

Query No. 46

Subject: Revenue recognition from Contracts with Customers under Ind AS 115.¹

A. Facts of the Case

1. A company (hereinafter referred to as ‘the Company’) is a public limited company owned by the Government of India and is one of the leading shipyards in India. The Company is a ‘Miniratna’, Schedule A, Category I Central Public Sector Enterprise (CPSE) incorporated and domiciled in India.

The Company is engaged in mainly two activities:

- Ship building – Construction of defence, commercial and offshore vessels;
- Ship repair - Repairs and refits of vessels including upgradation of ships, periodical layup repairs and life extension of ships.

2. Ship Building

a. Types of vessels

The Company is engaged in the construction of various categories of vessels/ships like defence ships, tankers, bulk carriers, passenger vessels, bollard pulls tugs, etc. Each of these vessels is meant for different uses for different sectors. The ships/vessels are constructed against specific orders from the ship owners and are custom made to suit the requirements of the ship owners.

b. Ship Building Process

The whole process of ship building can be broadly categorised as:

(i) Hull Construction

The hull is the notable structure of the ship. Hull is defined as the watertight enclosure of the ship which protects the cargo, machinery and accommodation spaces of the ship from the weather, flooding and structural damage. The construction of the hull is carried out at the dock and involves various processes like block fabrication, sub-assembly, hull erection etc.

(ii) Outfitting

Outfitting of a ship involves fitting-out of pipes, cables, bought-out components like main engines, Diesel Generator (DG) sets, accommodation, heating, ventilation and air conditioning (HVAC), etc. This stage follows the float-out/launching i.e. transfer of vessel from land to water and precedes sea trials. It is the period when all the remaining construction of the ship is completed and readied for delivery to owners.

(iii) Sea Trials

¹ Opinion finalised by the Committee on 17.1.2024.

A sea trial is the testing phase of a vessel. It is usually the last phase of construction and takes place on open water; and it can last from a few hours to many days. Sea trials are conducted to measure a vessel's performance and general seaworthiness. Testing of a vessel's speed, maneuverability, equipment and safety features are usually conducted. Usually in attendance are technical representatives from the builder (and from builders of major systems), governing and certification officials and representatives of the owners. Successful sea trials subsequently lead to a vessel's certification for commissioning, delivery and acceptance by its owner.

Although, the construction processes across all vessels are broadly similar, they vary in intricacies/technicalities involved in the construction of Hull and Outfitting for different types of vessels. (Emphasis supplied by the querist.)

(iv) Cost structure

The cost incurred in the construction of a ship is spread across the aforesaid processes. However, the level of complexities involved in each of these processes differs for different types of vessels and accordingly the proportion of total cost incurred varies across the processes for different categories of vessels/ships.

The components of total cost in ship building are:

- (i) Material costs
- (ii) Sub-contract costs
- (iii) Direct expenses
- (iv) Direct labour
- (v) Overheads

Being made to specification products, designed and constructed to the specific requirements of customers ranging from Indian Navy and Dredging Corporation of India (defence vessels and dredgers) to foreign owners for highly sophisticated vessels operating in different sectors (i.e. cargo, offshore wind industry, etc.), the proportion of the cost components varies across the projects. The contract price of the major vessels ranges from Rs. 500 to Rs. 2000 crores and the material component in each category differs widely from 60% - 85%. And the types of materials also vary.

The cost of conversion per tonne of the vessel varies from project to project depending on the intricacies of the work involved. Similarly, the total conversion cost also varies depending upon the modifications that crops up as the design progresses as many of these vessels being constructed are the first of its kind.

(v) Period of construction and consideration

The period of completion of projects range between 2-8 years. Single project may comprise of multiple vessels depending upon the contracts with the owner.

The consideration for the ship building contracts are received based on the milestones achieved over the progress of the vessels. In the case of Naval vessels, there would be more than 10 stages of construction milestones for stage receipts

whereas for the other contracts, 3-5 stage payments based on the construction progress of the vessels are being received.

3. Ship Repair

On the ship repair front, the Company undertakes the maintenance and repairs of all kinds of defence, commercial and specialised vessels including aircraft carriers, tankers and bulk carriers.

4. *Accounting policies of the Company related to revenue recognition from contracts with customers of ship building*

Prior to introduction of Ind AS 115, the income from ship building was recognised on percentage of completion method, in the proportion of the cost incurred for the work performed up to the reporting date to the estimated total contract cost (financial progress), considering the physical progress or financial progress, whichever is lower. Where current estimates of total contract costs and revenue indicate a loss, provision was made for the entire loss, irrespective of the amount of work done. When the percentage of physical completion was less than the financial completion, the cost proportionate to excess of percentage of financial completion over physical completion was treated as 'Work in progress'.

Effective April 1, 2018, the Company has adopted Ind AS 115, 'Revenue from Contracts with Customers'. In respect of contracts that were not completed on the date of initial application (April 1, 2018), the Company has applied the Standard retrospectively by recognising the cumulative effect of applying the same at the effective date, as an adjustment to the opening balance of retained earnings and accordingly figures for earlier years have not been retrospectively adjusted.

- (i) Revenue from contracts with customers is measured based on transaction price, which is the fair value of consideration received or receivable. Revenue is recognised when the Company satisfies performance obligations by transferring promised goods and services to the customer over a period of time using output method based on measurement of physical performance completed to date in respect of contracts with customers for ship building.
- (ii) Recognition of revenue for a performance obligation satisfied over time, is made only if the Company can reasonably measure its progress towards complete satisfaction of the performance obligation.
- (iii) The Company exercises significant judgement in measuring progress of performance obligations satisfied over time for recognition of revenue from contracts with customers by involving the technical expertise to determine the percentage of physical progress of completion for each and every ship in both the segments.
- (iv) Based on the technical assessment considering the latest available information to the Company, the progress measured towards complete satisfaction of a performance obligation in the method adopted is revised/updated on an ongoing basis.

- (v) During the initial stages of a contract, where the Company may not be able to reasonably measure the outcome of a performance obligation and the Company expects to recover the costs incurred in satisfying the performance obligation, revenue is recognised only to the extent of the costs incurred until such time that it can reasonably measure the outcome of the performance obligation.
- (vi) Contract modifications are accounted when additions, deletions or changes are approved either to the contract scope or contract price. The accounting for modifications of contracts involves assessing whether the services added to an existing contract are distinct and whether the pricing is at the standalone selling price. Where the goods or services added are not distinct, adjustment to revenue is made on a cumulative catch up basis. Where the goods or services added are distinct, and such additional goods or services are priced at standalone selling prices, the contract modification is accounted for as a separate contract; whereas if the modification is not priced at standalone selling price, the same is accounted as a termination of the existing contract and creation of a new contract.
- (vii) If the consideration promised in a contract includes variable amounts like discounts, rebates, refunds, credits, price concessions, liquidated damages or other similar items, the Company estimates the net amount of consideration to which the Company is entitled in exchange for transferring the promised goods or services to a customer and accounts for the same.

5. *Methodology adopted by the Company for revenue recognition:*

- (a) As per paragraph 32 of Ind AS 115, the Company determines at the inception of each ship building contract whether it satisfies the performance obligations over time in accordance with paragraphs 35-37. *Paragraph 35 of Ind AS 115 states the following:*

“35 An entity transfers control of a good or service over time and, therefore, satisfies a performance obligation and recognises revenue over time, if one of the following criteria is met:

- (a) the customer simultaneously receives and consumes the benefits provided by the entity’s performance as the entity performs (see paragraphs B3–B4);
- (b) the entity’s performance creates or enhances an asset (for example, work in progress) that the customer controls as the asset is created or enhanced (see paragraph B5); or
- (c) the entity’s performance does not create an asset with an alternative use to the entity (see paragraph 36) and the entity has an enforceable right to payment for performance completed to date (see paragraph 37).”

The Company fulfills the condition as per paragraph 35 (c) as explained below and hence recognises revenue over time.

Condition No.1 - the entity’s performance does not create an asset with an alternative use to the entity (see paragraph 36)

As per paragraph 36, “An asset created by an entity’s performance does not have an alternative use to an entity if the entity is either restricted contractually from readily directing the asset for another use during the creation or enhancement of that asset or limited practically from readily directing the asset in its completed state for another use. ... Paragraphs B6–B8 provide guidance for assessing whether an asset has an alternative use to an entity.”

Practical Limitation – Paragraph B8 states that “A practical limitation on an entity’s ability to direct an asset for another use exists if an entity would incur significant economic losses to direct the asset for another use. A significant economic loss could arise because the entity either would incur significant costs to rework the asset or would only be able to sell the asset at a significant loss. For example, an entity may be practically limited from redirecting assets that either have design specifications that are unique to a customer or are located in remote areas”.

Ships are not standard and off-the-shelf products. The ships are constructed only after the contracts are signed. The contracts are signed after extensive discussion on the specific requirements of the buyer and each contract therefore provides for distinct functional requirements and technical specifications like dimensions, draft (vertical distance between the waterline and the bottom of the hull), propelling machinery, design features, facilities onboard, guaranteed speed, guaranteed deadweight (carrying capacity), guaranteed fuel consumption, material of construction and much more. Therefore, even in the same segment (passenger, cargo, tugs etc.) of the ships/vessels, two ships are never exactly the same.

The Company constructs various categories of vessels/ ships like defence ships, tankers, bulk carriers, passenger vessels, bollard pulls tugs etc. for different buyers which are meant for different uses in different sectors. The Company is bound to design, construct and deliver the vessels/ships as per the characteristics, purpose, technical specifications, quality prescribed etc. which are unique to the satisfaction of the customer. And each contract being a contract for construction and delivery of ships, customised to the requirement of the buyer, does not have an alternate market. Hence, as stated in paragraph B8, the Company cannot readily redirect it for another use. Even if in some cases, it will be able to do so, it can only be done after significant changes and at significant cost.

Condition No.2 - the entity has an enforceable right to payment for performance completed to date (see paragraph 37).

As per paragraph 37, “An entity shall consider the terms of the contract, as well as any laws that apply to the contract, when evaluating whether it has an enforceable right to payment for performance completed to date... at all times throughout the duration of the contract, the entity must be entitled to an amount that at least compensates the entity for performance completed to date if the contract is terminated by the customer or another party for reasons other than the entity’s failure to perform as promised. Paragraphs B9–B13 provide guidance for assessing the existence and enforceability of a right to payment and whether an entity’s right to payment would entitle the entity to be paid for its performance completed to date.”

Paragraph B9 specifies “...An amount that would compensate an entity for performance completed to date would be an amount that approximates the selling price of the goods

or services transferred to date (for example, recovery of the costs incurred by an entity in satisfying the performance obligation plus a reasonable profit margin) rather than compensation for only the entity's potential loss of profit if the contract were to be terminated..."

Right to payment for performance completed till date - Paragraph B10 states that "An entity's right to payment for performance completed to date need not be a present unconditional right to payment. In many cases, an entity will have an unconditional right to payment only at an agreed-upon milestone or upon complete satisfaction of the performance obligation. In assessing whether it has a right to payment for performance completed to date, an entity shall consider whether it would have an enforceable right to demand or retain payment for performance completed to date if the contract were to be terminated before completion for reasons other than the entity's failure to perform as promised."

Enforceability of a right to payment - As per paragraph B12, "In assessing the existence and enforceability of a right to payment for performance completed to date, an entity shall consider the contractual terms as well as any legislation or legal precedent that could supplement or override those contractual terms..."

The Company recognises revenue to the extent of performance completed till date plus reasonable profit margin in line with paragraph B9. As referred in paragraph B10, although contract stipulates agreed milestones for payment, the Company has an enforceable right to demand or retain payment for performance completed to date if the contract were to be terminated before completion for reasons other than the entity's failure to perform as promised.

In the Company's contracts with customers, the customer does not have the right to terminate the contract unless the Company fails to perform as promised and the Company would have an enforceable right to all of the consideration promised under the contract if it continues to perform as promised. Therefore, the terms of the contract and the practices in the legal jurisdiction indicate that there is a right to payment for performance completed to date as per paragraphs 37 and B12.

Considering the above, the condition of enforceability of a right to payment for performance completed, as mentioned in paragraph 37 with reference to paragraphs B9, 10 and B12 is complied with.

Based on the facts as stated in the above paragraphs, the Company's performance does not create an asset with an alternative use to the Company and the Company has an enforceable right to payment for performance completed to date. Hence, the criterion specified in paragraph 35 (c) of Ind AS 115 is met and consequently, the Company transfers control of vessel built over time and satisfies performance obligation; and recognises revenue over time in line with paragraph 35 of Ind AS 115.

(b) *Measuring progress towards complete satisfaction of a performance obligation:*

As per paragraphs 39 and 40 of Ind AS 115, for each performance obligation satisfied over time, the Company recognises revenue over time by measuring the progress towards complete satisfaction of that performance obligation.

- (c) Paragraph 41 permits the adoption of appropriate methods of measuring progress which include output methods and input methods. Paragraphs B14–B19 of Ind AS 115 provide guidance for using output methods and input methods to measure an entity’s progress towards complete satisfaction of a performance obligation.
- (d) During transition to Ind AS 115, the Company evaluated the revenue recognition methods under the following considerations:
- As per paragraph B15 of Ind AS 115, the output methods recognise revenue on the basis of direct measurements of the value to the customer of the goods or services transferred to date relative to the remaining goods or services promised under the contract.

When an entity evaluates whether to apply an output method to measure its progress, the entity shall consider *whether the output selected would faithfully depict the entity’s performance towards complete satisfaction of the performance obligation*. (Emphasis supplied by the querist.)

- The performance obligations of ship building contracts could be measured reliably as a percentage of the tonnage completed to the total estimated tonnage of the vessel using the output method.
 - The Company has a full-fledged system which could accurately measure the tonnage completed and hence the progress of construction could be measured reliably.
 - The Company was predominantly constructing similar hull intensive vessels and these were more or less of similar category.
- (e) Accordingly, the Company adopted the output method for measuring the progress of the performance obligation for revenue recognition and the physical performance is measured as % of the actual achieved/constructed tonnage of the vessel on the estimated total tonnage of each vessel. The Company adopted this methodology during transition to Ind AS 115 since this method provided a faithful depiction of the Company’s performance to the satisfaction of the performance obligation.

6. Current status:

- a. As part of its expansion programme in accordance with the business strategies and the business plan, the Company is diversifying its portfolio across different segments. The Company has recently bagged orders for 6 next generation missile vessels for Indian Navy and has contracts with foreign owners for construction of vessels operating in different segments of operation like eco freighters, commissioning/service operational vessels for the offshore wind industry, etc. The Company has also recently received an order for construction of dredger from Dredging Corporation of India (DCI) and has also started constructing zero emission hydrogen fueled vessels.
- b. Considering the technical specifications of vessels to be constructed in current and forthcoming years, each vessel is unique for many reasons such as :
- i. The purpose, technical specifications and characteristics of each type of vessel.
 - ii. Design specifications, drawings and class certification norms.

- c. Also, many of the defence vessels that have been recently contracted are weapon intensive; and the material cost forms a significant part of the total vessel cost.
- d. Differences in the nature and complexity of ships likely to be constructed in future, out of current orders in hand, may result in financial (cost incurred as a percentage of total estimated cost to complete) and physical completion mismatch due to the reasons as brought out earlier.
- e. Therefore, adoption of the same methods of income recognition for all the projects under construction may not faithfully depict the progress of the performance obligation for the purpose of revenue recognition.

The querist has also shared the further information with regard to circumstances which necessitates change in method of measuring progress:

- i. The Company was predominantly constructing conventional vessels and hence construction progress of these vessels could be monitored more or less of similar way. But with the commitments made by the Countries to reduce carbon footprints, there is a demand for niche products which are run on green fuels like hydrogen, ammonia, methanol, electric power etc. Further, with the latest developments in automation, communication, control, artificial intelligence, the modern ships are very different from the earlier ships. The latest trend of eliminating fossil fuel has resulted in new technologies and new propulsion methods using green fuels.
- ii. The market is also changing with India looking at coastal and river waters as alternate mode of freight and passenger transportation. This has brought in new markets for vessels meant for shallow water. These vessels are substantially different from the existing ones in terms of the materials used for construction of hull and source of power used for propulsion etc.
- iii. The Company has accordingly run its R&D programme and has diversified its product portfolio across various segments.
- iv. Although, the generic term used for all kinds of vessel constructed is ship/vessel, the ships/vessels actually vary in size, usage, power used for propulsion, hull (flat bottomed, catamarans, mono hulls) and the materials that are used for construction of vessel (steel, aluminum etc.)
- v. A ship can be sea-going or river-going. It can be a container vessel, oil tanker, LNG vessel, bulk carrier, RoRo vessel (Roll on Roll off), passenger vessel, fishing vessel, tug, warship ranging from aircraft carriers to anti-submarine warfare shallow water craft, dredger, offshore vessel, boat etc. Each of these differ within the segment and across the segment in terms of usage, the water they navigate, the hull, the power, the speed and the draft etc.
- vi. Considering the different functional requirements, each type of ship varies in design and equipment fitted. Thus, it could be a highly sophisticated vessel with lot of automation or a conventional displacement ship with purely mechanical propulsion.
- vii. Even a passenger ship segment, a 1000 passenger ship compared with another ship of 1000 passenger capacity could be of different design, size, and complexity depending on type of accommodation, speed of vessel, facilities provided on board, technologies employed etc. In similar manner, each category of vessel can vary significantly with the customer requirement.
- viii. Ships are again not off-the-shelf items. The ships are constructed only after the ship building contracts are signed. These contracts provide functional requirements and technical specifications like dimensions, draft (vertical distance between the waterline and the bottom of the hull), propelling machinery, design features,

- facilities onboard, guaranteed speed, guaranteed deadweight (carrying capacity), guaranteed fuel consumption, material of construction etc.
- ix. Each contract, is a distinct contract for design, construction and delivery of ships, is customised to the requirement of a buyer, is different from the other and does not have an alternate market immediately. The probability of finding an alternative customer when the vessel is fully built is practically very remote. Hence, the Company would not be able to readily direct the vessel being built for one client for another use. Even in some cases where it is able to do so, it can only be done after significant changes and at significant cost.
 - x. Accordingly, it is worth to note that in recent contracts, the Company has entered into, the technicalities and complexities are much diverse than the earlier vessels it has been constructing.
 - xi. Additionally, some of these new vessels also require new construction and commissioning infrastructure to be established. For example, a battery driven vessel need a charging infrastructure, hydrogen driven vessel need a hydrogen bunkering facility which again is technology driven.

Considering all the factors/parameters detailed above, the Company is of the view that the performance obligation for the shipbuilding segment is design, construction and delivery of customer specific ship/vessel and the circumstances over the performance obligations are not similar, specifically with regard to the infrastructure needs (construction and commissioning), hull and outfit ratio, labor-material intensity in the project and other parameters.

Hence, the Company proposes to realign its accounting policy and method of measuring progress in recognising the revenue for shipbuilding segment.

The Company plans to assess the performance obligations at the inception of each contract with regard to the applicability of input or output method vis-a-vis similar circumstances or similar performance obligations. At the time of assessment, the Company shall assess whether input method or output method would faithfully depict the entity's performance towards complete satisfaction of the performance obligation with respect to specific contracts.

B. Query

7. Based on the above facts and circumstances and with reference to paragraphs 39, 40, 41 of Ind AS 115, 'Revenue from Contracts with Customers', opinion of the Expert Advisory Committee of the Institute of Chartered Accountants of India (ICAI) is sought in respect of the following:

- (i) Whether different methods of measurement – output or input method - can be applied to different vessels within the ship building segment based on the assessment of the Company having regard to the specific characteristics of the performance obligation.
- (ii) Whether the change in the method of measuring progress from output method to input method for revenue recognition is to be considered as a 'change in accounting policy' or a 'change in accounting estimate'.

- (iii) In case of adoption of an output method for revenue recognition, whether the Company can account for ‘work-in-progress’, when physical progress of completion is less than the financial progress of completion.

C. Points considered by the Committee

8. The Committee restricts its opinion to the issues raised by the querist, viz., whether different methods of measurement (input/output) can be used for measuring progress of different vessels (having regard to specific characteristics of the performance obligations), whether change in method of measurement is a change in accounting policy or accounting estimate and whether ‘work-in-progress’ can be used for the costs incurred on the contract. The Committee has, therefore, examined only these issues and has not examined any other issue that may arise from the Facts of the Case, such as, accounting under the previous GAAP and at the time of transition to Ind AS, appropriateness of application of other aspects of Ind AS 115 including revenue recognition during initial stages of contract and in case of contract modification, accounting for various components of consideration viz. discounts, rebates, refunds, credits, price concessions, liquidated damages, etc., measurement of revenue, timing of recognition of revenue including whether the Company has an enforceable right to payment for performance completed to date, method to be selected for determination of progress of performance, etc. Further, the Accounting Standards referred to hereinafter are Indian Accounting Standards, notified under the Companies (Indian Accounting Standards) Rules, 2015, as amended/revised from time to time.

9. With regard to the issues raised, the Committee notes the following requirements of Ind AS 115, ‘Revenue from Contracts with Customers’ and Basis for Conclusions (BC) to International Financial Reporting Standard (IFRS) 15, ‘Revenue from Contracts with Customers’ (which is corresponding to Ind AS 115 and as there is no difference between Ind AS 115 and IFRS 15 with regard to these requirements), issued by International Accounting Standards Board (IASB):

Ind AS 115

“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.”

“39 For each performance obligation satisfied over time in accordance with paragraphs 35–37, an entity shall recognise revenue over time by measuring the progress towards complete satisfaction of that performance obligation. The objective when measuring progress is to depict an entity’s performance in transferring control of goods or services promised to a customer (ie the satisfaction of an entity’s performance obligation).

40 An entity shall apply a single method of measuring progress for each performance obligation satisfied over time and the entity shall apply that method consistently to similar performance obligations and in similar circumstances. At the end of each reporting period, an entity shall remeasure its progress towards complete satisfaction of a performance obligation satisfied over time.

Methods for measuring progress

- 41 Appropriate methods of measuring progress include output methods and input methods. Paragraphs B14–B19 provide guidance for using output methods and input methods to measure an entity’s progress towards complete satisfaction of a performance obligation. In determining the appropriate method for measuring progress, an entity shall consider the nature of the good or service that the entity promised to transfer to the customer.
- 42 When applying a method for measuring progress, an entity shall exclude from the measure of progress any goods or services for which the entity does not transfer control to a customer. Conversely, an entity shall include in the measure of progress any goods or services for which the entity does transfer control to a customer when satisfying that performance obligation.
- 43 As circumstances change over time, an entity shall update its measure of progress to reflect any changes in the outcome of the performance obligation. Such changes to an entity’s measure of progress shall be accounted for as a change in accounting estimate in accordance with Ind AS 8, *Accounting Policies, Changes in Accounting Estimates and Errors.*”

Basis for Conclusions (BC) to International Financial Reporting Standard (IFRS) 15

“Measuring progress towards complete satisfaction of a performance obligation (paragraphs 39–45 and B14–B19)

...

- BC159 There are various methods that an entity might use to measure its progress towards complete satisfaction of a performance obligation. Because of the breadth of the scope of IFRS 15, the boards decided that it would not be feasible to consider all possible methods and prescribe when an entity should use each method. Accordingly, an entity should use judgement when selecting an appropriate method of measuring progress towards complete satisfaction of a performance obligation. That does not mean that an entity has a ‘free choice’. The requirements state that an entity should select a method of measuring progress that is consistent with the clearly stated objective of depicting the entity’s performance—that is, the satisfaction of an entity’s performance obligation—in transferring control of goods or services to the customer.
- BC160 To meet that objective of depicting the entity’s performance, an entity would need to consider the nature of the promised goods or services and the nature of the entity’s performance. ...
- BC161 The boards decided that an entity should apply the selected method for measuring progress consistently for a particular performance obligation and also across contracts that have performance obligations with similar characteristics. *An entity should not use different methods to measure its performance in satisfying the same or similar performance obligations*, otherwise that entity’s revenue would not be comparable in different reporting periods. The boards also noted that if an entity were permitted to apply more than one method to measure

its performance in fulfilling a performance obligation, it would effectively bypass the requirements for identifying performance obligations.”

(Emphasis supplied by the Committee.)

From the above, the Committee notes that as per Ind AS 115, when performance obligation is satisfied over time, an entity shall select a single appropriate method, viz., input method or output method for measuring the progress towards complete satisfaction of the performance obligation (viz., transfer of control over goods and services) over time. Thus, once a method is selected, the same has to be applied consistently over time. Further, the Standard provides that while determining the appropriate method, nature of the goods or services that the entity promised to transfer to the customer is to be considered. Accordingly, an appropriate method of measuring progress, which faithfully depicts the entity’s performance towards complete satisfaction of the performance obligation, has to be selected carefully considering the nature of performance, nature of goods and services etc.

The Committee also notes that though the Standard requires that at the end of each reporting period, an entity shall remeasure its progress towards complete satisfaction of a performance obligation satisfied over time, it does not permit to change the method of measure of progress. Thus, once an entity starts recognising revenue based on a method, say, an input method, it cannot subsequently change to an output method. Accordingly, revenue for a performance obligation is to be accounted for using single appropriate method from its inception till the full satisfaction of performance obligations in a contract. Therefore, the question of change in method of measuring progress in a single contract with customer does not arise.

Furthermore, the Standard requires that once a method is selected, the same has to be applied consistently to similar performance obligations and in similar circumstances across various contracts. Thus, the Standard restricts an entity to apply the selected method (input/output) for measuring progress consistently for similar contracts that have similar performance obligations. In other words, the entity has to consistently apply the selected method for measuring progress across contracts for particular performance obligations with similar characteristics.

Thus, in the extant case, the Company, considering its own specific facts and circumstances including the nature of goods and services to be provided and various performance obligations, should technically evaluate whether various performance obligations under different contracts of ship building segment are different, for example, in terms of significant variation in bought out materials, significant technological features leading to different performance obligations etc.; and if there are different performance obligations, viz., performance obligations having different characteristics under different contracts, different methods of measurement of progress may be applied for different contracts provided these methods faithfully depict the entity’s performance towards complete satisfaction of the performance obligation in transferring control of goods and services to the customers. Therefore, under various contracts having different performance obligations having different characteristics, different methods of measuring progress is permitted. Further, since the above-mentioned evaluation of performance obligations under different contracts is to be performed at the contract inception itself as per the requirements of Ind AS 115, it is the selection of the method of measuring progress in a contract at its inception only and, therefore, the question of change in method does not arise. The Committee also wishes to point out that mismatch between cost incurred and physical progress is not the basis or ground to adopt a different method of measuring progress.

10. Further, with regard to the issue raised regarding use of ‘work-in-progress’ for the costs incurred on the contract where the Company has performed by transferring goods or services to a customer before the customer pays consideration or before payment is due, the Committee notes the following paragraphs from Ind AS 115 and BC to IFRS 15:

“**contract asset** An entity’s right to consideration in exchange for goods or services that the entity has transferred to a **customer** when that right is conditioned on something other than the passage of time (for example, the entity’s future performance).”

“106 If a customer pays consideration, or an entity has a right to an amount of consideration that is unconditional (ie a receivable), before the entity transfers a good or service to the customer, the entity shall present the contract as a contract liability when the payment is made or the payment is due (whichever is earlier). A contract liability is an entity’s obligation to transfer goods or services to a customer for which the entity has received consideration (or an amount of consideration is due) from the customer.

107 If an entity performs by transferring goods or services to a customer before the customer pays consideration or before payment is due, the entity shall present the contract as a contract asset, excluding any amounts presented as a receivable. A contract asset is an entity’s right to consideration in exchange for goods or services that the entity has transferred to a customer. An entity shall assess a contract asset for impairment in accordance with Ind AS 109. An impairment of a contract asset shall be measured, presented and disclosed on the same basis as a financial asset that is within the scope of Ind AS 109 (see also paragraph 113(b)).

108 A receivable is an entity’s right to consideration that is unconditional. A right to consideration is unconditional if only the passage of time is required before payment of that consideration is due. For example, an entity would recognise a receivable if it has a present right to payment even though that amount may be subject to refund in the future. An entity shall account for a receivable in accordance with Ind AS 109. Upon initial recognition of a receivable from a contract with a customer, any difference between the measurement of the receivable in accordance with Ind AS 109 and the corresponding amount of revenue recognised shall be presented as an expense (for example, as an impairment loss).

109 This Standard uses the terms ‘contract asset’ and ‘contract liability’ but does not prohibit an entity from using alternative descriptions in the balance sheet for those items. If an entity uses an alternative description for a contract asset, the entity shall provide sufficient information for a user of the financial statements to distinguish between receivables and contract assets.”

Basis for Conclusions (BC) to International Financial Reporting Standard (IFRS) 15

“BC324 Once an entity has an unconditional right to consideration, it should present that right as a receivable separately from the contract asset and account for it in accordance with other requirements (for example, IFRS 9 or Topic 310). The boards decided that IFRS 15 need not address the accounting for receivables in addition to revenue recognition. Issues such as the measurement (or impairment)

of receivables and disclosures relating to those assets are already addressed in IFRS and US GAAP.

BC325 In many cases, an unconditional right to consideration arises when the entity satisfies the performance obligation and invoices the customer. For example, a payment for goods or services is typically due and an invoice is issued when the entity has transferred the goods or services to the customer. However, the act of invoicing the customer for payment does not indicate whether the entity has an unconditional right to consideration. For instance, the entity may have an unconditional right to consideration before it invoices (unbilled receivable) if only the passage of time is required before payment of that consideration is due. In other cases, an entity can have an unconditional right to consideration before it has satisfied a performance obligation. For example, an entity may enter into a non-cancellable contract that requires the customer to pay the consideration a month before the entity provides goods or services. In those cases, on the date when payment is due, the entity has an unconditional right to consideration. (However, in those cases, the entity should recognise revenue only after it transfers the goods or services.)”

From the above, the Committee notes that if an entity performs by transferring goods or services to a customer before the customer pays consideration or before payment is due, the entity shall present the contract as a contract asset, excluding any amounts presented as a receivable. A contract asset is an entity’s right to consideration in exchange for goods or services that the entity has transferred to a customer when that right is conditioned on something other than the passage of time (for example, the entity’s future performance), whereas a receivable is an entity’s right to consideration that is unconditional, i.e. only the passage of time is required before payment of that consideration is due.

Thus, when an entity satisfies a performance obligation but does not have an unconditional right to consideration, for example, because it first needs to satisfy another performance obligation in the contract, it should recognise a contract asset, whereas an entity would recognise a receivable if it has a present right to payment.

Therefore, in the extant case, the Committee notes that in case physical progress of completion as per output method is less than the financial performance based on costs incurred, the Company should recognise the costs incurred as contract asset or receivables depending on the requirements of presenting as contract asset and receivables as discussed above.

The Committee also notes that Ind AS 115 does not prohibit an entity from using alternative descriptions in the balance sheet for ‘contract assets’. An entity may use an alternative description for a contract asset, however, sufficient information should be provided for a user of the financial statements to distinguish between receivables and contract assets. Thus, in the extant case, the Company may present contract asset with an alternative appropriate nomenclature.

D. Opinion

11. On the basis of the above, the Committee is of the following opinion on the issues raised in paragraph 7 above:

- (i) and (ii) In the extant case, the Company, considering its own specific facts and circumstances including the nature of goods and services to be provided and various performance obligations, should technically evaluate whether various performance obligations under different contracts of ship building segment are different and if there are different performance obligations, viz., performances having different characteristics under different contracts, different methods of measurement of progress may be applied provided these methods faithfully depict the entity's performance towards complete satisfaction of the performance obligation in transferring control of goods and services to the customers. Therefore, under various contracts having different performance obligations having different characteristics, different methods of measuring progress are permitted. Further, since the above-mentioned evaluation of performance obligations under different contracts is to be performed at the contract inception itself as per the requirements of Ind AS 115, the question of change in method does not arise. Further, revenue for a performance obligation is to be accounted for using single appropriate method from its inception till the full satisfaction of that obligation. Therefore, the question of change in method of measuring progress in a single contract with customer does not arise.
- (iii) The Company should recognise the costs incurred as contract asset or receivables depending on the requirements of presenting as contract asset and receivables, as discussed in paragraph 10 above. Ind AS 115 does not prohibit an entity from using alternative descriptions in the balance sheet for 'contract assets'. An entity may use an alternative description for a contract asset, however, sufficient information should be provided for a user of the financial statements to distinguish between receivables and contract assets. Thus, in the extant case, the Company may present contract asset with an alternative appropriate nomenclature.
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