Ind AS-115
REVENUE FROM CONTRACTS WITH CUSTOMERS

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OVERVIEW

Ind AS 11: Construction contracts
Ind AS 18: Revenue recognition
All related appendix
Guidance note on real estate transactions

→

Ind AS 115
Revenue from contracts with customers

Transfer of **Risk and Reward**

→

Transfer of Control

Why Ind AS 115?

IAS 11
Construction contracts

01-Jan-1980
Effective first time

01-Jan-1995
Revised

01-Jan-2018
Replaced by IFRS 15

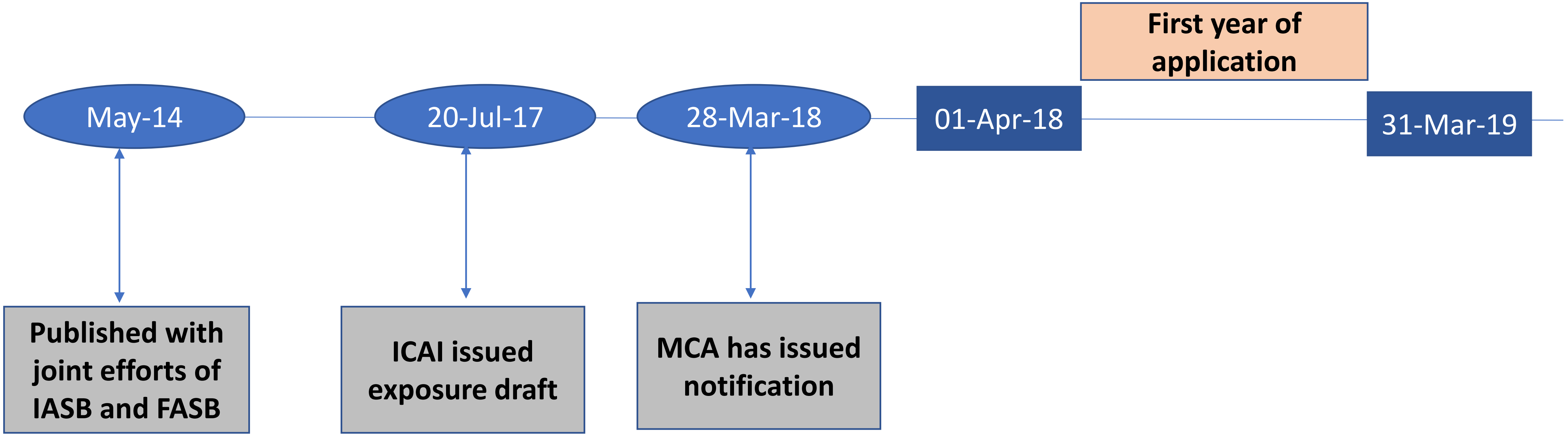
IAS 18
Revenue

01-Jan-1984
Effective first time

01-Jan-1995
Revised

01-Jan-2018
Replaced by IFRS 15

APPLICABILITY OF IND AS-115



Five steps model- Accounting

CORE PRINCIPLE: Revenue should be recognised
- When an entity transfer control of goods or services to a customer
- At the amount to which the entity expects to be entitled.

Step 1- Identify the **contract** with the customer

Step 2- Identify the **performance obligation** in the contract

Step 3- Determine the **transaction price**

Step 4- **Allocate** the transaction price to the performance obligation

Step 5- **Recognise** revenue when (or as) the entity satisfies its performance obligation

Step 1: Identify the contract with customers

Step 1 – IDENTIFY THE CONTRACT WITH CUSTOMER

What is a contract?

- A contract is an agreement
- Between two or more parties
- That creates enforceable rights and obligations.

1. A contract must be legally enforceable. Enforceability is a matter of law so an entity need to consider local relevant legal requirement to determine the enforceability.

2. A contract can be written, oral or implied (based on customary business practices)

3. Contract does not exist if both parties can cancel without cancel it without compensating the other party since there is no enforceable rights.

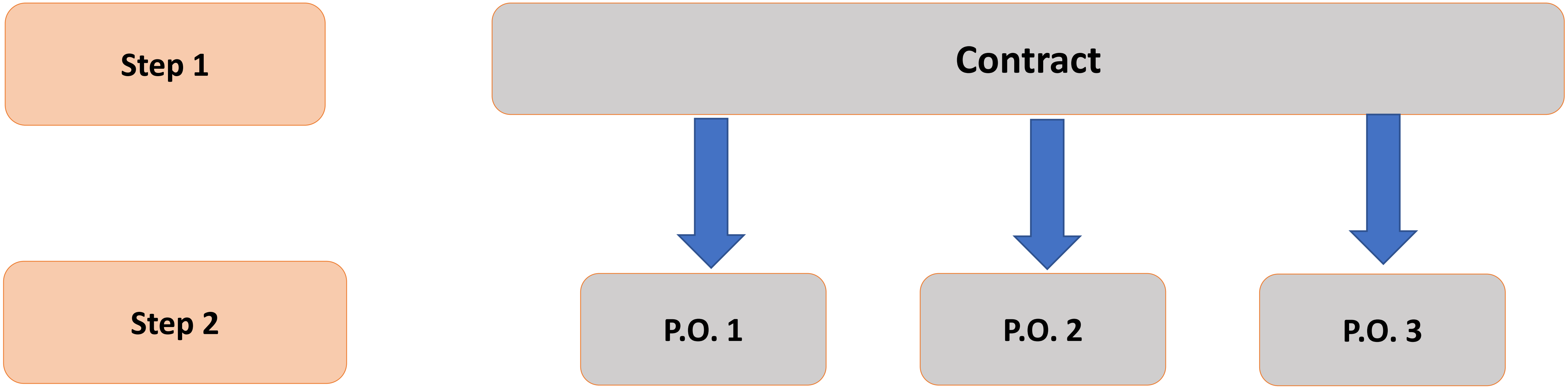
Step 1 – IDENTIFY THE CONTRACT WITH CUSTOMER

A contract must satisfy all following 5 conditions to pass the step 1 and move to the next step.

- The parties have **approved** the contract and are committed to perform their contractual obligation
- Each parties **rights** regarding the goods or services to be transferred can be identified
- **Payment terms** for the goods or services to be transferred can be identified
- There is **commercial substance** in the contract (for example, exchange of cars by car dealers)
- It is probable to **collect** substantially all of the **consideration** to which entity expects to be entitled (Intention+ ability)

Step 2: Identify performance obligation

STEP 2- IDENTIFY THE PERFORMANCE OBLIGATION IN THE CONTRACT



STEP 2- IDENTIFY THE PERFORMANCE OBLIGATION IN THE CONTRACT

Performance obligation=

<u>Promises</u> of goods or service in contract

- Distinct
  - Separate Recognition
- Non distinct
  - Combined Recognition

STEP 2- IDENTIFY THE PERFORMANCE OBLIGATION IN THE CONTRACT

Distinct

(both)

Customer can benefit from the good or service

- on its own or

- together with other readily available resources

Promise is **separately identifiable** from other promises in the contract

Significant integration service is not provided

No significant **customisation or modification**

Not highly **dependent** or interrelated

Performance obligation- case study

Example	Solution
I.T. Sector **Goods or services** a. Software license b. Software updates c. Technical support Condition Software will remain functional without updates and technical support.	i) Capable of being distinct: Yes ii) Distinct within the context of contract: Yes Hence there are three performance obligations in the contract.
In continuation of above example Software updates and technical updates are **essential** to ensure functionality of software.	i) Capable of being distinct: No, since customer cannot benefit on its own or together with other resource. ii) Distinct within the context of contract: No, since highly interdependent. Hence there is one performance obligation in the contract.

Performance obligation- case study

Example	Treatment
Construction Sector Construction of water purifier which includes a. Engineering service b. Procuring materials c. Construction service Conditions 1. The entity provides each good or service separately or together in a bundle.	i) Capable of being distinct: Yes ii) Separately identifiable: No, because there is significant integration of each input is required to provide combined output (water purifier). All goods and services are single performance obligation.
Auto Sector **Goods or services** a. Car b. Maintenance service **Condition** 1. Customer can buy maintenance service from same entity or from other entity.	i) capable of being distinct: Yes ii) Separately identifiable: Yes, because there is no significant integration, not highly interdependent. Goods and services are **Two separate performance obligation.**

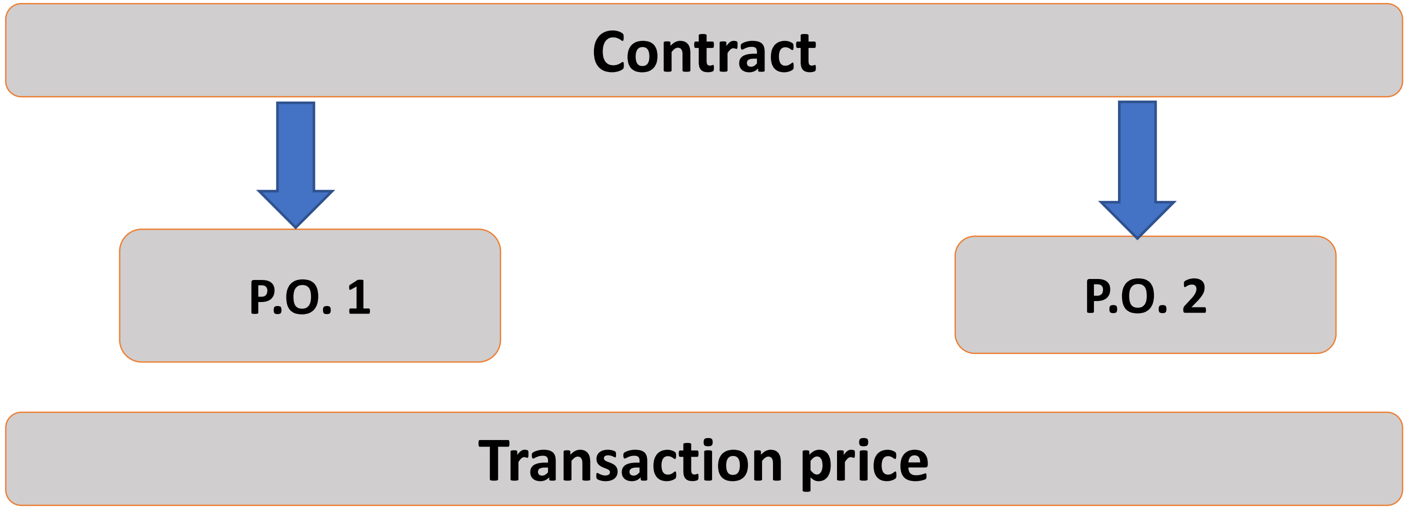
Step 3: Determination of Transaction price

STEP 3- DETERMINATION OF TRANSACTION PRICE

Step 1: Identify the contract

Step 2: Identify the separate performance obligations

Step 3: Determine the transaction price



STEP 3- DETERMINATION OF TRANSACTION PRICE

What is 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.

If an entity expects to receive a lower amount than contracted price then it should be the transaction price.

While determining the transaction price, the entity shall consider the effect of following.

i) Variable consideration
ii) Significant financing component
iii) Non-cash consideration
iv) Consideration payable to a customer

Amount collected on behalf of third party is not the part of transaction price.

VARIABLE CONSIDERATION

What is Variable consideration?

- Consideration which is **dependent upon occurrence or non-occurrence** of any future events.
- Variable consideration can be **variable or fixed in amount**.
- Consideration can be variable due to discounts, rebates, refunds, credits, price concession, incentive, performance bonus etc. It means it could be **positive or negative**.

Recognition of Variable consideration

Recognised only if it is highly probable that a subsequent change in its estimate would not result in a significant revenue reversal

VARIABLE CONSIDERATION

Estimation of Variable consideration	
Using either of the following method	
Expected value method	- This method is appropriate if entity has a large number of contracts with similar characteristics. - Value is calculated as <u>sum of probability weighted amount</u> in a range of possible consideration.
Most likely amount	- This method is appropriate if entity has only two possible outcomes. - Amount is <u>single most likely amount in a range</u>.
An entity shall apply one method consistently throughout the contract.	

Variable consideration- case study

Example

XYZ Ltd. enters into a contract to build a school building to DPS limited. The contract price for completing the building is Rs 20 Crore in a period of 24 months. XYZ Ltd is also entitle for bonus/ incentive based on early completion of school building. The range of incentive, based completion are as under:

If completion by 15^{th} month the incentive will be 30% of the contract price,

If completion by 18^{th} month the incentive will be 20% of the contract price,

If completion by 20^{th} month the incentive will be 10% of the contract price.

Determine the transaction price.

Variable consideration- case study

Solution				
In this case there are four possible outcomes, hence we will apply expected value method as under Expected value method= Sum of probability weighted amount				
Possible outcomes	**Bonus %**	**Bonus amount**	**Probability**	**Weighted amount**
If completed on 24^{th} months	Nil	Nil	50%	Nil
If completed on 20^{th} months	10%	2 Cr	30%	0.60 Cr
If completed on 18^{th} months	20%	4 Cr	20%	0.80 Cr
If completed on 15^{th} months	30%	6 Cr	10%	0.60 Cr
Variable consideration				**2 Cr**
Fixed Consideration				**20 Cr**
Total Consideration				**22 Cr**

SIGNIFICANT FINANCING COMPONANT

What is Significant financing component?

Timing of transfer of control of promised goods or services and timing of payment specified in the contract may different.

i. If customer make payment in advance (Advance received): Interest expense

ii. If customer make payment later (credit extended): Interest income

The objective of adjusting the financing component is to recognise revenue from contract at cash selling price.

Both the factors to be checked for identifying significant financing component.

1. There is a difference between amount of promised consideration and the cash selling price of promised goods or service.
2. Prevailing interest rate and length of time between transfer of goods or service and receiving of payment from customer.

Practical expedient

Financing component can be ignored if difference between payment and transfer of goods or service is 12 months or less.

SIGNIFICANT FINANCING COMPONANT

Exceptions

A contract would not have significant financing component if any of the following factor exist.

1) **Utilisation** of goods or service is the **discretion of customer** whereas payment is made in advance (Prepaid mobile service).

2) Substantial amount of **consideration is variable** and consideration is dependent on factors outside the control of partiers. (Royalty payment to author on sale of books)

3) The difference between consideration and cash selling price is due to **reason other than non-financing** component. Like for product assurance/ satisfaction of service etc. ex Retention money.

SIGNIFICANT FINANCING COMPONANT

Discount rate

Discount rate is the rate at which entity could have taken finance.

If that rate is not available then entity can compute IRR. (The rate at which inflow and outflow are equal) Which equates the promised consideration and cash selling price.

- The discount rate should be computed at contract inception and that shall not be updated post contract inception even there is a change in interest rate and other circumstances.

NON-CASH CONSIDERATION

Measurement of non-cash consideration	
<u>Initial measurement</u>	
1st preference	Measure the non-consideration at fair value (Received)
2nd preference	Measure indirectly by reference to the standalone selling price of goods or service promised to customer
<u>Subsequent measurement</u>	
Variation in consideration due to its <u>form</u> (Shares)	Do not adjust the transaction price
Other than above	Apply cumulative catch up method

CONSIDERATION PAYABLE TO A CUSTOMER

Sometimes contract require entity to pay to the customer or the other party's that purchase the entity's goods or services from the customer. These considerations could be cash, credit etc.	
The payment to the customer is in exchange for distinct goods or services provided by the customer.	
No	Reduce the full amount of payment from the transaction price
Yes	Consideration payable is accounted for a purchase from supplier (Separate transaction from revenue) Note: If consideration payable to a customer exceeds the fair value of the distinct good or service from the customer: The difference is accounted for as a reduction in the entity's transaction price. If an entity cannot reasonably estimate the fair value of goods or services received from the customer: Reduce the entire consideration from transaction price.

Step 4: ALLOCATE THE TRANSACTION PRICE TO PERFORMANCE OBLIGATION

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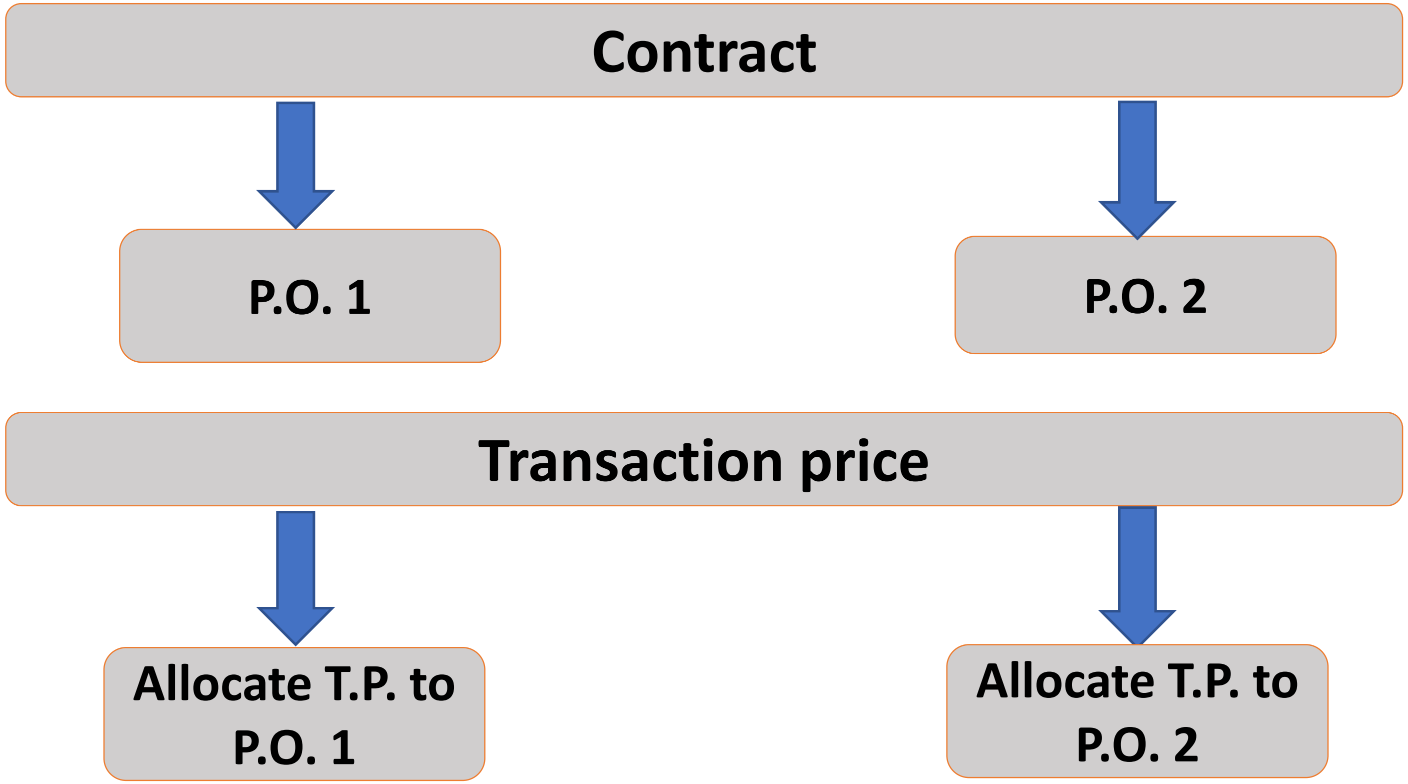

Step 4- ALLOCATE THE TRANSACTION PRICE TO PERFORMANCE OBLIGATION

- **Where a contract contains more than one distinct performance obligation**
- **A company allocates the transaction price to all separate performance obligation**
- **In proportion to the standalone selling price of each performance obligation**

Whether goods or service are sold separately (Availability of observable price)	
Yes	Consider the standalone selling price at which entity sell **separately** (observable price)
No	Company would have to estimate its standalone selling price

Standalone selling price

Estimation of standalone selling price	
Methods of estimating standalone selling price includes	
Adjusted market assessment approach	- Evaluate the market in which it sells goods or services and estimate the price that a customer in that market would be willing to pay for those goods or services. - It include referring to prices from the entity's competitors for similar goods or services
Expected cost plus a margin approach	- Forecast its expected costs of satisfying a performance obligation and then add an appropriate margin
Residual approach	Estimate the stand-alone selling price by reference to the total transaction price Less: the sum of the observable stand-alone selling prices of other goods or services promised in the contract
An entity shall apply one method consistently throughout the contract.	

Allocation- Case study

Example

Sale of mobile handset by supplier X Ltd. to customer with 2 year network service

Conditions

1. Price of mobile handset is Free (Handset standalone selling price Rs 400)
2. Network service Rs 150 per month

Solution

Allocation: Under Ind AS 115, we need allocate T.P. (Rs 150*24= 3600) to each separate P.O.

P.O.	**S. S. P.**	**%**	**Allocated price**
Mobile handset	400	10%	360
Network service	3600	90%	3240
Total Price	4000	100%	3600

Recognition:

	Year 1	**Year 2**
Mobile handset	360	-
Network	1620	1620
Total	**1980**	**1620**

STEP 5- RECOGNISE REVENUE WHEN (or as) A PERFORMANCE OBLIGATION IS SATISFIED

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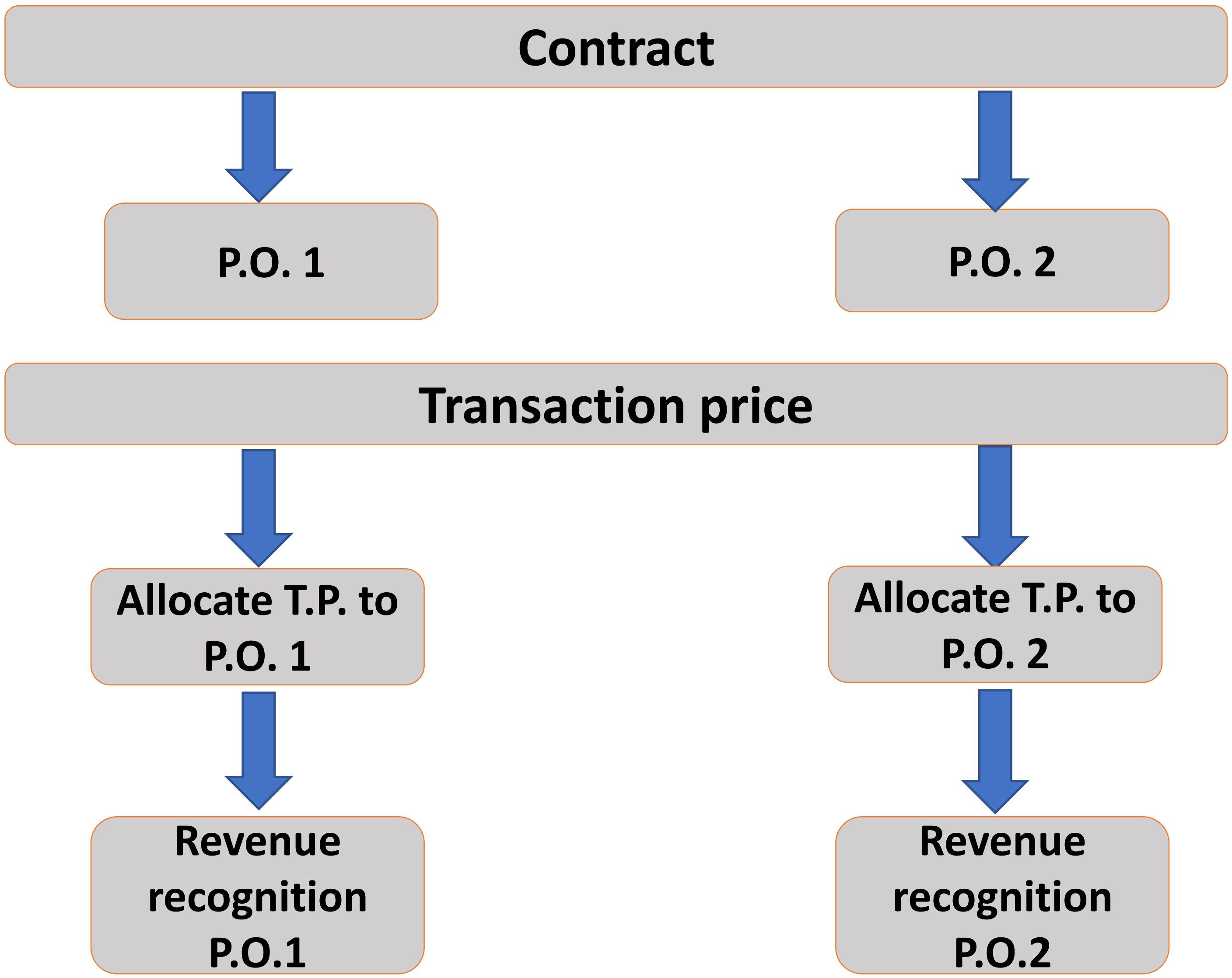
Step 5: Recognise revenue when a performance obligation is satisfied



STEP 5- RECOGNISE REVENUE WHEN (or as) A PERFORMANCE OBLIGATION IS SATISFIED

Satisfaction of Performance obligation = Transferring **control** of Goods or services to customer - Ability to direct the use if asset - Ability to obtain substantially all economic benefits from the asset
Indication of Control, if any of following indicator exist
a. Transfer of ownership
b. Transfer of physical possession of goods or service
c. Present right to receive the payment
d. Risk and reward of ownership is transferred
e. Acceptance of asset by the customer

Transfer of **control** of Goods or services	
Over time	Customer simultaneously receives and consumes all the benefits (such as cleaning services in hotel, Routine recurring services); or
	The entity's performance creates or enhance asset controlled by customer (such as renovation of building, Constructing building at customers land); or
	The entity's performance does not create an asset with alternative use to the entity **and** entity has enforceable right to payment for performance completed to date. (Customised machinery to customer)
At a point in time	If any of above criteria is not met

There are two methods of measuring performance over time

Output based method	Input based method
1. Surveys of performance completed to date (Get certification from expert)	1. Resource consumed
2. Milestones reached (Results achieved)	2. Cost incurred
3. Time elapsed (Cable T.V., Wifi)	3. Labour hours
4. Units produced or units delivered	4. Machine hours used

- An entity shall apply one method consistently throughout the contract.
- If entity is unable to reasonably estimate the progress, revenue is not recognised until progress can be estimated. However, entity can determine that no loss will be incurred, it can recognise revenue up to cost incurred.

Thanks

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