Ind As 115 - Revenue from contracts with customer

Party contracted with Entity to obtain Goods/services that are output of Entity's Ordinary activities in Exchange for Consideration.

Note : Ind As 115 applies only if counterparty is a Customer.

To Recognise Revenue Entity should apply Five steps Model

Step 1 : Identify contract with customers

⟨ Japan ltd entered into contract to sell lift, installation of lift and 5year maintenance services ⟩

Step 2 : Identify Performance obligations in the contract.

⟨ P.O. - 1) Lift 2) Installation of lift 3) 5years Maintenance services ⟩

Step 3 : Determine Transaction Price

⟨ Expected Consideration (T.P.) — ₹ 50,00,000 ⟩

Step 4 : Allocate transaction Price to Performance obligations

⟨ Allocation - 1) Lift - 40,00,000 2) Installation - 200000 3) maintenance - 800000 ⟩

Step 5 : Recognize Revenue when Entity satisfies Performance Obligations.

1) 25th March 2001 (Control of Lift transferred) → Revenue Recognized - ₹ 40,00,000
2) 10th April 2001 (Installation completed) → Recognize Revenue - ₹ 200000
3) ₹ 800000 recognized over a period of 5 years.

Step 1 - identify the Contract {Written, Oral or Customary Business Practices}

Agreement betⁿ Two or more Parties that creates enforceable rights & obligations.

Contract exists only when arrangement meets All Five Criteria

1) All parties Approved the Contract (And Committed)
2) Can identify each party's rights regarding goods/services to be transferred.
3) Identify Payment terms
4) Contract has Commercial Substance

   {Prevent Entities from transferring goods or services to each other for little or no consideration to artificially inflate their revenue.}

5) Probable that Entity will collect substantially all consideration.

   {To Assess Collectibility, check customer Intention & Ability to Pay.}

The Entity Can recognise revenue even if contract do not exist in below cases:

1) Contract do not exist but Goods/services transferred and has no remaining obligations and substantially All consideration received and is Non Refundable.

2) Contract do not exist but whatever contract done is now terminated and Consideration received is Non Refundable.

Step 2- identifying Performance obligations

Explicit or Implicit

In cases where Multiple Goods or Services are Promised in a single Contract, Entity shall Identify whether there are more than one performance obligation.

⟨Eg. Promise in a single contract to Provide Software, Installation, 3 yrs Maintenance and technical Support⟩

Performance obligations defined as a Promise with a Customer to transfer either:-

A) Distinct Goods or service

B) A series of distinct Goods or services that are substantially the same and have same pattern of transfer to the Customer.

A. Distinct Performance obligations

Kya wo separately sell hote he

Promised Goods/services are Distinct if both criteria met :-

(i) Good or Services is Capable of being distinct i.e.

— Customer Can benefit from the individual good or services on its own, OR,

— Together With other readily available resources ⟨Eg. Pendrive Lectures, software⟩

Good or Service that is Sold separately or Customer has already obtained from Entity or from other transaction/events.

ii) Separately Identifiable from other promises in the Contract which includes :-

a) Significant Integration services not Provided ⟨Eg. Personal Computer, Water Purification⟩

Eg. - Water Purification Plant where Company is responsible for all aspects incl. Engineering and Design services, Procurement of Pumps, Physical constⁿ Site Preparation, testing water Quality and the integration of all Components.

b) One good or service do not significantly modify or customise other good or service.

Contract to transfer software licence, perform installation and provide technical support for 5 years. However as part of installation, software to be substantially customise to add new functionality to enable the software to interface with other customised software application used by customer.

c) Goods or services are not highly interdependent or interrelated.

Contract to provide pendrive lectures, software licence and books which are highly interdependent or interrelated

Few Points from Illustrations

1) Entity provides broadband, voice call and modem separately (911-LL)

2) Design and construct multiple level shopping centre with customer car parking where entity may require to continually alter the design of shopping centre and parking facility during construction. {Highly interrelated & significant customisation / modification}

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

There might be cases where distinct goods or services are provided continuously over a period of time. {E.g. Security services, Book keeping, Hotel Management service etc.}

If consumption of those service is symmetrical, it is considered as single performance obligation satisfied over a period of time.

Step 2 - Crux

1st condition

Good or services Distinct if → Benefit on its own or Together with other readily available resources.

Sold separately

2nd condition

a) Significant Integration service not provided.

b) One good or service do not significantly Modify | customise other good or service

c) Not Highly Inter related or Inter dependent.

Computer

- Mother Board ✓
- RAM ✓
- Hard disk ✓
- Monitor ✓
- UPS. ✓
- keyboard ✓
- Mouse ✓
- Assembly ✓

5000

Capable of being distinct

Not computer but collection of spare parts of computer

⇓

8 separate P.O

If computer but not collection of spare parts

⇓

i.e. significant Integration service

⇓

Single Performance obligation

E.g.: Lenskart

Customer option for Additional goods & services (Gift Cards, loyalty Points)

If Entity Grants Additional right to customer which is material, such right is a separate Performance obligation.

E.g. Sale of Product A = ₹ 1000 Consideration. (S.A.P = ₹ 1000)

9/11-23 Discount on Future Purchase = 40% (Normal Discount on all future sales = 10%)

80% chances that customer will redeem Discount & Average purchase ₹ 500.

Soln

500 × 80% = 400
× 30%
120

2 Performance obligation

1st P.O. — Product A = ₹ 1000
2nd P.O. — Future Discount = ₹ 120 (500 × 80% × 30%)
₹ 1120

Total Consideration Received = ₹ 1000

Product A
($1000 \times \frac{1000}{1120}$)
₹ 892 =
Recognize Revenue when Product A control is transferred.

Future Discount
($1000 \times \frac{120}{1120}$)
₹ 108
Recognize Revenue when customer redeem Discount or when it expires.

Bank A/c	1000	
To Revenue		892
To Contract Liability		108

Consignment Arrangements ⟨Deliver on Consignment Basis to distributor, dealer⟩

Agreement between Consignee and Consignor for the storage, transfer, sale, or resale and use of the goods.

Indications to evaluate whether Arrangement is a consignment arrangement

1. Product controlled by Entity until sale to a customer or specified Period expires.
2. Entity able to require return or transfer of Product to another dealer.
3. No unconditional obligation for the dealer to pay for the product

Revenue not recognized for consignment when goods delivered to consignee because control not yet transferred. {It is recognized when control transferred}

But in case of sale with right to return, revenue is recognized because control is transferred ⟨Here customer decides whether to put back goods to seller⟩

9|1|25

E.g. Consignor deliver 1000 dresses to Consignee @ ₹ 20 per dress which consignee shall pay when dress sold to End Customer. Consignor has right to require ret? on transfer to another dealer. State whether control transferred? — NO.

Principal VS Agent consideration

When other parties are involved in Providing goods or services to Entity's Customer, the entity determine whether its Performance obligation is ÷

To Provide Good or Service itself {Principal}

⇓

Revenue Recognized is the Gross Amount to which entity expects to be entitled.

To arrange for another party to Provide Good or Service. {Agent}

⇓

Revenue Recognized is the Net Amount {Entity's Fee or Commission}

** Indications that Entity is a Principal includes ÷

1. Entity is Primarily responsible for Fulfilling the contract.
2. The Entity has inventory risk
3. Entity has discretion in establishing Prices for Goods | Services.

Non refundable upfront fees

{Club Membership Joining fees, Telecom service Activation fees}

↓

Does the fee relate to specific goods or services transferred to customer?

Yes

Account for as a promised good or service

NO

Account for as Advance Payment for future good or service.

Eg. Customer buys New Data Connection and pays one time registration. The Customer will be charged based on Data usage on monthly basis.

Here, customer will not benefit just from buying data card and data service.
The Activity of registering and activating connection is not a service to customer and therefore does not represent satisfaction of performance obligation.

STEP 3 - DETERMINING TRANSACTION PRICE

The next step is to determine transaction price.
The transaction price is the amount of consideration to which entity expects to be entitled in exchange for goods/services. {Excl. GST}
The consideration promised may include - Fixed Amounts, Variable Amounts or Both.

When determining transaction price, Entity shall consider effects of :-

1) Variable Consideration	2) Significant Financing Component.
3) Non cash consideration	4) Consideration payable to customer.

1) Variable Consideration { Incentives, Performance Bonus, Price concessions, refunds, Credits, Penalties etc. }

↓

It may be fixed in Amount but Entity's right to receive is contingent on a future outcome. {Eg :- Fixed Performance Bonus received only if target is met}

Variable consideration is estimated using either of the following methods

1. Expected Value Method	2. Most Likely Amount
E.V.M is appropriate when Entity has large number of contracts with similar characteristics {more than two possible outcomes}	M.L.A is appropriate if contract has only two possible outcomes.

Note: The choice is based on the method which better predicts the amount of consideration to be entitled. {i.e. No Free choice}

Eg.

Contract Fixed Consideration — 25 Crore

Variable Consideration

1) 15% Bonus if completed by 30th month — 25% chance
   10% Bonus if completed by 32nd month — 40% chance
   5% Bonus if completed by 34th month — 15% chance

More than two outcomes → Expected Value Method

2) Quality Bonus of ₹ 2 crore if Inspector assign gold star rating — 60% chance {2 possible outcome → Most likely Amount}

Soln

Fixed consideration — 25cr

(+) Variable Consideration included in Transaction price

Bonus (Expected Value Method)

$= 3.75 \times 25\% + 2.5 \times 40\% + 1.25 \times 15\% + 0 \times 20\% = 2.125$

Quality Bonus (Most likely Amount)

60% Prob. of getting ₹ 2 crore (More likely) = 2 — 4.125

29.125

Refund Liabilities {contract liability}

Entity shall recognise a refund liability if it expects to refund some amount of consideration received. Refund liability is updated at the end of each reporting period. {Say Amount received ₹ 100000, Refund expected = ₹ 15000}

∴ Revenue Recognised = ₹ 85000, Refund liability = ₹ 15000

Example (Q11 31): Entity sold 10 units of Product A for ₹ 1000 per unit. If a customer purchase more than 100 units in a F.Y., Price is retrospectively reduced to ₹900 per unit. For the 1st Q Ended 30th June, Entity sells 10 units in total and estimates that purchase will not exceed 100 units. {i.e. it is Highly Probable that significant reversal in Amount of Revenue will not occur when uncertainity is resolved}

1st Q Ended – Revenue Recognized {10 units × 1000} = ₹ 10000

Further in 2nd Q ended 30th sept, Entity sold 50 more units. In the light of New Fact, Entity estimates that customer purchase will exceed 100 units for the F.Y. and therefore require to retrospectively reduce price/unit to ₹ 900.

2nd Q Ended – Revenue Recognised {50 units × 900 – 10 units × 100} = 44000

Refund liability (Contract liability) {60 units × 100} = 6000

Reassessment of Variable Consideration

At Each Reporting Period end, Entity shall UPDATE estimated transaction Price. {including updating its assessment of whether Est. of Variable Consideration is constrained.}

Q11 32 (V.V.Imp)

Example – Fixed Fee Contract – ₹ 10,00,000, Estimated Cost to Complete = ₹ 950000

Incentive Award ⇒ Wt. 951 or Greater = 0% = ₹ NIL
Wt. 701 – 950 = 10% = ₹ 100000
Wt. 700 or less = 25% = ₹ 250000

} Variable Consideration.

1st 3 years, Entity believes that it will achieve ₹ 100000 incentive fees.

At 4th yr end, " " " " " " ₹ 250000 " ".

Cost Incurred: Yr. 1 ₹ 50000 (5.263%), Yr. 2 ₹ 175000 (18.421%), Yr. 3 – ₹ 400000 (42.105%)

Yr. 4 ₹ 275000 (28.947%), Yr. 5 ₹ 50000 (5.263%).

Solⁿ

Ill. 32 Revenue to be recognised — Revenue — Cost — Margin

1st yr ⇒ $\langle 1000000 + 100000 \rangle \times \frac{50000}{950000}$ = 57895 − 50000 = 7895 (13.63%)

2nd yr → $\langle 1000000 + 100000 \rangle \times \frac{175000}{950000}$ = 202632 − 175000 = 27632 (13.63%)

3rd yr → $\langle 1000000 + 100000 \rangle \times \frac{400000}{950000}$ = 463158 − 400000 = 63158 (13.63%)

4th yr → $\langle 1000000 + 250000 \rangle \times \frac{275000}{950000}$ = 361842

$150000 \times \frac{625000}{950000}$ = 98684

460526 − 275000 = 185526 (40.28%)

ICAI 186216

5th yr → $\langle 1000000 + 250000 \rangle \times \frac{50000}{950000}$ = 65789 − 50000 = 15789 (24%)

300000

Sale with a right of return ⟨Refund against return, credit, Another Product in Exchange⟩

In such cases, Revenue Recognition shall be as per the substance of the arrangement.

Substance is that of Consignment Sale

⇓

Account as per Guidance related to Consignment Sales.

Other cases

⇓

To Account for sales with a right of return, Recognise all of the following :-

a) Revenue Excl. Products expected to be returned.

b) Refund liability*

c) Asset for its right to recover product on settling refund liability

Note*: An entity shall update refund liability at each reporting period end and correspondingly adjust revenue.

E.g. Sale of 1000 products @ ₹ 50 each {Entity's cost of each product is ₹ 30}
Customer can refund within 30 days and receive full refund. Using expected value method, Entity estimates that 970 products will not be returned.

Soln Revenue = {970 x 50} = ₹ 48500

Refund liability = {30 x 50} = ₹ 1500

Asset {right to recover products} = {30 x 30} = ₹ 900

Accounting for restocking fees for goods expected to be returned

Fees levied to compensate entity for cost of repackaging, shipping, reselling at lower price to customer.

Restocking fees for goods expected to be returned included in transaction price at contract inception and recorded as revenue when control of goods transfers.

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

Warranties

Some warranties provide customer with assurance that product will function as the parties intended because it complies with agreed upon specifications

{Assurance type Warranty}

⇓

Customer does not have option to purchase separately

⇓

Account as per Ind AS 37

Other warranties provide customer with service in addition to the assurance

{Service type Warranty}

⇓

Customer has option to purchase separately.

⇓

Account for promised warranty as P.O. and allocate a portion of transaction price to that P.O. {Ind As 115}

Notes

1) If warranty is required by law, it is not a P.O. because it exist to protect customer from risk of purchasing defective products. (Assurance Warranty)

2) The longer the coverage period, the more likely that promised warranty is a P.O. because it is more likely to provide a service in addition to assurance warranty.

3) If Entity promises both Assurance type and service type warranty but cannot reasonably account separately, Entity shall account for both warranties as a single P.O.

E.g. Total transaction Price for Sale of Computer & 3yrs Extended Warranty = ₹ 36000
(9/135) Assurance warranty provided for First 90 Days.
Stand Alone Price → Computer = 32000, Extended Warranty = 4000
Entity Estimates it will incur ₹ 2000 to repair defects within 1st 90 Days.

Soln

Total Transaction Price (36000)

Computer with Assurance Warranty (₹ 32000)

Journal

Bank a/c 32000
To Revenue 32000

Warranty Exp 2000 (P/L)
To Accrued Warranty (Prov.) 2000 (Liab)

Extended service Warranty (₹ 4000)

Journal

Bank 4000
To Contract Liability 4000

2.Significant financing component

The contract contains a significant financing component if –

(i) Customer pays before entity performs its obligation {Customer loan to Entity} Int Exp

(ii) Customer pays after entity performs its obligation ⟨ Entity loan to customer⟩ Int Income

Objective : To recognise revenue at cash price equivalent amount which would have received at the time of transferring control of goods or services.

The financing component is presented separately from Revenue. It is recognised as Interest expenses or interest income using effective interest method as per Ind AS 109.

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

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

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

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

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

E.g. Cash Selling Price = ₹ 100000

Promised Consideration payable after 2 years = Cash Price + 10% interest
{$100000 \times (1.10)^2$} = 121000

CASE 1

10% interest rate is commensurate with the rate that would be reflected in a separate financing transaction

∴ Transaction Price = $\frac{121000}{(1.10)^2}$ = 100000

Financing Element = 21000

CASE 2

14% interest rate is commensurate with the rate that would be reflected in a separate financing transaction)

∴ Transaction Price = $\frac{121000}{(1.14)^2}$ = 93105

Financing Element = 27895

Journal Entries		
0th Receivables	100000	
To Revenue		100000
1st Receivables	10000	
To Interest Income (P/L)		10000
2nd Receivables	11000	
To Interest Income (P/L)		11000
2nd Bank	121000	
To Receivables		121000

Journal Entries		
Receivables	93105	
To Revenue		93105
Receivables	13035	
To Interest Income (P/L)		13035
Receivables	14860	
To Interest Income (P/L)		14860
2nd Bank	121000	
To Receivables		121000

Ind AS 115 Contains Overriding Provisions which specifies that contract would not have significant financing component if any below factor exists :-

a) Customer at his discretion Paid in Advance {E.g. Prepaid Recharge Card}

b) Substantial Consideration Promised by customer is variable and timing of that consideration varies on the basis of occurrence or Non occurrence of a Future event not within the Control of Customer or Entity {E.g. Sales Based Royalty}

c) Financing component may arises from reason other than Finance
{For E.g. Payment terms might Protect Entity or Customer from other Party failing to adequately complete its obligations under Contract.

3. Non cash consideration {Shares of common stock, Equity Instt., Equipment etc.}

To determine transaction Price, an Entity shall

a) Measure Non Cash Consideration at Fair Value. {F.V. of NCC Receivable}

b) If Cannot reliably estimate Fair Value, measure Consideration by reference to stand-alone selling price of good or service.

Subsequent Measurement of Non cash Consideration

Fair Value of Non Cash Consideration Varies after Contract inception because of its form. {E.g. Change in Price of a share}	Fair Value of Non Cash Consideration Varies other than only the form of consideration {E.g. due to Entity's performance.}
⇓	⇓
The entity does not adjust transaction Price	Apply the Guidance on Variable consideration and the constraint when determining transaction price.

Customer Provided goods or Services {E.g. Material, labour or Equipment}

Assess whether it Obtains Control of those contributed Goods or services

↓

YES

↓

Account for Contributed goods or Services as Non Cash Consideration received from customer. (Part of T.P.)