

## Insights into Revenue Recognition under Ind AS

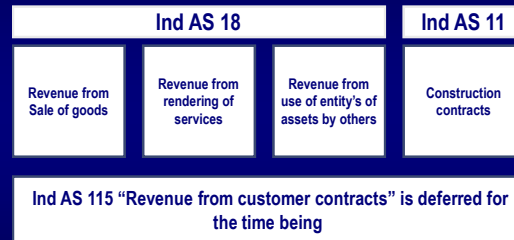
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Chinnsamy Ganesan  
FCA DISA(ICA)

# Ind AS Pocket Referencer

Chinnsamy Ganesan

## Structure of the discussion



## Exclusion from Ind AS 18 and 11

### Other types of income (gains)

Framework, other standards and Interpretations  
 Ind AS 104 "Insurance"  
 Ind AS 17 "Leases"  
 Ind AS 109 "Financial Instruments"  
 Ind AS 41 "Agriculture"  
 Ind AS 28 "Associates and JVs"  
 Ind AS 16 "Gain on Disposal of PPE"  
 Ind AS 40 "Investment Property"

## Ind AS 18 – Significant Differences

Substance over form

Multiple Element Arrangements

Treatment of Extended Credit period

Effective Interest Rate method/Up-front fees

Treatment of Extended Warranty

% completion for Service Contracts

## Ind AS 18 – Significant Differences

Accounting for real estate developers

Royalty recognition principles

Barter Transactions

Transfer of assets from customers

Service concession arrangements

Customer loyalty programs

## Revenue Vs Income

Revenue

Economic benefits arising in the ordinary course of an entity's activities.

Income

Income includes such benefits that arise from all activities whether ordinary or otherwise

## Definition of Revenue

In the course of the ordinary activities

Gross inflow of economic benefits

Result in an increase in equity

Other than contributions from equity participants

## Sale of Goods

Substance over form

Contractual terms

Linked transactions

May require judgement

## Revenue – Initial recognition

Transfer of significant risks and rewards of ownership of the goods

Neither continuing managerial involvement effective control over the goods sold are retained

The amount of revenue can be measured reliably

It is probable that economic benefits associated with the transaction will flow to the entity

The cost incurred or to be incurred in respect of sale can be measured reliably

All conditions have to be satisfied

## Sale of Goods

Transfer of significant risks and rewards usually occurs when legal title or possession is transferred to the buyer. It may, however, occur before or after delivery.

Consider :

- Who has the performance risk?
- Who has the price risk?
- Whether installation is significant part of the contract?
- Who has the inventory return risk?

### Rebuttable Presumption

Transfer of risks and rewards of ownership coincides with the transfer of title or the passing of possession to the buyer. Transfer of legal title is, therefore not a condition for revenue recognition under Ind AS 18

## Multiple Element Arrangements

- "... in certain circumstances, it is necessary to apply the recognition criteria to the separately identifiable components of a single transaction in order to reflect the substance of the transaction"
- For example, when the selling price of a product includes an identifiable amount for subsequent servicing, that amount is deferred and recognised as revenue over the period during which the service is performed.

## 3 Step approach

1

Identify components

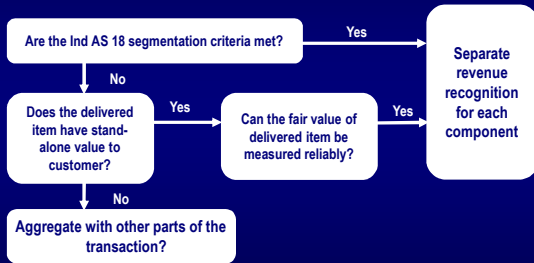
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Allocate consideration

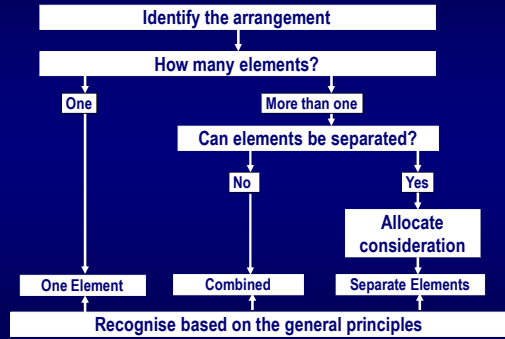
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Recognise revenue

## Separating Components



## Multiple elements – Decision tree



## Multiple Elements – When cannot be separated?

Elements do not have stand alone value or could not be sold separately in stand alone transaction

Delivery of future elements is not within the control of the vendor or is not probable

Fair value cannot established for each element

Other elements are significant

Key factor - Commercial substance to be viewed from the perspective of buyer and not from seller

## Allocating Considerations

Allocate considerations based on relative fair value of the elements

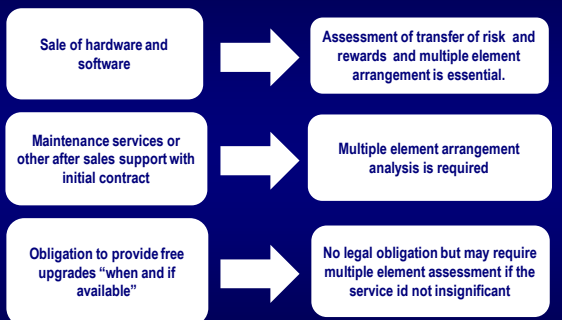
## Initial Measurement

- To be measured at the fair value of the consideration received or receivable
  - Cash sale - amount of cash received
  - credit sale - present value of the cash receivable
  - Net of all discounts (trade discount, volume discount and cash discount)

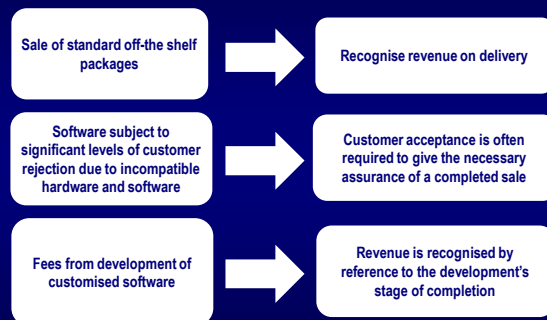
## Initial Measurement

- Any guidance on extended credit period?
- present value of the revenue is recognised if a longer, interest-free credit period is given
- Discount rate - customer's borrowing rate, not the seller's borrowing rate.
  - Can also be the rate by which the price has been discounted to arrive current cash sales price
- The difference between the fair value and the nominal amount of the consideration should be deferred in the balance sheet and recognised as interest revenue using the effective interest method (as per Ind AS 109)

## Software Industry



## Software Industry



## Rendering of Services

Outcome should be really estimated

The amount of revenue can be measured reliably

It is probable that economic benefits associated with the transaction will flow to the entity

The transaction's stage of completion at the balance sheet date can be measured reliably

The costs incurred or to be incurred in respect of the transaction can be measured reliably

All conditions to be satisfied

## Rendering of Services

Reliable estimate of outcome ?

Yes

No

Profit ?

Expenses recoverable?

Yes

No

Yes

No

Recognise revenue according to stage of completion

Recognise expected loss immediately

Recognise revenue to the extent of recoverable expenses (no profit recognised)

No revenue is recognised (costs incurred are recognised as expenses)

## Rendering of Services

Straight line method

Output method

Input method

Selection of method depends on the fact pattern of each contract

## Interest Revenue

Interest revenue should be recognised using the effective interest method

Effective interest rate is the rate that exactly discounts estimated future cash payments or receipts through the expected useful life of the financial instrument to the net carrying amount of the financial asset or liability

## Royalty Revenue

Should be recognised on an accrual basis in accordance with the substance of the relevant agreement

Care!  
Lumpsum payments at the inception of the agreement

## Dividend Revenue

Should be recognised when shareholder's right to receive is established

Care!  
Local rules and regulation to be considered to determine the timing of right to receive

## Ind AS 11 - Construction Contracts

- Contract specifically negotiated for the construction of
  - an asset or
  - a combination of assets that are closely interrelated or interdependent in terms of their design, technology and function, or their ultimate purpose or use
- the date of commencement and the date of completion fall into different accounting periods

## Selecting the right Standard

Contract of Consultancy for constructing an asset

Ship breaking activity

Contract for development of software

Contracts not exceeding one accounting period

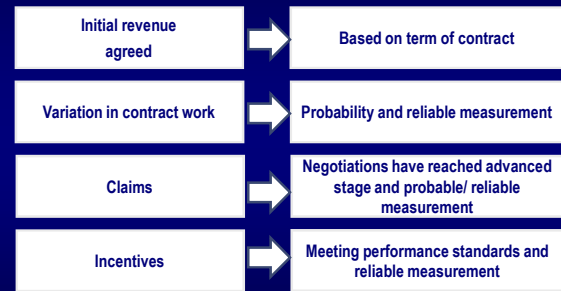
Maintenance contracts

Developer of Property

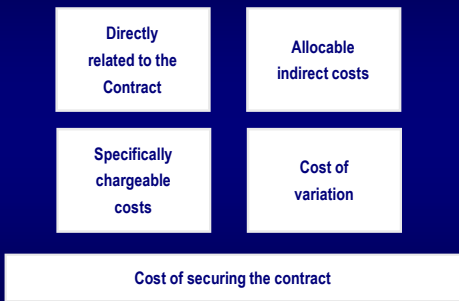
### Contract types



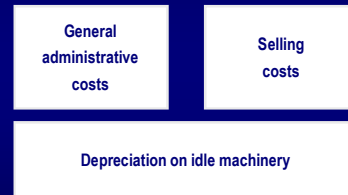
### Contract revenue



### Contract costs

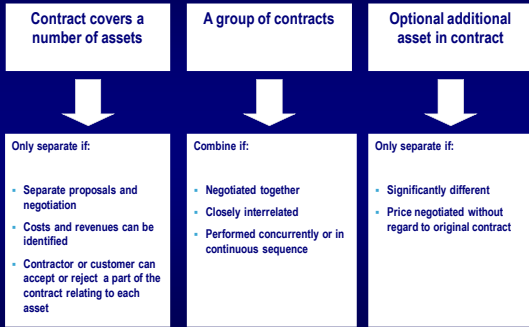


### Costs to be excluded





## Combining and Segmenting

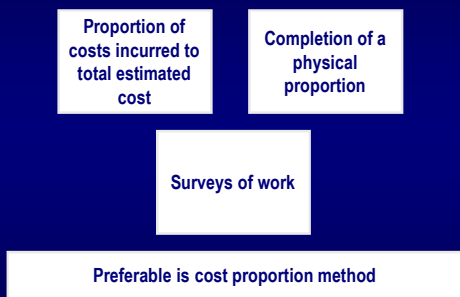


## Revenue Recognition

- Revenue can be measured reliably
- Probable that the economic benefits will flow to the entity
- Stage of completion can be measured reliably
- Costs can be measured reliably

Cost Plus Contract

## Methods to decide % of completion



## Key points to consider

- Foreseeable future losses
- Advance and retention moneys
- Costs relating to next stage of completion
- When reliable estimate cannot be made of outcome
- Running bills raised on the customers

## Major Disclosures

- Contract revenue recognised as revenue during the period
- method used to determine contract revenue
- methods used to determine the stage of completion
- in respect of contracts in progress
  - aggregate of cost/ recognised profits
  - advances received
  - retention money

## Going forward

Ind AS 115 – A single revenue standard to cover all types of revenue

Terms of contract/ performance obligation is the driver

Revenue at a Point in time or Over the time

5 Step process prescribed by the Standard

Implementation issues at each step

## 5 Step approach of Ind AS 115

Identify the contract with a customer

Identify the performance obligations

Determine the transaction price

Allocate the transaction price

Recognise revenue

## Thank you



[ganesanca@yahoo.com](mailto:ganesanca@yahoo.com)/ 0 99401 30403