 4	(M)	9,00,000	
Estimated costs to complete	(N)	9,50,000	
Percent complete in Year 4	(O = M/N)		94.74%
Cumulative variable revenue through Year 4	(P)		1,38,165
Cumulative catch-up adjustment	(F = L x O - P)		98,685

Question 20

On 1st April, 20X1, S Limited enters into a contract with Corp Limited to construct heavy-duty equipment for a promised consideration of ₹ 20,00,000 with a bonus of ₹ 2,50,000 if the equipment is completed within 24 months. At the inception of the contract, S Limited correctly accounts for the promised bundle of goods and services as a single performance obligation in accordance with Ind AS 115. At the inception of the contract, the Company expects the costs to be ₹ 11,00,000 and concludes that it is highly probable that a significant reversal in the amount of cumulative revenue recognised will occur. Completion of the heavy-duty equipment is highly susceptible to factors outside of the Company's influence, mainly due to difficulties with the supply of components.

At 31st March, 20X2, S Limited has satisfied 65% of its performance obligation on the basis of costs incurred to date and concludes that the variable consideration is still constrained in accordance with Ind AS 115. However, on 4th June 20X2, the contract is modified with the result that the fixed consideration and expected costs increase by ₹ 1,50,000 and ₹ 80,000 respectively. The time allowable for achieving the bonus is extended by six months with the result that S Limited concludes that it is highly probable that the bonus will be achieved and that the contract remains a single performance obligation.

S Limited wants your opinion on accounting treatment of contract with Corp Limited as per Ind AS 115:

- (i) Revenue from the contract, contract costs & resultant profit for financial year 20X1-20X2
- (ii) Additional revenue as on the date of modification of the contract i.e. 4th June, 20X2

Answer

(i) For the year 20X1-20X2

S Limited accounts for the promised bundle of goods and services as a single performance obligation satisfied over time in accordance with Ind AS 115. At the inception of the contract, S Limited expects the following:

Transaction price	₹ 20,00,000
Expected costs	(₹ 11,00,000)
Expected profit (45%)	₹ 9,00,000

At contract inception, S Limited excludes the ₹ 2,50,000 bonus from the transaction price because it cannot be concluded that it is highly probable that a significant reversal in the amount of cumulative revenue recognised will not occur. Completion of the heavy-duty equipment is highly susceptible to factors outside the entity's influence.

By the end of the first year, the entity has satisfied 65% of its performance obligation on the basis

of costs incurred to date. Costs incurred to date are therefore ₹ 7,15,000 and S Limited reassesses the variable consideration and concludes that the amount is still constrained. Therefore, at 31st March, 20X2, the following would be recognised:

Revenue (₹ 20,00,000 x 65%)	₹ 13,00,000
Costs (₹ 11,00,000 x 65%)	(₹ 7,15,000)
Gross profit	₹ 5,85,000

(ii) For the year 20X2-20X3

On 4th June, 20X2, the contract is modified. As a result, the fixed consideration and expected costs increase by ₹ 1,50,000 and ₹ 80,000, respectively.

The **total potential consideration after the modification is ₹ 24,00,000 which is ₹ 21,50,000 fixed consideration + ₹ 2,50,000 completion bonus**. In addition, the allowable time for achieving the bonus is extended by six months with the result that S Limited concludes that it is highly probable that including the bonus in the transaction price will not result in a significant reversal in the amount of cumulative revenue recognised in accordance with Ind AS 115. Therefore, the bonus of ₹ 2,50,000 can be included in the transaction price.

S Limited also concludes that the contract remains a single performance obligation. Thus, S Limited accounts for the contract modification as if it were part of the original contract. Therefore, S Limited updates its estimates of costs and revenue as follows:

S Limited has **satisfied 60.59% of its performance obligation** (₹ 7,15,000 actual costs incurred compared to ₹ 11,80,000 total expected costs). The entity **recognises additional revenue of ₹ 1,54,160** [(60.59% of ₹ 24,00,000) – ₹ 13,00,000 revenue recognised to date] at the date of modification i.e. on 4th June, 20X2 as a cumulative catch-up adjustment.

Question 21

A Ltd. enters into a contract with a customer for the exclusive supply of paint for a three-year period. A Ltd. makes a ₹ 50,000 upfront payment, which the customer will use to customize its paint sprayers for A Ltd.'s product. A Ltd. determines the upfront payment is not in respect of a distinct good or service.

A Ltd. estimates ₹ 10,00,000 in sales with the customer over the three-year period. Sales for Quarter 1 is ₹ 1,00,000 and for Quarter 2 is ₹ 1,25,000. However, A Ltd. updated its estimate of total sales over the contract to ₹ 15,00,000 during Quarter 2.

Determine the net revenue to be recognized in Quarter 1 and Quarter 2 by A Ltd.

Answer

Treatment of upfront payment of ₹ 50,000

Upfront payment of ₹ 50,000 would be accounted for as a **reduction of the transaction price**. It would be deferred and recognised as a reduction of revenue (in proportion to estimated sales) over the contract term.

Accounting for Quarter 1 and Quarter 2 is as follows:

For the first quarter

- Quarter 1 sales = ₹ 1,00,000
- Entity estimates ₹ 10,00,000 sales over the three-year period

- **Percentage of Quarter 1 sale to total estimated sale** = $(₹ 1,00,000 / ₹ 10,00,000) \times 100 = 10\%$
- **Share of upfront payment to be recognised in Quarter 1**
 $= 10\% \times ₹ 50,000 = ₹ 5,000$

Hence, in Quarter 1, A Ltd. **recognizes revenue of ₹ 95,000** (₹ 1,00,000 actual sales – ₹ 5,000 consideration paid to the customer)

For the second quarter

- Quarter 2 sales = ₹ 1,25,000
- A Ltd. updates its estimate of total sales over the contract to ₹ 15,00,000
- **Total sales to date till Quarter 2**
 $= ₹ 1,00,000 + ₹ 1,25,000 = ₹ 2,25,000$
- **Percentage of sale till Quarter 2 to total estimated sale** = $(₹ 2,25,000 / ₹ 15,00,000) \times 100 = 15\%$
- **Share of upfront payment to be recognised in Quarter 2**
 $= (15\% \times ₹ 50,000 \text{ upfront payment}) - \text{Upfront payment recognized in Quarter 1}$
 $= ₹ 7,500 - ₹ 5,000 = ₹ 2,500$

Hence, A Ltd. would **recognize revenue of ₹ 1,22,500 for Quarter 2** (₹ 1,25,000 actual sales – ₹ 2,500 upfront payment made to the customer).

Question 22

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

Based on its experience, Growth Ltd. determines that customising the infrastructure will take approximately 200 hours in total to complete the project and charges ₹ 150 per hour.

After incurring 100 hours of time, Growth Ltd. and the customer agree to change an aspect of the project and increases the estimate of labour hours by 50 hours at the rate of ₹ 100 per hour.

Determine how contract modification will be accounted as per Ind AS 115.

Answer

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

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

*₹ 35,000/250 hours = ₹ 140

Sale of Product with Right of Return**Question 23**

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

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

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

Answer

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

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

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

- (a) revenue of ₹ 48,500 (₹ 50 x 970 products not expected to be returned);
- (b) a refund liability of ₹ 1,500 (₹ 50 refund x 30 products expected to be returned); and
- (c) an asset of ₹ 900 (₹ 30 x 30 products for its right to recover products from customers on settling the refund liability).

Sale of Product with Warranty**Question 24**

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 years two through five 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.

Answer

The entity will record the following journal entries:

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

Particulars		₹	₹
Bank	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 recognised as revenue over the service warranty period (years 2-5). The costs of providing the service warranty are recognised as incurred. The assurance warranty obligation is used/derecognised 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.

Question 25

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.

Answer

The entity will record the following journal entries:

Ind AS 115: Revenue from Contracts with Customers

Particulars		₹	₹
Bank	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)			
Cost of goods sold	Dr.	14,400	
To Inventory			14,400
(To derecognise inventory and recognise cost of goods sold)			

The entity derecognises 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 recognises the contract liability associated with the service-type warranty as revenue during the contract warranty period and recognises 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 recognised as an expense as incurred.

Sale of Product with Reward [Discount Voucher or Loyalty Points]

Question 26

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.

Answer

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 of additional products. Consequently, 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 discount voucher and resulting allocation of the ₹ 1,000 transaction price are as follows:

Performance obligations	Stand-alone selling price (₹)
-------------------------	-------------------------------

Ind AS 115: Revenue from Contracts with Customers

Product A	₹ 1,000
Discount voucher	₹ 120
Total	₹ 1,120

Performance obligations	Allocated transaction price (₹)	
Product A	₹ 893	$[(₹ 1,000 \div ₹ 1,120) \times ₹ 1,000]$
Discount voucher	₹ 107	$[(₹ 120 \div ₹ 1,120) \times ₹ 1,000]$
Total	₹ 1,000	

The entity allocates ₹ 893 to Product A and recognises revenue for Product A when control transfers. The entity allocates ₹ 107 to the discount voucher and recognises revenue for the voucher when the customer redeems it for goods or services or when it expires.

Question 27

A Ltd. owns 20 resorts across India. Every customer who stays in any of the resorts owned by A Ltd. is entitled to get points on the basis of total amount paid by him. Under this scheme, 1 point is granted for every ₹ 100 spent for stay in the resort. As per the past experience of A Ltd., the likelihood of exercise of the points is 100% and the standalone price of each such point is ₹ 5. Customer X spends ₹ 10,000 in one of the resorts of A Ltd. What is the accounting treatment for the points granted by A Ltd.?

Answer

Paragraph B40 of Ind AS 115, inter alia, states that, “if in a contract, an entity grants a customer the option to acquire additional goods or services, that option gives rise to a separate performance obligation only if the option provides a material right to the customer that it would not receive without entering into that contract”.

Further, paragraph B41 states that if a customer has the option to acquire an additional good or service at a price that would reflect the stand-alone selling price for that good or service, that option does not provide the customer with a material right even if the option can be exercised only by entering into a previous contract. In those 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.

In the given case, the customer does get a material right by way of a discount of ₹ 500 for every 100 points that he would not receive without the previous stay in that resort. Thus, customer in effect pays the entity in advance for future goods and the entity recognises revenue when goods are transferred.

According to paragraph B42, paragraph 74 requires an entity to allocate the transaction price to performance obligations on a relative stand-alone selling price basis. If the standalone selling price for a customer's option to acquire additional goods or services is not directly observable, an entity shall estimate it on the basis of percentage discount the customer may obtain upon exercising the option and the likelihood of the option getting exercised.

In accordance with above, an entity shall account for award credit as a separate performance obligation of the sales transactions in which they are initially granted. The value of the consideration the entity expects to be entitled in respect of the initial sale shall be allocated between the award credits and the other components of the sale.

In the current case, the standalone selling price of the 100 points is ₹ 500. A Ltd. should allocate the fair value of the consideration (i.e. ₹ 10,000) between the points and the other components of the sale as ₹ 476 $[(\text{₹ } 500 / \text{₹ } 10,500) \times \text{₹ } 10,000]$ and ₹ 9,524 $[(\text{₹ } 10,000 / \text{₹ } 10,500) \times \text{₹ } 10,000]$ respectively in proportion of their standalone selling price. Since A Ltd. supplies the awards itself (i.e. it acts as a principal), it should recognise ₹ 476 as revenue when points are redeemed.

Question 28

KK Ltd. runs a departmental store which awards 10 points for every purchase of ₹ 500 which can be discounted by the customers for further shopping with the same merchant. Unutilised points will lapse on expiry of two years from the date of credit. Value of each point is ₹ 0.50. During the accounting period 20X1-20X2, the entity awarded 1,00,00,000 points to various customers of which 18,00,000 points remained undiscounted. The management expects only 80% of the total award points during the year will be discounted of which normally 60% - 70% are redeemed during the next year.

The Company has approached your firm with the following queries and has asked you to suggest the accounting treatment (Journal Entries) under the applicable Ind AS for these award points:

- (a) How should the recognition be done for the sale of goods worth ₹ 10,00,000 on a particular day?
- (b) How should the redemption transaction be recorded in the year 20X1-20X2? The Company has requested you to present the sale of goods and redemption as independent transaction. Total sales of the entity is ₹ 50,00,00,000.
- (c) How much of the deferred revenue should be recognised at the year-end (20X1-20X2) because of the estimation that only 80% of the outstanding points will be redeemed?
- (d) In the next year 20X2-20X3, 60% of the expected outstanding points were discounted. Balance 40% of the outstanding points of 20X1-20X2 still remained outstanding. How much of the deferred revenue should the merchant recognize in the year 20X2-20X3 and what will be the amount of balance deferred revenue?
- (e) How much revenue will the merchant recognized in the year 20X3-20X4, if 3,00,000 points are redeemed in the year 20X3-20X4?

Answer

- (a) Points earned on ₹ 10,00,000 @ 10 points on every ₹ 500 = $[(\text{₹ } 10,00,000 / \text{₹ } 500) \times 10]$
 = 20,000 points

It is expected that 80% of award points will only be redeemed. Hence, considering the likelihood of the variable consideration, Value of points = 20,000 points x ₹ 0.5 each point x 80% = ₹ 8,000

Performance obligations	Allocated transaction price (₹)	
Revenue recognized for sale of goods	9,92,063	$[(\text{₹ } 10,00,000 \times (\text{₹ } 10,00,000 / \text{₹ } 10,08,000))]$
Revenue for points deferred	7,937	$[(\text{₹ } 10,00,000 \times (\text{₹ } 8,000 / \text{₹ } 10,08,000))]$

Journal Entry

Particulars		₹	₹
Bank A/c	Dr.	10,00,000	
To Sales A/c			9,92,063
To Liability under Customer Loyalty programme			7,937

- (b) Points earned on ₹ 50,00,00,000 @ 10 points on every ₹ 500 = [(₹ 50,00,00,000/₹ 500) × 10]**
= 1,00,00,000 points

Value of points considering future likelihood = 1,00,00,000 points × ₹ 0.5 each point × 80%
= ₹ 40,00,000

Revenue recognized for sale of goods = ₹ 49,60,31,746 [₹ 50,00,00,000 × (₹ 50,00,00,000/₹ 50,40,00,000)]

Revenue for points = ₹ 39,68,254 [₹ 50,00,00,000 × (₹ 40,00,000/₹ 50,40,00,000)]

Journal Entries in the year 20X1

Particulars		₹	₹
Bank A/c Dr.		50,00,00,000	
To Sales A/c			49,60,31,746
To Liability under Customer Loyalty programme			39,68,254
(On sale of Goods)			
Liability under Customer Loyalty programme Dr.		32,53,968	
To Sales A/c			32,53,968
(On redemption of {(100 lakhs - 18 lakhs) × 80%} points)			

Revenue for points to be recognized

Undiscounted points estimated to be recognized next year = 18,00,000 × 80% = 14,40,000 points

Total expected points to be redeemed within 2 years = 1,00,00,000 × 80% = 80,00,000

Points redeemed in the previous year = (1,00,00,000 - 18,00,000) × 80% = 65,60,000

Revenue to be recognised with respect to discounted point

= ₹ 39,68,254 × (65,60,000/80,00,000) = ₹ 32,53,968

- (c) Revenue to be deferred with respect to undiscounted point in 20X1-20X2**

= ₹ 39,68,254 - ₹ 32,53,968 = ₹ 7,14,286

- (d) In 20X2-20X3, KK Ltd. would recognize revenue for discounting of 60% of expected outstanding points as follows:**

Outstanding points = 18,00,000 × 80% × 60% = 8,64,000 points

Total points discounted till date = 65,60,000 + 8,64,000 = 74,24,000 points

Revenue to be recognized in the year 20X2-20X3

= [{₹ 39,68,254 × (74,24,000/80,00,000)} - ₹ 32,53,968] = ₹ 4,28,572

Particulars		₹	₹
Liability under Customer Loyalty programme Dr.		4,28,572	
To Sales A/c			4,28,572
(On redemption of further 8,64,000 points)			

The Liability under Customer Loyalty programme at the end of the year 20X2-20X3 will be ₹ 7,14,286 - ₹ 4,28,572 = ₹ 2,85,714

- (e) In the year 20X3-20X4, merchant will recognized balance revenue of ₹ 1,84,873 irrespective of points redeemed as this is the last year for redeeming points. Journal entry will be as follows:**

Particulars		₹	₹
Liability under Customer Loyalty programme	Dr.	2,85,714	
To Sales A/c			2,85,714
(On redemption of further points)			

Sale of Product with Retrospective Volume Discount

Question 29

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 retrospectively once the customer reaches certain sales volume, defined, as follows:

Price per container	Cumulative sales volume
₹ 100	1 – 10,00,000 containers
₹ 90	10,00,001 – 30,00,000 containers
₹ 85	30,00,001 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 7,00,000 containers to the customer during the first quarter ended 31st March 20X8 for a contract price of ₹ 100 per container.

Determine the transaction price, revenue and liability, if any, as per Ind AS 115 for the quarter ended 31st March 20X8.

Answer

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 recognised will not occur when the uncertainty is resolved. Revenue is therefore recognised at a selling price of ₹ 90 per container as each container is sold. Entity J will recognise 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 (7,00,000 containers x ₹ 90) and a liability of ₹ 7 million [7,00,000 containers x (₹ 100 – ₹ 90)].

Entity J will update its estimate of the total sales volume at each reporting date until the uncertainty is resolved.

Question 30

ABC Limited supplies plastic buckets to wholesaler customers. As per the contract entered into

between ABC Limited and a customer for the financial year 20X1-20X2, the price per plastic bucket will decrease retrospectively as sales volume increases within the stipulated time of one year.

The price applicable for the entire sale will be based, on sales volume bracket during the year.

Price per unit (₹)	Sales volume
90	0 – 10,000 units
80	10,001 – 35,000 units
70	35,001 units & above

All transactions are made in cash.

- (i) Suggest how revenue is to be recognised in the books of accounts of ABC Limited as per expected value method, considering a probability of 15%, 75% and 10% for sales volumes of 9,000 units, 28,000 units and 36,000 units respectively. For workings, assume that ABC Limited achieved the same number of units of sales to the customer during the year as initially estimated under expected value method for the financial year 20X1-20X2.
- (ii) You are required to pass Journal entries in the books of ABC Limited if the revenue is accounted for as per expected value method for financial year 20X1-20X2.

Answer

- (i) **Determination of how revenue is to be recognised in the books of ABC Ltd. as per expected value method**

Calculation of probability weighted sales volume

Sales volume (units)	Probability	Probability-weighted sales volume (units)
9,000	15%	1,350
28,000	75%	21,000
36,000	10%	3,600
		25,950

Calculation of probability weighted sales value

Sales volume (units)	Price per unit (₹)	Probability	Probability-weighted sales value (₹)
9,000	90	15%	1,21,500
28,000	80	75%	16,80,000
36,000	70	10%	2,52,000
			20,53,500

Average unit price = Probability weighted sales value/Probability weighted sales volume

$$= ₹ 20,53,500 / 25,950 = ₹ 79.13 \text{ per unit}$$

Revenue is recognised at ₹ 79.13 for each unit sold. Sales of 25,950 units (as the question states that ABC Ltd. achieved the same number of units of sales to the customer during the year as initially estimated under the expected value method for the financial year 20X1-20X2) will be booked at ₹ 80 per unit and **liability is accrued for the difference price of ₹ 0.87 per unit** (₹ 80 – ₹ 79.13) and revenue will be deferred.

- (ii) **Journal Entries in the books of ABC Ltd.**

Particulars	₹	₹
-------------	---	---

Bank A/c (25,950 x ₹ 80)	Dr.	20,76,000	
To Revenue A/c (25,950 x ₹ 79.13)			20,53,424
To Liability (25,950 x ₹ 0.87)			22,576
(Revenue recognised on sale of 25,950 units)			
Liability	Dr.	22,576	
To Revenue A/c			22,576
(On reversal of liability at the end of the financial year 20X1-20X2 i.e. after completion of stipulated time)			

Question 31

HT Limited enters into a contract with a customer on 1st April, 20X1 to sell Product A 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 units threshold required for the volume discount in the financial year. HT Limited determines that it has significant experience with this product and with the purchasing pattern of the customer. Thus, HT Limited concludes that it is highly probable that a significant reversal in the cumulative amount of revenue recognised (i.e. ₹ 1,000 per unit) will not occur when the uncertainty is resolved (i.e. when 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 units threshold for the financial year and therefore it will be required to retrospectively reduce the price per unit to ₹ 900.

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

Answer

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

HT Limited recognises 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.

Question 32

On 1st April, 20X1, Entity X enters into a contract with Entity Y to sell mobile chargers for ₹ 100 per charger. As per the terms of the contract, if Entity Y purchases more than 1,000 chargers till March 20X2, the price per charger will be retrospectively reduced to ₹ 90 per unit. Till September 20X1, Entity X sold 95 chargers to Entity Y. Entity X estimates that Entity Y's purchases by March 20X2 will not exceed the required threshold of 1,000 chargers.

In October 20X1, Entity Y acquires another Entity C and from October 20X1 to December 20X1, Entity X sells an additional 600 chargers to Entity Y. Due to these developments, Entity X estimates that purchases of Entity Y will exceed the 1,000 chargers threshold for the period and therefore, it will be required to retrospectively reduce the price per charger to ₹ 90. Analyse the above scenario in light of Ind AS 115 and state how the revenue should be recognised in such a situation.

Answer

Paragraph 56 of Ind AS 115 states that 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 recognised will not occur when the uncertainty associated with the variable consideration is subsequently resolved.

Further, paragraph 57 of Ind AS 115 state that in assessing whether it is highly probable that a significant reversal in the amount of cumulative revenue recognised 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 good 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.

Entity X estimates that the consideration in the above contract is variable. Therefore, in accordance with paragraphs 56 and 57 of Ind AS 115, Entity X is required to consider the constraints in estimating variable consideration. Entity X determines that it has significant experience with this product and with the purchasing pattern of the Entity Y. Thus, if Entity X concludes that it is highly probable that a significant reversal in the cumulative amount of **revenue recognised (i.e. ₹ 100 per unit)** will not occur when the uncertainty is resolved (i.e. when the total amount of purchases is known), then the Entity X will **recognise revenue of ₹ 9,500 (95 chargers x ₹ 100 per charger) for the half year ended 30th September, 20X1.**

Further, paragraphs 87 and 88 of Ind AS 115 that 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.

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 recognised as revenue, or as a reduction of revenue, in the period in which the transaction price changes."

In accordance with the above, in the month of October 20X1, due to change in circumstances on account of Entity Y acquiring Entity C and consequential increase in sale of chargers to Entity Y, Entity X estimates that Entity Y's purchases will exceed the 1,000 chargers threshold till March 20X2 for the period and therefore, it will be required to **retrospectively reduce the price per charger to ₹ 90**.

Consequently, the Entity X will recognise revenue of ₹ 53,050 for the quarter ended December 20X1 which is calculated as follows:

Particulars	Amount in ₹
Sale of 600 chargers (600 chargers x ₹ 90 per charger)	54,000
Less: Change in transaction price for the reduction of revenue relating to units sold till September 20X1 (95 chargers x ₹ 10 price reduction)	(950)
Revenue recognised for the quarter ended December 20X1	53,050

Sale of Product with Financing

Question 33

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 ₹ 1,00,00,000 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, i.e., 10%.

Case B: Contractual discount rate does not reflect the rate in a separate financing transaction, i.e., 14%.

(PVAF of 60 monthly instalments at 10% and 14% interest rate is 47.06547 and 42.97711 respectively)

Answer

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

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

The market terms of the financing mean that the **cash selling price of equipment is ₹ 1,00,00,000**. This amount is **recognised as revenue** and as a loan receivable when control of the equipment transfers to the customer. The entity accounts for the receivable in accordance with Ind AS 109.

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

In evaluating the discount rate in the contract that contains a significant financing component, the entity observes that the 10% contractual rate of interest is significantly lower than the 14% interest rate that would be used in a separate financing transaction between the entity and its customer at contract inception (i.e. the contractual rate of interest of 10% does not reflect the credit characteristics of the customer). This suggests that the cash selling price is less than ₹ 1,00,00,000.

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 **transaction price is ₹ 91,31,347** (60 monthly

payments of ₹ 2,12,470 discounted at 14%). The entity **recognises revenue** and a loan receivable for that amount. The entity accounts for the loan receivable in accordance with Ind AS 109.

Question 34

Grant Limited enters into a contract with a customer to sell a machinery. The machinery is transferred to the customer when the contract is signed. The price as per the contract is ₹ 10.00 lakhs plus contractual rate of interest at 8% per annum, payable in 5 annual equal instalments of ₹ 2,50,438 each. No down payment is envisaged for the sale.

Grant Limited avails loan @ 10% per annum from its banker for similar back-to-back transactions. Statutory Auditors of the Company had advised Grant Limited to recognize the transaction price of the machinery after discounting instalment payments @ 10% per annum and observes that the 8% contractual rate of interest is significantly lower than the 10% interest rate at which company avails loan from its bankers to fund such transactions.

- (i) Determine the transaction price of the machinery if the company accepts the suggestion of the Statutory Auditors of the Company.
- (ii) Should Grant Limited accept the offer of the customer where the customer wants to cancel the contract for payment in instalments and offers a cash price of ₹ 9.65 lakhs.

(Present value of inflow of equated amount stream of annual instalments for 5 years discounted at 10% rate of interest is 3.79 times of the yearly equated instalment amount) (Your response should be as per applicable Ind AS).

Answer

- (i) In evaluating the discount rate in the contract that contains a significant financing component, the entity observes that the 8% contractual rate of interest is significantly lower than the 10% 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 8% does not reflect the credit characteristics of the customer). This suggests that cash selling price is less than ₹ 10 lakhs. Grant Limited determines the transaction price by adjusting the promised amount of consideration to reflect the contractual payments **using the 10% interest rate** that reflects the credit characteristics of the customer. Consequently, the entity determines that the **transaction price is ₹ 9.49 lakhs** (5 annual payments of ₹ 2,50,438 discounted at 10%). The entity **recognises revenue** and a loan receivable for that amount. The entity accounts for the loan receivable in accordance with Ind AS 109.
- (ii) Yes, Grant Limited should **accept the offer** of the customer where the customer wants to cancel the contract for payment in instalments and offers a cash price of ₹ 9.65 lakhs.

Question 35

Mercury Ltd. has sold goods to Mars Ltd. on 1st April, 20X1 at a consideration of ₹ 10,00,000, the receipt of which receivable in three equal installments of ₹ 3,33,333 over a two year period (receipts on 1st April, 20X1, 31st March, 20X2 and 31st March, 20X3).

The company is offering a discount of 5% (i.e. ₹ 50,000) if payment is made in full at the time of sale. The sale agreement reflects an implicit interest rate of 5.36% p.a.

Ind AS 115: Revenue from Contracts with Customers

The total consideration to be received from such sale is at ₹ 10,00,000 and hence, the management has recognised the revenue from sale of goods for ₹ 10,00,000.

Analyse whether the above accounting treatment made by the accountant is in compliance of the Ind AS. If not, advise the correct treatment along with journal entries and extracts of Statement of Profit & Loss and Balance Sheet.

Answer

The revenue from sale of goods shall be recognised at the fair value of the consideration received or receivable. The fair value of the consideration is determined by discounting all future receipts using an imputed rate of interest where receipt is deferred beyond normal credit terms. The difference between the fair value and the nominal amount of the consideration is recognised as interest revenue. Hence, the accounting treatment of recognizing revenue of ₹ 10,00,000 by the accountant is not correct.

The fair value of consideration (cash price equivalent) of the sale of goods to be recognised on the date of sale should be calculated as follows: ₹

Year	Consideration (Installment)	PVF @ 5.36%	Present value of consideration
Time of sale	3,33,333	1.000	3,33,333
End of 1 st year	3,33,333	0.949	3,16,333
End of 2 nd year	3,33,334	0.901	3,00,334
	10,00,000		9,50,000

The Company that agrees for deferring the cash inflow from sale of goods will recognise the revenue from sale of goods and finance income as follows (Journal entries):

Particulars		₹	₹
Initial recognition of sale of goods			
Bank A/c Dr.	3,33,333		
Trade Receivable A/c Dr.	6,16,667		
To Sale A/c			9,50,000
Recognition of interest expense and receipt of second installment			
Bank A/c Dr.	3,33,333		
To Interest Income A/c (6,16,667 x 5.36%)			33,053
To Trade Receivable A/c			3,00,280
Recognition of interest expense and payment of final installment			
Bank A/c Dr.	3,33,334		
To Interest Income A/c (Balancing figure)			16,947
To Trade Receivable A/c (6,16,667 - 3,00,280)			3,16,387

Statement of Profit and Loss (extracts) for year ended 31st March, 20X2 and 31st March, 20X3 ₹

	As at 31 st March, 20X2	As at 31 st March, 20X3
Income		
Sale of Goods	9,50,000	-
Other Income (Finance income)	33,053	16,947

Balance Sheet (extracts) as at 31st March, 20X2 and 31st March, 20X3 ₹

	As at 31 st March, 20X2	As at 31 st March, 20X3
Assets		
Current Assets		
Financial Assets		
Trade Receivables	3,16,387	–

Question 36

A Ltd. is a company which is in the business of manufacturing engineering machines and providing after sales services. The company entered into a contract with Mr. Anik to supply and install a machine, namely 'model pi' on 1st April 20X1 and to service this machine on 30th September 20X1 and 1st April 20X2. The cost of manufacturing the machine to A Ltd. was ₹ 1,60,000.

It is possible for a customer to purchase both the machine 'model pi' and the maintenance services separately. Mr. Anik is contractually obliged to pay A Ltd. ₹ 4,00,000 on 1st April, 20X2.

The prevailing rate for one-year credit granted to trade customers in the industry is 5 percent per six-month period.

As per the experience, the servicing of the machine 'model pi' sold to Mr. Anik is expected to cost A Ltd. ₹ 30,000 to perform the first service and ₹ 50,000 to perform the second service. Assume actual costs equal expected costs. When A Ltd. provides machine services to customers in a separate transaction it earns a margin of 50% on cost. On 1st April, 20X1, the cash selling price of the machine 'model pi' sold to Mr. Anik is ₹ 2,51,927.

The promised supply of machine 'model pi' and maintenance service obligations are satisfactorily carried out in time by the company.

You are required to:

- (i) Segregate the components of the transaction that A Ltd. shall apply to the revenue recognition criteria separately as per Ind AS 115;
- (ii) Calculate the amount of revenue which A Ltd. must allocate to each component of the transaction;
- (iii) Prepare journal entries to record the information set out above in the books of accounts of A Ltd. for the years ended 31st March 20X2 and 31st March 20X3; and

Answer

- (i)** As per para 27 of Ind AS 115, a good or service that is promised to a customer is distinct if both of the following criteria are met:

- (a) the customer can benefit from the good or service either on its own or together with other resources that are readily available to them. A readily available resource is a good or service that is sold separately (by the entity or another entity) or that the customer has already obtained from the entity or from other transactions or events; and
- (b) the entity's promise to transfer the good or service to the customer is separately identifiable from other promises in the contract.

Factors that indicate that two or more promises to transfer goods or services to a customer are separately identifiable include, but are not limited to, the following:

- (a) significant integration services are not provided (i.e. the entity is not using the goods or

services as inputs to produce or deliver the combined output called for in the contract)

- (b) the goods or services does not significantly modify or customize other promised goods or services in the contract.
- (c) the goods or services are not highly inter-dependent or highly interrelated with other promised goods or services in the contract

Accordingly, on 1st April, 20X1, entity A entered into a single transaction with **three identifiable separate components**:

1. **Sale of a good** (i.e. engineering machine);
2. **Rendering of services** (i.e. engineering machine maintenance services on 30th September, 20X1 and 1st April, 20X2); and
3. **Providing finance** (i.e. sale of engineering machine and rendering of services on extended period credit).

(ii) Calculation and allocation of revenue to each component of the transaction

Date	Opening balance	Finance income	Goods	Services	Payment received	Closing balance
1 st April, 20X1	-	-	2,51,927	-	-	2,51,927
30 th September, 20X1	2,51,927	12,596 (Note 1)	-	45,000	-	3,09,523
31 st March 20X2	3,09,523	15,477 (Note 2)	-	-	-	3,25,000
1 st April, 20X2	3,25,000	-	-	75,000	(4,00,000)	

Notes:

1. Calculation of finance income as on 30th September, 20X1 = $5\% \times ₹ 2,51,927 = ₹ 12,596$
2. Calculation of finance income as on 31st March, 20X2 = $5\% \times ₹ 3,09,523 = ₹ 15,477$

(iii) Journal Entries

Date	Particulars	Dr. (₹)	Cr. (₹)
1 st April, 20X1	Mr. Anik Dr. To Revenue - sale of goods (Profit or loss A/c) (Being revenue recognised from sale of machine on credit)	2,51,927	2,51,927
	Cost of goods sold (Profit or loss A/c) Dr. To Inventories (Being cost of goods sold recognised)	1,60,000	1,60,000
30 th September 20X1	Mr. Anik Dr. To Finance Income (Profit or loss A/c) (Being finance income recognised)	12,596	12,596
	Mr. Anik Dr. To Revenue - rendering of services (Profit or loss A/c) (Being revenue of maintenance services recognised)	45,000	45,000
	Cost of services (Profit or loss A/c) Dr. To Bank (Being cost of performing maintenance service recognised)	30,000	30,000

31 st March 20X2	Mr. Anik Dr.	15,477	
	To Finance Income (Profit or loss A/c) (Being finance income recognised)		15,477
1 st April, 20X2	Mr. Anik Dr.	75,000	
	To Revenue - rendering of services (Profit or loss A/c) (Being revenue of maintenance services recognised)		75,000
	Cost of services (Profit or loss A/c) Dr.	50,000	
	To Bank (Being cost of performing maintenance service recognised)		50,000
	Bank Dr.	4,00,000	
	To Mr. Anik (Being the receipt of cash from the customer recognised)		4,00,000

Question 37

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:

- (i) Payment of ₹ 5,000 in two years when the customer obtains control of the asset or
- (ii) 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%, 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.

Answer

Journal Entries showing accounting for the significant financing component

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

Particulars		₹	₹
Bank A/c 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 recognising interest on ₹ 4,000 at 6% for two years:

Particulars		₹	₹
Interest for 1 st Year			

Interest expense	Dr.	240	
To Contract liability			240
($\text{₹ } 4,000 \text{ contract liability} \times 6\%$)			
Interest for 2nd Year			
Interest expense	Dr.	254	
To Contract liability			254
[($\text{₹ } 4,000 + \text{₹ } 240$) $\times 6\%$]			

(c) **Recognise revenue for the transfer of the asset:**

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

Service Concession Arrangement

Question 38

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

- (a) **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 is ₹ 100 crore;
 - Fair Value of the construction services is ₹ 110 crore;
 - Total Cash Flow guaranteed by the Government under 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.
- (b) **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, UK Ltd. has recorded the expenses incurred on the said project as an Intangible Asset.

Required:

- What would be the classification of Bhilwara-Jabalpur Toll Project as per applicable Ind AS? Give brief reasoning.
- What would be the classification of Kolhapur-Nagpur Expressway Toll Project as per applicable Ind AS? Give brief reasoning.
- What should be the accounting entries for the preparation of financial statements as per Ind AS for the above 2 projects.

Answer

- (i) Here the operator has a **contractual right to receive cash** from the grantor. The grantor has little, if any, discretion to avoid payment, usually because the agreement is enforceable by law. The operator has an unconditional right to receive cash if the grantor contractually guarantees to pay the operator. Hence, operator **recognizes a financial asset** to the extent it has a contractual right to receive cash.
- (ii) Here the operator has a **contractual right to charge users of the public services**. A right to charge users of the public service is not an unconditional right to receive cash because the amounts are contingent on the extent that the public uses the service. Therefore, the operator shall **recognise an intangible asset** to the extent it receives a right (a licence) to charge users of the public service.
- (iii) **Accounting treatment for preparation of financial statements**

Bhilwara-Jabalpur Toll Project

Journal Entries

Particulars	Dr. (₹ in crore)	Cr. (₹ in crore)
During construction:		
Financial asset A/c (Debtors) Dr. To Construction revenue (To recognise revenue relating to construction services, to be settled in case)	110	110
Cost of construction (profit or loss) Dr. To Bank A/c (As and when incurred) (To recognise costs relating to construction services)	100	100
During the operation phase:		
Financial asset (Debtors) Dr. To Finance revenue (When received or due to receive) (To recognise interest income under financial asset model)	15	15
Financial asset (Debtors) Dr. To Revenue [(₹ 200 crore – ₹ 110 crore) – ₹ 15 crore] (To recognise revenue relating to the operation phase)	75	75
Bank A/c Dr. To Financial asset (Debtors) (To recognise cash received from the grantor)	200	200

Kolhapur-Nagpur Expressway - Intangible asset

Journal Entries

Particulars	Dr. (₹ in crore)	Cr. (₹ in crore)
During construction:		
Cost of construction (profit or loss) Dr. To Bank A/c (As and when incurred) (To recognise costs relating to construction services)	110	110

Intangible asset To Revenue (To recognise revenue relating to construction services provided for non-cash consideration)	Dr. 	200	200
During the operation phase: Amortisation expense To Intangible asset (accumulated amortisation) (To recognise amortisation expense relating to the operation phase over the period of operation)	Dr. 	200	200
Bank A/c To Revenue (To recognise revenue relating to the operation phase)	Dr. 	?	?

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

Sale of Membership with Annual Renewal Option at Discount

Question 39

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

Answer

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

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

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)

Basis on above, it is to be noted that although entity has collected ₹ 7,500 but revenue can be recognised 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.

Grant of License

Question 40

Determine the revenue recognition and nature of license in the following cases:

- (i) 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.

- (ii) Franchisor Y Ltd. licenses the right to operate a store in a specified location to Franchisee F. The store bears Y Ltd.'s trade name and F will have a right to sell Y Ltd.'s products for 10 years. F pays an up-front fixed fee. The franchise contract also requires Y Ltd. to maintain the brand through product improvements, marketing campaigns etc.

Answer

- (i) Basis 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 good 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.
- (ii) The licence provides F access to the IP as it exists at any point in time in the licence period. This is because:
- Y Ltd. is required to maintain the brand, which will significantly affect the IP by affecting F's ability to obtain benefit from the brand;
 - any action by Y Ltd. may have a direct positive or negative effect on F; and
 - these activities do not transfer a good or service to F.

Therefore, Y Ltd. **recognises the up-front fee over the 10-year franchise period.**

Question 41

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

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 percent of the customer's future sales of products that use Licence B. For purposes of allocation, the entity estimates its sales-based royalties (i.e. the variable consideration) to be ₹ 20,00,000.

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

Case B

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 percent of the customer's future sales of products that use Licence B. The entity's estimate of the sales-based royalties (i.e. 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 recognised for each licence and the contract liability, if any.

Answer

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 (i.e. the sales-based royalties) should be allocated entirely to Licence B. The entity concludes that the criteria are met for the following reasons:

- (a) the variable payment relates specifically to an outcome from the performance obligation to transfer Licence B (i.e. 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.

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 recognise revenue because the consideration allocated to Licence B is in the form of a sales-based royalty. Therefore, the entity recognises revenue for the sales-based royalty when those subsequent sales occur.

When Licence A is transferred, entity recognises as revenue ₹ 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, entity applies the criteria in paragraph 85 of Ind AS 115 to determine whether to allocate the variable consideration (i.e. 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 (i.e. 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 recognise 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 recognises as revenue ₹ 3,33,333 $[(₹ 20,00,000 \div ₹ 36,00,000) \times ₹ 6,00,000]$ allocated to Licence B. When Licence A is transferred, entity recognises as revenue ₹ 2,66,667 $[(₹ 16,00,000 \div ₹ 36,00,000) \times ₹ 6,00,000]$ 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 recognises as revenue ₹ 2,22,222 $[(₹ 20,00,000 \div ₹ 36,00,000) \times ₹ 4,00,000]$ allocated to Licence B (which has been transferred to the customer and is therefore a satisfied performance obligation). The entity recognises a contract liability for the ₹ 1,77,778 $[(₹ 16,00,000 \div ₹ 36,00,000) \times ₹ 4,00,000]$ allocated to Licence A. This is because although the subsequent sale by entity's customer has occurred, the performance obligation to which the royalty has been allocated has not been satisfied.

Bill and Hold Arrangement**Question 42**

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

Answer

In the facts provided above, the entity has made sale of two goods - machine and spare 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:

- (i) **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 recognised on **31st March, 20X3**.
- (ii) **Sale of spare parts:** The customer has made payment for the spare parts and legal title has been passed to specifically identified goods, but such spares continue to be physically held by the entity. In this regard, the company shall evaluate if **revenue can be 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, read for delivery.
(d) 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.

- (iii) **Custodial services:** Such services shall be given for a period of 2 to 4 years from 31st March, 20X3. Where services are given uniformly & customer receive & consume benefit simultaneously, revenue for such service shall be recognized on a straight line basis over a period of time.

Entity Acting as Principal or Agent

Question 43

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

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

Determine whether the entity is a principal or an agent.

Answer

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

- (a) the entity is primarily responsible for fulfilling the contract, which is providing the right to fly. However, the entity is not responsible for providing the flight itself, which will be provided by the airline.
- (b) the entity has inventory risk for the tickets because they are purchased before they are sold to the entity's customers and the entity is exposed to any loss as a result of not being able to sell the tickets for more than the entity's cost.
- (c) the entity has discretion in setting the sales prices for tickets to its customers.

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

Question 44

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 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.
- 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.

Determine whether the D Ltd. is principal or an agent.

Answer

D Ltd. is primarily responsible for fulfilling the promise to provide advertising services. Although F Ltd. delivers the placement service, D Ltd. directly works 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 a principal in this case.**

Sale of Product with Repurchase Agreement**Question 45**

How would the entity account for the following transactions?

- 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.
- 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.

Answer

- 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 repurchase the 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:**
 - Amount received shall be **recognized as 'liability'**.
 - Difference** between sale price and repurchase price to be recognised as **'finance cost'** and recognised over the repurchase term.
- In the above case, where the entity has an obligation to buy back the goods upto a certain date-

- The entity shall evaluate if the customer has a significant economic incentive to return the goods. Since the repurchase price is significantly higher than market price, therefore, customer has a significant economic incentive to return the goods. There are no other factors which entity may affect this assessment.
- Therefore, company determines that 'control' of goods is not transferred to the customer till 31st December, 20X1, i.e., 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 (i.e., ₹ 10,00,000) and repurchase price (i.e., ₹ 9,00,000) **shall be recognized as lease income** over the period of lease.
- At the end of repurchase term, i.e., 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 (i.e., ₹ 9,00,000).

Modification of Service Contract with Customer

Question 46

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.

Answer

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 ₹ 2,70,000, which is 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. ₹ 2,70,000.

Question 47

Entity AB Ltd. enters into a three-year service contract with a customer CD Ltd. for ₹ 4,50,000 (₹ 1,50,000 per year). The standalone selling price for one year of service at inception of the contract is ₹ 1,50,000 per year. AB Ltd. accounts for the contract as a series of distinct services.

At the beginning of the third year, the parties agree to modify the contract as follows:

- (i) the fee for the third year is reduced to ₹ 1,20,000; and
 - (ii) CD Ltd. agrees to extend the contract for another three years for ₹ 3,00,000 (₹ 1,00,000 per year).
- The standalone selling price for one year of service at the time of modification is ₹ 1,20,000. How should AB Ltd. account for the modification? Analyze.

Answer

Paragraph 20 of Ind AS 115, inter alia, states that, “An entity shall account for a contract modification as a separate contract if both of the following conditions are present:

- (a) the scope of the contract increases because of the addition of promised goods or services that are distinct (in accordance with paragraphs 26–30); and
- (b) the price of the contract increases by an amount of consideration that reflects the entity’s stand-alone selling prices of the additional promised goods or services and any appropriate adjustments to that price to reflect the circumstances of the particular contract.

In accordance with the above, it may be noted that a **contract modification should be accounted for prospectively** if the additional promised goods or services are distinct and the pricing for those goods or services reflects their stand-alone selling price.

In the given case, even though the remaining services to be provided are distinct, the modification should not be accounted for as a separate contract because the price of the contract did not increase by an amount of consideration that reflects the standalone selling price of the additional services. The modification would be accounted for, from the date of the modification, as if the existing arrangement was terminated and a new contract created (i.e. on a prospective basis) because the remaining services to be provided are distinct.

AB Ltd. should **reallocate the remaining consideration to all of the remaining services to be provided** (i.e. obligations remaining from original contract and new obligation). AB Ltd. will **recognise a total of ₹ 4,20,000** (₹ 1,20,000 + ₹ 3,00,000) **over the remaining four-year service period** (one year remaining under the original contract plus three additional years), i.e., **₹ 1,05,000 per year**.

Contract Costs

Question 48

Whether the following expenses shall form part of ‘costs incurred to obtain a contract’. Give reasons:

- (i) Commission paid only upon successful signing of the contract;
- (ii) Legal fees for drafting the terms of the arrangement/agreement;
- (iii) Travel expenses of a sales person pitching for a new client contract;
- (iv) Salaries of sales people working exclusively on obtaining new clients;
- (v) Bonus based on quarterly sales;
- (vi) Commission paid to sales manager which is based on contracts obtained.

Answer

Table showing expenses whether forming part of ‘Cost to obtain a Contract’

S. N.	Cost	Capitalize or	Reason
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Ind AS 115: Revenue from Contracts with Customers

		expense/cost to obtain a contract	
(i)	Commission paid only upon successful signing of a contract	Capitalize/Yes	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.
(ii)	Legal fees for drafting terms of agreement	Capitalize/Yes	If the agreement is approved and signed, then it is an incremental cost which needs to be capitalised.
(iii)	Travel expenses for a salesperson pitching a new client contract	Expense/No	Because costs are incurred regardless of whether new contract is won or lost, the entity expense out the costs, unless they are expressly reimbursable.
(iv)	Salaries for salespeople working exclusively on obtaining new clients	Expense/No	Salaries are incurred regardless of whether contracts are won or lost and therefore are not incremental costs to obtain the contract.
(v)	Bonus based on quarterly sales	Capitalize/Yes	Bonuses based solely on sales are incremental costs to obtain a contract.
(vi)	Commission paid to sales manager based on contracts obtained	Capitalize/Yes	The commissions are incremental costs that would not have been incurred had the entity not obtained the contract.

Question 49

Customer outsources its information technology data centre.

Term = 5 years plus two 1 year 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

How should such costs be treated?

Answer

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	

Section B – Fully Irrelevant Theoretical Questions

Question 1

New Way Ltd. decides to enter a new market that is currently experiencing economic difficulty and expects that in future economy will improve. New Way Ltd. enters into arrangement with a customer in the new region for networking products for promised consideration of ₹ 12,50,000. 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 recognise this transaction.

Answer

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

Question 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.

Answer

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

Question 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.

Answer

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

Question 4

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

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

Answer

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

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

Question 5

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 or voice call services or both.

Are the performance obligations under the contract distinct?

Answer

Entity promises to customer to provide

- Broadband Service
- Voice Call services
- Modem

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

- Customer can benefit from the good or service either on its own or together with other resources that are readily available to the customer, and
- Entity's promise to transfer the good or service to the customer is separately identifiable from other promises in the contract

For broadband and voice call services

- Broadband and voice services are separately identifiable from other promises as company has various plans to provide the two services separately. These two services are not dependant or interrelated. Also, the customer can benefit on its own from the services received.

For sale of modem

- Customer can either buy product from entity or third party. No significant customisation or modification is required for selling product.

Based on the evaluation we can say that there are three separate performance obligation:

- Broadband Service
- Voice Call services
- Modem

Question 6

(SM)

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?

Answer

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

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

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

Question 7

(SM)

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

Answer

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

Question 8

(SM)

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

The design and construction of the shopping centre and parking facility involves multiple goods and

services from architectural consultation and engineering through procurement and installation of all of the materials. Several of these goods and services could be considered separate performance obligations because Entity A frequently sells the services, such as architectural consulting and engineering services, as well as standalone construction services based on third party design, separately. Entity A may require to continually alter the design of the shopping centre and parking facility during construction as well as continually assess the propriety of the materials initially selected for the project.

Determine how many performance obligations does the entity A have?

Answer

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.

Question 9

(SM)

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?

Answer

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

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

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

- The software license
- An installation service

- Software updates
- Technical support

Question 10**(SM)**

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). 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?

Answer

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

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

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

- (a) customised installation service (that includes the software license);
- (b) software updates; and
- (c) technical support.

Question 11**(SM)**

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.

Answer

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 recognise revenue on its cable television service regardless of the contract's time period.

Question 12

(SM)

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?

Answer

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.

Question 13

(SM)

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?

Answer

V Ltd. concludes that the licence and the updates are capable of being distinct because the anti-virus software can still deliver its original functionality during the licence period without the updates. C can also benefit from the updates together with the licence transferred when the contract is signed.

However, 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.

Question 14**(SM)**

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?

Answer

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.
- 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.

Question 15**(SM)**

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?

Answer

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 telephone support as a separate performance obligation in the transaction with D.

Question 16**(SM)**

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?

Answer

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 recognised when control of the vehicle is transferred to the dealer. Revenue from the maintenance services is recognised separately as and when the maintenance services are provided to the retail customer.

Question 17

(SM)

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?

Answer

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.
- 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.

Question 18

(SM)

A property sale contract includes the following:

- (a) Common areas
- (b) Construction services and building material
- (c) Property management services
- (d) Golf membership
- (e) Car park
- (f) Land entitlement

Analyse whether the above items can be considered as separate performance obligations as per the requirements of Ind AS 115?

Answer

Paragraph 22 of Ind AS 115 provides that at contract inception, an entity evaluates the promised goods or services to determine which goods or services (or bundle of goods or services) are distinct and therefore constitute a performance obligation.

A performance obligation is a promise in a contract to transfer to the customer either:

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

As per paragraph 27 of Ind AS 115, a good or service that is promised to a customer is distinct if both of the following criteria are met:

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

Each performance obligation is required to be accounted for separately.

Based on the above guidance, the following table discusses whether the common goods and services in property sale contract should be considered as separate performance obligation or not:

Goods/ Service	Whether a separate Performance obligation (PO) or not	Reason
Common areas	Unlikely to be separate PO	Common areas are unlikely to be a separate performance obligation because the interests received in common areas are typically undivided interests that are not separable from the property itself. However, if the common areas were sold separately by the developer, then they could be considered as a separate performance obligation provided that it is distinct in the context of the contract.
Construction services and building material	Unlikely to be separate PO	Construction services and building materials can meet the first criterion as they are items that can be used in conjunction with other readily available goods or services. However, the developer would be considered to be providing a significant integration service as it is bringing together all the separate elements to deliver a complete building.
Property management services and Golf membership	Likely to be separate PO	Property management services and golf membership are likely to be separate performance obligations as they may be used in isolation or with the property already acquired, i.e., management services can be used with the property. These types of services are not significantly customised, integrated with, or dependent on the property. This is because there is no change in their function with or without property. Also, property management service could be undertaken by third party.
Car park and Land entitlement	Analysis required	Items such as car parks and land entitlements generally meet the first criterion, i.e., capable of being distinct - as the buyer benefits from them on their own. Whether second criterion is met depends on facts and circumstances.

		For example, if the land entitlement can be sold separately or pledged as security as separate item, it may indicate that it is not highly dependent on, or integrated with, other rights received in the contract. In an apartment scenario, the customer can receive an undivided interest in the land on which the apartment block sits. This type of right is generally considered as highly inter-related with the apartment itself.*
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*However, if title to the land is transferred to the buyer separately, for example in a single party development, then the separately identifiable criterion may be met.

PS: Other facts and circumstances of each contract should also be carefully examined to determine performance obligations.

Question 19

(SM)

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?

Answer

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

Question 20

(SM)

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 Deshabandhu. How revenue for these non-monetary transactions in area of advertising will be recognised and measured?

Answer

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".

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.

Question 21**(SM)**

XYZ Limited enters into a contract with a customer to build a sophisticated machinery. The promise to transfer the asset is a performance obligation that is satisfied over time. The promised consideration is ₹ 2.5 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.

Answer

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

- (a) the entity decides to use the expected value method to estimate the variable consideration associated with the daily penalty or incentive (i.e. ₹ 2.5 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.

Question 22

(SM)

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 at least ₹ 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?

Answer

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.

Question 23

(SM)

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 percent 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 consideration.

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

Answer

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 recognised would not occur if the entity included its estimate of the management fee or the incentive fee in the transaction price.

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 recognised 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 recognises ₹ 2 crore as revenue for the quarter ended 31st March, 20X2.

Question 24**(SM)**

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?

Answer

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 recognised over the remaining term of the contract. If, in this question, 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 recognise the credit over the remaining term of the contract.

Question 25**(SM)**

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 contract or not.

Answer

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.

Question 26**(SM)**

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.

Answer

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.

Question 27

(SM)

An EPC contractor enters into a two-year contract to develop customized machine for a customer. The contractor concludes that goods and services in this contract constitute 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 holdback payment, there is gap between when control transfers and when consideration is received, creating financing component.

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

Answer

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.

Question 28

(SM)

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.

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.

Answer

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 transaction price.

Question 29

(SM)

A computer hardware vendor enters into a three-year arrangement with a customer to provide support services. For customers with low credit ratings, the vendor requires the customer to pay for the entire arrangement in advance of the provision of service. Other customers pay over time.

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

Answer

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.

Question 30

(SM)

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 time of buying product. Consideration for service is an additional ₹ 3,000. Customers electing to buy this service must pay for it upfront (i.e., monthly payment option is not available).

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

Answer

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 payment. Finally, the entity would incur higher administration costs such as cost related to administering renewal 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.

Question 31**(SM)**

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 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.

Answer

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

Question 32**(SM)**

A commercial airplane component supplier enters into a contract with a customer for promised consideration of ₹ 70,00,000. Based on an evaluation of the facts and circumstances, the supplier concluded that ₹ 1,40,000 represented a insignificant financing component because of an advance payment received in excess of a year before the transfer of control of the product.

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

What if the advance payment was larger and received further in advance, such that the entity concluded that ₹ 14,00,000 represented the financing component based on analysis of the facts and circumstances.

Answer

The entity may conclude that ₹ 1,40,000, or 2 percent 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 percent of the contract price, is significant, and the entity should adjust the consideration promised in determining the transaction price.

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

Question 33**(SM)**

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 percent (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.

Answer

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 percent (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.

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

Question 34**(SM)**

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

Answer

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

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

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

Question 35**(SM)**

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 ₹ 100 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?

Answer

The entity shall determine if revenue should be recognised 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 customer through the year. Therefore, best measure of progress is to recognise revenue on a straight line basis over the year.

Question 36**(SM)**

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 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?

Answer

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.

Question 37**(SM)**

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 % margin. The 15% 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?

Answer

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

- Criterion (a): whether the customer simultaneously receives and consumes the benefits from services provided by AFS: Company shall benefit only when the audit opinion is provided upon completion. And in case the contract was to be terminated, 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 contract was early terminated, for reasons other than AFS's failure to perform. And the profit margin approximates what entity otherwise earns.

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

Question 38**(SM)**

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

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

Answer

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

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

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

Question 39**(SM)**

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.

Answer

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.
- 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 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 criterion under para 35 is not satisfied. Thus, revenue cannot be recognised over a period of time.

Question 40

(SM)

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 recognised.

Answer

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 recognises 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.

Question 41

(SM)

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.

Answer

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.

Question 42

(SM)

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 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 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?

Answer

- (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 recognised 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 good or a service to M as they occur (i.e. the team playing games does not transfer a good 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.

Question 43

(SM)

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.

Answer

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 recognises revenue as the dresses are sold to the end customer.

Question 44**(SM)**

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?

Answer

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.

Question 45**(SM)**

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?

Answer

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

Question 46**(SM)**

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 systems at a deep discount if both P and Q purchases the security system.

Should these contracts be combined or separately accounted?

Answer

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

Question 47

(SM)

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.

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 percent 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. recognise revenue from sale of machinery to P Ltd. in accordance with Ind AS 115?

Answer

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 (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 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 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 recognised, 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 recognise 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 recognise 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 recognised 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 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.

Question 48**(SM)**

An entity promises to sell 120 products to a customer for ₹ 1,20,000 (₹ 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 stand-alone selling price.

Determine the accounting for the modified contract.

Answer

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.

Question 49

(SM)

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

Determine appropriate method of amortisation.

Answer

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.