Analysis of Ind AS 11, *Construction Contracts* and Ind AS 18, *Revenue* as Notified by MCA

The Ministry of Corporate Affairs (MCA) has issued the Companies (Indian Accounting Standards) (Amendment) Rules, 2016 vide notification dated 30th March 2016, which has introduced two Indian Accounting Standards (Ind AS): Ind AS 11, Construction Contracts and Ind AS 18, Revenue, along with appendices. Through this notification, MCA has also omitted Ind AS 115, Revenue from Contracts with Customers and has made consequential amendments to other Ind ASs. The objective of this article is to give an overview of the two standards – Ind AS 11 and Ind AS 18 and highlight key differences with corresponding Accounting Standards and International Accounting Standards. Now, companies will have adequate time to prepare for adoption of the new standards IFRS 15.

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Background

MCA notified 39 Ind ASs on 16th February 2015 including Ind AS 115. The applicability of Ind ASs to corporates, banks, NBFCs and insurance companies has been notified by the Ministry of Corporate Affairs (MCA) from time to time.

IFRS 15 was issued by the IASB in May 2014 with an effective date of 1st January 2017. IFRS 15, which is a five step model for revenue recognition, was issued to address inconsistencies and weaknesses in previous revenue Standards. It

specifies a comprehensive and robust framework for the recognition, measurement and disclosure of revenue. It improves the comparability of revenue from contracts with customers, simplifies the preparation of financial statements by reducing the amount of guidance to which entities must refer and provides more useful information through improved disclosure requirements.

On account of some proposed amendments to guidance on licences and guidance on identifying performance obligations, and various comment letters received from stakeholders for deferral, IASB deferred the effective date of IFRS 15 by one year to 1st January 2018.

Omission of Ind AS 115

India was looking forward to implementing Ind AS 115 from FY 2016-17 ahead of global roll out of IFRS 15 which was challenging due to lack of practical precedents and the potential changes Ind AS 115 could undergo due to proposed changes in IFRS 15. Keeping in view the difficulties which would arise during implementation, the ICAI proposed deferral of Ind AS 115. On 30th March 2016, MCA issued a notification which introduced Ind AS 11 and Ind AS 18, and omitted Ind AS 115. The principles in these Ind AS are based on IAS 11, Construction Contracts and IAS 18, Revenue and the related interpretations.

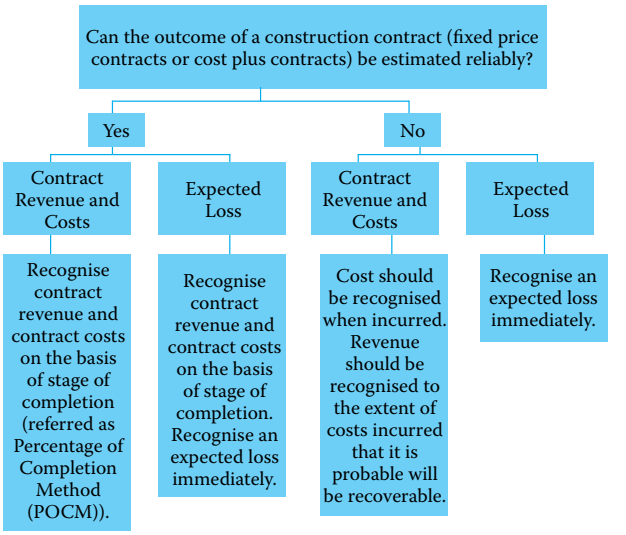
Ind AS 11 and Ind AS 18, and the Corresponding IASs and Interpretations

Ind AS	Name	IFRS Standard/ Interpretation
Ind AS 18	Revenue	IAS 18
Appendix A	Revenue—Barter Transactions Involving Advertising Services	SIC 31
Appendix B	Customer Loyalty Programmes	IFRIC 13
Appendix C	Transfers of Assets from Customers	IFRIC 18
Refer Note 1		IFRIC 15 Agreements for the Construction of Real Estate
Ind AS 11	Construction Contracts	IAS 11
Appendix A	Service Concession Arrangements	IFRIC 12
Appendix B	Service Concession Arrangements: Disclosures	SIC 29

Note:1: For real estate developers, revenue should be accounted for in accordance with 'Guidance Note on Accounting for Real Estate Transactions (for entities to whom Ind AS is applicable)' issued by the ICAI on 10th May 2016.

Ind AS 11, *Construction Contracts*: An Overview

Ind AS 11 prescribes the accounting treatment of revenue and costs associated with construction contracts by contractors. The recognition criteria of contract revenue and expenses are given below:



The Standard also gives various methods to determine the stage of completion which include proportion that contract costs incurred for work performed to date bear to the estimated total contract costs; surveys of work performed or completion of a physical proportion of the contract work. The Standard also provides guidance on 'Service Concession Arrangements', also called 'build-operate-transfer (BOT)', a 'rehabilitate-operate-transfer' or a 'public-to-private' service concession arrangement.

Appendix A: Service Concession Arrangements

BOT model is being used in India for development of various toll roads, container terminals, bus terminals, water supply and sewage disposal systems etc. The ICAI had published an exposure draft "Guidance Note on Accounting for Service Concession Arrangements by Concessionaires" in 2014 but the final version of the guidance note was not issued thereafter. Therefore, in the absence of any guidance under existing GAAP, there are diverse accounting practices being followed for such arrangements. After the notification of Ind AS 11, it is expected that there will be uniformity and consistency in accounting for such arrangements. It will impact the revenue and profit recognition in a significant manner during the period of arrangement for various Indian Operators.

An arrangement whereby the grantor *(a public sector entity, including a governmental body, or a private sector entity to which the responsibility for the service has been devolved)* enters into a contract with an operator (a private sector entity) to construct or upgrade the infrastructure used to provide the public service and to operate and maintain that infrastructure. This Appendix provides guidance on the accounting by operators and not the accounting by grantors.

The operator acts as a service provider and can provide two types of services:

(a) construction or upgrade services (constructs or upgrades infrastructure)

(b) operation services (operates and maintains the infrastructure)

Construction or upgrade services

Revenue and costs should be accounted in accordance with Ind AS 11. The consideration received or receivable is to be recognised at its fair value. The consideration may be rights to:

(a) a financial asset: Consideration to the extent that the operator has an unconditional contractual right to receive cash or another financial asset from or at the direction of the grantor to be recognised as financial asset; or

(b) an intangible asset: Consideration to the extent that the operator receives a right (a licence) to charge users of the public service to be recognised as intangible asset.

The amount due from or at the direction of the grantor is accounted for in accordance with Ind AS 109, *Financial Instruments,* at:

- amortised cost;
- fair value through other comprehensive income; or
- fair value through profit or loss.

For these two methods, Ind AS 109 requires interest calculated using the effective interest method to be recognised in profit or loss.

An entity is required to evaluate the conditions given in Ind AS 109 to identify whether the amount due from or at the direction of the grantor is to be accounted for at amortised cost, fair value through other comprehensive income or fair value through profit or loss. If the operator is paid for the construction services partly by a financial asset and partly by an intangible asset, each component is to be accounted separately. The consideration received or receivable for both components should be recognised initially at the fair value.

Operation services

The operator should account for revenue and costs relating to operation services in accordance with Ind AS 18. If the operator performs more than one service (i.e. construction or upgrade services and operation services) under a single contract or arrangement, consideration received or receivable shall be allocated by reference to the relative fair values of the services delivered, when the amounts are separately identifiable. The nature of the consideration determines its subsequent accounting treatment.

Example

Question: An operator enters into a contract to construct and operate a toll road which would cost ₹100 lakh. The fair value of the construction services provided is determined as ₹110 lakh. The total cash inflows over the entire life of the contract are expected to be ₹200 lakh, of which, ₹60 lakh is guaranteed by the grantor. The appropriate finance revenue to be recognised is in total ₹10 lakh over the entire life of the service concession arrangement, derived from applying the effective interest rate method in accordance with Ind AS 109. Make appropriate journal entries for both construction and operation phase.

Construction Phase

Revenue ₹110 Lakh Cost of construction ₹100 Lakh
Financial asset ₹60 Lakh Intangible asset110-60 = ₹50 Lakh
Finance revenue ₹10 Lakh

Journal entries

Financial asset Dr.60 lakh
Revenue Cr.60 lakh
(Recognition of revenue to be settled in cash)

Intangible asset Dr.50 lakh
Revenue Cr.50 lakh
(Recognition of cost related to construction)

Cost of construction Dr.100 lakh
Bank Cr.100 lakh
(Cost incurred related to construction)

Operational Phase

Finance Revenue ₹10 lakh
Revenue from operation ₹200 – 60 – 10 = 130 lakh

Journal entries

Financial asset Dr.10 lakh
Finance Revenue Cr.10 lakh
(Recognition of finance revenue)

Amortisation expense Dr.50 lakh
Intangible asset Cr.50 lakh
(Amortisation expense during operational phase)

Bank Dr.200 lakh
Revenue Cr.130 lakh
Financial asset Cr.70 lakh
(Recognition of revenue related to operational phase)

Total revenue over the life of the contract ₹250 lakh
Total cash inflows over the life of the contract ₹200 lakh
It is to be noted that the finance revenue is recognised using the effective interest rate method on the financial asset as well as revenue relating to the construction or subsequent upgrade phase and it is over and above the

Key Differences

Between Ind AS 11 and IAS 11	Between Ind AS 11 and existing AS 7
• No difference in accounting principles	• No difference in accounting principles except that Ind AS 11 requires the consideration to be measured at fair value. • Existing AS 7 scopes out 'Service Concession Arrangements'

Ind AS 18, *Revenue:* An Overview

Ind AS 18 prescribes accounting treatment of revenue arising from:

Sale of goods	Rendering of services	Use by others of entity assets yielding interest and royalties
Revenue from the sale of goods is to be recognised when: • the entity has transferred to buyer the significant risks and rewards of ownership of the goods; • the entity retains neither continuing managerial involvement to the degree usually associated with ownership nor effective control over goods sold; • the amount of revenue can be measured reliably; • it is probable that economic benefits associated with transaction will flow to entity; and • the costs incurred or to be incurred in respect of transaction can be measured reliably.	• Revenue from rendering of services is to be recognised on the basis of stage of completion of the transaction (POCM). • When services are performed by an indeterminate number of acts over a specified period of time, revenue is to be recognised on a straight-line basis over the specified period unless some other method better represents the stage of completion. • When the outcome of rendition of services cannot be estimated reliably, revenue is to be recognised only to the extent of the expenses recognised that are recoverable.	• Interest should be recognised using the effective interest method (as set out in Ind AS 109) • Royalties should be recognised on an accrual basis in accordance with the substance of the relevant agreement. Ind AS 18 does not deal with (a) measurement of interest charges; and (b) recognition and measurement of dividend These are dealt in by Ind AS 109, Financial Instruments.

Revenue should be measured at the fair value of the consideration received or receivable after considering trade discounts and volume rebates allowed by the entity.

Revenue includes only the gross inflows of economic benefits received and receivable by the entity on its own account. In an agency relationship, the amounts collected on behalf of the principal are not revenue. Only the amount of commission is revenue for the agent.

The appendixes of Ind AS 18 provide guidance for revenue recognition for various complex transactions.

Appendix A: Revenue - Barter Transactions Involving Advertising Services

This Appendix only applies to an exchange of dissimilar advertising services. An exchange of similar advertising services is not a transaction that generates revenue under Ind AS 18.

Revenue from a barter transaction involving advertising cannot be measured reliably at the fair value of advertising services received. However, a seller can reliably measure revenue at the fair value of the advertising services it provides in a barter transaction, on the basis of non-barter transactions that fulfill certain conditions specified in the appendix.

Appendix B: Customer Loyalty Programmes (CLPs)

- Addresses accounting by the entity that grants award credits to its customers.
- Award credits to be accounted for as a separately identifiable component of the sales transaction(s) in which they are granted (the 'initial sale').
- The fair value of the consideration to 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.
- The awards may be supplied by the entity itself or by a third party.

Awards supplied by the entity itself	Recognise revenue when award credits are redeemed and entity fulfills its obligations to supply awards.	
Awards supplied by the third party	**Consideration collected**	
	On behalf of the third party	**On its own account**
	Measure revenue as the net amount retained on its own account and recognise the revenue when the third party becomes obliged to supply the awards and entitled to receive consideration for doing so	Measure revenue as the gross consideration allocated to the award credits and recognise revenue when entity fulfills 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, the entity has onerous contracts and a liability should be recognised for the excess in accordance with Ind AS 37, Provisions, Contingent Liabilities and Contingent Assets.

Question:

A departmental store operates a customer loyalty programme. It grants programme members loyalty points when they spend a specified amount in fashion clothing. Programme members can redeem the points for further fashion clothing. The points have no expiry date. In one period, the entity grants 1000 points. Management estimates the fair value of fashion clothing for which each loyalty point can be redeemed as ₹1.25. Management expects only 80% of these points to be redeemed initially but revises it to 90% in year 2. 400 of the points have been redeemed in exchange for fashion clothing in year 1 and 410 points are redeemed in year 2. Calculate the amount of revenue that the entity recognises in year 1 and year 2.

Solution:

The fair value of each point is Re. 1, being the value of each loyalty point granted of ₹1.25 reduced to take into account points not expected to be redeemed ((800 points/1000 points) × ₹1.25 =Re 1).

Accordingly, management defers recognition of revenue of ₹1000.

Year 1

At the end of the first year, 400 of the points were redeemed i.e. half of those expected to be redeemed. The entity recognises revenue of (400 points/800 points) × ₹1000 =₹500.

Year 2

During the second year, 410 points are redeemed, bringing the total number redeemed to 400 + 410 = 810 points. The cumulative revenue that the entity recognises is (810 points/900 points) × ₹1000 = ₹900. The entity has recognised revenue of ₹500 in the first year, so it recognises Rs. 400 in the second year.

Appendix C: Transfers of Assets from Customers

This Appendix applies to the accounting where an entity receives items of property, plant and equipment (PPE) from its customers that must

be used to connect those customers to a network and provide them with ongoing access to a supply of goods or services (such as electricity, gas or water).

The entity should recognise the transferred asset (if the definition of an asset is met) as an item of PPE in accordance with recognition and measurement principles given in Ind AS 16 and measure its cost on initial recognition at its fair value in accordance with Ind AS 1.

For recognition of revenue from rendering of services (i.e. providing the customer with ongoing access to a supply of goods or services), the entity should identify the separately identifiable services included in the agreement.

Service identified	How is revenue recognised
Only one service	Recognise revenue when the service is performed in accordance with POCM.
More than one separately identifiable service	• Allocate fair value of the total consideration received or receivable to each service. • Apply the recognition criteria of Ind AS 18 to each service.
Ongoing service as part of the agreement	The period over which revenue should be recognised is determined by the terms of the agreement. 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.

If an entity receives a transfer of cash from a customer:
Assess whether the agreement is within the scope of this Appendix

↓Yes

Assess whether the constructed or acquired item of PPE meets the definition of an asset

↓Yes

- Recognise the item of PPE at its cost in accordance with Ind AS 16 and
- Recognise revenue in accordance with recognition principles given in Ind AS 18.

Differences between IAS 18 and Ind AS 18

IAS 18	Ind AS 18
Deals with recognition of dividend. Dividend is to be recognised when the shareholder's right to receive payment is established.	Does not deal with recognition of dividend. (Dealt by Ind AS 109, Financial Instruments)
Measurement of interest charges is given in IAS 18	Such measurement is given in Ind AS 109
IFRIC 15 provides guidance on how to determine whether an agreement for the construction of real estate is within the scope of IAS 11 or IAS 18 and, accordingly, when revenue from the construction should be recognised.	Ind AS 18 does not include appendix corresponding to IFRIC 15. For real estate developers, revenue should be accounted for in accordance with 'Guidance Note on Accounting for Real Estate Transactions (for entities to whom Ind AS is applicable)' issued by the ICAI. The Guidance Note recommends the accounting treatment by entities dealing in real estate as sellers or developers and requires recognition of revenue using the percentage of completion method in those real estate contracts which are in the nature of construction contracts.

Key Differences of Ind AS 18 from the Existing Indian GAAP
The key differences are given below.

Existing Indian GAAP – AS 9	Ind AS 18
Arrangement involving Financing Transaction	
No discounting of the inflow of cash or cash equivalents which are deferred, is required.	When the inflow of cash or cash equivalents is deferred (a financing transaction), the fair value of the consideration is determined by discounting all future receipts.
Linked Transactions	
Does not contain any guidance when two or more transactions are linked in such a way that the commercial effect cannot be understood without reference to the series of transactions as a whole.	The recognition criteria are applied to two or more transactions together if linked. For example an entity may sell goods and, at the same time, enter into a separate agreement to repurchase the goods at a later date, thus negating the substantive effect of the transaction. In such a case, the two transactions are dealt with together.
Sale of Goods	
Revenue from sale of goods is recognised when the seller has transferred the property in the goods to the buyer for a consideration, it is not unreasonable to expect ultimate collection and the seller retains no effective control of the goods transferred.	Ind AS 18 specifies 5 conditions which need to be satisfied to recognise revenue from sale of goods.
Multiple Element Arrangements/Contracts with Separately Identifiable Components (including Customer Loyalty Programmes)	
No specific guidance under AS 9. The ICAI issued "Technical Guide on Accounting Issues in the Retail Sector" in October 2012 which gives guidance on method of recognition of revenue in case of Customer Loyalty Programmes and Extended Warranties Offered by Retailers, both of which are multiple element arrangements.	Under Ind AS, it is necessary to apply the recognition criteria to the separately identifiable components of a single transaction in order to reflect the substance of the transaction. For example, when the selling price of a product includes an identifiable amount for subsequent servicing, that amount is deferred and recognised as revenue over the period during which the service is performed.
Barter Transactions involving Advertising Services	
No guidance under existing IGAAP. 'Guidance Note on Accounting by Dot-Com Companies' provides guidance on advertising barter transactions specific for the dot-com companies.	Appendix A to Ind AS 18 provides guidance for such transactions.
Transfers of Assets from Customers	
No specific guidance on accounting for transfers of items of PPE by entities that receive such transfers from their customers under existing IGAAP.	Appendix C to Ind AS 18 provides guidance for accounting for such transfers.

Concluding Remarks

MCA has provided a big relief to the companies which were required to prepare the financial statements under Ind AS by omitting Ind AS 115. MCA has not notified any future date for the applicability of Ind AS 115 and the companies will be applying provisions of Ind AS 11 and Ind AS 18 until further clarification about the applicability of Ind AS 115 is notified by MCA. We need to wait and watch whether the regulators are planning to implement Ind AS 115 together with the global roll-out of new revenue standard IFRS 15 or after the global roll-out.■

To be happy, we must not be too concerned with others. - Albert Camus