# Revenue Recognition Under Ind As 115: A Practical Guide for Modern Business

## SECTION 5: Detailed Judgements Involved in Each Step of Ind AS 115

Ind AS 115 is principle-based, not rule-based.

This means companies must apply **professional judgement** at many stages.

In real life, finance teams often spend more time interpreting contracts than passing entries.

This section explains the **key areas where judgement is required** and how organisations deal with them.

### 5.1 Judgements in Step 1: Identifying the Contract

Identifying a contract seems simple, but in practice, it can be tricky.

Many companies deal with verbal agreements, purchase orders, email approvals, and informal arrangements.

**Major judgements include:**

**1. Determining Enforceability**

Is the contract legally binding?

Some industries work on email confirmations or repeat purchase patterns.

**Example:**

A long-term distributor places orders every month without signing a fresh contract.

The company must decide whether this repeated arrangement forms an enforceable contract.

**2. Assessing Collectability**

Revenue can be recognised only when collection is "probable."

**Judgement needed:**

- Does the customer have good credit history?
- Is there financial stress?
- Are there past defaults?

**Example:**

Selling goods to a financially weak customer may require delayed revenue recognition until collectability is assured.

**3. Modifications and Change Orders**

Many contracts evolve over time.

**Example:**

In engineering or IT projects, customers add extra features mid-way.

Finance teams must decide whether it is:

- A **new contract**, or
- A **modification of the existing one**

This affects revenue timing.

### 5.2 Judgements in Step 2: Identifying Performance Obligations

Determining what is "distinct" can be highly subjective.

**Key judgement areas:**

**1. Bundled products**

Is the bundle one obligation or multiple?

**Example:**

Software + implementation + training + annual support.

Some companies treat them separately; others see them as an integrated solution.

**2. Customisation**

If the company significantly modifies the product for the customer, it may not be "distinct."

**Example:**

A software license that works only after custom coding → not distinct.

**3. Implicit promises**

Sometimes companies deliver more than what is written in the contract.

**Example:**

Free installation, free upgrades, free onboarding assistance.

These may become additional performance obligations depending on customer expectation.

### 5.3 Judgements in Step 3: Determining Transaction Price

The transaction price is rarely just the invoice amount.

Companies must estimate variable components and consider uncertainty.

**Areas requiring judgement:**

**1. Variable consideration**

**This includes:**

- Discounts
- Rebates
- Incentives

- Penalties
- Performance bonuses

Under Ind AS 115, companies must estimate these amounts **upfront.**

**2. Choosing the estimation method**

**Two methods are allowed:**

- Expected value method
- Most likely amount method

Companies must use the method that best predicts the final outcome.

**3. Significant financing component**

**If payment is:**

- Made far in advance, or
- Significantly deferred

...the company must adjust the transaction price for time value of money.

**Example:**

Customer pays ₹1 crore upfront for a service delivered over 4 years → financing component exists.

**4. Consideration payable to customers**

Cashbacks, vouchers, loyalty points, or dealer bonuses reduce the transaction price.

**Judgement:**

Estimating usage pattern and redemption rates.

**5.4 Judgements in Step 4: Allocation of Transaction Price**

When a contract has multiple performance obligations, allocation requires estimation.

**Key judgement areas:**

**1. Determining standalone selling prices**

If a company does not sell the goods/services separately, it must estimate the price.

**Methods include:**

- Adjusted market approach
- Cost-plus method
- Residual approach

**2. Discounts allocation**

**If the customer gets a bundled discount:**

- Should it be allocated equally?
- Or only to specific obligations?

**Example:**

Handset + service plan bundles often require detailed allocation based on relative standalone prices.

**3. Variable consideration allocation**

In some cases, variable consideration relates only to a specific performance obligation.

**Example:**

A performance bonus paid only for implementation work → allocate only to implementation, not to the software license.

**5.5 Judgements in Step 5: Recognising Revenue**

This step involves the highest level of judgement.

**1. Whether revenue is recognised over time or at a point in time**

**The core judgement is:**

**Does the customer receive benefit as work happens?**

Construction, AMC, and long-term IT projects usually recognise revenue over time.

Retail sales, hardware sales, and standalone products usually recognise at a point in time.

**2. Measuring progress**

**For over-time revenue, companies must measure progress using:**

- Cost-to-cost method
- Surveys of work completed
- Units produced or delivered
- Engineering assessments
- Milestone achievements

Choosing the right method requires significant judgement.

**3. Contract assets vs receivables**

If a company completes work but cannot bill yet, it creates a **contract asset,** not a receivable.

Judgement is needed to determine when billing rights arise.

**4. Customer acceptance**

In some cases, control transfers only when the customer approves the work.

**Example:**

A software customization project may be complete technically but cannot be recognised as revenue until customer acceptance testing is done.

**5. Handling contract modifications**

**If scope or price changes, the company must decide:**

- Does the modification create a new contract?
- Or is it part of the existing contract?

This affects revenue timing and allocation.

**Summary of Section 5**

Ind AS 115 requires companies to apply judgement at almost every step.

The standard provides the framework, but real-life application depends on a deep understanding of the contract, customer expectations, and business model.

**Finance teams must work closely with:**

- Sales
- Operations
- Legal
- Project managers
- Business analysts

...to ensure revenue is recognised correctly.


## SECTION 6 - Identifying Performance Obligations under Ind AS 115

One of the most important steps in the revenue recognition process is **identifying performance obligations.** This step decides when and how revenue will be recognized. In practice, many companies struggle with this because products and services are often bundled together, discounted, or dependent on each other.

Ind AS 115 requires entities to **identify each promise** made to the customer and determine whether it is a **distinct performance obligation.**

### 6.1 What Is a Performance Obligation?

**A performance obligation is:**

- A **promise** in a contract to transfer a good or service
- That is **distinct, meaning** the customer can benefit from it on its own or with other resources
- And is **separately identifiable** within the contract

**In simple terms:**

Each item or service the customer is paying for — if distinct — becomes a performance obligation.

### 6.2 When Is a Good or Service "Distinct"?

**Ind AS 115 provides a two-step test:**

**(A) Customer Can Benefit from the Good or Service**

**This means:**

- The item has standalone utility
- The customer could buy it separately
- Or use it with other items already owned

**Examples:**

- A mobile phone alone → distinct
- Installation service alone → distinct
- Spare parts sold separately → distinct

**(B) The Good or Service Is Separately Identifiable**

This means the item is **not heavily integrated** with other items.

**Indicators a good/service is not separately identifiable:**

- The seller provides a **significant integration service**
- Goods are **highly interdependent**
- One item significantly modifies/customizes another

**Example:**

A software license that needs heavy customization → **NOT distinct.**

A ready-made software plus simple installation → **distinct.**

### 6.3 Common Practical Scenarios in India

**1. Telecom Companies**

Bundle: Mobile handset + Data plan

- Handset → distinct
- Data plan → distinct
  Revenue is split between the handset and the plan.

**2. Construction and Real Estate**

**Contract for:**

- Base construction
- Interior work
- Custom design
- Maintenance

Often these are **integrated,** resulting in **one performance obligation,** unless clearly separable.

**3. Software Companies**

Licenses + Implementation + AMC

- License (distinct)
- Implementation (may or may not be distinct depending on level of customization)
- AMC (distinct)
  Each is assessed separately.

**4. Manufacturing**

Sale of machinery + installation

If installation is simple → separate obligations

If installation is complex and machinery cannot function without it → single obligation

### 6.4 Promises That Are NOT Performance Obligations

Not everything stated in a contract automatically becomes a performance obligation.

Examples:

- **Quality assurance** warranties (these are normal warranties, not separate obligations)
- **Marketing incentives** with no real value
- **Administrative tasks** (sending invoices, documentation)

These do not transfer value and therefore are not obligations.

**6.5 Combination of Goods/Services into One Obligation**

Sometimes goods/services must be combined.

Examples:

- EPC contracts
- Custom-built machinery
- Large building projects
- Software requiring deep customization

In these cases, the customer receives a single integrated output, so revenue is recognized using % completion or over time.

**6.6 Practical Challenges Companies Face**

1. Bundled Pricing

Indian companies often bundle goods without separate pricing.

Solution: allocate transaction price based on standalone selling price.

2. "Free" Items

Free maintenance, service visits, or accessories may actually be separate obligations.

They must be valued and part of revenue allocation.

3. Customization Level

The challenge is deciding whether customization is:

- Minor → Separate obligation
- Significant → Combined obligation

4. Multiple Contract Modifications

Changes in scope require re-evaluation of obligations each time.

**6.7 Documentation Required in Practice**

To apply Ind AS 115 correctly, auditors expect documentation such as:

- Contract analysis sheet
- List of promises
- Distinctness test (benefit + separable)
- Allocation basis
- Analysis of warranties
- Notes on integration/customization
- Internal approvals

This documentation helps defend the revenue treatment during audits.

**6.8 Summary**

Identifying performance obligations is the **foundation** of Ind AS 115.

It ensures that:

- Revenue is recognized at the correct time
- Bundled products are properly split
- Complex contracts are handled consistently
- Financial statements maintain integrity

## SECTION 7

Determining the Transaction Price

Once the performance obligations are identified, the next step under Ind AS 115 is to determine the **transaction price**—the amount of consideration the entity expects to receive in exchange for transferring goods or services.

In simple terms:

Transaction price is the total money (or value) the company expects from the customer.

But in reality, this amount is often not straightforward. Discounts, incentives, bonuses, penalties, financing components, and variable pricing make it more complex.

This section explains how entities determine the transaction price in practical situations.

**7.1 What Is the Transaction Price?**

The transaction price is the **expected consideration** an entity will receive, considering:

- Fixed amounts
- Variable amounts
- Non-cash consideration
- Significance of financing components
- Any consideration payable to customers

It reflects the actual economic substance of the transaction — not just the invoice amount.

**7.2 Components of Transaction Price**

1. Fixed Consideration

These are amounts clearly agreed upon in the contract.

**Examples:**

- Product sold at ₹1,00,000
- Fixed installation fee ₹10,000
- Subscription service at ₹2,000/month

Fixed consideration is straightforward and forms the base of the transaction price.

**2. Variable Consideration**

Many contracts include conditions that affect the final price.

**Variable consideration may include:**

- Volume discounts
- Early payment discounts
- Rebates
- Price incentives
- Performance bonuses
- Penalties for delays
- Sales returns
- Usage-based fees

Ind AS 115 requires companies to **estimate variable consideration upfront** using one of two methods:

**(A) Expected Value Method**

Suitable when the company has multiple contracts with similar customers.

**(B) Most Likely Amount Method**

Used when the outcome is binary (bonus achieved or not achieved).

**Example:**

A contractor will receive ₹5 lakhs bonus only if the project is completed before deadline.

Most likely amount method is used.

### 7.3 Constraint on Variable Consideration

Ind AS 115 is conservative with revenue.

Companies must include variable consideration in transaction price **only if it is highly probable that revenue will not reverse later.**

This is called the **"constraint" requirement.**

**Example:**

A company expects a bonus from a government contract but approval is uncertain.

Revenue is **NOT recognized** until probability becomes high.

### 7.4 Significant Financing Component

**Sometimes customers pay:**

- In advance (subscription fees, real estate booking)
- In arrears (deferred payment, EMI sale)

If timing provides a **significant financing benefit** to either party, interest must be separated from revenue

**Indicators of significant financing:**

- Long gap (generally more than 12 months)
- Price difference between cash and credit terms
- Customer benefit from deferring payment

**Not counted as financing:**

- Advance payments purely for security
- Short gaps (less than 12 months)
- Customer payments tied to progress milestones

### 7.5 Non-Cash Consideration

**Transaction price must include:**

- Goods given by the customer
- Services provided by the customer
- Barter transactions

**Example:**

A customer provides raw material instead of paying part of the fee.

Its **fair value** must be included in revenue.

### 7.6 Consideration Payable to Customers

Sometimes businesses pay customers to promote, sell, or buy their products.

**Example:**

- Credit notes
- Cashback
- Trade schemes
- Shelf-display fees paid to retailers

These payments are treated as **reduction of revenue,** not expenses, unless the payment is for a distinct service received from the customer.

### 7.7 Practical Industry Examples

**1. FMCG Industry**

**Companies give:**

- Trade discounts
- Volume rebates
- Schemes

This creates variable consideration.

Revenue recognized only after assessing "high probability" of no reversal.

**2. Telecom Industry**

Usage-based charges (data usage, SMS packs) require estimation of variable revenue.

Bonus data packs are treated as reduction of transaction price, not marketing expense.

**3. Real Estate**

Customers often pay in instalments over long periods.

This may create a **significant financing component.**

Revenue must be discounted using a financing rate.

**4. EPC/Construction**

**Contracts often include:**

- Performance bonuses
- Liquidated damages
  Both treated as variable consideration.

Entity must estimate whether bonuses will be earned or penalties will apply.

### 7.8 Practical Challenges Companies Face

**1. Estimating variable consideration accurately**

**Businesses often struggle due to:**

- Complex sales schemes
- Unpredictable customer behaviour
- Dependence on external approvals

**2. Separate accounting for financing components**

Many companies miss discounting long-term receivables.

**3. Assessing whether incentives are for customers or for a distinct service**

This is judgment-heavy.

**4. Documentation**

Auditors expect detailed working papers explaining calculations.

### 7.9 Summary

Determining the transaction price is one of the most judgmental areas under Ind AS 115.

**Companies must consider all components:**

- Fixed and variable pricing
- Rebates, bonuses, penalties
- Financing effects
- Non-cash consideration
  Customer payments


## Conclusion

Ind AS 115 has fundamentally changed the way companies look at revenue. It is no longer just about recording sales when an invoice is raised, or when cash is received. Instead, the standard requires businesses to understand their contracts, identify each promise made to the customer, and recognise revenue only when value is truly delivered.

For many companies, this shift has been challenging. It demands judgement, documentation, and coordination between finance, sales, procurement, and legal teams. Yet, it has also brought clarity, discipline, and consistency across industries. When applied correctly, Ind AS 115 ensures that financial statements reflect the real economics of a transaction, not just its paperwork.

From identifying performance obligations to estimating variable consideration, from determining transaction price to evaluating contract modifications, every step requires thoughtful analysis. In practice, the goal is simple:

**Revenue should represent the transfer of goods or services—not assumptions, not timing differences, and not outdated habits.**

Indian companies are gradually adopting a more structured approach to contracts, pricing, and delivery because of this standard. As a result, revenue recognition is becoming more transparent, comparable, and investor-friendly.

Ultimately, Ind AS 115 is not just an accounting rule—it is a framework that promotes fairness, accountability, and a deeper understanding of business performance. When implemented carefully, it strengthens trust between companies, auditors, regulators, and most importantly, the users of financial statements.

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