WIRC Study Ind AS Study Circle

Practical issues of Ind AS 11 and Ind AS

9.1.2016 at ICAI Bhavan

IFRS 115 supersedes the following standards

- IAS 11 Construction Contract
- IAS 18 Revenue
- IFRIC 13 Customer Loyalty programme
- IFRIC 15 Arrangements for the Construction of Real Estate
- IFRIC 18 Transfer of Assets from Customers
- SIC 31 Revenue - Barter Transactions Involving Advertisement Services

Ind AS was notified and was to be implemented early , but now it is deferred And Ind AS corresponding to above IFRS standards will be implemented. This presentation covers Ind AS 11 and Ind AS 18.

Ind AS 18 V/S AS 9

Ind AS 18	AS 9
• *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.	• Revenue is the gross inflow of cash, receivables or other consideration arising in the course of the ordinary activities of an enterprise4 from the sale of goods, from the rendering of services, and from the use by others of enterprise resources yielding interest, royalties and dividends.
• *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	• No mention of Fair Value

Measurement

IAS 18	AS 9
• Revenue shall be measured at the fair value of the consideration receivedor receivable. • After taking into account the amount of any trade discounts and volume rebates allowed by the entity.	•Revenue is measured by the charges made to customers or clients for goods supplied and services rendered to them and by the charges and rewards arising from the use of resources by them. In an agency relationship, the revenue is the amount of commission and not the gross inflow of cash, receivables or other consideration.

Normally Revenue = Cash & Cash Equivalent

If Deferred then

Discount all future receipts using an imputed rate of interest , and recognise difference as interest revenue.

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.

Which is determinable either:

(a) By 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 IFRS 9.

Swapping of Goods

IAS 18	AS 9
•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.	• No such provision

Exchange Transactions : Similar Goods

❖ Goods or services of similar nature and value are swapped

- No revenue recognised

❖ **When dissimilar goods or services are swapped,**

Recognise revenue , and measure at :-

Fair Value of goods or services received

If not possible then at Fair value of the goods or services given up

Less any adjustment for cash or cash equivalent.

For Example :

ABC Swapped dissimilar goods with XYZ

Market Value of inventory

ABC is 1.25 Lacs. And XYZ Ltd is Rs. 1.5 lacs.

ABC also paid Rs. 10,000 besides the inventory.

Revenue for ABC = Rs. 1.50 Lacs Minus Rs. 10 = Rs. 1.40 Lacs

Revenue for XYZ = Rs. 1.25 Lacs Plus Rs. 10 = Rs. 1.35 Lacs.

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Separately Identifiable Components

IAS 18	AS 9
The recognition are usually applied separately to each 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.	• No Such Provisions

Identification of Separate Transactions

In some cases

Single transaction need to be split and recognition criteria to be applied separately.

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.Revenue Example.doc

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Example of one transaction – which are in fact two separately identifiable component
Sale with free servicing

In such case split the transactions into two components and apply recognition criteria separately two each component

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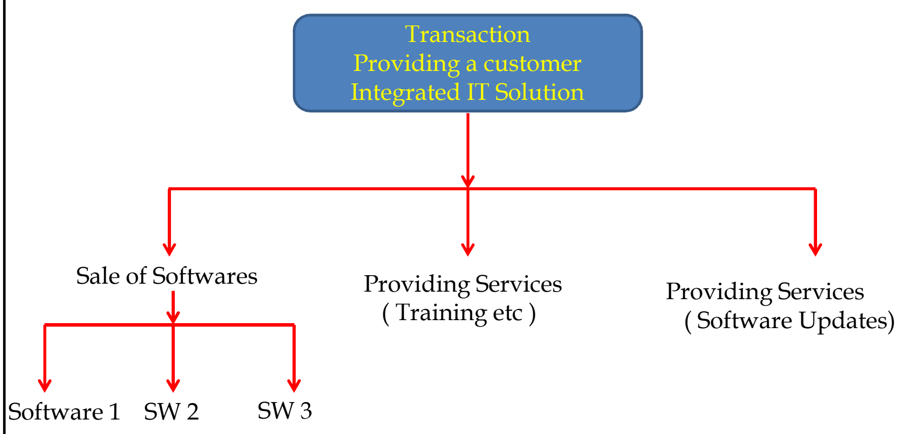
Also known as Multiple Element Arrangements

An arrangement containing multiple revenue-generating activities that has been negotiated as a package. Such activities are separately identifiable also.

A total price for all activities (delivery of goods and services) may have been agreed to. As of the balance-sheet date, certain revenue-generating activities may not yet have been performed.

Example: Sale of a software together with services that are required by the customer to use the software.

Problem:
Identification of the unit or units of accounting that are to be considered in applying revenue recognition rules. (Does the arrangement represent a single unit of accounting, or are there multiple units of accounting to be separately considered.



Separation
Question:
When is a multiple-element arrangement to separated into components (units of accounting) for purpose of revenue recognition?

Answer:

A separation into units of accounting is required (reflecting substance over form), if:

– the components already delivered under the arrangement have „stand-alone value“ for the customer.

- Stand-alone value“ for a component exists if it is sold separately by any vendor or the customer could resell the delivered item(s) on a stand-alone basis“

And

– There is reliable evidence of the fair value for the components which have not yet been delivered under the arrangement.

Revenue allocation and revenue recognition

Scenario 1

If the above-mentioned conditions are not all met, the components of the arrangement are to be considered as one unit of accounting for purposes of revenue recognition (no separation).

- The requirements for recognition of revenue must be applied to the entire arrangement as a single unit of accounting.

Scenario 2

If the conditions are all met and a separation into more than one unit of accounting is appropriate, then fulfilment of applicable revenue recognition criteria is to be determined separately for the individual units of accounting.

- The revenue applicable to a unit of accounting is determined using the relative fair value method, as follows:

$$\frac{\text{Fair value of individual accounting unit}}{\text{Sum of all individual unit fair values}} \times \text{Total arrangement price}$$

	SW 1	SW 2	SW 3	Call Centre Training
Performance made at the balance sheet date	Yes	Yes	No	Partially Performed
Standalone value to customer	Yes	Yes	Yes	No
Fair value reliably estimable	Yes	Yes	Yes	No (YES)
Fair value amount	50	80	20	(50)
Total Arrangement Price	CU 160			

Revenue recognition in Scenario 1

Revenue recognition could be considered for the delivered Software 1 and 2 and the partially performed services (call center, training) as of the balance-sheet date.

However, in the initial example no revenue recognition is permitted through the date of the balance sheet, since the fair value of the contract elements which have not been (completely) performed at the balance-sheet date cannot be reliably established.

The revenue recognition for the entire arrangement therefore is deferred until the completion of the call-center and training services.

Revenue recognition: Scenario 2

The contract elements already delivered have standalone value to the customer

and

there is reliable evidence of fair value for the elements to be completed after the balance-sheet date.

- For the software items 1 and 2 (assuming recognition of applicable revenue recognition criteria) revenue is to be recognized.

- The revenue amount is determined based on the relative fair value method, as follows:

Sum of the individual fair values		**200**
Total arrangement price for software and services		**160**
Software 1 and 2 share of total fair value	**= (50+80)/200**	**65%**
Revenue to be recognized =	**65 % x 160 (arrangement price)**	**104**

Recognition Criteria

IAS 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.

AS 9

•A key criterion for determining when to recognise revenue from a transaction involving the sale of goods is that the seller has transferred the property in the goods to the buyer for a consideration.

The transfer of property in goods, in most cases, results in or coincides with the transfer of significant risks and rewards of ownership to the buyer

Example of 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.

Terms of Sale	Revenue Recognition
Sale and Re-purchase other than Financial Assets	No Sale to be recognised – Difference to be treated as Finance Charges
For Example , Entity Sold Goods for Rs. 1,50,000.00 Buys back after 15 Days for Rs. 1,60,000.00	Rs. 10,000 To be treated as Finance Charges. Para 13 of IAS 18.

Examples of situations in which the entity may retain the significant risks and rewards of ownership are: (ownership is not transferred)

(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

(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.

Rendering of Services

IAS 18

•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

AS 9

•Revenue from service transactions is usually recognised as the service is performed, either

•by the proportionate completion method or

•by thecompleted service contract method.

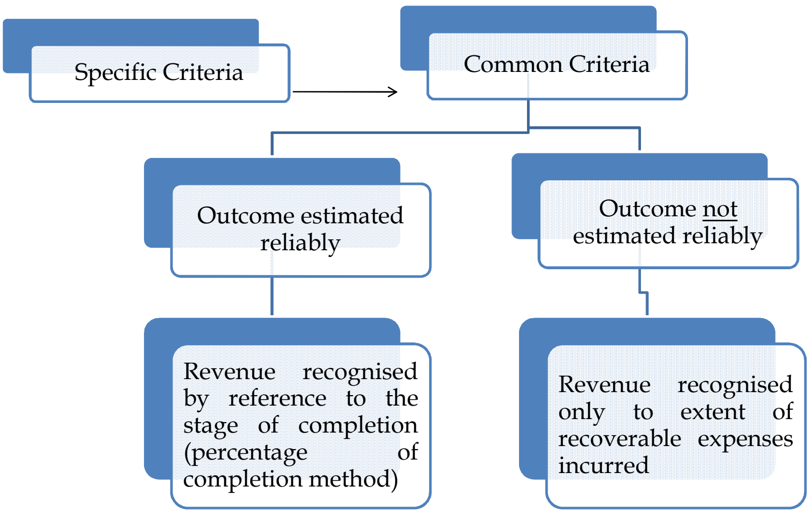
•Thus two methods permitted.

Revenue from Services

Outcome of a transaction (service) can be measured reliably only when "All" Conditions fulfilled :-

(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.

Revenue Recognition Criteria – Service.



Reliable estimate can normally be made when the entity has agreed on followings with the other party…..

(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.

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Outcome of a transaction can be measured reliably…….

- Revenue to be recognised on the basis of stage of completion , also referred to as the percentage completion method.
- Revenue is recognised in the year during which the activity is performed.
- Requirements of IAS 11 are generally applicable

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How Stages of completion can be measured ?

(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.

How Progress payment and advances received from the customer affect the measurement ?

When outcome of a transaction can NOT be measured reliably ?

Revenue shall be recognised only to the extent of the expenses recognised that are recoverable.

DIRECT COSTS

Site labour cost.	Materials.
Transport charge.	Cost of design.
Cost of rectification and guarantee work, including warranty costs	Depreciation of Plant & Machinery Used in Construction
Cost of Hiring Plant	Cost of moving plant to and from contract site
Claims from third parties.	Technical assistance charge.

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Direct Construction Costs – Decreases

- Any incidental income resulting from sale of surplus material and
- The disposal of equipment at the end of the contract.

- Provided such income not included in contract revenue.

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Cost Attributable Costs - Excluded

Selling and marketing costs

General and administrative costs for which the reimbursement is not specified in the contract

Research and development costs for which reimbursement is not specified in the contract

Depreciation on idle plant and equipment whose use cannot be attributable to any construction

contract

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Three possibilities of Outcome

1. Contract which expected to be make profit and where the outcome is reasonably certain

- *Revenue and costs will be recognise in comprehensive income (profit or loss) resulting in some profit being taken.*

2. Contract where loss is expected.

- *An expected loss on the construction contract should be recognized as an expense immediately.*
- *Prudence requires that this (expected) loss be recognised immediately and in full.*

3. **Contract where the outcome can not be assessed with reasonable certainty.**

- *Recognise revenue to the extent of cost incurred that it is probable will be recovered.*

❑ **The standard does not specify a single method for calculating the percentage of completion. The methods include:**

-- the proportion that contract costs incurred for work performed to date bear to the estimated total contract costs
-- surveys of work performed
-- completion of a physical proportion of the contract work.

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Calculations

❑Make all calculations on contract by contract basis. There is no netting-off of profits on, or assets relating to, one contract against losses or liabilities on another .

(a) Calculate total expected profit

		CU
Contract price		X
Less	Costs to date	(X)
	Estimated future costs	<u>(X)</u>
Estimated total profit		<u>X</u>

(b)

Acceptable methods include

Sales Basis
<u>Value of work done to date</u>
Total sales value

Cost Basis
<u>Costs to date</u>
Total costs

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Calculations

(c) Calculate revenue and costs for the year

(i) calculate attributable revenue and costs to *date* (using proportion above at (b))

(ii) Deduct any revenue and costs recognized in profit or loss in **earlier statements of comprehensive income.**

(iii) If profit can not be prudently recognized, include the same amount in the statement of comprehensive income for both revenue and cost of sales given to a nil profit.

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Debate over Pre-Contract Costs

If such "pre-contract" costs are reliably measurable and it is probable that the contract will be secured, then such costs are included as part of the overall contract cost.

If the contract has been secured by the time the financial statements are authorized for issue, then the condition of probability of securing the contract is satisfied and the costs can be included.

Once such "pre-contract" costs have been expensed, they cannot be reinstated once the contract is secured.

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Ind AS 11 Construction Contract

Basic Journal Entries for Construction Contracts

	Amount (Dr.)	Amount (Cr.)
1 When cost are actually incurred on Contract.		
Dr. Contract Account	+++++	
Cr. Cash/Accruals/Expenses		+++++
2 When the Amounts are Billed		
Dr. Receivables	+++++	
Cr. Contract Account		+++++
3 To Recognise Revenue		
Dr. Contract Account	+++++	
Cr. Revenue Account		+++++
4 To Recognise Costs		
Dr. Cost of Sales	+++++	
Cr. Contract Account		+++++

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