

## **Query No. 16**

**Subject:** *Accounting treatment of assets funded by customers for its use in specific project.*<sup>1</sup>

### **A. Facts of the Case**

1. A Company (hereinafter referred to as ‘the Company’) is an Indian State owned aerospace and defence company, headquartered in Bangalore and is the largest public sector undertaking (PSU) under the Ministry of Defence in terms of value of production. The Company is engaged in the design, development, manufacture, repair, overhaul, upgrade and servicing of a wide range of products including aircrafts, helicopters, aero engines, avionics, accessories and aerospace structures.

2. The Company’s operations are managed by 5 (five) complexes, namely:

- (i) Bangalore complex
- (ii) MIG complex
- (iii) Helicopter complex
- (iv) Accessories complex and
- (v) Design complex,

The Company has 29 accounting units located across the country. The Company relies on indigenous research as well as enters into technology transfer and license agreement to manufacture various products.

3. The Company is under the administrative control of Ministry of Defence, Department of Defence Production. Manufacture of the Company’s products involves a substantial period of time and is subject to high precision and stringent quality control measures and inspection procedures.

4. The querist has stated that in terms of value of business, majority comes from the Indian Defence Services, i.e., Indian Air force, Indian Army, Indian Navy and Indian Coast Guard. Defence services place orders on the Company in the form of contracts for manufacture and supply of aircrafts, helicopters, aero engines, spares and LRUs for helicopter, aircraft and aero engines; and repair, service and overhaul of aircraft, helicopters, aero engines and LRUs.

*Accounting Treatment in the books of account:*

### **Accounting treatment on Transition to Ind AS**

5. As per the querist, apart from payment for supplies as per unit rate agreed in the contract, contract provides for funding for establishing infrastructure facilities inside the Company for effective management of production activities in line with customers requirement.

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<sup>1</sup> Opinion finalised by the Committee on 6.10.2021.

Accordingly, the Company has procured items of property, plant and equipment with funds given by the customer.

The Company has adopted Indian Accounting Standards (Ind AS) from the financial year (F.Y.) 2016-17 with April 1, 2015 as the transition date. On transition to Ind AS, the Company capitalised all assets created after 01.04.2016, with customer funding, by applying Appendix C 'Transfer of Assets from Customers' of the erstwhile Indian Accounting Standard (Ind AS) 18, 'Revenue'<sup>2</sup>.

Paragraph 20 of Appendix C of Ind AS 18, provided as follows:

“If an ongoing service is identified as part of the agreement, the period over which revenue shall be recognised for that service is generally determined by the terms of the agreement with the customer. If the agreement does not specify a period, the revenue shall be recognised over a period no longer than the useful life of the transferred asset used to provide the ongoing service.”

Based on the above conclusion, the items of property, plant and equipment were shown as 'Property, Plant and Equipment-Customer Funded' in the books of account of the Company. Depreciation was provided in the books as per Schedule II to the Companies Act, 2013, based on useful life of the assets. Revenue was recognised to the extent of depreciation provided on such assets.

#### **Accounting treatment on implementation of Ind AS 115 which is presently being followed**

6. Ind AS 115, 'Revenue from Contracts with Customers', became applicable to the Company from 01.04.2018. Subsequent to implementation of Ind AS 115 from 01.04.18, Ind AS 18 is withdrawn. Paragraphs 66-69 of Ind AS 115 deal with 'Non-Cash consideration'. Paragraph 69 of Ind AS 115 states as follows:

“If a customer contributes goods or services (for example, materials, equipment or labour) to facilitate an entity's fulfilment of the contract, the entity shall assess whether it obtains control of those contributed goods or services. If so, the entity shall account for the contributed goods or services as non-cash consideration received from the customer.”

In the present case, as the contract was entered into between the Company and the customer, the assets bought by the Company with the funds provided by the customer are to be used for fulfillment of the specific project for which the funds have been provided. Also, as per the querist, the Company has obtained control over the asset. Hence, the Company determines that the assets purchased will be considered as non-cash consideration and the accounting treatment as prescribed under non-cash consideration of Ind AS 115 will be applicable. The accounting treatment will vary based on the control aspect of the asset.

#### **Accounting treatment where the Company has obtained control over the assets funded by customer**

7. The assets funded by customers are capitalised and shown under property, plant and equipment along with the Company-funded assets. Depreciation is calculated for all these

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<sup>2</sup> Ind AS 18 has been substituted by Ind AS 115 vide Notification G.S.R. 310(E) dated 28<sup>th</sup> March, 2018.

assets. Further, revenue is recognised during the reporting period, to the extent of depreciation provided on such customer-funded assets. The advance received from customer towards purchase of the asset and outstanding in the books is adjusted to the trade receivable to the extent of depreciation recognised as revenue.

Thus, the funds given by the customer for purchase of assets for specific use for their project are recognised as revenue over the useful life of the assets.

**Accounting treatment where the Company has not obtained control over the assets funded by customer**

8. The expenditure incurred in respect of assets funded by the customer is not capitalised. Instead, the expenditure incurred on purchase of customer-funded assets is initially recognised in ‘Capital Work in Progress’ and on the completion of installation and commissioning of the asset, it is adjusted against advance received from customer for the purchase of the asset. Necessary disclosure is also made in notes to financial statements indicating that the property, plant and equipment of the Company does not include assets given by the customers for use of their jobs by the Company.

*Issue raised by the auditors:*

9. During the audit of the financial statements for the year ended 31<sup>st</sup> March 2020, the statutory auditor appointed by the Comptroller and Auditor General (C&AG) has raised an issue over the accounting treatment followed by the Company in the case of customer-funded assets where the Company obtains control over the assets as under:

In the contract with the Government Space Agency, Article VII reads as under.

“The Augmented facility for Cryogenic Engines and Semi-cryogenic Engines at the Company shall be the property of the DEPARTMENT located at the Company for long term utilization for the above program and other allied future programs of the DEPARTMENT.”

The Article is specific that the assets acquired out of the advance from the Government Space Agency, shall be the property of the Department and for long term utilisation of the programme mentioned in the agreement and other allied future programmes of the Department.

*Thus, the control expressly vests with the Government Space Agency.*

Therefore, reducing the amount received from the cost of the assets acquired and disclosure by a note in the financial statements that assets belonging to the customer are in the custody of the Company, is in order.

*However, the arrangement with the Ministry of Defence, Department of Defence Production is different.*

In the communication from the Ministry of Defence, Department of Defence Production, the Government approves setting up of facilities by the Company for specific projects/work at a pre-determined cost for which the funding is made available by the Government of India.

The communication granting the funds is for specific projects or orders and therefore, the assets acquired out of the funds given by the Ministry of Defence partakes the character of non-cash consideration.

It may be a fact that the facilities may be utilised by the company for further orders from the Department of Defence Production. The communication is not specific as to who controls the assets, but the advance is made for a specific project. As there is no specific mention that assets would be in the control of the Company, the Company cannot treat the assets as its own or having control by an assumption.

Assuming but not admitting, the Ministry of Defence does not exercise control over the assets, as the facilities are created for a specific order leads to a conclusion that the facilities created are for the purpose of executing the order and had the Company spent this amount on their own, the price charged would have been higher to the customer.

Since, the price is not loaded with the cost of the facilities created, the same amounts to a non-cash consideration which will have to be recognised as revenue over the number of articles to be manufactured under the Contract, even though the money is received from the Government.

- a. Ind AS 115 applies to all entities and all contracts with customers to provide goods or services in the ordinary course of business except for the specific exclusions as mentioned under Paragraph 5 (a) to (d) of Ind AS 115. Thus Ind AS 115 applies to a contract (other than a contract listed in the exceptions) only if the counter party to the contract is a customer.
- b. A customer is defined as a party that has contracted with an entity to obtain goods or services that are output of the entity's ordinary activities in exchange for consideration.
- c. As per Paragraph 69 of Ind AS 115, in such cases, where the contract is with a customer and a customer contributes goods or services to facilitate an entity's fulfilment of the contract, the entity shall assess whether it obtains control of these contributed goods or services. If so, the entity shall account for the contributed goods or services as non-cash consideration received from the customer.
- d. Further, as per Ind AS 20, 'Accounting for Government Grants and Disclosure of Government Assistance', Government grants are assistance by the government in the form of transfers of resources to an entity in return for past or future compliance with certain conditions relating to the operating activities of the entity. They exclude those forms of government assistance which cannot reasonably have a value placed upon them and transactions with government which cannot be distinguished from the normal trading transactions of the entity.
- e. The amount received from the Government (customer) is not a transfer of resources in return for past or future compliance with the conditions relating to operating activities of the entity, and therefore not a government grant.

- f. The contribution made by the Government (customer) to the Company in the form of funding for plant and machinery, etc. towards supply of products will be covered under Ind AS 115 and to be treated as non-cash consideration and not as government grant under Ind AS 20.

In the auditor's opinion, the accounting should be as under:

- a) The assets acquired out of funds should be treated as property, plant and equipment (PPE) and depreciation to be recognised based on the useful life and the residual value of the assets.
- b) The amount of funding receipt should be recognised as income over the number of production units specified in the agreement for extending the funding, even though the facilities may be available for use for any other purpose/order from the Government.
- c) Recognition of revenue equal to the amount of depreciation charged and adjustment of the advance against the trade receivable towards the revenue, so recognised, may not be the correct accounting, as the entire revenue will be recognised over the useful life of the assets, when the advance/funding is given for a specific order.

(Emphasis supplied by the querist.)

The auditor is of the opinion that since the assets purchased out of funds given by the customer are to be used only for the specific project of the customer, revenue should be recognised towards the value of non-cash consideration over the fulfilment of the project as and when the performance obligation is fulfilled for each unit of goods given to the customer and the present method of recognising revenue over period of the useful life of the assets at an amount equal to deprecation charged is not correct.

*Comments of the Company:*

10. The Company is of the view that although the assets purchased out of funds given by customer are to be used only for the specific project of the customer, these assets remain with and within the control of the entity even after the end of the project and the entity is at liberty to use these assets for other projects of the same defence customers till the end of the useful life of these assets. In view of the above, the entity recognises the revenue towards the customer-funded assets over the useful life of the assets equivalent to yearly depreciation for such asset.

## **B. Query**

11. In view of the above, the querist has sought the opinion of the Expert Advisory Committee on the following issues:

- (i) Whether the view taken by the Company that it has control over the assets since the Company is at liberty to use these assets for other projects of the same Defence customers till the end of the useful life of these assets is correct.
- (ii) Whether the present accounting treatment followed by the Company of recognising revenue towards non-cash consideration received in the form of assets, over the useful life of the asset, to the extent of depreciation provided on such assets is in line with Ind AS 115.

- (iii) If the answer to (i) above is in the negative, whether the Company should recognise the revenue towards non-cash consideration in the form of assets over the total duration of the project as and when performance obligation is fulfilled.

### C. Points considered by the Committee

12. The Committee notes that the basic issue raised by the querist relates to accounting for funds received from the customers (viz., Department of Space and Department of Defence Production, Ministry of Defence) for creation of manufacturing/infrastructure facilities which will be used for manufacturing/providing goods or services to the customer. The Committee has, therefore, considered only this issue and has not examined any other issue that may arise from the Facts of the Case, such as, depreciation accounting on property, plant and equipment (if any) recognised by the Company, recognition of revenue arising from goods/services other than that towards funds received from the Department of Space and Department of Defence Production, Ministry of Defence, accounting impact on transition to Ind AS by the Company, presentation of the funds received and spent on manufacturing/infrastructure facility in the financial statements of the Company, appropriateness of journal entries passed by the Company in respect of the above-mentioned transactions as separately supplied the querist, evaluation of the contracts with clauses for use of premises of the Company for facility or storage from Ind AS 116 perspective and accounting thereof, timing of transfer of control over facilities, etc. Further, the opinion expressed hereinafter is purely from accounting perspective and not from the perspective of legal interpretation of agreement with the customers of the Company or the Government/Ministry orders. Furthermore, the Committee has not examined (apart from those supplied by the querist) any other contract or agreement or communication as mentioned in the Contracts with the customers (for example, Article XII of the Contract with Department of Space states that “On signing of this MoU, a separate contract shall be entered into, between the Department and the Company for carrying out the Developmental, Learning and Series production of Engine Hardware to meet the Department’s requirements.”). The Committee presumes in the extant case that the Company is acting in the capacity of principal and not as an agent of the Department of Space or the Department of Defence Production, Ministry of Defence.

13. At the outset, the Committee notes the following relevant information from the Memorandum of Understanding between the Department of Space/ISRO (the ‘Department’) and the Company for setting up of Integrated Cryogenic Engines Manufacturing Facility (the ‘manufacturing facility’) at the Company dated 31<sup>st</sup> December 2013 (hereinafter referred to as the ‘Contract A’) and Communication from the Ministry of Defence, Department of Defence Production to the Company dated 13<sup>th</sup> August 2009 (hereinafter referred to as the ‘Contract B’) for establishment of facilities (‘infrastructure facility’) by the Company under license from the Country X Government for Repair & Overhaul of specific Aircraft and its Aggregates (together referred hereinafter as the ‘Contracts’):

- a. Apart from payment for supplies and other services as agreed in the contracts, the contracts provide for funding for establishing manufacturing/infrastructure facilities inside the Company for effective management of production activities in line with customers requirement.

Contract A is in respect of an integrated cryogenic engines manufacturing facility for producing cryogenic and semi-cryogenic engines. Article I of the contract states that necessary facilities would be set up/augmented at the Company which shall be funded by the Department on the *land belonging to the Company as per*

*financial arrangements to be worked out and mutually agreed to*, provided these are essential for processing the Engine realisation work at the Company. It also states that the Company shall be eligible for a specified % of facility cost as handling charges and a specified % profit on handling charges. As per Article IV of the Contract, the Company will be responsible for the procurement and commissioning of the machineries and setting up of facilities. Article V of Contract A further states that the Company agrees to make available in its premises adequate space for the establishment of necessary buildings and facilities. Whereas the Company will endeavor to meet the requirements of ISRO, ISRO on its part recognises that the Company is deploying its prime land for this project and will ensure enough Turnover.”

- b. Article VII of Contract A states that the augmented facility for Cryogenic Engines and Semi cryogenic Engines at the Company shall be the property of the Department located at the Company for long term utilisation for the above programme and other allied future programmes of the Department. Further, Article VIII states that the production of each type of engine would be spread over three phases – Development, Learning and Series Production.
- c. Contract B with the Ministry of Defence, Government of India, provides for reimbursement of total cost of project of establishment of facilities for repair and overhaul of specific aircrafts alongwith its aggregates, including cost of foreign supplies/support on DRE, cost of indigenous DRE, profit, cost of facilities creation, i.e., civil works, plant and machinery etc., storage space, etc. Further, it specifies that the freight and insurance will be reimbursed based on FPQ of respective Division of the Company and would be reimbursed separately. It also states that the non-recurring costs would be funded by the Government of India and that these costs will be reimbursed on incurrance by the Company alongwith a specified% profit thereon on submission of proof of payment. Further, all the recurring costs of material, labour and overheads and profits thereon will be paid. Moreover, all capital expenditure for civil works including storage space for liaison establishment and plant and machinery and services is also being reimbursed in two instalments at the beginning of each year by the Government/Ministry.

From the above, the Committee notes that the Company procured/created items of property, plant and equipment for establishing the facilities with the funds given by the Customer (viz., the Department of Space and Ministry of Defence). Since these facilities are funded by the customers as per the Contracts, The Committee notes the following requirements of Ind AS 115, ‘Revenue from Contracts with Customers’:

- “66 To determine the transaction price for contracts in which a customer promises consideration in a form other than cash, an entity shall measure the non-cash consideration (or promise of non-cash consideration) at fair value.”
- “69 If a customer contributes goods or services (for example, materials, equipment or labour) to facilitate an entity’s fulfilment of the contract, the entity shall assess whether it obtains control of those contributed goods or services. If so, the entity shall account for the contributed goods or services as non-cash consideration received from the customer.”

The Committee notes that the above requirements are in respect of goods or services (non-cash items) received from the customer whereas in the extant case, fund/cash has been received for creation of above-mentioned facilities; however, the Committee is of the view that these requirements can still be applied in respect of funds/cash received from customer for creation/acquisition of a specific asset (property, plant and equipment), which is to be used for providing goods or services to customers. The Committee further notes that in order to apply the above-reproduced requirements in respect of non-cash consideration, it needs to be assessed whether the Company obtains ‘control’ of the assets acquired out of customer’s funds. Further, with respect to the meaning of the term ‘control’, the Committee notes paragraphs 33 and 38 of Ind AS 115, ‘Revenue from Contracts with Customers’ and paragraph BC 120 of Basis for Conclusions to IFRS 15 (which lays down requirements similar to Ind AS 115), issued by the International Accounting Standards Board (IASB) as follows:

“33 Goods and services are assets, even if only momentarily, when they are received and used (as in the case of many services). Control of an asset refers to the ability to direct the use of, and obtain substantially all of the remaining benefits from, the asset. Control includes the ability to prevent other entities from directing the use of, and obtaining the benefits from, an asset. The benefits of an asset are the potential cash flows (inflows or savings in outflows) that can be obtained directly or indirectly in many ways, such as by:

- (a) using the asset to produce goods or provide services (including public services);
- (b) using the asset to enhance the value of other assets;
- (c) using the asset to settle liabilities or reduce expenses;
- (d) selling or exchanging the asset;
- (e) pledging the asset to secure a loan; and
- (f) holding the asset.”

“38 If a performance obligation is not satisfied over time in accordance with paragraphs 35–37, an entity satisfies the performance obligation at a point in time. To determine the point in time at which a customer obtains control of a promised asset and the entity satisfies a performance obligation, the entity shall consider the requirements for control in paragraphs 31–34. In addition, an entity shall consider indicators of the transfer of control, which include, but are not limited to, the following:

- (a) The entity has a present right to payment for the asset—if a customer is presently obliged to pay for an asset, then that may indicate that the customer has obtained the ability to direct the use of, and obtain substantially all of the remaining benefits from, the asset in exchange.
- (b) The customer has legal title to the asset—legal title may indicate which party to a contract has the ability to direct the use of, and obtain substantially all of the remaining benefits from, an asset or to restrict the access of other entities to those benefits. Therefore, the transfer of legal title of an asset may indicate that the customer has obtained control of the asset. If an entity retains legal title solely as protection against the customer’s failure to pay, those rights of the entity would not preclude the customer from obtaining control of an asset.

- (c) The entity has transferred physical possession of the asset—the customer’s physical possession of an asset may indicate that the customer has the ability to direct the use of, and obtain substantially all of the remaining benefits from, the asset or to restrict the access of other entities to those benefits. However, physical possession may not coincide with control of an asset. For example, in some repurchase agreements and in some consignment arrangements, a customer or consignee may have physical possession of an asset that the entity controls. Conversely, in some bill-and-hold arrangements, the entity may have physical possession of an asset that the customer controls. Paragraphs B64–B76, B77–B78 and B79–B82 provide guidance on accounting for repurchase agreements, consignment arrangements and bill-and-hold arrangements, respectively.
- (d) The customer has the significant risks and rewards of ownership of the asset—the transfer of the significant risks and rewards of ownership of an asset to the customer may indicate that the customer has obtained the ability to direct the use of, and obtain substantially all of the remaining benefits from, the asset. However, when evaluating the risks and rewards of ownership of a promised asset, an entity shall exclude any risks that give rise to a separate performance obligation in addition to the performance obligation to transfer the asset. For example, an entity may have transferred control of an asset to a customer but not yet satisfied an additional performance obligation to provide maintenance services related to the transferred asset.
- (e) The customer has accepted the asset—the customer’s acceptance of an asset may indicate that it has obtained the ability to direct the use of, and obtain substantially all of the remaining benefits from, the asset. To evaluate the effect of a contractual customer acceptance clause on when control of an asset is transferred, an entity shall consider the guidance in paragraphs B83–B86.”

**“Developing the notion of control**

BC120 The boards’ description of control is based on the meaning of control in the definitions of an asset in the boards' respective conceptual frameworks. Thus, the boards determined that control of a promised good or service (ie an asset) is the customer's ability to direct the use of, and obtain substantially all of the remaining benefits from, the asset. The components that make up the description of control are explained as follows:

- (a) ability—a customer must have the present right to direct the use of, and obtain substantially all of the remaining benefits from, an asset for an entity to recognise revenue. For example, in a contract that requires a manufacturer to produce an asset for a particular customer, it might be clear that the customer will ultimately have the right to direct the use of, and obtain substantially all of the remaining benefits from, the asset. However, the entity should not recognise revenue until the customer has

actually obtained that right (which, depending on the contract, might occur during production or afterwards).

- (b) direct the use of—a customer’s ability to direct the use of an asset refers to the customer's right to deploy that asset in its activities, to allow another entity to deploy that asset in its activities, or to restrict another entity from deploying that asset.
- (c) obtain the benefits from—the customer must have the ability to obtain substantially all of the remaining benefits from an asset for the customer to obtain control of it. Conceptually, the benefits from a good or service are potential cash flows (either an increase in cash inflows or a decrease in cash outflows). A customer can obtain the benefits directly or indirectly in many ways, such as by using, consuming, disposing of, selling, exchanging, pledging or holding an asset.”

From the above, the Committee notes that paragraph 33 of Ind AS 115 states that control of an asset refers to the ability to direct the use of, and obtain substantially all of the remaining benefits from, the asset. Control includes the ability to prevent other entities from directing the use of, and obtaining the benefits from, an asset.

In this context, the Committee notes that the Article VII of Contract A is specific that the assets acquired out of the advance from the Government Space Agency, shall be the property of the Department and for long term utilisation of the programme mentioned in the agreement and other allied future programmes of the Department.

The funding for the facilities as per Contract B is for the specific project. Thus, use of the facilities is apparently strictly as per the Contract. The querist has also mentioned that the Company is at liberty to use these assets for other projects of the *same* defence customers till the end of the useful life of these assets. Therefore, manufacturing/infrastructure facilities, apparently, cannot be utilised by the Company for further orders other than from the Customer as per the Contract. In other words, the facilities can be used for specific purpose for specific customer only. The Company cannot deploy the assets (facilities) in its activities or use/deal with the asset as it pleases e.g. cannot sell/exchange, pledge etc. and accordingly, does not have the right to direct the use of the asset. Further, the Committee notes that the Company is not only reimbursed the entire cost but also a profit margin for creation of such asset, which also indicates that the asset is being constructed for the Customer only.

Further, the Committee notes that as per paragraph 38 of Ind AS 115, to determine the point in time at which a customer obtains control of a promised asset and the entity satisfies a performance obligation, the entity shall consider indicators of the transfer of control, which include, but are not limited to, the following:

- (a) **The entity has a present right to payment for the asset** – The facilities are funded by the customers as per the contracts and hence, the Company has the right to payment for establishment of the facilities as per the contracts.
- (b) **The customer has legal title to the asset** – As per Contract A, the property of the facility is with the Department. However, Contract B is silent on this aspect.

- (c) **The entity has transferred physical possession of the asset** – Although, the facilities are established/set up on the land/premises of the Company as per the specifications and terms of the contracts, the facilities are specifically used only for the orders placed by the customers as per the contracts. Further, although both the contracts explicitly require the facilities to be in the physical possession of the Company, they take into consideration storage/custodial services provided by the Company. In Contract B, one of the price components relates to storage. From this, it appears that these facilities are held by the Company on behalf of its customers and the Company is providing custodial services for these facilities.
- (d) **The customer has the significant risks and rewards of ownership of the asset** – In this regard, the Committee notes that Contract A states that, “Whereas the company shall be responsible to maintain the facilities in operational condition, the Department recognises that the Company needs to be compensated suitably for maintaining these exclusive facilities, which will be mutually discussed and agreed to”. It implies that the asset is being maintained by the Company on behalf of the Department of space, viz., customer. Further, the Contract B specifically mentions about reimbursement of insurance costs as per the terms agreed, which indicates that the risk under insurance cover is being borne by the customer.
- (e) **The customer has accepted the asset** – The facilities are established or set up as per the specifications and terms of the Department /customer under the contracts.

From the above, the Committee is of the view that the Company in the extant case has transferred ‘control’ over the manufacturing/infrastructure facilities created out of the customer’s funds to the customer and the Company does not possess control over such facilities. Therefore, the facilities cannot be considered and accounted for as non-cash consideration received from the customer and should also not be recognised as property, plant and equipment by the Company.

14. As regards the recognition of revenue from the funds received in the extant case, the Committee notes the following requirements of Ind AS 115:

“22 **At contract inception, an entity shall assess the goods or services promised in a contract with a customer and shall identify as a performance obligation each promise to transfer to the customer either:**

- (a) **a good or service (or a bundle of goods or services) that is distinct; or**
- (b) **a series of distinct goods or services that are substantially the same and that have the same pattern of transfer to the customer (see paragraph 23).”**

“27 A good or service that is promised to a customer is distinct if both of the following criteria are met:

- (a) the customer can benefit from the good or service either on its own or together with other resources that are readily available to the customer (ie the good or service is capable of being distinct); and
- (b) the entity’s promise to transfer the good or service to the customer is separately identifiable from other promises in the contract (ie the

promise to transfer the good or service is distinct within the context of the contract).

- 28 A customer can benefit from a good or service in accordance with paragraph 27(a) if the good or service could be used, consumed, sold for an amount that is greater than scrap value or otherwise held in a way that generates economic benefits. For some goods or services, a customer may be able to benefit from a good or service on its own. For other goods or services, a customer may be able to benefit from the good or service only in conjunction with other readily available resources. A readily available resource is a good or service that is sold separately (by the entity or another entity) or a resource that the customer has already obtained from the entity (including goods or services that the entity will have already transferred to the customer under the contract) or from other transactions or events. Various factors may provide evidence that the customer can benefit from a good or service either on its own or in conjunction with other readily available resources. For example, the fact that the entity regularly sells a good or service separately would indicate that a customer can benefit from the good or service on its own or with other readily available resources.
- 29 In assessing whether an entity's promises to transfer goods or services to the customer are separately identifiable in accordance with paragraph 27(b), the objective is to determine whether the nature of the promise, within the context of the contract, is to transfer each of those goods or services individually or, instead, to transfer a combined item or items to which the promised goods or services are inputs. Factors that indicate that two or more promises to transfer goods or services to a customer are not separately identifiable include, but are not limited to, the following:
- (a) the entity provides a significant service of integrating the goods or services with other goods or services promised in the contract into a bundle of goods or services that represent the combined output or outputs for which the customer has contracted. In other words, the entity is using the goods or services as inputs to produce or deliver the combined output or outputs specified by the customer. A combined output or outputs might include more than one phase, element or unit.
  - (b) one or more of the goods or services significantly modifies or customises, or are significantly modified or customised by, one or more of the other goods or services promised in the contract.
  - (c) the goods or services are highly interdependent or highly interrelated. In other words, each of the goods or services is significantly affected by one or more of the other goods or services in the contract. For example, in some cases, two or more goods or services are significantly affected by each other because the entity would not be able to fulfil its promise by transferring each of the goods or services independently."

**“Satisfaction of performance obligations**

- 31 **An entity shall recognise revenue when (or as) the entity satisfies a performance obligation by transferring a promised good or service (ie an**

**asset) to a customer. An asset is transferred when (or as) the customer obtains control of that asset.**

32 For each performance obligation identified in accordance with paragraphs 22–30, an entity shall determine at contract inception whether it satisfies the performance obligation over time (in accordance with paragraphs 35–37) or satisfies the performance obligation at a point in time (in accordance with paragraph 38). If an entity does not satisfy a performance obligation over time, the performance obligation is satisfied at a point in time.”

**“46 When (or as) a performance obligation is satisfied, an entity shall recognise as revenue the amount of the transaction price (which excludes estimates of variable consideration that are constrained in accordance with paragraphs 56–58) that is allocated to that performance obligation.”**

The Committee notes from the above that in the extant case, the Company should assess the goods or services promised in the contract with customer and should identify as its performance obligations each promise to transfer a distinct good or service. Accordingly, in the extant case, the Company should evaluate whether the manufacturing/infrastructure facility created out of the funds received from the customer in the extant case is a distinct good or service considering whether the Company’s promise to create facilities for the customer is separately identifiable from other promises in the contract, for example, providing goods or services to the customer using the manufacturing facility. Further, after identifying the performance obligations, the Company should determine whether it satisfies the performance obligation over time or satisfies the performance obligation at a point in time, and accordingly, recognise revenue in accordance with the above-reproduced requirements of Ind AS 115.

In the extant case, the Committee is of the view that manufacturing/infrastructure facility is a distinct good as it is not dependent on other goods or services to be provided and has an economic value separate from other goods or services in the contract with the customers. Therefore, in accordance with the requirements of Ind AS 115, reproduced above, revenue in respect of such performance obligation (viz., promise to transfer the manufacturing/infrastructure facility) should be recognised when (or as) the Company satisfies a performance obligation by transferring the promised good (ie an asset) to the customer. Further, in this regard, the Committee wishes to point out that the expenditure incurred by the Company on creation of facilities should not be recognised as ‘Capital work-in-progress (CWIP)’.

#### **D. Opinion**

15. On the basis of above, the Committee is of the following opinion on the issues raised in paragraph 11 above:

- (i) The view taken by the Company that it has control over the assets is not correct, as discussed in paragraphs 13 and 14 above.
- (ii) The present accounting treatment followed by the Company of recognising revenue towards the consideration received in the form of assets, over the useful life of the asset, to the extent of depreciation provided on such assets is not correct.

- (iii) The revenue in respect of funds received from the customer for the manufacturing facility should be recognised as or when the control over manufacturing facility is transferred to the customer as per the requirements of Ind AS 115, as discussed in paragraph 14 above.

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