

Educational Material on Indian Accounting Standard (Ind AS) 18 Revenue



The Institute of Chartered Accountants of India
(Set up by an Act of Parliament)
New Delhi

**Educational Material on
Indian Accounting Standard (Ind AS) 18
Revenue**



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Foreword

The financial reporting has always been critical from the point of view of allocation of economic resources. Meaningful and transparent financial reporting serves an entity favourably in the long run since it establishes the credibility of an entity in the eyes of the investors, regulators and other users. Further, information about a particular entity is greatly useful if it can be compared with similar information about another entity. Comparability between entities and consistency in the application of methods over time increases the informational value of comparisons of relative economic opportunities or performance. In this era of globalisation, to address this issue of comparability across the globe and considering other factors, need for a single set of high quality accounting standards has been felt. This need has been taken care by the International Accounting Standards Board (IASB) by issuing International Financial Reporting Standards (IFRSs) which are increasingly being recognised as Global Financial Reporting Standards.

In the current scenario where various countries are moving towards IFRS, India has also decided to converge with IFRS. For this purpose, the Institute of Chartered Accountants of India (ICAI) is actively engaged in formulation of IFRS-converged Indian Accounting Standards (Ind ASs). Another very significant responsibility of the ICAI is getting the members and other stakeholders ready for proper implementation of these Standards, which is being discharged by the ICAI through its Ind AS (IFRS) Implementation Committee. To accomplish its primary objective of providing guidance to members and other stakeholders for implementation of Ind ASs, the Committee formulates Educational Materials on Ind ASs.

An Educational Material contains summary of the respective Indian Accounting Standard and Frequently Asked Questions (FAQs) covering the issues which are expected to be encountered frequently while implementing the Standard. Accordingly, the Committee has come out with the Educational Material on Ind AS 18, *Revenue*.

I may acknowledge with thanks the sincere efforts of CA. Amarjit Chopra, Chairman, Ind AS (IFRS) Implementation Committee, and all the members of the Committee for bringing out this Educational Material on an Indian Accounting Standard which deals with a very important aspect of the financial statements, i.e., revenue.

Since the subject will be relevant for all the entities, I am confident that this Educational Material will be very useful for the members of the Institute and other concerned stakeholders in proper understanding and implementation of the Standard.

New Delhi
February 1, 2013

CA. Jaydeep Narendra Shah
President

Preface

The Institute of Chartered Accountants of India (ICAI) being premier accounting body in the country has always taken proactive measures to establish sound financial reporting system in the country. Continuing with its endeavour to achieve international benchmarks of accounting, convergence with International Financial Reporting Standards (IFRS) issued by the International Accounting Standards Board had been decided.

For smooth implementation of IFRS-converged Indian Accounting Standards (Ind ASs), the Ind AS (IFRS) Implementation Committee of the ICAI is actively engaged in getting the members ready. For this purpose, the Committee formulates Educational Materials on Ind ASs. The Committee has brought out Educational Material on Ind AS 18, *Revenue*.

Revenue is a very significant element which needs to be accounted for appropriately to reflect true and fair view of financial performance of an entity. This Standard prescribes the recognition and measurement principles for revenue arising from certain types of transactions and events. Since revenue is an element which can influence the decisions of the users of the financial statements, the principles prescribed in the Indian Accounting Standard need to be applied very carefully. Moreover, with regard to certain provisions need of practical guidance has been felt. Accordingly, efforts have been made to deal with such implementation issues in this Educational Material.

It may be mentioned that the views expressed in this Educational Material are the views of the Ind AS (IFRS) Implementation Committee and are not necessarily the views of the Council of the Institute. Though efforts have been made to provide guidance on implementation of principles prescribed in the Standard with the help of examples and FAQs, while implementing the Standard in a practical situation reference should be made to the text of the Standard.

I wish to place on record my sincere appreciation of efforts put in by CA. P. Rajendra Kumar, Convenor and members of the Study group for preparing the draft of this Educational Material. I would also like to thank all the members of the Ind AS (IFRS) Implementation Committee for their valuable inputs in formulation and finalisation of this Educational Material. My thanks are also due to our Honourable President CA. Jaydeep Narendra Shah for

providing me this opportunity. I may also thank the members of the Accounting Standards Board for their valuable comments on the Educational Material.

I would like to thank Dr. Avinash Chander, Technical Director, CA. Parminder Kaur, Secretary, Ind AS (IFRS) Implementation Committee and CA. Bibhuti Bhusan Nayak, Executive Officer, of the Institute of Chartered Accountants of India for their efforts and support in finalising this publication.

I sincerely believe this Educational Material will be of immense use in understanding the provisions of Ind AS 18 and in implementation of the same.

New Delhi
February 1, 2013

CA. Amarjit Chopra
Chairman
Ind AS (IFRS) Implementation Committee

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Educational Material on Indian Accounting Standard (Ind AS) 18 Revenue

I Ind AS 18 – Summary

Introduction

Revenue is income that arises in the course of ordinary activities of an entity, e.g., sales, fees, interest, dividends and royalties. Revenue is very crucial element for existence and growth an entity. It is indispensable for an entity to generate revenue to meet its day-to-day expenses and obligations, to pay its employees, to pay suppliers, and to run its production process. The main objective of any profit-making entity is to generate revenue to the maximum extent possible. The size and growth of an entity depends on its size and growth of its revenue.

Any stakeholder of any entity, say, shareholder, investor, employee, supplier, customer, banker, regulator, management, would be interested in the amount of revenue. Revenue has direct impact on operating profit of an entity. It is one of the key indicators of the financial performance of an entity. Revenue is an important item for a user of financial statements. Therefore, to reflect true and fair view of financial performance and financial position of an entity, revenue needs to be measured and recognised correctly.

Objective

This Standard prescribes the recognition and measurement principles for revenue arising from certain types of transactions and events. The primary issue in accounting for revenue is determining when to recognise revenue. Revenue is recognised when it is probable that future economic benefits will flow to the entity and these benefits can be measured reliably. This Standard prescribes the criteria to be met for recognition of revenue. It also provides practical guidance on the application of these criteria.

Scope

This Standard shall be applied in accounting for revenue arising from the following transactions and events:

- (a) the sale of goods;
- (b) the rendering of services; and
- (c) the use by others of entity assets yielding interest, royalties and dividends.

This Standard does not deal with revenue arising from:

- (a) lease agreements (see Ind AS 17, *Leases*);
- (b) dividends arising from investments which are accounted for under the equity method (see Ind AS 28, *Investments in Associates*);
- (c) insurance contracts within the scope of Ind AS 104, *Insurance Contracts*;
- (d) changes in the fair value of financial assets and financial liabilities or their disposal (see Ind AS 39, *Financial Instruments: Recognition and Measurement*);
- (e) changes in the value of other current assets;
- (f) initial recognition and from changes in the fair value of biological assets related to agricultural activity (see Ind AS 41, *Agriculture*);
- (g) initial recognition of agricultural produce (see Ind AS 41); and
- (h) the extraction of mineral ores.

Revenue arising from contracts for rendering services related to construction contracts is dealt with in Ind AS 11, *Construction Contracts*. Therefore, this Standard does not deal with revenue arising from such contracts. The definition of a Construction Contract in Ind AS 11 includes agreements of real estate development. Accordingly, revenue arising from such agreements is not dealt with in this Standard.

Key Requirements of Ind AS 18

Measurement of Revenue

This Standard prescribes that revenue shall be measured at the fair value of the consideration received or receivable taking into account the amount of any trade discounts and volume rebates allowed by the entity.

In most cases, the consideration is in the form of cash or cash equivalents and the amount of revenue is the amount of cash or cash equivalents received or receivable. However, 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. 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. The imputed rate of interest is determined by reference to the prevailing rate for a similar instrument of an issuer with a similar credit rating; or a rate of interest that discounts the nominal amount of the instrument to the current cash sales price of the goods or services.

The difference between the fair value and the nominal amount of the consideration is recognised as interest revenue using effective interest method as set out in Ind AS 39.

Revenue is recognised only when it is probable that the economic benefits associated with the transaction will flow to the entity. However, when an uncertainty arises about the collectibility 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.

Exchange or Swap of Goods or Services

Exchange or Swap of Goods and Services for Similar Nature and Value

When goods or services are exchanged or swapped for goods or services

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which are of a similar nature and value, the exchange is not regarded as a transaction which generates revenue.

Exchange or Swap of Goods and Services for Dissimilar Goods and Services

When goods are sold or services are rendered in exchange for dissimilar goods or services, the exchange is regarded as a transaction which generates revenue.

The revenue is measured at the fair value of the goods or services received, adjusted by the amount of any cash or cash equivalents transferred. When the fair value of the goods or services received cannot be measured reliably, the revenue is measured at the fair value of the goods or services given up, adjusted by the amount of any cash or cash equivalents transferred.

Identification of the Transaction

The recognition criteria in this Standard are usually applied separately to each transaction. However, 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. Conversely, the recognition criteria are applied to two or more transactions together when they are linked in such a way that the commercial effect cannot be understood without reference to the series of transactions as a whole.

Sale of Goods

Goods includes goods produced by the entity for the purpose of sale and goods purchased for resale, such as merchandise purchased by a retailer or land and other property held for resale.

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;

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- (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.

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. 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.

If the entity retains significant risks of ownership, the transaction is not a sale and revenue is not recognised. However, if an entity retains only an insignificant risk of ownership, the transaction is a sale and revenue is recognised.

Revenue and expenses that relate to the same transaction or other event are recognised simultaneously; this process is commonly referred to as the matching of revenues and expenses. Expenses, including warranties and other costs to be incurred after the shipment of the goods can normally be measured reliably when the other conditions for the recognition of revenue have been satisfied. However, revenue cannot be recognised when the expenses cannot be measured reliably; in such circumstances, any consideration already received for the sale of the goods is recognised as a liability.

Rendering of Services

Rendering of services typically involves performance by the entity of a contractually agreed task over an agreed period of time. The services may be rendered within a single period or over more than one period.

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When the outcome of a transaction involving the rendering of services can be estimated reliably, revenue associated with the transaction shall be recognised by reference to the **stage of completion (percentage completion method)** of the transaction at the end of the reporting period. The outcome of a transaction can be estimated reliably when all the following conditions are satisfied:

- (a) the amount of revenue can be measured reliably;
- (b) it is probable that the economic benefits associated with the transaction will flow to the entity;
- (c) the stage of completion of the transaction at the end of the reporting period can be measured reliably; and
- (d) the costs incurred for the transaction and the costs to complete the transaction can be measured reliably.

Under percentage completion method, revenue is recognised in the accounting periods in which the services are rendered. The stage of completion of a transaction may be determined by a variety of methods. The method used by the entity should reliably measure the services performed. These methods may include:

- (a) surveys of work performed;
- (b) services performed to date as a percentage of total services to be performed; or
- (c) the proportion that costs incurred to date bear to the estimated total costs of the transaction.

Costs incurred to date = Costs that reflect services performed to date.
Estimated Total Cost = Total cost that reflect services performed or to be performed.

Progress payments and advances received from customers often do not reflect the services performed.

When services are performed by an indeterminate number of acts over a specified period of time, revenue is recognised on a straight-line basis over

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the specified period unless there is evidence that some other method better represents the stage of completion. When a specific act is much more significant than any other acts, the recognition of revenue is postponed until the significant act is executed.

When the outcome of the transaction involving the rendering of services cannot be estimated reliably, revenue shall be recognised only to the extent of the expenses recognised that are recoverable. When it is not probable that the costs incurred will be recovered, revenue is not recognised and the costs incurred are recognised as an expense. When the uncertainties that prevented the outcome of the contract being estimated reliably no longer exist, revenue is recognised in accordance with paragraph 20 of Ind AS 18.

Interest, Royalties and Dividends

Interest charges are charges for the use of cash or cash equivalents or amounts due to the entity. Royalties are charges for the use of long-term assets of the entity, for example, patents, trademarks, copyrights and computer software. Dividends are distributions of profits to holders of equity investments in proportion to their holdings of a particular class of capital.

Revenue arising from the use by others of entity assets yielding interest, royalties and dividends shall be recognised when:

- (a) it is probable that the economic benefits associated with the transaction will flow to the entity; and
- (b) the amount of the revenue can be measured reliably.

Revenue shall be recognised on the following bases:

- (a) interest shall be recognised using the effective interest method as set out in Ind AS 39;
- (b) royalties shall be recognised on an accrual basis in accordance with the substance of the relevant agreement; and
- (c) dividends shall be recognised when the shareholder's right to receive payment is established.

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When unpaid interest has accrued before the acquisition of an interest-bearing investment, the subsequent receipt of interest is allocated between pre-acquisition and post-acquisition periods; only the post-acquisition portion is recognised as revenue.

Royalties accrue in accordance with the terms of the relevant agreement and are usually recognised on that basis unless, having regard to the substance of the agreement, it is more appropriate to recognise revenue on some other systematic and rational basis.

Disclosure

An entity should disclose:

- (a) the accounting policies adopted for the recognition of revenue, including the methods adopted to determine the stage of completion of transactions involving the rendering of services;
- (b) the amount of each significant category of revenue recognised during the period, including revenue arising from:
 - (i) the sale of goods;
 - (ii) the rendering of services;
 - (iii) interest;
 - (iv) royalties;
 - (v) dividends; and
- (c) the amount of revenue arising from exchanges of goods or services included in each significant category of revenue.

II Frequently Asked Questions

Question 1

How is revenue different from income?

Response

Paragraph 7 of Ind AS 18 defines revenue as the gross inflow of economic benefits during the period arising in the course of the ordinary activities of an entity when those inflows result in increases in equity, other than increases relating to contributions from equity participants.

Income is defined in the *Framework for the Preparation and Presentation of Financial Statements* issued by the Institute of Chartered Accountants of India as increases in economic benefits during the accounting period in the form of inflows or enhancements of assets or decreases of liabilities that result in increases in equity, other than those relating to contributions from equity participants.

On the basis of above definitions, income is a wider term as revenue is income that arises in the course of ordinary activities of an entity, whereas income encompasses both revenue and gains where the gains may not arise in the ordinary course of business.

Example: In case of a manufacturer of cement, the sale of cement is revenue. Whereas the same entity if during the course of the year disposes its surplus land, the profit on sale of land is a gain and not revenue. Its income would be comprising revenue from sale of cement and gain on sale of land.

Question 2

A car manufacturer sells a car at Rs. 1,00,000 which includes excise duty of Rs. 10,000 and VAT of Rs. 5,000. What is the amount to be recognised as revenue?

Response

Paragraph 8 of Ind AS 18 provides that revenue includes only the gross inflows of economic benefits received and receivable by the entity on its

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own account. Amounts collected on behalf of third parties such as sales taxes, goods and services taxes and value added taxes are not economic benefits which flow to the entity and do not result in increases in equity. Therefore, they are excluded from revenue.

Recovery of excise duty flows to the entity on its own account because it is a liability of the manufacturer which forms part of the cost of production, irrespective of whether the goods are sold or not. Since the recovery of excise duty flows to the entity on its own account, revenue includes excise duty.

VAT is not received by the entity on its own account, it is tax collected on value added to the commodity by the seller on behalf of the Government, therefore, it is excluded from revenue.

Accordingly, in the present case, revenue is Rs. 95,000.

Question 3

How excise duty should be presented in the statement of profit and loss? Is there any change in the presentation of excise duty as compared to the presentation prescribed in AS 9?

Response

As far as disclosure of excise duty in presentation of revenue from sales transactions is concerned, AS 9 specifically provides that the excise duty included in the turnover should be shown as reduction from the gross turnover on the face of the statement of profit and loss. Though Ind AS 18 does not specifically prescribe any guidance for presentation of excise duty, the entity may provide the information related to turnover gross of excise duty as well as net of excise duty in the notes.

Question 4

A company pays dividends to its shareholders. The shareholders receive the dividend net of tax deducted at source (TDS) on dividends. Is it appropriate for shareholders to recognise its dividend revenue net of the tax withheld?

Response

Ind AS 18 defines revenue as gross inflow of economic benefits during the period arising in the course of the ordinary activities of an entity when those inflows result in increases in equity, other than increases relating to contributions from equity participants.

Further, paragraph 8 of Ind AS 18 provides that revenue includes only the gross inflows of economic benefits received and receivable by the entity on its own account.

In accordance with the above, revenue is to be recognised for the gross inflows, which are received and receivable by the entity on its own account. Tax deducted at source by the company on dividend paid is deposited with the Government on behalf of the shareholders and its credit can be claimed by the shareholders for the amount of tax due on their account. This implies that the income is earned by the shareholder for the gross amount.

Therefore, dividends from investments should be recognised at the gross amount of dividends.

Question 5

A company is engaged in generation and supply of power to Electricity Boards. As per power supply agreement, it recovers from the Electricity Boards the income tax relating to the power generation activity for supply of power in addition to the normal tariff. It presently adjusts the recovery of income tax from its income tax provision made in the statement of profit and loss. Is the treatment correct?

Response

Paragraph 8 of Ind AS 18 provides that revenue includes only the gross inflows of economic benefits received and receivable by the entity on its own account.

Income tax being a direct tax is a charge on the enterprise's income and it has to be borne by the enterprise itself. Although income tax is a charge on the enterprise's income but in the instant case income tax is recovered from

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the Electricity Boards as a part of consideration for supply of power, i.e., it is only a mode of determining the value of consideration and is not a reimbursement. Therefore, it should form part of revenue arising on account of sale of power and corresponding income tax expense should be recognised in the statement of profit and loss. Hence, the accounting treatment being followed by the company is not correct.

Question 6

A TV manufacturer sells TVs to its dealers at a list price of Rs. 10,000 per TV. If the dealer takes more than 8,000 sets during the contract period, then he/she is eligible for a discount of 5% on the list price. The contract period starts from June and ends in May of each year. At the end of year on March 31, 2012, a particular dealer has purchased 5,000 sets. Based on the past trends, it is expected that the total purchases made by dealer during the contract period up to May 2012 will be more than 8,000 sets. How revenue should be measured in this case on the balance sheet date?

Response

Paragraph 10 of Ind AS 18 prescribes that the amount of revenue arising on a transaction is usually determined by agreement between the entity and the buyer or user of the asset. It is measured at the fair value of the consideration received or receivable taking into account the amount of any trade discounts and volume rebates allowed by the entity.

In accordance with the above, the amount of revenue will be determined on the basis of terms of the agreement between the manufacturer and the dealer. In the instant case, based on past trends and other available evidence, it is probable that 5% discount will have to be allowed. Therefore, the amount of revenue should be adjusted for the probable discount that may have to be allowed, as the economic benefits to that extent may not flow to the entity. Therefore, revenue should be adjusted for probable discount on sales made till March 31, 2012. While estimating the amount of discount expected to be allowed, events occurring between the end of the reporting period and the date when the financial statements are approved shall also be considered in accordance with the requirements of Ind AS 10, *Events After the Reporting Period*.

Question 7

A Ltd. is a manufacturer of garments and sells the garments to certain retailers with a right to return in case the retailer is not satisfied with the quality of garments. Cash is refunded to retailer provided that garments are undamaged. Based on past experience, at the end of the year, it is expected that 5% of goods sold during the year will be returned by the retailers in the next financial year. The margin on sale of garments is 10%. How revenue should be recognised by A Ltd?

Response

According to paragraph 14 of Ind AS 18, 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.

In the present case, on the basis of past experience, it is expected that 5% of goods sold will be returned for which A Ltd. will have to refund cash to retailers. Therefore, though significant risks and rewards have been transferred to retailers but it is not probable that economic benefits attributable to possible returns will flow to the entity.

Therefore, revenue should be adjusted for expected returns for which cash will have to be refunded.

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Question 8

When does an arrangement between the entity and the buyer qualify as a financing transaction and what is the accounting treatment if an arrangement qualify as a financing transaction?

Response

Paragraph 11 of Ind AS 18, *inter alia*, states that when 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.

On the basis of the above, if inflow of cash and cash equivalents for sale of goods is deferred over a period, beyond normal credit period, the fair value of the consideration will be less than the nominal amount of cash received or receivable. Such an arrangement will constitute a sale transaction and a financing transaction.

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. The imputed rate of interest is the more clearly determinable of either:

- (a) the prevailing rate for a similar instrument of an issuer with a similar credit rating; or
- (b) a rate of interest that discounts the nominal amount of the instrument to the current cash sales price of the goods or services.

The difference between the fair value and the nominal amount of the consideration is recognised as interest revenue in accordance with paragraphs 29 and 30 of Ind AS 18 and in accordance with Ind AS 39.

For example, A Ltd. has sold goods to B Ltd. for Rs. 1,00,000 and allowed an extended credit period of 2 years. The imputed rate of interest is 10%.

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In this case, fair value of the consideration will be determined by discounting all future receipts using imputed rate of interest.

Nominal value of cash receivable = Rs. 1,00,000

Fair value = $1,00,000 \times [1/(1.1)^2]$ = Rs. 82,645

The difference of Rs. 17,355 (i.e. 1,00,000 – 82,645) will be recognised as interest revenue using effective interest method as set out in Ind AS 39. The interest revenue to be recognised over the period of two years is calculated as follows:

| Year | Amortised cost at the start of the year (a) | Interest income (b) = (a) x 10% | Amortised cost at the end of year (c) = (a) + (b) |
|------|--|---------------------------------------|--|
| 1 | 82,645 | 8264 | 90,909 |
| 2 | 90,909 | 9091 | 1,00,000 |

Question 9

A Ltd. and B Ltd. both are engaged in manufacturing of bottles. A Ltd. operates in northern, eastern and central parts of India. B Ltd. operates in western and southern parts of India. A Ltd. fulfills the demands of its customers based on western and southern India by using the bottles manufactured by B Ltd. Similarly, B Ltd. fulfills the demands of customer based on northern, eastern and central parts of India by delivering bottles manufacture by A Ltd. How A Ltd. and B Ltd. should recognise the revenue?

Response

Paragraph 12 of Ind AS 18 states that when goods or services are exchanged or swapped for goods or services which are of a similar nature and value, the exchange is not regarded as a transaction which generates revenue. Based on the above principle, assuming that the bottles exchanged are similar in nature and are of equal value, A Ltd. and B Ltd. should not

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recognise any revenue on account of exchange of goods. The revenue will be recognised only to the extent of amounts charged from the respective customers.

Question 10

A Ltd., a telecommunication company, entered into an agreement with B Ltd. which is engaged in generation and supply of power. The agreement provided that A Ltd. will provide 1,00,000 minutes of talk time free to employees of B Ltd. in exchange for getting free power equivalent to 20,000 units. A Ltd. normally charges Re. 0.50 per minute and B Ltd. charges Rs. 3 per unit. How to measure revenue in this case?

Response

Paragraph 12 of Ind AS 18, *inter alia*, provides that when goods are sold or services are rendered in exchange for dissimilar goods or services, the exchange is regarded as a transaction which generates revenue. In such cases the revenue is measured at the fair value of the goods or services received, adjusted by the amount of any cash or cash equivalents transferred. When the fair value of the goods or services received cannot be measured reliably, the revenue is measured at the fair value of the goods or services given up, adjusted by the amount of any cash or cash equivalents transferred. On the basis of the above, revenue will be recognised in the books of A Ltd. at fair value of power units received, i.e., Rs. 60,000 (20,000 units x Rs. 3) and in the books of B Ltd. the same will be recognised at fair value of talk time received, i.e., Rs. 50,000 (1,00,000 minutes x Re. 0.50).

In this case, if A Ltd. is not able to determine the fair value of units received, the revenue will be recognised at Rs. 50,000 being the fair value of talk time given up. Similarly, if B Ltd. is not able to determine the fair value of talk time received, the revenue will be recognised at Rs. 60,000 being the fair value of power units given up.

Question 11

Q TV released an advertisement in Deshabandhu, a vernacular daily. Instead of paying for the same Q TV allowed Deshabandhu a free advertisement

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spot, which was duly utilised by Deshabandu. How revenue for these barter transactions in the area of advertising will be recognised and measured?

Response

As per paragraph 12 of Ind AS 18, revenue for exchange of goods or services will be recognised where goods or services exchanged are of dissimilar nature. In the instant case, revenue will be recognised as the exchange of advertising services between Q TV and Deshabandu is exchange of dissimilar services because both of the entities deal in different mode of media, i.e., one is print media and another is electronic media.

With regard to measurement of revenue from a barter transaction involving dissimilar advertising services, paragraph 5 of Appendix A to Ind AS 18 provides that revenue from a barter transaction involving advertising cannot be measured reliably at the fair value of advertising services received. However, a seller can reliably measure revenue at the fair value of the advertising services it provides in a barter transaction, by reference only to non-barter transactions that:

- (a) involve advertising similar to the advertising in the barter transaction;
- (b) occur frequently;
- (c) represent a predominant number of transactions and amount when compared to all transactions to provide advertising that is similar to the advertising in the barter transaction;
- (d) involve cash and/or another form of consideration (e.g., marketable securities, non-monetary assets, and other services) that has a reliably measurable fair value; and
- (e) do not involve the same counterparty as in the barter transaction.

In accordance with the above, QTV and Deshabandu will measure the revenue at the fair value of the advertising services provided by them. Fair value will be determined by reference to non-barter transactions as per the above mentioned principles.

Question 12

When components of a single transaction are separately identifiable, and

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how revenue should be recognised in case of a transaction with two or more separately identifiable components?

Response

Paragraph 13 of Ind AS 18, *inter alia*, provides that the recognition criteria in Ind AS 18 are usually applied separately to each transaction. However, 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, warranty is provided to a customer at the time of sale of goods, which allows a customer to get the product repaired from the supplier in case of any problem. Warranty can be normal warranty or extended warranty. Normal warranty does not constitute a separate element of sale transaction as revenue includes insignificant amount of the warranty cost. In this case, revenue is recognised in full and is not deferred. However, the cost of warranty should be determined and a corresponding provision for warranty cost should be recognised in accordance with requirement of Ind AS 37, *Provisions, Contingent Liabilities and Contingent Assets*.

An extended warranty is provided either to provide warranty in addition to normal warranty or to cover the warranty period which is more than the period covered by the normal warranty. In this case, the price of the product often includes identifiable amount for the extended warranty. Accordingly, the arrangement with customer has two components; one is sale of the goods and another sale of the warranty. According to paragraph 13 of Ind AS 18, recognition criteria shall be applied separately to each identifiable component of a single transaction. Accordingly, the fair value of the consideration related to extended warranty should be deferred and recognised as revenue over the period of warranty.

A case where goods are sold with extended warranty is illustrated below:

Cars manufactured by X Ltd. are sold with an extended warranty of 2 years for Rs. 5,00,000 while an identical car without the extended warranty is sold in the market for Rs. 4,50,000 and equivalent warranty is given in the market for Rs. 60,000. How should X Ltd. recognise and measure revenue in its books on sale of the car and warranty?

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The substance of the transaction in the issue is that X Ltd. has sold two products: car and the extended warranty, where both the components operate independently from each other, therefore, these components should be unbundled and the revenue earned on sale of each product should be recognised separately. Revenue attributable to both the components is calculated as follows:

| | |
|---|-----------------------|
| Total fair value of car and extended warranty: (4,50,000 + 60,000) | Rs. 5,10,000 |
| Less: Sale price of the car with extended warranty: | <u>(Rs. 5,00,000)</u> |
| Discount | <u>Rs. 10,000</u> |

Discount and revenue attributable to each component of the transaction

| | |
|--|----------------|
| Proportionate discount attributable to sale of car (10,000 x 4,50,000/5,10,000) | : Rs. 8,824 |
| Revenue from sale of car (4,50,000 - 8,824) | : Rs. 4,41,176 |
| Proportionate discount attributable to extended warranty (10,000 x 60,000/5,10,000) | : Rs. 1,176 |
| Revenue from extended warranty (60,000 - 1,176) | : Rs. 58,824 |

Revenue in respect of sale of car should be recognised immediately and revenue from warranty should be recognised over the period of warranty.

Question 13

A steel company dispatches stocks from its plant to its customers on Free on Road and invoice is also raised on the date of dispatch of the stocks. The Lorry Receipts are taken in the name of its stock yard. The Lorry Receipt is sent to the stock yard and when the customer pays the amount due on the invoice, the Lorry Receipt is endorsed in his favor, which amounts to passing on the title of the goods and risks and rewards to the customer. The company books the sales revenue immediately on dispatch. This is the usual practice followed by the company for many years. Is it correct?

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Response

Paragraph 14 of Ind AS 18 states that "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"

In the present case, the invoice is raised on the date of dispatch of the stocks but the Lorry Receipt is sent to the stock yard and endorsed in the favour of the customer only when he pays the amount due on the invoice. In this case, though the goods are dispatched, the title of the goods is still with the entity and the significant risks and rewards of ownership of the goods are transferred when the Lorry Receipt is endorsed in the name of customer.

Based on above, it is apparent that condition mentioned in paragraph 14(a) of Ind AS 18 is not fulfilled. Accordingly, the entity cannot book revenue immediately on dispatch of the goods; hence the accounting treatment followed by the entity is not correct.

Question 14

In December 2011, Zero Cycles entered into a contract with the Local Government for supply of 50,000 cycles. The Local Government will specify the timing and place of delivery. As per the terms of the transaction, Zero Cycles must deliver the cycles in the manner specified.

Other information:

- (i) Usual credit terms apply.

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- (ii) As at the year end on March 31, 2012, Zero Cycles had an inventory of 75,000 cycles. Out of these 50,000 cycles have been identified for delivery to the local government.
- (iii) The Goods Inspector from the Government has inspected the goods and have been sealed for delivery. Bill has been raised and the same has been accepted by the Government. Significant risks and rewards of ownership of the goods have been transferred to the Government.
- (iv) Delivery is expected to take place in May 2012.

When Zero Cycles can recognise revenue?

Response

According to Appendix E to Ind AS 18, 'Bill and hold sales' are those in which delivery is delayed at the buyer's request but the buyer takes title and accepts billing. In this case, revenue is recognised when the buyer takes title, provided:

- (a) it is probable that delivery will be made;
- (b) the item is on hand, identified and ready for delivery to the buyer at the time the sale is recognised
- (c) the buyer specifically acknowledges the deferred delivery instructions; and
- (d) the usual payment terms apply.

In the given case, the goods have been identified and ready for delivery. The delivery of goods is probable as the delivery is deferred to May 2011 on the request of Local Government. The buyer has accepted billing. Further, the Goods Inspector of the Local Government has inspected the goods and the goods have been sealed for delivery. In this case, the entity has transferred to the buyer the significant risks and rewards of ownership of the goods. Assuming that all other conditions specified in paragraph 14 of Ind AS 18 have been satisfied, revenue can be recognised by Zero Cycles on March 31, 2012 itself.

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Question 15

X Ltd. a company engaged in research enters into an agreement with Y Ltd. for development of a drug for HIV. This research project is expected to take about 4 years. X Ltd. will have to periodically update Y Ltd. on the results of its work. Y Ltd. has an exclusive right over the development results. X Ltd. is entitled to upfront non-refundable fee of Rs. 20 lakhs for setting up the project and 4 equal installments of Rs. 50 lakhs each on clearance of various testing phases, i.e., preclinical testing, Phase I testing, Phase II testing and Phase III testing. How should X Ltd. recognise revenue in its books?

Response

The upfront fee has been received for setting up the project, where various facilities set up under the project will be used for the purpose of the research project over the project period. Therefore, upfront fee should be recognised over the project period.

With regard to recognition of revenue to be received on clearance of various test phases, paragraph 20 of Ind AS 18 may be noted which, *inter alia*, provides that “when the outcome of a transaction involving the rendering of services can be estimated reliably, revenue associated with the transaction shall be recognised by reference to the stage of completion of the transaction at the end of the reporting period.”

In the instant case, since the outcome of the transaction can be estimated reliably only on clearance of relevant testing phase because flow of economic benefits associated with the transaction to the entity becomes probable only on clearance of the relevant testing phase, clearance of various testing phases should be considered various stages of the project. Accordingly, revenue related to each testing phase will be recognised on clearance of the relevant testing phase presuming that other conditions of estimating reliably the outcome of the transaction are fulfilled.

Question 16

A public sector company is engaged in the production and distribution of LPG. It has evolved a TATKAL SCHEME, whereby a person who pays a

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non-refundable additional amount, is given priority in allotment of the LPG connections. The petroleum ministry has given a directive to the company that amounts collected under this scheme should be deposited into a separate account and should be utilised for the purpose of development of LPG Infrastructure. The company accounts for the additional amount received as liability and does not recognise any revenue in this regard. Do you agree with the accounting being done by the company regarding additional amount received?

Response

The response to above question deals with the issue of recognition of revenue only and does not address any other accounting implications.

In the instant case, the additional amount is received for allotment of LPG connections on priority basis. Paragraph 20 of Ind AS 18 provides that when the outcome of a transaction involving the rendering of services can be estimated reliably, revenue associated with the transaction shall be recognised by reference to the stage of completion of the transaction at the end of the reporting period. Accordingly, the amounts received for allotting the connections on priority basis should be recognised as revenue when services are rendered, i.e., when LPG connection is allotted. Utilisation of the additional amount for the purpose of LPG infrastructure as per the directive of the petroleum ministry is a separate event, which would not affect the recognition of revenue.

Question 17

A Ltd. owns 20 resorts across the country. Every customer who stays in any of the resorts owned by A Ltd. is entitled to get points on the basis of total bill amount charged to him. Under this scheme, 1 point is granted for every Rs. 100. Points can be redeemed only in multiples of 100 points and the customers are allowed Rs. 500 discount for every 100 points for stay in any of the resorts owned by A Ltd. What is the accounting treatment of the points granted by A Ltd. in its books of account?

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Response

Appendix B of Ind AS 18, *Customer Loyalty Programmes*, deals with customer loyalty programmes that are used by entities to provide customers with incentives to buy their goods or services. If a customer buys goods or services, the entity grants the customer award credits (often described as 'points'). The customer can redeem the award credits for awards such as free or discounted goods or services. In the instant case, A Ltd. allows award credits for staying in its resorts and customer are allowed to redeem the award credits on fulfillment of certain conditions. Accordingly, the instant case is a customer loyalty programme.

Appendix B of Ind AS 18 prescribes the following relevant principles in this regard:

An entity shall apply paragraph 13 of Ind AS 18 and account for award credits as a separately identifiable component of the sales transaction(s) in which they are granted (the 'initial sale'). The fair value of the consideration received or receivable in respect of the initial sale shall be allocated between the award credits and the other components of sale.

The consideration allocated to the award credits shall be measured by reference to their fair value, i.e. the amount for which the award credits could be sold separately. If the fair value is not directly observable, it must be estimated.

If the entity supplies the awards itself, it shall recognise the consideration allocated to award credits as revenue when award credits are redeemed and it fulfils its obligations to supply awards.

Let us assume a customer has stayed for 2 days in a resort of A Ltd. The total bill amount charged by A Ltd. is Rs. 10,000. Then, the customer is entitled to get 100 points ($1/100 \times 10,000$). The fair value of the 100 points is Rs. 500. In this case, A Ltd. should allocate the fair value of the consideration (i.e. Rs. 10,000) between the points and the other components of the sale as Rs. 500 and Rs. 9,500 respectively. Since A Ltd. supplies the awards itself, it should recognise Rs. 500 as revenue when points are redeemed.

Question 18

XYZ Ltd., a knowledge management company, entered into an agreement with ABC, an educational institute, to formulate some study material on a particular subject for a total revenue of Rs. 10 lakhs. The contract terms stipulated that XYZ Ltd. has to complete the contract before March 31, 2012, and in the event of failure to complete the same within the stipulated time, it will be reimbursed only 75% of the cost incurred by it. XYZ Ltd. could complete only 85% of the assignment till March 31, 2012. Till that date XYZ Ltd. has incurred cost of Rs. 4 lakhs and has sought an extension of time and it is not sure whether it will be granted or not? How and when XYZ Ltd. should recognise revenue?

Response

Paragraph 26 of Ind AS 18 states that “when the outcome of the transaction involving the rendering of services cannot be estimated reliably, revenue shall be recognised only to the extent of the expenses recognised that are recoverable”.

In the present case, the outcome of the contract cannot be measured reliably, but it is certain that XYZ Ltd. can recover the 75% of the cost incurred as per terms of the agreement. Accordingly, XYZ Ltd. can recognise 75% of the cost incurred as revenue, i.e., Rs. 3 lakhs (4 lakhs x 75/100).

Question 19

A Ltd. has investments in B Ltd. The Board of Directors of B Ltd. approves payment of interim dividend on the 29th March which is paid in the subsequent financial year. Can A Ltd. recognise the dividend as income of the year in which the Board of Directors of B Ltd. has approved the dividend or in the next financial year when the payment is made?

Response

Paragraph 30 of Ind AS 18 requires that dividend shall be recognised when the shareholder’s right to receive payment is established. In this case, the right to receive the interim dividend is established when Board of Directors have approved it unconditionally, i.e., on 29th March, accordingly, the same

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should be recognised immediately even though it is received in the subsequent financial year.

Question 20

An entity sells goods to a customer and also bills the customer for insurance, shipping and handling costs. How should company present the amounts billed for insurance, shipping and handling costs in its statement of profit and loss?

Response

The appropriate presentation of amounts billed to a customer for insurance, shipping and handling costs will depend upon the timing of transfer of significant risks and rewards to the buyer and the terms of the sale agreement entered into with the buyer.

When the goods are sold on Cost, Insurance and Freight (CIF) basis, generally, risks and rewards are transferred to the buyer when goods are delivered to it and the risk of loss or damage during transit is borne by the seller. Accordingly, insurance, shipping and handling costs are incurred by the entity to deliver the goods to the customer in acceptable condition. In such a case, even if insurance, shipping and handling costs are charged separately, the same will be treated as revenue presuming that risks and rewards are transferred to the buyer when goods are delivered to it. Corresponding, insurance, shipping and handling costs incurred by the seller will be treated as an expense.

When goods are sold on Free on Board (FOB) basis, generally, risks and rewards are transferred to the buyer at the time of shipment and the risk of loss or damage during transit is borne by the buyer. In such a case, the seller may bear insurance, shipping and handling costs only as an agent of the buyer. In that case, presuming that risks and rewards have been transferred to the buyer at the time of shipment, revenue should be recognised when goods are shipped and insurance, shipping and handling charges received from the customer should be offset against the insurance, shipping and handling costs incurred.

Appendices

Appendix I

Indian Accounting Standard (Ind AS) 18

Revenue

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Indian Accounting Standard (Ind AS) 18

Revenue

*(This Indian Accounting Standard includes paragraphs set in **bold** type and plain type, which have equal authority. Paragraphs in bold type indicate the main principles.)*

Objective

Income is defined in the *Framework for the Preparation and Presentation of Financial Statements* issued by the Institute of Chartered Accountants of India as increases in economic benefits during the accounting period in the form of inflows or enhancements of assets or decreases of liabilities that result in increases in equity, other than those relating to contributions from equity participants. Income encompasses both revenue and gains. Revenue is income that arises in the course of ordinary activities of an entity and is referred to by a variety of different names including sales, fees, interest, dividends and royalties. The objective of this Standard is to prescribe the accounting treatment of revenue arising from certain types of transactions and events.

The primary issue in accounting for revenue is determining when to recognise revenue. Revenue is recognised when it is probable that future economic benefits will flow to the entity and these benefits can be measured reliably. This Standard identifies the circumstances in which these criteria will be met and, therefore, revenue will be recognised. It also provides practical guidance on the application of these criteria.

Scope

1 This Standard shall be applied in accounting for revenue arising from the following transactions and events¹:

- (a) the sale of goods;**
- (b) the rendering of services; and**
- (c) the use by others of entity assets yielding interest, royalties and dividends.**

2 [Refer to Appendix 1]

3 Goods includes goods produced by the entity for the purpose of sale and goods purchased for resale, such as merchandise purchased by a retailer or land and other property held for resale.

4 The rendering of services typically involves the performance by the entity of a contractually agreed task over an agreed period of time. The services may be rendered within a single period or over more than one period. Some contracts for the rendering of services are directly related to construction contracts, for example, those for the services of project managers and architects. Revenue arising from these contracts is not dealt with in this Standard but is dealt with in accordance with the requirements for construction contracts as specified in Ind AS 11 *Construction Contracts*. The definition of a Construction Contract in Ind AS 11 includes agreements of real estate development. Accordingly, revenue arising from such agreements is not dealt with in this Standard.

5 The use by others of entity assets gives rise to revenue in the form of:

- (a) interest—charges for the use of cash or cash equivalents or amounts due to the entity;**

¹ For rate regulated entities, this standard shall stand modified, where and to extent the recognition and measurement of revenue of such entities is affected by recognition and measurement of regulatory assets/liabilities as per the Guidance Note on the subject being issued by the Institute of Chartered Accountants of India.

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- (b) royalties—charges for the use of long-term assets of the entity, for example, patents, trademarks, copyrights and computer software; and
 - (c) dividends—distributions of profits to holders of equity investments in proportion to their holdings of a particular class of capital.
- 6 This Standard does not deal with revenue arising from:
- (a) lease agreements (see Ind AS 17 *Leases*);
 - (b) dividends arising from investments which are accounted for under the equity method (see Ind AS 28 *Investments in Associates*);
 - (c) insurance contracts within the scope of Ind AS 104 *Insurance Contracts*;
 - (d) changes in the fair value of financial assets and financial liabilities or their disposal (see Ind AS 39 *Financial Instruments: Recognition and Measurement*);
 - (e) changes in the value of other current assets;
 - (f) initial recognition and from changes in the fair value of biological assets related to agricultural activity (see Ind AS 41 *Agriculture*²);
 - (g) initial recognition of agricultural produce (see Ind AS 41); and
 - (h) the extraction of mineral ores.

Definitions

7 The following terms are used in this Standard with the meanings specified:

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

² Indian Accounting Standard (Ind AS) 41, *Agriculture*, is under formulation.

***Fair value* is the amount for which an asset could be exchanged, or a liability settled, between knowledgeable, willing parties in an arm's length transaction.**

8 Revenue includes only the gross inflows of economic benefits received and receivable by the entity on its own account. Amounts collected on behalf of third parties such as sales taxes, goods and services taxes and value added taxes are not economic benefits which flow to the entity and do not result in increases in equity. Therefore, they are excluded from revenue. Similarly, in an agency relationship, the gross inflows of economic benefits include amounts collected on behalf of the principal and which do not result in increases in equity for the entity. The amounts collected on behalf of the principal are not revenue. Instead, revenue is the amount of commission.

Measurement of revenue

9 Revenue shall be measured at the fair value of the consideration received or receivable.³

10 The amount of revenue arising on a transaction is usually determined by agreement between the entity and the buyer or user of the asset. It is measured at the fair value of the consideration received or receivable taking into account the amount of any trade discounts and volume rebates allowed by the entity.

11 In most cases, the consideration is in the form of cash or cash equivalents and the amount of revenue is the amount of cash or cash equivalents received or receivable. However, 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. The imputed rate of interest is the more clearly determinable of either:

³ See also Appendix A of this standard, *Revenue—Barter Transactions Involving Advertising Services*.

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- (a) the prevailing rate for a similar instrument of an issuer with a similar credit rating; or
- (b) a rate of interest that discounts the nominal amount of the instrument to the current cash sales price of the goods or services.

The difference between the fair value and the nominal amount of the consideration is recognised as interest revenue in accordance with paragraphs 29 and 30 and in accordance with Ind AS 39.

12 When goods or services are exchanged or swapped for goods or services which are of a similar nature and value, the exchange is not regarded as a transaction which generates revenue. This is often the case with commodities like oil or milk where suppliers exchange or swap inventories in various locations to fulfil demand on a timely basis in a particular location. When goods are sold or services are rendered in exchange for dissimilar goods or services, the exchange is regarded as a transaction which generates revenue. The revenue is measured at the fair value of the goods or services received, adjusted by the amount of any cash or cash equivalents transferred. When the fair value of the goods or services received cannot be measured reliably, the revenue is measured at the fair value of the goods or services given up, adjusted by the amount of any cash or cash equivalents transferred.

Identification of the transaction

13 The recognition criteria in this Standard are usually applied separately to each transaction. However, 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. Conversely, the recognition criteria are applied to two or more transactions together when they are linked in such a way that the commercial effect cannot be understood without reference to the series of transactions as a whole. For example, an entity may sell goods and, at the same time, enter into a separate agreement to repurchase the goods at a later date, thus negating the substantive effect of the transaction; in such a case, the two transactions are dealt with together.

Sale of goods

14 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.**

15 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.

16 If the entity retains significant risks of ownership, the transaction is not a sale and revenue is not recognised. An entity may retain a significant risk of ownership in a number of ways. Examples of situations in which the entity may retain the significant risks and rewards of ownership are:

- (a) when the entity retains an obligation for unsatisfactory performance not covered by normal warranty provisions;
- (b) when the receipt of the revenue from a particular sale is contingent on the derivation of revenue by the buyer from its sale of the goods;
- (c) when the goods are shipped subject to installation and the installation is a significant part of the contract which has not yet been completed by the entity; and

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- (d) when the buyer has the right to rescind the purchase for a reason specified in the sales contract and the entity is uncertain about the probability of return.

17 If an entity retains only an insignificant risk of ownership, the transaction is a sale and revenue is recognised. For example, a seller may retain the legal title to the goods solely to protect the collectibility of the amount due. In such a case, if the entity has transferred the significant risks and rewards of ownership, the transaction is a sale and revenue is recognised. Another example of an entity retaining only an insignificant risk of ownership may be a retail sale when a refund is offered if the customer is not satisfied. Revenue in such cases is recognised at the time of sale provided the seller can reliably estimate future returns and recognises a liability for returns based on previous experience and other relevant factors.

18 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. For example, it may be uncertain that a foreign governmental authority will grant permission to remit the consideration from a sale in a foreign country. When the permission is granted, the uncertainty is removed and revenue is recognised. However, when an uncertainty arises about the collectibility 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.

19 Revenue and expenses that relate to the same transaction or other event are recognised simultaneously; this process is commonly referred to as the matching of revenues and expenses. Expenses, including warranties and other costs to be incurred after the shipment of the goods can normally be measured reliably when the other conditions for the recognition of revenue have been satisfied. However, revenue cannot be recognised when the expenses cannot be measured reliably; in such circumstances, any consideration already received for the sale of the goods is recognised as a liability.

Rendering of services

20 When the outcome of a transaction involving the rendering of services can be estimated reliably, revenue associated with the transaction shall be recognised by reference to the stage of completion of the transaction at the end of the reporting period. The outcome of a transaction can be estimated reliably when all the following conditions are satisfied:

- (a) the amount of revenue can be measured reliably;
- (b) it is probable that the economic benefits associated with the transaction will flow to the entity;
- (c) the stage of completion of the transaction at the end of the reporting period can be measured reliably; and
- (d) the costs incurred for the transaction and the costs to complete the transaction can be measured reliably.⁴

21 The recognition of revenue by reference to the stage of completion of a transaction is often referred to as the percentage of completion method. Under this method, revenue is recognised in the accounting periods in which the services are rendered. The recognition of revenue on this basis provides useful information on the extent of service activity and performance during a period. Ind AS 11 also requires the recognition of revenue on this basis. The requirements of that Standard are generally applicable to the recognition of revenue and the associated expenses for a transaction involving the rendering of services.

22 Revenue is recognised only when it is probable that the economic benefits associated with the transaction will flow to the entity. However, when an uncertainty arises about the collectibility 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.

⁴ See also Appendix A of this standard, *Revenue—Barter Transactions Involving Advertising Services* and Appendix B of Ind AS 17, *Evaluating the Substance of Transactions Involving the Legal Form of a Lease*.

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23 An entity is generally able to make reliable estimates after it has agreed to the following with the other parties to the transaction:

- (a) each party's enforceable rights regarding the service to be provided and received by the parties;
- (b) the consideration to be exchanged; and
- (c) the manner and terms of settlement.

It is also usually necessary for the entity to have an effective internal financial budgeting and reporting system. The entity reviews and, when necessary, revises the estimates of revenue as the service is performed. The need for such revisions does not necessarily indicate that the outcome of the transaction cannot be estimated reliably.

24 The stage of completion of a transaction may be determined by a variety of methods. An entity uses the method that measures reliably the services performed. Depending on the nature of the transaction, the methods may include:

- (a) surveys of work performed;
- (b) services performed to date as a percentage of total services to be performed; or
- (c) the proportion that costs incurred to date bear to the estimated total costs of the transaction. Only costs that reflect services performed to date are included in costs incurred to date. Only costs that reflect services performed or to be performed are included in the estimated total costs of the transaction.

Progress payments and advances received from customers often do not reflect the services performed.

25 For practical purposes, when services are performed by an indeterminate number of acts over a specified period of time, revenue is recognised on a straight-line basis over the specified period unless there is evidence that some other method better represents the stage of completion.

When a specific act is much more significant than any other acts, the recognition of revenue is postponed until the significant act is executed.

26 When the outcome of the transaction involving the rendering of services cannot be estimated reliably, revenue shall be recognised only to the extent of the expenses recognised that are recoverable.

27 During the early stages of a transaction, it is often the case that the outcome of the transaction cannot be estimated reliably. Nevertheless, it may be probable that the entity will recover the transaction costs incurred. Therefore, revenue is recognised only to the extent of costs incurred that are expected to be recoverable. As the outcome of the transaction cannot be estimated reliably, no profit is recognised.

28 When the outcome of a transaction cannot be estimated reliably and it is not probable that the costs incurred will be recovered, revenue is not recognised and the costs incurred are recognised as an expense. When the uncertainties that prevented the outcome of the contract being estimated reliably no longer exist, revenue is recognised in accordance with paragraph 20 rather than in accordance with paragraph 26.

Interest, royalties and dividends

29 Revenue arising from the use by others of entity assets yielding interest, royalties and dividends shall be recognised on the bases set out in paragraph 30 when:

- (a) it is probable that the economic benefits associated with the transaction will flow to the entity; and
- (b) the amount of the revenue can be measured reliably.

30 Revenue shall be recognised on the following bases:

- (a) interest shall be recognised using the effective interest method as set out in Ind AS 39;
- (b) royalties shall be recognised on an accrual basis in accordance with the substance of the relevant agreement; and

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- (c) **dividends shall be recognised when the shareholder's right to receive payment is established.**

31 [Refer to Appendix 1]

32 When unpaid interest has accrued before the acquisition of an interest-bearing investment, the subsequent receipt of interest is allocated between pre-acquisition and post-acquisition periods; only the post-acquisition portion is recognised as revenue.

33 Royalties accrue in accordance with the terms of the relevant agreement and are usually recognised on that basis unless, having regard to the substance of the agreement, it is more appropriate to recognise revenue on some other systematic and rational basis.

34 Revenue is recognised only when it is probable that the economic benefits associated with the transaction will flow to the entity. However, when an uncertainty arises about the collectibility 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.

Disclosure

35 **An entity shall disclose:**

- (a) **the accounting policies adopted for the recognition of revenue, including the methods adopted to determine the stage of completion of transactions involving the rendering of services;**
- (b) **the amount of each significant category of revenue recognised during the period, including revenue arising from:**
 - (i) **the sale of goods;**
 - (ii) **the rendering of services;**
 - (iii) **interest;**

- (iv) royalties;
- (v) dividends; and
- (c) the amount of revenue arising from exchanges of goods or services included in each significant category of revenue.

36 An entity discloses any contingent liabilities and contingent assets in accordance with Ind AS 37 *Provisions, Contingent Liabilities and Contingent Assets*. Contingent liabilities and contingent assets may arise from items such as warranty costs, claims, penalties or possible losses.

Appendix A

Revenue—Barter Transactions Involving Advertising Services

Issue

1 An entity (Seller) may enter into a barter transaction to provide advertising services in exchange for receiving advertising services from its customer (Customer). Advertisements may be displayed on the Internet or poster sites, broadcast on the television or radio, published in magazines or journals, or presented in another medium.

2 In some cases, no cash or other consideration is exchanged between the entities. In some other cases, equal or approximately equal amounts of cash or other consideration are also exchanged.

3 A Seller that provides advertising services in the course of its ordinary activities recognises revenue under Ind AS 18 from a barter transaction involving advertising when, amongst other criteria, the services exchanged are dissimilar (paragraph 12 of Ind AS 18) and the amount of revenue can be measured reliably (paragraph 20(a) of Ind AS 18. This Appendix only applies to an exchange of dissimilar advertising services. An exchange of similar advertising services is not a transaction that generates revenue under Ind AS 18.

4 The issue is under what circumstances can a Seller reliably measure revenue at the fair value of advertising services received or provided in a barter transaction.

Accounting Principles

5 Revenue from a barter transaction involving advertising cannot be measured reliably at the fair value of advertising services received. However, a Seller can reliably measure revenue at the fair value of the advertising services it provides in a barter transaction, by reference only to non-barter transactions that:

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- (a) involve advertising similar to the advertising in the barter transaction;
- (b) occur frequently;
- (c) represent a predominant number of transactions and amount when compared to all transactions to provide advertising that is similar to the advertising in the barter transaction;
- (d) involve cash and/or another form of consideration (e.g. marketable securities, non-monetary assets, and other services) that has a reliably measurable fair value; and
- (e) do not involve the same counterparty as in the barter transaction.

Appendix B

Customer Loyalty Programmes

Background

1 Customer loyalty programmes are used by entities to provide customers with incentives to buy their goods or services. If a customer buys goods or services, the entity grants the customer award credits (often described as 'points'). The customer can redeem the award credits for awards such as free or discounted goods or services.

2 The programmes operate in a variety of ways. Customers may be required to accumulate a specified minimum number or value of award credits before they are able to redeem them. Award credits may be linked to individual purchases or groups of purchases, or to continued custom over a specified period. The entity may operate the customer loyalty programme itself or participate in a programme operated by a third party. The awards offered may include goods or services supplied by the entity itself and/or rights to claim goods or services from a third party.

Scope

- 3 This Appendix applies to customer loyalty award credits that:
- (a) an entity grants to its customers as part of a sales transaction, i.e. a sale of goods, rendering of services or use by a customer of entity assets; and
 - (b) subject to meeting any further qualifying conditions, the customers can redeem in the future for free or discounted goods or services.

The Appendix addresses accounting by the entity that grants award credits to its customers.

Issues

- 4 The issues addressed in this Appendix are:
- (a) whether the entity's obligation to provide free or discounted goods or services ('awards') in the future should be recognised and measured by:
 - (i) allocating some of the consideration received or receivable from the sales transaction to the award credits and deferring the recognition of revenue (applying paragraph 13 of Ind AS 18); or
 - (ii) providing for the estimated future costs of supplying the awards (applying paragraph 19 of Ind AS 18); and
 - (b) if consideration is allocated to the award credits:
 - (i) how much should be allocated to them;
 - (ii) when revenue should be recognised; and
 - (iii) if a third party supplies the awards, how revenue should be measured.

Accounting Principles

5 An entity shall apply paragraph 13 of Ind AS 18 and account for award credits as a separately identifiable component of the sales transaction(s) in which they are granted (the 'initial sale'). The fair value of the consideration received or receivable in respect of the initial sale shall be allocated between the award credits and the other components of the sale.

6 The consideration allocated to the award credits shall be measured by reference to their fair value, ie the amount for which the award credits could be sold separately.

7 If the entity supplies the awards itself, it shall recognise the consideration allocated to award credits as revenue when award credits are redeemed and it fulfils its obligations to supply awards. The amount of revenue recognised shall be based on the number of award credits that

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have been redeemed in exchange for awards, relative to the total number expected to be redeemed.

8 If a third party supplies the awards, the entity shall assess whether it is collecting the consideration allocated to the award credits on its own account (i.e. as the principal in the transaction) or on behalf of the third party (i.e. as an agent for the third party).

- (a) If the entity is collecting the consideration on behalf of the third party, it shall:
 - (i) measure its revenue as the net amount retained on its own account, i.e. the difference between the consideration allocated to the award credits and the amount payable to the third party for supplying the awards; and
 - (ii) recognise this net amount as revenue when the third party becomes obliged to supply the awards and entitled to receive consideration for doing so. These events may occur as soon as the award credits are granted. Alternatively, if the customer can choose to claim awards from either the entity or a third party, these events may occur only when the customer chooses to claim awards from the third party.
- (b) If the entity is collecting the consideration on its own account, it shall measure its revenue as the gross consideration allocated to the award credits and recognise the revenue when it fulfils its obligations in respect of the awards.

9 If at any time the unavoidable costs of meeting the obligations to supply the awards are expected to exceed the consideration received and receivable for them (i.e. the consideration allocated to the award credits at the time of the initial sale that has not yet been recognised as revenue plus any further consideration receivable when the customer redeems the award credits), the entity has onerous contracts. A liability shall be recognised for the excess in accordance with Ind AS 37. The need to recognise such a liability could arise if the expected costs of supplying awards increase, for example if the entity revises its expectations about the number of award credits that will be redeemed.

Application guidance on Appendix B

This application guidance is an integral part of Appendix B.

Measuring the fair value of award credits

AG1 Paragraph 6 of Appendix B requires the consideration allocated to award credits to be measured by reference to their fair value, i.e. the amount for which the award credits could be sold separately. If the fair value is not directly observable, it must be estimated.

AG2 An entity may estimate the fair value of award credits by reference to the fair value of the awards for which they could be redeemed. The fair value of the award credits takes into account:

- (a) the amount of the discounts or incentives that would otherwise be offered to customers who have not earned award credits from an initial sale; and
- (b) the proportion of award credits that are not expected to be redeemed by customers.

If customers can choose from a range of different awards, the fair value of the award credits will reflect the fair values of the range of available awards, weighted in proportion to the frequency with which each award is expected to be selected.

AG3 In some circumstances, other estimation techniques may be available. For example, if a third party will supply the awards and the entity pays the third party for each award credit it grants, it could estimate the fair value of the award credits by reference to the amount it pays the third party, adding a reasonable profit margin. Judgement is required to select and apply the estimation technique that satisfies the requirements of paragraph 6 of Appendix B and is most appropriate in the circumstances.

Illustrative examples for Appendix B

These examples accompany, but are not part of, Appendix B.

Example 1—Awards supplied by the entity

IE1 A grocery retailer operates a customer loyalty programme. It grants programme members loyalty points when they spend a specified amount on groceries. Programme members can redeem the points for further groceries. The points have no expiry date. In one period, the entity grants 100 points. Management estimates the fair value of groceries for which each loyalty point can be redeemed as Rs 1.25. This amount takes into account an estimate of the discount that management expects would otherwise be offered to customers who have not earned award credits from an initial sale. In addition, management expects only 80 of these points to be redeemed. Therefore, the fair value of each point is Re. 1, being the value of each loyalty point granted of Rs 1.25 reduced to take into account points not expected to be redeemed $((80 \text{ points}/100 \text{ points}) \times \text{Rs } 1.25 = \text{Re } 1)$. Accordingly, management defers recognition of revenue of Rs.100.

Year 1

IE2 At the end of the first year, 40 of the points have been redeemed in exchange for groceries, ie half of those expected to be redeemed. The entity recognises revenue of $(40 \text{ points}/80^5 \text{ points}) \times \text{Rs. } 100 = \text{Rs. } 50$.

Year 2

IE3 In the second year, management revises its expectations. It now expects 90 points to be redeemed altogether.

IE4 During the second year, 41 points are redeemed, bringing the total number redeemed to $40^6 + 41 = 81$ points. The cumulative revenue that the entity recognises is $(81 \text{ points}/90^7 \text{ points}) \times \text{Rs. } 100 = \text{Rs. } 90$. The entity

⁵ total number of points expected to be redeemed

⁶ number of points redeemed in year 1

⁷ revised estimate of total number of points expected to be redeemed

has recognised revenue of Rs. 50 in the first year, so it recognises Rs. 40 in the second year.

Year 3

IE5 In the third year, a further nine points are redeemed, taking the total number of points redeemed to $81 + 9 = 90$. Management continues to expect that only 90 points will ever be redeemed, ie that no more points will be redeemed after the third year. So the cumulative revenue to date is $(90 \text{ points}/90^8 \text{ points}) \times \text{Rs. } 100 = \text{Rs. } 100$. The entity has already recognised Rs. 90 of revenue (Rs. 50 in the first year and Rs. 40 in the second year). So it recognises the remaining Rs. 10 in the third year. All of the revenue initially deferred has now been recognised.

Example 2—Awards supplied by a third party

IE6 A retailer of electrical goods participates in a customer loyalty programme operated by an airline. It grants programme members one air travel point with each Re. 1 they spend on electrical goods. Programme members can redeem the points for air travel with the airline, subject to availability. The retailer pays the airline Rs. 0.009 for each point.

IE7 In one period, the retailer sells electrical goods for consideration totalling Rs. 1 million. It grants 1 million points.

Allocation of consideration to travel points

IE8 The retailer estimates that the fair value of a point is Rs. 0.01. It allocates to the points $1 \text{ million} \times \text{Rs. } 0.01 = \text{Rs. } 10,000$ of the consideration it has received from the sales of its electrical goods.

Revenue recognition

IE9 Having granted the points, the retailer has fulfilled its obligations to the customer. The airline is obliged to supply the awards and entitled to

⁸ total number of points still expected to be redeemed.

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receive consideration for doing so. Therefore the retailer recognises revenue from the points when it sells the electrical goods.

Revenue measurement

IE10 If the retailer has collected the consideration allocated to the points on its own account, it measures its revenue as the gross Rs. 10,000 allocated to them. It separately recognises the Rs. 9,000 paid or payable to the airline as an expense. If the retailer has collected the consideration on behalf of the airline, ie as an agent for the airline, it measures its revenue as the net amount it retains on its own account. This amount of revenue is the difference between the Rs. 10,000 consideration allocated to the points and the Rs. 9,000 passed on to the airline.

Appendix C

Transfers of Assets from Customers

Background

1 In the utilities industry, an entity may receive from its customers items of property, plant and equipment that must be used to connect those customers to a network and provide them with ongoing access to a supply of commodities such as electricity, gas or water. Alternatively, an entity may receive cash from customers for the acquisition or construction of such items of property, plant and equipment. Typically, customers are required to pay additional amounts for the purchase of goods or services based on usage.

2 Transfers of assets from customers may also occur in industries other than utilities. For example, an entity outsourcing its information technology functions may transfer its existing items of property, plant and equipment to the outsourcing provider.

3 In some cases, the transferor of the asset may not be the entity that will eventually have ongoing access to the supply of goods or services and will be the recipient of those goods or services. However, for convenience this Appendix refers to the entity transferring the asset as the customer.

Scope

4 This Appendix applies to the accounting for transfers of items of property, plant and equipment by entities that receive such transfers from their customers.

5 Agreements within the scope of this Appendix are agreements in which an entity receives from a customer an item of property, plant and equipment that the entity must then use either to connect the customer to a network or to provide the customer with ongoing access to a supply of goods or services, or to do both.

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6 This Appendix also applies to agreements in which an entity receives cash from a customer when that amount of cash must be used only to construct or acquire an item of property, plant and equipment and the entity must then use the item of property, plant and equipment either to connect the customer to a network or to provide the customer with ongoing access to a supply of goods or services, or to do both.

7 This Appendix does not apply to agreements in which the transfer is either a government grant as defined in Ind AS 20 or infrastructure used in a service concession arrangement that is within the scope of Appendix A of Ind AS 11 *Service Concession Arrangements*.

Issues

8 The Appendix addresses the following issues:

- (a) Is the definition of an asset met?
- (b) If the definition of an asset is met, how should the transferred item of property, plant and equipment be measured on initial recognition?
- (c) If the item of property, plant and equipment is measured at fair value on initial recognition, how should the resulting credit be accounted for?
- (d) How should the entity account for a transfer of cash from its customer?

Accounting Principles

Is the definition of an asset met?

9 When an entity receives from a customer a transfer of an item of property, plant and equipment, it shall assess whether the transferred item meets the definition of an asset set out in the *Framework for the Preparation and Presentation of Financial Statements* issued by the Institute of Chartered Accountants of India. Paragraph 49(a) of the Framework states that 'an asset is a resource controlled by the entity as a result of past events and

from which future economic benefits are expected to flow to the entity.' In most circumstances, the entity obtains the right of ownership of the transferred item of property, plant and equipment. However, in determining whether an asset exists, the right of ownership is not essential. Therefore, if the customer continues to control the transferred item, the asset definition would not be met despite a transfer of ownership.

10 An entity that controls an asset can generally deal with that asset as it pleases. For example, the entity can exchange that asset for other assets, employ it to produce goods or services, charge a price for others to use it, use it to settle liabilities, hold it, or distribute it to owners. The entity that receives from a customer a transfer of an item of property, plant and equipment shall consider all relevant facts and circumstances when assessing control of the transferred item. For example, although the entity must use the transferred item of property, plant and equipment to provide one or more services to the customer, it may have the ability to decide how the transferred item of property, plant and equipment is operated and maintained and when it is replaced. In this case, the entity would normally conclude that it controls the transferred item of property, plant and equipment.

How should the transferred item of property, plant and equipment be measured on initial recognition?

11 If the entity concludes that the definition of an asset is met, it shall recognise the transferred asset as an item of property, plant and equipment in accordance with paragraph 7 of Ind AS 16 and measure its cost on initial recognition at its fair value in accordance with paragraph 24 of that Standard.

How should the credit be accounted for?

12 The following discussion assumes that the entity receiving an item of property, plant and equipment has concluded that the transferred item should be recognised and measured in accordance with paragraphs 9–11.

13 Paragraph 12 of Ind AS 18 states that 'When goods are sold or services are rendered in exchange for dissimilar goods or services, the exchange is regarded as a transaction which generates revenue.' According to the terms of the agreements within the scope of this Appendix, a transfer

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of an item of property, plant and equipment would be an exchange for dissimilar goods or services. Consequently, the entity shall recognise revenue in accordance with Ind AS 18.

Identifying the separately identifiable services

14 An entity may agree to deliver one or more services in exchange for the transferred item of property, plant and equipment, such as connecting the customer to a network, providing the customer with ongoing access to a supply of goods or services, or both. In accordance with paragraph 13 of Ind AS 18, the entity shall identify the separately identifiable services included in the agreement.

15 Features that indicate that connecting the customer to a network is a separately identifiable service include:

- (a) a service connection is delivered to the customer and represents stand-alone value for that customer;
- (b) the fair value of the service connection can be measured reliably.

16 A feature that indicates that providing the customer with ongoing access to a supply of goods or services is a separately identifiable service is that, in the future, the customer making the transfer receives the ongoing access, the goods or services, or both at a price lower than would be charged without the transfer of the item of property, plant and equipment.

17 Conversely, a feature that indicates that the obligation to provide the customer with ongoing access to a supply of goods or services arises from the terms of the entity's operating licence or other regulation rather than from the agreement relating to the transfer of an item of property, plant and equipment is that customers that make a transfer pay the same price as those that do not for the ongoing access, or for the goods or services, or for both.

Revenue recognition

18 If only one service is identified, the entity shall recognise revenue

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when the service is performed in accordance with paragraph 20 of Ind AS 18. If such a service is ongoing, revenue shall be recognised in accordance with paragraph 20 of this Appendix.

19 If more than one separately identifiable service is identified, paragraph 13 of Ind AS 18 requires the fair value of the total consideration received or receivable for the agreement to be allocated to each service and the recognition criteria of Ind AS 18 are then applied to each service.

20 If an ongoing service is identified as part of the agreement, the period over which revenue shall be recognised for that service is generally determined by the terms of the agreement with the customer. If the agreement does not specify a period, the revenue shall be recognised over a period no longer than the useful life of the transferred asset used to provide the ongoing service.

How should the entity account for a transfer of cash from its customer?

21 When an entity receives a transfer of cash from a customer, it shall assess whether the agreement is within the scope of this Appendix in accordance with paragraph 6. If it is, the entity shall assess whether the constructed or acquired item of property, plant and equipment meets the definition of an asset in accordance with paragraphs 9 and 10. If the definition of an asset is met, the entity shall recognise the item of property, plant and equipment at its cost in accordance with Ind AS 16 and shall recognise revenue in accordance with paragraphs 13–20 at the amount of cash received from the customer.

Illustrative examples for Appendix C

These examples accompany, but are not part of, Appendix C.

Example 1

IE1 A real estate company is building a residential development in an area that is not connected to the electricity network. In order to have access to the electricity network, the real estate company is required to construct an electricity substation that is then transferred to the network company responsible for the transmission of electricity. It is assumed in this example that the network company concludes that the transferred substation meets the definition of an asset. The network company then uses the substation to connect each house of the residential development to its electricity network. In this case, it is the homeowners that will eventually use the network to access the supply of electricity, although they did not initially transfer the substation. By regulation, the network company has an obligation to provide ongoing access to the network to all users of the network at the same price, regardless of whether they transferred an asset. Therefore, users of the network that transfer an asset to the network company pay the same price for the use of the network as those that do not. Users of the network can choose to purchase their electricity from distributors other than the network company but must use the company's network to access the supply of electricity.

IE2 Alternatively, the network company could have constructed the substation and received a transfer of an amount of cash from the real estate company that had to be used only for the construction of the substation. The amount of cash transferred would not necessarily equal the entire cost of the substation. It is assumed that the substation remains an asset of the network company.

IE3 In this example, the Appendix applies to the network company that receives the electricity substation from the real estate company. The network company recognises the substation as an item of property, plant and equipment and measures its cost on initial recognition at its fair value (or at its construction cost in the circumstances described in paragraph IE2) in accordance with Ind AS 16 Property, Plant and Equipment. The fact that

users of the network that transfer an asset to the network company pay the same price for the use of the electricity network as those that do not indicate that the obligation to provide ongoing access to the network is not a separately identifiable service of the transaction. Rather, connecting the house to the network is the only service to be delivered in exchange for the substation. Therefore, the network company should recognise revenue from the exchange transaction at the fair value of the substation (or at the amount of the cash received from the real estate company in the circumstances described in paragraph IE2) when the houses are connected to the network in accordance with paragraph 20 of Ind AS 18 Revenue.

Example 2

IE4 A house builder constructs a house on a redeveloped site in a major city. As part of constructing the house, the house builder installs a pipe from the house to the water main in front of the house. Because the pipe is on the house's land, the owner of the house can restrict access to the pipe. The owner is also responsible for the maintenance of the pipe. In this example, the facts indicate that the definition of an asset is not met for the water company.

IE5 Alternatively, a house builder constructs multiple houses and installs a pipe on the commonly owned or public land to connect the houses to the water main. The house builder transfers ownership of the pipe to the water company that will be responsible for its maintenance. In this example, the facts indicate that the water company controls the pipe and should recognise it.

Example 3

IE6 An entity enters into an agreement with a customer involving the outsourcing of the customer's information technology (IT) functions. As part of the agreement, the customer transfers ownership of its existing IT equipment to the entity. Initially, the entity must use the equipment to provide the service required by the outsourcing agreement. The entity is responsible for maintaining the equipment and for replacing it when the entity decides to do so. The useful life of the equipment is estimated to be three years. The outsourcing agreement requires service to be provided for ten years for a

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fixed price that is lower than the price the entity would have charged if the IT equipment had not been transferred.

IE7 In this example, the facts indicate that the IT equipment is an asset of the entity. Therefore, the entity should recognise the equipment and measure its cost on initial recognition at its fair value in accordance with paragraph 24 of Ind AS 16. The fact that the price charged for the service to be provided under the outsourcing agreement is lower than the price the entity would charge without the transfer of the IT equipment indicates that this service is a separately identifiable service included in the agreement. The facts also indicate that it is the only service to be provided in exchange for the transfer of the IT equipment. Therefore, the entity should recognise revenue arising from the exchange transaction when the service is performed, ie over the ten-year term of the outsourcing agreement.

IE8 Alternatively, assume that after the first three years, the price the entity charges under the outsourcing agreement increases to reflect the fact that it will then be replacing the equipment the customer transferred.

IE9 In this case, the reduced price for the services provided under the outsourcing agreement reflects the useful life of the transferred equipment. For this reason, the entity should recognise revenue from the exchange transaction over the first three years of the agreement.

Appendix D

References to matters contained in other Indian Accounting Standards

This Appendix is an integral part of Indian Accounting Standard 18.

This appendix lists the appendices which are part of other Indian Accounting Standards and make reference to Ind AS 18, *Revenues*

1 Appendix A, *Service Concession Arrangements* contained in Ind AS 11 *Construction Contracts*.

2 Appendix B, *Evaluating the Substance of Transactions Involving the Legal Form of a Lease* contained in Ind AS 17 *Leases*

Appendix E

Illustrative examples

These illustrative examples accompany, but are not part of, Ind AS 18. The examples focus on particular aspects of a transaction and are not a comprehensive discussion of all the relevant factors that might influence the recognition of revenue. The examples generally assume that the amount of revenue can be measured reliably, it is probable that the economic benefits will flow to the entity and the costs incurred or to be incurred can be measured reliably.

Sale of goods

1 *'Bill and hold' sales, in which delivery is delayed at the buyer's request but the buyer takes title and accepts billing.*

Revenue is recognised when the buyer takes title, provided:

- (a) it is probable that delivery will be made;
- (b) the item is on hand, identified and ready for delivery to the buyer at the time the sale is recognised;
- (c) the buyer specifically acknowledges the deferred delivery instructions; and
- (d) the usual payment terms apply.

Revenue is not recognised when there is simply an intention to acquire or manufacture the goods in time for delivery.

2 *Goods shipped subject to conditions.*

- (a) *installation and inspection.* Revenue is normally recognised when the buyer accepts delivery, and installation and inspection are complete. However, revenue is recognised immediately upon the buyer's acceptance of delivery when:

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- (i) the installation process is simple in nature, for example the installation of a factory tested television receiver which only requires unpacking and connection of power and antennae; or
 - (ii) the inspection is performed only for purposes of final determination of contract prices, for example, shipments of iron ore, sugar or soya beans.
- (b) *on approval when the buyer has negotiated a limited right of return.*

If there is uncertainty about the possibility of return, revenue is recognised when the shipment has been formally accepted by the buyer or the goods have been delivered and the time period for rejection has elapsed.

- (c) *consignment sales under which the recipient (buyer) undertakes to sell the goods on behalf of the shipper (seller).*
- Revenue is recognised by the shipper when the goods are sold by the recipient to a third party.
- (d) *cash on delivery sales.*

Revenue is recognised when delivery is made and cash is received by the seller or its agent.

3 *Lay away sales under which the goods are delivered only when the buyer makes the final payment in a series of instalments.*

Revenue from such sales is recognised when the goods are delivered. However, when experience indicates that most such sales are consummated, revenue may be recognised when a significant deposit is received provided the goods are on hand, identified and ready for delivery to the buyer.

4 *Orders when payment (or partial payment) is received in advance of delivery for goods not presently held in inventory, for example, the goods are still to be manufactured or will be delivered directly to the customer from a third party.*

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Revenue is recognised when the goods are delivered to the buyer.

5 *Sale and repurchase agreements (other than swap transactions) under which the seller concurrently agrees to repurchase the same goods at a later date, or when the seller has a call option to repurchase, or the buyer has a put option to require the repurchase, by the seller, of the goods.*

For a sale and repurchase agreement on an asset other than a financial asset, the terms of the agreement need to be analysed to ascertain whether, in substance, the seller has transferred the risks and rewards of ownership to the buyer and hence revenue is recognised. When the seller has retained the risks and rewards of ownership, even though legal title has been transferred, the transaction is a financing arrangement and does not give rise to revenue. For a sale and repurchase agreement on a financial asset, Ind AS 39 *Financial Instruments: Recognition and Measurement* applies.

6 *Sales to intermediate parties, such as distributors, dealers or others for resale.*

Revenue from such sales is generally recognised when the risks and rewards of ownership have passed. However, when the buyer is acting, in substance, as an agent, the sale is treated as a consignment sale.

7 *Subscriptions to publications and similar items.*

When the items involved are of similar value in each time period, revenue is recognised on a straight-line basis over the period in which the items are despatched. When the items vary in value from period to period, revenue is recognised on the basis of the sales value of the item despatched in relation to the total estimated sales value of all items covered by the subscription.

8 *Instalment sales, under which the consideration is receivable in instalments.*

Revenue attributable to the sales price, exclusive of interest, is recognised at the date of sale. The sale price is the present value of the consideration, determined by discounting the instalments receivable at the imputed rate of interest. The interest element is recognised as revenue as it is earned, using the effective interest method.

9 [Refer to Appendix 1]

Rendering of services

10 *Installation fees.*

Installation fees are recognised as revenue by reference to the stage of completion of the installation, unless they are incidental to the sale of a product, in which case they are recognised when the goods are sold.

11 *Servicing fees included in the price of the product.*

When the selling price of a product includes an identifiable amount for subsequent servicing (for example, after sales support and product enhancement on the sale of software), that amount is deferred and recognised as revenue over the period during which the service is performed. The amount deferred is that which will cover the expected costs of the services under the agreement, together with a reasonable profit on those services.

12 *Advertising commissions.*

Media commissions are recognised when the related advertisement or commercial appears before the public. Production commissions are recognised by reference to the stage of completion of the project.

13 *Insurance agency commissions.*

Insurance agency commissions received or receivable which do not require the agent to render further service are recognised as revenue by the agent on the effective commencement or renewal dates of the related policies. However, when it is probable that the agent will be required to render further services during the life of the policy, the commission, or part thereof, is deferred and recognised as revenue over the period during which the policy is in force.

14 *Financial service fees.*

The recognition of revenue for financial service fees depends on the purposes for which the fees are assessed and the basis of accounting for any associated financial instrument. The description of fees for financial services

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may not be indicative of the nature and substance of the services provided. Therefore, it is necessary to distinguish between fees that are an integral part of the effective interest rate of a financial instrument, fees that are earned as services are provided, and fees that are earned on the execution of a significant act.

- (a) *Fees that are an integral part of the effective interest rate of a financial instrument.*

Such fees are generally treated as an adjustment to the effective interest rate. However, when the financial instrument is measured at fair value with the change in fair value recognised in profit or loss, the fees are recognised as revenue when the instrument is initially recognised.

- (i) *Origination fees received by the entity relating to the creation or acquisition of a financial asset other than one that under Ind AS 39 is measured at fair value through profit or loss*

Such fees may include compensation for activities such as evaluating the borrower's financial condition, evaluating and recording guarantees, collateral and other security arrangements, negotiating the terms of the instrument, preparing and processing documents and closing the transaction. These fees are an integral part of generating an involvement with the resulting financial instrument and, together with the related transaction costs (as defined in Ind AS 39), are deferred and recognised as an adjustment to the effective interest rate.

- (ii) *Commitment fees received by the entity to originate a loan when the loan commitment is outside the scope of Ind AS 39.*

If it is probable that the entity will enter into a specific lending arrangement and the loan commitment is not within the scope of Ind AS 39, the commitment fee received is regarded as compensation for an ongoing involvement with the acquisition of a financial instrument and, together with the related transaction costs (as defined in Ind AS 39), is deferred and

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recognised as an adjustment to the effective interest rate. If the commitment expires without the entity making the loan, the fee is recognised as revenue on expiry. Loan commitments that are within the scope of Ind AS 39 are accounted for as derivatives and measured at fair value.

(iii) *Origination fees received on issuing financial liabilities measured at amortised cost.*

These fees are an integral part of generating an involvement with a financial liability. When a financial liability is not classified as 'at fair value through profit or loss', the origination fees received are included, with the related transaction costs (as defined in Ind AS 39) incurred, in the initial carrying amount of the financial liability and recognised as an adjustment to the effective interest rate. An entity distinguishes fees and costs that are an integral part of the effective interest rate for the financial liability from origination fees and transaction costs relating to the right to provide services, such as investment management services.

(b) *Fees earned as services are provided.*

(i) *Fees charged for servicing a loan.*

Fees charged by an entity for servicing a loan are recognised as revenue as the services are provided.

(ii) *Commitment fees to originate a loan when the loan commitment is outside the scope of Ind AS 39.*

If it is unlikely that a specific lending arrangement will be entered into and the loan commitment is outside the scope of Ind AS 39, the commitment fee is recognised as revenue on a time proportion basis over the commitment period. Loan commitments that are within the scope of Ind AS 39 are accounted for as derivatives and measured at fair value.

(iii) *Investment management fees.*

Fees charged for managing investments are recognised as revenue as the services are provided.

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Incremental costs that are directly attributable to securing an investment management contract are recognised as an asset if they can be identified separately and measured reliably and if it is probable that they will be recovered. As in Ind AS 39, an incremental cost is one that would not have been incurred if the entity had not secured the investment management contract. The asset represents the entity's contractual right to benefit from providing investment management services, and is amortised as the entity recognises the related revenue. If the entity has a portfolio of investment management contracts, it may assess their recoverability on a portfolio basis.

Some financial services contracts involve both the origination of one or more financial instruments and the provision of investment management services. An example is a long-term monthly saving contract linked to the management of a pool of equity securities. The provider of the contract distinguishes the transaction costs relating to the origination of the financial instrument from the costs of securing the right to provide investment management services.

(c) *Fees that are earned on the execution of a significant act.*

The fees are recognised as revenue when the significant act has been completed, as in the examples below.

(i) *Commission on the allotment of shares to a client.*

The commission is recognised as revenue when the shares have been allotted.

(ii) *Placement fees for arranging a loan between a borrower and an investor.*

The fee is recognised as revenue when the loan has been arranged.

(iii) *Loan syndication fees.*

A syndication fee received by an entity that arranges a loan and retains no part of the loan package for itself (or retains a part at the same effective interest rate for comparable risk as other participants) is

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compensation for the service of syndication. Such a fee is recognised as revenue when the syndication has been completed.

15 *Admission fees.*

Revenue from artistic performances, banquets and other special events is recognised when the event takes place. When a subscription to a number of events is sold, the fee is allocated to each event on a basis which reflects the extent to which services are performed at each event.

16 *Tuition fees.*

Revenue is recognised over the period of instruction.

17 *Initiation, entrance and membership fees.*

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

18 *Franchise fees.*

Franchise fees may cover the supply of initial and subsequent services, equipment and other tangible assets, and know-how. Accordingly, franchise fees are recognised as revenue on a basis that reflects the purpose for which the fees were charged. The following methods of franchise fee recognition are appropriate:

(a) *Supplies of equipment and other tangible assets.*

The amount, based on the fair value of the assets sold, is recognised as revenue when the items are delivered or title passes.

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(b) *Supplies of initial and subsequent services.*

Fees for the provision of continuing services, whether part of the initial fee or a separate fee, are recognised as revenue as the services are rendered. When the separate fee does not cover the cost of continuing services together with a reasonable profit, part of the initial fee, sufficient to cover the costs of continuing services and to provide a reasonable profit on those services, is deferred and recognised as revenue as the services are rendered.

The franchise agreement may provide for the franchisor to supply equipment, inventories, or other tangible assets, at a price lower than that charged to others or a price that does not provide a reasonable profit on those sales. In these circumstances, part of the initial fee, sufficient to cover estimated costs in excess of that price and to provide a reasonable profit on those sales, is deferred and recognised over the period the goods are likely to be sold to the franchisee. The balance of an initial fee is recognised as revenue when performance of all the initial services and other obligations required of the franchisor (such as assistance with site selection, staff training, financing and advertising) has been substantially accomplished.

The initial services and other obligations under an area franchise agreement may depend on the number of individual outlets established in the area. In this case, the fees attributable to the initial services are recognised as revenue in proportion to the number of outlets for which the initial services have been substantially completed.

If the initial fee is collectible over an extended period and there is a significant uncertainty that it will be collected in full, the fee is recognised as cash instalments are received.

(c) *Continuing franchise fees.*

Fees charged for the use of continuing rights granted by the agreement, or for other services provided during the period of the agreement, are recognised as revenue as the services are provided or the rights used.

(d) *Agency transactions.*

Transactions may take place between the franchisor and the franchisee which, in substance, involve the franchisor acting as agent for the franchisee. For example, the franchisor may order supplies and arrange for their delivery to the franchisee at no profit. Such transactions do not give rise to revenue.

19 *Fees from the development of customised software.*

Fees from the development of customised software are recognised as revenue by reference to the stage of completion of the development, including completion of services provided for post-delivery service support.

Interest, royalties and dividends

20 *Licence fees and royalties.*

Fees and royalties paid for the use of an entity's assets (such as trademarks, patents, software, music copyright, record masters and motion picture films) are normally recognised in accordance with the substance of the agreement. As a practical matter, this may be on a straight-line basis over the life of the agreement, for example, when a licensee has the right to use certain technology for a specified period of time.

An assignment of rights for a fixed fee or non-refundable guarantee under a non-cancellable contract which permits the licensee to exploit those rights freely and the licensor has no remaining obligations to perform is, in substance, a sale. An example is a licensing agreement for the use of software when the licensor has no obligations subsequent to delivery. Another example is the granting of rights to exhibit a motion picture film in markets where the licensor has no control over the distributor and expects to receive no further revenues from the box office receipts. In such cases, revenue is recognised at the time of sale.

In some cases, whether or not a licence fee or royalty will be received is contingent on the occurrence of a future event. In such cases, revenue is recognised only when it is probable that the fee or royalty will be received, which is normally when the event has occurred.

Recognition and measurement

21 *Determining whether an entity is acting as a principal or as an agent.*

Paragraph 8 states that 'in an agency relationship, the gross inflows of economic benefits include amounts collected on behalf of the principal and which do not result in increases in equity for the entity. The amounts collected on behalf of the principal are not revenue. Instead, revenue is the amount of commission.' Determining whether an entity is acting as a principal or as an agent requires judgement and consideration of all relevant facts and circumstances.

An entity is acting as a principal when it has exposure to the significant risks and rewards associated with the sale of goods or the rendering of services. Features that indicate that an entity is acting as a principal include:

- (a) the entity has the primary responsibility for providing the goods or services to the customer or for fulfilling the order, for example by being responsible for the acceptability of the products or services ordered or purchased by the customer;
- (b) the entity has inventory risk before or after the customer order, during shipping or on return;
- (c) the entity has latitude in establishing prices, either directly or indirectly, for example by providing additional goods or services; and
- (d) the entity bears the customer's credit risk for the amount receivable from the customer.

An entity is acting as an agent when it does not have exposure to the significant risks and rewards associated with the sale of goods or the rendering of services. One feature indicating that an entity is acting as an agent is that the amount the entity earns is predetermined, being either a fixed fee per transaction or a stated percentage of the amount billed to the customer.

Appendix 1

Note: This appendix is not a part of the Indian Accounting Standard. The purpose of this Appendix is only to bring out the differences, if any, between Indian Accounting Standard (Ind AS) 18 and the corresponding International Accounting Standard (IAS) 18, Revenue, SIC 31, Revenue — Barter Transactions Involving Advertising services, IFRIC 13, Customer Loyalty Programmes, and IFRIC 18, Transfers of Assets from Customers.

Comparison with IAS 18, Revenue, SIC 31, IFRIC 13 and IFRIC 18

1. The transitional provisions given in IAS 18, SIC 31 and IFRIC 13 have not been given in Ind AS 18, since all transitional provisions related to Ind ASs, wherever considered appropriate have been included in Ind AS 101, First-time Adoption of Indian Accounting Standards corresponding to IFRS 1, First-time Adoption of International Financial Reporting Standards.

2. On the basis of principles of the IAS 18, IFRIC 15 on *Agreement for Construction of Real Estate* prescribes that construction of real estate should be treated as sale of goods and revenue should be recognised when the entity has transferred significant risks and rewards of ownership and retained neither continuing managerial involvement nor effective control. IFRIC 15 has not been included in Ind AS 18 to scope out such agreements and to include the same in Ind AS 11, *Construction Contracts*. Paragraph 9 of Illustrative Examples of IAS 18 which is with reference to IFRIC 15 has been deleted in Appendix E (Illustrative Examples) of Ind AS 18. However, paragraph number 9 has been retained in Appendix E of Ind AS 18 to maintain consistency with paragraph numbers of IAS 18..

3. Paragraph 2 of IAS 18 which states that IAS 18 supersedes the earlier version IAS 18 is deleted in Ind AS 18 as this is not relevant in Ind AS 18. However, paragraph number 2 is retained in Ind AS 7 to maintain consistency with paragraph numbers of IAS 18.

4. Paragraph number 31 appear as 'Deleted 'in IAS 18. In order to maintain consistency with paragraph numbers of IAS 18, the paragraph number is retained in Ind AS 18.

Appendix II

Differences between Ind AS 18, *Revenue*, and AS 9, *Revenue Recognition*

1 Definition of 'revenue' given in the Ind AS 18 is broad compared to the definition of 'revenue' given in existing AS 9 because it covers all economic benefits that arise in the ordinary course of activities of an entity which result in increases in equity, other than increases relating to contributions from equity participants. On the other hand, as per the existing AS 9, revenue is gross inflow of cash, receivables or other consideration arising in the course of the ordinary activities of an enterprise from the sale of goods, from the rendering of services, and from the use by others of enterprise resources yielding interest, royalties and dividends.

2 Revenue arising from agreements of real estate development are specifically scoped out from Ind AS18. Existing AS 9 does not exclude the same.

3 Measurement of revenue is briefly covered in the definition of revenue in the existing AS 9, while Ind AS 18 deals separately in detail with measurement of revenue. As per existing AS 9, revenue is recognised at the nominal amount of consideration receivable. Ind AS 18 requires the revenue to be measured at fair value of the consideration received or receivable.

4 Ind AS 18 specifically deals with the exchange of goods and services with goods and services of similar and dissimilar nature. In this regard specific guidance is given regarding barter transactions involving advertising services. This aspect is not dealt with in the existing AS 9.

5 Ind AS 18 provides guidance on application of recognition criteria to the separately identifiable components of a single transaction in order to reflect the substance of the transaction. Existing AS 9 does not specifically deal with the same.

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6 For recognition of revenue in case of rendering of services, existing AS 9 permits the use of completed service contract method. Ind AS 18 requires recognition of revenue using percentage of completion method only.

7 Existing AS 9 requires the recognition of revenue from interest on time proportion basis. Ind AS 18 requires interest to be recognised using effective interest rate method.

8 Ind AS 18 specifically provides guidance regarding revenue recognition in case the entity is under any obligation to provide free or discounted goods or services or award credits to its customers due to any customer loyalty programme. Existing AS 9 does not deal with this aspect.

9 Ind AS 18 deals with accounting of transfer of property, plant and equipment by the customers to the entity, which are used by the entity to connect the customer to a network or to provide the customer with ongoing access to a supply of goods or services. Existing AS 9 does not deal with this aspect.

10 Existing AS 9 specifically deals with disclosure of excise duty as a deduction from revenue from sales transactions. Ind AS 18 does not specifically deal with the same.

11 Disclosure requirements given in the Ind AS 18 are more detailed as compared to existing AS 9.