After studying this unit, you will be able to:

- Examine the principles for recognition of revenue from sale of goods, rendering of services and revenue arising from use by others of entity assets yielding interest and royalties.
- Measure revenue from sale of goods, rendering of services and revenue arising from use by others of entity assets yielding royalties.
- Comprehend the disclosures to be made in the financial statements.
UNIT OVERVIEW

Ind AS 18, Revenue

Revenue from sale of goods
- Transfer of significant risks and rewards of ownership of goods
- No continuing managerial involvement to the degree associated with ownership and no effective control over goods sold
- Reliable measurement of revenue
- Probable economic benefits
- Reliable measurement of costs

Revenue from rendering of services
- Reliable measurement of stage of completion
- Reliable measurement of revenue
- Probable economic benefits
- Reliable measurement of costs

Revenue from interest and royalties
- Probable economic benefits
- Reliable measurement of revenue

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2.1 INTRODUCTION

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, fee, interest, dividends and royalties.

2.2 OBJECTIVE

- The objective of Ind AS 18 is to prescribe the accounting treatment of revenue arising from certain types of transactions and events.
- A 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.
- Ind AS 18 identifies the circumstances in which these criteria will be met and, therefore, revenue will be recognised.

2.3 SCOPE

2.3.1 Inclusions

- Ind AS 18 should 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 resources yielding interest and royalties.

* For real estate developers, revenue should be accounted for in accordance with the Guidance Note on the subject being issued by ICAI.
Ind AS 18 deals with recognition of interest. However, the following are dealt in accordance with Ind AS 109, *Financial Instruments*:

(a) measurement of interest charges for the use of cash or cash equivalents or amounts due to the entity; and

(b) recognition and measurement of dividend.

The impairment of any contractual right to receive cash or another financial asset arising from this Standard should be dealt in accordance with Ind AS 109, *Financial Instruments*.

**Note:**

- Goods includes goods produced or purchased by the entity for the purpose of sale or land and other property held for resale.
- 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.
- Contracts for the rendering of services directly related to construction contracts are not dealt with by Ind AS 18.

The use by others of entity’s 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;
(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.

2.3.2 Exclusions

The Standard does not deal with revenue arising from:

- Lease Agreements (Ind AS 17)
- Dividends arising from Investments accounted under Equity Method (Ind AS 28)
- Insurance Contracts (Ind AS 104)
- Changes in Fair Value of Financial Assets and Liabilities or their disposal (Ind AS 109)
- Changes in the value of other assets
- Initial recognition and from changes in the fair value of biological assets related to agricultural activity and Initial Recognition of Agricultural Produce (Ind AS 41)
- Extraction of mineral ores

2.4 DEFINITIONS

The following definitions are relevant for the purpose of understanding the requirements of Ind AS 18:

1. **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. **Fair value** is the price that would be received to sell an asset or paid to transfer a liability in an orderly transaction between market participants at the measurement date.
   - 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 goods and services taxes are excluded from revenue since they do not result in increase in equity.
In an agency relationship, the amounts collected on behalf of the principal are not revenue. Instead, revenue is the amount of commission.

Illustration

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?

Solution

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.

Illustration

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?

Solution

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

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.

2.5 MEASUREMENT OF REVENUE

- Revenue should 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.

- The amount of revenue arising on a transaction is usually determined by agreement between the entity and the buyer or user of the asset.

- Generally, the amount of revenue is the consideration received or receivable in the form of cash or cash equivalents.

Illustration 1

A TV manufacturer sells TVs to its dealers at a list price of ₹ 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, 20X2, 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 20X2 will be more than 8,000 sets. How revenue should be measured in this case on the balance sheet date?
Solution

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, 20X2. 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.

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.

Example: An entity provided interest-free credit to the buyer or accepted 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:

- 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 in accordance with Ind AS 109.

Illustration 2

X Ltd. is engaged in manufacturing and selling of designer furniture. It sells goods on extended credit. X Ltd. sold furniture for ₹40,00,000 to a customer, the payment against which was receivable after 12 months with interest at the rate of 3% per annum. The market interest rate on the date of transaction was 8% per annum. How will X Ltd. recognise revenue for the above transaction?
Solution

X Ltd. should determine the fair value of revenue by calculating the present value of the cash flows receivable.

Total amount receivable = ₹ 40,00,000 x 1.03 = ₹ 41,20,000.

Present Value of receivable (Revenue) = ₹ 41,20,000/1.08 = ₹ 38,14,815.

Interest income = ₹ 41,20,000 - ₹ 38,14,815 = ₹ 3,05,185.

Therefore, on transaction date ₹ 38,14,815 will be recognised as revenue from sale of goods and ₹ 3,05,185 will be recognised as interest income over the period in accordance with Ind AS 109.

A transaction will not be considered as generating revenue, if the goods or services are exchanged or swapped for goods or services of a similar nature and value.

Example: 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.

Illustration 3

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 manufactured by A Ltd. How A Ltd. and B Ltd. should recognise the revenue?

Solution

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 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.

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.

Illustration 4

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.
Solution

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., ₹ 60,000 (20,000 units x ₹ 3) and in the books of B Ltd. the same will be recognised at fair value of talk time received, i.e., ₹ 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 ₹ 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 ₹ 60,000 being the fair value of power units given up.

- 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.

Illustration 5

X Ltd. a dealer of garments, entered into following transactions:

1. It gave 1,000 yellow T-shirts in exchange for 1,000 green T-shirts to another dealer. The yellow and green shirts have similar values.

2. X Ltd. got the renovation of one shop carried out by Y Ltd. In turn, it gave 100 T-shirts and ₹ 3,000 to Y Ltd. as full payment for the renovation work. Y Ltd. would normally charge ₹ 15,000 for the work done. X Ltd. usually sells T-shirts at ₹ 120 each.

How Both X Ltd. and Y Ltd. will account for the above transactions?

Solution

X Ltd.

1. These goods are similar in nature and value and therefore the transaction does not have commercial substance. As such, no revenue is recognised in the books of X Ltd. and Y Ltd. Inventory records may be adjusted.
2. X Ltd. received service in exchange of goods. These are dissimilar in nature. In such case, 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. The fair value of service received is ₹ 15,000 (i.e., the amount that Y Ltd. normally charges for the same work) and also X Ltd. has transferred cash of ₹ 3,000 to Y Ltd. So X Ltd. will recognise revenue from sale of goods (T-shirts) as ₹ 12,000 (₹ 15,000 - ₹ 3,000).

Y Ltd.

Y Ltd. will recognise revenue (from renovation activities) as ₹ 15,000 [(₹ 120 x 100) + ₹ 3,000].

### 2.6 IDENTIFICATION OF THE TRANSACTION

- The recognition criteria in Ind AS 18 are usually applied separately to each transaction.
- Sometime the recognition criteria are applied to the separately identifiable components of a single transaction in order to reflect the substance of the transaction.

**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.

**Illustration 6**

_X Pvt. Ltd. is a dealer of water purifiers. It sells each purifier for ₹ 10,000 and promises to service it twice in a year. The value of each service is ₹ 500 which is included in the sale price. How the above sale transaction will be dealt by X Pvt. Ltd?_

**Solution**

The sale transaction has two components viz sale of water purifiers and maintenance service. Both the components operate independently from each other. Therefore, these components should be unbundled and the revenue earned on sale of each component should be recognised separately. Revenue attributable to both the components is calculated as follows:

- The value of each service is ₹ 500. Total cost of service is ₹ 1,000.
- Current revenue from sale of water purifier = ₹ 9,000 (₹ 10,000 - ₹ 1,000).
- Deferred revenue = ₹ 1,000.

₹ 1,000 is considered a payment in advance of service, and will be recognised as revenue as and when each of the service occurs.

- 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.
**Example:** An entity sells 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.

**Illustration 7:** 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 ₹ 5,00,000 while an identical car without the extended warranty is sold in the market for ₹ 4,50,000 and equivalent warranty is given in the market for ₹ 60,000. How should X Ltd. recognise and measure revenue in its books on sale of the car and warranty?*

**Solution**

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):** ₹ 5,10,000
- **Less: Sale price of the car with extended warranty:** (₹ 5,00,000)
  - **Discount:** ₹ 10,000

**Discount and revenue attributable to each component of the transaction:**

- **Proportionate discount attributable to sale of car:** ₹ 8,824
  \[(10,000 \times 4,50,000/5,10,000)\]
- **Revenue from sale of car:** ₹ 4,41,176
  \[(4,50,000 - 8,824)\]
- **Proportionate discount attributable to extended warranty:** ₹ 1,176
  \[(10,000 \times 60,000/5,10,000)\]
- **Revenue from extended warranty (60,000 - 1,176):** ₹ 58,824
  \[(60,000 - 1,176)\]

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

### 2.7 SALE OF GOODS

- Revenue from the sale of goods should be recognised when **all the following conditions** have been satisfied:
Transfer of significant risks and rewards of ownership requires an examination of the circumstances of the transaction i.e whether it coincides with the transfer of the legal title or the passing of possession to the buyer or it 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.

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

(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

Illustration 8

X Electrical Ltd. has sold three machines to a public utility firm Y Ltd. for ₹50,00,000 each during the financial year 20X1-20X2. The contract includes delivery and installation of machines. The customer will accept the machines only after the final inspection of machines after installations. The customer has accepted delivery of two machines till March 31, 20X2.

How should X Electrical Ltd. record the transactions?
Solution

For three machines which are sold to Y Ltd., installation is a significant part of the contract and for one machine installation has not yet been completed by the entity till March 31, 20X2. So, X Electrical Ltd. should recognise revenue for two machines only, the installation and delivery of which has been accepted by Y Ltd.

- If an entity retains only an insignificant risk of ownership, the transaction is a sale and revenue is recognised.

Examples

1. A seller retains the legal title to the goods solely to protect the collectability 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.

2. In a retail sale, offer of a refund 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.

- Revenue is recognised only when it is probable that the economic benefits associated with the transaction will flow to the entity.

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.

- When collectability of an amount already included in revenue is uncertain, such uncollectible 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.

Illustration 9

X Ltd. is engaged in the business of exporting various products. It has an existing customer Y Ltd. to whom goods worth of ₹50,00,000 was sold as on May 1, 20X1 and it has recognised revenue in respect of the said transaction. However, in March 20X1, X Ltd. learnt that Y Ltd. has filed for bankruptcy under overseas legal provisions. Thereby, the collectability of the amount has ceased to be probable. X Ltd. reversed the revenue of ₹50,00,000 that it had booked earlier. Advise X Ltd. whether the accounting treatment made by it is correct?

Solution

When an uncertainty arises about the collectability of an amount already included in revenue, the uncollectible amount or the amount in respect of which recovery has ceased to be probable is recognised as an expense, rather than as an adjustment of the amount of revenue originally recognised.
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.

Illustrative Examples on Sale of Goods (when to recognise revenue)

The law in different countries may mean the recognition criteria in Ind AS 18 are met at different times. In particular, the law may determine the point in time at which the entity transfers the significant risks and rewards of ownership. Therefore, the examples below need to be read in the context of the laws relating to the sale of goods in the country in which the transaction takes place.

<table>
<thead>
<tr>
<th>Situation</th>
<th>Revenue Recognition</th>
</tr>
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</table>
| 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:  
(i) 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:  
i. the installation process is simple in nature  
Example: Installation of a factory tested television receiver which only requires... |
| (ii) | 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. |
| (iii) | 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. |
| (iv)  | 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

![](image)

4. Orders when payment (or partial payment) is received in advance of delivery for goods not presently held in inventory

**Example:** The goods are still to be manufactured or will be delivered directly to the customer from a third party

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

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
repurchase, or the buyer has a put option to require the repurchase, by the seller, of the goods.

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 109 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.

Illustration 10

A publisher of scientific journals publishes and dispatches journals on oceanography on monthly basis to various libraries and research institutes. The publisher receives the subscription in advance for 3 years for a period of July 20X1, to June 20X3, amounting to ₹18,00,000 (100 copies of ₹500 each for every month). The publisher’s financial year is April-March. How would the publisher account for the revenue in its books for the financial year 20X1-20X2?

Solution

The publisher should recognise revenue of ₹4,50,000 (100 x 50 x 9) from sale of journals for the financial year 20X1-20X2. The balance amount of ₹13,50,000 (18,00,000 – 4,50,000) should be considered as an advance to be recognised in the following years based on number of copies sold.
2.8 RENDERING OF SERVICES

- When the outcome of a transaction involving the rendering of services can be estimated reliably, revenue associated with the transaction should be **recognised by reference to the stage of completion (percentage of 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:

  - The amount of revenue can be measured reliably
  - It is probable that the economic benefits associated with the transaction will flow to the entity
  - The stage of completion of the transaction at the end of the reporting period can be measured reliably
  - The costs incurred for the transaction and the costs to complete the transaction can be measured reliably

- Revenue is recognised only when it is probable that the economic benefits associated with the transaction will flow to the entity.

- Similar to recognition of revenue in case of sale of goods, here also when collection of amount becomes uncertain, the **uncollectible amount for which recovery has ceased to be probable, is recognised as an expense, rather than as an adjustment of the amount of revenue originally recognised.**

- 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.

- An entity uses the stage of completion method that measures reliably the services performed. Depending on the nature of the transaction, the methods may include:
  - surveys of work performed
  - services performed to date as a percentage of total services to be performed
  - the proportion that costs incurred to date bear to the estimated total costs of the transaction

**Note:**
- 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.
Illustration 11

\textit{X Computer Training Institute Pvt. Ltd. is in the business of training of computer courses. The duration of different courses is three, six, twelve and twenty-four months. Training fee for courses are payable either in installments or in lump sum. How should X Computer Training Institute Pvt. Ltd. account for the course fees received from students?}

\textbf{Solution}

In respect of different courses run by X Computer Training Institute Pvt. Ltd., the services are rendered over the period of the course. Therefore, for recognition of revenue in respect of these courses, the percentage of completion method would be appropriate i.e., if the duration of particular course is, say 6 months and on March 31, 20X1, 3 months training is imparted, revenue to be recognised for the period up to March 31, 20X1 would be $\frac{1}{2}$ of the total course fees received. The balance $\frac{1}{2}$ of the course fees should be treated as course fees received in advance and be recognised as revenue in next year.

- 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.

Illustration 12

\textit{X Ltd. is engaged in selling of electronic products and in addition to this it also provides maintenance service. The maintenance contract tenure generally stands for a period of two years. During the financial year 20X1-20X2, it had collected ₹ 50,00,000 from its various customers against the maintenance contract of two years. How should X Ltd. recognise the revenue from maintenance contract?}

\textbf{Solution}

Revenue from the contract to provide maintenance services should be recognised on a straight line basis over the span of the service period i.e., two years, which will be most appropriate method in this case.

Illustration 13

\textit{X Ltd. a leading architect firm provides architectural and designing services. It has currently undertaken an interior design work for Y Ltd.'s new office building. Fees are charged on timely basis, but will not be payable unless the design work is completed fully. X Ltd. normally bills its fees monthly. When should X Ltd. recognise revenue?}
Solution

The significant act is the design work being completed fully. Until that point, no revenue should be recognised by X Ltd., even though it may have provided services. This is because until the design work is completed fully, revenue is not receivable and if this (i.e., completion of design work) does not occur, no economic benefits will flow to the entity.

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

- During the early stages of a transaction, when the outcome of the transaction cannot be estimated reliably, 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.

- 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 the recognition principles for revenue from rendering of services.

Illustration 14

XYZ Ltd. has undertaken a service contract for ₹10,00,00,000. It has spent ₹50,00,000 till year end. At the close of the year, due to rising cost of the inputs, XYZ Ltd. is not able to estimate reliably whether profit will be earned on the project or not. Suggest whether XYZ Ltd. should recognise revenue or not? What would be the treatment if due to some legal issues, XYZ Ltd. decides to suspend the project for an uncertain period and assesses that the cost incurred of ₹50,00,000 may not be recoverable.

Solution

Situation 1: When the outcome of the transaction involving the rendering of services cannot be estimated reliably, revenue should be recognised only to the extent of the costs incurred that are expected to be recoverable. XYZ Ltd. should recognise ₹50,00,000 as revenue and ₹50,00,000 as expenses in the first year.

Situation 2: 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.

Since XYZ Ltd. has suspended the project for an uncertain period and it is not certain that cost incurred of ₹50,00,000 would be recoverable, so XYZ Ltd. should not recognise revenue against the cost incurred. XYZ Ltd. should recognise the cost incurred of ₹50,00,000 as an expense.
Illustrative Examples on Rendering of Services

<table>
<thead>
<tr>
<th>S.No.</th>
<th>Particulars</th>
<th>Revenue Recognition</th>
</tr>
</thead>
<tbody>
<tr>
<td>1.</td>
<td>Installation fees</td>
<td>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.</td>
</tr>
<tr>
<td>2.</td>
<td>Servicing fees included in the price of the product</td>
<td>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.</td>
</tr>
</tbody>
</table>

Illustration 15

A leading laptop manufacturer X launches a scheme during a festival whereby a new laptop is available for ₹ 35,000 with free servicing for 2 years. The manufacturer would ordinarily charge ₹ 2,500 on an annual basis for servicing the laptop. How should X account for the revenue?

Solution

The fair value of the servicing portion i.e., ₹ 5,000 for two years should be reduced from the sales value. The sale of the laptop should be recognised as ₹ 30,000 and the revenue from rendering services should be recognised as ₹ 2,500 in the first year and ₹ 2,500 be shown as advance against future services and shown as service revenue in the 2nd year.

<table>
<thead>
<tr>
<th>S.No.</th>
<th>Particulars</th>
<th>Revenue Recognition</th>
</tr>
</thead>
<tbody>
<tr>
<td>3.</td>
<td>Advertising commissions</td>
<td>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.</td>
</tr>
<tr>
<td>4.</td>
<td>Insurance agency commissions</td>
<td>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</td>
</tr>
</tbody>
</table>
thereof, is deferred and recognised as revenue over the period during which the policy is in force.

| 5. | Financial service fee | 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 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 109 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 109), 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 109.**

If it is probable that the entity will enter into a specific loan commitment, the commitment fees are deferred and recognised as revenue over the period during which the commitment is expected to be used.
lending arrangement and the loan commitment is not within the scope of Ind AS 109, 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 109), is deferred and 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 109 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 109) 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 109.

If it is unlikely that a specific lending arrangement will be entered into and the loan commitment is outside the scope of Ind AS 109, 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 109 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. 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 109, 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.
### 5.62 FINANCIAL REPORTING

<p>| | | |</p>
<table>
<thead>
<tr>
<th></th>
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<tbody>
<tr>
<td></td>
<td>The fee is recognised as revenue when the loan has been arranged.</td>
<td></td>
</tr>
<tr>
<td></td>
<td><strong>(iii) Loan syndication fees.</strong></td>
<td></td>
</tr>
<tr>
<td></td>
<td>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 compensation for the service of syndication. Such a fee is recognised as revenue when the syndication has been completed.</td>
<td></td>
</tr>
<tr>
<td>6.</td>
<td>Admission fees</td>
<td>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.</td>
</tr>
<tr>
<td>7.</td>
<td>Tuition fees</td>
<td>Revenue is recognised over the period of instruction.</td>
</tr>
<tr>
<td>8.</td>
<td>Initiation, entrance and membership fees</td>
<td>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 collectability 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.</td>
</tr>
<tr>
<td>9.</td>
<td>Franchise fees</td>
<td>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:</td>
</tr>
<tr>
<td></td>
<td>(a) <strong>Supplies of equipment and other tangible assets.</strong></td>
<td></td>
</tr>
<tr>
<td></td>
<td>The amount, based on the fair value of the assets sold, is recognised as revenue when the items are delivered or title passes.</td>
<td></td>
</tr>
</tbody>
</table>
(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.

10. **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.

### 2.9 INTEREST AND ROYALTIES

- Revenue arising from the use by others of entity assets yielding interest and royalties should 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 should be recognised on the following bases:
  
  (a) interest should be recognised using the effective interest method
  
  (b) royalties should be recognised on an accrual basis in accordance with the substance of the relevant agreement

- Royalties accrue and is recognize in accordance with the terms of the relevant agreement unless, it is more appropriate to recognise revenue on some other systematic and rational basis.

**Illustration 16**

X Ltd. grants a license to Y Ltd. to use certain resources. The license allows Y Ltd. to use the resource of X Ltd. for a period of two years (July 1, 20X1 to June 30, 20X3) and Y Ltd. paid the total amount of license fee of ₹24,00,000 at the beginning of the first year i.e., on July 1, 20X1. How should X Ltd. account for the license fee received during the financial year 20X1-20X2?
Solution

The revenue from the license fee should be recognised over the period of two years as the entity has an obligation to provide its resource to be used by Y Ltd. for the next two years, therefore the fee of ₹ 24,00,000 received on July 1, 20X1 should be recognised as a liability. The same should be recognised over the period for which license has been granted. Accordingly, for the period ended March 31, 20X2, the total revenue from license fee will be ₹ 9,00,000 (i.e., 24,00,000/ 24 x 9).

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.

Illustration 17

Mr. X purchased a bond for cum-interest price of ₹ 1,05,000 on July 1, 20X1. It has a face value of ₹ 1,00,000. It pays interest of ₹ 20,000 every March 31. Determine the interest income that Mr. X should recognise for the period ended March 31, 20X2 and give the necessary journal entries.

Solution

The total interest that Mr. X will receive on March 31, 20X2 is ₹ 20,000. The price Mr. X paid, therefore, includes 3 months of accrued interest (₹ 1,05,000 includes ₹ 5,000 accrued interest). So the total interest income of ₹ 20,000 will be split between pre-acquisition (₹ 5,000) and post-acquisition periods (₹ 15,000). The pre-acquisition portion (₹ 5,000) is deducted from the cost of the financial instruments. The post-acquisition portion (₹ 15,000) is recognised as revenue (interest income).

At the time of purchases of bond

<table>
<thead>
<tr>
<th>Debit</th>
<th>Credit</th>
</tr>
</thead>
<tbody>
<tr>
<td>Investment Dr. ₹ 1,00,000</td>
<td></td>
</tr>
<tr>
<td>Accrued interest Dr. ₹ 5,000</td>
<td></td>
</tr>
<tr>
<td>To Bank</td>
<td>₹ 1,05,000</td>
</tr>
</tbody>
</table>

On receipt of interest

<table>
<thead>
<tr>
<th>Debit</th>
<th>Credit</th>
</tr>
</thead>
<tbody>
<tr>
<td>Bank Dr. ₹ 20,000</td>
<td></td>
</tr>
<tr>
<td>To Accrued interest</td>
<td>₹ 5,000</td>
</tr>
<tr>
<td>To Interest income</td>
<td>₹ 15,000</td>
</tr>
</tbody>
</table>

Revenue is recognised only when it is probable that the economic benefits associated with the transaction will flow to the entity.
However, when the collection is uncertain, 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.

**Illustration 18**

*Producer X enters into a licensing agreement with a distributor, Y Ltd. to exhibit a motion picture movie in the market. The arrangement includes a non-refundable one-off fee of ₹ 10,00,00,000 to be paid by Y Ltd. The licensor (producer) has no control over the distributor and the licensor has no share in the box office collection. At what point of time producer X should recognise revenue?*

**Solution**

In this situation, producer X should recognise revenue when the license is granted and other conditions for revenue recognition from sale of goods under Ind AS 18 are fulfilled.

In some cases, whether or not a license 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.

### 2.10 DISCLOSURE

- An entity should disclose:
  - 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;
  - the amount of each significant category of revenue recognised during the period, including revenue arising from:
    - the sale of goods
    - the rendering of services
    - royalties
  - the amount of revenue arising from exchanges of goods or services included in each significant category of revenue

- An entity should also disclose any contingent liabilities and contingent assets which may arise from items such as warranty costs, claims, penalties or possible losses. The disclosure of such items is made in accordance with Ind AS 37, *Provisions, Contingent Liabilities and Contingent Assets.*
2.11 RECOGNITION OF REVENUE IN SOME SPECIFIC CASES

2.11.1 Customer Loyalty Programmes

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. These programmes are common in the financial services sector, airlines, hospitality and the retail trade industry.

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.

This section 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.

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

The accounting issues in respect of customer loyalty programmes addressed below are as follows:

(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 (refer paragraph 18.5 of this Chapter); or
   (ii) providing for the estimated future costs of supplying the awards (refer paragraph 18.6.4 of this Chapter); 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.
2.11.1.1 Accounting principles

- An entity should 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 should be allocated between the award credits and the other components of the sale.

- The consideration allocated to the award credits should be measured by reference to their fair value.

### Measuring the fair value of award credits

The consideration allocated to award credits is required to be measured by reference to their fair value. If there is not a quoted market price for an identical award credit, fair value must be measured using another valuation technique.

An entity may measure 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, as appropriate:

1. the amount of the discounts or incentives that would otherwise be offered to customers who have not earned award credits from an initial sale
2. the proportion of award credits that are not expected to be redeemed by customers
3. non-performance risk

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

In some circumstances, other valuation techniques may be used. 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 measure 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 valuation technique that is most appropriate in the circumstances.

- If the entity supplies the awards itself, it should 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 should be based on the number of award credits that have been redeemed in exchange for awards, relative to the total number expected to be redeemed.

- If a third party supplies the awards, the entity should 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 should:
(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 should 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.

- 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 an onerous contracts. A liability should 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.

Illustration 19

A pharmacy chain operates a customer loyalty programme. It grants programme members loyalty points when they spend a specified amount on medicines. Programme members can redeem the points for further medicines. The points have no expiry date. In one period, the entity grants 100 points. Management estimates the fair value of medicines for which each loyalty point can be redeemed as ₹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. At the end of the first year, 40 of the points have been redeemed in exchange for medicines, i.e., half of those expected to be redeemed. In the second year, management revises its expectations. It now expects 90 points to be redeemed altogether. During the second year, 41 points are redeemed. In the third year, a further nine points are redeemed. Management continues to expect that only 90 points will ever be redeemed, i.e., that no more points will be redeemed after the third year.

How would the pharmacy chain account for the customer loyalty program?
Solution

The fair value of medicines for which each loyalty point can be redeemed as ₹ 1.25. Since management expects that only 80 points to be reimbursed, the revenue that should be deferred is of ₹ 100 (80 x 1.25).

Year 1

At the end of the first year, 40 of the points have been redeemed in exchange for medicines, i.e., half of those expected to be redeemed. The entity recognises revenue of (40 points/80 points) x ₹100 = ₹ 50.

Year 2

During the second year, 41 points are redeemed, bringing the total number redeemed to 40 + 41 = 81 points. The cumulative revenue that the entity recognises is (81 points/90 points) x ₹ 100 = ₹ 90. The entity has recognised revenue of ₹ 50 in the first year, so it recognises ₹ 40 in the second year.

Year 3

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, i.e., that no more points will be redeemed after the third year. So the cumulative revenue to date is (90 points/90 points) x ₹ 100 = ₹ 100. The entity has already recognised ₹ 90 of revenue (₹ 50 in the first year and ₹ 40 in the second year). So it recognises the remaining ₹ 10 in the third year. All of the revenue initially deferred has now been recognised.

Illustration 20

An apparel retail chain participates in a customer loyalty programme operated by an airline. It grants programme members one air travel point with each ₹ 1 they spend on apparels. Programme members can redeem the points for air travel with the airline, subject to availability. The retailer pays the airline Re. 0.009 for each point. In one period, the retailer sells apparels for consideration totaling ₹ 10 lakhs. It grants 10 lakhs points. The retailer estimates that the fair value of a point is ₹ 0.01.

How would the retailer account for the award credits if it is collecting the consideration on behalf of airline or on its own account?

Solution

Allocation of consideration to travel points

The retailer estimates that the fair value of a point is ₹ 0.01. It allocates to the points 10 lakhs x ₹ 0.01 = ₹ 10,000 of the consideration it has received from the sales of its apparels.

Revenue recognition

Having granted the points, the retailer has fulfilled its obligations to the customer. The airline is
obliged to supply the awards and entitled to receive consideration for doing so. Therefore the retailer recognises revenue from the points when it sells the apparels.

**Revenue measurement**

If the retailer has collected the consideration allocated to the points on its own account, it measures its revenue as the gross ₹ 10,000 allocated to them. It separately recognises ₹ 9,000 paid or payable to the airline as an expense. If the retailer has collected the consideration on behalf of the airline, i.e., as an agent for the airline, it measures its revenue as the net amount it retains on its own account, i.e., ₹ 1,000. This amount of revenue is the difference between ₹ 10,000 consideration allocated to the points and ₹ 9,000 passed on to the airline.

### 2.11.2 Transfer of Assets from Customers

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. These items could be substations or meters in the case of electricity connections, meters in the case of water connections or boosters in case of mobile telephony.

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.

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

Agreements within the scope of this section 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. It 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.

This section 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.
5.72  FINANCIAL REPORTING

2.11.2.1  Is the definition of an asset met?

When an entity receives from a customer a transfer of an item of property, plant and equipment, it should 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. In accordance with the Framework, ‘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. It needs to be noted that, 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.

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 should 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.

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

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

2.11.2.3  How should the credit be accounted for?

In determining how the credit should be accounted for paragraph 18.4.3 of this Chapter provides guidance. The paragraph states “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”. So, a transfer of an item of property, plant and equipment would be an exchange for dissimilar goods or services. Consequently, the entity should recognise revenue in accordance with Ind AS 18.

2.11.2.4  Identifying the separately identifiable services

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 18.5 of this Chapter, the entity should identify the separately identifiable services included in the agreement.
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.

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.

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.

2.11.2.5 Revenue recognition

If only one service is identified, the entity should recognise revenue when the service is performed in accordance with paragraph 18.7.1 of this Chapter.

If more than one separately identifiable service is identified, the entity should determine 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 should then applied to each service.

If an ongoing service is identified as part of the agreement, the period over which revenue should 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 should be recognised over a period no longer than the useful life of the transferred asset used to provide the ongoing service.

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

When an entity receives a transfer of cash from a customer, it should assess whether the agreement is within the scope of this section. If it is, the entity should assess whether the constructed or acquired item of property, plant and equipment meets the definition of an asset. If the definition of an asset is met, the entity should recognise the item of property, plant and equipment at its cost in accordance with Ind AS 16 and should recognise revenue in accordance with the above guidance at the amount of cash received from the customer.

Illustration 21

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

Based on the above facts, suggest how the entity would recognise revenue?

What will be your suggestion if 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?

Solution

Situation 1

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 the relevant provisions 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, i.e., over the ten-year term of the outsourcing agreement.

Situation 2

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.

2.11.3 Revenue — Barter Transactions Involving Advertising Services

According to paragraph 18.4.3 of this Chapter, when goods are sold or services are rendered in exchange for dissimilar goods or services, the revenue should be measured at the fair value of the goods or services received, adjusted by the amount of any cash or cash equivalents transferred. But, revenue from a barter transaction involving dissimilar advertising cannot be measured reliably at the fair value of advertising services received. Therefore, in such a case, 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.

Accordingly, revenue from a barter transaction involving dissimilar advertising services should be measured at the fair value of advertising services given, in accordance with the above mentioned criteria. It may be noted that an exchange of similar advertising services is not a transaction that generates revenue under Ind AS 18.

### 2.12 SIGNIFICANT DIFFERENCES IN IND AS 18 VIS-À-VIS AS 9

<table>
<thead>
<tr>
<th>S. No.</th>
<th>Particulars</th>
<th>Ind AS 18</th>
<th>AS 9</th>
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</thead>
<tbody>
<tr>
<td>1.</td>
<td>Definition of ‘Revenue’</td>
<td>Definition of ‘revenue’ given in Ind AS 18 is broad because it covers all economic benefits that arise in the ordinary course of activities of an entity which result in increases in equity</td>
<td>Definition of ‘Revenue’ covers only 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.</td>
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<td>2.</td>
<td>Measurement of revenue</td>
<td>At fair value of consideration</td>
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<td>3.</td>
<td>Barter Transactions</td>
<td>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.</td>
<td>This aspect is not dealt with in the existing AS 9.</td>
</tr>
<tr>
<td>4.</td>
<td>Recognition of Separately Identifiable</td>
<td>Ind AS 18 provides guidance on application of recognition criteria to the separately identifiable</td>
<td>Existing AS 9 does not specifically deal with the same.</td>
</tr>
<tr>
<td>Components</td>
<td>Recognition of Separately Identifiable Components</td>
<td>Guidance Regarding Revenue Recognition in Specific Cases</td>
<td>Deferred consideration</td>
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<tr>
<td>components of a single transaction in order to reflect the substance of the transaction.</td>
<td>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.</td>
<td>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.</td>
<td>Discounting to present value is required and interest income is accounted for separately.</td>
</tr>
</tbody>
</table>
Recognition of revenue

Sale of goods: Recognised at fair value of consideration

Rendering of services: Recognised by reference to stage of completion

Interest: Recognised using effective interest method (under Ind AS 109)

Royalties: Recognised on accrual basis (in accordance with substance of the agreement)
Practical Questions

1. XYZ Ltd. enters a contract with Y Ltd. to undertake a research work, which it expects to take 3 years. XYZ Ltd. will have to periodically update Y Ltd. with the progress of the work. Y Ltd. has exclusive rights over the results of research work. Y Ltd. will make an upfront payment of ₹ 10 crores on contract signature and three equal annual payments of ₹ 2 crores, provided XYZ Ltd. demonstrates compliance with the development programme. In addition, upon successful testing, Y Ltd. will pay a further ₹ 4 crores. XYZ Ltd. estimates the total project cost will be ₹ 15 crores. XYZ Ltd. incurred ₹ 5 crores in year one in line with its original estimate. XYZ Ltd. is in agreement with other terms and conditions of the contract. In year 2 and 3, it has incurred ₹ 7 crores and ₹ 3 crores respectively. Towards the end of year 3, Y Ltd. concluded the successful testing of the research work. How should XYZ Ltd. recognise the revenue in year 1, 2 and 3?

2. 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 ₹ 20 lakhs for setting up the project and 4 equal installments of ₹ 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?

3. 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 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?

4. 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 ₹ 10 lakhs. The contract terms stipulated that XYZ Ltd. has to complete the contract before March 31, 20X2, 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, 20X2. Till that date XYZ Ltd. has incurred cost of ₹ 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?

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Answers to Practical Questions

1. The contract involves carrying research work for Y Ltd. Here, XYZ Ltd. should recognise the revenue for payments received in accordance with percentage of completion method.

Under percentage of completion method, ₹ 4 crores relating to the successful testing of research result will be excluded from total contract revenue. This is because the payment depends upon the outcome of testing results. Until the outcome of testing result is known, it cannot be assumed that the company will receive economic benefit.

Total contract revenue is ₹ 16 crores (₹ 10 crores + 6 crores) and the total contract cost is ₹ 15 crores.

**Year 1**

Since XYZ Ltd. has met its obligation and the research work is in line with the estimates and it is forecasted that profit will be earned.

So XYZ Ltd. should recognise the revenue of ₹ 5.33 crores (₹16 crores/3) and costs of ₹ 5 crores (₹ 15 crores/3).

₹ 6.87 crores (₹ 10.2 crores + ₹ 2 crores - ₹ 5.33 crores) will be recognised as a liability in XYZ Ltd.’s books of account.

**Year 2**

Percentage of work completed till the end of the year 2 is (₹ 5 crores + 7 crores)/15 crores = 80%.

So, XYZ Ltd. should recognise total revenue of ₹12.8 crores (80% x 16 crores) till the end of year 2.

Since in year 1, ₹ 5.33 crores have already been recognised, balance amount of ₹ 7.47 crores should be recognised in year 2.

Till the end of the year 2, total cash received is ₹ 14 crores and total revenue recognised is ₹ 12.8 crores. So ₹ 1.2 crores (₹ 14 crores - ₹ 12.8 crores) will be recognised as a liability in the books of XYZ Ltd.

**Year 3**

Till the end of the year 3, since the work is completed 100%, so total revenue of ₹ 16 crores should be recognised till the end of the year 3.

Since revenue of ₹ 12.8 crores has already been recognised, balance amount of ₹ 3.2 crores (₹ 16 crores - ₹ 12.8 crores) should be recognised in year 3. In addition, ₹ 4 crores upon successful testing by Y Ltd. should also be recognised by XYZ Ltd. in year 3.
2. 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.

3. 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.

4. 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., ₹ 3 lakhs (4 lakhs x 75/100).