REVENUE FROM CONTRACTS WITH CUSTOMERS

IND AS 115

INTRODUCTION

Ind AS 115 Revenue from Contracts with Customers is set out in paragraphs 1–129 and Appendices A–E. All the paragraphs have equal authority.

Ind AS 115 is effective for annual periods beginning on or after 1 April 2018. Earlier application is permitted.

Ind AS 115 supersedes:

a) Ind AS 11 Construction Contracts;

b) Ind AS 18 Revenue;

LIMITATIONS OF EXISTING GAAP (IND AS 18 / IND AS 11)

No clear guidance on cost of warranties;

No clear guidance on allowance for sales returns;

No clear guidance on multiple deliverables;

Consideration paid back to customers;

Concept of constructive obligation in sales contracts

INTRODUCTION – MAIN FEATURES

One accounting literature for both construction contracts and other than construction contracts;

Five step approach for accounting of any revenue related transaction:

Step 1: Identify the contract with customer;

Step 2: Identify the performance obligations;

Step 3: Determine the transaction price;

Step 4: Allocate the transaction price to performance obligations;

Step 5: Recognise revenue when (or as) the entity satisfies a performance obligation

EFFECTIVE DATE AND TRANSITION

Ind AS 115 is applicable for periods beginning on or after 1 April 2018, with early application permitted.

There are two transition approaches:

An entity shall apply this Standard using one of the following two methods:

(a) retrospectively to each prior reporting period presented in accordance with Ind AS 8, Accounting Policies, Changes in Accounting Estimates and Errors, subject to the expedients in paragraph C5; or

(b) retrospectively with the cumulative effect of initially applying this Standard recognised at the date of initial application in accordance with paragraphs C7–C8.

In addition, the standard provides three practical expedients to simplify transition for contracts that are completed.

SCOPE

Ind AS 115 applies to all entities and all **contracts with customers** to provide goods or services in the ordinary course of business, except for the following contracts, which are specifically excluded:

- Lease contracts
- Insurance contracts
  - The entity does not reflect the risk assessment in setting the price;
  - The customer receives services rather than money;
  - The insurance risk transferred arises primarily from the customer's use of services rather than from uncertainty over cost of those services
- Financial instruments and other contractual rights or obligations
- Non-monetary exchanges between entities in the same line of business to facilitate sales to customers or potential customers.

SCOPE

In addition, as part of the consequential amendments associated with Ind AS 115, the legacy requirements for the recognition of a gain or loss on the disposal of a non-financial asset (e.g., assets within the scope of Ind AS 16 Property, Plant and Equipment or Ind AS 38 Intangible Assets) were amended. The recognition and measurement requirements in Ind AS 115 apply when recognising and measuring any gains or losses on disposal of such non-financial assets, when that disposal is not in the ordinary course of business. An entity is required to look to the control model in Ind AS 115 to determine when to derecognise the nonfinancial asset (i.e., when control is transferred). The entity will estimate consideration to measure the gain or loss following the requirements in Ind AS 115 for determining the transaction price.

CUSTOMER

The standard defines a customer "as a party that has contracted with an entity to obtain goods or services that are an output of the entity's ordinary activities in exchange for consideration". Ind AS 115 does not define the term 'ordinary activities' because it is already widely used in IFRS.

An entity provides internet-based advertising services to companies. As part of those services, the entity purchases banner-space on various websites from a selection of publishers. For certain contracts, the entity provides a sophisticated service of matching the ad placement with the pre-identified criteria of the advertising party (i.e., the customer). In addition, the entity pre-purchases the banner-space from the publishers before it finds advertisers for that space. Assume that the entity appropriately concludes it is acting as the principal in these contracts. Accordingly, the entity identifies that its customer is the advertiser to whom it is providing services.

In other contracts, the entity simply matches advertisers with the publishers in its portfolio, but the entity does not provide any sophisticated ad-targeting services or purchase the advertising space from the publishers before it finds advertisers for that space. Assume that the entity appropriately concludes it is acting as the agent in these contracts. Accordingly, the entity identifies that its customer is the publisher to whom it is providing services.

CUSTOMER

Collaborative arrangements

Such contracts could still be within the scope of Ind AS 115, at least partially, if the collaborator or partner meets the definition of a customer for some, or all, aspects of the arrangement.

Interaction with other Standards

If the other standard specifies how to separate and measure one part of the contract, apply that standard first;

If not, apply Ind AS 115 first and the balance component to the other standard(s).

CUSTOMER

Sharia-compliant instruments – Are these scoped in or scoped out?

Generally considered as outside the scope of Revenue

Credit card fee within the scope of the Standard?

Whether they are part of effective interest rate model is the key question?

Card reward programmes?

Generally considered as part of receivables

Contributions received by non-profit organisations

Part of revenue accounting standard

Sale of scrap and bye-products

Whether such sale of bye-products and scrap is an ordinary activity?

FIVE STEP APPROACH

Step 1: Identify the contract with customer;

Step 2: Identify the performance obligations;

Step 3: Determine the transaction price;

Step 4: Allocate the transaction price to performance obligations;

Step 5: Recognise revenue when (or as) the entity satisfies a performance obligation

IDENTIFY THE CONTRACT WITH CUSTOMERS

- Entity must first identify the contract;
- A contract must create enforceable rights and obligations;
- Such contracts may be written, oral or implied by an entity's customary business practices.

The entities will need to look at the relevant legal framework to determine whether the contract is enforceable because factors that determine enforceability may differ among jurisdictions.

IT Support Co. provides online technology support for customers remotely via the internet. For a fixed fee, IT Support Co. will scan a customer's personal computer (PC) for viruses, optimise the PC's performance and solve any connectivity problems. When a customer calls to obtain the scan services, IT Support Co. describes the services it can provide and states the price for those services. When the customer agrees to the terms stated by the representative, payment is made over the telephone. IT Support Co. then gives the customer the information it needs to obtain the scan services (e.g., an access code for the website). It provides the services when the customer connects to the internet and logs onto the entity's website (which may be that day or a future date).

In this example, IT Support Co. and its customer are entering into an oral agreement, which is legally enforceable in this jurisdiction, for IT Support Co. to repair the customer's PC and for the customer to provide consideration by transmitting a valid credit card number and authorisation over the telephone.

IDENTIFY THE CONTRACT WITH CUSTOMERS

The following attributes must be present in order for an arrangement to be construed as contract under this standard:

- The parties **have approved** the contract and **are committed** to perform their respective obligations.
- Each party's rights regarding the goods or services to be transferred can be identified.
- Payment terms can be identified.
- The contract has commercial substance.
- 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.

IDENTIFY THE CONTRACT WITH CUSTOMERS

The parties have approved the contract and are committed to perform their respective obligations:

- Intent for oral or implied contracts; Approval for written contracts;
- the entity must also be able to conclude that both parties are committed to perform their respective obligations. That is, the entity must be committed to providing the promised goods or services. In addition, the customer must be committed to purchasing those promised goods and services.
- Termination clauses are also an important consideration when determining whether both parties are committed to perform under a contract and, consequently, whether a contract exists

Master Supply Agreement is unlikely to create enforeceable rights and obligations and hence cannot be considered as satisfied for Step 1

Each party's rights regarding the goods or services to be transferred can be identified.

Pretty straightforward - If the goods and services to be provided in the arrangement cannot be identified, it is not possible to conclude that an entity has a contract within the scope of the model in Ind AS 115.

IDENTIFY THE CONTRACT WITH CUSTOMERS

Payment terms can be identified:

Identifying the payment terms does not require that the transaction price be fixed or stated in the contract with the customer. As long as there is an enforceable right to payment (i.e., enforceability as a matter of law) and the contract contains sufficient information to enable the entity to estimate the transaction price, the contract would qualify for accounting under the standard.

Commercial substance:

Primarily to avoid round tripping;

Determining whether a contract has commercial substance for the purposes of Ind AS 115 may require significant judgement. In all situations, the entity must be able to demonstrate a substantive business purpose exists, considering the nature and structure of its transactions;

Impacts the entities that indulge in barter transactions.

IDENTIFY THE CONTRACT WITH CUSTOMERS

Collectability is probable

- Refers to customer's intent and ability to pay;
- For this one should consider the customer's financial capacity, his intention and past experiences.
- Should be evaluated at the contract inception itself;
- Probable – more likely than not;
- Assessment shall be carried out for transaction price not the contract price – Transaction price includes the impact of variable consideration as well.

It is generally expected that only a small number of arrangements may fail to meet the collectability criterion.

IDENTIFY THE CONTRACT WITH CUSTOMERS

An entity, a real estate developer, enters into a contract with a customer for the sale of a building for CU1 million. The customer intends to open a restaurant in the building. The building is located in an area where new restaurants face high levels of competition and the customer has little experience in the restaurant industry.

The customer pays a non-refundable deposit of CU50,000 at inception of the contract and enters into a long-term financing agreement with the entity for the remaining 95 per cent of the promised consideration. The financing arrangement is provided on a non-recourse basis, which means that if the customer defaults, the entity can repossess the building, but cannot seek further compensation from the customer, even if the collateral does not cover the full value of the amount owed. The entity's cost of the building is CU600,000. The customer obtains control of the building at contract inception.

In assessing whether the contract meets the criteria in paragraph 9 of Ind AS 115, the entity concludes that the criterion in paragraph 9(e) of Ind AS 115 is not met because it is not probable that the entity will collect the consideration to which it is entitled in exchange for the transfer of the building. In reaching this conclusion, the entity observes that the customer's ability and intention to pay may be in doubt because of the following factors:

(a) the customer intends to repay the loan (which has a significant balance) primarily from income derived from its restaurant business (which is a business facing significant risks because of high competition in the industry and the customer's limited experience);

(b) the customer lacks other income or assets that could be used to repay the loan; and

(c) the customer's liability under the loan is limited because the loan is nonrecourse.

Because the criteria in paragraph 9 of Ind AS 115 are not met, the entity applies paragraphs 15–16 of Ind AS 115 to determine the accounting for the nonrefundable deposit of CU50,000. The entity observes that none of the events described in paragraph 15 have occurred—that is, the entity has not received substantially all of the consideration and it has not terminated the contract. Consequently, in accordance with paragraph 16, the entity accounts for the non-refundable CU50,000 payment as a deposit liability.

IDENTIFY THE CONTRACT WITH CUSTOMERS

Collectability is probable

How would an entity assess collectability for a portfolio of contracts?

If an entity has determined it is probable that a customer will pay amounts owed under a contract, but the entity has historical experience that it will not collect consideration from some of the customers within a portfolio of contracts, it would be appropriate for the entity to record revenue for the contract in full and separately evaluate the corresponding contract asset or receivable for impairment. That is, the entity would not conclude the arrangement contains an implicit price concession and would not reduce revenue for the uncollectable amounts.

An entity has a large volume of similar customer contracts for which it invoices its customers in arrears, on a monthly basis. Before accepting a customer, the entity performs procedures designed to determine if it is probable that the customer will pay the amounts owed. It does not accept customers if it is not probable that the customer will pay the amounts owed. Because these procedures are only designed to determine whether collection is probable (and, thus, not a certainty), the entity anticipates that it will have some customers that will not pay all of the amounts owed. While the entity collects the entire amount due from the vast majority of its customers, on average, the entity's historical evidence (which is representative of its expectations for the future) indicates that the entity will only collect 98% of the amounts invoiced. In this case, the entity would recognise revenue for the full amount due and recognise a bad debt expense for 2% of the amount due (i.e., the amount the entity does not expect to collect).

IDENTIFY THE CONTRACT WITH CUSTOMERS

Collectability is probable

When would an entity reassess collectability?

In a nut shell, the reassessment **SHALL NOT** be done for all the minor changes.

The intent is to require an entity to reassess collectability when changes occur that are relatively minor in nature (i.e., those that do not call into question the validity of the contract). TRG members generally agreed that entities will need to exercise judgement to determine whether changes in the facts and circumstances are significant enough to indicate that a contract no longer exists.

IDENTIFY THE CONTRACT WITH CUSTOMERS

Combing contracts

The standard requires entities to combine contracts entered into at, or near, the same time with the same customer (or related parties of the customer) if they meet **one or more** of the criteria below:

- The contracts are negotiated together with a single commercial objective
- The consideration to be paid for one contract is dependent on the price or performance of another contract
- The goods or services promised in the contracts are a single performance obligation

IDENTIFY THE CONTRACT WITH CUSTOMERS

Contract modifications

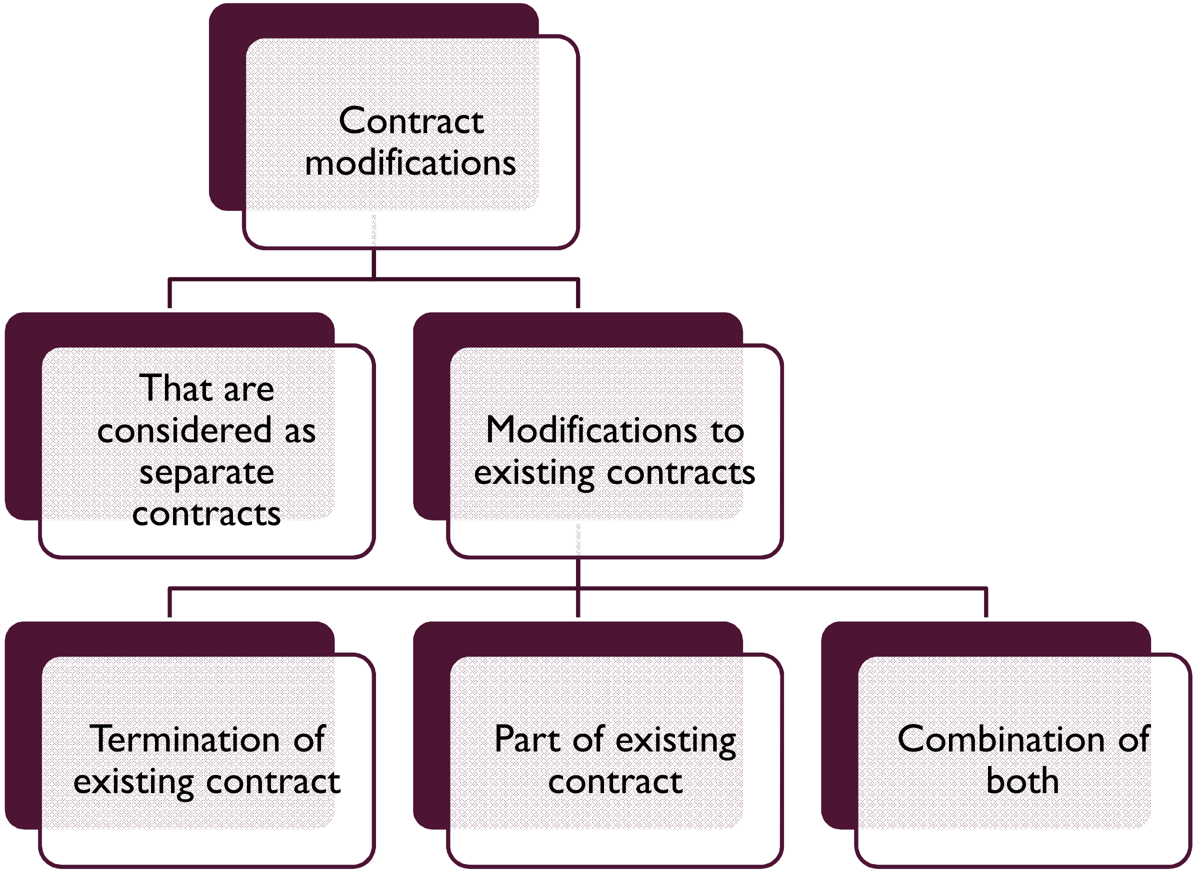
Either because of change in the scope or price or both;

In some jurisdictions, it is termed as variations or change orders etc.,

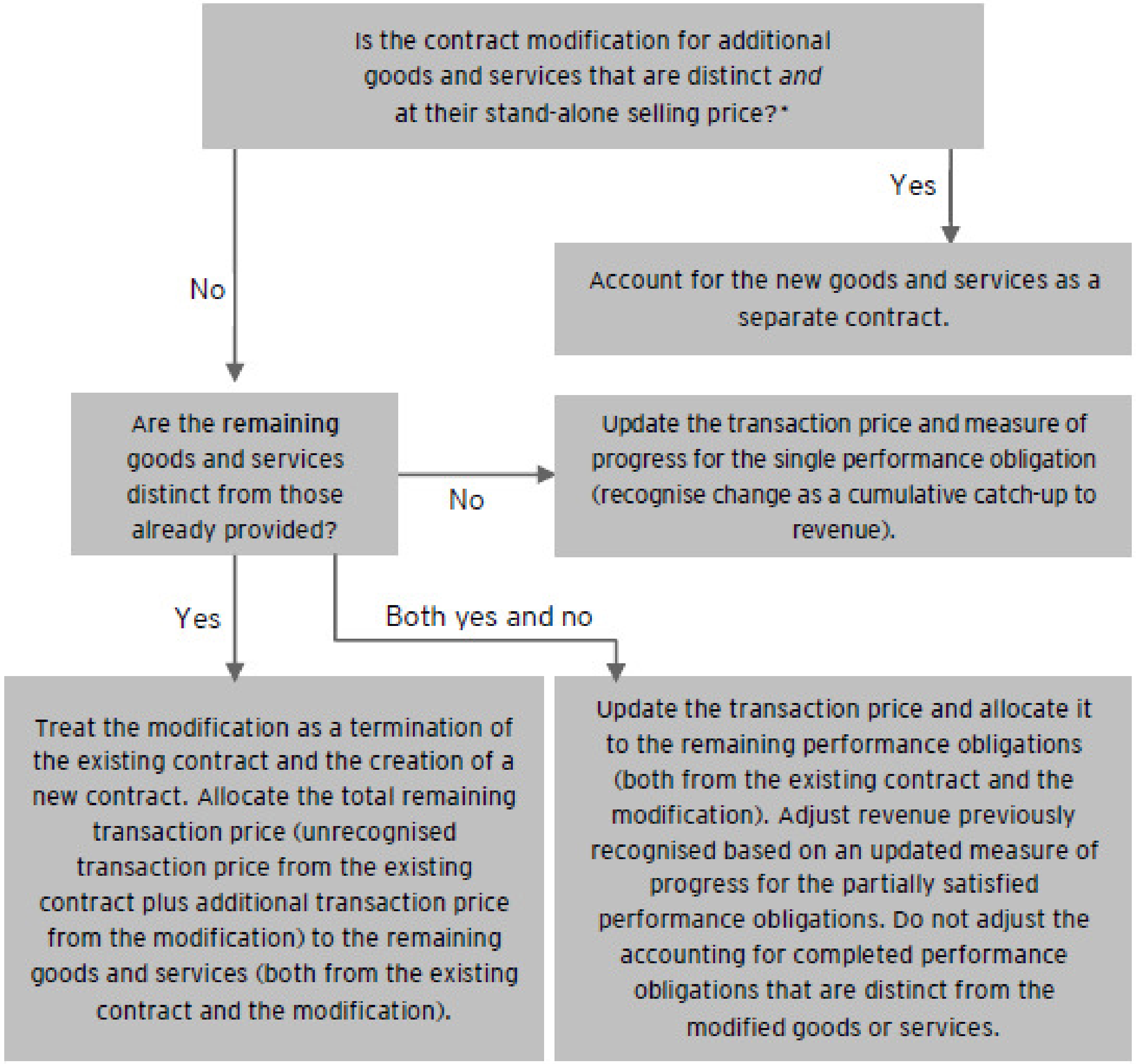
A contract modification could be approved in writing, by oral agreement or implied by customary business practices.

Once an entity has determined that a contract has been modified, the entity determines the appropriate accounting treatment for the modification. Certain modifications are treated as separate stand-alone contracts, while others are combined with the original contract and accounted for in that manner.

IDENTIFY THE CONTRACT WITH CUSTOMERS



The following chart illustrates these requirements:



IDENTIFY THE CONTRACT WITH CUSTOMERS

Illustrative examples

Example 1 *— Modification of a contract for goods*

An entity promises to sell 120 products to a customer for CU12,000 (CU100 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. The additional 30 products were not included in the initial contract.

Case A—Additional products for a price that reflects the stand-alone selling price

When the contract is modified, the price of the contract modification for the additional 30 products is an additional CU2,850 or CU95 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 (in accordance with paragraph 27 of Ind AS 115) from the original products.

In accordance with paragraph 20 of Ind AS 115, 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. The entity recognises revenue of CU100 per product for the 120 products in the original contract and CU95 per product for the 30 products in the new contract.

IDENTIFY THE CONTRACT WITH CUSTOMERS

Illustrative examples

Example 1 *— Modification of a contract for goods*

Case B—Additional products for a price that does not reflect the stand-alone selling price

During the process of negotiating the purchase of an additional 30 products, the parties initially agree on a price of CU80 per product. However, the customer discovers that the initial 60 products transferred to the customer contained minor defects that were unique to those delivered products. The entity promises a partial credit of CU15 per product to compensate the customer for the poor quality of those products. The entity and the customer agree to incorporate the credit of CU900 (CU15 credit × 60 products) into the price that the entity charges for the additional 30 products. Consequently, the contract modification specifies that the price of the additional 30 products is CU1,500 or CU50 per product. That price comprises the agreed-upon price for the additional 30 products of CU2,400, or CU80 per product, less the credit of CU900.

At the time of modification, the entity recognises the CU900 as a reduction of the transaction price and, therefore, as a reduction of revenue for the initial 60 products transferred. In accounting for the sale of the additional 30 products, the entity determines that the negotiated price of CU80 per product does not reflect the stand-alone selling price of the additional products. Consequently, the contract modification does not meet the conditions in paragraph 20 of Ind AS 115 to be accounted for as a separate contract. Because the remaining products to be delivered are distinct from those already transferred, the entity applies the requirements in paragraph 21(a) of Ind AS 115 and accounts for the modification as a termination of the original contract and the creation of a new contract. Consequently, the amount recognised as revenue for each of the remaining products is a blended price of CU93.33 {[(CU100 × 60 products not yet transferred under the original contract) + (CU80 × 30 products to be transferred under the contract modification)] ÷ 90 remaining products}.

IDENTIFY THE CONTRACT WITH CUSTOMERS

Arrangements that do not meet the definition of a contract under the standard

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.

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.

FIVE STEP APPROACH

Step 1: Identify the contract with customer;

Step 2: Identify the performance obligations;

Step 3: Determine the transaction price;

Step 4: Allocate the transaction price to performance obligations;

Step 5: Recognise revenue when (or as) the entity satisfies a performance obligation

IDENTIFY THE PERFORMANCE OBLIGATIONS

Identify the promises in the contract– Implicit promise Vs Explicit promise;

Determine when the promises are performance obligations;

Principal Vs agent considerations;

Consignment arrangements;

Customer options for additional goods and services (loyalty programmes)

Sale of products with right of return

IDENTIFY THE PERFORMANCE OBLIGATIONS

Identify the promises in the contract

At contract inception, an entity shall assess the goods or services promised in a contract with a customer and shall identify as a performance obligation each promise to transfer to the customer either:

(a) a good or service (or a bundle of goods or services) that is distinct; or

(b) a series of distinct goods or services that are substantially the same and that have the same pattern of transfer to the customer (see paragraph 23).

Unlike legacy Standard, which did not define elements/deliverables, the new standard provides guidance on the types of items that may be goods or services promised in the contract.

Promises of the entity in a contract can be either explicit or implied due to customer's valid expectations.

IDENTIFY THE PERFORMANCE OBLIGATIONS

Identify the promises in the contract

Example — Explicit and implicit promises in a contract

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

Case A—Explicit promise of service

In the contract with the distributor, the entity promises to provide maintenance services for no additional consideration (ie 'free') to any party (ie the end customer) that purchases the product from the distributor. The entity outsources the performance of the maintenance services to the distributor and pays the distributor an agreed-upon amount for providing those services on the entity's behalf. If the end customer does not use the maintenance services, the entity is not obliged to pay the distributor.

The contract with the customer includes two promised goods or services –

(a) the product and (b) the maintenance services. The promise of maintenance services is a promise to transfer goods or services in the future and is part of the negotiated exchange between the entity and the distributor.

The entity assesses whether each good or service is distinct in accordance with paragraph 27 of Ind AS 115. The entity determines that both the product and the maintenance services meet the criterion in paragraph 27(a) of Ind AS 115. The entity regularly sells the product on a stand-alone basis, which indicates that the customer can benefit from the product on its own. The customer can benefit from the maintenance services together with a resource the customer already has obtained from the entity (ie the product).

The product and the maintenance services are not inputs to a combined item in the contract. The entity is not providing a significant integration service because the presence of the product and the services together in this contract do not result in any additional or combined functionality. In addition, neither the product nor the services modify or customise the other. Lastly, the product and the maintenance services are not highly interdependent or highly interrelated because the entity would be able to fulfil each of the promises in the contract independently of its efforts to fulfil the other (ie the entity would be able to transfer the product even if the customer declined maintenance services and would be able to provide maintenance services in relation to products sold previously through other distributors).

Consequently, the entity allocates a portion of the transaction price to each of the two performance obligations (ie the product and the maintenance services) in the contract.

IDENTIFY THE PERFORMANCE OBLIGATIONS

Identify the promises in the contract

Example — Explicit and implicit promises in a contract

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

Case B—Implicit promise of service

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

However, on the basis of its customary business practice, the entity determines at contract inception that it has made an implicit promise to provide maintenance services as part of the negotiated exchange with the distributor. That is, the entity's past practices of providing these services create valid expectations of the entity's customers (ie the distributor and end customers) in accordance with paragraph 24 of Ind AS 115. Consequently, the entity assesses whether the promise of maintenance services is a performance obligation. For the same reasons as in Case A, the entity determines that the product and maintenance services are separate performance obligations.

IDENTIFY THE PERFORMANCE OBLIGATIONS

Identify the promises in the contract

Example — Explicit and implicit promises in a contract

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

Case C—Services are not a promised service

In the contract with the distributor, the entity does not promise to provide any maintenance services. In addition, the entity typically does not provide maintenance services and, therefore, the entity's customary business practices, published policies and specific statements at the time of entering into the contract have not created an implicit promise to provide goods or services to its customers. The entity transfers control of the product to the distributor and, therefore, the contract is completed. However, before the sale to the end customer, the entity makes an offer to provide maintenance services to any party that purchases the product from the distributor for no additional promised consideration.

The promise of maintenance is not included in the contract between the entity and the distributor at contract inception. That is, in accordance with paragraph 24 of Ind AS 115, the entity does not explicitly or implicitly promise to provide maintenance services to the distributor or the end customers. Consequently, the entity does not identify the promise to provide maintenance services as a performance obligation. Instead, the obligation to provide maintenance services is accounted for in accordance with Ind AS 37 Provisions, Contingent Liabilities and Contingent Assets. Although the maintenance services are not a promised service in the current contract, in future contracts with customers the entity would assess whethe it has created a business practice resulting in an implied promise to provide maintenance services.

IDENTIFY THE PERFORMANCE OBLIGATIONS

Determining when promises are performance obligations

After identifying the promised goods and services within a contract, an entity determines which of those goods and services will be treated as separate performance obligations.

Promised goods or services represent separate performance obligations if the goods or services are distinct.

If a promised good or service is not distinct, an entity is required to combine that good or service with other promised goods or services until it identifies a bundle of goods or services that, together, is distinct.

An entity will be required to account for all the goods or services promised in a contract as a single performance obligation if the entire bundle of promised goods and services is the only performance obligation identified.

IDENTIFY THE PERFORMANCE OBLIGATIONS

Determining when promises are performance obligations

Determination of distinct

Two step process:

Consideration at the level of the individual good or service of **whether the customer can benefit from the good or service on its own** or with other readily available resources;

Consideration of whether the good or service is **separately identifiable** from other promises in the contract.

Customer can benefit from the good or service on its own?

A customer can benefit from a good or service in accordance with paragraph 27(a) if the good or service could be used, consumed, sold for an amount that is greater than scrap value or otherwise held in a way that generates economic benefits. For some goods or services, a customer may be able to benefit from a good or service on its own. For other goods or services, a customer may be able to benefit from the good or service only in conjunction with other readily available resources. A readily available resource is a good or service that is sold separately (by the entity or another entity) or a resource that the customer has already obtained from the entity (including goods or services that the entity will have already transferred to the customer under the contract) or from other transactions or events. Various factors may provide evidence that the customer can benefit from a good or service either on its own or in conjunction with other readily available resources. For example, the fact that the entity regularly sells a good or service separately would indicate that a customer can benefit from the good or service on its own or with other readily available resources.

IDENTIFY THE PERFORMANCE OBLIGATIONS

Determining when promises are performance obligations

Determination of distinct

Separately identifiable (Distinct within the context of the contract)

The promises in the contract are **not** separately identifiable:

- If the entity provides a significant service of integrating the goods or services with other goods or services (Primarily in construction industry);
- one or more of the goods or services significantly modifies or customises, or are significantly modified or customised by, one or more of the other goods or services promised in the contract;
- The goods or services are highly interdependent or highly interrelated

IDENTIFY THE PERFORMANCE OBLIGATIONS

Determining when promises are performance obligations

Determination of distinct

Case A—Significant integration service

An entity, a contractor, enters into a contract to build a hospital for a customer. The entity is responsible for the overall management of the project and identifies various promised goods and services, including engineering, site clearance, foundation, procurement, construction of the structure, piping and wiring, installation of equipment and finishing.

The promised goods and services are capable of being distinct in accordance with paragraph 27(a) of Ind AS 115. That is, 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 promises to transfer the goods and services are not separately identifiable in accordance with paragraph 27(b) of Ind AS 115 (on the basis of the factors in paragraph 29 of Ind AS 115). This is evidenced by the fact that the entity provides a significant service of integrating the goods and services (the inputs) into the hospital (the combined output) for which the customer has contracted.

Because both criteria in paragraph 27 of Ind AS 115 are 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.

IDENTIFY THE PERFORMANCE OBLIGATIONS

Determining when promises are performance obligations

Determination of distinct

Significant customization

New software implementation is the best example

Highly interrelated (two way dependency or transformative relationship)

Sale of dossier and supply of goods

IDENTIFY THE PERFORMANCE OBLIGATIONS

Series of distinct goods and services that are substantially the same and have the same pattern of transfer

As discussed above, Ind AS 115.22(b) defines, as a second type of performance obligation, a promise to transfer to the customer a series of distinct goods or services that are substantially the same and that have the same pattern of transfer, if both of the following criteria from Ind AS 115.23 are met:

- Each distinct good or service in the series that the entity promises to transfer represents a performance obligation that would be satisfied over time, in accordance with Ind AS 115.35, if it were accounted for separately.

- The entity would measure its progress toward satisfaction of the performance obligation using the same measure of progress for each distinct good or service in the series.

IDENTIFY THE PERFORMANCE OBLIGATIONS

A vendor and customer execute a 10-year information technology (IT) outsourcing arrangement in which the vendor continuously delivers the outsourced activities over the contract term (e.g., it provides server capacity, manages the customer's software portfolio, runs an IT help desk). The total monthly invoice is calculated based on different units consumed for the respective activities. The vendor concludes that the customer simultaneously receives and consumes the benefits provided by its services as it performs (meeting the over-time criterion in Ind AS 115.35(a)).

The vendor first considers the nature of its promise to the customer. Because the vendor has promised to provide an unspecified quantity of activities, rather than a defined number of services, it can be noted that the vendor could reasonably conclude that the nature of the promise is an obligation to stand ready to provide the integrated outsourcing service each day. If the nature of the promise is the overall IT outsourcing service, each day of service could be considered distinct because the customer can benefit from each day of service on its own and each day is separately identifiable. It is also noted that the vendor could reasonably conclude that each day of service is substantially the same. That is, even if the individual activities that comprise the performance obligation vary from day to day, the nature of the overall promise is the same from day to day. Accordingly, it would be reasonable for an entity to conclude that this contract meets the series requirement.

IDENTIFY THE PERFORMANCE OBLIGATIONS

Promised goods and services that are not distinct

If a promised good or service does not meet the criteria to be considered distinct, an entity is required to combine that good or service with other promised goods or services until the entity identifies a bundle of goods or services that, together, is distinct. This could result in an entity combining a good or service that is not considered distinct with another good or service that, on its own, would have met the criteria to be considered distinct.

The standard provides two examples of contracts with promised goods and services that, while capable of being distinct, are not distinct in the context of the contract because of a significant integration service that combines the inputs (the underlying goods and services) into a combined output.

IDENTIFY THE PERFORMANCE OBLIGATIONS

Principal versus agent considerations

When more than one party is involved in providing goods or services to a customer, the standard requires an entity to determine whether it is a principal or an agent in these transactions by evaluating the nature of its promise to the customer. An entity is a principal (and, therefore, records revenue on a gross basis) if it controls a promised good or service before transferring that good or service to the customer. An entity is an agent (and, therefore, records as revenue the net amount that it retains for its agency services) if its role is to arrange for another entity to provide the goods or services.

In the Basis for Conclusions, the Board explained that in order for an entity to conclude that it is providing the good or service to the customer, it must first control that good or service. That is, the entity cannot provide the good or service to a customer if the entity does not first control it. If an entity controls the good or service, the entity is a principal in the transaction. If an entity does not control the good or service before it is transferred to the customer, the entity is an agent in the transaction.

IDENTIFY THE PERFORMANCE OBLIGATIONS

When another party is involved in providing goods or services to a customer, the entity shall determine whether the nature of its promise is a performance obligation to provide the specified goods or services itself (ie the entity is a principal) or to arrange for those goods or services to be provided by the other party (ie the entity is an agent). An entity determines whether it is a principal or an agent for each specified good or service promised to the customer. A specified good or service is a distinct good or service (or a distinct bundle of goods or services) to be provided to the customer (see paragraphs 27–30). If a contract with a customer includes more than one specified good or service, an entity could be a principal for some specified goods or services and an agent for others.

To determine the nature of its promise (as described in paragraph B34), the entity shall:

(a) identify the specified goods or services to be provided to the customer (which, for example, could be a right to a good or service to be provided by another party (see paragraph 26)); and

(b) assess whether it controls (as described in paragraph 33) each specified good or service before that good or service is transferred to the customer.

An entity is a principal if it controls the specified good or service before that good or service is transferred to a customer. However, an entity does not necessarily control a specified good if the entity obtains legal title to that good only momentarily before legal title is transferred to a customer. An entity that is a principal may satisfy its performance obligation to provide the specified good or service itself or it may engage another party (for example, a subcontractor) to satisfy some or all of the performance obligation on its behalf.

IDENTIFY THE PERFORMANCE OBLIGATIONS

When another party is involved in providing goods or services to a customer, an entity that is a principal obtains control of any one of the following:

(a) a good or another asset from the other party that it then transfers to the customer.

(b) a right to a service to be performed by the other party, which gives the entity the ability to direct that party to provide the service to the customer on the entity's behalf.

(c) a good or service from the other party that it then combines with other goods or services in providing the specified good or service to the customer. For example, if an entity provides a significant service of integrating goods or services (see paragraph 29(a)) provided by another party into the specified good or service for which the customer has contracted, the entity controls the specified good or service before that good or service is transferred to the customer. This is because the entity first obtains control of the inputs to the specified good or service (which includes goods or services from other parties) and directs their use to create the combined output that is the specified good or service.

IDENTIFY THE PERFORMANCE OBLIGATIONS

Principal versus agent considerations

Indicators that an entity controls the specified good or service before it is transferred to the customer (and is therefore a principal (see paragraph B35)) include, but are not limited to, the following:

(a) *the entity is primarily responsible for fulfilling the promise to provide the specified good or service.*

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

(c) *the entity has discretion in establishing the price for the specified good or service.*

(EITF 99-19 had other indications as well such as credit risk, discretion in supplier selection, who takes the service specifications from the customer, and etc.,)

IDENTIFY THE PERFORMANCE OBLIGATIONS

Principal versus agent considerations - Examples

1) Office maintenance services – Entity – Customer and third party service provides working on behalf of the entity;

2) Entity purchasing air tickets at reduced prices from airlines – Entity is principal;

3) Selling vouchers that offer significant discounts to customers;

IDENTIFY THE PERFORMANCE OBLIGATIONS

Consignment arrangements

Pretty straight forward guidance.

Customer options for additional goods or services

- Many sales contracts give customers the option to acquire additional goods or services. These additional goods and services may be priced at a discount or may even be free of charge.
- Sales incentives / frequent flying points / volume-tiered pricing structures / coupons etc.,
- Such options becomes a separate performance obligation if it provides material right to the customer.
- No bright line guidance for the word material

IDENTIFY THE PERFORMANCE OBLIGATIONS

Customer options for additional goods or services

Example — Option that provides the customer with a material right (discount voucher)

An entity enters into a contract for the sale of Product A for CU100. As part of the contract, the entity gives the customer a 40 per cent discount voucher for any future purchases up to CU100 in the next 30 days. The entity intends to offer a 10 per cent discount on all sales during the next 30 days as part of a seasonal promotion. The 10 per cent discount cannot be used in addition to the 40 per cent discount voucher.

Because all customers will receive a 10 per cent discount on purchases during the next 30 days, the only discount that provides the customer with a material right is the discount that is incremental to that 10 per cent (ie the additional 30 per cent discount). The entity accounts for the promise to provide the incremental discount as a performance obligation in the contract for the sale of Product A.

To estimate the stand-alone selling price of the discount voucher in accordance with paragraph B42 of Ind AS 115, the entity estimates an 80 per cent likelihood that a customer will redeem the voucher and that a customer will, on average, purchase CU50 of additional products. Consequently, the entity's estimated stand-alone selling price of the discount voucher is CU12 (CU50 average purchase price of additional products × 30 per cent incremental discount × 80 per cent likelihood of exercising the option). The stand-alone selling prices of Product A and the discount voucher and the resulting allocation of the CU100 transaction price are as follows:

IDENTIFY THE PERFORMANCE OBLIGATIONS

Customer options for additional goods or services

Example — Option that provides the customer with a material right (discount voucher)

Performance obligations	Stand-alone selling price	
	CU	
Product A	100	
Discount voucher	12	
Total	112	
	Allocated transaction price	
Product A	89	(CU100 ÷ CU112 × CU100)
Discount voucher	11	(CU12 ÷ CU112 × CU100)
Total	100	

The entity allocates CU89 to Product A and recognises revenue for Product A when control transfers. The entity allocates CU11 to the discount voucher and recognises revenue for the voucher when the customer redeems it for goods or services or when it expires.

IDENTIFY THE PERFORMANCE OBLIGATIONS

Customer options for additional goods or services

Example of customer option with no contractual penalties

An entity sells equipment and consumables, both of which are determined to be distinct goods that are recognised at a point in time.

The stand-alone selling price of the equipment and each consumable is CU10,000 and CU100, respectively. The equipment costs CU8,000 and each consumable costs CU60. The entity sells the equipment for CU6,000 (i.e., at a 40% discount on its stand-alone selling price) with a customer option to purchase each consumable for CU100 (i.e., equal to its stand-alone selling price). There are no contractual minimums, but the entity estimates the customer will purchase 200 parts over the next two years. This is an exclusive contract in which the customer cannot purchase the consumables from any other vendors during the contract term.

It is generally agreed that the consumables underlying each option would not be considered part of the contract. Furthermore, the option does not represent a material right because it is priced at the stand-alone selling price for the consumable. This is the case even though the customer is compelled to exercise its option for the consumables because the equipment cannot function without the consumables and the contract includes an exclusivity clause that requires the customer to acquire the consumables only from the entity. Accordingly, the transaction price is CU6,000 and it is entirely attributable to the equipment. This would result in a loss for the entity of CU2,000 when it transfers control of the equipment to the customer.

IDENTIFY THE PERFORMANCE OBLIGATIONS

Sale of products with a right of return

An entity may provide its customers with a right to return a transferred product.

A right of return may be contractual, an implicit right that exists due to the entity's customary business practice or a combination of both (e.g., an entity has a stated return period, but generally accepts returns over a longer period).

A customer exercising its right to return a product may receive a full or partial refund, a credit that can be applied to amounts owed, a different product in exchange or any combination of these items.

Ind AS 115.B22 states that such an obligation does not represent a performance obligation. Instead, the Board concluded that an entity makes an uncertain number of sales when it provides goods with a return right. That is, until the right of return expires, the entity is not certain how many sales will fail. Therefore, an entity does not recognise revenue for sales that are expected to fail as a result of the customer exercising its right to return the goods. Instead, the potential for customer returns needs to be considered when an entity estimates the transaction price because potential returns are a component of variable consideration.

FIVE STEP APPROACH

Step 1: Identify the contract with customer;

Step 2: Identify the performance obligations;

Step 3: Determine the transaction price;

Step 4: Allocate the transaction price to performance obligations;

Step 5: Recognise revenue when (or as) the entity satisfies a performance obligation

DETERMINE THE TRANSACTION PRICE

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.

Steps involved in determining the transaction price:

- Variable consideration;
- Constraining estimates of variable consideration;
- Existence of significant financing component;
- Non-cash consideration; and
- Consideration payable to customer

DETERMINE THE TRANSACTION PRICE

Variable consideration:

The transaction price reflects an entity's expectations about the consideration to which it will be entitled to receive from the customer. The standard provides the following requirements for determining whether consideration is variable and, if so, how it would be treated under the model:

Paragraph 50

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

Paragraph 51

Exists only in IFRS. Ind AS 115 carves this out and provides separate guidance

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

The terms relating to variable consideration may be explicitly stated or implicitly demonstrated

DETERMINE THE TRANSACTION PRICE

Variable consideration:

Paragraph 51AA

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

DETERMINE THE TRANSACTION PRICE

Example —Volume discount incentive

An entity enters into a contract with a customer on 1 January 20X8 to sell Product A for CU100 per unit. If the customer purchases more than 1,000 units of Product A in a calendar year, the contract specifies that the price per unit is retrospectively reduced to CU90 per unit. Consequently, the consideration in the contract is variable.

For the first quarter ended 31 March 20X8, the entity sells 75 units of Product A to the customer. The entity estimates that the customer's purchases will not exceed the 1,000-unit threshold required for the volume discount in the calendar year.

The entity considers the requirements in paragraphs 56–58 of Ind AS 115 on constraining estimates of variable consideration, including the factors in paragraph 57 of Ind AS 115. The entity determines that it has significant experience with this product and with the purchasing pattern of the entity.

Thus, the entity concludes that it is highly probable that a significant reversal in the cumulative amount of revenue recognised (ie CU100 per unit) will not occur when the uncertainty is resolved (ie when the total amount of purchases is known). Consequently, the entity recognises revenue of CU7,500 (75 units × CU100 per unit) for the quarter ended 31 March 20X8.

In May 20X8, the entity's customer acquires another company and in the second quarter ended 30 June 20X8 the entity sells an additional 500 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 1,000-unit threshold for the calendar year and therefore it will be required to retrospectively reduce the price per unit to CU90.

Consequently, the entity recognises revenue of CU44,250 for the quarter ended 30 June 20X8. That amount is calculated from CU45,000 for the sale of 500 units (500 units × CU90 per unit) less the change in transaction price of CU750 (75 units × CU10 price reduction) for the reduction of revenue relating to units sold for the quarter ended 31 March 20X8 (see paragraphs 87 and 88 of Ind AS 115).

DETERMINE THE TRANSACTION PRICE

Example — Consideration is not the stated price – implicit price concession

An entity sells 1,000 units of a prescription drug to a customer for promised consideration of CU1 million. This is the entity's first sale to a customer in a new region, which is experiencing significant economic difficulty. Thus, the entity expects that it will not be able to collect from the customer the full amount of the promised consideration. Despite the possibility of not collecting the full amount, the entity expects the region's economy to recover over the next two to three years and determines that a relationship with the customer could help it to forge relationships with other potential customers in the region.

When assessing whether the criterion in paragraph 9(e) of Ind AS 115 is met, the entity also considers paragraphs 47 and 52(b) of Ind AS 115. Based on the assessment of the facts and circumstances, the entity determines that it expects to provide a price concession and accept a lower amount of consideration from the customer. Accordingly, the entity concludes that the transaction price is not CU1 million and, therefore, the promised consideration is variable. The entity estimates the variable consideration and determines that it expects to be entitled to CU400,000.

The entity considers the customer's ability and intention to pay the consideration and concludes that even though the region is experiencing economic difficulty, it is probable that it will collect CU400,000 from the customer. Consequently, the entity concludes that the criterion in paragraph 9(e) of Ind AS 115 is met based on an estimate of variable consideration of CU400,000. In addition, on the basis of an evaluation of the contract terms and other facts and circumstances, the entity concludes that the other criteria in paragraph 9 of Ind AS 115 are also met. Consequently, the entity accounts for the contract with the customer in accordance with the requirements in Ind AS 115.

DETERMINE THE TRANSACTION PRICE

How should this variable consideration be measured? (Paragraph 53)

Similar to the approach mentioned in Ind AS 37

- Expected value approach; or
- Most likely amount

Constraining estimates of variable consideration

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

An entity needs to consider both the likelihood and the magnitude of such reversal

Additional guidance from the parent Standard:

The IASB explained in the Basis for Conclusions that it did not intend to eliminate the use of estimates from the revenue recognition standard. Instead, it wanted to make sure the estimates are robust and result in useful information. Following this objective, the Board concluded that it was appropriate to include estimates of variable consideration in revenue only when an entity has a 'high degree of confidence' that revenue will not be reversed in a subsequent reporting period.

DETERMINE THE TRANSACTION PRICE

There are some types of variable consideration that are frequently included in contracts that have significant uncertainties. It will likely be more difficult for an entity to assert it is highly probable that these types of estimated amounts will not be subsequently reversed. Examples of the types of variable consideration include the following:

• Payments contingent on regulatory approval (e.g., regulatory approval of a new drug)

• Long-term commodity supply arrangements that settle based on market prices at the future delivery date

• Contingency fees based on litigation or regulatory outcomes (e.g., fees based on the positive outcome of litigation or the settlement of claims with government agencies)

Another example:

Entity A provides transportation services to theme park customers for a fixed fee of CU 400,000. Its performance may yield a bonus of CU 0 to CU 600,000. Based on its history with the theme park, customer travel patterns and its current expectations, Entity A estimates the probabilities as under:

Bonus amount	Probability of outcome
-	30%
CU 200,000	30%
CU 400,000	35%
CU 600,000	5%

Would the answer be different if the bonus amount can only be one of the amounts but not a range

DETERMINE THE TRANSACTION PRICE

Accounting for specific types of variable consideration

Rights of return:

B21. To account for the transfer of products with a right of return (and for some services that are provided subject to a refund), an entity shall recognise all of the following:

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

(b) a refund liability; and

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

DETERMINE THE TRANSACTION PRICE

Example — Right of return

An entity enters into 100 contracts with customers. Each contract includes the sale of one product for CU100 (100 total products × CU100 = CU10,000 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 CU60. The entity applies the requirements in Ind AS 115 to the portfolio of 100 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.

Because 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 97 products will not be returned.

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 CU9,700 (CU100 × 97 products not expected to be returned) can be included in the transaction price. The entity considers the factors in paragraph 57 of Ind AS 115 and determines that although the returns are outside the entity's influence, it has significant experience in estimating returns for this product and customer class. In addition, the uncertainty will be resolved within a short time frame (ie the 30- day return period). Thus, the entity concludes that it is highly probable that a significant reversal in the cumulative amount of revenue recognised (i.e., CU9,700) will not occur as the uncertainty is resolved (ie 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 100 products, the entity does not recognise revenue for the three 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 CU9,700 (CU100 × 97 products not expected to be returned);

(b) a refund liability of CU300 (CU100 refund × 3 products expected to be returned); and

(c) an asset of CU180 (CU60 × 3 products for its right to recover products from customers on settling the refund liability).

DETERMINE THE TRANSACTION PRICE

Sales-based and usage-based royalties on licences of intellectual property

The standard provides explicit application guidance for recognizing consideration from sales and usage-based royalties provided in exchange for licences of intellectual property. The standard states that an entity recognises sales and usage-based royalties as revenue only at the later of when:

(1) The subsequent sales or usage occurs. **Or**

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

Appears that the above guidance is not applicable for normal profit share arrangements that are based on subsequent sale of the goods, rather than the use of intellectual property.

DETERMINE THE TRANSACTION PRICE

Significant financing component

For some transactions, the receipt of the consideration does not match the timing of the transfer of goods or services to the customer (e.g., the consideration is prepaid or is paid after the services are provided). When the customer pays in arrears, the entity is effectively providing financing to the customer. Conversely, when the customer pays in advance, the entity has effectively received financing from the customer.

Exceptions to financing considerations -

Time based consideration - As a practical expedient, an entity need not adjust the promised amount of consideration for the effects of a significant financing component if the entity expects, at contract inception, that the period between when the entity transfers a promised good or service to a customer and when the customer pays for that good or service will be one year or less.

Materiality based consideration - an entity is not required to adjust the promised amount of consideration for the effects of a significant financing component if the entity expects, at contract inception

Discount rate -

It should reflect the rate in the separate financing transaction.

Financial statement presentation –

Interest income or expense as the case may be.

DETERMINE THE TRANSACTION PRICE

Non cash consideration

Customer consideration may be in the form of goods, services or other non-cash consideration (e.g., property, plant and equipment, a financial instrument). When an entity (i.e., the seller or vendor) receives, or expects to receive, non-cash consideration, the fair value of the non-cash consideration is included in the transaction price.

An entity will likely apply the requirements of Ind AS 113 Fair Value Measurement or Ind AS 102 Share-based payment when measuring the fair value of any non-cash consideration.

DETERMINE THE TRANSACTION PRICE

Consideration paid or payable to customer

Many entities make payments to their customers. In some cases, the consideration paid or payable represents purchases by the entity of goods or services offered by the customer that satisfy a business need of the entity. In other cases, the consideration paid or payable represents incentives given by the entity to entice the customer to purchase, or continue purchasing, its goods or services.

70. Consideration payable to a customer includes cash amounts that an entity pays, or expects to pay, to the customer (or to other parties that purchase the entity's goods or services from the customer). Consideration payable to a customer also includes credit or other items (for example, a coupon or voucher) that can be applied against amounts owed to the entity (or to other parties that purchase the entity's goods or services from the customer). An entity shall account for consideration payable to a customer as a reduction of the transaction price and, therefore, of revenue unless the payment to the customer is in exchange for a distinct good or service (as described in paragraphs 26–30) that the customer transfers to the entity. If the consideration payable to a customer includes a variable amount, an entity shall estimate the transaction price (including assessing whether the estimate of variable consideration is constrained) in accordance with paragraphs 50–58.

71. If consideration payable to a customer is a payment for a distinct good or service from the customer, then an entity shall account for the purchase of the good or service in the same way that it accounts for other purchases from suppliers. If the amount of consideration payable to the customer exceeds the fair value of the distinct good or service that the entity receives from the customer, then the entity shall account for such an excess as a reduction of the transaction price. If the entity cannot reasonably estimate the fair value of the good or service received from the customer, it shall account for all of the consideration payable to the customer as a reduction of the transaction price.

Examples – Slotting fee, Co-operative advertising arrangements, Price protection, Coupons and rebates, pay to play contracts etc.,

FIVE STEP APPROACH

Step 1: Identify the contract with customer;

Step 2: Identify the performance obligations;

Step 3: Determine the transaction price;

Step 4: Allocate the transaction price to performance obligations;

Step 5: Recognise revenue when (or as) the entity satisfies a performance obligation

ALLOCATE THE CONSIDERATION TO POS

Broad steps in allocating the consideration:

- Estimating the stand-alone selling prices;
- Applying the relative standalone selling price method;
- Allocating variable consideration;
- Allocating discounts;
- Changes in the transaction price after inception; and
- Allocation of transaction price to components outside the scope of Ind AS 115

ALLOCATE THE CONSIDERATION TO POS

Estimating the stand-alone selling prices

Identify the stand-alone selling prices if they are readily available;

If not readily available, ESTIMATE the standalone selling price.

Suitable methods for estimating the stand-alone selling prices:

Adjusted market assessment approach – The price that a customer in the relevant market would be willing to pay for the asset

Expected cost plus margin approach – Costs incurred so far and appropriate margin percentage. The margin is not what the entity would charge but rather the margin that the market is willing to pay for the product.

Residual approach – Total contract price minus standalone selling prices of other performance obligations

ALLOCATE THE CONSIDERATION TO POS

Illustration - Measuring an option

A machinery maintenance contract provider offers a promotion to new customers who pay full price for the first year of maintenance coverage that would grant them an option to renew their services for up to two years at a discount. The entity regularly sells maintenance coverage for CU750 per year. With the promotion, the customer would be able to renew the one-year maintenance at the end of each year for CU600. ***The entity concludes that the ability to renew is a material right*** *because the customer would receive a discount that exceeds any discount available to other customers. The entity also determines that no directly observable stand-alone selling price exists for the option to renew at a discount.*

Scenario A – Estimate the stand-alone selling price of the option directly

Since the entity has no directly observable evidence of the stand-alone selling price for the renewal option, it estimates the stand-alone selling price of an option for a CU150 discount on the renewal of service in years two and three. When developing its estimate, the entity would consider factors such as the likelihood that the option will be exercised and the price of comparable discounted offers. For example, the entity may consider the selling price of an offer for a discounted price of similar services found on a 'deal of the day' website.

The option will then be included in the relative stand-alone selling price allocation. In this example, there will be two performance obligations: one-year of maintenance services; and an option for discounted renewals. The consideration of CU750 is allocated between these two performance obligations based on their relative stand-alone selling prices.

ALLOCATE THE CONSIDERATION TO POS

Scenario B – Practical alternative to estimating the stand-alone selling price of the option using the renewal option approach

Assume the entity obtained 100 new customers under the promotion. Based on its experience, the entity anticipates approximately 50% attrition annually, after giving consideration to the anticipated effect that the CU150 discount will have on attrition. The entity considers the constraint on variable consideration and concludes that it is not highly probable that a significant revenue reversal will not occur. Therefore, the entity concludes that, for this portfolio of contracts, it will ultimately sell 175 contracts, each contract providing one-year of maintenance services (100 customers in the first year, 50 customers in the second year and 25 customers in the third year).

The total consideration the entity expects to receive is CU120,000 [(100 x CU750) + (50 x CU600) + (25 x CU600)] (i.e., the hypothetical transaction price). Assuming the stand-alone selling price for each maintenance contract period is the same, the entity allocates CU685.71 (CU120,000/175) to each maintenance contract sold.

During the first year, the entity will recognise revenue of CU68,571 (100 one-year maintenance service contracts sold x the allocated price of CU685.71 per maintenance service contract). Consequently, at contract inception, the entity would allocate CU6,429 to the option to renew (CU75,000 cash received – CU68,571 revenue to be recognised in the first year).

If the actual renewals in years two and three differ from expectations, the entity would have to update the hypothetical transaction price and allocation accordingly. However, the estimate of the standalone selling prices at contract inception would not be updated.

For example, assume that the entity experiences less attrition than expected (e.g., 40% attrition annually, instead of 50%). Therefore, the entity estimates that it will ultimately sell 196 one-year maintenance services (100 + 60 renewals after year one + 36 renewals after year two). Accordingly, the total consideration that the entity expects to receive is CU132,600 [(100 x CU750) + (60 x CU600) + (36 x CU600)] (i.e., the updated hypothetical transaction price). The entity would not update its estimates of the stand-alone selling prices (which were assumed to be the same for each maintenance period). As such, the entity allocates CU676.53 (CU132,600/196) to each maintenance period. This would require the entity to reduce the amount of revenue it recognises in year one by CU918 (CU68,571 – (100 x CU676.53)) because the amount allocated to the option would have been higher at contract inception.

ALLOCATE THE CONSIDERATION TO POS

Allocating variable consideration

85. An entity shall allocate a variable amount (and subsequent changes to that amount) entirely to a performance obligation or to a distinct good or service that forms part of a single performance obligation in accordance with paragraph 22(b) **if both** of the following criteria are met:

a) the terms of a variable payment relate specifically to the entity's efforts to satisfy the performance obligation or transfer the distinct good or service (or to a specific outcome from satisfying the performance obligation or transferring the distinct good or service); and

b) allocating the variable amount of consideration entirely to the performance obligation or the distinct good or service is consistent with the allocation objective in paragraph 73 when considering all of the performance obligations and payment terms in the contract.

ALLOCATE THE CONSIDERATION TO POS

Allocating discount

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 standalone 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.

ALLOCATE THE CONSIDERATION TO POS

Manufacturing Co. entered into a contract with a customer to sell a machine for CU100,000. The total contract price included installation of the machine and a two-year extended warranty. Assume that Manufacturing Co. determined there were three performance obligations and the stand-alone selling prices of those performance obligations were as follows: machine — CU75,000, installation services — CU14,000 and extended warranty — CU20,000.

The aggregate of the stand-alone selling prices (CU109,000) exceeds the total transaction price of CU100,000, indicating there is a discount inherent in the contract. That discount must be allocated to each of the individual performance obligations based on the relative stand-alone selling price of each performance obligation. Therefore, the amount of the CU100,000 transaction price is allocated to each performance obligation as follows:

Machine — CU68,807 (CU100,000 x (CU75,000/CU109,000))

Installation — CU12,844 (CU100,000 x (CU14,000/CU109,000))

Warranty — CU18,349 (CU100,000 x (CU20,000/CU109,000))

The entity would recognise as revenue the amount allocated to each performance obligation when (or as) each performance obligation is satisfied.

ALLOCATE THE CONSIDERATION TO POS

An entity enters into a contract with a customer for two intellectual property licences (Licences X and Y), which the entity determines to represent two performance obligations each satisfied at a point in time. The stand-alone selling prices of Licences X and Y are CU800 and CU1,000, respectively.

Case A—Variable consideration allocated entirely to one performance obligation

The price stated in the contract for Licence X is a fixed amount of CU800 and for Licence Y the consideration is three per cent of the customer's future sales of products that use Licence Y. For purposes of allocation, the entity estimates its sales-based royalties (ie the variable consideration) to be CU1,000, in accordance with paragraph 53.

To allocate the transaction price, the entity considers the criteria in paragraph 85 and concludes that the variable consideration (ie the sales-based royalties) should be allocated entirely to Licence Y. The entity concludes that the criteria in paragraph 85 of Ind AS 115 are met for the following reasons:

(a) The variable payment relates specifically to an outcome from the performance obligation to transfer Licence Y (ie the customer's subsequent sales of products that use Licence Y).

(b) Allocating the expected royalty amounts of CU1,000 entirely to Licence Y is consistent with the allocation objective in paragraph 73. This is because the entity's estimate of the amount of sales based royalties (CU1,000) approximates the stand-alone selling price of Licence Y and the fixed amount of CU800 approximates the stand-alone selling price of Licence X. The entity allocates CU800 to Licence X in accordance with paragraph 86 of Ind AS 115. This is because, based on an assessment of the facts and circumstances relating to both licences, allocating to Licence Y some of the fixed consideration in addition to all of the variable consideration would not meet the allocation objective in paragraph 73.

ALLOCATE THE CONSIDERATION TO POS

The entity transfers Licence Y at inception of the contract and transfers Licence X one month later. Upon the transfer of Licence Y, the entity does not recognise revenue because the consideration allocated to Licence Y is in the form of a sales-based royalty. Therefore, in accordance with paragraph B63, the entity recognises revenue for the sales based royalty when those subsequent sales occur.

When Licence X is transferred, the entity recognises as revenue the CU800 allocated to Licence X.

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

The price stated in the contract for Licence X is a fixed amount of CU300 and for Licence Y the consideration is five per cent of the customer's future sales of products that use Licence Y. The entity's estimate of the sales-based royalties (ie the variable consideration) is CU1,500 in accordance with paragraph 53.

The entity allocates the transaction price of CU300 to Licences X and Y on the basis of relative stand-alone selling prices of CU800 and CU1,000, respectively. The entity also allocates the consideration related to the salesbased royalty on a relative stand-alone selling price basis. However, in accordance with paragraph B63 of Ind AS 115, 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 Y is transferred to the customer at the inception of the contract and Licence X is transferred three months later. When Licence Y is transferred, the entity recognises as revenue the CU167 (CU1,000 ÷ CU1,800 × CU300) allocated to Licence Y. When Licence X is transferred, the entity recognises as revenue the CU133 (CU800 ÷ CU1,800 × CU300) allocated to Licence X.

In the first month, the royalty due from the customer's first month of sales is CU200. Consequently, in accordance with paragraph B63 of Ind AS 115, the entity recognises as revenue the CU111 (CU1,000 ÷ CU1,800 × CU200) allocated to Licence Y (which has been transferred to the customer and is therefore a satisfied performance obligation). The entity recognises a contract liability for the CU89 (CU800 ÷ CU1,800 × CU200) allocated to Licence X. This is because although the subsequent sale by the entity's customer has occurred, the performance obligation to which the royalty has been allocated has not been satisfied.

FIVE STEP APPROACH

Step 1: Identify the contract with customer;

Step 2: Identify the performance obligations;

Step 3: Determine the transaction price;

Step 4: Allocate the transaction price to performance obligations;

Step 5: Recognise revenue when (or as) the entity satisfies a PO

SATISFACTION OF PERFORMANCE OBLIGATIONS

What this section primarily teaches us?

Entities need to identify whether the performance obligations:

- Are satisfied over a period of time; or
- Are satisfied at a point in time.

This is very important because the timing of recognition of revenue differs under both the sections

SATISFACTION OF PERFORMANCE OBLIGATIONS

Performance obligations satisfied over time

Ind AS 115.35 states that an entity transfers control of a good or service over time if one of the following criteria are met:

• As the entity performs, the customer simultaneously receives and consumes the benefits provided by the entity's performance.

• The entity's performance creates or enhances an asset (e.g., work in progress) that the customer controls as the asset is created or enhanced.

• The entity's performance does not create an asset with an alternative use to the entity and the entity has an enforceable right to payment for performance completed to date.

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

SATISFACTION OF PERFORMANCE OBLIGATIONS

Performance obligations satisfied over time

If the entity decides that the performance obligations are satisfied over period of time, then it is appropriate that the entity recognises revenue over the period of time.

How does it recognise the revenue over the period of time?

This is carried out by measuring the progress of the performance over the period. For this purpose, the Standard proposes two methods of measuring the progress.

1) Output methods;

2) Input methods

SATISFACTION OF PERFORMANCE OBLIGATIONS

Output methods

B15. Output methods recognise revenue on the basis of direct measurements of the value to the customer of the goods or services transferred to date relative to the remaining goods or services promised under the contract.

Output methods include methods such as **surveys of performance completed to date**, appraisals of results achieved, milestones reached, time elapsed and units produced or units delivered. When an entity evaluates whether to apply an output method to measure its progress, the entity shall consider whether the output selected would faithfully depict the entity's performance towards complete satisfaction of the performance obligation.

Input methods

B18. Input methods recognise revenue on the **basis of the entity's efforts or inputs to the satisfaction of a performance obligation** (for example, resources consumed, labour hours expended, costs incurred, time elapsed or machine hours used) **relative to the total expected inputs to the satisfaction of that performance obligation.** If the entity's efforts or inputs are expended evenly throughout the performance period, it may be appropriate for the entity to recognise revenue on a straight-line basis.

SATISFACTION OF PERFORMANCE OBLIGATIONS

Control transferred at point in time

38. If a performance obligation is not satisfied over time in accordance with paragraphs 35–37, an entity satisfies the performance obligation at a point in time. To determine the point in time at which a customer obtains control of a promised asset and the entity satisfies a performance obligation, the entity shall consider the requirements for control in paragraphs 31–34. In addition, an entity shall consider indicators of the transfer of control, which include, but are not limited to, the following:

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

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

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

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

(e) The customer has accepted the asset

REPURCHASE AGREEMENTS

B64. A repurchase agreement is a contract in which an entity sells an asset and also promises or has the option (either in the same contract or in another contract) to repurchase the asset. The repurchased asset may be the asset that was originally sold to the customer, an asset that is substantially the same as that asset, or another asset of which the asset that was originally sold is a component.

B65. Repurchase agreements generally come in three forms:

a) an entity's obligation to repurchase the asset (a forward);

b) an entity's right to repurchase the asset (a call option); and

c) an entity's obligation to repurchase the asset at the customer's request (a put option).

BILL AND HOLD

For a customer to have obtained control of a product in a bill-and-hold arrangement, all of the following criteria must be met:

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

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

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

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

CONTRACT COSTS

Costs to obtain a contract

For those costs within the scope of the cost requirements in Ind AS 115, the incremental costs of obtaining a contract with a customer are recognised as an asset if the entity expects to recover them. An entity can expect to recover contract acquisition costs through direct recovery (i.e., reimbursement under the contract) or indirect recovery (i.e., through the margin inherent in the contract). Incremental costs are those that an entity would not have incurred if the contract had not been obtained.

Success based commission or fee paid / payable for obtaining / **modifying** a contract;

Important thing to be considered is whether the costs are incremental

Costs to fulfil a contract

The standard divides contract fulfilment costs into two categories: (1) costs that give rise to an asset; and (2) costs that are expensed as incurred. When determining the appropriate accounting treatment for such costs, Ind AS 115 makes it clear that any other applicable standards are considered first. If those other standards preclude capitalisation of a particular cost, then an asset cannot be recognised under Ind AS 115. If other standards are not applicable to contract fulfilment costs, **Ind AS 115 provides the following criteria for capitalisation**:

• The costs directly relate to a contract or to a specifically identifiable anticipated contract (e.g., costs relating to services to be provided under renewal of an existing contract or costs of designing an asset to be transferred under a specific contract that has not yet been approved).

• **The costs generate or enhance resources of the entity that will be used in satisfying** (or in continuing to satisfy) performance obligations in the future.

• The costs are expected to be recovered.

If all of the criteria are met, an entity is required to capitalise these costs.

CONTRACT COSTS

Significant judgement may be required to determine whether costs generate or enhance resources of the entity that will be used in satisfying performance obligations in the future. *In the Basis for Conclusions, the IASB explained that the standard only results in the capitalisation of costs that meet the definition of an asset and precludes an entity from deferring costs merely to normalise profit margins throughout a contract (by allocating revenue and costs evenly over the contract term).*

For costs to meet the 'expected to be recovered' criterion, they need to be either explicitly reimbursable under the contract or reflected through the pricing on the contract and recoverable through margin.

If the costs incurred in fulfilling a contract do not give rise to an asset, based on the criteria above, they must be expensed as incurred.

DISCLOSURES

Disclosures as per
Ind AS 115

HAPPY READING