Intensive Refresher Course on Practical Aspects of Accounting Standards
AS 9/7/19/12

WIRC of ICAI
June 22

By Vijay Maniar

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Accounting Standard 9
Revenue Recognition

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Revenue Recognition

- **Revenue** is the gross inflow of cash, receivables or other consideration arising in course of **ordinary activities**.
- **Recognition** is a process of recording and reporting an item as an element of financial statement.
- Revenue recognition emphasizes on the **timing of recognition** of revenue in the statement of profit and loss of an enterprise.
- Assessment of uncertainty to ultimate collection.

Exclusions

AS 9 does not deal with the following types of revenue :

- Revenue arising from construction contracts
- Revenue arising from hire-purchase, lease agreements
- Revenue arising from government grants and other similar subsidies
- Revenue of insurance companies arising from insurance contracts

Revenue – Introduction

AS 9 deals with the revenue from the following :-

- Sale of goods
- Rendering of Services
- Interest, Royalties & Dividends

Items not included in the definition of revenue

- Realized gains from disposal of **non-current assets**
- Realized or Unrealized gains from changes in **foreign exchange rates.**
- Realized gains from discharge of **obligation < carrying amount.**
- Unrealized gains from holding of **non-current assets**
- Unrealized gains from holding of **current assets**

Revenue from Sale of Goods

Revenue should be recognized from sale of goods if following conditions are satisfied:

Ownership has been transferred or Risk & Rewards incidental to ownership has been transferred.

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No uncertainty of consideration & its ultimate collection

Case Study- 1

A Ltd. entered into a contract with B Ltd. to dispatch goods valuing ₹ 25,000 every month for 4 months upon receipt of entire payment. B Ltd. accordingly made the payment of ₹ 1,00,000. A Ltd. already had the goods and started dispatching as per the instructions of B Ltd.

In third month, due to a natural calamity, A Ltd. communicated to B Ltd that there would be delay in the delivery though it is holding the remaining goods worth ₹ 50,000 ready for dispatch once the situation improves.

A Ltd. accounted ₹ 100,000 as sales as entire money has been received

Comment upon the accounting treatment by A Ltd

Case Study- 2

A Ltd. entered into a contract with B Ltd. to dispatch goods valuing ₹ 25,000 every month for 4 months upon receipt of entire payment. B Ltd. accordingly made the payment of ₹ 1,00,000 and A Ltd. Already had the goods and started dispatching as per the instructions of B Ltd.

In third month, due to a natural calamity, B Ltd. requested A Ltd. not to dispatch goods until further notice though A Ltd. is holding the remaining goods worth ₹ 50,000 ready for dispatch.

A Ltd. accounted ₹ 100,000 as sales as entire money has been received

Comment upon the accounting treatment by A Ltd

Case Study- 3

A Ltd. sold and delivered goods worth Rs 50 lacs to B Ltd, who has 100 retail stores all over the county and houses various brands

The key terms of the agreement are as under:

- B Ltd will place store wise order which will be delivered by A Ltd
- B Ltd will have right to return unsold goods
- Credit period is 90 days
- Selling rate is MRP decided by A Ltd however B Ltd can offer discount as it deems appropriate
- A Ltd will share the discount provided by B Ltd

Comment upon the revenue recognition by A Ltd

Case Study- 4

A Ltd. sold and delivered goods worth Rs 50 lacs to B Ltd, who has 100 retail stores all over the county.

The key terms of the agreement are as under:

- B Ltd will place store wise order which will be delivered by A Ltd
- B Ltd will have right to return unsold goods
- B Ltd will make payment only when goods are sold to ultimate customer
- Selling rate is MRP decided by A Ltd however B Ltd can offer discount as it deems appropriate
- A Ltd will share the discount provided by B Ltd

Comment upon the revenue recognition by A Ltd

Case Study- 5

A Ltd. sold and delivered goods worth Rs 50 lacs to B Ltd, who has 100 retail stores all over the county and houses various brands

The key terms of the agreement are as under:

- A Ltd will deliver goods to each store based on past experience and future expectations and invoice it to B Ltd
- B Ltd will have right to return unsold goods
- B Ltd will make payment only when goods are sold to ultimate customer
- Selling rate is MRP and discount is decided by A Ltd
- A Ltd will share the discount provided by B Ltd

Comment upon the revenue recognition by A Ltd and B Ltd

Case Study- 6

A Ltd. sells machinery to B Ltd on following key terms

- The selling price is Rs 50 lacs
- The credit period is 120 days
- B Ltd has provided guarantee for one year and warranty for two years
- B Ltd has the history of successful delivering machines however there is also history of replacing machines during guarantee period due to faulty conditions and/or installations

Comment upon accounting treatment of in the books of A Ltd

Case Study- 7

A Ltd. sells chemicals to B Ltd on following key terms

- The selling price is Rs 50 per kg
- Credit period is 90 days
- B Ltd will be entitled to quantity discount on annual basis as under:
    - 100 - 500kg – 2%
    - 501 -1000 kg - 4%
    - 1001-2000 kg – 6%
- A Ltd has invoiced 500 kgs till September 30
- A Ltd is preparing its half yearly financial statements to be limited reviewed by the auditor to be submitted to the bank

Comment upon accounting treatment of Discount in the books of A Ltd and B Ltd

Case Study- 8

A Ltd. sells agro chemicals to B Ltd on the following key terms:

- The selling price is Rs 50 per kg
- Credit period is 90 days
- **B Ltd will be entitled to 2% if it pays invoice within 7 days**
- B Ltd will be entitled to quantity discount on annual basis as under:
  - 100 - 500kg – 2%
  - 501 -1000 kg - 4%
  - 1001-2000 kg – 6%
- **A Ltd has invoiced 500 kgs till September 30 out of which invoice for 100 kg dated 27th September is pending. All invoices are settled and expected to settle by B Ltd within 7 days**
- A Ltd is preparing its half yearly financial statements to be limited reviewed by the auditor to be submitted to the bank

Comment upon accounting treatment of Discounts in the books of A & B Ltd

Case Study- 9

A Ltd. sells specialty chemicals to B Ltd on the following key terms:

- The selling price is Rs 50 per kg
- B Ltd will test the chemical in its laboratory and if its not of the agreed quality will return the goods
- B Ltd will take 7 days to test the chemical
- Credit period is 90 days from the date of the invoice

Comment upon accounting treatment of in the books of A

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Case Study- 10

A Ltd. sells agro chemicals to B Ltd on the following key terms:

- The selling price is Rs 50 per kg
- B Ltd will sell this chemicals to farmers. Depending on monsoon and other weather conditions, if this chemicals are not sold, B Ltd can return the goods or A Ltd will offer additional discount to B Ltd to liquidate
- Credit period is 90 days from the date of the invoice

Comment upon accounting treatment of in the books of A Ltd

Revenue from Services

Revenue should be recognized from rendering of services on the basis of following conditions:

As Services are rendered either on proportionate completion method or completed services contract method

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No uncertainty of consideration & its ultimate collection.

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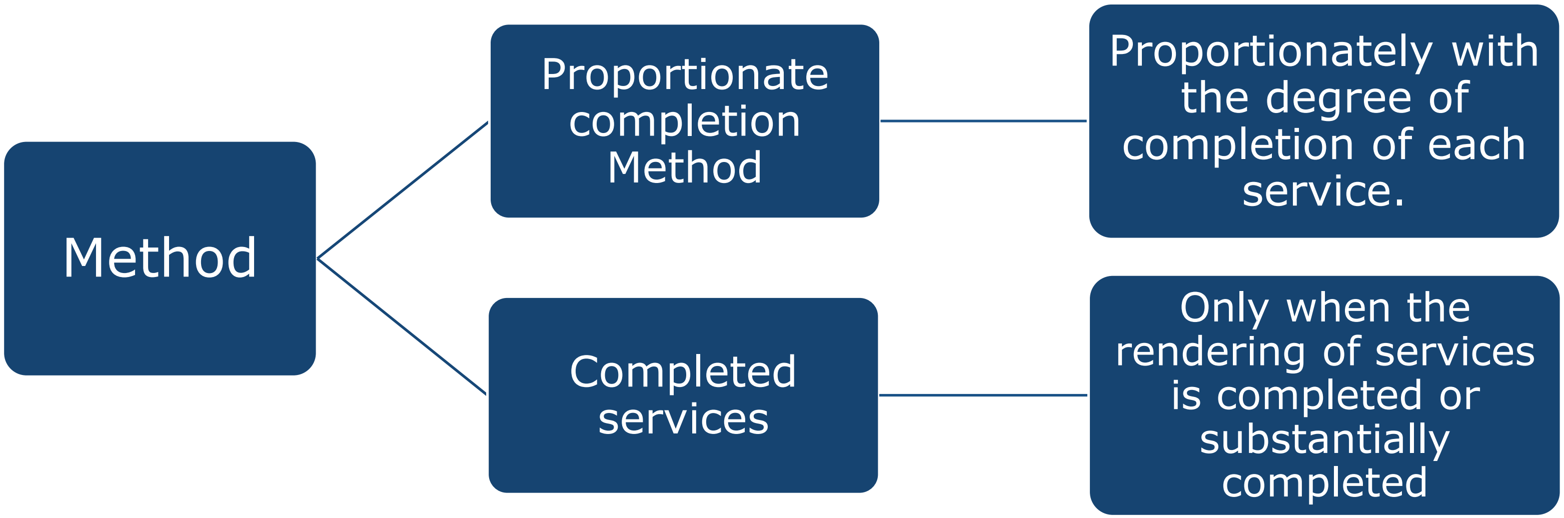
Revenue from Services



Case Study- 11

A Ltd is a software development company and an expert in accounting software since past 10 years. It has developed several vendors for installation of its software and a customer is free to engage either A Ltd or any other vendor

A Ltd. has agreed to sale accounting software to B Ltd on the following key terms.

- The selling price is Rs 3 lacs which includes license fee, installation, warranty and all free upgrades for 3 years
- Credit period is 90 days from the UAT date

Comment upon accounting treatment of in the books of A Ltd

Case Study- 12

A Ltd is a software development company and an expert in accounting software since past 10 years. It has developed several vendors for installation of its software and a customer is free to engage either A Ltd or any other vendor.

A Ltd. has agreed to sale accounting software to B Ltd on the following key terms.

- The selling price is Rs 3 lacs which includes license fee, installation, warranty and all upgrades for 3 years
- As there are lot of regulatory changes expected to occur which would significantly impact accounting software and there is likely to be reorganization of B Ltd, A Ltd has agreed to provide all the upgrades which includes regulatory changes as well as other upgrades as may requested by B Ltd.
- Credit period is 90 days from the UAT date

Comment upon accounting treatment of in the books of A Ltd

Case Study- 13

A Ltd is a software development company and has been developing software for third party. Now it has developed its own accounting software.

B Ltd. has agreed to purchased the above accounting software from A Ltd on the following key terms.

- The selling price is Rs 2.5 lacs (as against Rs 3 lacs) as B Ltd is the first company to purchase this software. The selling price includes license fee, installation, warranty and all upgrades for 3 years
- Credit period is 90 days from the UAT date
- A Ltd is preparing its half yearly financial statements to be limited reviewed by the auditor to be submitted to the bank
- As at half year end, installation of software is in progress and is expected to be complete in 60 days

Comment upon accounting treatment of in the books of A

Uncertainties on Revenue Recognition

Where the ability to assess the **ultimate collection** with reasonable certainty is **lacking at the time of raising any claim**, revenue recognition is **postponed to the extent of uncertainty involved**.

When the **uncertainty** relating to collectability arises **subsequently** to the time of sale or the rendering of services, it is more appropriate to make a **separate provision** to reflect the uncertainty rather than to adjust the amount of revenue originally recorded.

Revenue From Interest, Royalties and Dividend

- **Regarding Interest** should be based on time basis.
- **Regarding Dividend,** right to receive dividend should exist (When dividend is declared in AGM)
- **Regarding Royalty,** revenue is recognized based on compliance of agreement conditions.

Case Study- 14

A Ltd has lent money to its subsidiary in Sri Lanka. Subsidiary is a profitable company with healthy reserves.

Due to precarious foreign exchange condition, Sri Lanka has decided to closely scrutinise all foreign exchange remittances and application for payment of interest for 3 quarters is pending with the authorities Subsidiary has set aside this funds in a separate account pending approval

How should A Ltd account for Interest while finalizing its books of account

Case Study- 15

A LLP is a Chartered Accountancy firm specializing in Audit. Its keeps its books on accrual system of accounting.

It has got a mandate to do Statutory audit as well as limited review of a listed entity B Ltd for a fee of Rs 50 lacs – Rs 5 lacs per quarter for limited review and Rs 35 lacs for year end audit. A LLP has estimated 3000 hours (including 250 hours per quarter for limited review) for this audit for various resources from articles to partner.

How should A LLP account for revenue while finalizing its books of account for the year ended 31st March considering that 3 quarters limited review is complete and year end audit is in progress for which board meeting is fixed for 21 May

Disclosure Requirements

Revenue recognition policy should be disclosed.

Circumstances in which revenue recognition has been postponed.

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An Overview of Accounting Standard – 7 “Construction Contracts”

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Scope

- This Standard should be applied in accounting for construction contracts in the financial statements of contractors.

Objective

- The objective of this Standard is to prescribe the accounting treatment of revenue and costs associated with construction contracts

Construction Contract

A contract specifically negotiated for

construction of an asset

OR

combination of assets

closely interrelated or interdependent (in terms of design/ technology/ function/ use)

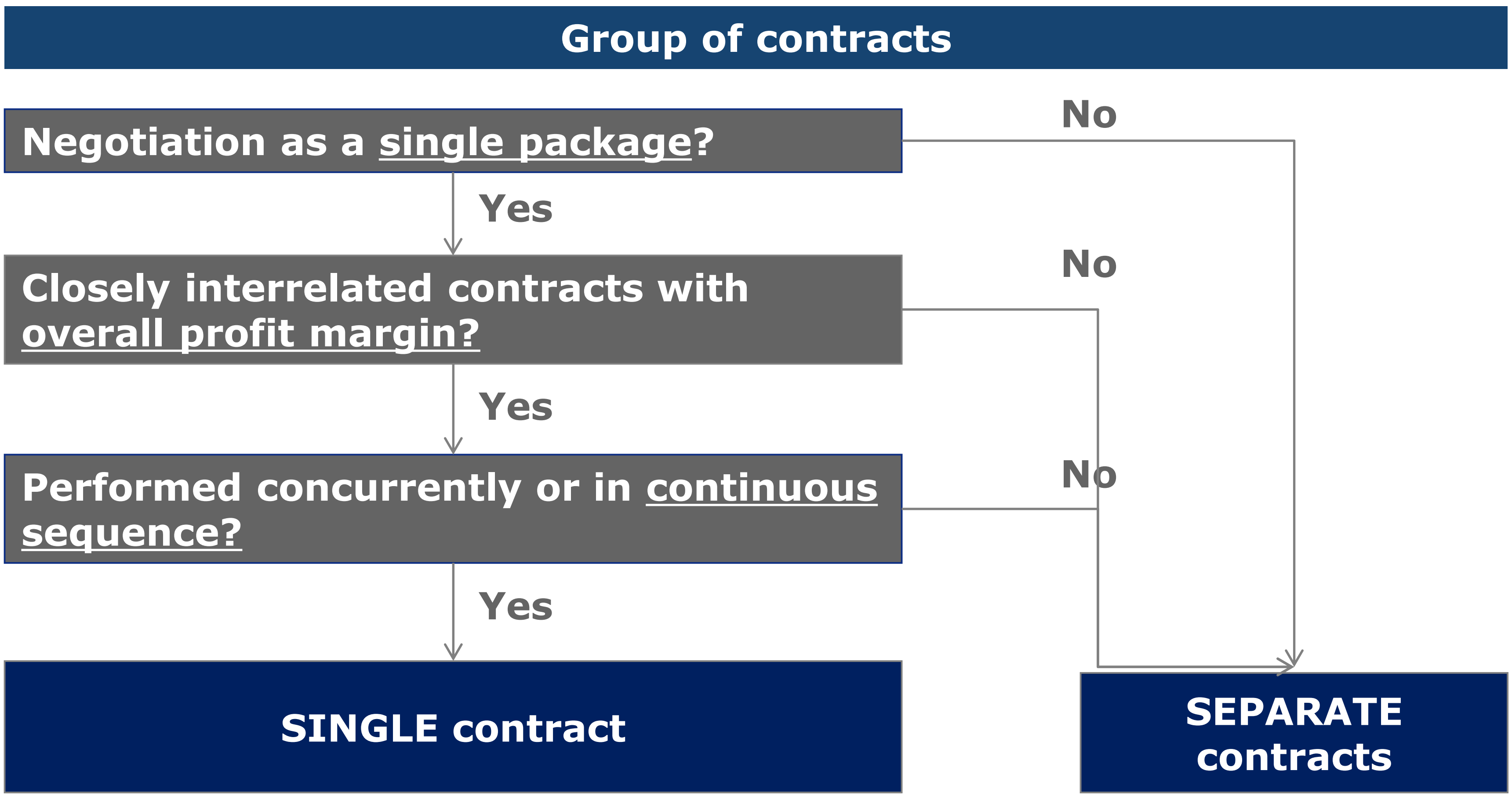
Construction Contract

Construction contracts also includes:

Contract for services directly related to construction contracts

Contract for demolition and restoration of assets and restoration of the environment after an asset is demolished

Combination of Contracts



Segmentation of Contracts

Single contract covering construction of no. of separate assets

Separate proposals for each asset? — No → SINGLE contract

Yes ↓

Separate negotiation for each asset? — No → SINGLE contract

Yes ↓

Costs and revenues identifiable for each asset? — No → SINGLE contract

Yes ↓

SEPARATE contracts (for each asset)

SINGLE contract

Construction of additional asset

Contract anticipates construction of additional asset at customer's discretion

Significantly different in design, technology or function?

Yes → **NEW contract**

No ↓

Price negotiation without regard to original contract price?

Yes → **NEW contract**

No ↓

COMBINED contract

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Types of Contracts

Fixed price contract

Fixed contract price or fixed rate per unit of output, which in some cases subject to escalation.

Cost plus contract

Allowable or otherwise defined costs *plus* a percentage of costs or a fixed fee.

Contract Revenue

- Initial amount of revenue agreed in the contract.

- Variations in contract work, claims and incentive payments:

  (i) it is probable that they will result in revenue; and

  (ii) they are capable of being reliably measured.

Contract Cost

- Costs that relate directly to the specific contract.
- Costs that are attributable to contract activity in general and can be allocated to the contract; and
- Such other costs as are specifically chargeable to the customer under the terms of the contract.
- Costs which cannot be attributed to contract activity or cannot be allocated to contract are excluded

Borrowing Cost

- Borrowing costs are interest and other costs incurred by an entity in connection with the borrowing of funds.

- Borrowing cost attributable to contract activity in general and can be allocated to specific contracts costs.

Valuation of Inventory

- AS-2 does not deals with the work in progress inventories arising under construction contracts including directly related service Standard.

Recognition of Contract Revenue and Cost

- If the final outcome of the contract
  - Can be estimated reliably
    - Recognise contract revenue and contract costs as per **Percentage of completion method**
  - Can not be estimated reliably
    - Recognise revenue to the extent **of incurred contract costs,** probable of recovery
    - Recognise contract costs as expense when incurred and any expected loss should be recognised immediately

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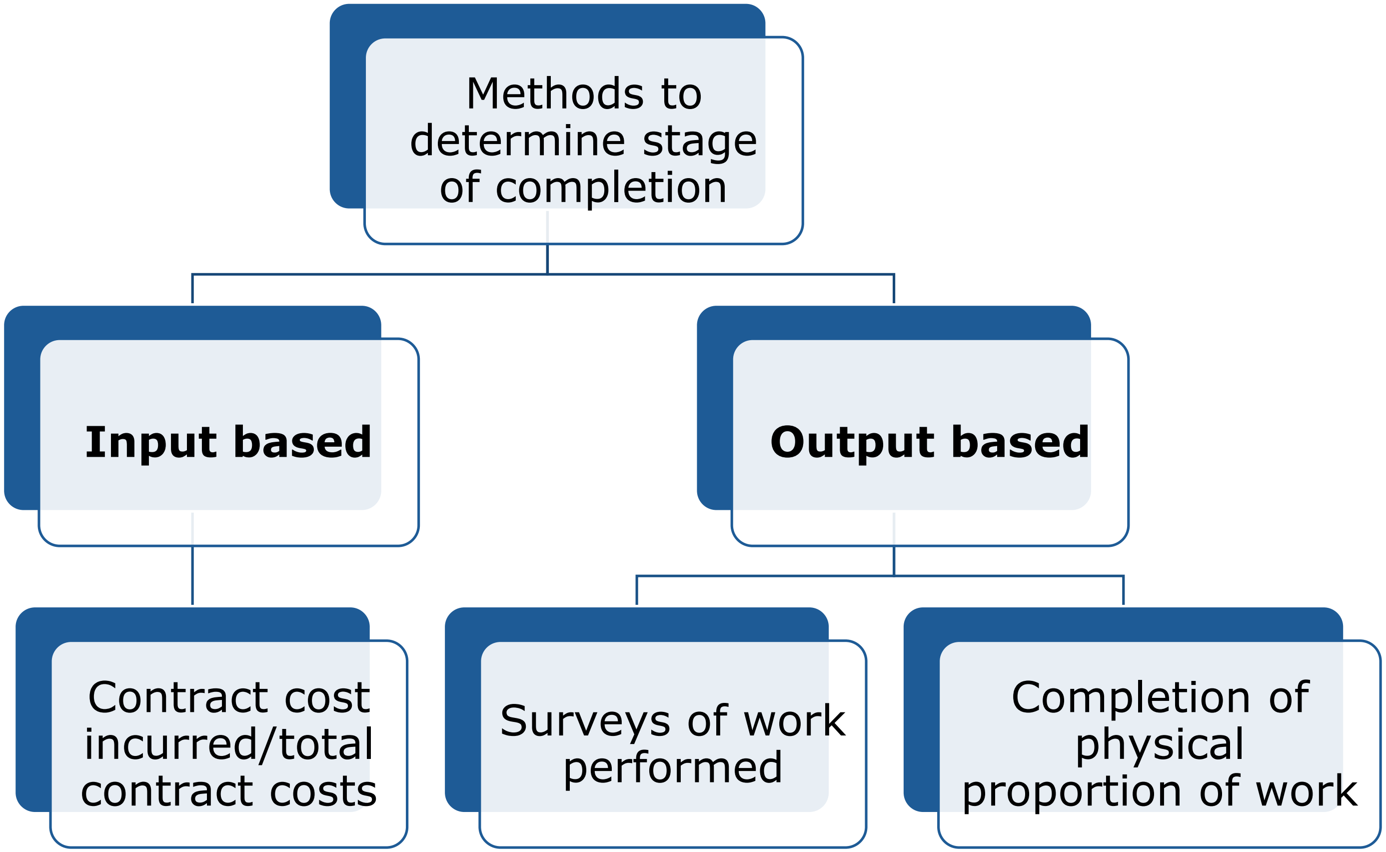
Percentage of completion method

The stage of completion of a contract may be determined by using the method that measures reliably the work performed.



Additional Points

- Contract costs relating to future contract activity recognised as ‘contract WIP’ as long as it is probable of recovery

- If doubts about collectability of revenue already recognise
  - write off as bad debt expense
  - no adjustment to revenue

- Progress payments and payment in advance may not reflect work performed

Case Study 16

Contract:

- A Ltd. is engaged in a construction contract with an expected sales value of INR 10,00,000.

Case I: A Ltd. has incurred costs of INR 4,00,000 (including INR 50,000 in respect of unapplied raw materials. INR 3,00,000 is the best estimate of remaining costs to complete the contract.

Case II: An independent surveyor has certified that at the period-end the contract is 55% complete. Retention amount is 5%.

Case III: A Ltd.'s best estimate of the physical proportion of the work it has completed is that it is 60% complete.

Determine contract revenue to be recognized?

Case Study 16

<u>Contract revenue to be recognized</u>

Case I: INR 5,00,000 (i.e., (4,00,000-50,000)/7,00,000*10,00,000)

Case II: INR 5,50,000 (i.e., 10,00,000 * 55%)

Case III: INR 6,00,000 (i.e., 10,00,000 * 60%)

Changes in Estimates

- Percentage of completion method applied on a cumulative basis to the current estimates of contract revenue and cost.

- Effect of change treated as change in accounting estimate to be accounted for prospectively as per Accounting Standard (AS) 5, Net Profit or Loss for the Period, Prior Period Items and Changes in Accounting Policies

- The changed estimates are used in determination of the amount of revenue and expenses recognized in the statement of profit or loss in the period in current period and in subsequent periods.

Case Study 17

- A construction contractor has a fixed price contract to build a bridge. The initial amount of revenue agreed in the contract is INR 9,000 cr. The contractor's initial estimate of contract costs is INR 8,000 cr. It will take 3 years to build the bridge.
- By the end of year 1, the contractor's estimate of contract costs has increased to INR 8,050 cr.
- In year 2, the customer approves a variation resulting in an increase in contract revenue of INR 200 cr and estimated additional contract costs of INR 150 cr. At the end of year 2, costs incurred include INR 100 cr for standard materials stored at the site to be used in year 3 to complete the project.

Particulars	Year 1	Year 2	Year 3
Contract costs incurred to date (INR in cr)	2,093	6,168	8,200

Case Study 17

Particulars	Year 1	Year 2	Year 3
	INR in cr	INR in cr	INR in cr
Initial amount of revenue agreed	9,000	9,000	9,000
Variation	-	200	200
Total contract revenue	**9,000**	**9,200**	**9,200**
Contract costs incurred to date	2,093	6,168	8,200
Contract costs to complete (B.F)	5,957	2,023	-
Total estimated contract costs	**8,050**	**8,200**	**8,200**
Estimated profit	950	1,000	1,000
Stage of completion	26%	74%*	100%

Case Study 17

Particulars	To date	Recognised in prior years	Recognised in current year
Year 1			
Revenue (9,000 x 26%)	2,340	-	2,340
Expenses	2,093	-	2,093
Profit	247	-	247
Year 2			
Revenue (9,200 x 74%)	6,808	2,340	4,468
Expenses (6,168 – 100)	6,068	2,093	3,975
Profit	740	247	493
Year 3			
Revenue (9,200 x 100%)	9,200	6,808	2,392
Expenses	8,200	6,068	2,132
Profit	1,000	740	260

Case Study 18

- A construction contractor has a fixed price contract to build a bridge. The initial amount of revenue agreed in the contract is INR 9,000 cr. The contractor's initial estimate of contract costs is INR 8,000 cr. It will take 3 years to build the bridge.
- By the end of year 1, the contractor's estimate of contract costs has increased to INR 8,500 cr.
- Contractor requested customer to approve additional contract costs of Rs 500 crores and has submitted all the documents to the customer to evaluate
- Contractor has incurred Rs 800 crores during year 1

How should Contractor account for contract revenue and contract cost at the end of year 1?

Case Study 19

Continuing the same example further…

- ❑ By the end of year 2, the contractor's estimate of contract costs has increased to INR 9,100 cr.
- ❑ Contractor requested customer to approve additional contract costs of Rs 600 crores in addition to Rs.500 crores of earlier year and has submitted all the documents to the customer to evaluate. Customer could not evaluate additional cost due to Covid pandemic
- ❑ Contractor expects cost to increase by 50 crores in the 3^{rd} year due to Covid pandemic

How should Contractor account for contract revenue and contract cost at the end of year 2 out of the following options?

- **Consider that customer will approve addl cost for the reasons mentioned**
- **Ignore the approval of addl cost provide loss of Rs 100 crores**
- **Ignore the approval of addl cost and provide loss of Rs 150 crores**

Presentation

Gross amount due from customers — **As an asset**

Due to customers — **As a Liability**

Disclosure

- Contract revenue recognized as revenue
- Methods used to determine contract revenue
- Methods used to determine stage of completion
- For contracts in progress:
  - aggregate of costs incurred and recognized profits
  - advances received
  - Retentions

An Overview of
Accounting Standard – 19
“Leases ”

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Lease – Few Definitions

Lease is an agreement whereby lessor conveys to the lessee in return for a payment or series of payments right to use an asset for an agreed period of time

Finance Lease is a lease that transfers substantially all the risks and rewards incident to ownership of an asset

Operating Lease is a lease other than a finance lease

Economic life is either a period over which an asset is expected to be economically usable by one or more users OR the number of production or similar units expected to be obtained from the asset by one or more users

Useful Life of a leased asset is either the period over which the leased asset is expected to be used by the lessee OR the number of production or similar units expected to be obtained from the use of asset by the lessee

Lease Term is the non cancellable period for which the lessee has agreed to take on lease asset together with any further periods for which the lessee has option to continue the lease of an asset, with or without further payment which at the inception of the lease it is reasonably certain that the lessee will exercise

Finance Lease v/s Operating Lease

- Lease transfers ownership of the asset to the lessee by the end of the lease term
- Lessee has option to purchase the asset at a price which is expected to be sufficiently lower than the fair value at the date the option becomes exercisable
- Lease term is for the major part of the economic life of the asset even if title is not transferred
- Lease payments substantially equal to fair value
- In case of cancellation, lessors loss associated with cancellation are borne by lessee
- Gains and losses from fluctuation in the fair value of the residual fall to the lessee
- Lessee can continue in secondary period at substantially lower than market rate

Accounting of Finance Lease

- **In the books of the Lessee**
  - Recognise both Asset and Liability at present value of minimum lease payments
  - Amortise asset over useful life
  - Lease payments to be bifurcated in to settlement of liability and interest payment

- **In the books of the Lessor**
  - Net Investment in lease/Loan
  - Lease payments to be bifurcated in to repayment of loan and interest income

Accounting of Operating Lease

- **In the books of the Lessee**
  - Recognise lease payment as an expense over the lease term on a straight line basis unless some other basis is more representative

- **In the books of the Lessor**
  - Recognise leased asset as fixed asset
  - Lease receipts as income on straight line basis over a lease term unless some other basis is more representative
  - Amortise leased asset over useful life

Case study 20

- A Ltd (Lessor) enters in to lease arrangement with B Ltd (Lessee) for leasing car.
- The key terms of the lease is as under:
  - The fair value of the car at the date of inception is Rs 30 lacs
  - The lease term is for a period of 5 years
  - At the end of the lease term the fair value of the car expected to be Rs 10 lacs.
  - B Ltd has option to purchase car at the end of lease term for Rs 5 lacs

Is the above contract Finance lease or Operating lease?

Case study 21

- A Ltd (Lessor) enters in to lease arrangement with B Ltd (Lessee) for leasing machine
- The key terms of the lease are as under:
  - The fair value of the machine at the date of inception is Rs 50 lacs
  - The lease term is for a period of 10 years
  - The economic life of machine is 15 years

Is the above contract Finance lease or Operating lease?

Case study 22

- A Ltd (Lessor) enters in to lease arrangement with B Ltd (Lessee) for leasing machine
- The key terms of the lease are as under:
  - The fair value of the machine at the date of inception is Rs 50 lacs
  - The lease term is for a period of 15 years
  - The economic life of machine is 16 years

Is the above contract Finance lease or Operating lease?

Case study 23

Sale and Lease back

- B Ltd was in need of funds hence sold its one asset to A Ltd and leased it back
- The key terms of the lease is as under:
  - The carrying value of asset is Rs 25 lacs
  - The asset is sold for Rs 30 lacs
  - The balance useful life of the asset is 10 years
  - The lease term is 6 years

Is the above contract Finance lease or Operating lease and also discuss the accounting treatment in the books of B Ltd

Case study 24

Sale and Lease back

- B Ltd was in need of funds hence sold its one asset to A Ltd and leased it back
- The key terms of the lease are as under:
    - The carrying value of asset is Rs 25 lacs
    - The asset is sold for Rs 20 lacs
    - The balance useful life of the asset is 10 years
    - The lease term is 10 years

Is the above contract Finance lease or Operating lease and also discuss the accounting treatment in the books of B Ltd

Case study 25

Sale and Lease back

- B Ltd was in need of funds hence sold its one asset to A Ltd and leased it back
- The key terms of the lease are as under:
  - The carrying value of asset is Rs 25 lacs
  - The asset is sold for Rs 30 lacs
  - The balance useful life of the asset is 10 years
  - The lease term is 10 years

Is the above contract Finance lease or Operating lease and also discuss the accounting treatment in the books of B Ltd

An Overview of Accounting Standard – 12 "Government Grants"

MEANING OF 'GOVERNMENT GRANTS'

- Government Grants are assistance by the Govt. in the form of cash or kind to an enterprise in return for past or future compliance with certain conditions

- Government assistance, which cannot be valued reasonably, is excluded from Government Grants

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APPROACHES TOWARDS TREATMENT OF GOVERNMENT GRANTS

Capital

- The grant is treated as a part of the shareholder's funds

Income

- The grant is taken as income for one or more periods

Government grants should be recognized in the profit and loss statement on a <u>systematic and rational basis over the periods necessary to match them with the related costs</u>

RECOGNITION OF GOVERNMENT GRANTS

Grant Related to Assets	Gross vs Net Approach
Non Monetary Grant	Non-monetary assets given free of cost are recorded at a nominal value.
Grant Related to Revenue	shown separately in under 'other income' or deducted from related expense.

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GRANTS IN THE NATURE OF PROMOTER’S CONTRIBUTION

- Treated as capital reserve
- Neither be distributed as dividend nor considered as deferred income

Thank You

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