

Query No. 24

Subject: Accounting treatment for Customer Acquisition Cost under AS framework.¹

A. Facts of the Case

1. ABC Private Limited (hereinafter referred to as ‘the Company’) provides digital tele-health services through health products of 12 / 24 / 36 months, which includes unlimited consultations and an insurance cover for the specified period of the policy. The Company’s business partners are NBFC micro financial institutions (MFIs) and banks who promote the Company’s business and sell its digital tele-health enrolments to their customers.

Brief of Revenue and Collection:

2. As stated above, the Company’s products are sold by NBFC MFIs, who on its behalf collect the funds from the customers and on the basis of the database shared by them, the amount is then transferred to the Company in bulk. The amounts collected by them are booked in the Company’s accounts as collections from the partners. For the collection generated by them and transferred to the Company on a regular basis, NBFC MFIs charge a fee from the Company, which is primarily considered as customer acquisition fees or facilitation fees.

Stakeholders review the business/ operational performance based on financial statements as well as other key non-financial indicators, such as, number of e-clinics, number of customers, geographical presence, business partners etc.

Brief of Accounting Treatment of Revenue and Expenses under IGAAP:

3. The querist has stated that as per Accounting Standard (AS) 9, ‘Revenue Recognition’, the Company spreads or amortises its revenue up to the time period as specified in the health product enrolment (12 / 24 / 36 months) as there is a continuing obligation on its part till the subscription period ends towards performance of services. As and when the Company receives collection from its partner, the amortised amount of the revenue for the month is accounted for as ‘income’ and the balance part is credited to ‘Unearned Revenue’ which is booked as income over a period of time of enrolment.

4. According to querist, since Accounting Standards are silent on amortisation of expenses, the customer acquisition fees charged by the partners are booked in the same month only in which the enrollment is sourced, as service has been provided at a point of time and there is no obligation pending at their end. Amount is also not being amortised as it does not fall under the definition of asset. Moreover, the payment is also upfront one time. The Company also has other material direct expenses which are also being charged upfront, such as, e-clinic expenses, business promotion expenses, advertising expenses.

Brief of Effect on Financial Statements:

5. The querist has further stated that due to the above accounting treatment, it seems that the financial statements of the Company do not show true and fair view as income is being amortised over the period whereas the direct cost is upfront charged and not deferred. It does

¹ Opinion finalised by the Committee on 4.10.2024.

not truly reflect the correct business model operationally since the amount of expense is material in nature.

6. The Company also has a substantial amount of cash balance in the form of term deposits and other forms of investments but not equivalent to unearned revenue which will take care of the corresponding expenses to be incurred in future.

7. The querist has also separately clarified as follows:

- (i) The facilitation fee is payable only if there is a collection from the interested customer towards the digital health services by the Bank/ NBFC. Moreover, as per the business practice, initially, the Company receives the collection from the customers through Bank/ NBFC in the form of enrolment subscription along with the details of the customers. Facilitation fee is payable thereafter on receipt of invoice from Bank/NBFC after verification at the Company's end. It is to be noted that there is no payment on account of facilitation fees if there is no receipt of enrolment subscription in advance.
- (ii) The facilitation fee per enrolment/customer payable to Bank/NBFC is fixed in nature based on the terms of agreement, however, number of enrolments may vary from time to time. Further, as stated in point no. (i) above, facilitation fees are only payable once, when a person becomes the customer and there is no provision of any payment before becoming a customer or just wanting/ wishing to avail the Company's services.
- (iii) The data being shared by the Bank/NBFC is only for the customers who are availing the Company's services. As per the operational practices of the Company, there are welcome calls to all the customers and follow-up calls post their consultations with the doctors/ medical team to ensure their progress and satisfaction with the Company's services. The data being shared is required so that the Company can ensure that the customers get the best services that are being provided. Hence, it may be noted that the data being shared is to ensure providing of desired services. As a practice, the Company does not utilise this data other than rendering this service; the Company does not cross or upsell any other services. The Company is compliant to the Reserve Bank of India (RBI) data security regulations in this regard.
- (iv) There is no data base shared by the Bank/NBFC other than for the Company's enrolled customers. Since there is no data being shared, there is no question of any fees or quantum in respect thereof. There is no reference of such clause in the Agreement signed between the parties. The Company gets the data for the customers who are interested in enrolling in the Company's product and have paid the enrolment fees for the same.
- (v) There is no access for Bank/NBFC's customer data base and the Company does not have any right to use customer data base for its business operations except for the Company's enrolled customers. As a practice, the Company does not utilise this data other than rendering this service for the enrolment period only; the Company does not cross sell or upsell any other services.

B. Query

8. On the basis of the above, the querist seeks to have opinion on the following issues to ensure that the Company is following the correct accounting policy considering prudence,

substance over form and materiality as well as fundamental accounting assumptions, i.e., going concern, consistency and accrual as per Accounting Standard (AS) 1, 'Disclosure of Accounting Policies':

- (a) Whether the Company can amortise the customer acquisition cost which is paid to the business partners, as per the same principle, the Company follows for amortising the revenue over a period of enrollment, as this being direct cost and material in nature.
- (b) Since the Company is amortising only the revenue and not the expenditure related to that, does it lead to any variance in the matching principle within the Accounting Standard framework? Is there any exception permissible to amortise such cost over the period of subscription?

C. Points considered by the Committee

9. The Committee notes that the basic issue raised by the querist relates to the accounting for the fees/ charges paid by the Company to the banks/ NBFCs (business partners), inter alia, to facilitate collection of amounts from the customers as per notified Accounting Standards (AS) under the Companies (Accounting Standards) Rules, 2021. The Committee has, therefore, considered only this issue and has not examined any other issues that may arise from the Facts of the Case, such as, revenue recognition or its amortisation by the Company, treatment of collection amount collected from the banks/ NBFCs, accounting treatment of direct expenses, e-clinic expenses, promotion and advertising expenses, treatment of amount paid/payable, if any, towards customer data/list to Bank/NBFC, accounting for insurance contract (if any) embedded in the contract with customers, etc. The Committee has examined the issue only from an accounting perspective and has not examined the regulatory or legal classification and implications, including those arising under Income-tax Act, Goods and Services Tax Act, Information Technology Act, RBI regulations, Insurance Regulatory and Development Authority (IRDA) regulations and other related regulations, Data Privacy laws and regulations, etc.

The Committee notes that the querist has submitted that the data being shared is only for the customers who are availing the Company's services; as per the operational practices of the Company, there are welcome calls to all the customers and follow up calls post their consultations with the doctors/ medical team to ensure their progress and satisfaction with its services. The data being shared is required so that the Company can ensure that the customers get the best services that are being provided. Hence, the data being shared is to ensure providing of desired services and the Company is compliant to the RBI data security regulations. The Committee relies on the information so provided by the querist and further reiterates that it has not looked into the regulatory or legal aspects, including compliance with the Data Privacy laws and RBI regulations in this regard, if any.

10. The Committee notes the following key clauses of the sample Memorandum of Understanding entered into between the Company and the Bank/NBFC, as supplied by the querist:

“WHEREAS:

- A. ABC ('the Company') is engaged in the business of providing facility services as described in Annexure "A" (hereinafter referred to as Facility Service/Service Facility) to the present Memorandum of Understanding.
 - B.('Bank/NBFC') has a customer base, who are likely to be interested in the Facility Services being rendered by ABC, and ABC is interested in associating with to offer the Facility Services to such interested customers.
 - C. and ABC are hence desirous of recording the terms and conditions of the tie-up arrangement for the offering of facility services of ABC by to the customers of, as provided hereinafter.
- ...

NOW IT IS HEREBY AGREED AS FOLLOWS:

1. Arrangement

- 1.1. will provide the option to its own customers to opt voluntarily for availing the facility services of ABC and agree to its terms including "product price" [hereinafter referred to as "Enrolled Customers"].
 - 1.2. will facilitate the collection of product prices from the Enrolled Customers. The 'product price' shall be mutually agreed upon between the Parties.
 - 1.3. shall, towards meeting/fulfilment of the sole purpose of this Memorandum of Understanding, provide the verified details of the Enrolled Customers (including details of the Name, Age, Mobile Number, Customer ID, etc.) [hereinafter referred to as "Verified Details"] to ABC on weekly frequency through API/or such other mode as agreed between the Parties in writing in the given format of Annexure "C" without undue delay.
 - 1.4. Upon receipt of the information in Annexure "C", ABC shall take the necessary steps for creating the database of the Verified Details of the Enrolled Customers provided by, which shall be kept in a secured manner in compliance with the provisions of applicable laws including without limitation, the Information Technology Act, 2000 and the applicable rules made thereunder and enrol the customers for availing the ABC facility services.
- ...
- 1.6. For performing its obligations under this Memorandum of Understanding, shall be entitled to receive a Facilitation Fee for the distribution of facility services, as per the terms provided in Annexure "D" to the present Memorandum of Understanding.
- ...

2. Service Facility

- 2.1. ABC is engaged in the business of providing medical advice and consultancy via phone, video call or other means by providing, assisting and facilitating all support services for enabling the said service facility as per the applicable laws, guidelines, regulations and professional etiquette by the Registered Medical Practitioners engaged by ABC through the call centre service and E-Clinic Setup operations

(referred to as “Telemedicine Service/E-Clinic Setup in the present Memorandum of Understanding).

2.2. ABC provides medical & health services which shall include medical check-ups and medical advice to the patients.

...

5. Obligation of

5.1. The liability and responsibility of shall be limited only to the extent of provisioning of intimating to its customer about the facility service of ABC and collecting product price.

5.2. shall deposit the product price on a working day in the bank account of ABC on a Monthly basis, as provided by the ABC during the execution of the Memorandum of Understanding (or such other account in respect of which notice in writing has been served by ABC on) without delay.

5.3. shall share the consolidated list of customers who would need cancellation, for ABC to cancel their subscription to the product/service.

5.4. The method of dissemination of information about the Facility Services among its clientele shall be the obligation of and it shall take all reasonable steps to ensure a genuine effort.”

From the above, the Committee notes that the Bank/NBFC intimates to its customers about the facility service of the Company and collects the product price from the customers; and for these services, it shall be entitled to receive a facilitation fee from the Company.

11. With regard to accounting for facilitation fee, the Committee notes that Accounting Standard (AS) 9, ‘Revenue Recognition’ is silent and does not prescribe any guidance with respect to the costs relating to revenue arrangements with customers. Therefore, in this regard, the Committee notes the following requirements of the Framework for the Preparation and Presentation of Financial Statements, issued by the ICAI:

“49(a) An *asset* is a resource controlled by the enterprise as a result of past events from which future economic benefits are expected to flow to the enterprise.”

“56. Many assets, for example, receivables and property, are associated with legal rights, including the right of ownership. In determining the existence of an asset, the right of ownership is not essential; thus, for example, an item held under a hire purchase is an asset of the hire purchaser since the hire purchaser controls the benefits which are expected to flow from the item. Although the capacity of an enterprise to control benefits is usually the result of legal rights, an item may nonetheless satisfy the definition of an asset even when there is no legal control. For example, know-how obtained from a development activity may meet the definition of an asset when, by keeping that know-how secret, an enterprise controls the benefits that are expected to flow from it.”

- “82. An item that meets the definition of an element should be recognised if:
- (a) it is probable that any future economic benefit associated with the item will flow to or from the enterprise; and
 - (b) the item has a cost or value that can be measured with reliability.”

“Recognition of Expenses

...

94. Many expenses are recognised in the statement of profit and loss on the basis of a direct association between the costs incurred and the earning of specific items of income. This process, commonly referred to as the matching of costs with revenues, involves the simultaneous or combined recognition of revenues and expenses that result directly and jointly from the same transactions or other events; for example, the various components of expense making up the cost of goods sold are recognised at the same time as the income derived from the sale of the goods. However, the application of the matching concept under this Framework does not allow the recognition of items in the balance sheet which do not meet the definition of assets or liabilities.

95. When economic benefits are expected to arise over several accounting periods and the association with income can only be broadly or indirectly determined, expenses are recognised in the statement of profit and loss on the basis of systematic and rational allocation procedures. This is often necessary in recognising the expenses associated with the using up of assets such as plant and machinery, goodwill, patents and trademarks; in such cases, the expense is referred to as depreciation or amortisation. These allocation procedures are intended to recognise expenses in the accounting periods in which the economic benefits associated with these items are consumed or expire.

96. An expense is recognised immediately in the statement of profit and loss when an expenditure produces no future economic benefits. An expense is also recognised to the extent that future economic benefits from an expenditure do not qualify, or cease to qualify, for recognition in the balance sheet as an asset.”

From the above, the Committee notes that an expense is recognised immediately in the statement of profit and loss when it does not qualify for recognition in the balance sheet as an asset. Also, the application of the matching concept under the Framework does not allow the recognition of items in the balance sheet which do not meet the definition of assets. The Committee further notes that an asset is a resource controlled by the enterprise from which future economic benefits are expected to flow to it. Further, as per paragraph 14 of Accounting Standard (AS) 26, ‘Intangible Assets’, “An enterprise controls an asset if the enterprise has the power to obtain the future economic benefits flowing from the underlying resource and also can restrict the access of others to those benefits...”. In this regard, the Committee also notes that paragraph 56 of the Framework also, inter alia, provides that an item may meet the definition of an asset, when an enterprise controls the benefits that are expected to flow from it.

Thus, the Committee is of the view that it is only where the asset is controlled by an entity such that the entity controls the benefits that are expected to flow from it and when the conditions as per the recognition criteria for an asset are satisfied, that the entity should recognise an asset in its financial statements in respect of the expenditure incurred. Therefore, in the extant case, if

facilitation fee does not qualify for recognition as an asset as mentioned above, the same should be recognised as an expense in the Statement of Profit and Loss.

Further, in this context, the Committee notes that AS 2, 'Valuation of Inventories' requires selling costs of inventories to be expensed when incurred. Similarly, AS 26, 'Intangible Assets' require selling costs (including expenditure on advertising and promotional activities) of introducing new products to be expensed in the Statement of Profit and Loss as no intangible or other asset is acquired or created out of such costs/expenditure, that can be recognised (and these costs cannot be directly attributed to preparing the asset for their use). The Committee also notes that some other standards, such as AS 7, 'Construction Contracts' allow directly related costs that are incurred in securing the contract (if they can be separately identified and measured reliably and it is probable that the contract will be obtained) to be deferred and recognised as expenses by reference to the stage of completion of the contract activity.

Accordingly, the Committee is of the view that in the extant case, if facilitation fee is of the nature of selling or advertising and promotional costs that are incurred in *attempting* to obtain customer contracts, the same should be recognised as an expense *unless* these costs give rise to acquisition or creation of an asset, as mentioned above (and the recognition criteria as an asset are satisfied). For example, if these costs are directly attributable to *securing* a specifically identifiable customer contract and are *specifically* recoverable from the customer pursuant to contractual or other legal rights (and not as part of general pricing or through overall margin), in such limited circumstances, the same may result into future economic benefits and control over such benefits due to contract with the customer; and therefore, these costs may satisfy the definition and recognition criteria of an asset, which should be allocated/amortised in the accounting periods in which the economic benefits associated with the same are consumed. This needs to be evaluated by the Company based on the facts and circumstances applicable to each such case.

D. Opinion

12. On the basis of above and subject to paragraph 9 above, the Committee is of the following opinion:

- (a) As mentioned in paragraph 11 above, if facilitation fee is of the nature of selling or advertising and promotional costs that are incurred in *attempting* to obtain customer contracts, the same should be recognised as an expense *unless* these costs give rise to acquisition or creation of an asset (and the recognition criteria as an asset are satisfied). For example, if these costs are directly attributable to *securing* a specifically identifiable customer contract and are *specifically* recoverable from the customer pursuant to contractual or other legal rights (and not as part of general pricing or through overall margin), in such limited circumstances, the same may result into future economic benefits and control over such benefits due to contract with the customer; and therefore, these costs may satisfy the definition and recognition criteria of an asset, which should be allocated/amortised in the accounting periods in which the economic benefits associated with the same are consumed. This needs to be evaluated by the Company based on the facts and circumstances applicable to each such case.

- (b) As mentioned in paragraph 11 above, the application of the matching concept under the Framework does not allow the recognition of items in the balance sheet which do not meet the definition of assets. Also, Refer (a) above.
