1660-100 Comment Letter No. 26

Comments to Discussion Paper - "Preliminary views on Revenue Recognition in ^agreement / Contracts with Customers "

Presented by

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1660-100 Comment Letter No. 2

Comments to Discussion Paper - "Preliminary views on Revenue Recognition in ^ agreement / Contracts with Customers "

At the outset this DP is an important effort in the history of Accounting and Commerce.

The Octopus type standards, interpretations / policy guidance, task force pronouncements, Bulletins, other nick names to the "Revenue Recognition" should now integrate to basic "Revenue-Cost Recognition".

For Business Valuation –since Revenue influences decision value, the point up-to which contract value can be pro-rated/ considered as Revenue and those costs which are obligated in a contract to be considered as cost craves for a firm accounting rule to minimize result distortions. It is agreed that every aspect of arrangement flows thro "Performance Obligation" but its measurement is fluid due to varied pulls / pressures in the contractual terms /practices. Ultimately the traditional wisdom of Revenue-Cost Recognition in the reporting period should prevail. Multiple pronouncements issued now should get into a handbook for all the line items in the credit side of Income statement and for its related Costs to portray the transaction and its results in lieu of the earlier guidance on Revenue / top line alone

Qn.1. Single principle of Revenue recognition based on contract asset / liability or Nil position

Yes Revenue has to be recognized based on Rights and Obligations fulfillment status - But the basic concepts (viz., period cut-off, Revenue-Cost matching, acceptance criteria, transfer of risks and ownership status, valuation or measurement, accruals etc) should be considered to reflect true and fair position. Besides the thrust on 'contract', 'Rights & Obligations' principle should align with respective terms on transfer of risks and ownership for each type of (a) goods – movable/ immovable (b) Services © combination thereof (d) business operational models in regard to rights such as right to use, franchise/license/subscription/renewal, legislation etc. To ensure completeness and fair reflection of economic activities of the enterprise, even in a no/nil Contract position the respective transaction's Revenue, Cost, asset, liability should get captured in financial statements and for operational results the emphasis should be on Rights & Obligations fulfillment status integration with Revenue-Cost matching concept.

Qn.2. Are there any contracts for which single principle of Revenue recognition based on contract asset / liability or Nil position proposed by the board would not hold good

As in Qn 1 the principle needs to be blended with basic concepts. Besides, Finance / Investment income, compensation claims, Contract of sale of 'PPE/ Fixed assets' may need a ref.

Qn.3. Do you agree with the term Contract defined here

No. Para 2.14 states that "a contract exists when an agreement between two or more parties creates enforceable obligations between those parties. Such an agreement does not need to be in writing to be considered a contract". Enforceable obligation for a transaction could not be deciphered without the contract being in writing especially when it occur over a period or remain incomplete. Practically each transaction gets negotiated on case-by-case basis and the distinction between deliverable phases, items delivered and values thereon is a challenge. Definition can be aligned to world trade practice or legislation. Even in service/e-business the basic documents such as — PO /MSA /Invoice /DC/email confirmation etc prevail

Qn.4. Performance Obligation fulfillment status and ability to identify components / deliverables in a contract

"Performance Obligation fulfillment status" for "Revenue Pro-ration" has to be viewed with reference to the discharge / completion of tasks by the Seller up to the point of transfer of risk & ownership and certainty in realization from the customer and should not get extended to the future right/ action by the customer. If the seller has executed all the present obligation in relation to the good / service and transfer of risk and ownership is complete, Revenue has to be reckoned in full disregarding the expected Sales Incentives/Promotional promises. Pro-ration / Deferral of Revenue towards meeting the future rights of the customer would be clumsy especially after the ownership is passed /terms of realization met. The secondary obligation if any arising out of future/ further actions from the customer has to be estimated and cost thereto has to be accrued to fulfill Revenue-Cost matching principle. In regard to 'customer right to return post purchase' such actions by customer is to be treated like sales returns by netting off against Sales as and when the good is received with accrual for replacement costs.

In a failed service, no revenue is reckoned when it fails to meet the acceptance criteria stipulated in the contract. To sum up, Non-reflection of full revenue even after cessation of ownership to goods /service under the pretext of sales incentives / customer right to return would lead to suppression of Income, associated costs and relevant taxes. Further, such definition of 'performance obligation' would be in conflict with tenets of legislation and 'substance over form'. Introduction / extension of the complexities of construction contract revenue recognition to other business transaction under the umbrella "contract/ performance obligation" would multiply ambiguities to trade/commerce and statutory authorities.

Qn.5. separate the performance obligations in a contract on the basis of when the entity transfers the promised assets to the customer? Why Ultimately in the commercial world, conclusiveness of a sale transaction is based on core activity of transfer of risk and ownership, flow of consideration and income measurement to be on the basis of reasonable certainty. Post sale service cost / other customer rights which have contingent costs are to be accrued to prevent timing difference between revenue and contractual / committed costs if any.

Qn.6. Entity's obligation to accept a returned good and refund the customer's consideration is a performance obligation or not?

It is a performance obligation but it occurs post conclusion of sale. As long as 'going concern' is in tact, the dividing line to reckon revenue is on conclusion of sale viz., 'transfer of risk and ownership'. The obligations cost which arise after this point of conclusiveness / arise out of the fresh action / customer right whose occurrence is contingent and as and when goods are returned would be effected in inventory, sales returns and replacement costs. In case of services, revenue to be reckoned based on acceptance criteria and where it is reckoned based on percentage of completion and when the service is finally failed the revenue reckoned earlier or job costs held in WIP would be fully absorbed.

Qn.7. sales incentives (eg discounts on future sales, customer loyalty points) give rise to performance obligations? Why or why not?

Ultimately in the commercial world, transaction is to be based on core activity of transfer of risk and ownership, consideration flow and income measurement to be on the basis of reasonable certainty.

Post sale service cost / other customer rights which have contingent costs are to be estimated and accrued to prevent timing difference between revenue and contractual / committed costs if any.

Qn.8. Do you agree that an entity transfers an asset to a customer (and satisfies a performance obligation) when the customer controls the promised good or when the customer receives the promised service? Why or why not? If not, please suggest an alternative for determining when a promised good or service is transferred.

Yes when a customer controls the good / receive the service, it is the conclusiveness of sale. The circumstance can be further explained in respect of movable properties, immovable properties, services, combination of goods & services and influencing factors viz., business models on right to use, franchise/license/subscription/renewal/extension, distribution channels, legislative requirements etc. to portray the reality. In a long term service contract / works contract it cannot be so easily translated and in many countries 'completed contract method' of revenue recognition is unacceptable and PoC method has to be adhered.

Qn.9. The boards propose that an entity should recognize revenue only when a performance obligation is satisfied. Are there contracts for which that proposal would not provide decision-useful information?

Yes 'satisfaction of performance obligation up to the point of conclusiveness of sale / transfer of risk and ownership'.

When a customer controls the good / receive the service, it is the conclusiveness of sale.

The basic concept of Revenue-Cost matching to be ensured for the reporting period to report true and fair view of Revenue, Cost, asset, liability.

Revenue Recognition principle should be implemented along with the Revenue Related cost accounting basics to enable a satisfactory financial statement

Solution Handbook on Accounting of Revenue & Cost of Revenue

In a country like India, every line item in Income Statement is subject to tax or to discretionary decision change by a legislation/govt. Stretching the deferral of revenue after the point of transfer of risk/ownership would be chaotic and would <u>suppress revenue</u>, <u>related cost and taxes</u>. Instead of narrowing this DP to Contract based Revenue Recognition alone, the initiative can be to establish a robust one stop solution handbook on "Revenue-Cost Recognition" by:

- a) Compilation of Revenue Recognition methods standardized / practiced / propagated / legislated across industry / countries and
- b) Compilation of accounting for Cost of goods mfrd or sold or serviced or Revenue Related Cost accounting methods standardized / practiced / propagated / legislated across industry / countries.

Based on a & b, a Solution Handbook on "Accounting of Revenue and Cost of Revenue" be compiled, as simultaneous guidance is needed to integrate revenue recognition & revenue related cost for a 'fair view'.