

Query No. 35

Subject: Revenue recognition policy for Online Testing and Assessment Services (OTAS) division of the company.¹

A. Facts of the Case

1. A company (hereinafter referred to as the ‘company’) is a ‘Mini Ratna’ public sector enterprise wholly owned under the administrative control of the Ministry of Human Resource Development (MHRD), Government of India. The company offers project management and consultancy services in the area of education and human resource development value chain addition within India and overseas.

2. The clients of the company include mostly state and central government department, public sector undertakings (PSUs) and autonomous bodies including IITs, IIMs, IIITs, Kendriya Vidyalaya and Navodaya Vidyalaya. The vision of the company is to be the most trusted project management and consultancy organization offering educational and human resource consultancy services. The company undertakes end-to-end projects on turnkey basis from concept to commissioning and ensures effective management of activities from identification of objectives through continuous monitoring leading to optimal fulfilment of targets within the stipulated time frame. The verticals of the company have leveraged expertise gained over three decades, strong alliances and commitment of dedicated teams to ensure a strong national and global presence for the company. These have strengthened the company’s core competency in all areas of education and human resource development. The company presently has strong verticals in the following areas:

(i) Online Testing and Assessment Services (OTAS)

Based on two decades of expertise in handling offline recruitment tests, the company switched over to offering online recruitment solutions to bring in higher transparency and efficiency. This is the biggest vertical of the company which has received overwhelming market response. The clients include central and state governments, large PSUs and autonomous bodies etc. The vertical organises online recruitment tests across multiple segments of employees covering varied sectors of the economy. Being a PSU, targeted towards meeting educational needs, the company focuses on organising online examinations for recruitment of teachers and principals as a specialised service.

(ii) Educational Infrastructure Services

Following key services are provided by the vertical covering educational infrastructure management (turnkey execution and project management consultancy) services:

- Concept Design
- Detailed Drawings
- Detailed Project Estimate with Bill of Material
- Construction Schedule /Procurement Plan
- Request for Proposal (RFP) documents
- RFP Process Management
- Project Construction Monitoring

¹ Opinion finalised by the Committee on 5.6.2018 and 6.6.2018.

- Incident Monitoring
- Modifications in Schedule
- Quality Assurance and Control
- Billing and Payments
- Getting Completion / Occupancy Certificates from Statutory Authorities
- Final Project Completion Report with Expense Analysis

(iii) Educational Procurement Services (Lab Equipment, Information technology (IT) products, Furniture etc.)

Leveraging three decades of experience in domestic and overseas sector, following key services are provided by the vertical as part of the procurement services focusing on maximizing TCO in educational and human resource development space:

- Educational product research
- Vendor empanelment
- Demand aggregation
- Development of sourcing strategy
- E-Tendering
- Bid analysis
- Finalisation of contract
- Order placement
- Monitoring receipt of shipment including quality check at client site
- Vendor payment management
- Monitoring Annual Maintenance Contract (AMC)/Warranty
- Monitoring client feedback.

(iv) Digital Education System

The company strongly believes that digitization will be a game changer in addressing of quality, quantity and governance needs in both school and higher education. The company accordingly focuses on all emerging areas of IT/Information and Communication Technologies (ICT) applications in the sector. Following key services are provided by the vertical as part of the digital education system:

- Wi-Fi and Network Solutions
- Enterprise Resource Planning (ERP) Implementation
- Digitisation of Records
- E-content Preparation
- Virtual Classrooms
- Smart Campuses
- Online Admission System
- Computer Labs

(v) Advisory Services

Following key services are offered by the advisory vertical in the education (school chains and higher education) and Human Resource (HR) advisory space:

- Preparation of Detailed Project Reports (DPRs) (Greenfield and Brown field)
- Organization Restructuring (sectoral /institutional)
- Improving Operational Efficiency
- Digitization Planning
- Training Designing
- Impact Assessment (ICT/other schemes)
- Designing of New Education Schemes
- Education Content Design

(vi) Overseas Education Services

Based on strong Ministry of External Affairs (MEA)/MHRD endorsement with in India, client confidence and alliances gained globally over three decades, the vertical executes sponsored and aggregated inbound overseas student admissions and faculty hiring and also effectively meets the individual needs of inbound students wanting to study in India. The vertical focuses on high potential target markets covering mostly South Asian Association for Regional Co-operation (SAARC), Middle East and African nations. The following services are specifically offered:

- Placement of overseas students in select Indian institutes (sponsored schemes as well as SFS segments)
- Placement of Indian faculty in overseas institutes
- Student/faculty exchanges
- All other project management and consulting services extended in domestic sector

(vii) TSG (Technical Support Group)

This is the company's project management and logistical support vertical (also known as Technical Support Group – TSG) to extend operational support to MHRD in implementing several mega pan-India projects. The services include:

- Logistical support to various large MHRD schemes
- Outsourcing of consultants etc.
- Event management support
- Procurement services
- Transportation support

3. The querist has further provided activity-wise details for its Online Testing & Assessment Services (OTAS) division as follows:

i) Preparation of business development letters for sending to new/old clients

- Preparation of business development letters for sending to new clients (central/state government departments, public sector undertakings, autonomous organisations and institutions of central and state Governments, etc.) detailing the modalities involved for successful conduct of computer based test / online examination.
- Fix-up the meeting with the clients for giving detailed presentation about the conduct of computer based test/examination.
- Oral or written request from the prospective client for conduct of computer based test / online examination
- Examine the requirement of client for conduct of computer based test /online examination and seek necessary details from the client for preparation of detailed proposal.
- On receipt of necessary clarification and information from client, the detailed proposal (scope of work, general approach & methodology of the company and client, scheme and syllabus, time schedule of exam, payment terms and other terms and conditions, etc.), along with cost estimate (based on the pricing policy of the company) / financial bid shall be prepared in line with the requirement of the client and submitted to the competent authority through finance department for necessary vetting and approval for submission to client.

ii) For award of project

- After submission of the proposal to the client, necessary follow-up shall be made.
- Additional clarification, if required by the client, shall be provided from time to time.
- If required by the client, negotiation meeting of the proposal wherever required, shall be arranged.
- Obtaining approval of competent authority on negotiated cost/proposal and submission to the client.
- Necessary follow-up with the client for award of project and issuance of LOA.

iii) Signing of Memorandum of understanding (MOU)/Agreement

- If required by the client, preparation of draft agreement/MOU in consultation with client.
- Vetting of agreement/MOU by legal cell and finance department of the company.
- Obtaining approval of agreement/MOU by competent authority and forwarding the same to client for approval and signing of the same.

iv) Formation of project implementation team

Issuance of office order by Head of Department (HOD), OTAS for formation of project implementation team (PIT) for smooth implementation of each project/assignment, keeping in view the pre-occupation of the existing manpower and value of the Project.

v) Release of advance by client

- Preparation and submission of performa invoice(s) to client along with RTGS details for the release of advance amount as per the terms of proposal / agreement / MOU.

- Coordination with PIT and the client for the release of advance funds for the execution of the project.
- Coordination with PIT and ensure submission of copies of proposal, award letter, agreement/MOU, etc. to finance department.

vi) Examination Related Activities

a) Pre-examination activities

- Provide the detailed advertisement to the service provider (XYZ) for design, development of software for acceptance of online applications.
- Provide the demo to the client for acceptance of prepared software; changes, if any, to get incorporated in the software.
- Hosting of software for acceptance of online applications on the specific date & time, liaison with XYZ and client(s).
- Ensure set up of help desk facility to clarify the query(ies) of prospective candidates while the online applications are being received.
- Compilation of applications data, bifurcation of data post-wise, common candidates-wise.
- Provide the application data to client.
- Co-ordination with service provider and client for conduct of computer based tests in number of centres / city(ies).
- Verification of roll numbers and capacity of centres for computer based test.
- Development of software for e-admit card in consultation with client and XYZ.
- Deputation of officials/appointment of observers in examination centres.
- Briefing meeting of the company's officials / observers.
- Uninterrupted communication with client and XYZ for smooth conduct of examination.
- Setting up of facilitation counter in city of examination to address the grievances of candidates related to e-admit cards.
- Liaison with XYZ and client for arrangements of local police personnel to handle any law and order situation in each centre of examination.

b) On the day of examination

- Set-up of control room in the company and supervision, operation and monitoring of all the examination centres. Monitoring to ensure decryption of the question papers at the specified time for each post.
- Conduct of online examination, ensuring physical security, data security, web surveillance, mobile phone jamming and bio-metric verification.

c) Post-examination activities

- Collection of raw data of examination completed from the service provider.
- Collection of content/question paper/answers from the service provider and providing link to the client for inviting objection management from the candidates.

- Re-verification of question paper & answer from the concerned subject expert after the examination and objection management, if required.
- Preparation /compilation of merit lists as per the advertisement, handing over the same to client in soft copies and hard copies (if required).
- Conduct of interviews / skill test, if required by client(s)
- Raising of invoice(s) for release of balance and final payment and receipt of funds from client. Sending of post examination material to client.
- Obtaining feedback from client.
- Filing of closure report.

4. During the financial year (F.Y.) 2015-16, the company introduced a new technology based on on-line examination product. XYZ Limited is a channel partner for the said business. Based on the experience gathered during the F.Y. 2015-16, the actual work completed for the online examination had been worked out and a detailed evaluation had been framed by the company during the year based on stage completion in accordance with Accounting Standard (AS) 9, 'Revenue Recognition' as under:

Stages	Particulars	Percentage of work completed
I	Pre-examination activity till the despatch of admit card	26%
II	Conduct of examination	71%
III	Declaration of result	3%
	Total	100%

As evident from above, there are three identifiable stages involved in the conduct of on-line examination. Based on this analysis, the company adopts revenue recognition policy for online testing and assessment vertical which is approved by its Board of Directors (BOD) also as under:

Stages	Particulars	Percentage of revenue to be recognized as per AS 9
I	Pre-examination activity till the dispatch of admit card	26%
II	Conduct of examination	71%
III	Declaration of result	3%
	Total	100%

5. Payment to XYZ Limited for conducting the examination is made in the following stages:

Stages	Particulars	Current Payment Terms with XYZ
I	Hall ticket Issuance	25%
II	Conduct of examination	50%
III	Result Publication	25%
	Total	100%

Payment terms as per agreement with one of the client of the company are as follows:

Stages	Payment Terms with Client
I	80% advance of the total project cost along with service tax at the time of award of project.
II	10% of the total project cost plus service tax after despatch of e-admit cards to the candidates.
III	Balance 10% of remaining total project cost plus service tax after conduct of examination and at the time of submission of results.

This is resulting in a gap for revenue recognition and expenditure booked as explained below:

Stages	Particulars	Current Payment Terms with XYZ	Current Revenue Policy approved by BOD	Lag
I	Hall Ticket Issuance	25%	26%	$(25-26)= 1\%$
II	Conduct of Examination	50%	71%	$(75-97)= 22\%$
III	Result Publication	25%	3%	$(100-100)= 0\%$

6. The querist has stated that payment terms are fixed via agreement according to which invoices are raised upon the company by XYZ Limited and revenue is being recognized according to the approved policy of board. But the percentages fixed are not in uniformity. To match the equation between the revenue and the associated cost, provisioning of expenses is required instead of merely booking as per the differential percentages. Accordingly, in stage I, since the revenue is being recognized at 26% and payment would be done 25%, to fill the gap of 1%, provision should be made for 1% less payment. Accordingly in stage 2nd, while making payment and booking cost of 50% of the total amount payable to vendor for the project, 21% of the amount payable to vendor for the project should be provisioned as expenses with the recognized revenue of 71% of contract value. And after conclusion of final, i.e., 3rd stage, while booking balance 3% of revenue, 3% of the total amount payable to vendor for the project should be booked as project expense and provision made in earlier stages ($1\%+21\%=22\%$) should be credited to Vendor Account and balance payment amounting 25% of the contract value should be released as per the terms of the agreement.

7. The querist has informed separately that the normal duration/time taken by the company for completing one cycle of online testing and assessment service (OTAS) division normally varies from 90-100 days wherein the first stage normally is receipt of purchase /work order from the client and the final stage is issue of merit list apart from receipt of payment from the client. Further, the querist has clarified that the other activities/cost involved e.g. administrative activities apart from the payment made to the channel partner are as follows:

- 1) **Pre-examination activities till the dispatch of admit card:** These activities by the company apart from activities performed by channel partner include inputs related to

recruitment rules and advertisement to the client as per the current government guidelines and rules and provide guidance to the technical team for various parameters such as categories, experience, etc. while designing and development of the application portal. The project team along with the technical team checks all the application parameters with respect to the categories, posts etc. to ensure an error free application portal. Checks are done to ensure that the admit cards have all the parameters as per the advertisement released earlier and the scheme of the examination. The admit cards are also checked at random to ensure that there is no mismatch in roll numbers, name, photos and other parameters and these are as per the details filled by the candidates. The company provides guidance on data finalisation and advises the technical team to remove the junk and duplicate applications. Accordingly, the major cost shall be related to channel partner only and the company's cost shall be limited to the administration cost.

- 2) **Conduct of examination:** It includes finalisation of the examination centres, examination days, examination shift in different cities after analysing the data and in consultation with the client. The company deposes around 15 full time manpower staff which is dedicated only for OTAS (Online testing and assessment services) division and ensures that proper question papers have been set as per the client's requirements by preparing necessary checklists. The company also hires external observers (which varies from project to project) for the conduct of examination and also almost all junior company staff visits different examination cities 02-03 days prior to examination date to check the centres as per checklist and ensure that no last-minute issues arise due to lack of any infrastructure or technology. The company opens facilitation counters manned by the company's employees at various centres to address queries that a candidate may have before the start of examination. The company's team supervises all the activities from the entry of the candidates, registration, photo, thumb impressions and during the conduct of examination at each centre to tackle any unseen issue that may come-up. Ensure encrypted delivery of question papers on the day of examination as well as check the decryption via password, either system generated or otherwise. Command centre is operated at the centralised level manned by the senior officials of the company for giving the necessary instructions and response to the queries. The records such as CCTV camera footage, biometrics and offline thumb impressions, hard-copies of online and offline attendance sheets, admit card copies with signature and photo taken on the date of examination, authorised signed and duly filled feedback forms are shared with the client. Objection management is done which takes care of any query, a candidate has regarding the question paper and answers. The objected questions are reviewed by subject matter experts and the merit list is prepared thereafter. The company's cost includes fixed manpower cost of dedicated team for OTAS division, manpower cost of senior executives and various other junior staff, hiring cost of observers, boarding and lodging cost of the company's observers and travelling cost etc. According to the querist, the same contributes around 20-25% of total cost of the project. In view of above discussion, 97% revenue has been booked up to this stage.

- 3) **Declaration of result:** At this stage, only nominal 3% portion is taken for the revenue booking because almost all the activities are completed in the examination phase itself.

The above discussed activities and costs by the company are significant as the overall responsibility of the entire project remains with the company. Further, the legal consequences, if any, in future shall also be on account of the company. Hence, these activities and cost are significant to complete any project under online testing and assessment service division.

B. Query

8. On the basis of the above, the querist has sought the opinion of the Expert Advisory Committee of the Institute of Chartered Accountants of India as to whether the revenue recognition policy and accounting treatment for booking of income and expense for online testing and assessment service division of the company is in accordance with applicable accounting standards and comply with the matching principle.

C. Points considered by the Committee

9. The Committee notes that the basic issue raised by the querist relates to accounting for costs and revenue relating to contracts of online testing and assessment service division of the company. Therefore, the Committee has considered only this issue and has not considered any other issue that may arise from the Facts of the Case, such as, accounting for costs and revenue in relation to other divisions of the company, accounting for the difference between the revenue recognised at any stage and the amount receivable as per the payment terms of the contract with the client, correctness of determination of various stages of completion of contract activities for recognition of revenue and the percentage of work completed upto that stage, what items of costs can be considered as contract costs, etc. Further, since AS 9 has been referred to in the Facts of the Case, the Committee has expressed its views, hereinafter in the context of Accounting Standards, notified under the Companies (Accounting Standards) Rules, 2006 and not in the context of Indian Accounting Standards (Ind ASs).

10. With regard to the issue raised, the Committee notes the following paragraphs of Accounting Standard (AS) 9, 'Revenue Recognition', notified under the Companies (Accounting Standards) Rules, 2006:

“7.1 Revenue from service transactions is usually recognised as the service is performed, either by the proportionate completion method or by the completed service contract method.

- (i) ***Proportionate completion method***—Performance consists of the execution of more than one act. Revenue is recognised proportionately by reference to the performance of each act. The revenue recognised under this method would be determined on the basis of contract value, associated costs, number of acts or other suitable basis. For practical purposes, when services are provided by an indeterminate number of acts over a specific period of time, revenue is recognised on a straight line basis over the specific period unless there is evidence that some other method better represents the pattern of performance.

- (ii) ***Completed service contract method***—Performance consists of the execution of a single act. Alternatively, services are performed in more than a single act, and the services yet to be performed are so significant in relation to the transaction taken as a whole that performance cannot be deemed to have been completed until the execution of those acts. The completed service contract method is relevant to these patterns of performance and accordingly revenue is recognised when the sole or final act takes place and the service becomes chargeable.”

“9.1 Recognition of revenue requires that revenue is measurable and that at the time of sale or the rendering of the service it would not be unreasonable to expect ultimate collection.”

“12. In a transaction involving the rendering of services, performance should be measured either under the completed service contract method or under the proportionate completion method, whichever relates the revenue to the work accomplished. Such performance should be regarded as being achieved when no significant uncertainty exists regarding the amount of the consideration that will be derived from rendering the service.”

“4.3 Proportionate completion method is a method of accounting which recognises revenue in the statement of profit and loss proportionately with the degree of completion of services under a contract.”

On the basis of above, the Committee notes that as per the requirements of AS 9, where the contract involves execution of more than one act, revenue should be recognised proportionately by reference to the performance of each act or degree of completion of services under the contract, which is commonly referred to as ‘proportionate completion method’. The Committee notes that the service contract in the extant case involves execution of many activities for which payment is receivable from time to time and is not dependent upon the execution of final act, viz., declaration of result. Moreover, since as per the querist, almost, all the activities are completed by the examination stage itself, which is an intermediate stage and not till the last stage (viz., declaration of result), the Committee is of the view that ‘completed service contract method’ should not be applied in the extant case. The Committee further notes that AS 9 does not give detailed guidance on application of proportionate completion method and accordingly, although Accounting Standard (AS) 7, ‘Construction Contracts’ is not applicable for the contracts of online testing and assessment service in the extant case, requirements/principles provided under AS 7 with reference to percentage of completion method which is also commonly known as proportionate completion method can still be applied in the extant case. Accordingly, the Committee notes the following requirements of AS 7:

“24. The recognition of revenue and expenses by reference to the stage of completion of a contract is often referred to as the percentage of completion method. Under this method, contract revenue is matched with the contract costs incurred in reaching the stage of completion, resulting in the reporting of revenue, expenses and profit which can be attributed to the proportion of work completed. This method provides useful information on the extent of contract activity and performance during a period.

25. Under the percentage of completion method, contract revenue is recognised as revenue in the statement of profit and loss in the accounting periods in which the work

is performed. Contract costs are usually recognised as an expense in the statement of profit and loss in the accounting periods in which the work to which they relate is performed. ...”

From the above, the Committee notes that under the percentage of completion method, revenue is recognised in the statement of profit and loss on the basis of stage of completion/work performed irrespective of the fact whether or not payment has been received or settled (provided other conditions of revenue recognition are also being fulfilled). Similarly, costs are also recognised in the statement of profit and loss of the period in which the work to which they relate are performed. Thus, both costs and revenue are recognised with reference to the work performed, i.e., stage of completion, which may be determined in a variety of ways, such as, surveys of work performed, completion of a physical proportion of the contract work, etc., depending on the nature of the contract and whichever method reliably measures the work performed. Payment terms with the client and that with the sub-contractor do not have any impact in determining stage of completion as it may not necessarily reflect the work performed. Thus, if the stage of completion of a contract is 26%, both costs and revenue should be recognised with reference to such stage irrespective of the payments made or becoming due to be made to the sub-contractors and amount collected or due to be collected from the clients. Accordingly, in the extant case, on reaching stage I, along with recognition of revenue of 26% corresponding to the stage of completion of the service contract, contract costs which are incurred in reaching 26% of stage of completion of the contract (which shall include the costs of activities performed by the company itself as well as by the service provider XYZ) should be recognised in the statement of profit and loss irrespective of the fact that a lesser percentage is to be paid as per the payment terms under the sub-contract. The difference as per the payment terms and the contract cost recognised will be provided/accounted for as contract payables. Similarly, for other stages of completion also, the costs and revenue should relate to the work performed/stage of completion.

11. Incidentally, the Committee wishes to mention that nature of individual contracts may vary; hence variations from contracts to contracts should also be factored into while determining the stage of completion, and revenue recognition from the contract. Thus, it is possible that even under the same vertical/division, (for example, for Online Testing and Assessment Services vertical) there are two different stages of completion and revenue recognition for two different types of contract considering the requirements of AS 7.

D. Opinion

12. On the basis of the above, the Committee is of the opinion that the revenue recognition policy and accounting treatment for booking of income and expense for online testing and assessment service division of the company should be with reference to the stage of completion of each act (depending on the nature of each contract). Payment terms with the client and that with the sub-contractor do not have any impact in determining stage of completion. Thus, if the stage of completion of a contract is 26%, both costs and revenue should be recognised with reference to such stage irrespective of the payments made or becoming due to be made to the sub-contractors and amount collected or due to be collected from the clients as discussed in paragraph 10 above. Accordingly, if the company is following the above accounting treatment, the same would be in accordance with the applicable accounting standards and comply with the matching principle.