
# Ind AS 115: Revenue from Contracts with Customers

## - Overview and Impact on Key Sectors

THE POWER OF BEING UNDERSTOOD

## 1.0 INTRODUCTION

On 29 March 2018, the Ministry of Corporate Affairs (MCA) notified Ind AS 115 *Revenue from Contracts with Customers* which is for companies following Indian Accounting Standards (Ind AS) from 1st April, 2018.

Ind AS 115 is based on IFRS 15, under IFRS and ASC 606, under US GAAP, which are internationally effective from annual periods starting January 1, 2018. These new standards are the result of several years of international joint discussions, deliberations and outreach across various sectors by the International Accounting Standards Board and the US Financial Accounting Standards Board.

With effect from financial year beginning from 1 April 2018, Ind AS 115 would replace the existing Ind AS standards, i.e., Ind AS 18 *Revenue*, Ind AS 11 *Construction Contracts* and their associated appendices.

Ind AS 115 differs significantly as compared to existing revenue recognition principles. The new standard seeks to remove inconsistencies and weaknesses in previous revenue requirements, provide a more robust framework and improve comparability of revenue recognition practices across entities. It is also intended to provide more useful information to users of financial statements through improved disclosure requirements.

Ind AS 115 requires retrospective application. The standard allows either 'full retrospective' adoption in which the standard is applied to all of the periods presented, including the comparative period, or a 'modified retrospective' adoption, under which the cumulative effect of retrospective application is recognised at the date of initial application.

Transition to Ind AS 115 may have significant impact across sectors, especially in telecom, information technology, engineering and construction, real estate and construction, consumer products and retail. Transition to new revenue recognition standard is not only an accounting change but is like to have significant impact on a company's data, systems and processes.

This publication takes you through each of the key steps involved in recognising revenue under Ind AS 115 and looks at some of the practical implications, the two transition methods, together with their comparative advantages and disadvantages, and available practical expedients. In addition, it includes a detailed look at the disclosures that will need to be provided under Ind AS 115. The publication also takes a look at the potential impact on certain key sectors and provides a broad comparison between revenue standards under Indian GAAP, current Ind AS and Ind AS 115.

## 1.2 OVERVIEW

### When is Ind AS 115 effective?

Ind AS 115 comes into effect for accounting periods beginning on or after 1 April 2018. For listed companies that prepare and file quarter financial results, the quarterly results for period ending 30 June 2018 should be based on Ind AS 115. Generally, in India, early adoption of accounting standards is not permitted, unless specifically permitted by the standard. Therefore, in absence of explicit early adoption provisions, it may not be possible for entities to early adopt Ind AS 115 for financial year ending 31 March 2018.

## In A Snapshot

Ind AS 115 sets out a single framework for revenue recognition. Its core principle is that an entity recognises revenue to depict the transfer of promised goods or services to customers in an amount that reflects the consideration to which the entity expects to be entitled in exchange for those goods or services. Ind AS 115 sets out five key steps to follow in applying this core principle.

| Step 1 | Step 2 | Step 3 | Step 4 | Step 5 |
|---|---|---|---|---|
| Identify the contract (s) with a customer | Identify the performance obligations in the | Determine the transaction price | Allocate the transaction price to the performance obligation | Recognise revenue when (or as) the entity satisfies a performance |

## Additional Guidance

Ind AS 115 also contains guidance on accounting for certain contract costs, payments to customers, and a cohesive set of disclosure requirements for revenue and associated contract balances.

## Major changes of Ind AS 115

The changes will impact entities to varying degrees, depending on the nature and terms of their customer contracts

- Current contract terms (explicit and implicit) and business practices may need to be reconsidered in order to avoid unintended consequences.
- Estimates and judgements previously made in the absence of specific financial reporting guidance may need to be revised to comply with the specific guidance given by Ind AS 115. For example: where it is necessary to allocate a transaction price between the goods/services it has promised to deliver (‘performance obligations’), an entity will need to consider whether its existing allocation method is consistent with the specific hierarchy of possible methods set out in Ind AS 115.
- Revenue may be accelerated or deferred. This is more likely to affect entities which provide a bundle of goods and services, or provide licences, or for those for whom consideration receivable is variable in nature e.g., because of discounts, rebates and other price concessions, incentives and performance bonuses, penalties or other similar items.
- The timing of revenue recognition may change even when there is only one performance obligation, particularly for those involved in providing services. Entities will need to determine whether revenue should be recognised over time or at a point in time.
- Existing accounting software may need to be adapted or replaced to ensure it is capable of capturing data to deal with the new accounting requirements; particularly for use in making estimates or supporting the extensive disclosures. For example, Ind AS 115 requires disclosure of reconciliation of the amount of revenue recognised in the statement of profit and loss with the contracted price showing separately each of the adjustments made to the contract price, for example, on account of discounts, rebates, refunds, credits, price concessions, incentives, performance bonuses, etc., specifying the nature and amount of each such adjustment separately.

Entities should carefully consider as soon as possible the impact of the available transitional options and practical expedients.
Application of Ind AS 115  can impact the timing of the revenue recognition, revenue-based metrics, profile of margin on contracts, debt covenants, dividend policy, performance related remuneration, contract negotiations with customers, systems and processes and narrative disclosures.

## 3.0 APPLYING IND AS 115

Ind AS 115 addresses revenue from contracts with customers and so is only applied to a contract in its scope if the counterparty to the contract is a customer.

Ind AS 115 specifically excludes collaborative (and certain other) agreements, e.g. two companies agree to collaborate on the development of a new drug, from its scope. However, such agreements can sometimes contain a vendor-customer relationship component and so judgement may be required to determine whether Ind AS 115 should be applied to certain collaborative arrangements from its scope where the collaborator or partner meets the definition of a customer for at least some of the arrangement.

### Step 1: Identify the contract(s) with a customer

The contract must create enforceable rights and obligations.
An entity only accounts for a contract when it meets all of the following five specified criteria:

- It has been agreed by its parties, who are committed to perform their respective obligations;
- it identifies each party's rights regarding the goods or services to be transferred;
- it identifies the payment terms;
- it has commercial substance; and
- 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.

These criteria represent the 'attributes' of a valid contract in respect of a genuine transaction.

Termination rights can affect the duration of a contract (Ind AS 115.11-12). A contract can only exist to the extent the parties have present enforceable rights and obligations.
Individual contracts entered into at or near to each other with the same customer may need to be combined for accounting purposes, when one or more of the three specified criteria in Ind AS 115.17 are met.

Special rules apply to the subsequent accounting for a contract where its scope or price (or both) are modified. These depend on a number of factors, including how the change has been priced and the distinctness of the new goods/services added or remaining performance obligations (Ind AS 115.20-21).

### Step 2: Identify the performance obligations in the contract

This critical step involves the identification and assessment of promises in the contract (explicit or implied) to determine what, and how many, performance obligations exist. Some promises may not lead to performance obligations.

Once the promises have been identified, an entity needs to consider whether they are performance obligations.

A performance obligation may be a promise to transfer a single ‘distinct’ good/service, a ‘distinct’ bundle of goods/services, or a ‘series’ of ‘distinct’ goods/services.

Goods/service capable of being distinct + Distinct within the context of the contract = Separate performance obligations

A good/ service is capable of being distinct if the customer can benefit from it (e.g. by use, consumption or sale) either on its own or together with other resources readily available to the customer (e.g. those already owned, or which can be acquired from the entity or another entity).

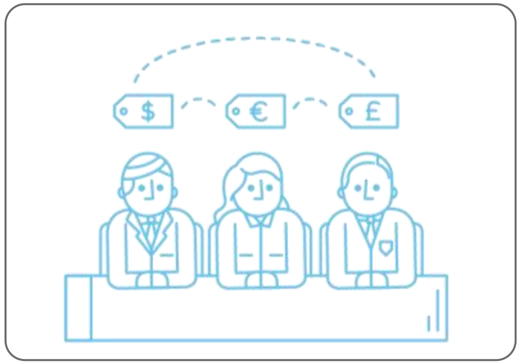
For example: if an entity sold a TV package that included a television and DVD player, these would be considered distinct goods because the television is capable of being used by the customer without the DVD player. Whilst the DVD player could not be used without the television, the customer could obtain an alternative television from another supplier or use their existing television

In assessing whether a promise is distinct within the context of the contracts, an entity considers whether the nature of its promise is to transfer each promised good/service individually or instead to transfer a combined item (s).
This evaluation needs consideration of the interrelationship between the various goods or services in the context of the process to fulfil the contract. An entity is required to consider the level of integration, interrelation or interdependence amongst the individual goods or services. Rather than considering whether one item, by its nature, depends on the other i.e., whether two items have a functional relationship, an entity evaluates whether there is a transformative relationship between the two or more items in the process of fulfilling the contract.

Some contracts provide a customer with an option to acquire additional goods/services in the future, often at a discount or even for free. These options come in many forms including sales incentives, loyalty point schemes and renewals. Such options must now be assessed to determine whether they provide the customer with a ‘material right’. If they do, that right (but not the underlying additional goods/services) is a performance obligation. This is an area where there may be additional performance obligation compared to Ind AS 18.

A ‘portfolio’ approach may be possible, in specified circumstances, for similar performance obligations across multiple customers for accounting purposes

## Step 3: Determine the transaction price



The transaction price is estimated at inception, assuming the contract is fulfilled in accordance with its terms and customary business practices, and is not cancelled, renewed or modified.

Variable consideration is included in the transaction price using either ‘expected value’ or ‘most likely amount’, but may need to be ‘constrained’. The ‘constraint’ applies to prevent too much revenue being recognised when it is too uncertain and runs the highly probable risk of resulting in a significant reversal. Ind AS 115 .57 sets out some factors that may help with this determination.

An exception applies to sales or usage based royalties receivable from a licence for the use of Intellectual Property (IP) (or where the IP is the predominant item in the contract) (Ind AS 115.B63)

IFRS 15 contains specific guidance on accounting for some of the causes of variability in a transaction price ie refunds/sales with a right of return and ‘breakage’ (Ind AS 115.B20-B27 and B44-47).

Significant financing benefits are taken into account (subject to a practical expedient) not only when an entity provides credit to its customers but, also when it receives a benefit due to payments received in advance (Ind AS 115.60-65).

Non-cash consideration is measured at fair value and variability in this is only taken into account when it arises due to reasons other than the form of the consideration (eg a change in the exercise price of a share option due to the entity’s performance).

Sometimes an entity pays consideration to its customer, or indeed to its customer’s customers. That consideration might be in the form of cash in exchange for goods or services received from the customer (e.g. slotting fees paid to a retail customer), or the provision of a credit such as a voucher or coupon for goods or services to be provided to the customer or end consumer (eg money-off coupons against future purchases by consumers), or a combination of both. Ind AS 115 requires an entity to determine whether the consideration payable is for a ‘distinct’ good or service; a reduction of the contract’s transaction price; or a combination of both. Consideration payable is only accounted for as an expense (in the same way as for other purchases from suppliers), rather than as a reduction in revenue, if the entity receives a good or service that is ‘distinct’.

## Step 4: Allocate the transaction price to the performance obligations in the contract

When a contract comprises more than one performance obligation, the transaction price is allocated to each obligation on the basis of directly observable stand-alone selling prices (determined only at contract inception and not changed).

Exceptions exist for allocating discounts and variable consideration that can be shown to be related to one or more but not all performance obligations (Ind AS 115.81-86).

Three alternative approaches can be applied in the absence of a directly observable stand-alone selling price (Ind AS 115.76-80): An adjusted market assessment;

- expected cost plus a margin; or
- a residual approach.

Specific rules apply if the transaction price changes, depending on the reason for the change ie the resolution of an uncertainty or as a result of a contract modification (Ind AS 115.87)


Specific guidance is provided in respect of warranties (Ind AS 115.B28-B33). A distinction is made between those warranties which provide the customer with a service (‘service-type warranty’) in addition to the assurance or guarantee that the related product/service complies with the agreed-upon specifications (‘assurance-type warranty’). If a warranty is separately priced or negotiated then it is a distinct service and therefore a performance obligation. If not, then an entity will need to assess whether the warranty it is supplying provides the customer with a service in addition to a guarantee.

Ind AS 115 provides guidance on making this assessment, which takes into account whether the warranty is required by law, the length of its coverage period, and the tasks the entity promises to perform under it. When a service warranty is provided, an entity allocates the transaction price between the related product/service and the warranty service using the allocation guidance noted above. Current practice may change under Ind AS 115 in respect of service-type warranties depending on judgements made in applying the warranty-type assessment guidance, and the guidance on allocating transaction prices. However, in respect of assurance-type warranties current practice is unaffected.

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

The focus here is on the transfer of ‘control’ rather than ‘risks and rewards’ when determining when to recognise revenue. This control concept also applies when determining whether an entity is acting as principal or agent from an accounting perspective.

Timing of revenue recognition requires the evaluation of whether control transfers (and therefore the performance obligation is satisfied) over time or at a point in time. If a performance obligation is not satisfied over time, then it is satisfied at a point in time.

## Revenue recognition over time

A performance obligation is satisfied over time if any of the following criteria are met

| | | |
|---|---|---|
| Customer simultaneously receives and consumes the benefits provided by the entity's performance as the entity | The entity's performance creates or enhances an asset 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<br>AND<br>The entity has an enforceable right to payment for performance completed to date |

Additional guidance is provided in respect of licenses to determine whether revenue should be recognised over time or a point in time. Where a licence is a separate performance obligation, an entity considers whether its promise is to provide the customer with either a 'right to access' the entity's IP, or a 'right to use' the IP as it exists at the point the licence is granted. A 'right to access' is an obligation that is satisfied over time, and a 'right to use' is satisfied at a point in time.

In making this assessment, the entity is required to consider different criteria to those applied to other performance obligations. These different criteria are necessary in the case of licences because it is difficult to assess when the customer obtains control of assets in a licence (as they could be changing) without first identifying the nature of the entity's performance obligation. Essentially these criteria require an entity to consider whether its activities significantly affect the IP to which the customer has rights. If they do, and those activities are not a separate performance obligation in their own right, then an entity is providing access to its IP over time.

If a licence is not distinct, then it is accounted for by evaluating when control transfers.

A method must be selected by which to measure an entity's progress towards satisfying a performance obligation over time. Ind AS 115 contains guidance on both output and input methods but ultimately it will be the entity's judgement call as to which method provides the most reasonable and reliable estimate of the measure of its progress.

Where an output method is most appropriate, a 'right to invoice' practical expedient may be applied when this invoicing corresponds directly with the value of each incremental good/service that is transferred to the customer (eg a fixed hourly rate for each hour of service provided)

### Accounting for certain contract costs

Incremental costs of obtaining a contract that are expected to be recovered must be recognised as an asset unless the amortisation period would be one year or less, in which case they can be expensed as a practical expedient.

Costs incurred in fulfilling a contract that are not in the scope of another standard must be recognised as an asset if they meet all three specified criteria:
Directly attributable to a specific contract or specific anticipated contract;

- generate or enhance resources to be used in the future in satisfying performance obligations; and
- be expected to be recovered.

These costs must be amortised on a systematic basis consistent with the transfer of those goods/services to the customer to which the costs relate.

## 4.0 DISCLOSURES

The disclosure objective of Ind AS 115 is to enable users of financial statements to understand the nature, amount, timing and uncertainty of revenue and cash flows.

Although the disclosure requirements are extensive (more than previously required), they are not prescriptive; rather, they require the disclosure of quantitative and qualitative information about: the nature of the entity’s revenues; how much is recognised and when; and any uncertainties about those revenues and related cash flows.

An entity is not expected to make disclosures that are irrelevant or immaterial to them, or to duplicate disclosures made elsewhere in the financial statements (in accordance with other Ind AS standard).

**Revenue**

- Disaggregation of revenue
- Revenue from opening contract liability
- Amounts recognized relating to performance in previous periods

**Contracts**

- Reconciliation of revenue recognized in profit and loss and contracted price
- Information about contract balances and changes
- Information about performance obligations
- Amounts allocated to remaining performance obligations

**Significant judgements**

- Timing and methods (input or output) of recognition
- Determining transaction price and allocating to performance obligations
- Costs to obtain or fulfill contracts

## Disaggregation of Revenue

Disaggregation of revenue is a key disclosure in Ind AS 115. It will require decisions to be made about how revenues should be analysed. There is guidance in Appendix B of Ind AS 115.In order to meet the disclosure objective, and be effective, the categories chosen for the analysis should take into account the users' needs.

The disclosures should be entity specific, industry relevant, reflect the entity's business model and depict the effect of economic factors. The acid test would be whether the user can tell from the disclosures what the entity actually does.

Furthermore, such disclosures ought to be consistent with other communications an entity makes about its revenues (e.g. press releases, other public filings, narrative reports included with the financial statements), and must be reconcilable with any disclosures made under Ind AS 108 *Operating Segments*. It may be that the Ind AS 108 disclosures are already sufficient to meet the disclosure objective in Ind AS 115 concerning disaggregation, but this will need to be considered by each entity.

## Significant Judgements

It is useful for users of the financial statements to understand if significant judgements have been made in determining when and how much revenue should be recognised. Clearly some judgement will always be necessary by all entities when applying the standard, but what these disclosures should do is enable the user to understand where significant judgements, or changes in judgements, have been necessary in applying Ind AS 115 to the entity's specific contracts.

## Practical Expedients

To aid comparison with other entities, the use of any practical expedients used in determining revenue recognition must be disclosed.

There is a practical expedient available in respect of disclosures. Disclosure about amounts allocated to remaining performance obligations is not required if either:

- The performance obligation is part of a contract that has an original expected duration of one year or less (because such information is only relevant when a contract is long-term); or
- revenue is recognised from the satisfaction of the performance obligation as it is invoiced in accordance with the 'right-to-invoice' practical expedient

## 5.0 TRANSITION DECISIONS

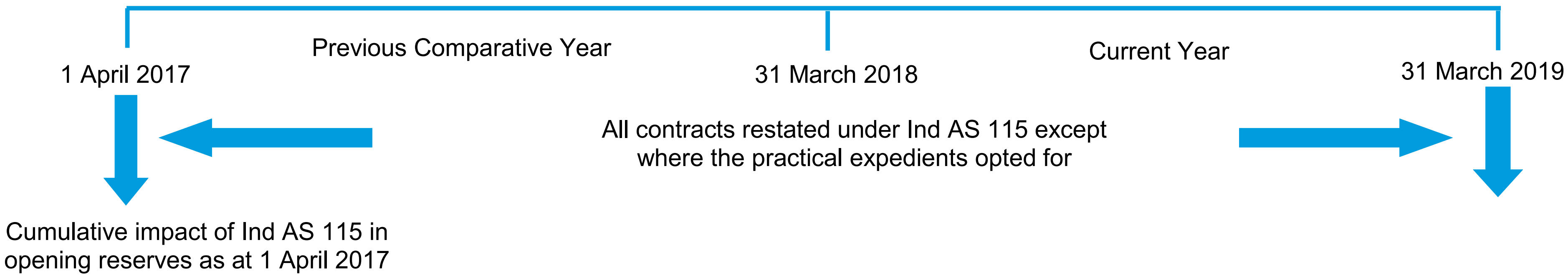
An entity shall apply Ind AS 115 using one of the following two methods:

- retrospectively to each prior reporting period presented in accordance with Ind AS 8, Accounting Policies, Changes in Accounting Estimates and Errors, subject to certain practical expedients ("full retrospective method"); or
- retrospectively with the cumulative effect of initially applying Ind AS 1115 recognised at the date of initial application, subject to certain practical expedients ("cumulative catch-up method").

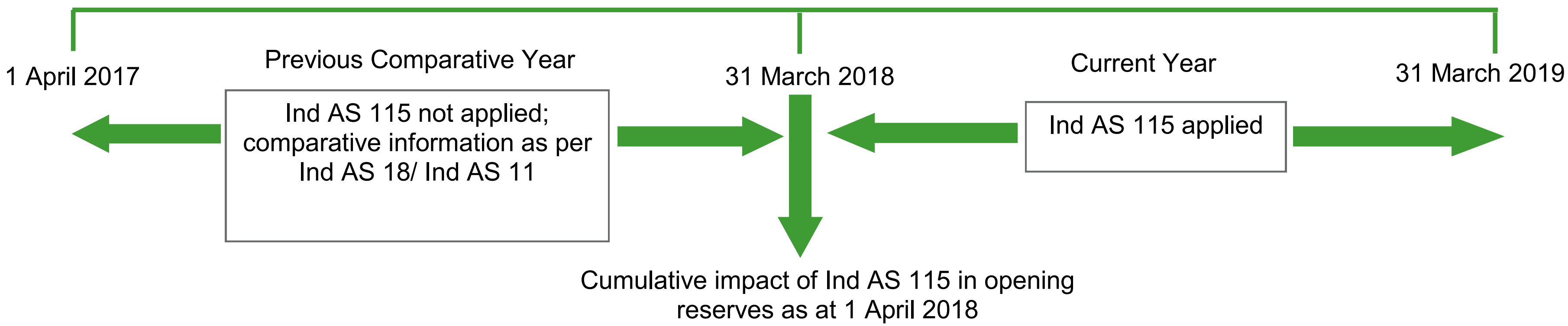
Both methods require retrospective application. Rather than requiring restatement of comparatives, the cumulative catch-up method requires the cumulative effect of initially applying Ind AS 115 to be adjusted against opening reserves at the beginning of the period in which it is first applied (1 April 2018 in case of an entity applying Ind AS 115 in financial year 2018-19), with comparatives left as previously reported under Ind AS 18 or Ind AS 11.

The diagram below summarises the two transition methods available for an entity, applying Ind AS 115 from its mandatory effective date of 1 April 2018.

### Full retrospective method




### Cumulative catch-up method



<table>
<tr><th>Full retrospective method</th><th>Cumulative catch-up method</th></tr>
<tr><td>Full retrospective method has the advantage of comparability between periods presented and so shows the trend in revenue. It may be costly and onerous for some entities but five practical expedients are available which either reduce the number of contracts that need to be restated on transition or simplify the re-statement by allowing the use of hindsight.</td><td></td></tr>
<tr><td>Practical expedients on transition - full retrospective method</td><td>Practical expedients on transition - cumulative catch-up method</td></tr>
<tr><td>1. No need to restate completed contracts that begin and end within the same annual reporting period. This expedient reduces the number of contracts which have to be restated so significantly reduces the burden when an entity has a lot of short-term contracts but:<br>• It may result in a lack of comparability with the current period; and<br>• It may also lead to a lack of comparability if interim reporting.<br><br>It must be noted that for the purpose of practical expedients, a completed contract is a contract for which the entity has transferred all of the goods or services identified in accordance with Ind AS 11 and Ind AS 18.<br><br>2. No need to restate completed contracts at the beginning of the earliest period presented. This expedient reduces the population of contracts which have to be restated and therefore the level of cost and effort involved.<br><br>3. May apply hindsight and use the actual transaction price on completion rather than estimating variable consideration amounts in the comparative reporting periods for completed contracts that have variable consideration. This relief simplifies how contracts are restated.<br><br>4. Apply hindsight and recognise the aggregate effect of modifications since contract inception at the beginning of the earliest period presented rather than assessing and accounting for each modification. This expedient is intended to reduce the burden of accounting for multi-year contracts that have been modified many times prior to adopting Ind AS 115.<br><br>5. No need to disclose the amount of the transaction price allocated to the remaining performance obligations and an explanation of when the entity expects to recognise that amount as revenue for comparative periods. This is because the effort involved would not result in useful information since it is out of date, and it would require significant use of hindsight to estimate the transaction price and expected timing.</td><td>May use hindsight, and recognise the aggregate effect of modifications at:<br>• the beginning of the earliest period presented (ie not having to wait until initial application); or<br>• the date of initial application of Ind AS 115.<br><br>This expedient is intended to reduce the burden of accounting for multi-year contracts that have been modified many times prior to adopting Ind AS 115.</td></tr>
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## Key points to consider on transition

- Entities will have to explore the differences between the two transition methods before making a decision, including the disclosures that will be needed for each method.
- Entities would have to consider the use of practical expedients on transition, as these could make the process easier and so influence the decision between the two methods.
- Entities would have to consider how the disclosure objective can best be met. Even if the numbers cannot be populated at this stage, decisions about how revenue should be disaggregated can still be made. It may be helpful to discuss the possibilities with key stakeholders to ensure that their needs and expectations will be met, and will be consistent with existing communications about revenues.
- Transition is an opportunity to take a fresh look, taking the time to fully understand the contractual terms and conditions applying to revenue transactions.
- Entities need to factor in time into the transition process to fully understand the disclosure requirements, which are more extensive than previous Ind AS standards.
- Don't underestimate the challenge the disclosure requirements may present. For example, Ind AS 115 requires disclosure of reconciliation of the amount of revenue recognised in the statement of profit and loss with the contracted price showing separately each of the adjustments made to the contract price, for example, on account of discounts, rebates, refunds, credits, price concessions, incentives, performance bonuses, etc., specifying the nature and amount of each such adjustment separately.
- Information systems may need to be changed to capture the necessary detail for disclosure, or to allocate transaction prices and these will need to be implemented and tested sooner rather than later.

# 6.0 KEY AREAS OF JUDGEMENT

Ind AS 115 is a comprehensive and complex standard and entities may find that its detailed guidance conflicts with certain judgements and interpretations made when applying Ind AS 18 or Ind AS 11. Whilst Ind AS 115 is intended to remove inconsistencies and improve comparability, there remains considerable scope for judgement.

**Applying the 'portfolio approach'**
This is a practical expedient intended to allow Ind AS 115 to be applied at a portfolio level for contracts (or performance obligations) with similar characteristics rather than on a contract-by-contract basis. However, its use is conditional on it being reasonably expected that the effects on the financial statements of applying Ind AS 115 to the portfolio will not differ materially from applying it to the individual contracts (or performance obligations) within that portfolio.

It will therefore be necessary for entities to use their judgement:

- To evaluate what 'similar characteristics' constitute a portfolio (e.g. the impact of different offerings, periods of time, or geographic locations);
- In deciding how large the population should be;
- In assessing when the portfolio approach may be appropriate; and
- In deciding to what stages of the revenue recognition process it applies.

Ind AS 115 does not provide any guidance on how to assess whether the outcome of using the approach is similar to that which would result if the contracts were assessed individually, nor the extent to which it is necessary to go to make that assessment.

As an alternative to using the portfolio approach, it may be easier for some entities to instead use a portfolio of transactions as a source of data to develop estimates to apply to individual contracts.

## Identifying the performance obligations

Under Ind AS 115, an entity is required to assess the promises in its contracts to determine whether they are performance obligations. However, it may not always be the case that certain promises are performance obligations, or that they need be assessed to determine whether they are. For example: Do certain promises actually represent a performance obligation or are they simply a fulfilment activity? Are they immaterial? What about pre-production activities?

It may apparently seem that all promises in a contract are performance obligation, however, the concept of assessing promises to determine the performance obligations is not expected to result in many more than would have been identified as deliverables under Ind AS 18.

Activities that an entity must undertake in order to fulfil a contract are not performance obligations unless they transfer a good/service to the customer. For example, both the promise to provide a customer statement on a periodic basis and a promise to provide a hotline to answer customers' questions about a product would be fulfilment activities with respect to a promise to sell a service/good rather than a separate performance obligation in their own right. Furthermore, any benefit these promises provide to the customer is likely to be viewed by the customer as minor and, consistently with Ind AS generally, immaterial items/promises need not be considered.

On the other hand, determining whether a pre-production activity is a fulfilment activity or a performance obligation will require more judgement.

**Example**

A long-term production contract includes some up-front engineering and design.

To assess whether it is an activity to fulfil the production contract or a separate performance obligation in its own right, it may be helpful to apply the criteria for determining when an entity transfers control of a good or service over time. In other words, determine whether the customer is simultaneously obtaining control of something as the entity undertakes the pre-production activities.

In this scenario, if the customer obtained the product from the contract and obtains the IP (patents) from the engineering and design activities, these would be considered as two separate performance obligations.

## Accounting for options

Ind AS 115 contains specific guidance which makes it clear that if a contract contains an option for the customer to acquire additional goods/services, then it is only a performance obligation if it provides the customer with a 'material right' that it would not receive without entering into that contract. For example, because the customer receives a discount on future selling prices that is incremental to the range of discounts normally given for those goods or services to that class of customer in that geographical area or market.

If the customer does not receive a material right (eg because the customer will have to pay the normal stand-alone selling price at that time) then the entity is simply deemed to have made a marketing offer.

However, when the option does provide a 'material right', the customer is effectively paying for the right as part of the current transaction (ie in advance) and so a portion of the transaction price is allocated to the option and recognised when the option is exercised or expires. Ind AS 115.B42 provides guidance on how to make the allocation.

There are two fundamental questions in accounting for such options which Ind AS 115 does not address:

- Firstly, it doesn't define a 'material right' and so entities will need to exercise judgement in deciding what factors to take into account when making such an assessment. Such factors may include rights obtained/expected from past/future transactions with the same customer in addition to those that will be obtained from the current transaction. Both quantitative and qualitative factors should be considered – including whether a right accumulates, as in some loyalty programmes.
- Secondly, it doesn't explain how to account for any consideration received when such an option is exercised. Two possibilities exist:
  - To treat the exercise as a continuation of the contract and add the proceeds from exercise to the price allocated originally to the material right and recognise when the option is exercised; or
  - To treat it as a modification of the original contract.

## Applying the 'series 'provision

When identifying performance obligations, Ind AS 115 requires a series of goods/services that are substantially the same and have the same pattern of transfer to the customer to be treated as a single performance obligation even if they are distinct. This is intended to simplify the application of the model (eg avoid the need to allocate the transaction price to each increment of service or product delivered when they are identical), and to promote consistency in identifying performance obligations. It's important to note that, whilst the series provision does simplify the model, it is a requirement rather than an optional practical expedient.

Whilst Ind AS 115 helpfully specifies the criteria to be met in assessing whether the goods/services have the same pattern of transfer, it doesn't help in determining what a series comprises and therefore when goods/services are substantially the same.

**Example**

Entity A enters into an outsourcing arrangement with Entity B. To comply with the service level agreement Entity B may need to perform lots of different activities over a period of time and these could differ, day by day, month by month.

In accordance with Ind AS 115.22, Entity B needs to assess the services promised in this arrangement and identify as a performance obligation, each promise to transfer either a service which is distinct or a series of distinct services that are substantially the same.

One way of making this evaluation could be to consider whether the entity's promise is to deliver a specified quantity of a service (service increment) or, because there is no specified quantity, to stand ready for a period of time or deliver a service over a period of time (time increment). However, other considerations may be appropriate and so judgement will be required.

So, if it is considered that the series comprises the individual activities (service increment) then the conclusion may well be that they are not substantially the same because there are so many different types of tasks involved in providing the service.

However, if it is considered that the series comprises distinct time increments, the conclusion is likely to be that each time increment is substantially the same as each other because the customer benefits from each day/month. It doesn't matter that each day/month's activities are different.
The nature of the overall promise is to provide a daily/monthly outsourcing service.

## Significant financing components

Ind AS 115 requires the transaction price of a contract to be adjusted for the effects of the time value of money if the timing of payments provides either party with a significant financing benefit. Ind AS 115.62 sets out factors which indicate when a contract would not have a significant financing component. It also provides a practical expedient which allows an entity to ignore the effects of a significant financing component if it is expected, at contract inception, that the period between transferring a promised good or service to a customer and the customer paying for it will be one year or less.

However, when there is a benefit that needs to be accounted for Ind AS 115 does not address:

a) Where and how the benefit should be allocated where multiple performance obligations are present in a contract; and

b) which obligation the practical expedient can be applied to.

For issue a), it is likely that the benefit will be excluded from the transaction price and the net transaction price allocated according to the normal rules. However, it may, instead, be reasonable to attribute the benefit to one or more but not all performance obligations - similar to the guidance on allocating a discount or variable consideration. In respect of issue b), it will be necessary to determine whether the payments are tied to one of the particular goods or services in the contract.

Under Ind AS 115, a significant financing component does not exist in all situations that include progress payments or a difference in timing between payments and transfer of goods and services. In particular, amounts retained by the customer in a long-term arrangement (commonly referred to as retention money) are usually intended to provide the customer with a form of security that the seller will perform as specified under the contract, rather than to provide the customer with a significant financing benefit. This is an important change from Ind AS 18, under which the ICAI's EAC had provided an EAC opinion[1] requiring discounting of retention money balance.

## Principal vs. Agent considerations

Ind AS 115 states that an entity assesses whether its performance obligation is to provide the 'specified' goods/services (acting as principal) or to arrange for their transfer (acting as agent). It does so by assessing whether it has control of each specified good/service before it is transferred to the customer. An entity must therefore first appropriately identify the specified good/service.

Ind AS 115 provides guidance to help entities determine whether they are acting as principal or agent when they engage a third party to provide services to the customer. It has also been clarified that an entity considers its role in respect of each distinct good/service (or distinct bundle), rather than at the contract level, so that even in a single contract an entity could be acting as principal for some goods/services and agent for others.

IFRS 15 sets out indicators of when an entity is acting as principal rather than agent, and explanatory text has been added to each of these to indicate how they reflect the control principle.

Entities should take care to remember the general control principle and consider the nature of the specified goods/ services and contractual conditions when assessing whether they act as principal. The indicators in Ind AS 115 should not be viewed in isolation because, as Ind AS 115 now states, other indicators may exist which are more persuasive than those explicitly stated.

1. EAC Opinion *Discounting of deferred debts (retention money)* finalized by the Committee on 2 September 2016.

## 7.0 KEY SECTOR-WISE IND AS 115 ANALYSIS

### 7.1 Fast Moving Consumer Goods

#### Identifying distinct performance obligations

Fast moving consumer goods (FMCG) companies often provide goods or assistance to retailers to help to retail their products to the end- customers. This assistance can take the form of, for example, training the retailer's sales employees, deploying their staff to work on-site at the retailer's location, providing gifts to be included with end-customer purchases, and shop-in-shops at retailer's location or concession areas. Under Ind AS 18, there is currently some diversity in practice in the accounting for such assistance. Under Ind AS 115, these provisions may result in additional performance obligations, which can affect the timing of revenue recognition.

FMCG companies will need to identify the different performance obligations in each agreement. Often retailers offer customers discount schemes under which the customer gets a right to purchase free or discounted goods or services in the future in connection with the current purchase of goods. These schemes would additional performance obligations under Ind AS 115.

Customer options such customer loyalty award credits or other customer incentive or discount schemes may give rise customers options to provide a material right that the customer would not receive without entering into the contract. The company should recognize revenue allocated to the option when the option expires or when the additional goods or services are transferred to the customer.

#### Gift card breakage revenue

Retailers often use sell gift cards to customers which are typically used by the customers to obtain products or services in the future up to a specified monetary value. The amount of gift certificates that are forfeited is commonly referred to as breakage. Breakage will typically result in the recognition of income for a retailer; however, the timing of recognition depends on expected customer behavior and the legal restrictions in the relevant jurisdiction.

Under Ind AS 115, expected breakage i.e., the customer's unexercised right should be estimated and recognized as revenue in proportion to the pattern of rights exercised by the customer. The variable consideration guidance is followed when estimating breakage. If the company is unable to estimate the breakage amount, revenue for the unused portion of the gift card is recognized when the likelihood of the customer exercising its remaining rights becomes remote. If a company is required to remit consideration associated with a customer's unclaimed rights to a third-party, such as a government body responsible for unclaimed property, the company should not recognize revenue related to unexercised rights.

#### Customer incentives

FMCGs and retailers commonly offer various customer incentives including rebates, free products, price protection, or price matching programs to their customers. Under Ind AS 115, customer incentives can affect the amount and timing of revenue recognition in many ways. They can create additional performance obligations, which can affect the timing of revenue recognition, and they often introduce variability into the transaction price, which can affect the amount of revenue recognized.

### Slotting fees

FMCG companies often pay retailers consideration for prominent placement of their products in their retail outlets, referred to as slotting fees. There can also be payments towards promotion events and co-branding advertisements.

Ind AS 115 requires a company to determine the transaction price, which is the amount of consideration it expects to be entitled to in exchange for transferring promised goods or services to a customer. Consideration payable by a company to a customer is accounted for as a reduction of the transaction price unless the payment is for a distinct good or service that the customer transfers to the company and the payment does not exceed fair value of that good or service.

The product placement services cannot be sold separately. Therefore, under Ind AS 115, these services may not qualify as distinct since the manufacturer would not obtain any rights or receive any benefit without selling products to the retailer. Therefore, such consideration paid to the retailer would have to be reduced from the revenue by the FMCG companies.

### Timing of revenue recognition

FMCG companies distribute their product to customers using various distribution channels, such as retail point of sale. Under Ind AS 115 revenue should be recognized when control of the goods or services is transferred to the customer. A company transfers a good or service when the customer obtains control of that good or service. A customer obtains control of a good or service if it has the ability to direct the use of and receive the benefit from the good or service.

### Customers’ right to return

Return rights are commonly granted to the customers in the FMCG industry. Some of these rights may be articulated in contracts with customers or distributors, while others are implied during the sales process, or based on historical business practice.

Under Ind AS 115, a right of return creates variability in the transaction price that an entity needs to estimate. An entity will recognise revenue based on the amount to which it expects to be entitled through to the end of the return period. Therefore, it will not recognise the portion of the revenue subject to the constraint until the amount is no longer constrained, which could be at the end of the return period. The will recognise the amount received or receivable that is expected to be returned as a refund liability, representing its obligation to return the customer’s consideration. Ind AS 115 also requires a return asset to be recognised at the time of the initial sale (i.e., when recognition of revenue is deferred due to the anticipated return), if an entity expects to receive the returned product in saleable or repairable condition. This return asset represents an entity’s right to recover the goods returned by the customer. Entities must present the return asset separately from both the refund liability (i.e., on a gross basis) and inventory.

**Shipment of goods to customers**

Often e-commerce companies or online retailers offer shipment services to customers free of cost. At times, for speedy delivery, some e-commerce companies or online retailers charge fees. Under Ind AS 115, entities should assess the explicit shipping terms to determine when control of the goods transfers to the customer and whether the shipping services are a separate performance obligation. Shipping services may be considered a separate performance obligation if control of the goods transfers to the customer before shipment, but the entity has promised to ship the goods (or arrange for the goods to be shipped). If control of a good does not transfer to the customer before shipment, shipping is not a separate promised service to the customer, but a fulfillment activity. Also, entities would need to assess whether the entity is the principal or an agent for the shipping service.

## 7.2 Pharmaceuticals and life science

**Identifying distinct performance obligations**

Many Indian pharmaceutical companies enter in to out licensing agreements for the purpose of selling their products overseas. Generally there are two deliverables - sale of product dossier based on which the customer gets ‘market authorisation’ and commitment to supply the products for sale in that specific country. Such arrangements take various structures and variations.

Certain companies in the pharmaceutical and life sciences industry provide multiple products or services to their customers as part of a single arrangement. For example, medical device manufacturers often transfer equipment with consumables and also perform installation, training, or other maintenance services. Clinical research companies offer a broad range of services that enable a customer to outsource parts or all of its clinical trial process.

Under Ind AS 115, these provisions may result in additional performance obligations, which can affect the timing of revenue recognition. Companies will need to determine whether the nature of the promise, within the context of the contract, is to transfer each of those goods or services individually or, instead, to transfer a combined item to which the promised goods or services are inputs.

**Estimated sales returns**

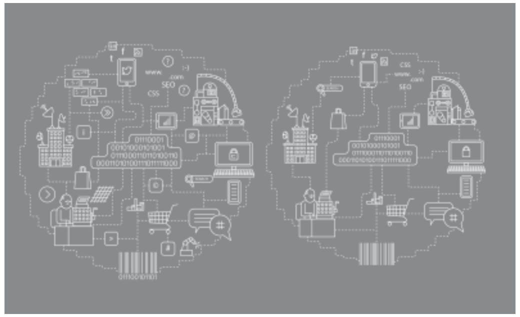
One of the prevalent trade practices in the Indian pharmaceutical industry is for the drug manufacturers to accept from the distributors and retailers the returns of products whose shelf lives have either expired or are nearing expiry.

Under Ind AS 115, a right of return creates variability in the transaction price that a life sciences entity needs to estimate. A life sciences entity will recognise revenue based on the amount to which it expects to be entitled through to the end of the return period. Therefore, it will not recognise the portion of the revenue subject to the constraint until the amount is no longer constrained, which could be at the end of the return period. The will recognise the amount received or receivable that is expected to be returned as a refund liability, representing its obligation to return the customer’s consideration. Ind AS 115 also requires a return asset to be recognised at the time of the initial sale (i.e., when recognition of revenue is deferred due to the anticipated return), if an entity expects to receive the returned product in saleable or repairable condition. This return asset represents an entity’s right to recover the goods returned by the customer. Entities must present the return asset (if recognised) separately from both the refund liability (i.e., on a gross basis) and inventory.

### Collaboration arrangements

Pharmaceutical and biotechnology companies frequently enter into strategic collaborations and licensing arrangements. Ind AS 115 require companies to assess whether the counterparty to the arrangement is (1) a customer or (2) a collaborator or partner sharing in the risks and benefits of the arrangement. An arrangement in which two parties share equally in the co-development of a drug compound, and then share equally in future profits earned on the commercialized drug, may be outside of the scope of Ind AS 115.

## 7.3 Technology and Information Technology



### Contract modifications

A common feature of software industry is to have changes in the contracts' scope or price. For example, a software company may initially license software and provide implementation support to a customer. Subsequently, based on the revised needs of the customer, the contract may involve additional software licences. Ind AS 115 requires an entity to determine whether a contract has been modified, consider following factors:

- the terms and conditions of the new contract were negotiated separately from the original contract, and
- the additional goods or services were subject to a competitive bid process, and
- any discount to the standalone selling price of the additional goods or services is attributable to the original contract.

Modifications are accounted for as either a separate contract or as part of the existing contract, either prospectively or through a cumulative catch-up adjustment.

### Identifying distinct performance obligations

Customer arrangements may typically comprise of: multiple goods and services, licenses, unspecified or specified future updates or up-grades/enhancements; Specified or unspecified additional software products; post-contract support; installation and services. Similarly, consulting ser-vices often involve implementation support, data conversion, software design or development, and customization of the licensed software.

The performance obligation in a contract with a customer may be explicitly stated in the arrangement or implied by the software vendor's customary business practices. Ind AS 115 requires companies to consider whether the customer has a valid expectation that the vendor will provide a good or ser-vice when it is not explicitly stated. If the customer has a valid expectation, the customer would view those promises as part of the goods or services in the contract.

**Customer options**

Many cloud computing entities enter into multi-year contracts with customers to provide cloud services. The contract often includes a cancellation option that allows the customer to unilaterally cancel the contract after each year for any reason without penalty. Under Ind AS 115, the contract may have to be treated as an annual contract with the customer having a renewal option. The entity should assess whether the renewal option provides a material right to the customer. The renewal option could provide a material right if prices for similar customers are expected to increase significantly over the contracted period.

## 7.4 Automotive and Ancillary Companies

**Collaborative arrangements**

Some original equipment manufacturers (OEMs) collaborate with automotive component suppliers to design and produce auto-components specific to certain models. Under Ind AS 115, entities will need to exercise judgement to determine whether such arrangements are collaborative arrangements and scoped out of the standard. This may be true, for example, if the risks of the development are shared jointly by the OEMs and the auto component company.

**Distinct performance obligations**

Often OEMs sell vehicles to dealers with a promotion of free maintenance on each vehicle to assist the dealer with selling the vehicles to the end customer. Under Ind AS 115, the transaction with the dealer may qualify as a sale because control of the vehicle transfers to the dealer when the vehicle is delivered. Free maintenance included as part of contracts for sales to dealers is a performance obligation and a portion of the total transaction price should be allocated to it.

**Tooling arrangements**

Auto component suppliers often enter into contracts with OEMs to construct a tool for the OEM and supply the OEM parts using the tool. The title of the tool may be with the OEM, and the supplier may recover its cost over the tenure of component supply arrangement. Under Ind AS 115, the supplier would be required to assess whether the construction of the tool constitutes a distinct performance obligation. The tool may be distinct if the customer i.e., the OEM can benefit from the tool either on its own or together with other resources readily available, and the tool is separable from the production parts.

## 7.5 Telecommunication

### Sales through dealer network

Telecommunication companies often use dealer channels and online retailers to sell service contracts to customers. Under Ind AS 115, a telecommunication company needs to carefully evaluate all the facts and circumstances of a dealer arrangement to determine the appropriate accounting.

The terms and conditions of arrangements with dealers vary throughout the industry. Dealers may purchase handsets from the manufacturer. The dealers may then sell the handsets to the end-customer, who concurrently enters into a contract for a monthly service plan with the telecommunication company. Telecommunication companies will need to determine whether payments made to a dealer represent a commission on the sale of the service contract i.e., costs to obtain a contract, or a handset discount (i.e., consideration paid or payable to a customer.

Also, Ind AS 115 would change practice for some entities that sell their products through dealers. Since the sales price of the handset to the dealer may not be finalised until the handset is sold to the end-customer, under Ind AS 18, entities may have wait until the product is sold to the end-customer to recognize revenue. Under Ind AS 115, entities are required to estimate any adjustments to the sales price that may be granted to the dealer, as well as the number of handsets that will be returned from the dealer as part of estimating the transaction price.

### Set-top boxes

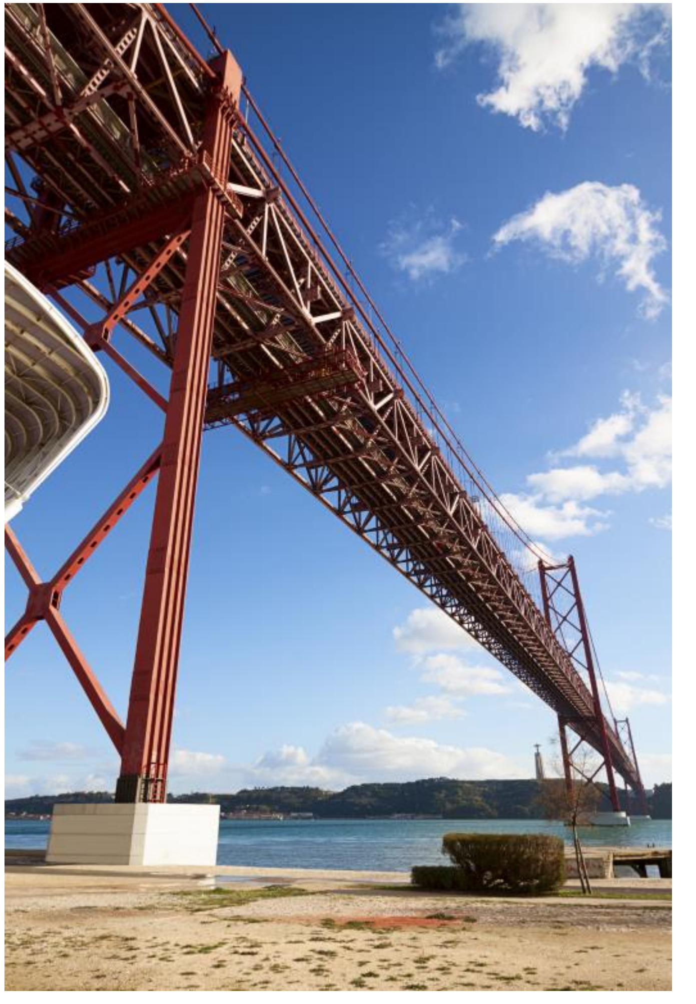
Telecommunication entities provide their customers with set-top boxes as part of providing cable services to the customer. Under Ind AS 115, entities will have to determine if the set-top box is a revenue element or a leasing element. If the customer does not have the right to control the use of an identified set-top box, the arrangement would not be a lease. This determination may need judgement and assessment of all the factors in the contract.

### Options for additional goods or services

Many telecommunication contracts provide the customers options to purchase additional services such as newly released movies, additional TV channels or international data plans, etc. These additional services may be priced at their stand-alone selling price, at a discount or may be provided free of charge.

Ind AS 115 states that when an entity grants a customer the option to acquire additional goods or services, that option is a separate performance obligation if it provides a material right to the customer. For example, the right would be material if it results in a discount that the customer would not receive without entering into the contract (e.g., one that exceeds the range of discounts typically given for those goods or services to that class of customer in that geographical area or market). If the price in the option reflects the stand-alone selling price, the entity is deemed to have made a marketing offer, rather than having granted a material right.

## 7.6 Engineering and Construction



### Contract Modification

Contract modifications or change orders are common in engineering and construction industry. Under Ind AS 115 are accounted for as either a separate contract or as part of the existing contract, depending on whether: the modification adds distinct goods or services; and the distinct goods or services are priced at their standalone selling prices.

A contract modification is accounted for as a separate contract when the additional goods and services are distinct and the contract price increases by an amount that reflects the standalone selling price of the additional goods or services. When the additional goods or services are distinct but not at standalone selling price, the modification is accounted for prospectively.
If the additional goods or services are not distinct, the modification is accounted for through a cumulative catch-up adjustment.

### Variable consideration

The transaction price i.e. the contract revenue is the consideration the entity expects to be entitled to in exchange for satisfying its performance obligations. Determination of variable consideration in a contract can be complex under Ind AS 115. Engineering contracts may have awards or incentive payments, penalties resulting in possible decreases in contract revenue, change orders or variations, claims and liquidated damages. When it is highly probable that a significant reversal in the amount of cumulative revenue recognized will not occur in the future, revenue related to variable consideration should be included in the transaction price.

### Retention money

Engineering contractors often enters into contracts that include progress payments based on various contractual milestones. The performance obligation in such contracts may be satisfied over time under Ind AS 115 i.e. revenue is recognized based on percentage of completion. The contracts often specify that the customer would retain a specified percentage (generally 5-10%) of each milestone payment with the retention due to the contractor after a certain number of months post completion of construction.

A question that generally engineering have been grappling with under Ind AS 18 or Ind AS 11 is whether such retention constitute significant financing component and if so, how to determine revenue.

Under Ind AS 115, the entity may conclude that the contract does not include a significant financing component if the milestone payments are estimated to coincide with the provision of goods and services and consequently, the amount of revenue to be recognized. With respect to the retention money, the entity may conclude that the delayed payment terms are for reasons other than to provide financing to the customer—that is, the retention is intended to provide the customer with some security against the contractor failing to adequately complete some or all of its obligations under the contract. In such cases, Ind AS 115 does not require discounting of the transaction value.

### Set-up and mobilization costs

Set-up and mobilization costs are typically incurred at the initial stage of a contract to enable the engineering / construction entity to fulfill its obligations under the contract. These costs may include labor, overhead, or other specific costs. Costs meeting the definition of assets under other Ind AS standards, such as property, plant, and equipment are covered in those standards. Costs not addressed by other standards are assessed under Ind AS 115. Mobilization costs include set-up cost incurred to move equipment or resources to prepare to provide the future engineering or construction services, including transportation and other expenses incurred prior to commencement of a service. Entities should consider whether the costs are costs to fulfill a contract that qualify for capitalization as an asset under Ind AS 115.

### Uninstalled materials at customers' site

Engineering entities generally apply an input method for revenue recognition under percentage of completion basis. Costs related to wasted materials or other significant inefficiencies are excluded for the purpose of percentage of completion revenue recognition method. When uninstalled materials meet the criteria prescribed in Ind AS 115, the entity is required to recognise revenue in an amount equal to the cost of the goods (i.e., at nil margin) and adjust its measure of progress to exclude the costs from the costs incurred and from the transaction price (i.e., from both the numerator and the denominator of its percentage complete calculation).

## 7.7 Media and entertainment

### Non cash consideration

Media companies often enter into contracts with advertisers, particularly start-up companies, to provide advertisement in exchange of non-cash considerations such as, equity shares, share warrants or share options. Under Ind AS 115, when an entity, i.e. a media company, receives, or expects to receive, non-cash consideration, the fair value of the non-cash consideration is included in the transaction price. For contracts with both non-cash consideration and cash consideration, an entity will need to measure the fair value of the non-cash consideration and it will look to other requirements within Ind AS 115 to account for the cash consideration. However, Ind AS 115 does not specify the measurement date for the purpose of the fair value measurement of the non-cash consideration. Therefore, an entity will need to use its judgement to determine the most appropriate measurement date when measuring the fair value of non-cash consideration.

### Principal vs. agent assessment

Media sector constitutes of a wide range of services in areas such as books, newspapers, magazines, music, film, television, internet, online and more. Often the content owned by a company requires a third party distribution medium to reach the ultimate target consumers.

Such arrangements between the content owner, distributor and consumer would require the media company to assess whether it is acting as an accounting agent or principal. Ind AS 115 sets out a two-step process that an entity would apply in determining if it is a principal or agent in a contract with a customer:

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); and
b. assess whether it controls each specified good or service before that good or service is transferred to the customer.

Identifying and understanding a company's promise (i.e. its performance obligation), and determining if the company controls these goods or services before their transfer to the customer, is fundamental to determining if the company is the principal or an agent. Media arrangements have been getting complex due to digital transformation and an ever-increasing variety of content formats and digital distribution routes.

## 7.8 Real Estate and Construction

**Percentage of completion method**

One of the major Ind AS issues in the sector is around revenue recognition for real estate development. In fact, one of the carve outs from IFRS is on account of non-inclusion of the equivalent of an IFRS interpretation, IFRIC 15 – *Agreements for the Construction of Real Estate*, under Ind AS. Instead, there is guidance note issued by the ICAI for real estate sales that is to be applied. As per the Ind AS GN, revenue is recognized generally by applying the percentage of completion method on the basis of the methodology explained in Ind AS 11 *Construction Contracts*.

Under Ind AS 115, an entity transfers control of a good or service over time (rather than at a point in time) when any of the following criteria are met:

- The customer simultaneously receives and consumes the benefits provided by the entity's performance as the entity performs.
- 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.

If an entity is unable to demonstrate that control transfers over time, the presumption is that control transfers at a point in time.

**Barters and joint development agreement**

Real estate companies in India often enter into redevelopment agreements with residential flat owners/societies for the demolition and reconstruction of existing building. The developer gets the development rights are acquired by way of construction of built-up area. Real estate companies also enter into various types of joint development agreements (JDAs) with land owners for permission to construct buildings in return for ownership of a part of the building. In practice such agreements are structured in different ways, often to optimize the tax impact or to facilitate fund-raising. Under Ind AS 115, identifying who is the customer, in such arrangements would be a matter of management judgement.

**Distinct performance obligations**

Real estate developers often provide add-on incentives to buyers in addition to the construction/ development of real estate — e.g, property management services, decorative interior fittings, etc.

Ind AS 115 identifies several activities common to the real estate developers that can be considered as promised goods and services, including the construction, manufacture or development of an asset on behalf of a customer and the performance of a contractually agreed-upon task for a customer (e.g., maintenance services). Under Ind AS 115, determining whether a promised good or service (or a bundle of goods and services) is distinct involves:

- Assessment at the level of the individual good or service (i.e., the good or service is capable of being distinct)
- Assessment of whether the good or service is separately identifiable from other promises in the contract (i.e., the good or service is distinct within the context of the contract).

## 7.9 Gems & Jewelry

**Customers' right to return**

At times, jewelry companies provide their customers with a right of returns. These rights may be explicit in the agreement or implied based on historical business practice.

Under Ind AS 115, a right of return creates variability in the transaction price that a life sciences entity needs to estimate. An entity recognises revenue based on the amount to which it expects to be entitled through to the end of the return period. Therefore, it will not recognise the portion of the revenue subject to the constraint until the amount is no longer constrained, which could be at the end of the return period. The will recognise the amount received or receivable that is expected to be returned as a refund liability, representing its obligation to return the customer's consideration. Ind AS 115 also requires a return asset to be recognised at the time of the initial sale (i.e., when recognition of revenue is deferred due to the anticipated return), if an entity expects to receive the returned product in saleable or repairable condition. This return asset represents an entity's right to recover the goods returned by the customer. Entities must present the return asset separately from both the refund liability (i.e., on a gross basis) and inventory.

**Customer incentives**

Jewelry companies commonly offer various customer incentives including rebates, making charges free and price protection, to their customers. Under Ind AS 115, customer incentives can affect the amount and timing of revenue recognition in many ways. They can create additional performance obligations, which can affect the timing of revenue recognition, and they often introduce variability into the transaction price, which can affect the amount of revenue recognized.

**Non cash consideration**

Jewelry companies may partly exchange new ornaments for old ornaments of the customers. Under Ind AS 115, when an entity, receives, or expects to receive, non-cash consideration, the fair value of the non-cash consideration is included in the transaction price. For contracts with both non-cash consideration and cash consideration, an entity will need to measure the fair value of the non-cash consideration and it will look to other requirements within Ind AS 115 to account for the cash consideration. Ind AS 115 does not specify the measurement date for the purpose of the fair value measurement of the non-cash consideration. Therefore, an entity will need to use its judgement to determine the most appropriate measurement date when measuring the fair value of non-cash consideration.

## 8.0 KEY DIFFERENCE WITH INDIAN GAAP AND IND AS

In this section we take a look at key high-level differences between the revenue standards under Indian GAAP (accounting standards notified under Companies (Accounting Standards) Rules,2006), existing Ind AS standards (Ind AS 18 *Revenue* and Ind AS 11 *Construction Contracts*) and Ind AS 115.

### 1 Applicable Standards and Appendices

| Indian GAAP | Ind AS 18/Ind AS 11 | Ind AS 115 |
|---|---|---|
| AS 7 *Construction Contracts*<br><br>AS 9 *Revenue Recognition*<br><br>Guidance Note for *Accounting for Real Estate Transactions* | Ind AS 11 *Construction Contracts*<br><br>Appendix A to Ind AS 11- *Service Concession Arrangements*<br><br>Appendix B to Ind AS 11- *Service Concession Arrangements: Disclosures*<br><br>Ind AS 18 *Revenue*<br><br>Appendix A to Ind AS 18- *Barter Transactions Involving Advertising Sales*<br><br>Appendix B to Ind AS 18- *Customer Loyalty Programmes*<br><br>Appendix C to Ind AS 18- *Transfer of Assets from Customers*<br><br>Guidance Note for *Accounting for Real Estate Transactions (for Ind AS companies)* | Ind AS 115 *Revenue from Contracts with Customers*<br><br>Appendix D to Ind AS 115 - *Service Concession Arrangements*<br><br>Appendix E to Ind AS 115 - *Service Concession Arrangements: Disclosures* |

## 2 Revenue recognition

| Indian GAAP | Ind AS 18/Ind AS 11 | Ind AS 115 |
|---|---|---|
| AS 9 requires recognition of revenue when (i) there is transfer of significant risks and rewards of ownership (ii) no significant uncertainty exists regarding the amount of consideration and (iii) at the time of performance, it is not unreasonable to expect ultimate collection.<br><br>Revenue from sale of goods is recognized when seller has transferred the property in the goods to the buyer for a consideration, which generally, would coincide with the transfer of significant risks and rewards of ownership.<br><br>Revenue from service transaction is usually recognized as the services are performed either by the proportionate completion method or by the completed service contract method. | Revenue from the sale of goods shall be recognised when all the following conditions have been satisfied:(a) the entity has transferred to the buyer the significant risks and rewards of ownership of the goods;(b) the entity retains neither continuing managerial involvement to the degree usually associated with ownership nor effective control over the goods sold; (c) the amount of revenue can be measured reliably; (d) it is probable that the economic benefits associated with the transaction will flow to the entity; and (e) the costs incurred or to be incurred in respect of the transaction can be measured reliably.<br><br>The assessment of when an entity has transferred the significant risks and rewards of ownership to the buyer requires an examination of the circumstances of the transaction. In most cases, the transfer of the risks and rewards of ownership coincides with the transfer of the legal title or the passing of possession to the buyer. This is the case for most retail sales. In other cases, the transfer of risks and rewards of ownership occurs at a different time from the transfer of legal title or the passing of possession. | The core principle under Ind AS 115 is that the entity should recognize revenue to depict the transfer of promised goods or services to customers in an amount that reflects the considerations to which the entity expected to be entitled in exchange for those goods or services.<br>To achieve that core principles, the following steps are applied:<br>1. Identify the contracts with a customer<br>2. Identify the performance obligations in the contract<br>3. Determine the transaction price<br>4. Allocate the transaction price to the performance obligation in the contract<br>5. Recognize revenue when the entity satisfies a performance obligation<br>Under Ind AS 115, an entity recognizes revenue if performance obligation is satisfied over time (i.e. using percentage of completion method) if certain criteria are met. If the prescribed criteria are not met, the entity is required to recognize revenue at a point in time at which it transfers control of the goods or service to the customer. An entity consider indicators for assessing the transfer of control, including (a) the entity has a present right to payment for the asset<br>(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 (e) the customer has accepted the asset |

## 3 Contract combination

| Indian GAAP | Ind AS 18/Ind AS 11 | Ind AS 115 |
|---|---|---|
| Under AS 7, a group of contracts, either with a single customer or with a group of customers are treated as a single construction contract when these are negotiated together, contracts are closely interrelated and contracts are performed concurrently or in a continuous sequence. | Ind AS 11 also contains a guidance that is similar to AS 7 for combining contracts. | Ind AS 115 provides guidance for combining the contracts entered into, at or around the same time with the same customer (negotiated as a package, consideration to be paid in one contract depends on the price and performance of the other contract, the goods and services promised in a contract are a single performance obligation). |

## 4 Contract modification

| Indian GAAP treatment | Ind AS 18/Ind AS 11 | Ind AS 115 |
|---|---|---|
| Under AS 7, construction of additional asset is treated as a separate contract if the assets differs significantly in design, technology, or function, or the price of the asset is negotiated without regard to the original contract price.<br><br>Variation and claims are part of the original contract revenue, unless the above treatment of construction of the additional asset as a separate contract applies.<br><br>Claims, variations are included in contract revenue only when the probability of customer accepting/approving the claim or variation is established and the amount of revenue can be reliably measured. | Ind AS 11 also contains a guidance that is similar to AS 7 for contract modification. | A change to an existing contract is a modification. A contract modification could change the scope of the contract, the price of the contract, or both. A contract modification exists when the parties to the contract approve the modification either in writing, orally, or based on the parties' customary business practices.<br>Contract modifications are accounted for as either a separate contract or as part of the existing contract depending on: the nature of the modification; whether the modification affects transaction price; whether the modification adds distinct goods or services and whether the contract price increases reflects the stand alone selling price of the additional distinct goods or services. |

## 5 Allocation of transaction price

| Indian GAAP | Ind AS 18/Ind AS 11 | Ind AS 115 |
|---|---|---|
| AS 9 does not require revenue contracts to be separately allocated to different elements. | Ind AS 18 requires the recognition criteria to be applies to the separately identifiable components of a single transaction in order to reflect the substance of the transaction. However, there is no specific guidance on how to allocate the transaction price. Two methodologies are followed: relative fair value and residual method. | Transaction price is to be allocated to each separate performance obligation in proportion to stand alone selling prices, with certain limited exceptions. The standard contains specific guidance for allocation of discount and variable consideration. |

## 6 Variable consideration

| Indian GAAP | Ind AS 18/Ind AS 11 | Ind AS 115 |
|---|---|---|
| AS 7 requires incentive payments to be included in the contract revenue when the contract is sufficiently advanced that is probable that the specified performance standards will be met or exceeded and the amount of the incentive payments can be measured reliably. | Revenue is recognised only when it is probable that the economic benefits associated with the transaction will flow to the entity. In some cases, this may not be probable until the consideration is received or until an uncertainty is removed. When the permission is granted, the uncertainty is removed and revenue is recognised. However, when an uncertainty arises about the collectability of an amount already included in revenue, the uncollectible amount or the amount in respect of which recovery has ceased to be probable is recognised as an expense, rather than as an adjustment of the amount of revenue originally recognised. | Under Ind AS 115, the objective of determining the transaction price is to predict the amount of consideration to which the entity will be entitled, including amounts that are variable. The entity determines the total transaction price, including an estimate of any variable consideration, at contract inception and reassesses this estimate at each reporting date. The entity should use all reasonably available information to make its estimate.<br><br>An entity shall estimate an amount of variable consideration by using either of the expected value method (sum of probability-weighted amounts in a range of possible consideration amounts) or the most likely amount (the most likely amount is the single most likely amount in a range of possible consideration amounts), depending on which method the entity expects to better predict the amount of consideration to which it will be entitled. An entity shall include in the transaction price some or all of an amount of variable consideration only to the extent that it is highly probable that a significant reversal in the amount of cumulative revenue recognized will not occur when the uncertainty associated with the variable consideration is subsequently resolved. |

## 7 Time value of money

| Indian GAAP | Ind AS 18/Ind AS 11 | Ind AS 115 |
|---|---|---|
| Revenue is generally not adjusted for the time value of money. | Revenue shall be measured at the fair value of the consideration received or receivable. When the inflow of cash or cash equivalents is deferred, the fair value of the consideration may be less than the nominal amount of cash received or receivable. For example, an entity may provide interest-free credit to the buyer or accept a note receivable bearing a below-market interest rate from the buyer as consideration for the sale of goods. When the arrangement effectively constitutes a financing transaction, the fair value of the consideration is determined by discounting all future receipts using an imputed rate of interest. | In determining the transaction price, an entity shall adjust the promised amount of consideration for the effects of the time value of money if the timing of payments agreed to by the parties to the contract (either explicitly or implicitly) provides the customer or the entity with a significant benefit of financing the transfer of goods or services to the customer. In those circumstances, the contract contains a significant financing component. A significant financing component may exist regardless of whether the promise of financing is explicitly stated in the contract or implied by the payment terms agreed to by the parties to the contract. |

## 8 Contract costs

| Indian GAAP | Ind AS 18/Ind AS 11 | Ind AS 115 |
|---|---|---|
| Capitalisation of contract cost not permitted. | Capitalisation of contract cost is generally not permitted. Under Ind AS 11, costs attributable to a contract for the period from the date of securing the contract to the final completion of the contract are included in contract costs. Costs that relate directly to a contract and are incurred in securing the contract are also included as part of the contract costs if they can be separately identified and measured reliably and it is probable that the contract will be obtained. | Ind AS 115 contains criteria for determining when to capitalize costs associated with obtaining and fulfilling a contract. Entities are required to capitalize recoverable incremental costs of obtaining a contract (for e.g. variable sales commission).<br><br>Such costs capitalised would be amortised in a manner consistent with the pattern of transfer of the goods or services to which the asset is related.<br><br>Capitalised costs are subjected to impairment testing if any impairment indicators exist. |

## 9 Disclosures

| Indian GAAP | Ind AS 18/Ind AS 11 | Ind AS 115 |
|---|---|---|
| Indian GAAP contains limited disclosure requirement. | Ind AS 18 and Ind AS 11 contain limited disclosure requirement. | Ind AS 115 contains extensive disclosure requirement. The standard requires the disclosure of quantitative and qualitative information about: the nature of the entity’s revenues; how much is recognised and when; and any uncertainties about those revenues and related cash flows. Key disclosure requirements include disaggregation of revenue, significant judgements and reconciliation of revenue. |

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