

Ind AS - 18 & Ind AS - 11

Revenue Recognition and Construction Contracts

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Agenda

- ▶ **Revenue recognition – current scenario**
- ▶ Revenue recognition under Ind AS 18
- ▶ Key GAAP differences – AS 9 vs. Ind AS 18
- ▶ Construction contracts – Ind AS 11

Revenue recognition - current scenario

- ▶ India defers adoption of Ind AS 115 due to concerns raised by industry
 - ▶ key issues:
 - ▶ identification of performance obligation
 - ▶ variable consideration
 - ▶ modification accounting
 - ▶ disclosures
 - ▶ adoption ahead of the rest of the world when the Standard itself is changing globally
 - ▶ As a consequence, ICAI issued Ind AS 11 and Ind AS 18
- ▶ IASB already deferred IFRS 15 by a year to 2018

Agenda

- ▶ Revenue recognition – current scenario
- ▶ **Revenue recognition under Ind AS 18**
- ▶ Key GAAP differences – AS 9 vs. Ind AS 18
- ▶ Construction contracts – Ind AS 11

Scope

Accounting for revenue arising from:

- ▶ sale of goods
- ▶ rendering of services
- ▶ use by others of entity assets yielding
 - ▶ interest and
 - ▶ Royalties

Out of scope

- ▶ dividends (Ind AS 109)
- ▶ measurement of interest (Ind AS 109)
- ▶ lease agreements (Ind AS 17)
- ▶ insurance contracts (Ind AS 104)
- ▶ changes in fair value of financial assets/ liabilities or their disposal (Ind AS 109)
- ▶ changes in value of other current assets
- ▶ biological assets related to agricultural activity (Ind AS 41)
- ▶ initial recognition of agricultural produce (Ind AS 41)
- ▶ extraction of mineral ores (Ind AS 106)

Definition

- ▶ **Income-** increases in economic benefits during the accounting period in the form of
 - ▶ inflows or
 - ▶ enhancements of assets or
 - ▶ decreases of liabilities
- that result in increases in equity, other than
- ▶ those relating to contributions from equity participants

Definition

▶ Revenue-

- ▶ Revenue is the gross inflow of economic benefits during the period
- ▶ arising in the course of the ordinary activities of an entity
- ▶ when those inflows result in increases in equity, other than
 - ▶ increases relating to contributions from equity participants.

Recognising revenue from sale of goods

Recognise revenue when all conditions met:

- ▶ Transfer of significant risks and rewards of ownership
- ▶ Neither continuing managerial involvement nor effective control
- ▶ Probable future economic benefits
- ▶ Reliable measurement of revenue
- ▶ Reliable measurement of costs

Transfer of risk and rewards of ownership

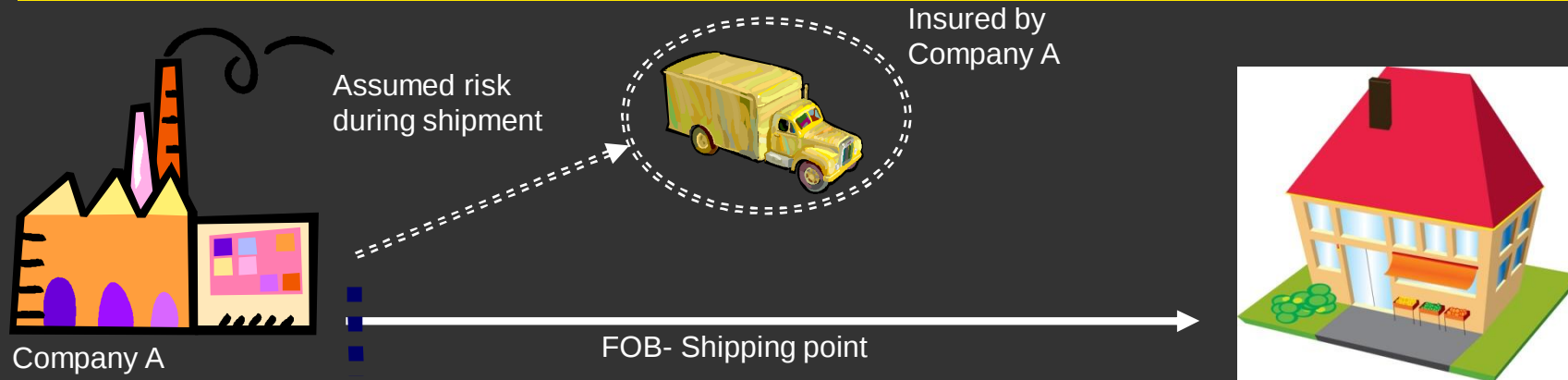
Most cases

- ▶ Coincides with transfer of legal title or passing of possession

Other cases – consider!

- ▶ Significant performance obligations
 - ▶ Installation
 - ▶ Inspection
- ▶ Warranty obligations
 - ▶ Abnormal warranty obligations
 - ▶ Extended warranty
- ▶ Receipt of revenue depends on buyer making a sale
- ▶ Right of return
- ▶ Sales with buyback arrangements
 - ▶ Repurchase options

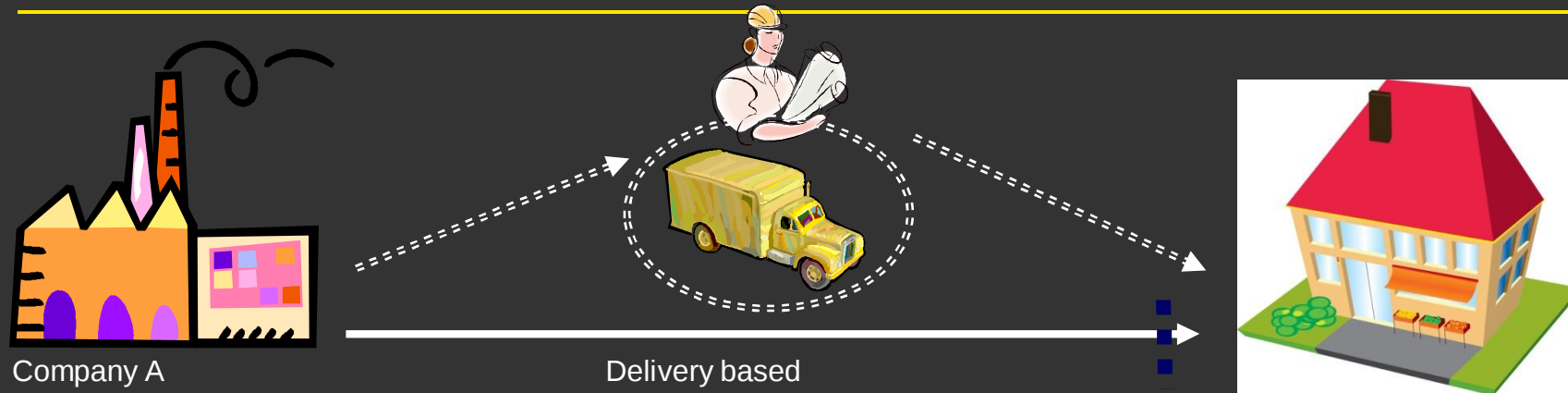
GOODS SHIPPED FOB SHIPPING POINT BUT SELLER ARRANGES SHIPPING



Can Company A recognise revenue once its products have been shipped?

No. While title has passed, Company A has retained a significant risk of ownership. The fact that Company A's insurance would cover a substantial loss is evidence that it has managed its risk, but Company A has still retained the risk.

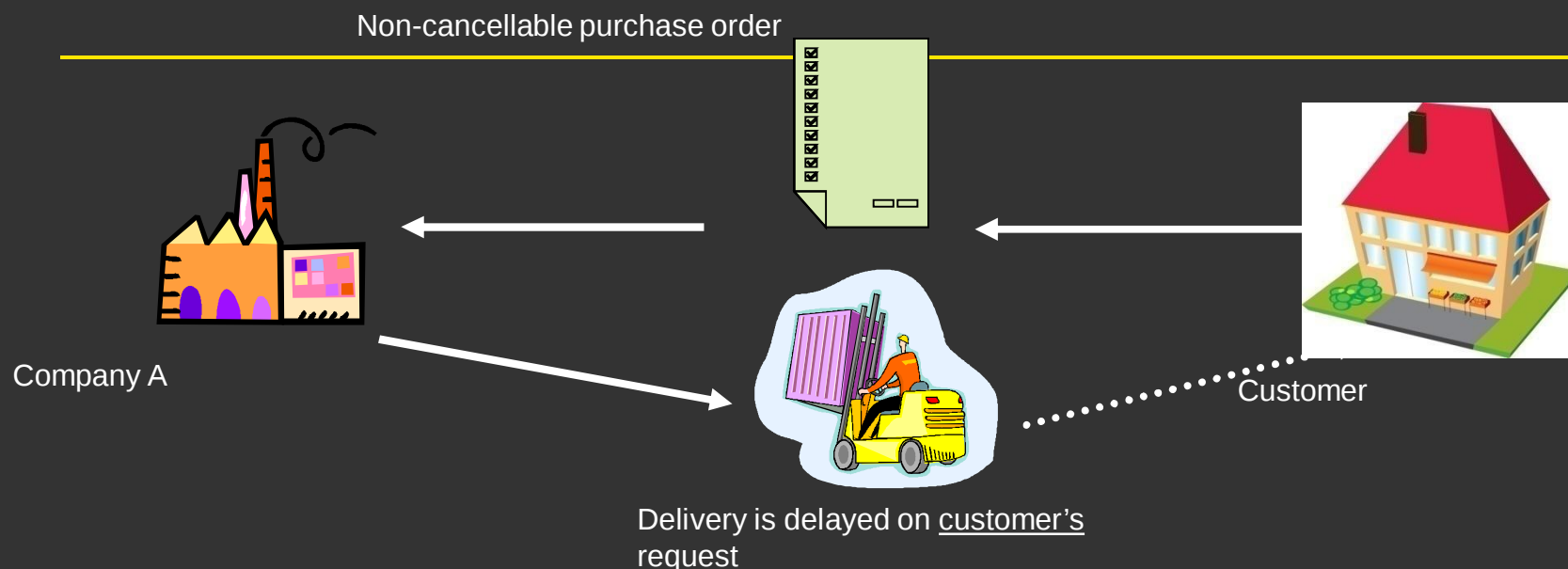
GOODS SHIPPED FOB DESTINATION BUT SHIPPING COMPANY ASSUMES RISK



Can Company A recognise revenue once its products have been shipped?

No. While Company A has managed its risk, it has not transferred risk to the buyer.

BILL AND HOLD SALES



Revenue can only be recognized only if the following are met :

- Delivery is probable
- Item is identified and ready for delivery
- Buyer specifically acknowledges the deferred delivery instructions
- Usual payment terms apply
- Buyer must have a substantial business purpose for bill and hold basis

Case study - 1

Warranty obligations

Facts

- ▶ A Ltd. sells 100 ultra-life batteries for INR 20 each and provides the customer with a five-year guarantee that the batteries will withstand the elements and continue to perform to specifications.
- ▶ A Ltd., which normally provides a one-year guarantee to customer purchasing ultra-life batteries, determines that years two through five represent a separate performance obligation.
- ▶ A Ltd. determines that INR 1,700 of the INR 2,000 transaction price should be allocated to the batteries and INR 300 to the service warranty.
- ▶ A Ltd.'s normal one-year warranty cost is INR 1 per battery.

Question

- ▶ How should A Ltd. account for the above transaction?

Case study - 1

Warranty obligations

Accounting

- ▶ Upon delivery of the batteries, A Ltd. should record the following entry:

Dr. Cash/ Receivables	2,000	
Cr. Revenue		1,700
Cr. Deferred revenue (service warranty)		300
Dr. Warranty expense	100	
Cr. Accrued warranty costs (assurance warranty)		100

- ▶ Contract liability should be recognised as revenue over the service warranty period (i.e., years 2-5).
- ▶ Costs of providing the service warranty should be recognised as incurred.
- ▶ Assurance warranty obligation is relieved 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.

Case study - 2

Right of return

Facts

- ▶ Company X dealing in electronics has a general policy regarding return of goods. If the customer is not satisfied with the product, he may return the product to the company within six months of the sale and the company refunds the amount paid by the customer for purchase of the product.

Question

- ▶ What is the impact of the 'right of return' available to customers on revenue recognition?

Case study - 2

Right of return

Solution

- ▶ Test of 'transfer of significant risks and rewards' to be applied
- ▶ Recognise revenue at the time of sale provided:
 - ▶ future returns can be reliably estimated, and
 - ▶ liability for returns recognised based on previous experience, etc. as a reduction from revenue

OTHER SPECIFIC CASES

Event	Revenue recognition
Consignment sales	Revenue is recognised by the shipper when the goods are sold by the recipient to a third party.
cash on delivery sales.	Revenue is recognised when delivery is made and cash is received by the seller or its agent.

Measurement of revenue

Overall principle

- ▶ Fair value* of consideration received or receivable
 - ▶ net of related taxes (e.g., VAT), trade discounts and volume rebates
 - ▶ at present value if payment deferred beyond normal credit terms

Challenging areas

- ▶ Discounts and rebates
- ▶ Deferred payment terms
- ▶ Non-cash transaction

** as per Ind AS 113*

Deferred consideration



When effectively a financing transaction

- ▶ Fair value of consideration determined by discounting future receipts
 - ▶ using imputed rate of interest
- ▶ Difference in fair value and nominal amount recognised as interest
 - ▶ as per 'effective interest rate' method

Case study - 4

Deferred consideration

Facts

- ▶ A Ltd. sells goods on extended credit
- ▶ The goods are sold for INR 10,000 with a 2-year credit period
- ▶ The customer can generally borrow @ 10% p.a.

Question

- ▶ How should A Ltd. recognise revenue in such a case?

Solution

- ▶ On transaction date, INR 8,265 is recognised as revenue
- ▶ Balance INR 1,735 is recognised as interest revenue over the 2 years period

Prompt settlement discounts

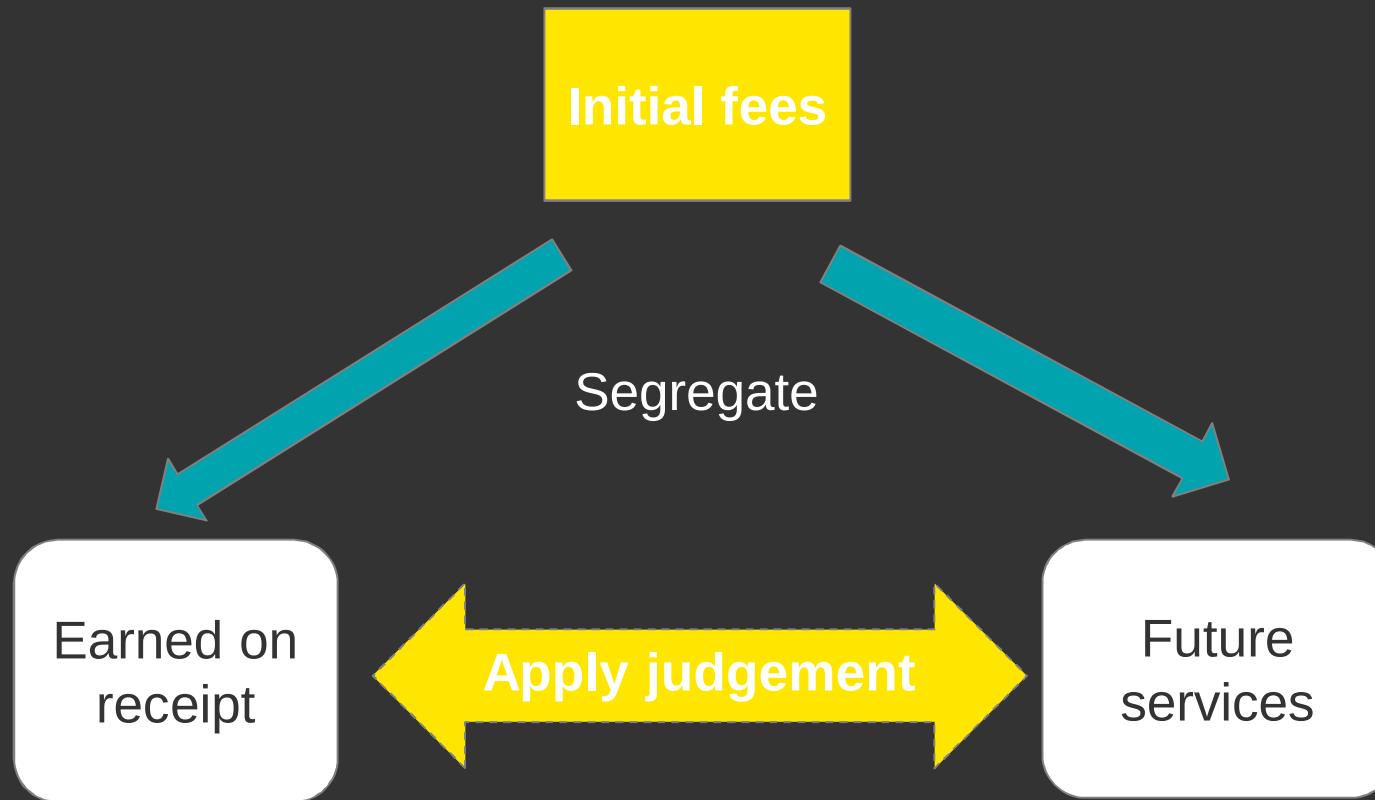
- ▶ To be deducted from revenue

Example

- ▶ On 1 January 2015, A Ltd. has made a sale of its mobile phone to Mr. X at a price of INR 10,000 with a payment term of 60 days (usual credit term). However, if Mr. X pays the amount within 7 days, A Ltd. will grant a discount of 5%.

In such a case, A Ltd. should recognise revenue of INR 9,500 at the time of sale.

Receipt of initial fees



Case study - 5

Receipt of initial fees

Facts

- ▶ A Ltd., a music company, enters into an arrangement with its customer, B Ltd.
 - ▶ Scenario I: A Ltd. to make its current product (past recordings) available and also required to make future products available to B Ltd. in exchange for an upfront payment
 - ▶ Scenario II: There is no expectation or obligation to provide future content

Question

- ▶ Determine the timing of revenue in each of the above scenarios.

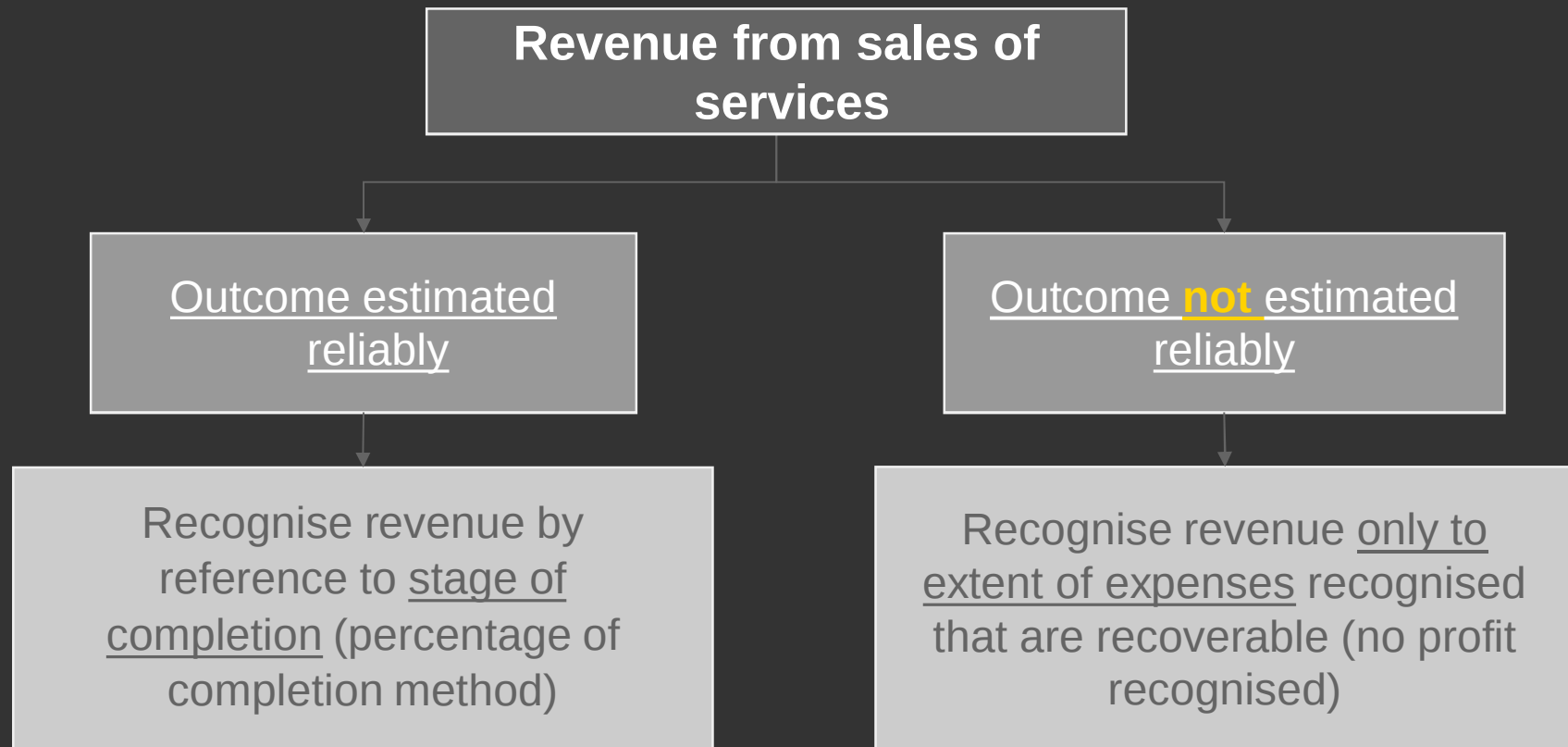
Case study - 5

Receipt of initial fees

Solution

- ▶ Scenario I: Revenue will be recognised over the term of the arrangement.
- ▶ Scenario II: Revenue will be recognised once the product has been made available to B Ltd.

Recognising revenue from sale of services



Reliable estimate of outcome

Factors to be considered:

- ▶ Reliable measurement of revenue
- ▶ Probable future economic benefits
- ▶ Reliable measurement of stage of completion
- ▶ Reliable measurement of costs (incurred and costs to complete)

Revenue recognition in case of specified services

Indeterminate no. of acts over a specified period

- ▶ Revenue recognised on a straight-line basis
 - ▶ Exception: Other method better represents stage of completion

Specified act much more significant than any other acts

- ▶ Revenue postponed until the significant act is executed

OTHER SPECIFIC CASES

Event	Revenue recognition
Installation fees.	Recognised as revenue by reference to the stage of completion of the installation, unless they are incidental to the sale of a product, in which case they are recognised when the goods are sold.
Advertising commissions.	when the related advertisement or commercial appears before the public
Insurance agency commissions.	recognised as revenue by the agent on the effective commencement or renewal dates of the related policies
Fees from the development of customised software.	recognised as revenue by reference to the stage of completion

OTHER SPECIFIC CASES

Event	Revenue recognition
Initiation, entrance and membership fees.	depends on the nature of the services provided If the fee permits only membership, and all other services or products are paid for , the fee is recognised as revenue when no significant uncertainty as to its collectibility exists. If the fee entitles the member to services or publications to be provided during the membership period, or to purchase goods or services at prices lower than those charged to non-members, it is recognised on a basis that reflects the timing, nature and value of the benefits provided.

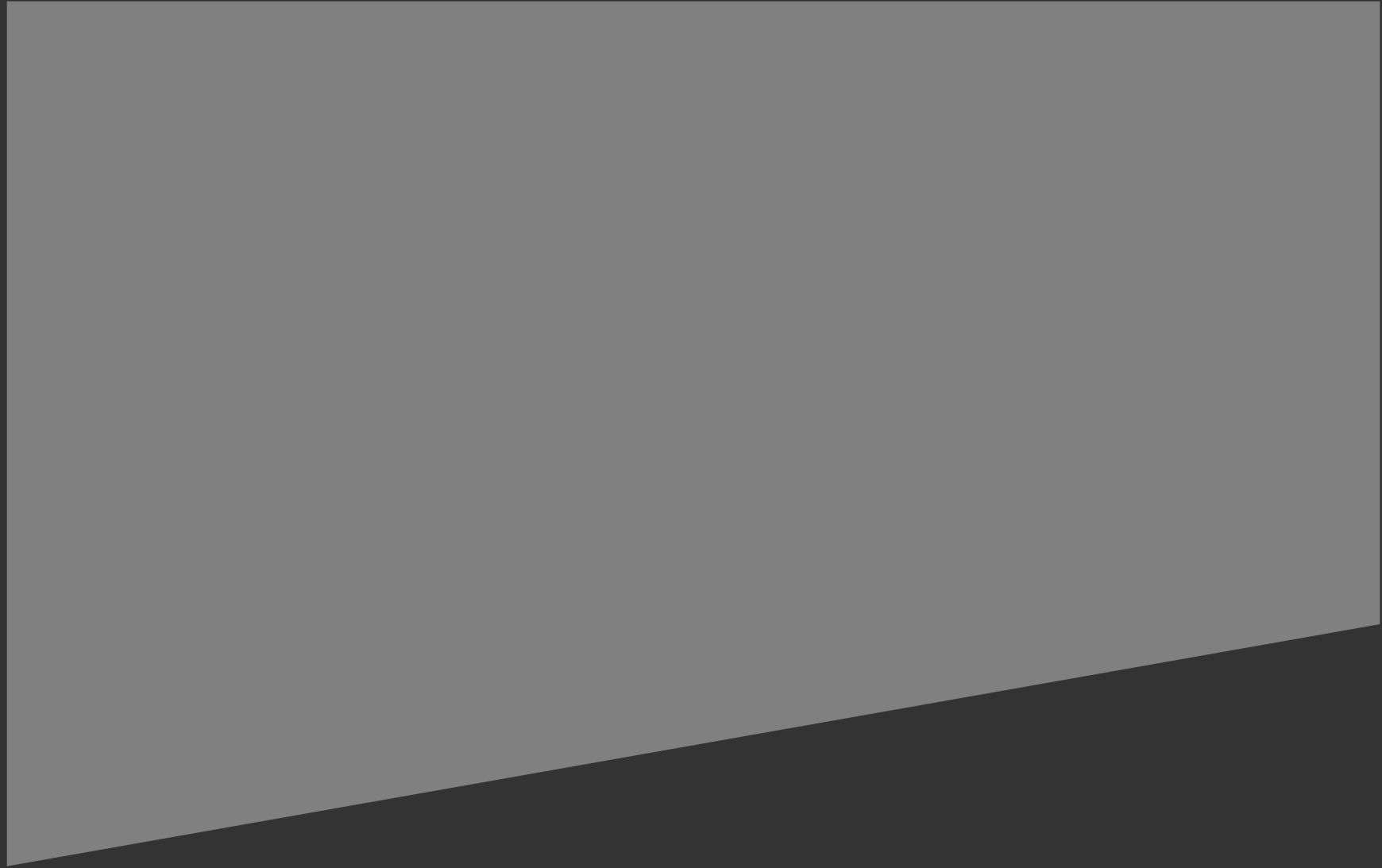
OTHER SPECIFIC CASES

Event	Revenue recognition
Fees that are an integral part of the effective interest rate of a financial instrument.	treated as an adjustment to the effective interest rate However, when instrument is measured at FVTPL, fees are recognised as revenue when instrument is initially recognised.
Commission on the allotment of shares to a client.	when the shares have been allotted.

OTHER SPECIFIC CASES

Event	Revenue recognition
Placement fees for arranging a loan between a borrower and an investor	The fee is recognised as revenue when the loan has been arranged.
Loan syndication fees.	A syndication fee received by an entity that arranges a loan and retains no part of the loan package for itself (or retains a part at the same effective interest rate for comparable risk as other participants) is compensation for the service of syndication. Such a fee is recognised as revenue when the syndication has been completed.

Other revenue



Interest and royalties

Recognition

- ▶ Probable future economic benefits
- ▶ Reliable measurement of revenue

Measurement

Income	Measurement base
Interest	<u>Effective interest method</u> (as per Ind AS 109)
Royalties	<u>Accrual basis</u> in accordance with substance of the agreement

Case study - 6

Receipts for out-licensing

Background

- ▶ ABC and XYZ enter into an agreement in which ABC will license XYZ's know-how and technology to develop and manufacture a new product in the market.
- ▶ ABC will use XYZ's technology in its facilities for a period of 3 years. XYZ will have to keep the technology updated and in accordance with ABC's requirements only during this 3-year period.
- ▶ XYZ obtains a non-refundable upfront payment of INR 30 lacs for access to the technology.
- ▶ XYZ will also receive a royalty of 20% from sales of the product, if ABC successfully develops the product.
- ▶ 20% royalty is in line with other comparable royalty arrangements entered into by ABC.

Case study - 6

Receipts for out-licensing

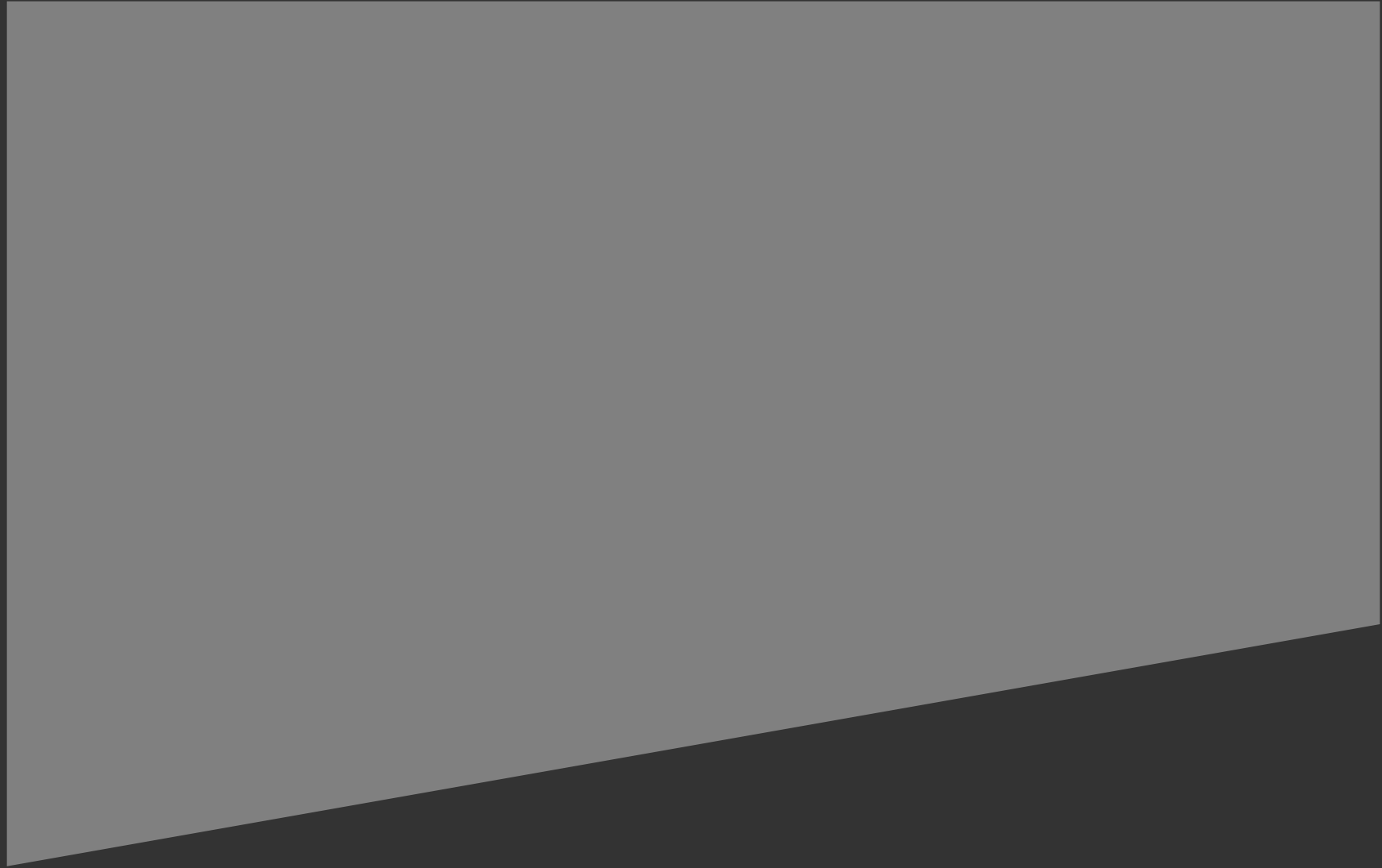
Question

How should XYZ account for a non-refundable upfront fee received for licensing out its know-how and technology to a third party?

Solution

- ▶ recognise non-refundable upfront fee on a straight-line basis over 3 years
- ▶ recognise royalty based on sale as revenue earned

Special revenue recognition issues



Principal vs Agent evaluation

Principal-agent relationship

In an agency relationship

- ▶ amounts collected on behalf of principal are not revenue
- ▶ Instead, revenue is the amount of commission

When is an entity acting as a principal?

- ▶ When it has exposure to significant risks and rewards associated with sale of goods or rendering or services

Principal vs Agent evaluation

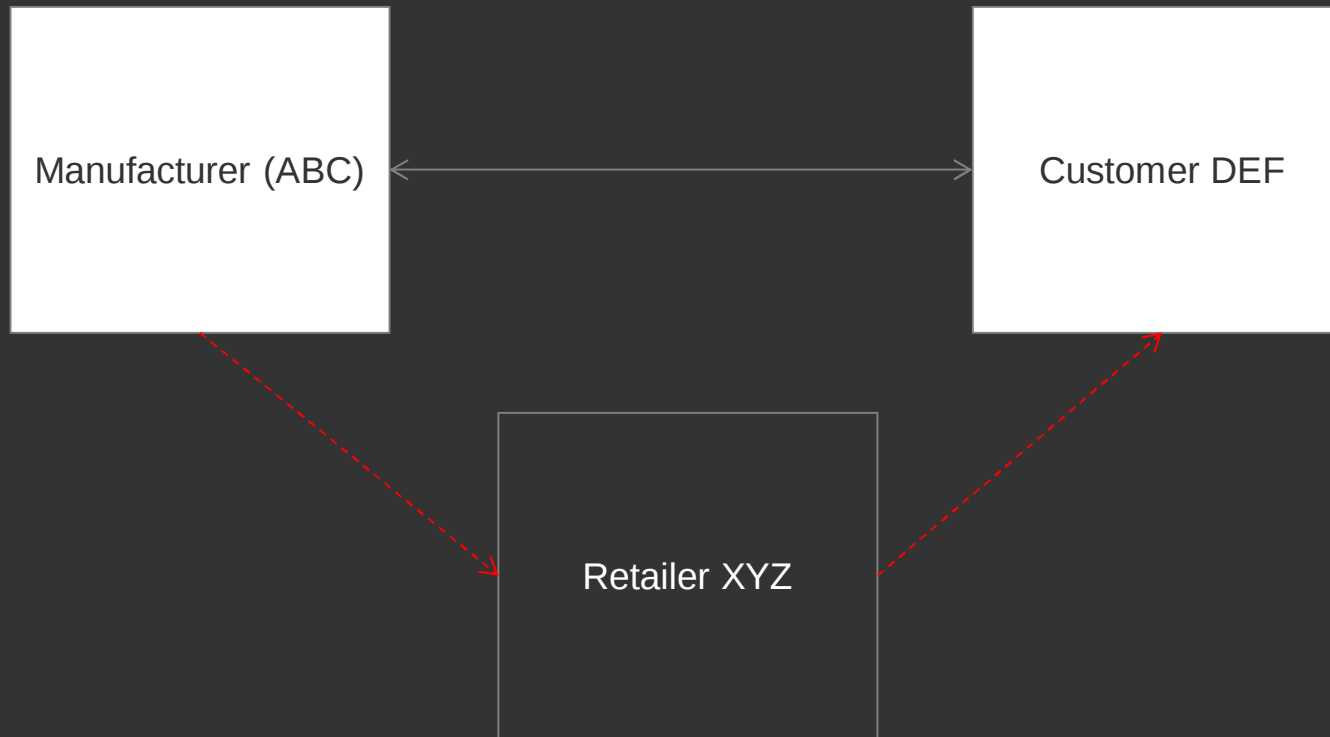
Indicators that an entity is acting as a principal

The entity:

- ▶ has primary responsibility for providing goods or services
- ▶ has inventory risk
- ▶ has latitude in establishing prices
- ▶ bears customer's credit risk

Case study - 7

Revenue recognition



Whether XYZ is an agent or a principal?

Case study - 7

Revenue recognition

- ▶ ABC has entered into contract with customer DEF to supply specified grocery products at the agreed rate. Both the parties have agreed that the products will be supplied through retailer XYZ.
- ▶ DEF can place direct order to ABC or through XYZ.
- ▶ XYZ exclusively work for ABC to supply products to customers.
- ▶ XYZ maintains inventory of 15-30 days to meet emergency orders and requirements from customers.
- ▶ ABC raises invoice in the name of XYZ while supplying the products.
- ▶ ABC pays commission to XYZ.
- ▶ XYZ can return the goods within 6 months of expiry period.

Whether XYZ is an agent or a principal?

Case study - 7

Revenue recognition

Points for consideration:

Factor	Points for consideration
Primary responsibility	Primary responsibility seems to be with ABC
Inventory risk	Although XYZ is maintaining inventory, he has the right to return stocks to ABC
Pricing latitude	Pricing latitude seems to be with ABC, as ABC has entered into contract with DEF
Credit risk	Credit risk seems to be with ABC

Thus, XYZ is an agent of ABC.

OTHER SPECIFIC CASES

Event	Revenue recognition
Sales to intermediate parties, such as distributors, dealers or others for resale.	Revenue from such sales is generally recognised when the risks and rewards of ownership have passed. However, when the buyer is acting, in substance, as an agent, the sale is treated as a consignment sale.

Identifying the transaction

- ▶ Transaction to be analysed as per its ***economic substance*** to determine whether it should be
 - ▶ combined
 - ▶ segmentedfor revenue recognition

When to combine?

- ▶ When transactions are linked in such a way that
 - ▶ commercial effect cannot be understood without reference to series of transactions as a whole
- ▶ Example - Sale of goods and at the same time, entering an agreement to repurchase the goods at a later date
- ▶ Criteria in Ind AS 11 may be useful (**refer section on construction contracts**)

Case study - 8

Identifying the transaction

Facts

- ▶ A Ltd., a software company, enters into a contract to license its CRM software to its customer B Ltd.
- ▶ Three days later, in a separate contract, A Ltd. agrees to provide consulting services to significantly customise the licensed software to function in B Ltd.'s IT environment.
- ▶ B Ltd. is unable to use the software until the customisation services are complete.

Question

- ▶ Does A Ltd. have to combine the two contracts under Ind AS 18?

Yes

Bundled offers/ multiple arrangements

- ▶ **A bundled offer is:**
 - ▶ a transaction with several deliverables
 - ▶ also referred to as a “multiple-element arrangement”
- ▶ Total consideration allocated to individual elements using:
 - ▶ relative fair value approach, or
 - ▶ residual value approach

Bundled offers/ multiple arrangements

- ▶ Method of allocation:
 - ▶ consistently applied to similar transactions
 - ▶ adequately disclosed
 - ▶ in accounting policy and notes to financial statements

Case study - 9

Multiple arrangements

Facts

- ▶ A Ltd. enters into an agreement with B Ltd. to sell hardware, professional services and maintenance services for INR 200,000.
- ▶ A Ltd. determines that each of the promised goods or services represents a separate performance obligation.
- ▶ Because A Ltd. frequently sells professional services and maintenance on a standalone basis, it uses those transactions to determine standalone selling prices of INR 25,000 and INR 15,000, respectively.

Case study - 9

Multiple arrangements

Facts

- ▶ A Ltd. rarely sells the hardware on a standalone basis, so it estimates the standalone selling price at INR 185,000 based on the hardware's underlying cost, the entity's targeted margin and the amount of margin the entity believes the market will bear.

Question

- ▶ How should the total consideration be allocated to different deliverables?

Case study - 9

Multiple arrangements

Allocation of consideration *(using relative fair value approach)*

Performance obligation	Estimated standalone selling price	% of relative selling price	Allocated discount	Allocation of transaction price
Hardware	INR 185,000	82.2	INR 20,600	INR 164,400
Professional services	INR 25,000	11.1	INR 2,800	INR 22,200
Maintenance services	INR 15,000	6.7	INR 1,600	INR 13,400
Total	INR 225,000	100.0	INR 25,000	INR 200,000

Case study - 10

Multiple arrangements

Facts

- ▶ Assume the same facts as in previous case study, except the arrangement also includes software for a total fee of INR 250,000.
- ▶ A Ltd. determines the software deliverable is also a separate performance obligation.
- ▶ A Ltd. never sells the software on a standalone basis.
- ▶ A Ltd. has bundled the software into a number of different arrangements with the pricing for that element ranging from INR 15,000 to INR 125,000.

Question

- ▶ How should the total consideration be allocated to different deliverables?

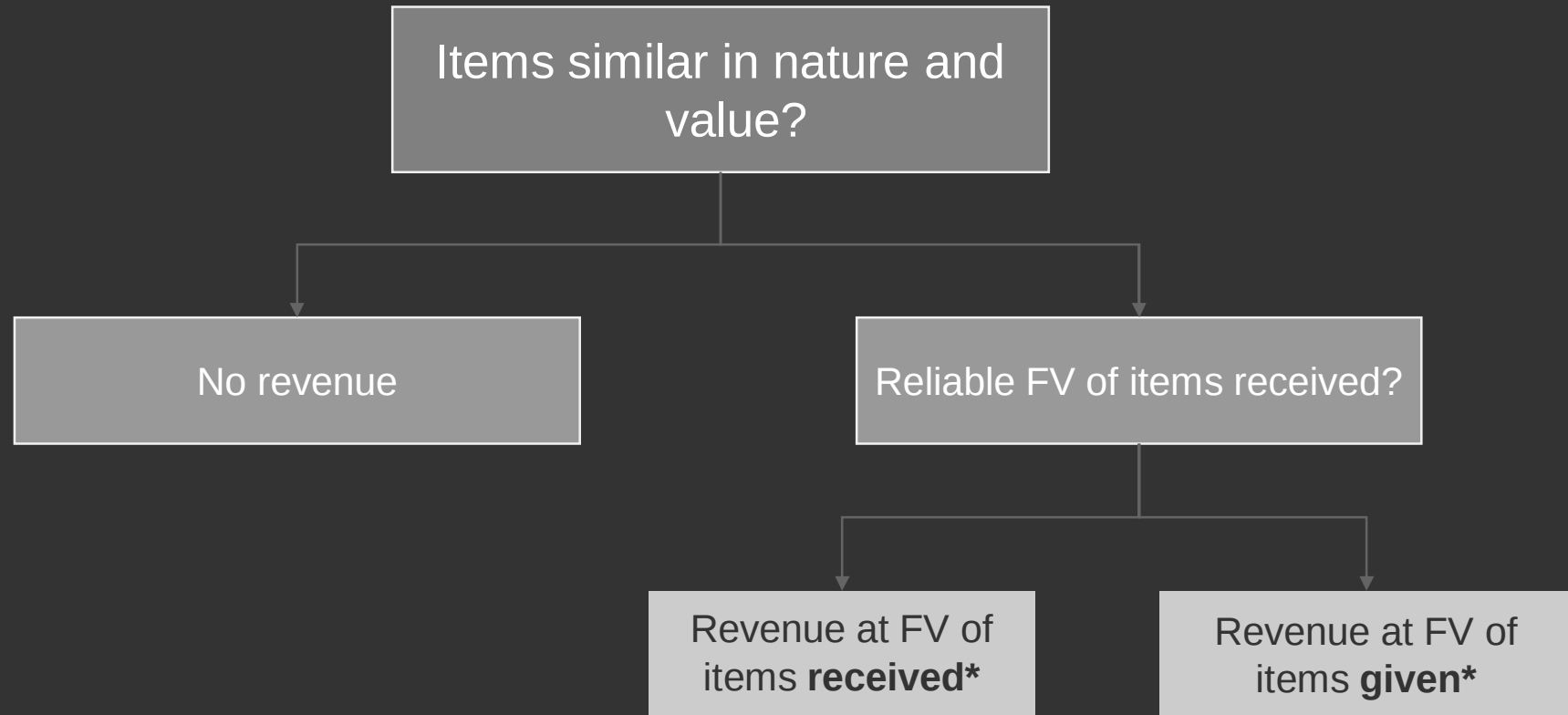
Case study - 10

Multiple arrangements

Allocation of consideration (*using residual fair value approach*)

Particulars	INR
Total arrangement consideration	2,50,000
Less: Estimated standalone selling prices of:	
Hardware	1,85,000
Professional services	25,000
Maintenance services	15,000
Standalone selling price of software	25,000

Barter transactions



** Adjusted by cash/ cash equivalents transferred*

Customer loyalty programmes- IFRIC 13

Scope

- ▶ Grant of award credits to customers as part of sale (therefore, not a marketing expense) and customers can redeem them, subject to conditions, for free or discounted goods and services

Recognition

- ▶ Award credits are accounted for as a separately identifiable component of the initial sales transaction



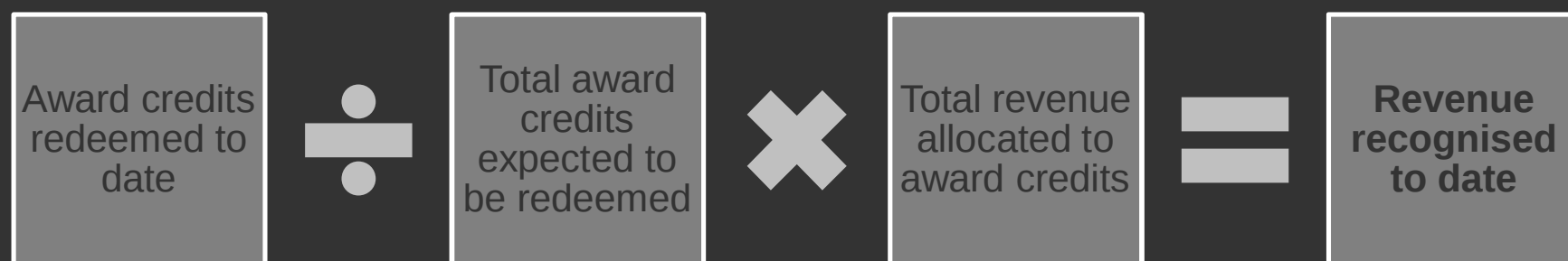
Customer loyalty programmes

- ▶ The transaction price is allocated to performance obligations (including the option) based on relative standalone selling prices
- ▶ Estimate (fair value) of standalone selling price of **option** reflects the discount a customer receives when exercising the option, adjusted for –
 - ▶ any discount that the customer would receive without exercising the option and
 - ▶ the likelihood the option will be exercised

Recognition of consideration allocated to award credits

If entity supplies awards

- ▶ Revenue is recognized when future goods and services are transferred (i.e. when award credits are redeemed) or when the option expires



Recognition of consideration allocated to award credits

If third party supplies awards

- ▶ Assess whether acting as principal or as an agent
- ▶ If agent, then net amount is recognised as revenue (i.e. difference between revenue allocated to award credits and amount entity pays to the third party to supply the awards)
- ▶ Entity satisfies its performance obligation when the points are transferred to the customer, as opposed to when the customer redeems the points with the third party
- ▶ Entity recognises a liability for the amount the entity expects to pay to the party that will redeem the points

Case Study - 11

Supply of awards by entity

Facts

- ▶ A grocery retailer operates a customer loyalty programme. It grants customers loyalty points (with no expiry date) when they spend a specified amount on groceries which can be redeemed for further groceries.
- ▶ **Beginning of year 1**
Entity granted 100 points; management expects 80 points to be redeemed, fair value of each loyalty point to be INR 1.25

Case Study - 11

Supply of awards by entity

Facts

- ▶ **End of year 1**

40 points redeemed

- ▶ **End of year 2**

41 points redeemed; management revises its expectations- expects 90 points to be redeemed altogether

- ▶ **End of year 3**

9 points redeemed; management expects that no more points will be redeemed after year 3

Case Study - 11

Supply of awards by entity

Accounting

- ▶ **Beginning of year 1**

Defer revenue of INR 100 (i.e., 80 points $\times$ INR 1.25)

- ▶ **End of year 1**

Recognise revenue of INR 50 (i.e., 40 points / 80 points $\times$ INR 100)

- ▶ **End of year 2**

Total no. redeemed is 81 points (i.e., 40 + 41)

Cumulative revenue = INR 90 (i.e., 81 points / 90 points $\times$ INR 100)

Revenue to be recognised = INR 40 (since INR 50 already recognised)

- ▶ **Year 3**

Cumulative revenue = INR 100 (i.e., 90 points / 90 points $\times$ INR 100)

Revenue to be recognised = INR 10 (since INR 90 already recognised)

Case Study - 12

Supply of awards by third party

Facts

- ▶ A Ltd. participates in a customer loyalty programme operated by an airline. It grants customers one airmile with each INR 1 they spend on its products. Customers can redeem the airmiles for air travel with the airline. A Ltd. pays the airline INR 0.009 for each airmile.
- ▶ In one period, A Ltd. sells products for consideration totalling INR 10 lacs and grants 10 lacs airmiles. A Ltd. estimates that the fair value of an airmile is INR 0.01.

Case Study - 12

Supply of awards by third party

Accounting

- ▶ **Allocation of consideration to airmiles**

A Ltd. allocates INR 10,000 (i.e., 10 lacs $\times$ 0.01)

- ▶ **Revenue recognition**

Recognise revenue from airmiles on sale of goods

- ▶ **Revenue measurement**

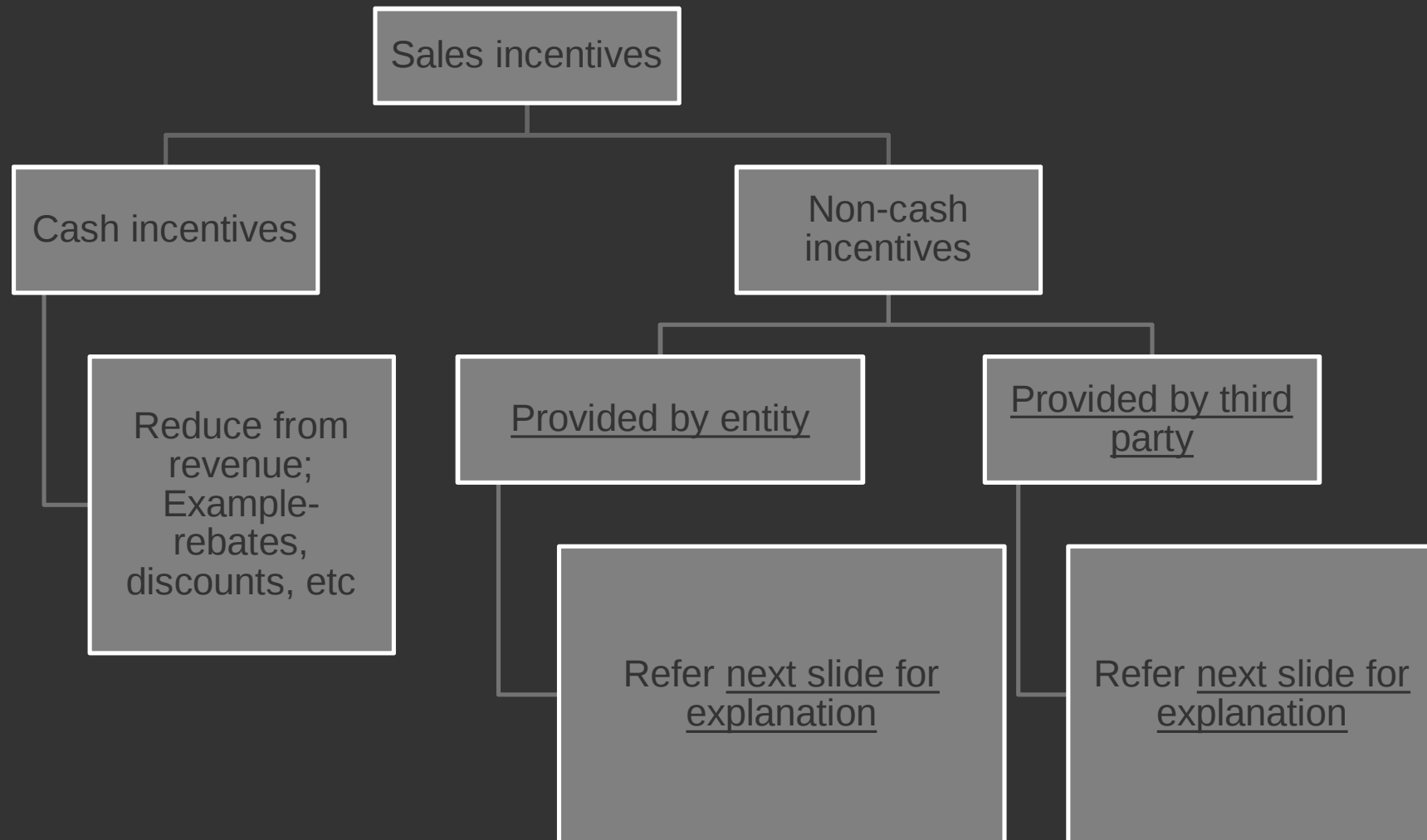
If principal- Measure INR 10,000 as revenue and INR 9,000 as expense

If agent- Measure INR 1,000 as revenue

Journal Entry:

Customer Dr. 1,000,000	
To Revenue	990,000
To Commission	1,000
To Liability	9,000

Sales incentives



Non-cash incentives provided by entity

Key Implications under Ind AS on financial reporting:

- ▶ Under IGAAP, all customer incentives are generally classified as sales expenses.
- ▶ Under Ind AS 18, such customer incentives have to be classified as cash incentives and non-cash incentives.

Incentives offered by the Company	Whether cash or non-cash incentive?
“Free of cost” supply of spare parts	Non-cash incentive
Reimbursement of the first EMI against a loan taken by a customer	In substance a cash payment to the customer
Insurance Premium for first year	In substance a cash payment to the customer
Free transportation of equipment to customer’s site	Non-cash incentive
Free erection, installation and commissioning of equipment	Non-cash incentive
Free registration of equipment	Non-cash incentive
Training services	Non-cash incentive

Non-cash incentives provided by entity

Cash incentive

- ▶ Under Ind AS 18, incentives classified as cash incentives will be accrued when the sales transaction occurs and will be considered a deduction from the transaction revenue.

Non- Cash incentive

- ▶ Under Ind AS 18, incentives classified as non-cash incentives will be considered to be separate performance obligations. A portion of total consideration should be allocated to each performance obligation based on their relative standalone selling price to the total value of the goods and services in the arrangement. The allocated revenue is required to be deferred till the corresponding performance obligation is met.

Non-cash incentives provided by entity

Non- cash incentive (Cont'd)

- § If the seller is acting as agent and has no further obligations in respect of that component then it will immediately recognise the margin on that element as its own revenue.
- § If acting as principal it will recognise the full transaction price as revenue but it will need to defer any element that relates to the provision of the good or service by the third party if that party still needs to provide that good or service (for example where the incentive is in the form of a voucher that is redeemable by the third party at a later date).

Transfer of assets from customers- IFRIC-18

Scope exclusions

- ▶ Transfer is a government grant- Ind AS 20
- ▶ Infrastructure used in service concession arrangement- Ind AS 11

Scope inclusion

Receipt of cash from customer to construct/ acquire asset

- ▶ Similar accounting

Exemption under Ind AS 101

- ▶ Prospective application, i.e., transfer of assets from customers on or after transition date

Transfer of assets from customers

Is the definition of 'asset' met?

- ▶ Determine control
 - ▶ consider all relevant facts and circumstances when assessing control
 - ▶ An entity that controls an asset can generally deal with that asset as it pleases. For example, the entity can exchange that asset for other assets, employ it to produce goods or services, charge a price for others to use it, use it to settle liabilities, hold it, or distribute it to owners

How to measure PPE on initial recognition?

- ▶ Apply guidance under Ind AS 16 for exchange of assets

Transfer of assets from customers

How to recognise revenue?

- ▶ Identify separately identifiable services, e.g., connecting the customer to a network, providing ongoing access to goods & services, etc.
 - ▶ If one service- Apply recognition criteria for 'rendering of service'
 - ▶ If more than one services- Allocate consideration and apply recognition criteria to each service

Case study - 13

Transfer of assets from customers

Background

- ▶ A Ltd. enters into an agreement with B Ltd. involving outsourcing of IT functions.
- ▶ B Ltd. transfers self owned IT equipment to A Ltd.
- ▶ A Ltd. must use the equipment to provide the service required by the agreement.
- ▶ A Ltd. is responsible for maintaining the equipment and for replacing it when it decides to do so.
- ▶ Useful life of the equipment is estimated to be 3 years.
- ▶ The agreement requires service to be provided for 10 years for a fixed price lower than the price A Ltd. would have charged had the IT equipment not been transferred.

Case study - 13

Transfer of assets from customers

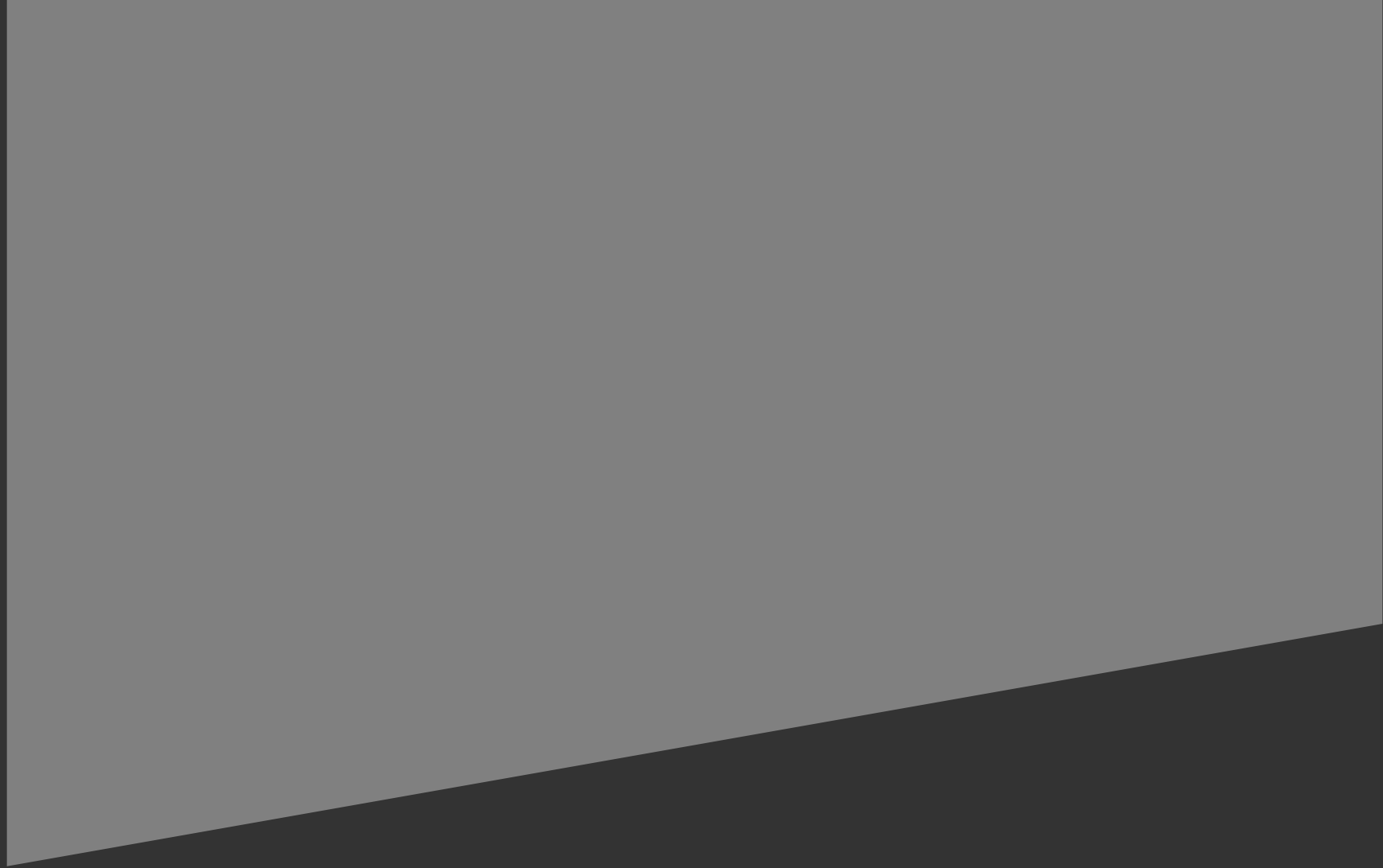
Question

- ▶ How should A Ltd. account for the above transaction?

Solution

- ▶ IT equipment to be recognised as PPE at fair value, together with a liability to provide the service.
- ▶ Separately identifiable service- recognise revenue when service is performed, i.e., over 10 years
- ▶ Depreciation to be provided over the useful life of asset

Disclosures



Disclosures

- ▶ Accounting policies adopted for recognition of revenue
 - ▶ including methods to determine stage of completion (in case of services)
- ▶ Revenue by significant category
 - ▶ amount of revenue arising from:
 - ▶ sale of goods
 - ▶ rendering of services
 - ▶ royalties
 - ▶ amount of revenue arising from exchanges of goods or services

Agenda

- ▶ Revenue recognition – current scenario
- ▶ Revenue recognition under Ind AS 18
- ▶ **Key GAAP differences – AS 9 vs. Ind AS 18**
- ▶ Construction contracts – Ind AS 11

AS 9 vs Ind AS 18

Particulars	AS 9	Ind AS 18
Measurement of revenue	At charges made to customers	At <u>fair value</u> of consideration
Deferred consideration	Normally, discounting not required Exception- Instalment sales	Discounting to present value required. <u>Interest income to be accounted for separately</u>
Revenue recognition- Sale of goods	Does not include criteria of ' <u>no continuing managerial involvement</u> ' and ' <u>reliable measurement of costs</u> '	Includes these two criteria as well
Revenue recognition – Rendering of services	Allows either <u>completed contract method</u> or <u>percentage completion method</u>	In case of reliable outcome, revenue recognised by reference to 'stage of completion'; otherwise recognise to the extent of recoverable expense incurred
Discount and incentive schemes	Trade discounts and volume rebates netted off from revenue – <u>cash discounts and other sales incentives are generally recognised as expense</u>	To be factored into the transaction price, i.e., have to be deducted from revenue including cash discount
Interest income	As per applicable rate	As per <u>effective interest rate method</u>

Agenda

- ▶ Revenue recognition – current scenario
- ▶ Revenue recognition under Ind AS 18
- ▶ Key GAAP differences – AS 9 vs. Ind AS 18
- ▶ **Construction contracts – Ind AS 11**

Scope of Ind AS 11

- ▶ This Standard shall be applied in accounting for construction contracts in the financial statements of contractors including the financial statements of real estate developers (Also refer guidance note on real estate accounting as issued by ICAI).

▶ No provision corresponding to IFRIC 15 incorporated in Ind AS 11

▶ Appendices A and B (corresponding to IFRIC 12 & SIC 29) on Service Concession Arrangements within the scope of Ind AS 11

Construction contract

A contract specifically negotiated for

construction of an asset

OR

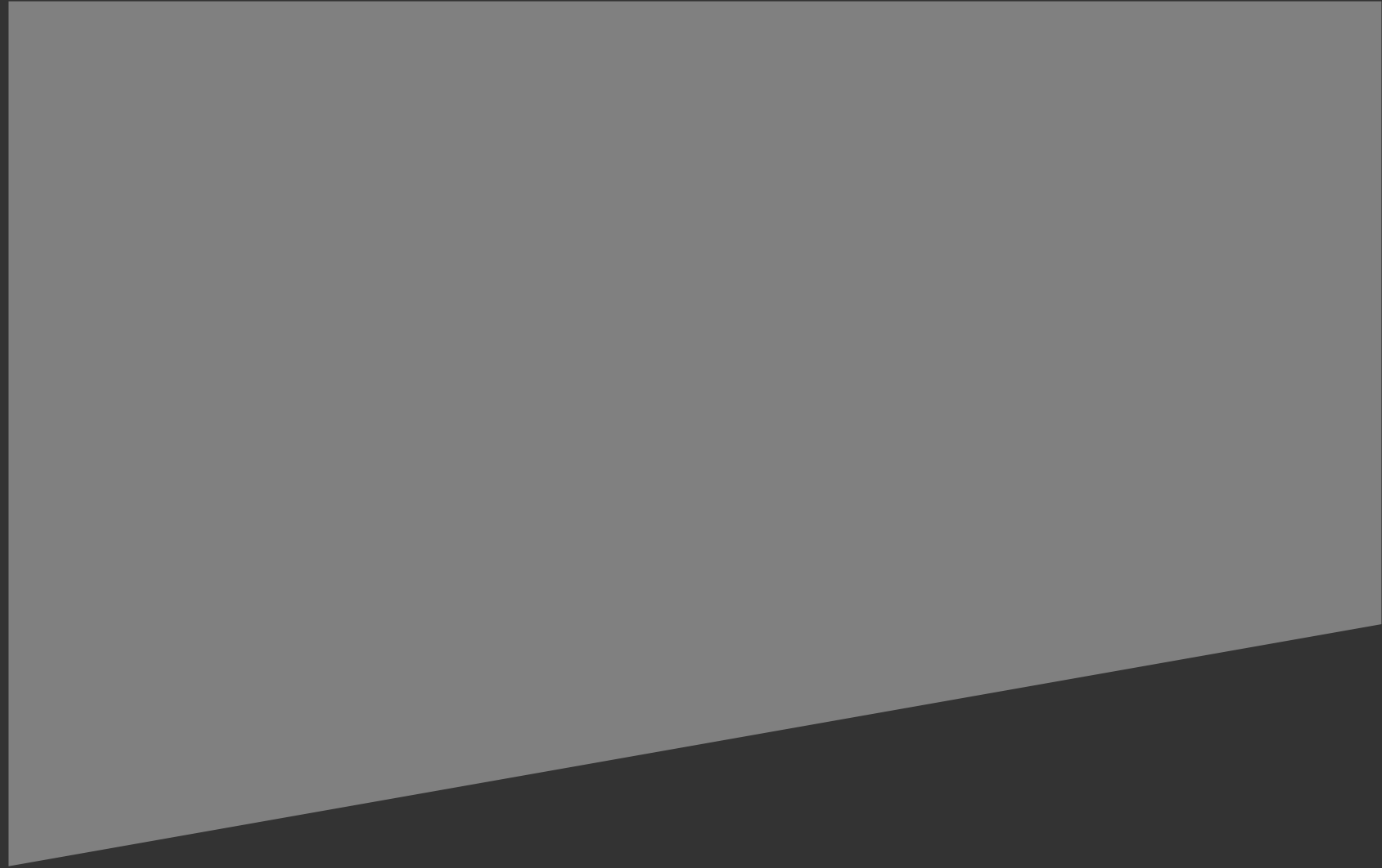
combination of assets

closely interrelated or
interdependent (in terms of
design/ technology/ function/
use)

Also includes:

- ▶ contract for services directly related to construction contracts
- ▶ contract for demolition and restoration of assets and restoration of the environment after an asset is demolished

Types of construction contracts



2 types of contracts

Fixed price contract

fixed contract price
or fixed rate per
unit of output

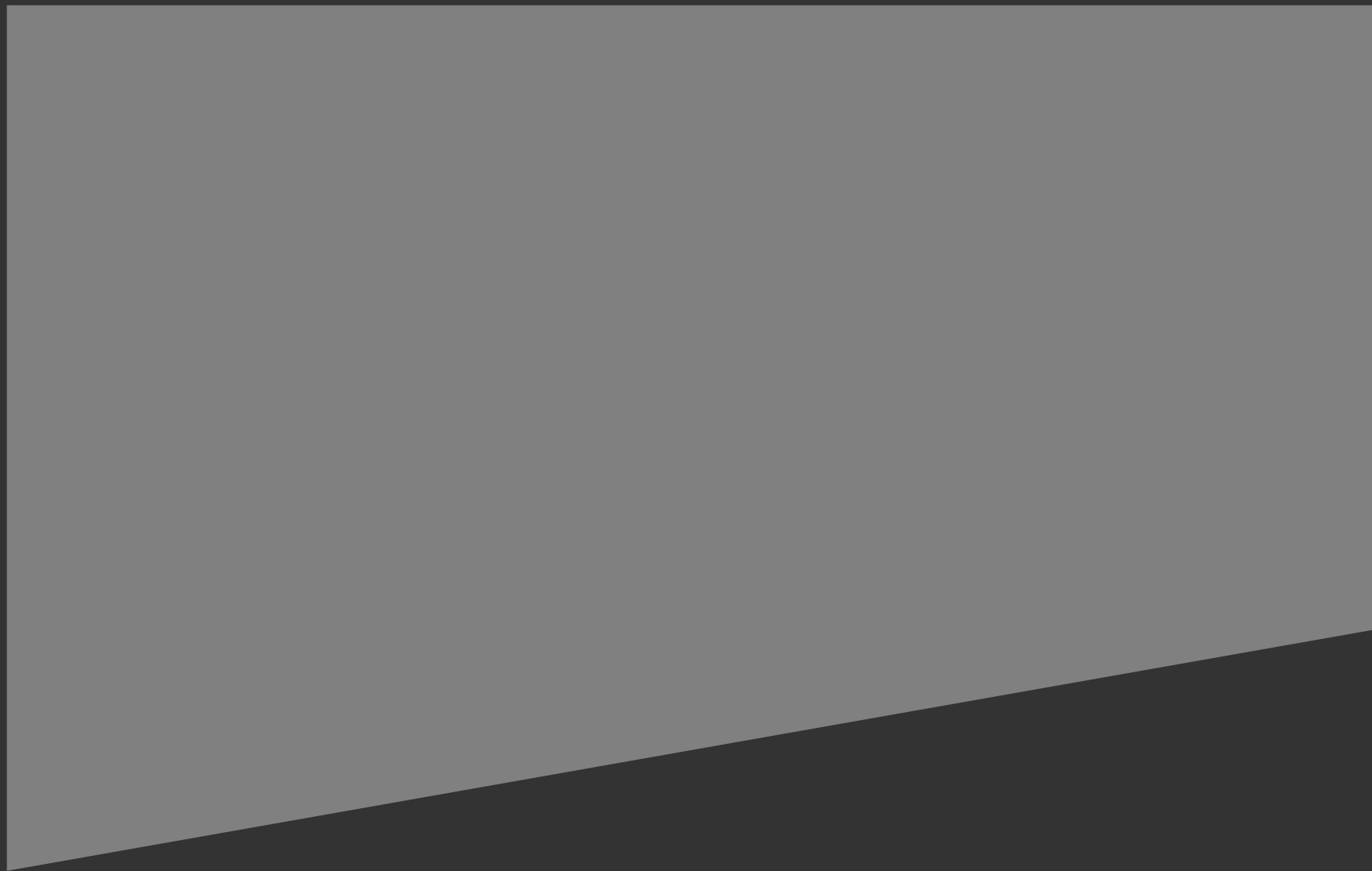
- subject to cost escalation

Cost plus contract

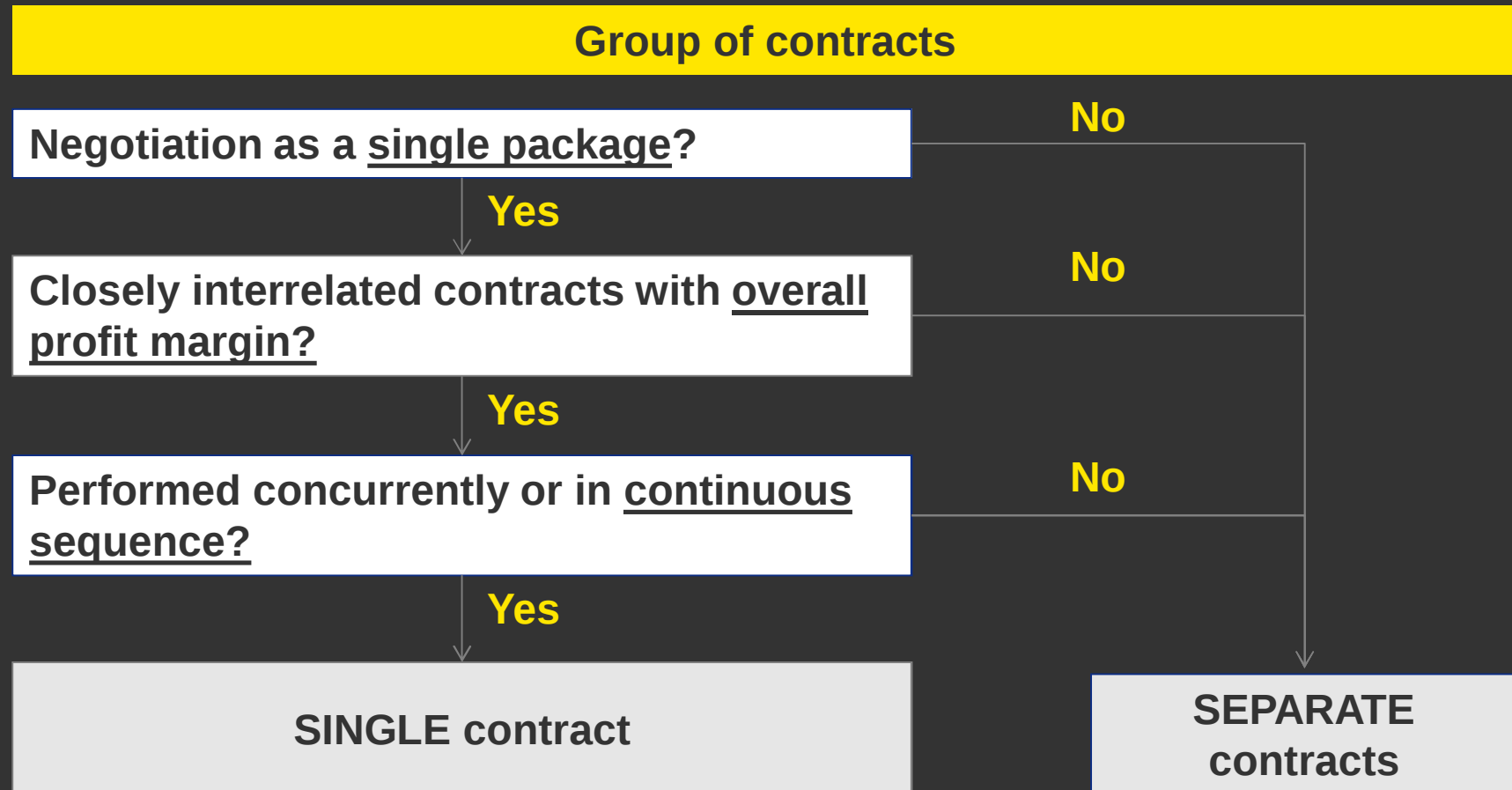
Allowable or
otherwise defined
costs *plus* a
percentage of
costs or a fixed fee

► These types
determine
the basis for
revenue
recognition

Combination and segmentation of contracts

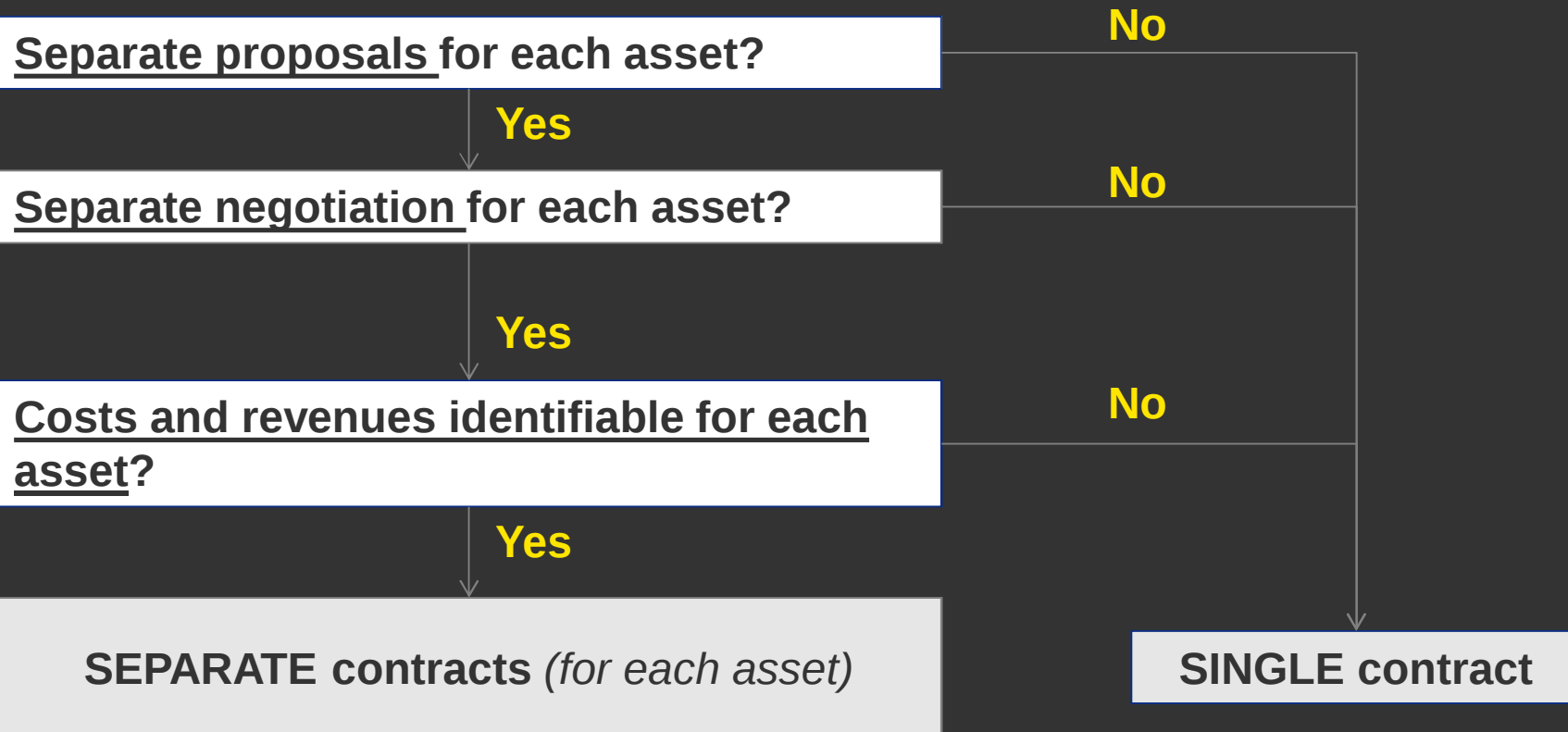


Combination of contracts



Segmentation of contracts

Single contract covering construction of no. of separate assets



Options for construction of additional asset

Contract anticipates construction of additional asset at customer's discretion

Significantly different in design, technology or function?

No

Price negotiation without regard to original contract price?

No

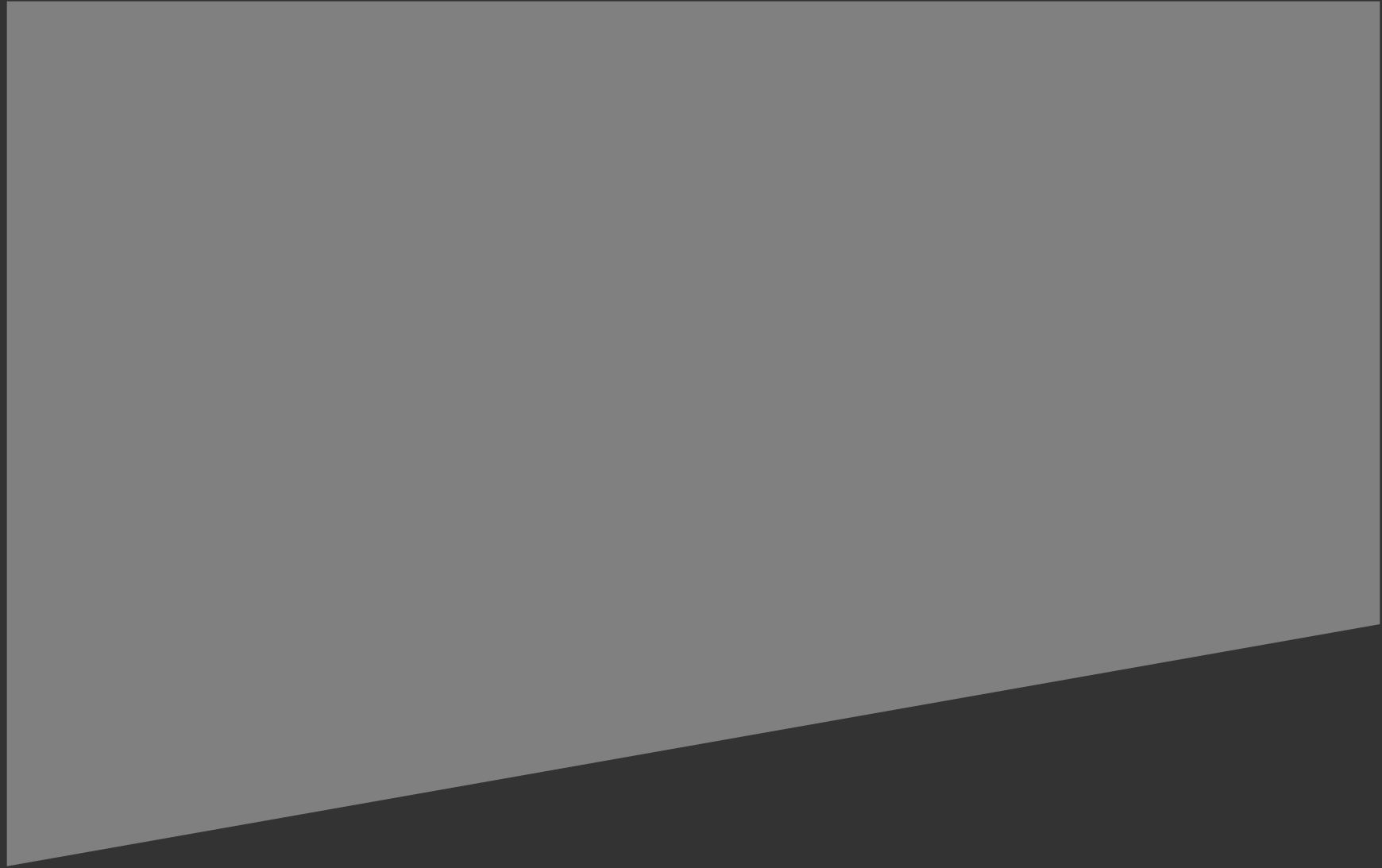
COMBINED contract

Yes

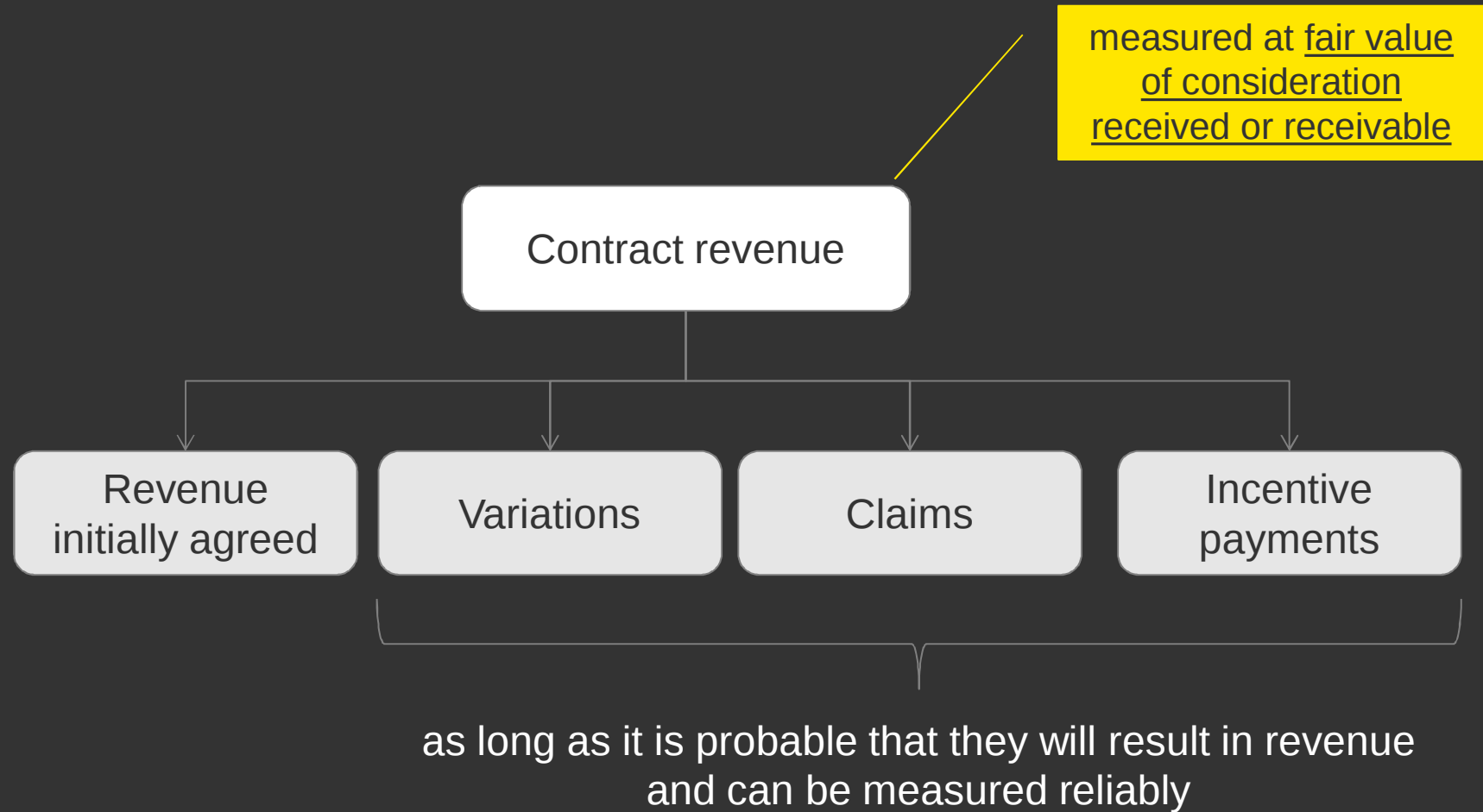
Yes

NEW contract

Contract revenue



Contract revenue



Contract revenue

Variation



- It is probable that the customer will approve the variation and amount of revenue from it



Reliable measurement of revenue

Claim



- Negotiations have reached an advanced stage such that it is probable that the customer will accept the claim



Reliable measurement of revenue

Incentive payment

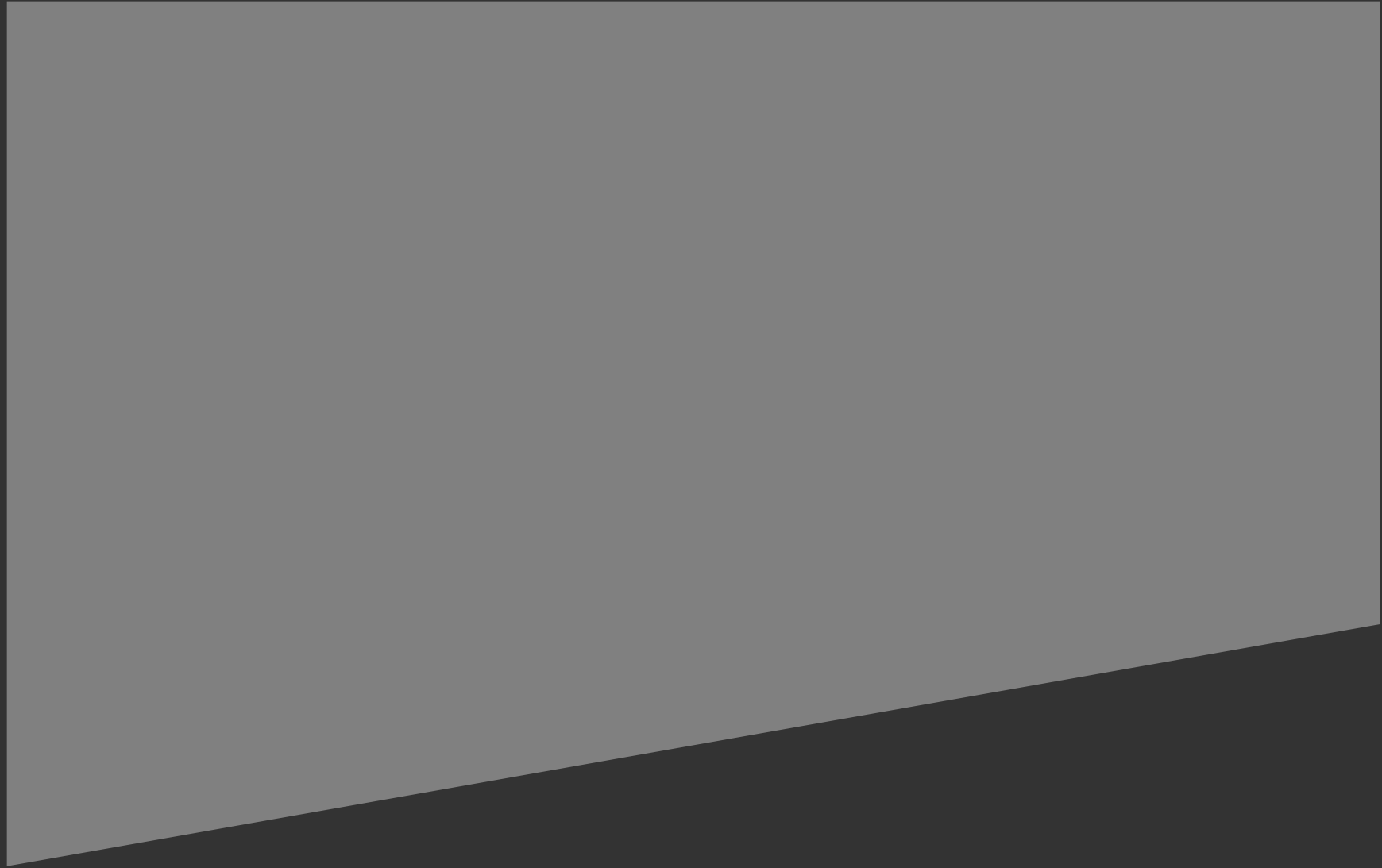


- Contract is sufficiently advanced that it is probable that the specified performance standards will be met or exceeded

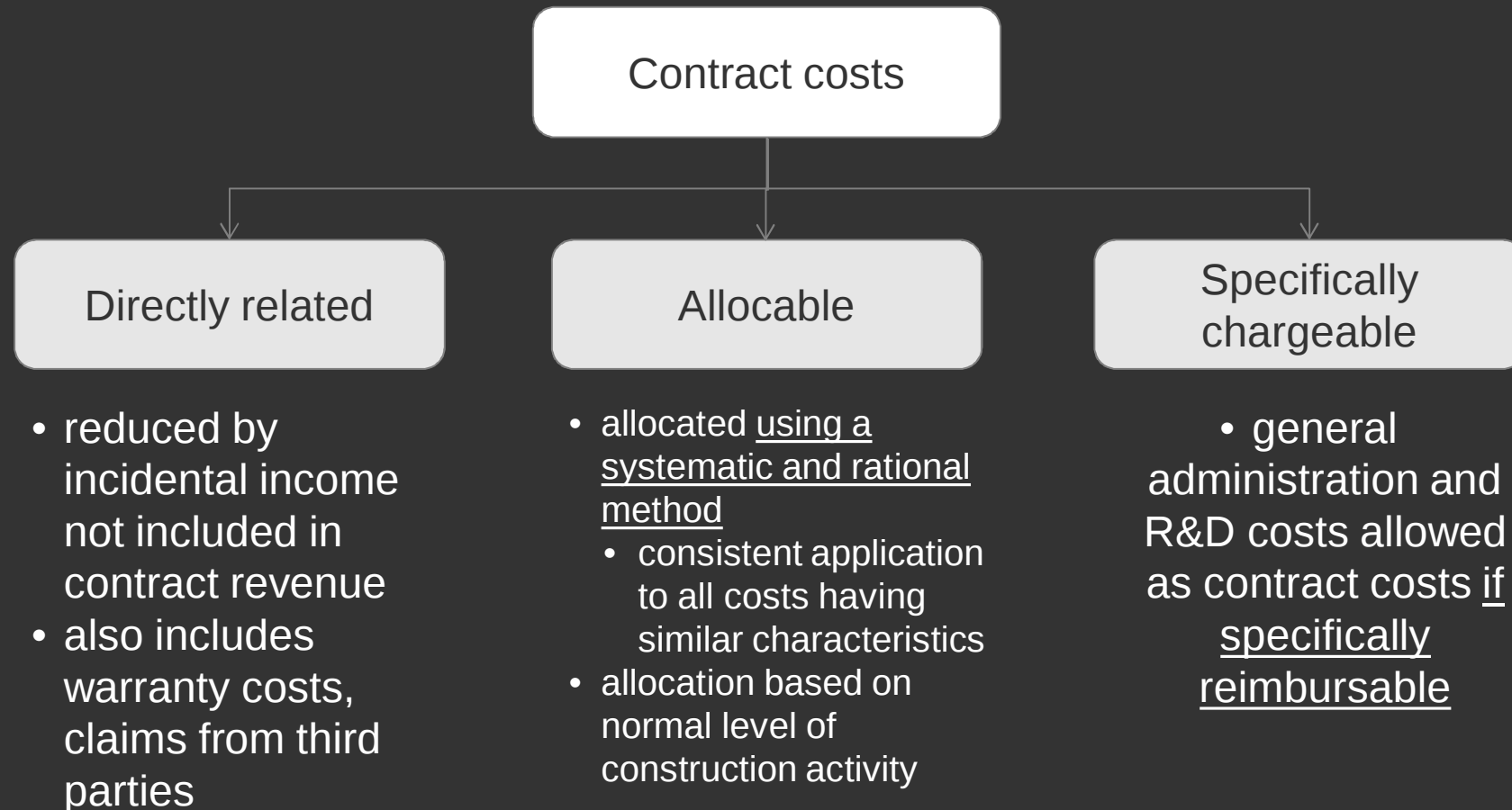


Reliable measurement of revenue

Contract costs

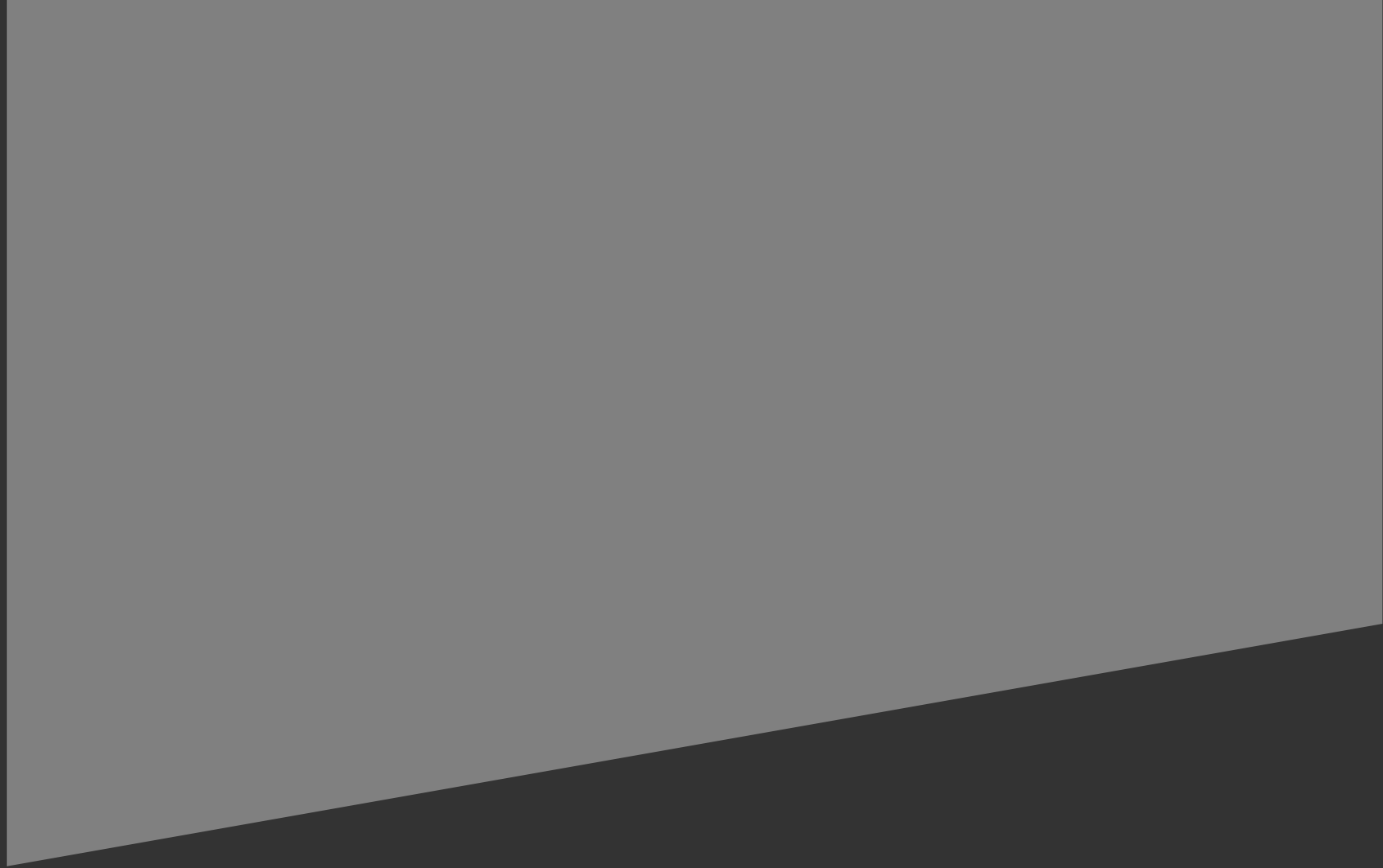


Contract costs



Contract inefficiencies and abnormal costs not included in contract costs;
judgement required to distinguish these costs

Recognition of contract revenue and contract costs



Reliable estimation of outcome of construction contract

- ▶ If outcome can be estimated reliably
 - ▶ recognise contract revenue and contract costs by reference to stage of completion
- ▶ If outcome cannot be estimated reliably
 - ▶ recognise revenue to the extent of incurred contract costs probable of recovery
 - ▶ recognise contract costs as expense when incurred
 - ▶ do not recognise profit

Loss making contract: Recognise expected loss immediately

Fixed price contract

- ▶ Probable future economic benefits
- ▶ Reliable measurement of:
 - ▶ total contract revenue
 - ▶ contract costs to complete the contract
 - ▶ stage of completion
 - ▶ contract costs attributable to the contract

Cost plus contract

- ▶ Probable future economic benefits
- ▶ Reliable measurement of:
 - ▶ contract costs attributable to the contract

Stage of completion method

also known as 'percentage of completion method'

Methods to determine stage of completion

Use method that measures reliably the work performed

Input based

Contract costs incurred/ total contract costs

Output based

Surveys of work performed

Completion of physical proportion of work

Points for consideration

- ▶ Contract costs relating to future contract activity recognised as 'contract WIP'
 - ▶ as long as it is probable of recovery
- ▶ If doubts about collectability of revenue already recognised
 - ▶ write off as bad debt expense
 - ▶ no adjustment to revenue
- ▶ Progress payments and payment in advance may not reflect work performed

Case study - 14

Determination of revenue

Facts

- ▶ A Ltd. is engaged in a construction contract with an expected sales value of INR 10,00,000.

Scenarios

- ▶ **Scenario I:** A Ltd. has incurred costs of INR 4,00,000 (including INR 50,000 in respect of unapplied raw materials. INR 3,00,000 is the best estimate of remaining costs to complete the contract.
- ▶ **Scenario II:** An independent surveyor has certified that at the period-end the contract is 55% complete. Retention amount is 5%.
- ▶ **Scenario III:** A Ltd.'s best estimate of the physical proportion of the work it has completed is that it is 60% complete.

Case study - 14

Determination of revenue

Contract revenue to be recognised

- ▶ **Scenario I:** INR 5,00,000 (i.e., $[4,00,000 - 50,000] / 7,00,000 \times 10,00,000$)
- ▶ **Scenario II:** INR 5,50,000 (i.e., $10,00,000 \times 55\%$)
- ▶ **Scenario III:** INR 6,00,000 (i.e., $10,00,000 \times 60\%$)

Changes in estimates

Percentage of completion method applied on a cumulative basis

- to the current estimates of contract revenues and costs

Effect of change treated as change in accounting estimate

- to be accounted for prospectively as per Ind AS 8

Disclosures

- where entity makes assumptions about future, and
- is subject to major sources of estimation uncertainty

Case study - 15

Determination of contract revenue and expenses

Facts

- ▶ A construction contractor has a fixed price contract to build a bridge. The initial amount of revenue agreed in the contract is INR 9,000 cr. The contractor's initial estimate of contract costs is INR 8,000 cr. It will take 3 years to build the bridge.
- ▶ By the end of year 1, the contractor's estimate of contract costs has increased to INR 8,050 cr.
- ▶ In year 2, the customer approves a variation resulting in an increase in contract revenue of INR 200 cr and estimated additional contract costs of INR 150 cr. At the end of year 2, costs incurred include INR 100 cr for standard materials stored at the site to be used in year 3 to complete the project.

Case study - 15

Determination of contract revenue and expenses

Facts

Particulars	Year 1	Year 2	Year 3
Contract costs incurred to date (INR in cr)	2,093	6,168	8,200

Question

- ▶ Calculate the amount of contract revenue and contract costs to be recognised in year 1-3.

Case study - 15

Determination of contract revenue and expenses

Accounting

Particulars	Year 1	Year 2	Year 3
	INR in cr	INR in cr	INR in cr
Initial amount of revenue agreed	9,000	9,000	9,000
Variation	-	200	200
Total contract revenue	9,000	9,200	9,200
Contract costs incurred to date	2,093	6,168	8,200
Contract costs to complete (B.F)	5,957	2,023	-
Total estimated contract costs	8,050	8,200	8,200
Estimated profit	950	1,000	1,000
Stage of completion	26%	74%*	100%

** 74% determined by excluding INR 100 cr of standard materials stored at site for use in year 3 from contract costs incurred to date*

Case study - 15

Determination of contract revenue and expenses

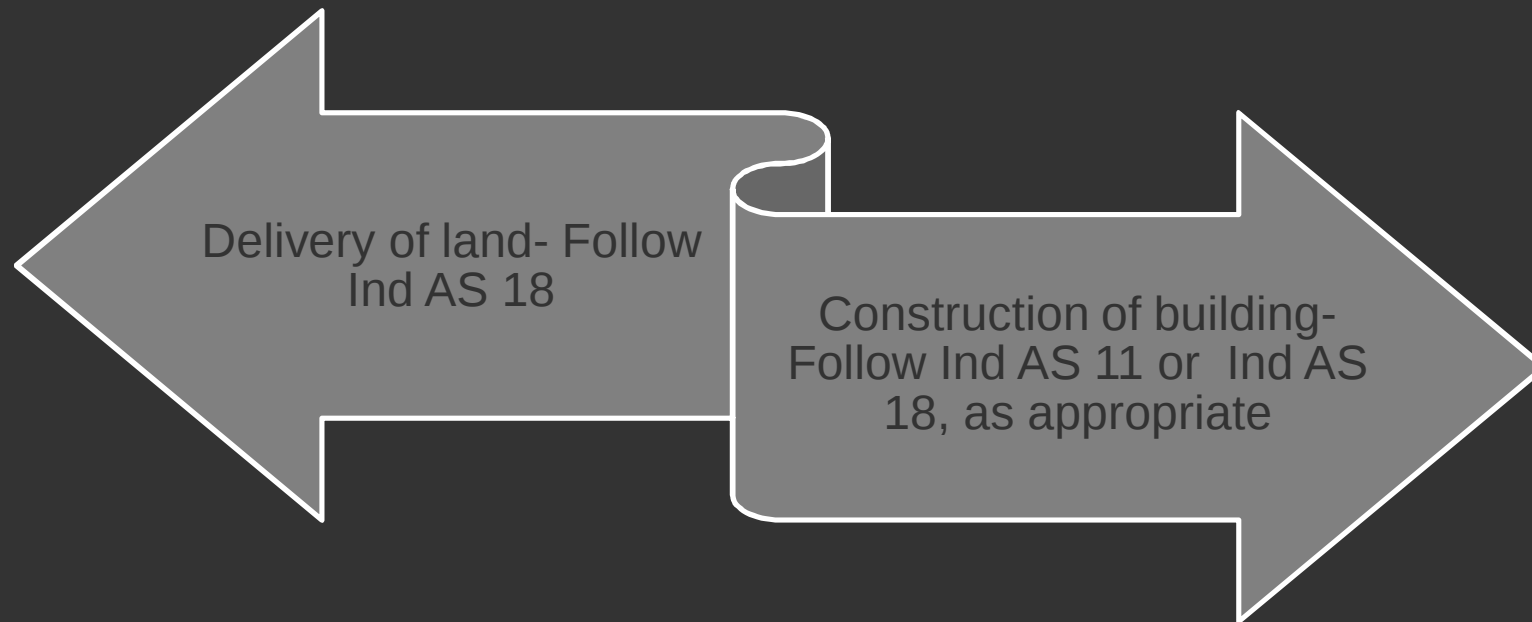
Particulars	To date	Recognised in prior years	Recognised in current year
Year 1			
Revenue (9,000 x 26%)	2,340	-	2,340
Expenses	2,093	-	2,093
Profit	247	-	247
Year 2			
Revenue (9,200 x 74%)	6,808	2,340	4,468
Expenses (6,168 – 100)	6,068	2,093	3,975
Profit	740	247	493
Year 3			
Revenue (9,200 x 100%)	9,200	6,808	2,392
Expenses	8,200	6,068	2,132
Profit	1,000	740	260

Contracts that contain sales of assets and construction contracts

▶ If contract can be segmented into:

- ▶ sale of asset (e.g., land)
- ▶ construction contract (e.g., construction of building)

then account for it as below.....



Case study - 16

Segmented construction contract

Facts

- ▶ On 1 April 2015, A Ltd. entered into a contract to construct a building on a piece of land it has acquired and, when construction is complete, to deliver the entire property to a customer.
- ▶ Total cost of land = INR 2 cr
- ▶ Estimated total cost of construction = INR 8 cr
- ▶ Estimated total cost of contract = INR 10 cr
- ▶ Agreed sales price of the completed building = INR 11 cr

Case study - 16

Segmented construction contract

Facts

- ▶ Construction has commenced and at the end of the reporting period (31 March 2016) total construction costs incurred amount to INR 2 cr.
- ▶ A Ltd. considers that the amount of revenue in the contract attributable to the construction is INR 8.5 crores and the amount to the sale of land is INR 2.5 cr.

Question

- ▶ Calculate the amount of contract revenue and contract costs to be recognised.

Case study - 16

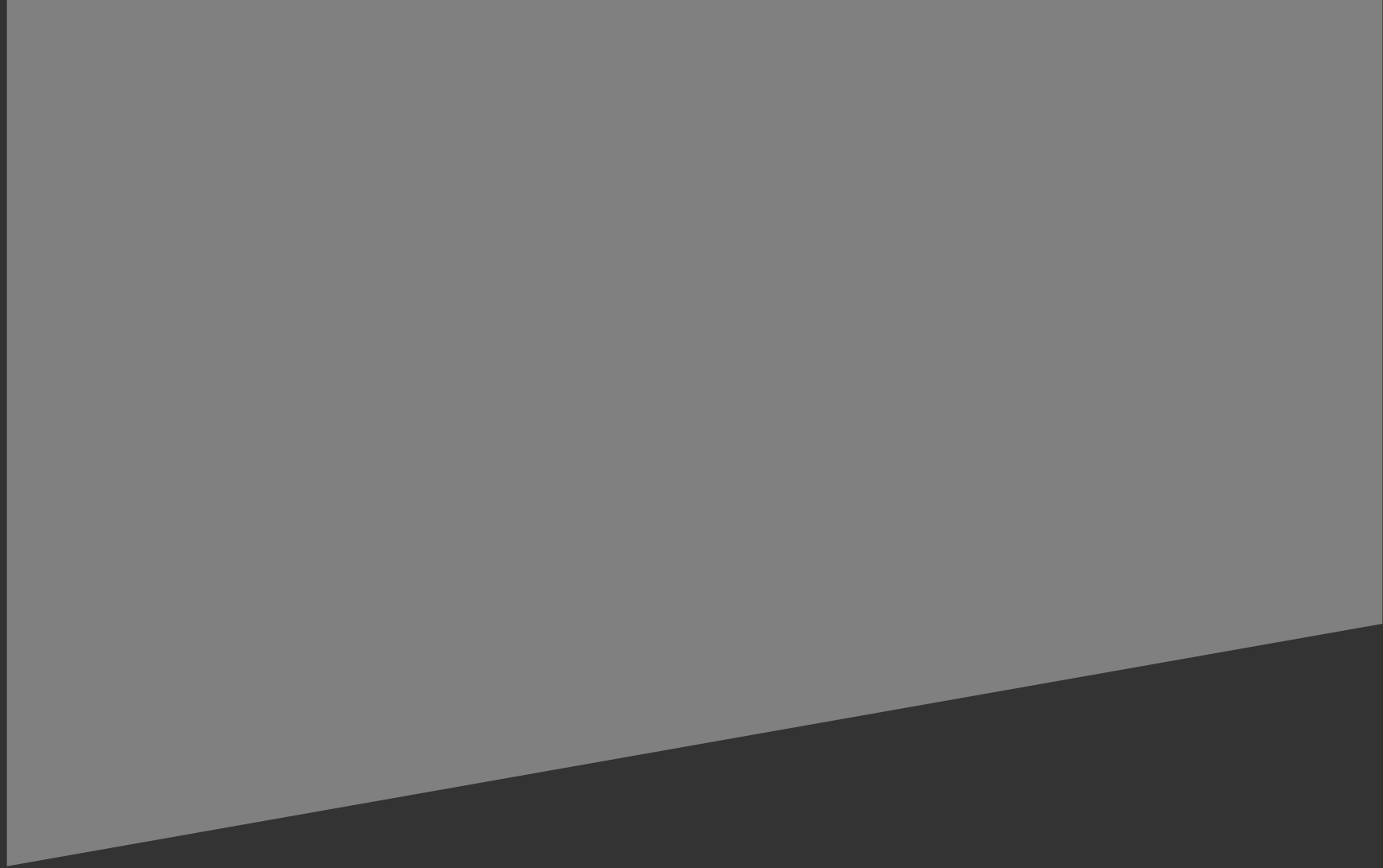
Segmented construction contract

Accounting

Percentage of completion	INR 2 cr / INR 8 cr	25%
Revenue	INR 8.5 cr x 25%	INR 2.13 cr
Contract expense		INR 2.00 cr
Gross amount due from customer	Revenue of INR 2.13 cr	INR 2.13 cr
Inventory	Cost of land	INR 2.00 cr

- ▶ Revenue and cost relating to the land should be recognised when the revenue recognition criteria of Ind AS 18 are met - this is often when legal title passes

Disclosures



Disclosures

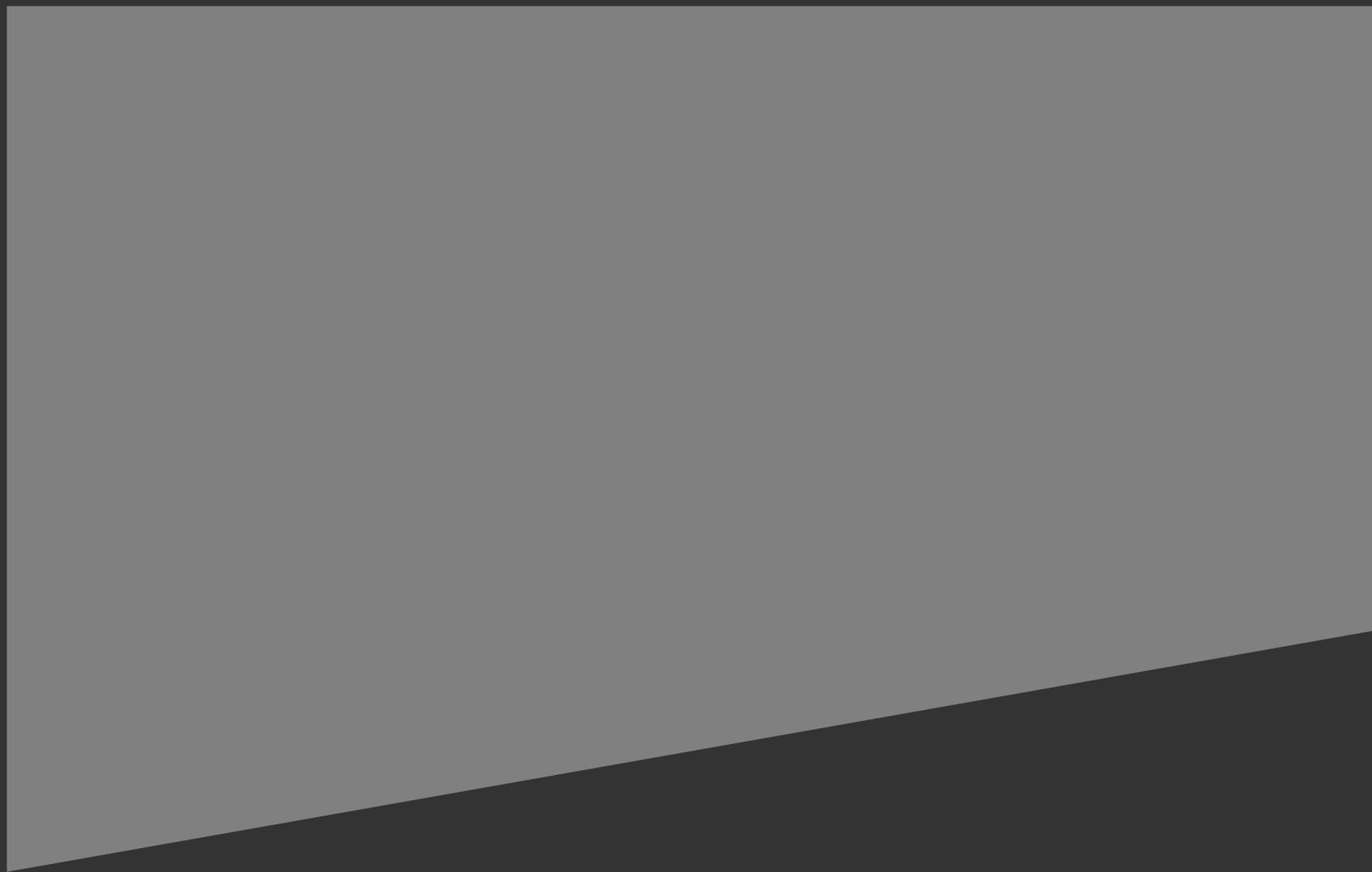
Disclosure

- ▶ contract revenue recognised as revenue
- ▶ methods used to determine contract revenue
- ▶ methods used to determine stage of completion
- ▶ for contracts in progress:
 - ▶ aggregate of costs incurred and recognised profits
 - ▶ advances received
 - ▶ Retentions
- ▶ contingent liabilities/ assets – as per Ind AS 37

Presentation

- ▶ Gross amount due from customers – Asset
- ▶ Gross amount due to customers - Liability

Service concession arrangements



Scope

- ▶ Accounting by operators (not grantors)
- ▶ Does not cover for private-to-private service concession arrangements. Operator may draw analogy from these principles as per Ind AS 8.

Control over services

- what services?
- to whom?
- at what price?

Control over significant residual interest in infrastructure

- ownership
- beneficial entitlement
- otherwise

Also known as ‘build-operate transfer’, ‘rehabilitate-operate-transfer’, ‘public-to-private’ service concession arrangements

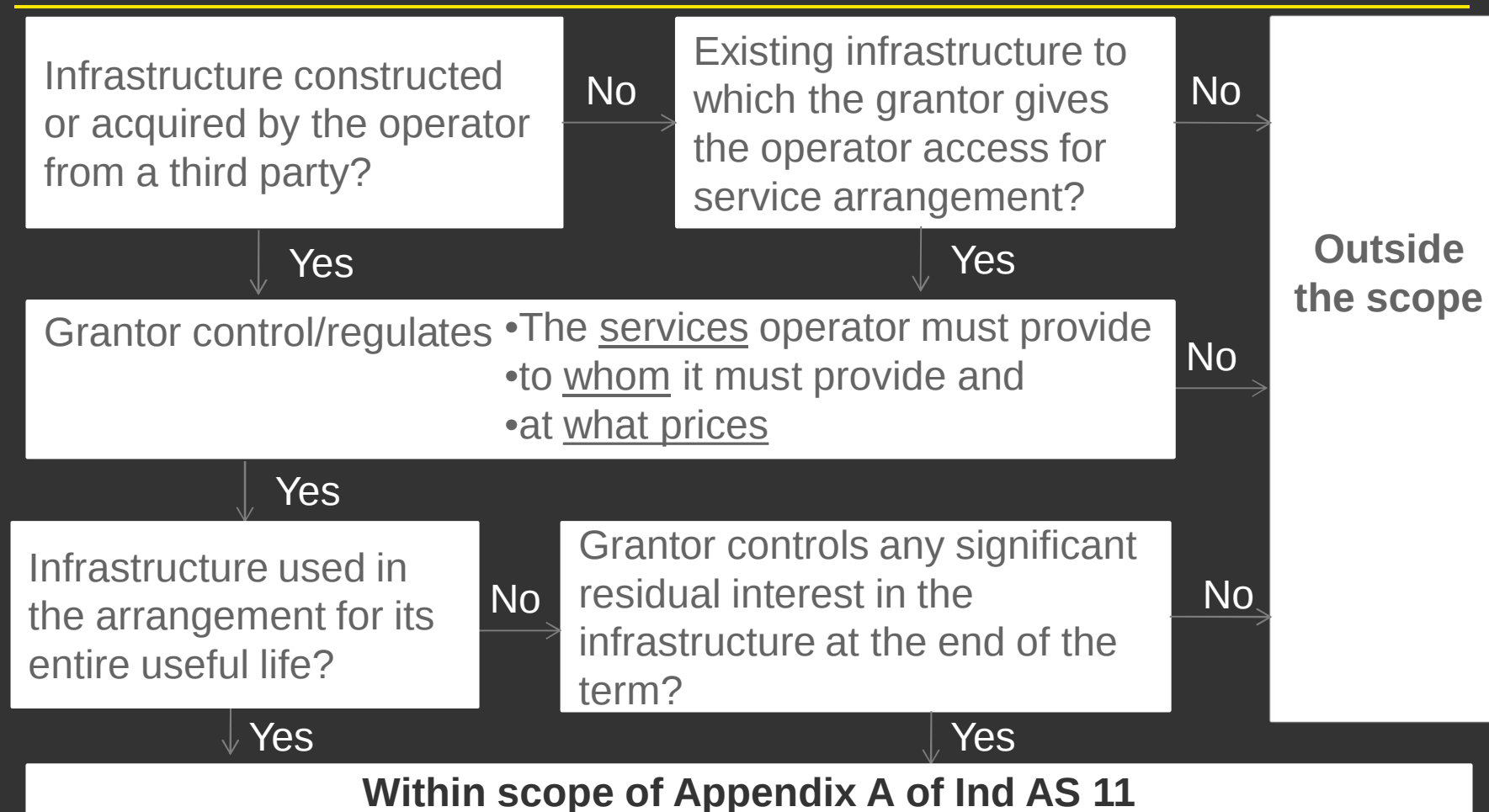
Accounting

Treatment of operator's right over infrastructure Not PPE	
Recognition and measurement of arrangement consideration	• Construction/ upgrade services • Operation services Allocate consideration by reference to relative fair values, if amounts separately identifiable
Construction or upgrade services	As per Ind AS 11
Consideration given by grantor to operator (recognised at FV)	• Financial asset- unconditional right to receive cash/ another financial asset (specified or determinable payments) • Intangible asset- a right to charge users of the public service (demand risk)
Operation services	As per Ind AS 18

Accounting

Contractual obligations to restore infrastructure to a specified level of serviceability	As per Ind AS 37
Borrowing costs incurred by operator	In case of: • Financial asset- expense • Intangible asset- capitalise if qualifying asset criteria being fulfilled
Financial asset	As per Ind AS 109
Intangible asset	As per Ind AS 38
Items provided to operator by grantor	Asset (recognised at FV) if operator can <u>keep or deal with as it wishes and it is part of consideration;</u> <u>recognise liability for unfulfilled obligations assumed in exchange for asset</u>

Appendix A of Ind AS 11 – Scope



Example

- ▶ An operator builds a road at a cost of C100. The construction profit is C10 and the total cash inflows over the life of the concession are C200.
- ▶ Under the financial asset model, the operator would recognise construction revenue at its fair value of C110 (cost + profit margin) and a financial asset (receivable) of C110. Of the future cash inflows of C200, C110 would be treated as repaying the receivable, with the remaining C90 being recognised as revenue over the life of the concession. Total revenue would be C200.

Example

- ▶ In contrast, under the intangible asset model, the operator would recognise the same construction revenue of C110, construction profit of C10 and an intangible asset of C110.
- ▶ Over the concession's life, the intangible asset would be amortised against revenues (which in this case would be from users) of C200. The net position is the same as the financial asset case, but total revenues would be C310 rather than C200

Disclosures

- ▶ description of arrangement
- ▶ significant terms of arrangement that may affect the amount, timing and certainty of future cash flows
- ▶ nature and extent of
 - ▶ rights to use specified assets
 - ▶ obligations to provide or rights to expect provision of services
 - ▶ obligations to acquire or build PPE
 - ▶ obligations to deliver or right to receive specified assets at end of concession period
 - ▶ renewal and termination options
 - ▶ other rights and obligations
- ▶ changes in the arrangement
- ▶ classification of arrangement
- ▶ revenue and profit (or losses) recognised

Disclosure for each service concession arrangement or in aggregate for each class

Thank You