Exposure Draft

Guidance Note on Accounting by E-commerce and Cloud Computing Companies

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Research Committee
The Institute of Chartered Accountants of India
(Set up by an Act of Parliament)
New Delhi

Exposure Draft

Guidance Note on Accounting by E-commerce and Cloud Computing Companies

Research Committee of the Institute of Chartered Accountants of India invites comments on any aspect of this Exposure Draft of the 'Guidance Note on Accounting by E-commerce and Cloud Computing Companies'. Comments are most helpful if they indicate the specific paragraph or group of paragraphs to which they relate, contain a clear rationale and, where applicable, provide a suggestion for alternative wording.

Comments should be submitted in writing to the Secretary, Research Committee, The Institute of Chartered Accountants of India, ICAI Bhawan, Post Box No. 7100, Indraprastha Marg, New Delhi – 110 002, to be received not later than ***May 31, 2020.*** *Comments can also be sent by e-mail at* research@icai.in .

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(*The following is the text of the Guidance Note on Accounting by E-commerce and Cloud computing companies, issued by the Institute of Chartered Accountants of India. With the issuance of this Guidance Note, the Guidance Note on Accounting by Dot- Com Companies, issued by the Institute of Chartered Accountants of India in February 2001, stands withdrawn.*)

Introduction

1. This Guidance Note deals with accounting by e-commerce and cloud-computing companies in respect of certain issues relating to revenue and expense recognition.

2. Some of the accounting issues in e-commerce and cloud-computing companies have arisen due to the new business models being used in such companies. Some accounting issues, such as those relating to advertising partnerships, rebates, point and loyalty programmes, which are more common in business carried on by e-commerce and cloud-computing companies, also exist in other businesses.

E commerce companies

3. E-commerce (electronic commerce) is the activity of electronically buying or selling of products on online services or over the Internet. Electronic commerce draws on technologies such as mobile commerce, electronic funds transfer, supply chain management, internet marketing, online transaction processing, electronic data interchange (EDI), inventory management systems, and automated data collection systems. E-commerce is in turn driven by the technological advances of the semiconductor industry and is the largest sector of the electronics industry. E-commerce is a business model that lets the firms and individuals conduct business over electronic networks, such as internet.

4. E-commerce, which can be conducted over computers, tablets, or smartphones may be thought of like a digital version of mail-order catalogue shopping. Nearly every imaginable product and service is available through e-commerce transactions, including books, music, plane tickets, and financial services such as stock investing and online banking. As such, it is considered a very disruptive technology.

5. One form of e-commerce companies is that of on-line content companies focus on the content sites, i.e., the internet sites that provide news, information and knowledge as their main business. These include companies that provide Internet navigation services and reference guide information for World

Wide Web and that publish, provide or present proprietary, advertising, and/or third-party content. Examples of content sites include askjeeves.com, infoseek.co.za, indiainfonline.com, yahoo.com, etc.

6. Another form of e-commerce is electronic retailing (e-tailing) is the sale of goods and services through the Internet. E-tailing can include business-to-business (B2B) and business-to-consumer (B2C) sales of products and services. E-tailing requires companies to tailor their business models to capture Internet sales, which can include building out distribution channels such as warehouses, Internet webpages, and product shipping centers. Examples of e-tailing vendors are Flipkart, Amazon, Makemytrip, Yatra.com, Trivago and Grofers. Electronic retailing includes a broad range of companies and industries.7. Internet commerce companies sell products and services over the websites on the Internet and include on-line dealers.

7. E-commerce operates in all four of the following major market segments:

- Business to business (B2B)
- Business to consumer(B2C)
- Consumer to consumer(C2C)
- Consumer to business(C2B)

8. B2B sites link different businesses or different parts of a business. Transactions on these sites take place between industrial manufacturers, wholesalers or retailers. Special features of these transactions are high volumes per customer, lesser number of customers, secured payment systems, privacy of information, etc. Examples of sites in this category are indiaconstruction.com, clickforsteel.com and seekandsource.com.

9. B2C sites sell products or services directly to consumers. A large number of e-commerce companies fall in this category. Transactions on these websites are characterised by low volumes per consumer and a large number of consumers. Examples of sites in this category are flipkart.com, amazon.com, rediff.com, jaldi.com, indiatimes.com, zipahead.com, and fabmart.com.

10. C2C sites enable consumers to buy and sell from each other through auction or other similar sites. Examples of sites in this category are bazee.com, snapdeal.com, olx.com, quikr.com, jabong.com, ebay.com, myntra.com and bidorbuy.com.

11 .C2B sites enable consumers to set prices and business enterprises bid to offer products and services. Examples of sites in this category are razorfinish.com and priceline.com.

12. There are many ways companies can earn revenue online. Of course, the first income source is through the sales of their product to consumers or businesses. However, both B2C and B2B companies could earn revenue by selling their services through a subscription-based model such as Netflix, Amazon Prime, which charges a monthly fee for access to media content. Revenue can also be earned through online advertising. For example, Facebook earns revenue from ads placed on its website by companies looking to sell to Facebook users.

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Elements of e-commerce transaction

13. In an e-commerce transaction, all the traditional elements of commerce exist though with some differences. The following elements are ordinarily present in an e-commerce transaction:

- A product or service;
- a place, namely, a website, that displays the products/services and where a business transaction takes place;
- a way for the people to visit the place (website);
- a way to accept orders, e.g., an on-line form;
- a way to accept consideration for the transaction – normally through credit cards.

14. Alternatively, the companies may use more traditional billing techniques either on-line or through the mail;

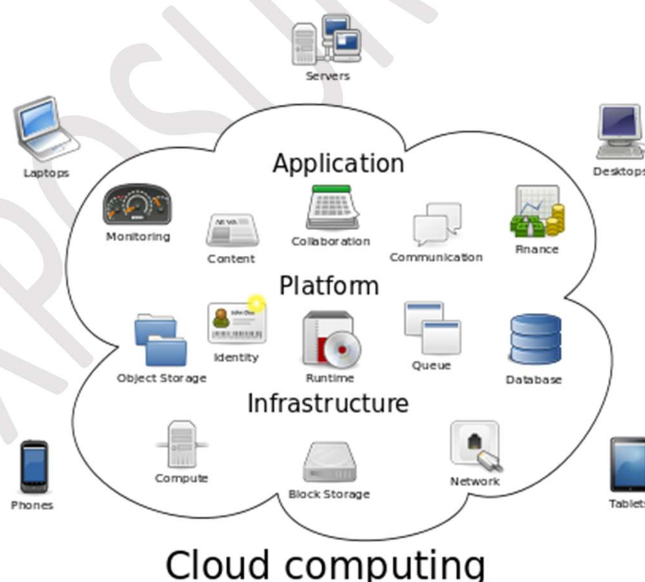
- a facility to ship products to customers (often, outsourced). In the case of software and information, the product can be transferred over the Web through a file download mechanism;
- a way to accept rejected/returned goods and services;
- a way to handle warranty claims, if necessary; and
- a way to provide customer service [often through e-mail, on-line forms, on-line knowledge bases and frequently asked questions (FAQs)].

15. Apart from the above elements of e-commerce transactions, certain facilities are also provided on the website, for example, information of the exact status of an order may be provided to the customer.

Cloud Service companies

16. Cloud computing is the delivery of computing services—servers, storage, databases, networking, software, analytics, intelligence and more—over the Internet ("the cloud") to offer faster innovation, flexible resources and economies of scale. Users typically pay only for cloud services they use, helping lower their operating costs, run your infrastructure more efficiently and scale as their business needs change. Cloud computing services often involve on-demand availability of computer system resources, especially data storage and computing power, without direct active management by the user. The term is generally used to describe data centers available to many users over the Internet. Large clouds, predominant today, often have functions distributed over multiple locations from central servers. If the connection to the user is relatively close, it may be designated an edge server.

The following is an illustrative diagram of cloud computing:



Source: Wikipedia

17. Cloud services arrangements may include the cloud services (such as software-as-a-service (SaaS)) or other products or services. These arrangements also frequently include a licence of the software, for which the customer may (or may not) have the right to take possession. Cloud services entities also frequently offer professional services, such as implementation, data migration, business process mapping, training and project management services, in addition to the cloud service itself. These professional services may be required for a customer to begin using the cloud services in the manner described in the contract.

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18.Cloud computing eliminates the capital expense of buying hardware and software and setting up and running on-site datacentres—the racks of servers, the round-the-clock electricity for power and cooling, the IT experts for managing the infrastructure.

19. On-site datacentres may require a lot of operational efforts such as hardware set up, software patching and other time-consuming IT management issues. Cloud computing removes the need for many of these tasks, so IT teams can spend time on achieving more important business goals.

20. The benefits of cloud computing services include the ability to scale elastically. In cloud speak, that means delivering the right amount of IT resources—for example, more or less computing power, storage, bandwidth—right when it is needed and from the right geographic location.

Scope

21. E-commerce and cloud service companies engaged in transactions that are similar to transactions entered into by other businesses should follow generally accepted accounting principles for recording those transactions. Similarly, in case of companies normally carrying on other businesses, the recommendations contained in this Guidance Note should be applied for recording e-commerce and cloud service transactions undertaken by them.

This Guidance Note applies to companies preparing their financial statements under Companies (Accounting Standards) Rules, 2006 under Section 133 of Companies Act, 2013 as well as those companies applying preparing their financial statements under Companies (Indian Accounting Standards) Rules, 2015 under section 133.

Revenue Recognition

22. The main sources of revenue of e-commerce companies presently include:

- Membership and subscription;
- Merchandising activities;
- Advertising services; and
- Other services like web-hosting, content selling, etc.

E-commerce companies are often valued based on revenue multiples and, therefore, it is one of the most important performance parameters. Most e-commerce companies either accept payments online through credit cards, internet banking, debit cards or cash on delivery. Further, in most cases, the delivery is the responsibility of the company and, hence, it is important to determine when does the 'risk and rewards' under Companies (Accounting Standards) Rules, 2006 or when does the 'control' under Companies (Indian Accounting Standards) Rules, 2015 get transferred to the customer. This is an important issue for business-to-customer as well as business-to-business models.

23. In respect of entities which are not subject to Indian Accounting Standards (Ind AS) Framework, the basic principles of revenue recognition as set out in Accounting Standard (AS) 9, 'Revenue Recognition', notified under Companies (Accounting Standards) Rules, 2006 and that issued by the ICAI apply to recognition of revenue from the above sources. The relevant extracts from AS 9 that are relevant in this context are reproduced below:

"4.1 Revenue is the gross inflow of cash, receivables or other consideration arising in the course of the ordinary activities of an enterprise from the sale of goods, from the rendering of services, and from the use by others of enterprise resources yielding interest, royalties and dividends. Revenue is measured by the charges made to customers or clients for goods supplied and services rendered to them and by the charges and rewards arising from the use of resources by them. In

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an agency relationship, the revenue is the amount of commission and not the gross inflow of cash, receivables or other consideration."

"10. Revenue from sales or service transactions should be recognised when the requirements as to performance set out in paragraphs 11 and 12 are satisfied, provided that at the time of performance it is not unreasonable to expect ultimate collection. If at the time of raising of any claim it is unreasonable to expect ultimate collection, revenue recognition should be postponed."

"11. In a transaction involving the sale of goods, performance should be regarded as being achieved when the following conditions have been fulfilled:
(i) the seller of goods has transferred to the buyer the property in the goods for a price or all significant risks and rewards of ownership have been transferred
to the buyer and the seller retains no effective control of the goods transferred to a degree usually associated with ownership; and
(ii) no significant uncertainty exists regarding the amount of the consideration that will be derived from the sale of the goods."

"12. In a transaction involving the rendering of services, performance should be measured either under the completed service contract method or under the proportionate completion method, whichever relates the revenue to the work accomplished.

Such performance should be regarded as being achieved when no significant uncertainty exists regarding the amount of the consideration that will be derived from rendering the service."

24. In respect of entities which are subject to Indian Accounting Standards (Ind AS) Framework i.e. Companies (Indian Accounting Standards) Rules, 2015, revenue recognition and measurement are based on the requirements of Ind AS 115 *Revenue from Contracts with Customers*. Ind AS 115 specifies the requirements an entity must apply to recognise and measure revenue and the related cash flows. The core principle of the standard is that an entity will recognise revenue at an amount that reflects the consideration to which the entity expects to be entitled in exchange for transferring promised goods or services to a customer. The relevant extracts from Ind AS 115 that are relevant in this context are reproduced below:

Identifying the contract

9 An entity shall account for a contract with a customer that is within the scope of this Standard only when all of the following criteria are met:
(a) the parties to the contract have approved the contract (in writing, orally or in accordance with other customary business practices) and are committed to perform their respective obligations;
(b) the entity can identify each party's rights regarding the goods or services to be transferred;
(c) the entity can identify the payment terms for the goods or services to be transferred;
(d) the contract has commercial substance (ie the risk, timing or amount of the entity's future cash flows is expected to change as a result of the contract); and
(e) it is probable that the entity will collect the consideration to which it will be entitled in exchange for the goods or services that will be transferred to the customer. In evaluating whether collectability of an amount of consideration is probable, an entity shall consider only the customer's ability and intention to pay that amount of consideration when it is due. The amount of consideration to which the entity will be entitled may be less than the price stated in the contract if the consideration is variable because the entity may offer the customer a price concession (see paragraph 52).

Identifying performance obligations

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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).**

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.

Determining the transaction price

47 An entity shall consider the terms of the contract and its customary business practices to determine the transaction price. The transaction price is the amount of consideration to which an entity expects to be entitled in exchange for transferring promised goods or services to a customer, excluding amounts collected on behalf of third parties (for example, some sales taxes). The consideration promised in a contract with a customer may include fixed amounts, variable amounts, or both.

Allocating the transaction price to performance obligations

73 The objective when allocating the transaction price is for an entity to allocate the transaction price to each performance obligation (or distinct good or service) in an amount that depicts the amount of consideration to which the entity expects to be entitled in exchange for transferring the promised goods or services to the customer.

25. On the basis of the above, accounting principles applicable to specific sources of revenue of e-commerce companies are discussed in the following paragraphs. Under both AS 9 and Ind AS 115, one of the indicators to determine the timing of revenue recognition is to know who bears the insurance costs and risk. In practice, many large e-retail enter into agreements with logistics providers who bear insurance cost and risk of delivery. Under such contracts, companies would recognise revenue on despatch of goods from the warehouse. However, when the cost of delivery is built into the pricing of the product and the cost of transport is borne by the e-commerce entity, then the risk of delivery and loss is still with the e-commerce company. In such cases, it may be appropriate to recognise revenues only once the products are delivered to the customer.

Further, in practice, the customers are often provided with an option to return the goods sold. It is important to evaluate each such offer more specifically to understand the facts and circumstances and their implications on accounting. Generally, when the buyer has a right of return and there is uncertainty about the possibility of return, revenue is not recognised until the shipment has been accepted by the customer/ goods are delivered to the customer and the time period for rejection has elapsed.

Historical experience may be considered in assessing the possibility of return. If based on past experience, the entity can make a reliable estimate of the amount of the goods that may be returned, then it would be appropriate to recognise revenue for the amount that is expected to be received for items that are not returned if other conditions for revenue recognition are met.

Upfront fee for membership and subscription

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26. Many a times, entities receive upfront payments from customers before they provide the contracted service or deliver a good. Such upfront fees generally relate to the activation or set-up of a good to be used or a service to be provided in the future. In many cases, the upfront amounts paid by the customer are non-refundable. In order to avail of the services provided by e-commerce entities, consumers are usually required to pay an amount as membership fees or subscription. Such membership fee or subscription may also be collected in the form of registration fee. While some services are available to members free of cost after registration, other services may be made available only on payment of an additional fee.

27. The membership/registration fees received by a e-commerce company may fall in the following categories:

- Non-refundable fees that entitle a member to use the services of the website by making payment for all services separately;
- Non-refundable fees that entitle a member to use the services of the website indefinitely without making any further payment for use of services;
- Non-refundable fees that entitle a member to use the services of the website for a specified period of time;
- Fees that are refundable subject to the fulfilment of certain conditions stipulated in the subscription agreement. Usually contractual stipulations require such conditions to be fulfilled within a specified time period; and
- Periodic membership/subscription fees on monthly, quarterly, annual or such other basis.

28. E-commerce companies often offer membership services to customers, wherein customers pay non-refundable upfront fees to the e-commerce company. In return, the members (customers) get, for example, discounts and other benefits in partner restaurants.

29. Under Companies (Accounting Standards) Rules, 2006, AS 9 contains guidance on the recognition of non-refundable fees as revenue

30. Revenue earning process is completed by performance of specified actions as per the terms of the arrangements, not simply by originating a revenue generating arrangement.

31. Supply of products or rendering of services by e-commerce companies may involve charge of a non-refundable upfront fee/initial (membership/ registration) fee with or without subsequent payments for products or services to be provided in future. In those cases where all products or services are to be separately paid for apart from the initial membership fee, the initial membership fee is of the nature of an entrance fee which should be capitalised and revenue from rendering of services or supply of products should be recognised on the basis specified in this regard in AS 9.

32. With regard to non-refundable fees that entitle a member to use the services of the website indefinitely without making any further payment for use of services, the initial fee, in substance, represents wholly or partly an advance payment for products or services to be provided in future. This implies that it is expected that the services would be provided on a continuous basis after payment of up-front fee. The non-refundable up-front fee and the continuing performance obligation related to the services to be provided or products to be delivered form an integrated package.

33. Accordingly, up-front membership fees, even if non-refundable, are actually earned as the products and/or services are delivered and/or rendered over the term of the arrangement or the expected period of performance.

34. Consequently, recognition of such non-refundable fees should be generally deferred and the same should be recognised systematically over the period(s) during which fees are earned. However, keeping in view the uncertain nature of business of an e-commerce company, non-refundable fees that entitle a member to use the services of the website indefinitely should be recognised as revenue over a

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reasonable period on a systematic and rational basis, i.e., on time proportion basis or any other basis, e.g., usage basis, whichever is more representative of the services rendered. In case the company also provides services for periodic subscription, the revenue in respect of non-refundable fees to be recognised on the aforesaid basis should not exceed the corresponding periodic subscription.

35. Non-refundable fees that entitle a member to use the services of the website for a specified period of time in excess of the reasonable period of time determined as per paragraph 34 above should be recognised as revenue over a longer period of time based on the members' entitlements.. However, in case the specified period is less than the reasonable period determined as per paragraph 34, the fees should be recognised as revenue on a systematic and rational basis usually on a time proportion basis over the specified period unless another systematic and rational basis is more representative of the services rendered, e.g., the usage basis.

36. In respect of membership fees that are refundable to members subject to fulfilment of certain conditions (for example, a stipulated volume of usage within a specified period, etc.), it is not appropriate to recognise such fees as revenue on receipt thereof since it is expected that a member would ordinarily fulfil the conditions. Accordingly, the revenue from such transactions should be recognised when it becomes reasonably certain that conditions would not be fulfilled. Pending the recognition of revenue as aforesaid, the amounts received from customers should be credited and retained in a liability account such as 'Customers Refundable Fees Account'. The company should periodically review the status of this account to ascertain the extent of fulfilment or otherwise of the conditions.

37. Periodic membership subscriptions paid by members to avail of the services offered by the website should be recognised as revenue over the period of the subscription, in accordance with the principles of AS 9.

38. Under Companies (Indian Accounting Standards) Rules, 2015, under Ind AS 115, there is specific guidance for accounting for upfront non-refundable fee revenue:

"B48 In some contracts, an entity charges a customer a non-refundable upfront fee at or near contract inception. Examples include joining fees in health club membership contracts, activation fees in telecommunication contracts, setup fees in some services contracts and initial fees in some supply contracts.

B49 To identify performance obligations in such contracts, an entity shall assess whether the fee relates to the transfer of a promised good or service. In many cases, even though a non-refundable upfront fee relates to an activity that the entity is required to undertake at or near contract inception to fulfil the contract that activity does not result in the transfer of a promised good or service to the customer (see paragraph 25). Instead, the upfront fee is an advance payment for future goods or services and, therefore, would be recognised as revenue when those future goods or services are provided. The revenue recognition period would extend beyond the initial contractual period if the entity grants the customer the option to renew the contract and that option provides the customer with a material right as described in paragraph B40.

B50 If the non-refundable upfront fee relates to a good or service, the entity shall evaluate whether to account for the good or service as a separate performance obligation in accordance with paragraphs 22–30.

B51 An entity may charge a non-refundable fee in part as compensation for costs incurred in setting up a contract (or other administrative tasks as described in paragraph 25). If those setup activities do not satisfy a performance obligation, the entity shall disregard those activities (and related costs) when measuring progress in accordance with paragraph B19. That is because the costs of setup activities do not depict the transfer of services to the customer. The entity shall

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assess whether costs incurred in setting up a contract have resulted in an asset that shall be recognised in accordance with paragraph 95."

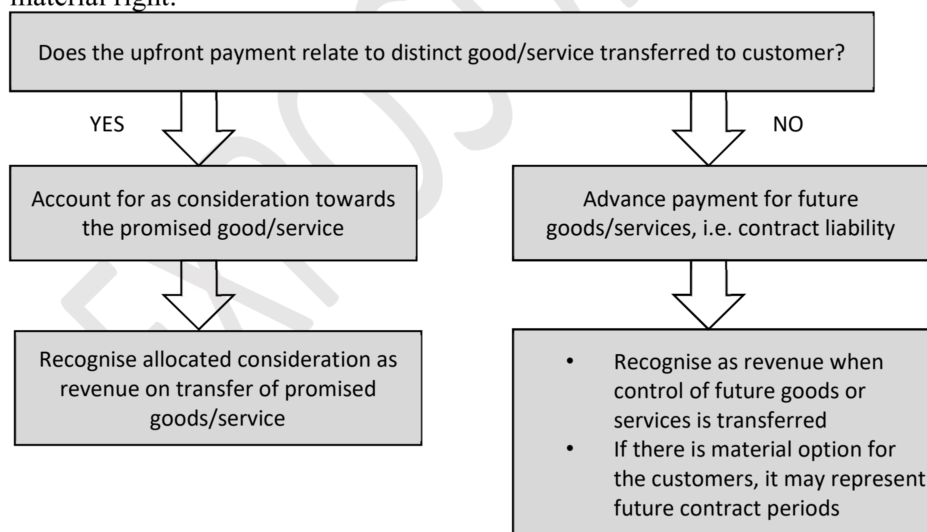
39. Entities must evaluate whether a non-refundable upfront fee relates to the transfer of a good or service. If it does, the entity is required to determine whether to account for the promised good or service as a separate performance obligation. Fees received towards setting-up of activities do not depict the transfer of services to a customer. These should also be ignored when measuring progress of an entity's performance.

40. Even though a non-refundable upfront fee relates to an activity that the entity is required to initially undertake towards the contract, in many cases, that activity will not result in the transfer of a promised good or service to the customer.

41. Non-refundable up-front fee may indicate that the arrangement includes an option to the customer for additional goods or services (e.g., renewal option for future goods or services at a reduced price, if the customer renews the agreement without the payment of an additional upfront fee). In such a case, an entity needs to assess to determine whether the option is a material right (i.e., another performance obligation in the contract). If the entity concludes that the non-refundable upfront fee does not provide a material right, the fee would be part of the consideration allocable to the goods or services in the contract and would be recognised when (or as) the good or service to which the consideration was allocated is transferred to the customer.

42. Non-refundable upfront fee that provides a material right to the customers, the amount of the fee allocated to the material right would be recognised over the period of benefit of the fee, which may or may not be the estimated customer life.

The following diagram depicts the allocation of a non-refundable upfront fee determined to be a material right:



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Example: Non-refundable upfront fees – restaurant membership fees

A customer signs a one-year contract with a Pomato Gold, an e-commerce entity, and is required to pay both a non-refundable initiation fee of Rs.10,000 and an annual membership fee in monthly instalments of Rs.4,000. The members get discounts and other benefits in

partner restaurants across India. At the end of each year, the customer can renew the contract for an additional year without paying an additional initiation fee. The customer is then required to pay an annual membership fee in monthly instalments for each renewal period. Pomato's activity of registering the customer does not transfer any service to the customer and, therefore, is not a performance obligation. By not requiring the customer to pay the upfront membership fee again upon renewal, Pomato is effectively providing a discounted renewal rate to the customer.

Pomato determines that the renewal option is a material right because it provides a renewal option at a lower price than the range of prices typically charged for new customers. Therefore, it is a separate performance obligation. Based on its experience, Pomato determines that its customers, on average, renew their annual memberships twice before terminating their relationship with Pomato. As a result, Pomato determines that the option provides the customer with the right to two annual renewals at a discounted price. In this scenario, Pomato would allocate the total transaction consideration of Rs.58,000 (Rs.10,000 upfront membership fee + Rs.48,000 (Rs.4,000 x 12 months)) to the identified performance obligations (monthly services for the one-year contract and renewal option) based on the relative stand-alone selling price method. The amount allocated to the renewal option would be recognised as each of the two renewal periods is either exercised or forfeited.

Alternatively, Pomato could value the option by 'looking through' to the optional goods and services using the practical alternative provided in Ind AS 115.B42. In that case, it would determine that the total hypothetical transaction price (for purposes of allocating the transaction price to the option) is the sum of the upfront fee plus three years of service fees Rs.154,000(i.e.,Rs.10,000 + Rs.144,000) and would allocate that amount to all of the services expected to be delivered or 36 months of membership (or Rs.5,144 per month). The amount allocated to the renewal option would be recognised as revenue over each renewal period. One acceptable approach would be to reduce the initial Rs.10,000 deferred revenue balance for the material right by Rs.278 each month (Rs.10,000 / 36 months remaining), assuming that the estimated renewal period of two years remains unchanged.

Example: Recognition of Upfront fee by cloud service company

A Ltd, a cloud service company, enters into a contract with a customer for a licence of its software and a non-cancellable one-year subscription to access the licensed application (the cloud services). The contract amount for the software licence is an upfront, non-refundable fee of Rs.10 Lakhs. The fee for the cloud services is Rs. 500,000 for one year. Therefore, the total fees paid by the customer for the first year's subscription is Rs. 15,00,000. The customer has the right to renew the cloud services each year for Rs.500,000.

Assume that A Ltd. determines the software licence and cloud services are a single performance obligation. There are no other promised goods and services in the contract. Therefore, the upfront fee is not associated with the transfer of any other good or service to the customer. However, A Ltd. determines there is an implied performance obligation. That is, the right to renew the cloud services each year for Rs.500,000 is a material right to the customer because that renewal rate is significantly below the rate the customer paid for the first year of service (Rs.15 Lakhs in total).

Based on its experience, A determines that its average customer relationship is three years. As a result, A determines that the performance obligations in the contract include the right to a discounted annual contract renewal and that the customer is likely to exercise twice. Therefore, A defers the non-refundable upfront fee of Rs.10,00,000 and recognises the same over the three years on a straight-line basis.

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Merchandising activities

43. In case of e-commerce entities, generally multiple parties are involved in providing good and services. When there are multiple parties involved in providing goods or services to a customer, an entity evaluates the nature of its promise to the customer. If an entity assumes the risks and rewards and obtains control of another party's goods or services before transferring the risks and rewards and control to the customer, then the entity's promise is to provide the goods or services itself. Therefore, the entity is acting as a principal for accounting purpose. In such cases, the entity records revenue on a gross basis.

44. On the other hand, if the entity does not control the goods or services before it is transferred to the customer, then the entity is acting as an agent for accounting purpose and arranges for that good or service to be provided by another party. In such cases, the entity records as revenue the net amount that it retains for its agency services.

45. One of the significant issues in accounting by e-commerce companies is whether to recognise gross amount of revenues and the related cost of sales or to recognise the revenue on net basis, similar to commission. The significance of this issue is enhanced due to the importance often placed on the revenue being used as the basis for valuation of e-commerce companies.

46. The question of gross versus net revenue and cost recognition ordinarily arises in connection with e-commerce companies that distribute or resell third party products or services. This issue typically arises in the B2C sites. Due to the legal framework in India, a B2B entity may not be allowed to make a sale to retail customers and is required to sell its goods to a B2C company. This relationship can also have an impact on the presentation of revenue is the books of the B2B and B2C companies on a gross or net basis.

47. In assessing whether revenue should be reported on gross basis with separate recognition of cost of sales or on net basis, under AS 9, it should be considered whether the e-commerce company:

- acts as a principal in the transaction, i.e., it assumes significant risks and rewards of ownership, such as the risk of loss in collection, delivery, or returns; or
- acts as an agent or broker for sale of goods or rendering of services, i.e., does not assume significant risks and rewards of ownership; compensation being commission or fee. In this case, the e-commerce company is merely engaged in providing the service of bringing the purchaser and the seller together.

48. Where a e-commerce company acts as a principal in the transaction, i.e., significant risks and rewards of ownership are first acquired by it and then transferred on sale, it is appropriate to recognise revenues and the related costs on a gross basis. If the e-commerce company does not do so, i.e., it merely acts as an agent, it would be appropriate to recognise only the service charges as revenue, similar to commission.

49. The Technical Guide on Accounting Issues in the Retail Sector is issued by the Institute of Chartered Accountants of India, provides guidance on presentation of revenues. As per the Technical Guide, some of the factors that indicate that an entity is acting as a principal in transactions could include (indicative list only):

- The customer understands that the entity is acting as the primary obligor in the arrangement
- The entity is able to set the selling price with the customer
- The entity has inventory risk
- The entity performs part of the services provided or modifies the goods supplied
- The entity has or assumes the credit risk associated with the transaction

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50. Determining whether an entity is acting as an agent or principal is based on an evaluation of the risks and responsibilities taken by the entity, including factors as mentioned above such an inventory risk and responsibility for the delivery of goods or services.

51. Revenue represents the amount received by an entity for its own account. Therefore, for a principal, revenue should be presented at its gross amount and is measured before deducting related costs such as cost of materials and salaries. On the other hand, in an agency relationship, the amounts collected on behalf of and passed on to the principal is not revenue of the agent. The revenue of the agent is the amount of net margin, plus any other amount charged by the agent to the principal or other parties. The revenue collected from the ultimate customer (net of taxes) is recorded as revenue by the principal. The principal recognises the consideration retained by the agent as a cost.

52. Common example is that of an e-commerce company purchasing traded goods from a wholesaler. E-commerce company generally would sell these goods to the end customer and may or may not carry the associated inventory risk as it purchases goods from the wholesaler only when it receives orders from the end customer. However, it may bear the risk of those inventory items that have been returned by the customer. In such cases, the e-commerce company does not seem to bear significant inventory risk, however, it may bear the following:

- Credit risk
- Is primary responsible for providing the goods to the customer, i.e., fulfilling the order
- Direct pricing discretion
- Discretion is selecting the supplies/ wholesaler

In such a case, the e-commerce company may asses the above criteria to be significant and reflect the gross billing to its customers as its revenue.

53. Under Companies (Indian Accounting Standards) Rules, 2015, Ind AS 115 contains the overall principle for the principal versus agent evaluation. These are little different from the indicators contained in Technical Guide on Accounting Issues in the Retail Sector. The relevant extracts of Ind AS 115 in the context are as follows:

B.34 When another party is involved in providing goods or services to a customer, the entity shall determine whether the nature of its promise is a performance obligation to provide the specified goods or services itself (i.e., the entity is a principal) or to arrange for those goods or services to be provided by the other party (i.e., the entity is an agent).

B34A To determine the nature of its promise (as described in paragraph B34), the entity shall:

(a) Identify the specified goods or services to be provided to the customer (which, for example, could be a right to a good or service to be provided by another party (see paragraph 26)); and

(b) Assess whether it controls (as described in paragraph 33) each specified good or service before that good or service is transferred to the customer.

B35 An entity is a principal if it controls the specified good or service before that good or service is transferred to a customer. However, an entity does not necessarily control a specified good if the entity obtains legal title to that good only momentarily before legal title is transferred to a customer. An entity that is a principal may satisfy its performance obligation to provide the specified good or service itself or it may engage another party (for example, a subcontractor) to satisfy some or all of the performance obligation on its behalf.

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54. An entity determines whether it is a principal or an agent for each specified good or service promised to the customer. A specified good or service is a distinct good or service (or a distinct bundle of goods or services) to be provided to the customer. If a contract with a customer includes more than one specified good or service, an entity could be a principal for some specified goods or services and an agent for others.

55. Following examples illustrate the accounting treatment.

Example: Restaurant/hotel coupon services

A Ltd. is an entity that sells restaurant/hotel electronic coupons on its mobile application and website. The vouchers sold by A Ltd. entitle customers to future meals at specified restaurants and hotels. The sales price of the voucher provides the customer with a significant discount ranging from 20% to 80% when compared with the normal selling prices of the meals and hotel room tariff. For example, a customer pays Rs. 1,000 for a voucher that entitles the customer to a meal at a restaurant that would otherwise cost Rs. 2,000. A Ltd. does not purchase or commit itself to purchase vouchers in advance of the sale of a voucher to a customer; instead, it purchases vouchers only as they are requested by the customers. A Ltd. sells the vouchers through its web-application and the vouchers are non-refundable.

A Ltd and the restaurants and hotels jointly determine the prices at which the vouchers will be sold to customers. Under the terms of its contracts with the restaurants, the entity is entitled to 15% of the voucher price when it sells the voucher.

A Ltd. also assists the customers in resolving complaints about the meals/hotels and has a buyer satisfaction programme. However, the restaurant is responsible for fulfilling obligations associated with the voucher, including remedies to a customer for dissatisfaction with the service.

To determine whether the entity is a principal or an agent, the entity identifies the specified good or service to be provided to the customer and assess whether it controls the specified good or service before that good or service is transferred to the customer. A customer obtains a voucher for the restaurant/hotel that it selects. A Ltd. does not engage the restaurants/hotels to provide meals to customers on the entity's behalf.

Therefore, A Ltd observes that the specified good or service to be provided to the customer is the right to a meal/hotel stay (in the form of a voucher) at a specified restaurant or hotel, which the customer purchases and then can use itself or transfer to another person. The entity also observes that no other goods or services (other than the vouchers) are promised to the customers.

A Ltd. concludes that it does not control the voucher (right to a meal) at any time. In reaching this conclusion, the entity principally considers the following:

(a) The vouchers are created only at the time that they are transferred to the customers and, thus, do not exist before that transfer. Therefore, A Ltd. does not at any time have the ability to direct the use of the vouchers or obtain substantially all of the remaining benefits from the vouchers, before they are transferred to customers.

(b) A Ltd. neither purchases, nor commits itself to purchase, vouchers before they are sold to customers. A Ltd also has no responsibility to accept any returned vouchers. Therefore, A Ltd. does not have inventory risk with respect to the vouchers.

Thus, A Ltd. concludes that it is an agent with respect to the vouchers. A Ltd. recognises revenue in the net amount of consideration to which the entity will be entitled in exchange for arranging for the restaurants/hotels to provide vouchers to customers for the restaurants' meals, which is the 15% commission it is entitled to upon the sale of each voucher.

Example: Electronic Airline ticket retailer

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Travel agent Ltd. is an entity that sell airlines tickets on its website and mobile application. Negotiates with major airlines to purchase tickets at reduced rates compared with the price of tickets sold directly by the airlines to the public. Travel agent Ltd. agrees to buy a specific number of tickets and must pay for those tickets regardless of whether it is able to resell them. The reduced rate paid by the entity for each ticket purchased is negotiated and agreed in advance.

Travel agent determines the prices at which the airline tickets will be sold to its customers. The entity sells the tickets and collects the consideration from customers when the tickets are purchased.

Travel agent also assists the customers in resolving complaints with the service provided by the airlines. However, each airline is responsible for fulfilling obligations associated with the ticket, including remedies to a customer for dissatisfaction with the service.

To determine whether Travel agent Ltd.'s performance obligation is to provide the specified goods or services itself (i.e., the entity is a principal) or to arrange for those goods or services to be provided by another party (i.e., the entity is an agent), the entity identifies the specified good or service to be provided to the customer and assesses whether it controls that good or service before the good or service is transferred to the customer. Travel agent Ltd. concludes that, with each ticket that it commits itself to purchase from the airline, it obtains control of a right to fly on a specified flight (in the form of a ticket) that the entity then transfers to one of its customers. Consequently, the entity determines that the specified good or service to be provided to its customer is that right (to a seat on a specific flight) that the entity controls. The entity observes that no other goods or services are promised to the customer.

Travel agent Ltd. controls the right to each flight before it transfers that specified right to one of its customers because the entity has the ability to direct the use of that right by deciding whether to use the ticket to fulfil a contract with a customer and, if so, which contract it will fulfil. The entity also has the ability to obtain the remaining benefits from that right by either reselling the ticket or obtaining all of the proceeds from the sale or, alternatively, using the ticket itself.

Travel agent Ltd. controls each specified right (ticket) before it is transferred to the customer. The entity has inventory risk with respect to the ticket because the entity committed itself to obtain the ticket from the airline before obtaining a contract with a customer to purchase the ticket. This is because the entity is obliged to pay the airline for that right regardless of whether it is able to obtain a customer to resell the ticket to or whether it can obtain a favourable price for the ticket. The entity also establishes the price that the customer will pay for the specified ticket.

Thus, Travel agent Ltd. concludes that it is a principal in the transactions with customers. The entity recognises revenue in the gross amount of consideration to which it is entitled in exchange for the tickets transferred to the customers.

Example: Advertising aggregator: principal v/s. agent– Gross Vs. Net presentation A Ltd., is an advertising agency having several advertiser companies in its client list. A Ltd. enters into an agreement with a social media website, WooHoo, to be its sole advertising agent in India. All the advertisers wishing to advertise on WooHoo are required to book advertising space only through A Ltd. and WooHoo cannot be directly approached.

A Ltd. enters into advertising contracts with a client for advertising on WooHoo. The arrangement does not require A Ltd. to provide any production services, i.e., the advertising content is provided by the client. The advertising cost is Rs.10 per click, i.e., each time the users of WooHoo would click on the web link of the advertiser that would appear on the social media site. The consideration payable to A Ltd. is Rs.2 per click. There are no minimum advertising charges.

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Monthly payments towards the advertisements (at Rs.12 per the user clicks for the month) made by the advertiser (client) are paid to A Ltd., who, in turn, passes on the payments to WooHoo (at Rs.10 per the user clicks for the month).

A question that arises is whether A Ltd. is an agent (revenue Rs. 2 per click) or principal (revenue of Rs. 12 per click and cost of Rs.10 per click).

In this case, the primary responsibility to provide advertisement services is of WooHoo and not A Ltd. There is no inventory risk. Although A Ltd. has some pricing latitude, it does not appear to be significant. A Ltd. seems to be an advertising aggregator in such an arrangement, rather than an advertisement service provider himself.

Based on the overall, analysis, A Ltd. is acting as an agent under Ind AS 115 and should therefore report revenue of Rs.2 per click.

Example: E-commerce retailer

E.com Ltd., a large internet based retailer, enters into a contract with Fashion, a readymade garment manufacturer, to sell its products through the online platform of E.com. The terms and conditions of the contract include:

- E.com will transport the product sold to the end customer;
- E.com does not take possession of the product sold to the customers; however, the customer returns the products back to E.com if they are dissatisfied;
- E.com has the right to return products to Fashion without penalty if they are returned by the customer;
- E.com may earn margin on the products sold, however, and it has flexibility in establishing the sales price of the product;
- E.com may, at its discretion, provide the end-customer its loyalty incentive points, discount points, and other incentives. Fashion does not have any influence on E.com for the incentives that it may wish to give to the end-customers.
- E.com's latitude on pricing (through incentives provided) indicates that E.com may control the products. However, this factor alone should not be decisive in the principal versus agent assessment. The factors such as, Fashion is responsible for providing the products to the end customer, bears the inventory risk, would also have to be considered in the assessment.

Auctions

56. Some companies host auction sites as part of their on-line activities where users can purchase or sell goods or services. The company ordinarily earns auction revenues through two sources – up-front (listing) fees and transaction-based fees.

57. Listing fees are the up-front fees that the e-commerce company receives at the time a seller registers for a listing to be maintained over a specified period of time. The purchaser is paying for a service that is delivered over time. It is appropriate that listing fees are recognised over the period of the contract or arrangement, provided there are no significant outstanding vendor obligations to be fulfilled and collection of the related receivable is reasonably certain.

58. Transaction fees are for facilitating the transaction and are usually based on a percentage of the revenue earned by the seller from the sale. Such fees should be recognised as revenue by the company upon completion of the transaction or at the time when no further vendor obligations remain to be performed as per the terms with the vendor.

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Shipping and handling

59. E-commerce companies selling products on-line often charge customers for shipping and handling activities. Such charges may or may not be a direct reimbursement of the costs incurred by e-commerce companies. Some companies display the charges separately whereas some do not.

60. In determining accounting treatment, it should be examined whether the products sold on-line are invoiced to the customers at a composite rate including shipping and handling charges or whether shipping and handling charges are recovered separately as an absolute amount or as a percentage of the sale value. In the former case, it may be appropriate to include such charges as a component of sales revenue provided a clear distinction cannot be made between the product value and the shipping and handling charge component. Where such charges are recovered as an absolute amount or as a percentage of sale value separately, these should not be included in sales revenue but should be recorded separately. Thus, such charges should not be included in computing the value of turnover to be disclosed in the statement of profit and loss. Shipping and handling charges should be recognised separately as an income and the actual cost incurred in respect thereof should be recognised as an expense. However, where these charges are clearly a reimbursement by the buyer of the actual cost incurred by the seller, these should be shown as a deduction from the shipping and handling cost in the statement of profit and loss, if the amount involved is material.

61. Under Companies (Indian Accounting Standards) Rules, 2015, the core principle of Ind AS 115 is that "an entity recognizes revenue to depict the transfer of promised goods or services to customers in an amount that reflects the consideration to which the entity expects to be entitled in exchange for those goods or services." However, the transaction price should exclude amounts collected on behalf of third parties (e.g., Goods and Services Tax). Ind AS 115 does not directly provide guidance on whether amounts billed to an entity's customer such as shipping and handling fees, are collected on behalf of third parties.

62. Entities may determine presentation on the basis of the principal-agent guidance in the standard (i.e., to determine whether the entity is merely a conduit). An entity would record amounts towards shipping and handling, gross unless the entity arranges shipping on behalf of the customer in accordance with the customer's specifications, in which case, the entity is only responsible for collecting and remitting fees to third parties. An entity would most likely need to assess whether it is acting as a principal or an agent to determine how to present amounts billed and collected on behalf of third parties.

63. When an entity acts as a "pass-through", amounts would be recognized on a net basis as if the entity was an agent if, for example,

(1) the customer chooses and contracts directly with the shipping/ logistics company, but the entity collects the shipping fee or

(2) goods or services are insured by third parties and the entity is collecting the insurance fee. However, there may be situations in which shipping is offered as customer incentive (e.g., free or discounted shipping terms), which has become more prevalent in e-commerce transactions, or in which entities are responsible for shipping (i.e., shipping is included in the entity's pricing of a good or service). In such instances, determining whether to recognize amounts of revenue on a gross or net basis may not be very clear.

64. The relevant extracts for Ind AS 115 are as follows:

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

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have the same pattern of transfer to the customer (see paragraph 23).

Ind AS 115 requires an entity to assess the goods or services promised in a contract with a customer in order to identify performance obligations. Therefore, an entity would need to consider:

- Whether shipping and handling activities represent fulfilment activities before the customer obtains control of the goods,
- Whether shipping and handling service would be a distinct performance obligation towards the customer; and
- Whether the entity is the principal for the shipping service or is an agent arranging for the shipping service to be provided to the customer when control of the goods transfers at shipping point.

65. Following example illustrates the consideration for shipping and handling services.

Example: Shipping service in a FOB contract

An electronics e-tailer enters into a contract to sell flat screen televisions to a customer. The delivery terms are free on board (FOB) shipping point (legal title passes to the retailer when the televisions are handed over to the carrier). A third-party carrier is used to deliver the televisions. The e-tailer has a past business practice of providing replacements to the retailer at no additional cost if the televisions are damaged during transit.

The customer does not have physical possession of the televisions during transit, but has a legal title at shipment and therefore can redirect the televisions to another party. The e-tailer is also precluded from selling the televisions to another customer while in transit.

The customer might conclude that it has two performance obligations: one for fulfilling the order for the televisions and a second for covering the risk of loss during transit based on its past business practice. The e-tailer has not satisfied its performance obligation regarding the risk of loss at the point of shipment.

The consideration from the customer should be allocated to the televisions and to the service that covers the risk of loss. Revenue for the televisions is recognized at the time of shipping when control transfers. Revenue allocated to the risk of loss service is recognized when performance occurs.

Multiple element arrangements

66. A multiple element arrangement generally exists where an e-commerce company agrees to deliver more than one product/ service concurrently and deliver certain additional products/services in future. These additional products/services may include upgrades, enhancements or maintenance services. It is sometimes customary to bundle such products and services for a consolidated price.

67. For accounting purposes, it is appropriate to 'unbundle' the separate elements of the arrangement or contract. For this purpose, company-specific fair values in respect of which objective evidence is available should be used, i.e., what the company would have received had it sold each item/ service separately. Company-specific objective evidence of fair value is determined in respect of transactions with unrelated parties. For example, an e-commerce company may agree to host another company's website and also provide web maintenance service for a fixed fee of Rs.15 lakh for a term of one year and six months, respectively. If the e-commerce company has evidence that in its recent transactions, it has charged separate fees for web hosting and web maintenance of Rs.12 lakh for one year and Rs.6 lakh for six months, respectively, then revenue in respect of the composite service now being provided

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should be recognised in the ratio of 2:1, i.e., Rs.10 lakh from web hosting over one year and Rs.5 lakh as revenue from web maintenance services over a period of six months.

68. Unbundling of revenues from multiple element arrangements is not performed where the revenue recognition criteria as well as the periods over which revenues would be recognised are the same for individual elements of the multiple element arrangement.

69. In the absence of availability of sufficient company-specific objective evidence of fair values for the allocation of revenue between various elements, it would be appropriate to defer recognition of the entire revenue from the contract until (a) sufficient company-specific objective evidence comes into existence, or (b) all elements of the arrangement are delivered, whichever is earlier. In the latter case, the composite amount is recognised as revenue on delivery of all elements of arrangement. Associated costs related to such deferred revenues should also be carried forward until they are capable of being matched against revenues recognised in the financial statements.

70. Ind AS 115 provides a framework for identifying the performance obligations in a contract. When an entity determines that the promised goods or services are distinct, it will need to determine whether it is providing a software licence (as a separate performance obligation from the hosting service) or a service (a licence and hosting services that, together, are a single performance obligation because the two promises are not distinct from one another).

71. In cloud services, most arrangements involving software also include promises for the right to receive services or unspecified upgrades and enhancements (or both) after the licence period begins. Generally, these services include telephone support and correction of errors (bug fixes or debugging), as well as unspecified upgrades or enhancements. These activities are commonly known as post-contract support (PCS). Entities may combine PCS with the software as a single component under Ind AS 115. While other entities may separate PCS as a separate component from the software or even into multiple separate components.

72. PCS is not a unique service contemplated or defined in Ind AS 115. As a result, entities will need to evaluate whether the individual services that comprise what is considered PCS today will be separate performance obligations. For example, a software entity may conclude that the promise to provide unspecified future upgrades and enhancements is a distinct promised good or service in the contract and, therefore, is a separate performance obligation. The entity may also determine that bug fixes and telephone support are provided to ensure that the software is functioning as promised. As a result, those services would be part of the assurance warranty coverage for the software and not a revenue element (such warranties will be accounted for under Ind AS 37 Provisions, Contingent Liabilities and Contingent Assets).

73. However, other entities may conclude that the promise to provide telephone support and bug fixes contains both an assurance-type warranty (non-revenue element) and service-type warranty (revenue element).

Multiple element arrangements- Considerations for cloud Services Company

74. Cloud services include Software-as-a-Service (SaaS) or other products or services. These arrangements also frequently include a licence of the software, for which the customer may (or may not) have the right to take possession. Cloud services may also include other services offerings, such as data migration, business process mapping, in addition to the cloud service itself. These services may be required for a customer to begin using the cloud services in the manner described in the contract.

75. Ind AS 115 requires identification of the performance obligations in a contract. An entity will, therefore, need to determine whether it is providing a software licence, as a separate performance obligation from the hosting service, or a service, a licence and hosting services that, together, represent a single performance obligation because the two promises are not distinct from one another.

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76. An entity may provide a customer with a software licence, but only in conjunction with a hosting service. Also, the customer may not take control of the licence or use the software without the hosting service. In such cases, the customer cannot benefit from the licence on its own and the licence is not separable from the hosting services. In such a scenario, the licence would have to be combined with the hosting service.

Sales Returns - Right of Return in exchange for cash/goods or services/vouchers

77. E-commerce companies, particularly e-tailers, often provide option of returning the goods for exchange either in cash or goods or services or by way of store credit vouchers which can be used by the customer for subsequent purchases, either with or without a time limit. In such cases, the entity would need to evaluate the appropriate timing of recognising revenue as there is certain level of uncertainty attached as to when and whether the customer would exchange the goods or services and further whether the customer would utilise the vouchers, if any, obtained in exchange of returning the goods or services. While most retailers are able to discern past trends with respect to returns, others may have a varied and disparate experience of 'sales returns' and would need to make the best estimates with the available information.

78. Under Companies (Accounting Standards) Rules, 2006, with regard to uncertainties, paragraph 10 of AS 9, "Revenue Recognition", states the following:

Revenue from sales or service transactions should be recognised when the requirements as to performance set out in paragraphs 11 and 12 are satisfied, provided that at the time of performance it is not unreasonable to expect ultimate collection. If at the time of raising of any claim it is unreasonable to expect ultimate collection, revenue recognition should be postponed.

Further, with regard to sale of goods, the criteria set out for revenue recognition in paragraph 11 of AS 9, "Revenue Recognition", are:

In a transaction involving the sale of goods, performance should be regarded as being achieved when the following conditions have been fulfilled:

(i) **the seller of goods has transferred to the buyer the property in the goods for a price or all significant risks and rewards of ownership have been transferred to the buyer and the seller retains no effective control of the goods transferred to a degree usually associated with ownership; and**

(ii) **no significant uncertainty exists regarding the amount of the consideration that will be derived from the sale of the goods.**

79. With regard to revenue recognition for service contracts, the criteria is set out in Paragraph 12 of AS 9 states that: -
In a transaction involving the rendering of services, performance should be measured either under the completed service contract method or under the proportionate completion method, whichever relates the revenue to the work accomplished. Such performance should be regarded as being achieved when no significant uncertainty exists regarding the amount of the consideration that will be derived from rendering the service.

5.35 Following Illustration in AS 9 explains the application of AS 9 to commercial situations.

"A. Sale of Goods

……..

2. Delivered subject to conditions

………

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(c) guaranteed sales i.e. delivery is made giving the buyer an unlimited right of return

Recognition of revenue in such circumstances will depend on the substance of the agreement. In the case of retail sales offering a guarantee of "money back if not completely satisfied" it may be appropriate to recognise the sale but to make a suitable provision for returns based on previous experience. In other cases, the substance of the agreement may amount to a sale on consignment, in which case it should be treated as indicated below.

(d) consignment sales i.e. a delivery is made whereby the recipient undertakes to sell the goods on behalf of the consignor. Revenue should not be recognised until the goods are sold to a third party."

Thus, where it is assessed that an estimated percentage of sales made could be returned, an adjustment should be made towards such estimated return.

Right of Return in exchange for cash

80. In cases where such right of return is provided, it is appropriate to proceed on the basis that the sales, to the extent of estimate of likely returns, have not been made. Accordingly, sales recognised during the period should be reduced by the estimate of the returns, at the gross amount of sales and a corresponding current asset should be recognised representing the inventory that may be returned. The example below illustrates this aspect.

Example: Right of return in exchange of cash

Arc, an electronic retailer, sells shirts with a right to the customers to return the shirts within 60 days of purchase through its website and mobile application. Returns are accepted with proof of purchase and if the shirts are unused and in good condition such that Arc can sell it as new. Historically, 10% of the Arc's sales are returned by customers and this rate is expected to continue. History has shown that all such returned shirts are resold at full price. The gross margin on sale of shirts is 5%. Customers have option to return shirts by communicating through Arc's mobile application or website subsequent to which Arc refunds money to the customer against returns, if return is in acceptable condition.

Arc has sold shirts of sale value of Rs. 1000 and the period of return is not expired till the end of the financial year in which sales are made. No returns have been received till the end of the financial year.

There are returns of Rs 80 in the following financial year before the expiry of return period. The accounting entries in this regard are as under.

At the time of initial sale:

Cash/bank	Dr.	Rs.1000	Cash received at the time of sale
Sales	Cr.	Rs.1000	Revenue recognised to the full extent

At the time of Year end

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Sales	Dr.	Rs.100	10% of sales based in the past trend of expected returns
Provision for expected Right to Returns (Current Liability)	Cr.	Rs.100	
Expected returns from customers (Current asset)	Dr.	Rs.95	Cost of sales - 95% of sale price – gross margin being 5 %
Cost of Sales	Cr	Rs. 95	

In the following financial year

Provision for expected 'right to return' (Current Liability)	Dr.	Rs.100	
Cash/Bank	Cr	Rs. 80	Cash paid on right of return exercised by the customer
Sales	Cr	Rs. 20	Balance sales (Rs.100-Rs.80) for which the period of right to return has expired
Expected returns from customers (Current asset)	Dr	Rs. 76	Inventory recognised to the extent of goods returned [(Rs. 80*Rs. 95)/Rs. 100]
Cost of sales	Dr.	Rs.19	Cost of sales recognised to the extent of sales revenue of Rs 20
Expected returns from customers (Current asset)	Cr	Rs. 95	Adjustment relating to costs reversed

Right of return against goods or services or vouchers

81. In the case of right of return in exchange of goods or services or vouchers giving the right to the customers to exchange the goods or services sold against other goods/services, the sales against which such right of return is given, should be treated to have been effected and simultaneously provision for expected returns should be made. Provision should be measured as the best estimate of the loss expected to be incurred by the retailer in respect of the estimated returns including any estimated incremental cost that would be necessary to resell the goods expected to be returned.

Example- Return of goods against goods/ services/ vouchers

X is an e-tailer which sells goods through its mobile application/ website. The customers have a right to return the goods within thirty days of purchase. Returns are accepted with proof of purchase and only if they are in good condition such that X can sell it. Customers do not get

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cash on return but get goods or vouchers which can only be redeemed for goods against returned goods. Estimates show that 10% of all goods sold are returned/exchanged.

At the end of the financial year, the period of right to return has not expired in case of goods sold for Rs. 1000. It is expected that the returns, if any, will be sold at 90% of original sale price. The margin on sale is 20% with regard to such sale of Rs. 1,000. The accounting entries will be as under:

At the time of making the sales:

Cash/ Bank	Dr.	Rs.1,000	
To Sales	Cr.		Rs.1,000

At the end of the year:
No journal entry

The reason would be that though 10% of Rs. 1000 worth of goods sold are likely to be returned as per the trend, no loss is expected as the goods are not expected to be sold below cost. (Since expected returns at sale price would be 10% of Rs. 1000 i.e. Rs. 100 and cost would be 80% of Rs. 100 i.e. Rs. 80.)

However, if it is expected that the returned goods will be sold for say 70% of the original sale price (70% of Rs. 100, i.e., Rs. 70), provision for expected loss should be made. The entry will be as under:

Profit & Loss A/c	Dr.	Rs.10	
To Provision for expected loss on returns	Cr.		Rs.10

Since as explained above, the cost is Rs. 80 and expected selling price being 70% of original sale price of Rs. 100 i.e. Rs. 70 and thus expected loss is Rs.10.

Consignment arrangements

82. Many e-tailers sell their products through resellers or consignment agents. Under AS 9, under Companies (Accounting Standards) Rules, 2006, the companies may use sell-through approach for some arrangements with resellers where revenue is not recognized until the product is sold by the distributor to the end customer (that is, the consumer) because the distributor may be able to return the unsold product, rotate older stock, or receive pricing concessions. As a result, the risks and rewards of ownership have not transferred. Some entities sell products using consignment arrangements under which the buyer (a dealer or distributor) takes physical possession of the goods but does not assume all of the risks and rewards.

5.35 Following Illustration in AS 9 explains the application of AS 9 to commercial situations.

"A. Sale of Goods

……..

2. Delivered subject to conditions

………

(c) guaranteed sales i.e. delivery is made giving the buyer an unlimited right of return

Recognition of revenue in such circumstances will depend on the substance of the agreement. In the case of retail sales offering a guarantee of "money back if not completely satisfied" it may be

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appropriate to recognise the sale but to make a suitable provision for returns based on previous experience. In other cases, the substance of the agreement may amount to a sale on consignment, in which case it should be treated as indicated below.

(d) consignment sales i.e. a delivery is made whereby the recipient undertakes to sell the goods on behalf of the consignor. Revenue should not be recognised until the goods are sold to a third party."

Therefore, under AS 9, generally, revenue should not be recognised until the product is sold to the end-customer because they do not meet all of the criteria in the risks and rewards model in AS 9 to recognise revenue on delivery to the reseller.

83. Under Ind AS 115, entities must first evaluate when control of the product transfers to the customer. In this respect, they need to assess whether their contracts with resellers are consignment arrangements. In a consignment arrangement, control generally does not transfer (and, thus, revenue is not recognised) until the reseller sells the product to an end-customer.

84. Ind AS 115 provides the following guidance in case of consignment sales:

B77 When an entity delivers a product to another party (such as a dealer or a distributor) for sale to end customers, the entity shall evaluate whether that other party has obtained control of the product at that point in time. A product that has been delivered to another party may be held in a consignment arrangement if that other party has not obtained control of the product. Accordingly, an entity shall not recognise revenue upon delivery of a product to another party if the delivered product is held on consignment.

B78 Indicators that an arrangement is a consignment arrangement include, but are not limited to, the following:
(a) the product is controlled by the entity until a specified event occurs, such as the sale of the product to a customer of the dealer or until a specified period expires;
(b) the entity is able to require the return of the product or transfer the product to a third party (such as another dealer); and
(c) the dealer does not have an unconditional obligation to pay for the product (although it might be required to pay a deposit).

85. Revenue should be recognized when a good or service is transferred to the customer. An entity transfers a good or service when the customer obtains control of that good or service. A customer obtains control of a good or service if it has the ability to direct the use of and receive the benefit from the good or service.

86. Indicators that the customer has obtained control of the good or service include:

- The entity has a present right to payment for the asset.
- The customer has legal title to the asset.
- The entity transferred physical possession of the asset.
- The customer has the significant risk and rewards of ownership.
- The customer has accepted the asset.

87. A product is held on consignment if the buyer has physical possession of a good but has not obtained control. An entity should not recognize revenue for products held on consignment.
Indicators that there is a consignment arrangement include:

- The product is controlled by the seller until a specified event, such as a sale to an end customer.
- The entity is able to require the return or transfer of the product.
- The dealer does not have an unconditional obligation to pay for the product.

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88. If an entity concludes that its contract with a reseller is not a consignment arrangement, waiting until the end-sale has occurred before revenue is recognised will not be acceptable if the only uncertainty is the variability in the pricing. The entity must recognise revenue upon the transfer of control of the promised goods based on its estimate of the amount of consideration to which it expects to be entitled, considering the constraint on variable consideration. An entity may recognise revenue earlier than that under AS 9 if it can determine that it is highly probable that a significant reversal will not occur for at least some of the variable consideration (i.e., the entity is able to estimate an amount of consideration that is not constrained).

Example: Consignment arrangement

An e-tailer entity uses its distributor and logistic network to supply products of other company on its mobile technology platform to the end customers. The entity does not receive the legal title and is required to pay for the products upon receipt and may return unsold product at the end of the contract term. Once the products are sold to the end customer, the e-tailer entity has no further obligations for the product.

Revenue is recognized once control of the product has transferred, which requires an analysis of the indicators of the transfer of control. The e-tailer has physical possession and a present obligation to pay for the asset. But it does not have: the legal ownership; the right to determine whether the goods are returned and may return unsold/returned goods back to the seller. Therefore, based on the indicators that control transferred when the goods were delivered to the e-tailer, the control has not transferred to the e-tailer. The entity is acting as a consignment agent and shall not recognised revenue on the goods sold under this arrangement as a principal. The guidance for principal / agency relation shall also be applicable here and the entity shall assess its relationship based on that guidance.

Significant financing component

89. Certain e-commerce entities give extended financing to customers, for example, through a ‘buy now, pay later’ scheme or an extended EMI payment scheme. When the customer is allowed to pay in arrears and the sale realization is deferred, it can be construed that the entity is effectively providing financing to the customer. Conversely, in certain cases, the customer may pay in advance. This may give rise to a question – whether the entity has effectively received financing from the customer.

90. AS 9 does not provide any specific guidance on how to account for such arrangements. Ind AS 115 provides the following guidance in relation to a significant financing component in a contract:

60 In determining the transaction price, an entity shall adjust the promised amount of consideration for the effects of the time value of money if the timing of payments agreed to by the parties to the contract (either explicitly or implicitly) provides the customer or the entity with a significant benefit of financing the transfer of goods or services to the customer. In those circumstances, the contract contains a significant financing component. A significant financing component may exist regardless of whether the promise of financing is explicitly stated in the contract or implied by the payment terms agreed to by the parties to the contract.

61 The objective when adjusting the promised amount of consideration for a significant financing component is for an entity to recognise revenue at an amount that reflects the price that a customer would have paid for the promised goods or services if the customer had paid cash for those goods or services when (or as) they transfer to the customer (i.e., the cash selling price). An entity shall consider all relevant facts and circumstances in assessing whether a contract contains

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a financing component and whether that financing component is significant to the contract, including both of the following:

(a) The difference, if any, between the amount of promised consideration and the cash selling price of the promised goods or services; and

(b) The combined effect of both of the following:

(i) The expected length of time between when the entity transfers the promised goods or services to the customer and when the customer pays for those goods or services; and

(ii) The prevailing interest rates in the relevant market.

62 Notwithstanding the assessment in paragraph 61, a contract with a customer would not have a significant financing component if any of the following factors exist:

(a) The customer paid for the goods or services in advance and the timing of the transfer of those goods or services is at the discretion of the customer.

(b) A substantial amount of the consideration promised by the customer is variable and the amount or timing of that consideration varies on the basis of the occurrence or non-occurrence of a future event that is not substantially within the control of the customer or the entity (for example, if the consideration is a sales-based royalty).

(c) The difference between the promised consideration and the cash selling price of the good or service (as described in paragraph 61) arises for reasons other than the provision of finance to either the customer or the entity, and the difference between those amounts is proportional to the reason for the difference. For example, the payment terms might provide the entity or the customer with protection from the other party failing to adequately complete some or all of its obligations under the contract.

63 As a practical expedient, an entity need not adjust the promised amount of consideration for the effects of a significant financing component if the entity expects, at contract inception, that the period between when the entity transfers a promised good or service to a customer and when the customer pays for that good or service will be one year or less.

64. To meet the objective in paragraph 61 when adjusting the promised amount of consideration for a significant financing component, an entity shall use the discount rate that would be reflected in a separate financing transaction between the entity and its customer at contract inception. That rate would reflect the credit characteristics of the party receiving financing in the contract, as well as any collateral or security provided by the customer or the entity, including assets transferred in the contract. An entity may be able to determine that rate by identifying the rate that discounts the nominal amount of the promised consideration to the price that the customer would pay in cash for the goods or services when (or as) they transfer to the customer. After contract inception, an entity shall not update the discount rate for changes in interest rates or other circumstances (such as a change in the assessment of the customer's credit risk).

91. In principle, a contract that includes a financing component comprise of two components— one for the sale of goods and/or services and one for the financing. The standard only requires entities to adjust the amount of the consideration for the effects of financing if the timing of payments specified in the contract provides the customer or the entity with a significant benefit of financing. The standard intends that revenue should be reported at the 'normal selling price' of the underlying goods or services at the time of transfer and should not be inflated by inclusion of the financing component.

92. As a practical expedient, the effects of a significant financing component are not required to be adjusted if the entity expects, at contract inception, that the period between when the entity transfers a promised good or

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service to a customer and when the customer pays for that good or service will be one year or less. This simplifies the application of the standard. If an entity uses this practical expedient, it is required to apply the expedient consistently to similar contracts in similar circumstances.

93. In absence of the practical expedient, determination of whether a significant financing component exists will be based on all relevant facts and circumstances, including:

(1) The difference between the cash selling price and the amount of promised consideration for the promised goods or services.

And

(2) The combined effect of the expected length of time between the transfer of the goods or services and the receipt of consideration and the prevailing market interest rates.

94. The timing between the transfer of and payment for goods and services is not determinative of significant financing component, but the combined effect of timing and the prevailing interest rates may provide a strong indication that an entity is providing or receiving a significant benefit of financing.

95. Even if conditions in a contract would otherwise indicate that a significant financing component exists, Ind AS 115 excludes several situations from the requirement to separate significant financing component.

> Example: Significant financing component
> An e-tailer sells its product to customers for Rs.121 that is payable 24 months after delivery. The customer obtains control of the product at contract inception. The selling price of the product had the payment been made within the normal credit period of 30 days (cash selling price) is Rs.100, which represents the amount that the customer would pay upon delivery for the same product sold under otherwise identical terms and conditions as at contract inception.
>
> The entity recognises revenue when control of the product transfers to the customer. The contract includes a significant financing component, in accordance with Ind AS 115. This is evident from the difference between the amount of promised consideration of Rs.121 and the cash selling price of Rs.100 at the date that the goods are transferred to the customer.
>
> The contract includes an implicit interest rate of 10% (i.e., the interest rate that over 24 months discounts the promised consideration of Rs.121 to the cash selling price of Rs.100). The entity evaluates the rate and concludes that it is commensurate with the rate that would be reflected in a separate financing transaction between the entity and its customer at contract inception. The following are the journal entries that the entity would pass to account for the contract under Ind AS 115.
>
> Until the entity receives the payment from the customer, interest revenue would be recognised in accordance with Ind AS 109. In determining the effective interest rate in accordance with Ind AS 109, the entity would consider the remaining contractual term. This example does not consider the impairment accounting for the receivable.

96. E-tailers often sell additional warranties or extended warranties in addition to the one provided by manufacturer at the time of sale of product. An extended warranty is an agreement to provide warranty protection in addition to the scope of coverage of manufacturer's original warranty, or to extend the period of coverage provided by the manufacturer's warranty. They are often sold separately from the product but, may even be included in the price of the product.

Warranties – additional or extended offered by the retailers

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97. Such sale of additional or extended warranties are, in substance, sale of separate product/service, distinct from the sale of goods/services with which the same are sold. Also, such additional or extended warranties are distinct from the original warranties offered by the manufacturer of the
products. Initial or original warranties offered by the manufacturer are accounted for by the manufacturer as liability in accordance with Accounting Standard (AS) 29, Provisions, Contingent Liabilities and Contingent Assets, under Companies (Accounting Standards) Rules, 2006.

98. The accounting treatment of sale of an extended warranty by e-tailer is illustrated below:

> Extended Warranties sold by the retailer A retailer sells electrical goods. The goods come with a manufacturer's one year warranty. The retailer also offers customers the option of purchasing an extended warranty to cover a further three year period after the expiry of the manufacturer's warranty.
>
> The sales price of the extended warranty is Rs. 120. The retailer typically receives valid
>
> warranty claims from 3% of customers during the extended warranty period. The average cost of repairing or replacing the goods under the warranty is Rs. 400 per valid claim.
>
> How is this arrangement accounted for?
>
> As per the multiple element arrangement discussion, revenue associated with the extended warranty is deferred and recognised on a straight-line basis over the period for which the extended warranty service is provided (unless there is evidence that some other method better represents the stage of completion). Accordingly, in the year of sale, revenue of Rs. 120 is not recognised (recognition is deferred) and the same is recognised annually. Thus annual revenue of Rs. 40 (Rs.120 divided by 3) is recognised each year as income from services- 'warranty' or as 'other operating income'.
>
> Costs incurred to fulfil the warranty obligation are charged to cost of sales as incurred.
> The arrangement is monitored to ensure that the expected cost of the warranty does not exceed the amount of deferred revenue. If this occurs, the warranty contract will be onerous, and a provision is recognised.

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99. Ind AS 115 provides the following guidance for accounting for warranties

B28 It is common for an entity to provide (in accordance with the contract, the law or the entity's customary business practices) a warranty in connection with the sale of a product (whether a good or service). The nature of a warranty can vary significantly across industries and contracts. Some warranties provide a customer with assurance that the related product will function as the parties intended because it complies with agreed-upon specifications. Other warranties provide the customer with a service in addition to the assurance that the product complies with agreed-upon specifications.

B29 If a customer has the option to purchase a warranty separately (for example, because the warranty is priced or negotiated separately), the warranty is a distinct service because the entity promises to provide the service to the customer in addition to the product that has the functionality described in the contract. In those circumstances, an entity shall account for the promised warranty as a performance obligation in accordance with paragraphs 22– 30 and allocate a portion of the transaction price to that performance obligation in accordance with paragraphs 73–86.

B30 If a customer does not have the option to purchase a warranty separately, an entity shall account for the warranty in accordance with Ind AS 37, *Provisions, Contingent Liabilities and Contingent Assets,* unless the promised warranty, or a part of the promised warranty, provides the customer with a service in addition to the assurance that the product complies with agreed-upon specifications.

B31 In assessing whether a warranty provides a customer with a service in addition to the assurance that the product complies with agreed-upon specifications, an entity shall consider factors such as:
(a) Whether the warranty is required by law—if the entity is required by law to provide a warranty, the existence of that law indicates that the promised warranty is not a performance obligation because such requirements typically exist to protect customers from the risk of purchasing defective products.
(b) The length of the warranty coverage period—the longer the coverage period, the more likely it is that the promised warranty is a performance obligation because it is more likely to provide a service in addition to the assurance that the product complies with agreed-upon specifications.
(c) The nature of the tasks that the entity promises to perform—if it is necessary for an entity to perform specified tasks to provide the assurance that a product complies with agreed-upon specifications (for example, a return shipping service for a defective product), then those tasks likely do not give rise to a performance obligation.

B32 If a warranty, or a part of a warranty, provides a customer with a service in addition to the assurance that the product complies with agreed-upon specifications, the promised service is a performance obligation. Therefore, an entity shall allocate the transaction price to the product and the service. If an entity promises both an assurance-type warranty and a service-type warranty but cannot reasonably account for them separately, the entity shall account for both of the warranties together as a single performance obligation.

B33 A law that requires an entity to pay compensation if its products cause harm or damage does not give rise to a performance obligation. For example, a manufacturer might sell products in a jurisdiction in which the law holds the manufacturer liable for any damages (for example, to personal property) that might be caused by a consumer using a product for its intended purpose. Similarly, an entity's promise to indemnify the customer for liabilities and damages arising from claims of patent, copyright, trademark or other infringement by the entity's products does not give rise to a performance obligation. The entity shall account for such obligations in accordance with Ind AS 37.

100. A warranty that can be purchased separately should be accounted for as a separate performance obligation because the entity promises a service to the customer in addition to the product.

101. If a customer does not have the option to purchase a warranty separately, the entity should account for the warranty in accordance with other existing guidance on product warranties.

102. A promised warranty, or a part of the promised warranty, which is not sold separately but provides the customer with a service in addition to the assurance that the product complies with agreed specifications, creates a performance obligation for the promised service.

103. An entity that cannot reasonably separate the service component from a standard warranty should account for both together as a separate performance obligation.

> Example: Warranty, separate performance obligation an e-tailer sells stereo equipment. A customer has elected to also purchase the optional 12-month extended warranty. How should the e-tailer account for the warranty?

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The e-tailer should treat the 12-month warranty as a separate performance obligation. A portion of the transaction price is allocated to the warranty based on its relative standalone selling price and is recognized as revenue when the warranty obligation is satisfied. The e-tailer will need to assess the pattern of warranty satisfaction to determine when revenue is recognized (that is, rateably or some other pattern).

Advertising services

104. One of the principal sources of revenue of e-commerce companies is from the sale of banner and sponsorship advertisements. Banner advertisements are usually hosted for a short duration. Sponsorship advertising contracts have longer terms than banner advertising contracts and also involve more service integration. High profile promotional sponsorships are typically focused on a particular event, such as sweepstakes and lotteries. Visitors to the website are ordinarily encouraged to complete the transaction by clicking on a hypertext link, also known as 'click-through'.

105. An e-commerce company's obligations typically include guarantees of minimum number of impressions or click-through. Impressions are the number of times that an advertisement appears in pages viewed by users of the e-commerce company's on-line sites. It is appropriate to recognise revenue on the basis of the number of impressions or 'click-through' unless another systematic and rational basis of revenue recognition is more representative of the services rendered. This is in line with Appendix to AS 9 which states that for "advertising agencies, media commissions will normally be recognised when the related advertisement or commercial appears before the public and the necessary intimation is received by the agency". To the extent the minimum guaranteed impressions are not met, recognition of the corresponding revenue should be postponed until the guaranteed impression levels are achieved. The advertising revenue should only be recognised when no significant obligations remain at the end of the period and collection of the resulting receivable is reasonably certain.

106. Companies may enter into agreements whereby they agree to host advertisements for customers, without any minimum guaranteed impressions. For example, company may enter into an agreement with another company to host a banner advertisement containing details of products/services offered by that company. In this case, it is appropriate to recognise advertising revenue on straight-line basis over the period for which the banner is to be hosted unless another systematic and rational basis of revenue recognition is more representative of the services rendered.

Measurement of consideration in advertising barter transactions

107. E-commerce companies sometimes enter into advertising barter transactions with each other, in which they exchange rights to place advertisements on each other's' on-line properties, i.e., websites or web pages. A barter transaction may involve exchange of advertising time for products or services.

108. Revenue from advertising barter transactions should be recognised only when the fair values of similar transactions are readily determinable from the entity's history. It would be appropriate to consider fair values of transactions that have occurred not later than six months preceding the sale of similar advertising to unrelated buyers. This will ensure that the comparable values are current and reflect the best estimate of a price at which a willing buyer and a willing seller would be willing to exchange an item or service in a situation other than a distress sale. If economic circumstances have changed such that prior (but not more than six months old) transactions are not representative of current fair value for the advertising surrendered, then a shorter, more representative period should be used. It is inappropriate to consider cash transactions subsequent to the barter transaction to determine fair value.

109. For determining the fair value of advertising space surrendered for cash to be considered 'similar' to the advertising space being surrendered in the barter transaction, the advertising space surrendered must have been in the same media and within the same advertising vehicle (for example, same publication, same website, or same broadcast channel) as the advertising in the barter transaction. In

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addition, the characteristics of the advertising space surrendered for cash must be reasonably similar to that being surrendered in the barter transaction with respect to:
(a) Circulation, exposure, or saturation within an intended market;
(b) Timing (time of day, day of week, daily/weekly, 24 hours a day/ 7 days a week, and season of the year);
(c) Prominence (page on website, section of periodical, location on page, and size of advertisement);
(d) Demographics of readers, viewers, or customers;
(e) Duration (length of time for which the advertisement will be displayed).

110 Where, however, reliable estimates of fair value are not available, it may not be appropriate to recognise revenue and the associated costs involved in barter transactions.

Other services

Revenue from maintenance of websites including web hosting

111. E-commerce companies may also earn revenue from hosting websites for their customers, maintenance of the customers' websites or providing such other services. Revenue from these services should be recognised over the period for which the website is to be hosted or maintained provided such services are rendered over the period of the contract on continuous basis unless another systematic and rational basis of revenue recognition is more representative of the services rendered.

Content Selling

112. Some companies maintain websites which contain text or other material which can be sold as a content for a price. Generally, a downloading facility of such content is available to the purchaser. In such a case, a question arises as to the timing of the recognition of revenue from the sale of the content downloaded by the customer. Applying the general principle of revenue recognition, the content should generally be considered to be sold when it is delivered to the purchaser. Therefore, keeping in view the terms of individual arrangements and the other relevant facts involved, the e-commerce company should determine the time at which the delivery of the content is considered to be complete and recognise the corresponding revenue.

Software as a Service (SaaS) arrangements in Cloud services arrangements

113. In SaaS arrangements, the capability provided by the supplier (the cloud service provider) to the customer is to access the supplier's application software running on the supplier's cloud infrastructure. The cloud infrastructure is a collection of hardware and software including network, servers, operating systems, storage, and individual software capabilities.

114. In such arrangements, the customer generally does not take possession of the software. Instead it accesses the software on an as-needed basis over the internet or via a dedicated line. The customer does not manage or control the underlying cloud infrastructure with the possible exception of customer-specific software configuration settings.

115. Contracts are often for an initial non-cancellable period (for example, two years), with options within the contracts for the customer to extend them. The contracts often include other services, such as technical support, implementation, data migration, business process mapping, training, and project management. The fees are generally paid on a monthly or yearly basis and are all inclusive, meaning they cover the right to access the software as well as these other services. For simplicity, let's focus only on:

(a) the customer's access to the supplier's application software without these other products and services; and

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(b) the fees paid to the supplier for the customer's access to the supplier's application software.

116. There can be three differing scenarios for customer rights relating to the software:

(a) a right to access non-dedicated application software running on non-dedicated infrastructure/hardware (Scenario 1).

(b) same as Scenario 1, except the customer also has a right to possess a copy of the application software.

(c) same as Scenario 1, except the customer specifies particular application software configurations (Scenario 2). Such configurations might range from basic to significant. To illustrate:

(i) Basic or standard configurations—such as a customer responding to standard configuration questions or inputting data into pre-existing fields. For example, an individual using a smart phone app may be required to answer standard configuration questions such as preferred language, whether to allow the app to track the phone's location, whether to allow the app access to other phone contacts, etc.

(ii) Significant configurations—such as modifications to the software to meet the customer's requirements. For example, financial accounting application software might require configuration to facilitate a unique group organisation structure, chart of accounts, approval requirements for journal entries, etc. In some cases, the customer may undertake the configuration whereas in other cases the supplier may configure the software for the customer based on the customer's input. In some cases, configuration might be viewed as so significant that it is akin to software development/customisation unique to the customer.

117. There can be various accounting issues arising in such arrangements:

- How to apply the definitions of an intangible asset and a lease in the context of these arrangements?
- How to differentiate property, plant & equipment and intangible assets, in particular how to distinguish between 'leases of intangible assets' and 'rights held by a lessee under licensing agreements'?
- How to measure the liability related to the acquisition of an intangible asset if the customer accounts for the arrangement?

118. Generally, customers assess these arrangements to determine whether they create an intangible asset and/or lease component. If not, customers account for the arrangements as service contracts. Customers generally account for SaaS arrangements as service contracts because it is difficult to demonstrate that the customer controls an intangible asset or the right to use an identifiable asset (lease). Depending on the type of contract, some customers recognise an intangible asset for the right to access the software and others account for the arrangements as service contracts.

119. Determining the appropriate accounting for these arrangements can be difficult because of the lack of specific requirements in the accounting standards. A customer has an intangible asset only if the customer is able to possess and run the software on its own servers, regardless of the extent of customer configuration. However, the customer has an intangible asset in other circumstances, for example, when there are significant customer configurations. It is unclear how customers should account for other fees (which can be significant), for example, fees for the customisation and implementation of the software.

120. Accounting standards under Companies (Accounting Standards) Rules, 2006, do not provide explicit guidance on determining whether an arrangement contains a lease. However, AS 1 "Disclosure

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of Accounting Policies" requires that transactions are accounted for and presented in accordance with their substance and economic reality and not merely their legal form.

121. Under Companies (Indian Accounting Standards) Rules, 2015, Ind AS 38 paragraph 6 states the following:

6 Rights held by a lessee under licensing agreements for items such as motion picture films, video recordings, plays, manuscripts, patents and copyrights are within the scope of this Standard and are excluded from the scope of Ind AS 116.

Paragraph 3 of Ind AS 116 excludes the following from the scope of Ind AS 116:

3. An entity shall apply this Standard to all leases, including leases of right-of-use assets in a sublease, except for
…

(e)rights held by a lessee under licensing agreements within the scope of Ind AS 38, Intangible Assets, for such items as motion picture films, video recordings, plays, manuscripts, patents and copyrights.

122. A lessee may, but is not required to, apply Ind AS to leases of intangible assets other than those described above.

Neither Ind AS 38 nor Ind AS 116 define 'licensing agreement'. A business definition of a 'licensing agreement' is 'written contract under which the owner of a copyright, know how, patent, service mark, trademark, or other intellectual property, allows a licensee to use, make, or sell copies of the original'. Furthermore, paragraph B52 of Ind AS 115 provides the following explanation of a 'licence':

B52 A licence establishes a customer's rights to the intellectual property of an entity. Licences of intellectual property may include, but are not limited to, licences of any of the following:
(a) software and technology;
(b) motion pictures, music and other forms of media and entertainment;
(c) franchises; and
(d) patents, trademarks and copyrights.

123. Considering the above, all leases of software would result in rights being held by a lessee under licensing agreements

Do SaaS arrangements create an intangible asset for the customer?

124. SaaS arrangements would be likely to meet the identifiability and future economic benefits elements of the definition of an intangible asset. However, the question is how to assess the control element and asks whether the 'underlying resource' in paragraph 13 of IAS 38 would be:

(a) the customer's right to access the supplier's software; or

(b) the application software itself.

125. Paragraph 8 of Ind AS 38 defines an intangible asset as 'an identifiable non-monetary asset without physical substance'. For the customer to have an intangible asset, the SaaS arrangement would need to give rise to:

(a) an asset, defined as 'a resource controlled by the entity as a result of past events and from which future economic benefits are expected to flow to the entity' (paragraph 8 of IAS 38);

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(b) that is identifiable, ie is separable or arises from contractual or other rights (paragraph 12 of IAS 38).

126. Paragraph 13 of Ind AS 38 states the following:

13 An entity controls an asset if the entity has the power to obtain the future economic benefits flowing from the underlying resource and to restrict the access of others to those benefits. The capacity of an entity to control the future economic benefits from an intangible asset would normally stem from legal rights that are enforceable in a court of law…

127. There are no requirements on what constitutes a resource in Ind AS 38 or in the *Conceptual Framework for Financial Reporting*. However, because an asset is defined as 'a resource controlled by an entity…', we think 'underlying resource' in paragraph 13 of Ind AS 38 is simply referring to the asset that an entity would recognise as an intangible asset. In other words, we read paragraph 13 of Ind AS 38 as follows: an entity controls an asset if the entity has the power to obtain the future economic benefits flowing from that asset and to restrict the access of others to those benefits.

128. This is because, the second sentence of paragraph 13 of Ind AS 38 refers to control of the 'future economic benefits from an intangible asset' rather than 'future economic benefits flowing from the underlying resource'.

The customer's right to access the supplier's application software is:

(a) a non-monetary resource without physical substance;

(b) from which future economic benefits are expected to flow to the customer (for example, through increases in revenues or reductions in production costs); and

(c) that is identifiable, because it arises from contractual rights.

129. The outstanding element in assessing whether the arrangement includes an intangible asset is whether the customer controls the right to access the supplier's software, ie whether it has the power to obtain the future economic benefits flowing from that right and to restrict the access of others to those benefits (paragraph 13 of Ind AS 38).

Scenario 1
In Scenario 1, the customer has the right to access non-dedicated application software without any configurations. There are two possible ways of considering whether the customer controls the right to access the software:

(a) View 1: Once a contract is signed, all parties to that contract will have rights from that contract and it could be argued that each party controls its own specific rights. The customer has its own specific right of access to the software (unique login) and access to its own copy, or 'instance', of the supplier's software that contains the customer's data. The customer has the power to obtain future economic benefits from its specific right of access during the contract period. Through its unique login, the customer can restrict the access of others to those benefits during that period. Applying View 1, the customer controls its individual right to access the supplier's software and has an intangible asset.

View 2: The customer does not receive a resource at contract inception that it controls. Instead it has received a right to access the software in the future, over the contract period. The supplier holds, manages and updates the software over that period and has not given up or transferred its own rights relating to the access and use of the software. Furthermore, the customer requires the supplier's ongoing hosting service to obtain benefits from access to the software and it benefits from ongoing updates to the software by the supplier. Consequently, it appears that

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the customer's right to access the software simply gives it the right to services in the future, as for other similar service contracts (for example, 24-hour technical support services over the contract period). Applying View 2, the customer does not have an intangible asset for the right to access the supplier's software.

View 2 above seems appropriate.

Although the customer accesses its own copy, or instance, of the software, SaaS arrangements are different from a scenario in which the customer downloads its own copy of the software or receives a copy of software on a CD ROM. In the later scenario, the customer receives a copy of the software at inception of the contract. The customer can generally use that copy as it wishes to obtain future economic benefits flowing from it (subject to copyright and other restrictions in the software licence)—for example, the customer can decide on which machine to install the software, whether to install updates to the software, etc—and it can restrict the access of others to benefits from that particular copy of software through possession. The supplier has transferred control of that copy of the software by handing it over to the customer and the customer has an intangible asset.

Scenario 2

In Scenario 2, the customer has a right to access the supplier's application software and also specify particular configurations. There can be following views:

(a) if there are only basic or standard configurations to the software, the arrangement is similar to Scenario 1. In that case, the customer has not obtained anything at inception of the contract that it controls. Consequently, the customer does not have an intangible asset and, instead, accounts for the arrangement as a service contract.

(b) if there are significant, non-standard, customer configurations to the software, then arguably the customer has the right to access a unique type of software. In this case, the customer might be able to restrict the access of others (the supplier and other customers) to the benefits from rights to access the software. Customers are also more likely to seek to have greater control over their rights to access customised software, particularly if they have incurred significant fees for the customisation and implementation of that software. The following are examples of circumstances that would influence whether the customer controls the right to access the software:

(i) whether the customer has a right to possess a copy of the software, for example on termination of the contract, and also whether the customer has the ability to host the software without the supplier's infrastructure.

(ii) whether the supplier can make the modified version of the software available to other customers or whether the modified version can be used only by that specific customer (either because this is specified in the contract or because of the nature of the customer-specific configurations).

(iii) whether the software continues to be modified/updated by the supplier over the period of the contract, or whether the customer manages when the configured software is updated.

(iv) whether the software is hosted purely on the supplier's cloud infrastructure, or whether the customer (or a third party) has any control over the infrastructure on which the software is hosted.

If configurations are significant, it is possible that the customer might have an intangible asset, depending on the particular terms and conditions of the arrangement.

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The facts and circumstances of cloud computing arrangements may differ and would therefore warrant careful evaluation of the appropriate accounting treatment based on the rights of the user companies.

Recognition and Measurement of Costs Accounting for website/ mobile application development costs

130. New website or mobile application development costs of a company, should be accumulated, along with other costs incurred up to the time the website is thrown open to the users thereof. Such costs include cost incurred in performing the activities relating to planning the website, obtaining and registering an Internet domain name, testing the website applications, creating initial graphics about website, etc.

Technology-related development costs representing all directly attributable development costs and including vendor invoices towards costs of design, configuration, coding, installation and testing of websites and mobile platforms are capitalized until implementation. Upon implementation, the asset is amortized to expense over its estimated useful life. Ongoing technology-related post-implementation costs of operation and application maintenance are charged to expense as incurred. In accordance with AS 26 "Intangible Assets" under Companies (Accounting Standards) Rules, 2006 and Ind AS 38 "Intangible Assets" under Companies (Indian Accounting Standards) Rules, 2015, technology-related development costs also include costs incurred on development related to internally generated intangible assets which have been capitalized on meeting the criteria of technical feasibility, future economic benefit, marketability and being separately identifiable.

131. Keeping in view the nature of the e-commerce business, particularly the susceptibility to the rapid technological obsolescence, it is recommended that such costs that are accumulated should be amortised on a systematic and rational basis, over a period of 3-5 years after the website is accessible to the users thereof. The costs so accumulated during the development should be presented under the head 'Intangible Asset under development'. All costs incurred, including those for development of new websites, after the first website/ mobile application of the company becomes open to the users should be expensed in the period in which they are incurred.

132. An e-commerce company would also incur expenditure on certain items that are similar to entities in other businesses, e.g., expenditure incurred in the acquisition or construction of tangible and intangible assets such as land, buildings, computer hardware, software and knowledge-based content. Since the items of the aforesaid nature are not peculiar only to companies, the treatment thereof should be the same as in the case of other businesses.

133. An illustrative list of activities performed in website development is given in the Appendix to this Guidance Note.

134. Under Companies (Indian Accounting Standards) Rules, 2015, Appendix A "Intangible Assets - Website Cost" to Ind AS 38 "Intangible Assets" clarifies how Ind AS 38 applies to costs in relation to websites designed for use by the entity in its business. The relevant paragraphs of the appendix are as follows:

7 An entity's own web site that arises from development and is for internal or external access is an internally generated intangible asset that is subject to the requirements of Ind AS 38.

8 A web site arising from development shall be recognised as an intangible asset if, and only if, in addition to complying with the general requirements described in paragraph 21 of Ind AS 38 for recognition and initial measurement, an entity can satisfy the requirements in paragraph 57 of Ind AS 38. In particular, an entity may be able to satisfy the requirement to demonstrate how its web site will generate probable future economic benefits in accordance with paragraph 57 (d)

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example, the web site is capable of generating revenues, including direct revenues from enabling orders to be placed. An entity is not able to demonstrate how a web site developed solely or primarily for promoting and advertising its own products and services will generate probable future economic benefits, and consequently all expenditure on developing such a web site shall be recognised as an expense when incurred.

9 Any internal expenditure on the development and operation of an entity's own web site shall be accounted for in accordance with Ind AS 38. The nature of each activity for which expenditure is incurred (e.g. training employees and maintaining the web site) and the web site's stage of development or post-development shall be evaluated to determine the appropriate accounting treatment. For example:

(a) the Planning stage is similar in nature to the research phase in paragraphs 54-56 of Ind AS 38. Expenditure incurred in this stage shall be recognised as an expense when it is incurred.

(b) the Application and Infrastructure Development stage, the Graphical Design stage and the Content Development stage, to the extent that content is developed for purposes other than to advertise and promote an entity's own products and services, are similar in nature to the development phase in paragraphs 57-64 of Ind AS 38. Expenditure incurred in these stages shall be included in the cost of a web site recognised as an intangible asset in accordance with paragraph 8 of this Appendix when the expenditure can be directly attributed and is necessary to creating, producing or preparing the web site for it to be capable of operating in the manner intended by management. For example, expenditure on purchasing or creating content (other than content that advertises and promotes an entity's own products and services) specifically for a web site, or expenditure to enable use of the content (eg a fee for acquiring a licence to reproduce) on the web site, shall be included in the cost of development when this condition is met. However, in accordance with paragraph 71 of Ind AS 38, expenditure on an intangible item that was initially recognised as an expense in previous financial statements shall not be recognised as part of the cost of an intangible asset at a later date (eg if the costs of a copyright have been fully amortised, and the content is subsequently provided on a web site).

(c) expenditure incurred in the Content Development stage, to the extent that content is developed to advertise and promote an entity's own products and services (eg digital photographs of products), shall be recognised as an expense when incurred in accordance with paragraph 69(c) of Ind AS 38. For example, when accounting for expenditure on professional services for taking digital photographs of an entity's own products and for enhancing their display, expenditure shall be recognised as an expense as the professional services are received during the process, not when the digital photographs are displayed on the web site.

(d) the Operating stage begins once development of a web site is complete. Expenditure incurred in this stage shall be recognised as an expense whenit is incurred unless it meets the recognition criteria in paragraph 18 of Ind AS 38.

10 A web site that is recognised as an intangible asset under paragraph 8 of this Appendix shall be measured after initial recognition by applying the requirements of paragraphs 72-87 of Ind AS 38. The best estimate of a web site's useful life should be short.

135. An entity's own website/mobile application that arises from development and is for internal or external access is an internally generated intangible asset under Ind AS 38. A website designed for external access may be used for various purposes such as to promote and advertise an entity's own products and services, provide electronic services to customers, and sell products and services. A website may be used within the entity to give staff access to company policies and customer details and allow them to search relevant information.

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136. Appendix A to Ind AS 38 does not apply to items that are accounted for under another standard, such as the development or operation of a website (or website software) for sale to another entity (Ind AS 2 and Ind AS 115); acquiring or developing hardware supporting a website (Ind AS 16); or in determining the initial recognition of an asset for a website subject to a leasing arrangement (Ind AS 116). However, Ind AS 116 should be applied by lessors providing a web site under an operating lease and by lessees considering the treatment of subsequent expenditure relating to a web site asset leased under a finance lease, because the related website asset will be carried on the entity's balance sheet.

137. Under Appendix A to Ind AS 38, an intangible asset should be recognised for website development costs if and only if, it meets the general recognition requirements in Ind AS 38 and the six conditions for recognition as development costs as mentioned above. Most important of these is the requirement to demonstrate how the website/mobile application will generate probable future economic benefits. An entity would be generally unable to demonstrate this for a website/mobile application developed solely or primarily for promoting and advertising its own products and services. All expenditure on developing such a website should be recognised as an expense when incurred. Accordingly, it is unlikely that costs will be eligible for capitalisation unless an entity can demonstrate that the website is used directly in the income-generating process, for example where customers can place orders on the entity's website.

138. The following stages of a website's development are identified by the Appendix:

(a) planning includes undertaking feasibility studies, defining objectives and specifications, evaluating alternatives and selecting preferences. Expenditures incurred in this stage are similar in nature to the research phase and should be recognised as an expense when they are incurred;

(b) application and infrastructure development include obtaining a domain name, purchasing and developing hardware and operating software, installing developed applications and stress testing. The requirements of Ind AS 16 are applied to expenditure on physical assets. Other costs are recognised as an expense, unless they can be directly attributed, or allocated on a reasonable and consistent basis, to preparing the website for its intended use and the project to develop the website meets the SIC-32 criteria for recognition as an intangible asset;

(c) graphical design development includes designing the appearance of web pages. Costs incurred at this stage should be accounted for in the same way as expenditure incurred in the 'application and infrastructure development' stage described under (b) above;

(d) content development includes creating, purchasing, preparing and uploading information, either textual or graphical in nature, on the website before the completion of the website's development. The costs of content developed to advertise and promote an entity's own products and services are always expensed as incurred. Other costs incurred in this stage should be recognised as an expense unless the criteria for recognition as an asset described in (b) above are satisfied; and

(e) the operating stage, which starts after completion of the development of a website, when an entity maintains and enhances the applications, infrastructure, graphical design and content of the website. Expenditure incurred in this stage should be expensed as incurred unless it meets the asset recognition criteria in Ind AS 38.

In making these assessments, the entity should evaluate the nature of each activity for which expenditure is incurred, independently of its consideration of the website's stage of development. This means that even where a project has been determined to qualify for recognition as an intangible asset, not all costs incurred in relation to a qualifying stage of development are eligible for capitalisation. For example, whilst the direct costs of developing an online ordering system might qualify for recognition as an asset, the costs of training staff to operate that system should be expensed because training costs

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are deemed not necessary to creating, producing or preparing the website for it to be capable of operating.

139. Examples of other costs that would be recognised as an expense regardless of the stage of the project are given in the Illustrative Example to Appendix A, including:
(a) selling, administrative and other general overhead expenditure unless it can be directly attributed to preparing the web site for use to operate in the manner intended by management;
(b) clearly identified inefficiencies in the project, such as those relating to alternative solutions explored and rejected; and
(c) initial operating losses incurred before the web site achieves planned performance. A website qualifying for recognition as an intangible asset should be measured after initial recognition by applying the cost model or the revaluation model in Ind AS 38. In respect of the useful life of website assets, the expectation is that it should be short.

140. The cost of an internally generated intangible asset is the sum of the expenditure incurred from the date when the intangible asset first meets the recognition criteria of Ind AS 38 and meets the detailed conditions for recognition of development phase costs as an asset.

141. It must be noted that costs incurred before these criteria are met are expensed, and cannot be reinstated retrospectively, because Ind AS 38 does not permit recognition of past expenses as an intangible asset at a later date.

142. The following example illustrates how these above rules should be applied in practice.

> Example: Recognition of internally generated intangible assets
> An entity is developing a new production process. During 2018, expenditure incurred was 1,000, of which 900 was incurred before 1 December 2018 and 100 was incurred between 1 December 2018 and 31 December 2018. The entity is able to demonstrate that, at 1 December 2018, the production process met the criteria for recognition as an intangible asset. The recoverable amount of the know-how embodied in the process (including future cash outflows to complete the process before it is available for use) is estimated to be 500.
>
> At the end of 2018, the production process is recognised as an intangible asset at a cost of 100 (expenditure incurred since the date when the recognition criteria were met, that is, 1 December 2018). The 900 expenditure incurred before 1 December 2018 is recognised as an expense because the recognition criteria were not met until 1 December 2018. This expenditure does not form part of the cost of the production process recognised in the statement of financial position.
>
> During 2019, expenditure incurred is 2,000. At the end of 2019, the recoverable amount of the know-how embodied in the process (including future cash outflows to complete the process before it is available for use) is estimated to be 1,900.
>
> At the end of 2019, the cost of the production process is 2,100 (100 expenditure recognised at the end of 2018 plus 2,000 expenditure recognised in 2019). The entity recognises an impairment loss of 200 to adjust the carrying amount of the process before impairment loss (2,100) to its recoverable amount (1,900). This impairment loss will be reversed in a subsequent period if the requirements for the reversal of an impairment loss in Ind AS 36 are met.

Rebates, discounts and other sales incentives and consideration payable to a customer

143. The accounting treatment of rebates, discounts and other sales incentives depends upon their nature.

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144. Under Companies (Accounting Standards) Rules, 2006, where an entity offers rebates or introductory offers at heavily reduced prices in order to stimulate sales and generate new customers, the value of such rebates should be reduced from turnover. This treatment is similar to that accorded to trade discounts. Where the rebates, discounts and other sales incentives are specific in relation to a particular customer, these should be shown by way of deduction from the value of the turnover in the statement of profit and loss of the e-commerce company.

145. Other forms of rebate or discount, which are general in nature, should be treated as a selling and marketing expense and charged separately in the profit and loss account under Companies (Accounting Standards) Rules, 2006. Where rebates, discounts and other sales incentives are in kind, an appropriate estimate of the costs thereof should be made and treated in the manner specified above.

146. Under Companies (Indian Accounting Standards) Rules, 2015, Ind AS 115 requires entities to identify all promised goods or services in a contract and determine whether to account for each promised good or service as a separate performance obligation.

147. A performance obligation defined as a promise in a contract to transfer a distinct good or service to a customer. This can also arise due to past business practices, even if there are no legal obligations on the entity. A good or service is distinct and is separated from other obligations in the contract if both:

- the customer can benefit from the good or service separately or together with other resources; and
- the good or service is separable from other goods or services in the contract.

148. Similarly, an entity may give customers gift vouchers or loyalty points which effectively provide the options to the customers to purchase additional promotional goods or services free of charge or at a discount in future. These options may represent separate performance obligation if the option provides a material right that the customer would not receive without entering into the contract. The entity should recognize revenue allocated to the option when the option expires or when the additional goods or services are transferred to the customer. An option to acquire an additional good or service at a price that is within the range of prices typically charged for those goods or services does not provide a material right, even if the option can be exercised only because of entering into the previous contract.

149. Also, the consideration payable by an entity to a customer is accounted for as a reduction of the transaction price unless the payment is for a distinct good or service that the customer transfers to the entity.

Example: Rebate scheme

The company has primary volume rebate schemes offered to distributors to encourage additional purchases of its products. The purchases of all E's products are covered in the scheme. The credit note for the annual discount will be issued at the end of the year.

The scheme works as follows:

Purchase value by the distributor for the year	**Rebate % on annual purchase value**
< Rs.10,00,000	NIL
> Rs.10,00,000 < Rs. 20,00,000	10% of the annual purchase value
>Rs. 20,00,000 < Rs. 25,00,000	15% of the annual purchase value
>Rs. 25,00,000 < Rs. 30,00,000	20% of the annual purchase value

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No rebates are available if the purchase value is less than Rs.10,00,000.

The retailer effectively provides the distributors (customer) an option to purchase additional goods at a discounted rate. This would represent separate performance obligation under Ind AS 115, as the discount represents a material right. It is a material right because it is incremental to the discount offered to a similar class of customers during the period.

The variable consideration is estimated using either of the following approaches.

Expected value approach:

Probability	**Purchase value by distributor A**	**Rebate % eligibility of distributor A**
15%	18,00,000	10%
65%	22,00,000	15%
20%	28,00,000	20%

E Ltd estimates that there could be a variety of scenarios for rebate payouts since it has a large number of distributors with similar characteristics. Therefore, the entity uses an expected value approach to estimate the variable consideration (rebate).

For distributor A, E Ltd estimates following probabilities.

Most likely approach:

E Ltd. considers a single most likely amount from a range of possible consideration amounts – distributor A would be purchased just over Rs. 22,00,000 worth goods and be entitled to 15% rebate.

Point and loyalty programmes

150. Point and loyalty programmes have varied features and may be structured in different ways. In some cases, an e-commerce company may sell points to its business partners, who then issue the same to their customers based on purchases or other actions. For example, an e-commerce company may arrange with a bookstore to issue reward points to the customers of the book store based on the minimum volume of purchases made by the customers. The customers can exchange these points with the dot-com company for use of the e-commerce company's website for a specified period of time. In some cases, the e-commerce company may itself award the points in order to encourage its members to take actions that will generate payments from business partners to the company.

151. With regard to the costs related to incentives under point and loyalty programmes incurred by an e-commerce company, the following accounting treatment should be adopted:

(i) Where the incentives under a point and loyalty programme are specific in relation to a particular customer, the cost of providing the incentives should be shown by way of deduction from the value of the turnover in the statement of profit and loss of the e-commerce company. In respect of incentives in kind, an appropriate estimate of the costs thereof should be made.

(ii) In respect of incentives under a point and loyalty programme which are general in nature, i.e., they are not related to specific customers, a general provision therefor should be made in the statement of profit and loss of the company based on an appropriate estimate of the costs itself.

152. There are several kinds of schemes or incentive programmes that are used by retailers and based on the programmes currently used, these can broadly be classified into:

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- Awards that entitle the holder to discounted/free goods or services in the same website/mobile application
- Awards that the holders can use in affiliated chain of websites/mobile applications, for discounted/free goods or services
- More complex arrangements, which include award credits that entitle the holder to discounted/free goods or services provided by another entity (for example, purchases in one store earn discount coupons that can be redeemed at a food outlet, or at a store of another entity)
- Qualitative benefits such as favoured treatments/additional facilities to club members
- Arrangements in which third party organisations provide service of redeeming awards against goods or services of the issuing entity or of others.

153. Loyalty programmes are not directly dealt with by Accounting Standard (AS 9), Revenue Recognition. This aspect has been dealt with under Ind AS 115. The relevant extracts of AS 9 and Ind AS 115 are given below. AS 9 defines revenue as:

Revenue is the gross inflow of cash, receivables or other consideration arising in the course of the ordinary activities of an enterprise from the sale of goods, from the rendering of services, and from the use by others of enterprise resources yielding interest, royalties and dividends. Revenue is measured by the charges made to customers or clients for goods supplied and services rendered to them and by the charges and rewards arising from the use of resources by them. In an agency relationship, the revenue is the amount of commission and not the gross inflow of cash, receivables or other consideration.

Paragraph 6.1 of AS 9 deals with timing of recognition of revenue in case of products and reads as follows:
A key criterion for determining when to recognise revenue from a transaction involving the sale of goods is that the seller has transferred the property in the goods to the buyer for a consideration.
The transfer of property in goods, in most cases, results in or coincides with the transfer of significant risks and rewards of ownership to the buyer. However, there may be situations where transfer of property in goods does not coincide with the transfer of significant risks and rewards of ownership. Revenue in such situations is recognised at the time of transfer of significant risks and rewards of ownership to the buyer. Such cases may arise where delivery has been delayed through the fault of either the buyer or the seller and the goods are at the risk of the party at fault as regards any loss which might not have occurred but for such fault. Further, sometimes the parties may agree that the risk will pass at a time different from the time when ownership passes."

Paragraph 7.1 of AS 9 deals with timing of recognition in case of services and reads as follows:
"Revenue from service transactions is usually recognised as the service is performed, either by the proportionate completion method or by the completed service contract method."

154. Under Ind AS 115, customer options to acquire additional goods or services may include sales incentives, customer loyalty points, contract renewal options, and other discounts. Volume discounts are also a form of customer option. Entities should assess each contract with the customer to determine if there are options embedded in the agreement, either explicit or implicit, and the accounting effect of any options identified.

155. Ind AS 115 generally requires transaction price is allocated between the product and the loyalty reward performance obligations based on relative stand-alone selling price.

156. Customer options may represent additional performance obligations in an arrangement if they provide the customer with a material right that it would not otherwise receive without entering into the

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arrangement. The customer is purchasing: the good or service originally purchased and the right to a free or discounted good or service in the future. Therefore, the customer is effectively paying in advance for future goods or services. Refunds, rebates, and other obligations to pay cash to a customer are not customer options. They affect measurement of the transaction price.

157. Ind AS 115 provides following guidance

B40 If, in a contract, an entity grants a customer the option to acquire additional goods or services, that option gives rise to a performance obligation in the contract only if the option provides a material right to the customer that it would not receive without entering into that contract (for example, a discount that is incremental to the range of discounts typically given for those goods or services to that class of customer in that geographical area or market). If the option provides a material right to the customer, the customer in effect pays the entity in advance for future goods or services and the entity recognizes revenue when those future goods or services are transferred or when the option expires.

B41 If a customer has the option to acquire an additional good or service at a price that would reflect the stand-alone selling price for that good or service, that option does not provide the customer with a material right even if the option can be exercised only by entering into a previous contract. In those cases, the entity has made a marketing offer that it shall account for in accordance with this Standard only when the customer exercises the option to purchase the additional goods or services.

Example: Loyalty points

A retailer has a loyalty program that rewards customers one point per Rs.10 spent. Points are redeemable for Re.1 off future purchases (but not redeemable for cash). A customer purchases Rs.1,000 of product at the normal selling price and earns 100 points redeemable for Rs.100 off future purchases of goods or services. The retailer expects redemption of 95 points (that is, 5% of points will expire unredeemed). The retailer, therefore, estimates a standalone selling price for the incentive of Rs.95 based on the likelihood of redemption.

The retailer would allocate the transaction price of Rs.1,000 between the product and points based on the relative standalone selling prices of Rs.1,000 for the product and Rs.95 for the loyalty reward as follows:

Product Rs.913 Rs.1,000 x Rs.1,000/Rs.1,095)

Points Rs.87 (Rs.1,000 x Rs.95/Rs.1,095)

The revenue allocated to the product is recognized upon transfer of control of the product and the revenue allocated to the points is recognized upon the earlier of the redemption or expiration of the points. The estimate of the number of awards that will expire unredeemed is updated at each period end.

158. With greater refinements of accounting theories and especially, after issuance of Ind AS, the accounting of sale of goods and services under loyalty programmes is also refined. Such sales of goods and services are now being considered as multiple element transactions; initial sale and future sales against redemption of the benefits under the loyalty programmes (referred to as "Deferment Model" in this Technical Guide).

159. Under AS 9, both the Provision Model and Deferment Model are prevalent in India for accounting of customer loyalty programmes. Some e-commerce companies treat it as a single element transaction and recognise revenue for the entire transaction at the time of initial sale. However, since a further cost is expected to be incurred in future with regard to the obligation to provide free/discounted goods or services, a provision is recognised towards the cost of such free/discounted goods or services as marketing expense at the time of initial sale. Others treat such sale of goods or services as multiple element transactions; one element being the initial sale and another being the future sale at discounted

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price/free against redemption of the loyalty programmes benefit. Accordingly, revenue relating to the obligation towards award credit/future redemption of benefits under the programmes is deferred and recognised in the period in which the obligations are fulfilled.

160. While both the treatments are in line with the matching concept, they lead to a difference in the timing of recognition of revenue and costs. Under the first one, treating the transaction as a single element one, the total revenue and total cost is recognised at the time of recognising the initial sale while under the second one, treating the transaction as a multiple element one, both revenue and costs relating to the loyalty programmes are recognised subsequent to the initial sale when the related obligations are fulfilled.

161. View that is now emerging post issuance of Ind AS, that multiple element treatment of loyalty programmes is also consistent with AS 9 on the basis that AS 9 prescribes recognition of revenue when and to the extent that, goods and services have been provided to the customer. In case of sale of goods and services which entitle the customer to points or award scheme/benefits/ rights which can be redeemed in future for discounted or free goods or services, the retailer has two obligations – firstly, to provide the initial goods or services and secondly, to provide further goods or services at a discounted price or even free of cost as and when customer redeems the award/benefit of the programmes.

162. Accordingly, the consideration received is towards fulfilling two obligations rather than just providing the initial goods or services.

163. The Deferment Model being more refined one is preferred model, though it does involve complex workings to arrive at the fair value of the award credits/obligations to be fulfilled in future. This Model thus, requires data for estimating the expected redemptions to establish patterns which may not be readily available with a retailer especially, since e-commerce is comparatively new in India. In case, reliable data is not available or the estimation of fair value of award credits presents significant difficulties, Provision Model may be used.

164. Awards that entitle the holder to discounted/free goods or services in the e-commerce website/mobile application. The concept of bifurcating the two elements of a transaction and accounting treatment for each element under the Deferment Model is explained in the following illustration:

Example: Award credits – Deferment Model
Entity A awards 80 points with each purchase of goods of Rs. 100. These points can be exchanged for goods supplied by the entity. The customer has a three year period over which he/she can use the credits. For every 1,000 points, goods with a retail sale price of Rs. 60 can be obtained. If the entity provides these goods itself, its cost is Rs. 12. The Entity has sold goods of Rs 150 under the Scheme. It has thus, awarded 120 points in connection with sale of goods of Rs.150. In Year 1, the Entity expects that 100 of these points will be redeemed. In Year 2, the Entity revises its estimate of estimated redemption to 90 points. The actual redemption is as under:
Year 1: 50 points redeemed
Year 2: 10 points redeemed
Year 3: 30 points redeemed or expired

Deferment Model
First of all, value of the Award Credits will need to be worked out. This works out to Rs 7.20 [(60*120/1000)]. However, since only 100 points are expected to be redeemed, the fair value of the total award credits works out to Rs.6 (Rs.7.2 *100/120).

The accounting treatment for this will be as under:
At the time of initial sale

Cash/Bank	Dr.	150	Cash received at the time of sale

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Deferred revenue Cr. 6 Fair value of the award [7.2 *(100/120)]
Sales Cr. 144 Rs.150-Rs.6

At the end of year 1:
Since 50 points have been redeemed, the entity will recognise revenue of Rs.3 (50/100*Rs.6). Rs. 6 is the initial estimate of the fair value of the award which was deferred at the time of sale on the basis that 100 points will be redeemed.

Deferred revenue Dr. 3 [50/100*Rs.6]
Sales Cr. 3

Correspondingly, as and when the points are redeemed, the entity will book the cost incurred towards redeeming the points. The entity incurs Rs.12 when it redeems 1000 points, accordingly, for 50 points the cost is worked out to Re. 0.60 i.e. (50/1000*12):

Cost of Goods Sold Dr. 0.60 [50/1000*Rs.12]
Inventory Cr. 0.60

Year 2:
During the second year, 10 points have been redeemed, bringing the total points redeemed to date to 10+50 = 60. Since management now expects a total of 90 points to be redeemed, it should recognise a revenue of Rs. 4 i.e. (60/90*Rs.6). As Rs. 3 has already been recognised, the company recognises a further Re.1 of the revenue. The entries in year 2 will be as follows:

Deferred revenue Dr. 1 Revenue to be recognised till date: 60 points/90 points *Rs.6= Rs.4 Less: recognised in Year 1: Rs.3.00 Balance: Re.1.00
Sales Cr. 1

Correspondingly, the entity incurs Rs.12 when it redeems 1000 points, accordingly, for 10 points the cost is worked out as (10/1000*12) which is Re.0.12.

Cost of goods sold Dr Re.0.12 (10/1000*Rs.12)
Inventory Cr Re.0.12

Year 3:
Since the remaining points are either redeemed or expired in the third year, the balance of deferred revenue should be recognised in this year. Since out of the total deferred revenue of Rs. 6, Rs. 4 has been recognised as revenue in the earlier years, the balance of Rs. 2 of deferred revenue is recognised in year 3. Further, if the balance points are not redeemed and they expire, then there will be no corresponding cost. However, if the balance points are redeemed, then the corresponding costs should also be recognised as illustrated for year 1 and year 2.

Deferred revenue Dr. 2 Total deferred revenue: Rs.6.00 Less: recognised in Year 1: Rs.3.00 Less: recognised in Year 2: Re.1.00 Balance: Rs.2.00
Sales Cr. 2

Accordingly, the impact of using the Deferment Model is that Rs.6 out of the revenue received in Year 1 is recognised over 3 year period in proportion to the expected redemptions. The total revenue recognised over the 3 year period continues to be Rs.150. The related costs of redemption are recognised correspondingly in the respective period when the redemption occurs.

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Provision Model:

In contrast, under the Provision model, the entire revenue is recognised at the time of initial sale, along with the entire expected cost of redemption for which a provision is recognised:

In contrast, under the Provision model, the entire revenue is recognised at the time of initial sale, along with the entire expected cost of redemption for which a provision is recognised:

Cash/Bank	Dr.	150	Cash received at the time of initial sale
Sales	Cr.	150	Revenue recognised fully

Marketing expense Dr. 1.20 Expected cost of goods to be used for redemption of 100 points: [Rs.12*100 points /1000 points]

Provision for marketing expense Cr. 1.20

As and when the points are redeemed in the subsequent years, the provision recognised as above is utilised. For example, in year 1, since 50 points are redeemed, provision for marketing expense is utilised as follows:

Provision for marketing expensed.	Dr.	Re. 0.60	(50/1000*Rs.12)
To Inventory	Cr.	Rs.0.60	

The difficult aspect in this process is the determination of the fair value of the points/award credits. This is further illustrated in the following example:

Example: Awards credits – identification of fair value

An electronic retailer sells a toy on its mobile application for Rs. 20. A voucher entitling the bearer to a discount of Rs. 6 on a subsequent purchase of the same type of toy is issued with each sale. Another retailer sells the same toy for Rs. 18 without the voucher.

The e-tailer's experience has been that for every two vouchers issued, one is redeemed. During a particular year, the e-tailer has sold 10 toys with vouchers.

In this case, the customer is purchasing both the toy and the voucher.

Therefore, revenue will be required to be allocated between the toy and the voucher (coupon). This is done using fair values of each element. The fair value of each voucher is worked out to Rs.4 as under:

Normal sale price of the toy without voucher		Rs.18
Less: Sale price of toy using voucher (Retail price of Rs. 20 less the face value of the voucher Rs. 6)	Rs.14	
Redemption value of the voucher		Rs.4

This value is then adjusted for the proportion of vouchers expected to be redeemed (50 per cent). Thus, the fair value of the Voucher works out to Rs. 2 (Rs. 4*50 %) and that of the toy to Rs. 18 (Rs. 20 minus Rs. 2 being the fair value of the voucher)

The accounting entry at the time of initial sale will be as under:

Cash/Bank	Dr	Rs. 200	Cash received at the time of sale (10 toys @ Rs. 20 per toy)
Sales	Cr	Rs. 180	Fair value of the toys*Rs.18 per toy
Deferred Revenue	Cr	Rs. 20	Fair value of the voucher (10 vouchers @ Rs.2 per voucher)

EXPOSURE DRAFT

The amount of revenue recognised upon redemption of the vouchers is based upon the Redemption Value of the vouchers.

Hence, when a single voucher is redeemed the accounting entry is:

Deferred Revenue	Dr	Rs.4 Redemption Value of each voucher
Cash/Bank	Dr –	Rs.14 Cash received at the time of sale (Sale Price Rs. 20 minus Rs. 6 face value of the voucher)
Sales	Cr	Rs.18 Redemption Value of voucher (Rs. 4) + amount received on sale (Rs. 14)

Award Credits that the holders can use in stores within the same website/ mobile application or chain of website/ mobile application, for discounted/free goods or services

165. The same principles as set out above in relation to award credits entitling the holder to discounted/free goods or services in the same website/ mobile application apply in this situation also except that the determination of the fair value of the award credits, goods or services will need to take into consideration the difference, if any, in the price at which the goods or services are sold through different websites/mobile applications.

166. In case Provision Model is adopted, the provision will have to take into consideration the difference, if any, in the cost of goods or services supplied through different websites/mobile applications.

167. Award credits that are redeemable against discounted/free goods or services provided by the issuer entity itself or for goods or services provided by another entity.

168. There could be a reciprocal arrangement too whereby the issuing entity redeems awards issued by the third party.

169. Such loyalty programmes may be administered by the issuer entity itself or the obligation and/or administration may be transferred to third party.

The accounting of self-administered programmes is illustrated below.

170. Where the customer can redeem awards issued by an entity at its own website/ mobile application or at a third party website/ mobile application, the entity retains the obligation for redemption till the point the customer redeems the award. This is because the customer is free to redeem the points in either own or third party website/ mobile applications.

171. In such cases, it may or may not be possible to estimate how many points the customer is likely to redeem in own store and how many in third party website/ mobile application. Normal assumption is that it is not feasible to predict which of the websites/ mobile applications the customer will choose for redemption and accordingly, it is presumed, for accounting purposes, that the customer will redeem all award credit points in own website/ mobile application. The accounting entries, in that case, will be same as explained above at the time of initial sale. The entity accounts for the payments to be made to the third party based on the contractual arrangement with the third party.

172. On the other hand, if reliable estimate for redemption pattern or choice of customers can be made based on past track record, the entity will account for the points estimated to be redeemed in own website/ mobile application applying principles explained above and will make provision for the amounts to be paid to third party website/ mobile application based on the contractual arrangement between the parties. This is explained in the Illustration below.

EXPOSURE DRAFT

Example: Award credits redeemable by another entity – self administration

Entity A awards 80 points with each purchase of goods of Rs. 100 through its website/ mobile application. These points can be exchanged for goods supplied by Entity A or Entity B. The customer has a three year period over which he/she can use the credits. For every 1,000 points, goods with a retail sale price of Rs. 60 can be obtained either in Entity A or Entity B. If Entity A provides these goods, its cost is Rs. 12 and if they are provided by Entity B, Entity A will have to pay Rs 40 to Entity B. Entity A has sold goods of Rs 150 under the Scheme. It has, thus, awarded 120 points in connection with sale of goods of Rs.150. In Year 1, Entity A expects that 100 of these points will be redeemed of which 60 will be redeemed in its own store and 40 will be redeemed in Entity B. In Year 2, the Entity revises its estimate of estimated redemption to 90 points of which 54 points are expected to be redeemed in its own store and 36 points in Entity B. The actual redemption is as under:

Year 1: 50 points redeemed – 30 points in Entity A and 20 points in Entity B
Year 2: 10 points redeemed – 8 points in Entity A and 2 points in Entity B
Year 3: 12 points redeemed in Entity A and balance 10 expired

Deferment Model

First of all, value of the Award Credits will need to be worked out. Value of 1000 points is Rs 60 so, value per point is Rs 0.06. Thus, value of 120 points works out to Rs 7.20 [(60*120)/1000]. However, since only 60 points are expected to be redeemed in Entity A, the fair value of the total award credits works out to Rs.3.6 (Rs.7.2 *60/120). Since 40 points are expected to be redeemed in Entity B, provision will have to be made for payment to be made to Entity B for the 40 points expected to be redeemed in Entity B.

The accounting treatment for Entity A for this will be as under:

At the time of initial sale:

Cash/Bank Dr	Rs.150.00	Cash received at the time of sale
Deferred revenue Cr	Rs.3.60	Fair value of the award [7.2 *(60/120)]
Sales Cr	Rs.146.40	Rs.150 – Rs.3.60

Marketing Expense Dr	Rs 1.60	Amount to be paid to Entity B (Rs. 40* 40/1000)
Provision for Redemption in Entity B Cr	Rs 1.60	Same as above

At the end of year 1:

Since 30 points have been redeemed by Entity A, Entity A will recognise revenue of Rs.1.80 (30/60*Rs.3.6). Rs.3.6 is the initial estimate of the fair value of the award expected to be redeemed in Entity A which was deferred at the time of sale on the basis that 60 points will be so redeemed.

Deferred revenue Dr	Rs.1.80	(30/60*Rs.3.6)
Sales Cr	Rs.1.80	

EXPOSURE DRAFT

Correspondingly, as and when the points are redeemed, Entity A will book the cost incurred towards redeeming the points. Entity A incurs Rs.12 when it redeems 1000 points, accordingly, for 30 points the cost is worked out to Rs. 0.36 i.e. (30/1000*12):

Cost of Goods Sold Dr	Re.0.36	(30/1000*Rs.12)
Sales Cr	Re.0.36	

Further, in respect of the points redeemed in Entity B, Entity A will have to make payment to Entity B at the rate of Rs 40 for every 1000 points redeemed. As only 20 points have been redeemed, the payment by Entity A to Entity B works out to Re. 0.80.

Provision for Redemption in Entity B Dr	Re. 0.80	Rs. (40 * 20/1000)
Cash/Bank Cr	Re. 0.80	Amount paid to Entity B against redemption of 20 points

Year 2
During the second year, 10 points have been redeemed of which 8 points are redeemed in Entity A and 2 points in Entity B. Thus, total points redeemed to date by Entity A works out to 38 (30 + 8). Since management now expects a total of 54 points to be redeemed in Entity A, it should recognise total revenue of Rs. 2.53 i.e. (38/54 * Rs.3.60). Of this, Rs. 1.80 has already been recognised, Entity A will recognise a further Re. 0.73 of the revenue. The entries in year 2 in the books of Entity A will be as follows:

Deferred revenue Dr	Re.0.73	Revenue to be recognised till date: 38 points/54 points *Rs.3.60 = Rs.2.53 Less: recognised in Year 1: Rs.1.80 Balance: Re.0.73
Sales Cr	Re.0.73	

Correspondingly, the entity incurs Rs.12 when it redeems 1000 points, accordingly, for 10 points the cost is worked out as (10/1000*12) which is Re.0.12:

Cost of goods sold Dr	Re.0.12	(10/1000*Rs.12)
Inventory Cr	Re.0.12	

Year 3:
Since 12 points are redeemed in Entity A and balance have expired in the third year, the balance of deferred revenue should be recognised in this year. Since out of the total deferred revenue of Rs.3.60, Rs.2.53 has been recognised as revenue in the earlier years, the balance of Rs. 1.07 of deferred revenue is recognised in year 3. Further, there will be corresponding cost which entity incurs – that cost is Rs 12 for 1000 points and accordingly, for 12 points, it works out to Re 0.144 (12/1000*12).

The accounting entries in books of Entity A in Year 3 will be as under:

Deferred revenue Dr	Rs. 1.07	Total deferred revenue: Rs.3.60 Less: recognised in Year 1: Rs.1.80 Less:

EXPOSURE DRAFT

		recognised in Year 2: Re.0.73 Balance: Rs.1.07
Sales Cr	Rs. 1.07	

Accordingly, the impact of using the Deferment Model is that Rs.3.60 out of the revenue received in Year 1 is recognised over 3 year period in proportion to the expected redemptions. The total revenue recognised over the 3 year period continues to be Rs.150. The related costs of redemption are recognised correspondingly in the respective period when the redemption occurs.

So far as Entity B is concerned, it will account for sales as they take place. It will recover part or no amount (depending on whether the arrangement is for discounted goods/service or free goods/service) from the customer and balance amount from Entity A.

If, however, the arrangement entered into with Entity A is onerous and it expects to incur loss in the transaction, it should make provision for the expected loss in accordance with AS 29.

Provision Model

Under the Provision Model, Entity A will recognise the entire revenue at the time of initial sale, along with the entire expected cost of redemption for which a provision is recognised:

Cash/Bank Dr	Rs. 150	Cash received at the time of initial sale
Sales Cr	Rs. 150	Revenue recognised fully

Marketing expense Dr	Rs. 2.32	Cost of goods to be used for redemption in own store (0.72) + amount to be paid to Entity B (Rs. 40 *40/1000) = 1.60
Provision for marketing expense Cr	Re. 0.72	Expected cost of goods to be used for redemption of 100 points: [Rs. 12*100 points/1000 points]
Provision for redemption in Entity B Cr	Rs. 1.60	Amount to be paid to Entity B (Rs. 40 *40/1000) = 1.60

As and when the points are redeemed in the subsequent years, the provision recognised as above is utilised. For example, in year 1, since 30 points are redeemed, provision for marketing expense is utilised as follows:

Provision for marketing expense Dr	Re. 0.36	(30/1000*Rs.12)
To Inventory Cr	Re. 0.36	

Accounting in situations where the issuer entity has transferred administration to third party

EXPOSURE DRAFT

173. In such cases, the issuer entity retains the obligation relating to the scheme and the third party is engaged merely to act as a service provider to facilitate the administration of the loyalty scheme.

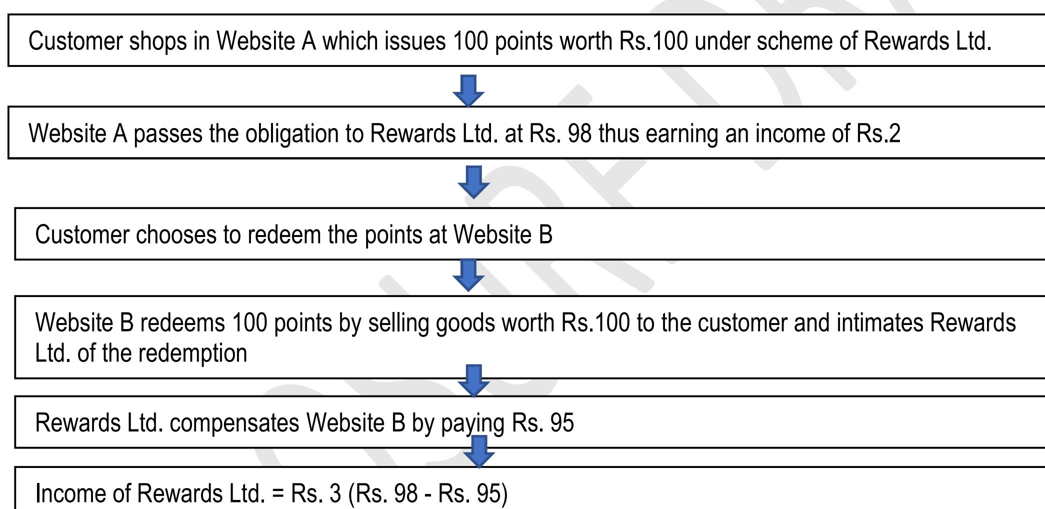
174. Since obligation continues to remain with the issuer entity, the principles explained above apply. The service fee of the third party for assistance in administering the loyalty scheme is to be accounted for based on the contractual arrangement between the entity and the third party.

Entity transfers the obligation of redeeming awards under the loyalty schemes to a third party in its entirety

175. The third party administrator who undertakes the obligation to redeem awards usually enters into contractual arrangements with entities participating in the scheme.

Normally, entities participating in such arrangements, act as both the issuing entity (in pursuance of its own loyalty scheme) as well as a redeeming entity (redeeming awards issued by other entities). The redeeming entity receives consideration from the third party administrator for undertaking such obligation.

176. The following flow chart illustrates a third party arrangement in which Website A and Website B have entered into contractual arrangement with Rewards Ltd. for administering reward schemes. Rewards Ltd has similar arrangements with multiple websites.



177. As the obligation is entirely passed on to the third party administrator, the issuing entity recognises the revenue in full on sale of goods/services and does not defer any revenue as there are no further obligations to be fulfilled by the entity. The expense/income on account of the transfer of obligation to the third party administrator, as per the agreement, are separately accounted for. The following illustration explains the accounting treatment in such cases.

Example: Awards obligation transferred to third party in its entirety

Rewards Ltd. runs a loyalty card scheme independently from any electronic retailers through their mobile applications/ website. The customer holds a loyalty points card which is issued by Rewards Ltd. and allows the customer to earn points at a given list of retailers and use points at other electronic retailers.

The face value of the point issued is Re. 1 and for each point issued, the issuing electronic retailer, Website A, will pay Re 0.98 to Rewards Ltd. and in doing so will earn Re. 0.02 of commission income. Once Website A has paid Rewards Ltd., it has no further obligation to the customer.

When another electronic retailer – Website B redeems points with a face value of Re. 1, it will receive compensating cash from Rewards Ltd. amounting to Re. 0.95. Rewards Ltd.'s margin is the difference between the redemption price and the issue price. Where either Website A or Website B both issue and redeem points, there is no netting of cash flows; cash is paid to Rewards Ltd. for points issued, and cash is received from Rewards Ltd. for points redeemed. The accounting for such a scheme in the books of Website A is as follows:
When the retailer makes a sale of Rs. 10, it issues points with face value of Re. 1:

Cash/Bank Dr	Rs.10	Cash received at the time of sale
Sales Cr	Rs.9	Revenue attributed to sale of product
Other Income Cr	Re. 0.02	Difference between obligation of Re.1 less the amount at which the liability is passed on to Rewards Ltd. Re. 0.98 = Re. 0.02. As Website A has no further obligations, it can recognise this income at the time of initial sale
Liability to Rewards Ltd Cr	Re. 0.98	Amount determined as per the contractual arrangement with Rewards Ltd. (Re.0.98 for every point worth Re.1)

When the risks and rewards associated with the points are immediately passed to Rewards Ltd., the liability is offset:

Liability Dr	Re. 0.98	
Cash/Bank Cr	Re. 0.98	Money paid to Rewards Ltd. for offsetting the liability.

The accounting for redemption in the books of Store B is as follows:

When the points are redeemed, the redeeming retailers will recognise the revenue made by the points with a face value of Re. 1 at Re. 0.95:

Receivable from Rewards Ltd Dr	Re. 0.95	Money receivable from Rewards Ltd on redemption of voucher as per the contractual arrangement with Rewards Ltd.
Sales Cr	Re. 0.95	

178. The expenses relating to launching and promoting loyalty schemes should be recognised in the profit and loss account as and when incurred.

Accounting for gift cards/coupons

179. The use of gift coupons and gift cards is common in the electronic retail industry. The gift cards or coupons are typically sold for cash and may be used by customers to obtain products or services in the future up to a specified monetary value. The amount of gift certificates that are forfeited is commonly referred to as breakage. Breakage will typically result in the recognition of income for a retailer; however, the timing of recognition depends on expected customer behaviour and the legal restrictions in the relevant jurisdiction.

EXPOSURE DRAFT

Example: Accounting for gift cards breakage

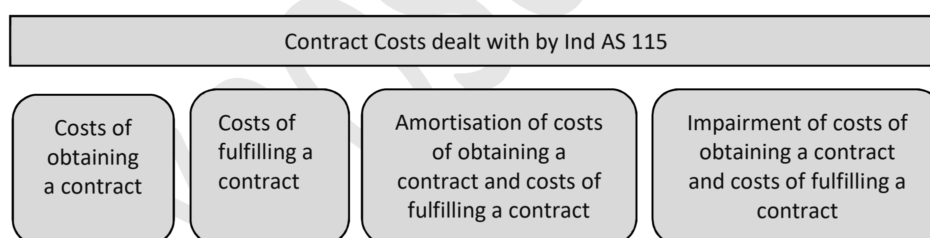
A retail store sells a gift card to customers aggregating to Rs.100,000. The gift card can be used for up to one year from the date of purchase. Under Ind AS 115, the retailer has to estimate the variable consideration in the arrangement. Based on the history of issuing gift cards, the retailer estimates that the customers generally redeem 98% of the gift card amounts and in 2% cases, they expire unused (2% breakage). The retailer has no requirement to remit any unused funds to the customer or any third party when the gift card expires unused. A contract liability of Rs. 2,000 is recorded upon the sale of the gift card.

Every time the customer redeems the gift card, the retailer recognizes proportionate breakage revenue of 2%. For example, if the customer purchases Rs.5000 worth products using the gift card from the retailer, the retailer recognizes Rs. 5,100 of revenue, reflecting the product's selling price and the estimated breakage of Rs.100.

Contract Costs

180. Entities generally incur costs to obtain a contract and costs to fulfil a contract before a good or service is provided to a customer. Under Companies (Indian Accounting Standards) Rules, 2015, Ind AS 115 specifies the accounting treatment for costs an entity incurs to obtain and fulfil a contract to provide goods and services to customers. Therefore, Ind AS 115 is not a standard that only deal with revenue recognition, but it also provides guidance on accounting treatment for such costs. An entity only applies these requirements to costs incurred that relate to a contract with a customer that is within the scope of Ind AS 115.

181. The standard provides guidance on costs to obtain and fulfil a contract that should be recognized as assets. Costs that are recognized as assets are amortized over the period that the related goods or services transfer to the customer and are periodically reviewed for impairment.



Costs to obtain a contract

182. E commerce companies incur significant cost to obtain new customers in order to increase their subscriber/ user base, often referred to as ‘cash burnout’. Under Ind AS 115, the incremental costs of obtaining a contract with a customer are deferred i.e., recognised as an asset if the entity expects to recover them. An entity can expect to recover contract acquisition costs through direct recovery (i.e., reimbursement under the contract) or indirect recovery (i.e., through the margin inherent in the contract).

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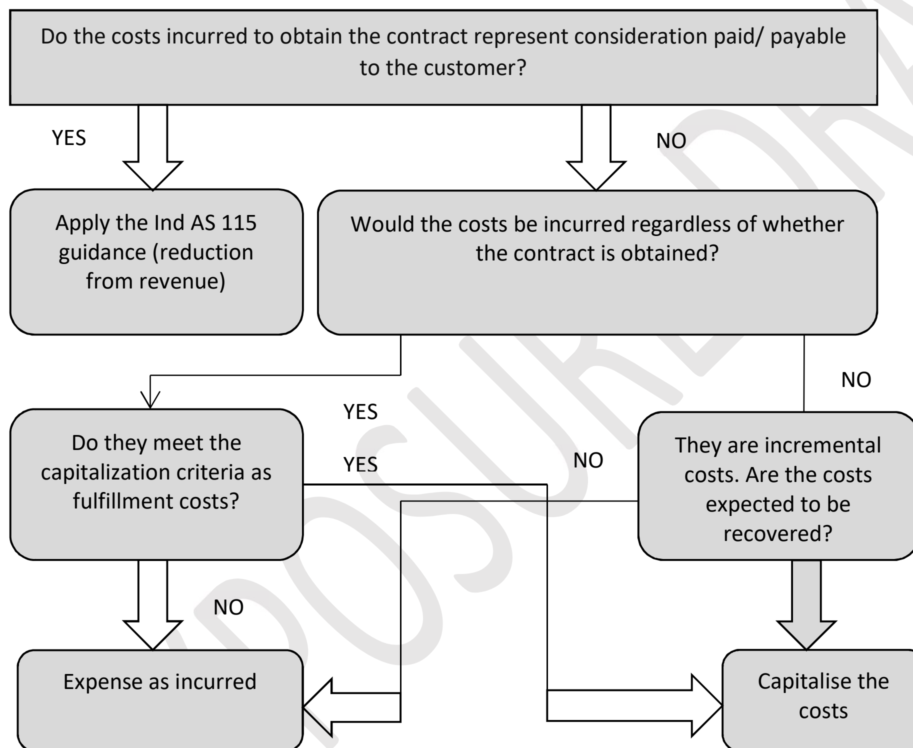
183. Costs that are incurred regardless of whether the contract is obtained, including costs that are incurred in attempting to obtain the contract, are expensed as incurred, unless they meet the criteria for capitalization as fulfilment costs. For example, salaries and benefits of sales employees that are incurred (i.e., paid to the employee) regardless of whether a contract was obtained are not incremental costs. Costs to participate in a tender or a bid for a sale contract would be an example of such costs.

184. Examples of incremental cost of obtaining a contract are sales commissions that are incremental to the contract.

185. Before applying these requirements, an entity needs to first consider whether the requirements on consideration payable to a customer under Ind AS 115 apply to the costs. Therefore, if the costs represent consideration paid or payable to customer, the relevant guidance of Ind AS 115 should be applied (i.e. these costs would have to be reduced from the revenue).

Following diagram illustrates that accounting:



186. In assessing whether the incremental cost to obtain contracts are recoverable, an entity should also consider potential renewal or extension of contracts with customers. Variable consideration that are constrained and not recognized as per Ind AS 115 are also considered to assess recoverability of incremental cost to obtain contracts.

Accounting for consideration payable to customers

187. Often e-commerce entities make payments to their direct and/or indirect customers. Often, the consideration payable represents incentives given by the entity to entice the customer to buy, or

continue buying, its goods or services. The consideration payable to customer can take various forms. It can be direct payment in monetary terms or it can be in non-cash form, such as, coupons, vouchers or loyalty points that can be redeemed by the customer in future. In certain cases, the consideration payable may be towards the separate purchases of goods and services by the entity from the customer.

188. Under Companies (Accounting Standards) Rules, 2006, AS 9 defines revenue as gross inflow of cash, receivables and other consideration arising in the course of ordinary activities of an enterprise from sale of goods or rendering of services. Revenue is measured by the charges made to customers or clients for goods supplied and services rendered to them.

189. Trade discounts and volume discounts are deducted in determining revenue. However, cash discounts are not deducted from revenue, instead presented as expense.

190. Under Companies (Indian Accounting Standards) Rules, 2015, Ind AS 115 provides the following guidance for consideration payable to a customer:

> **70. Consideration payable to a customer includes cash amounts that an entity pays, or expects to pay, to the customer (or to other parties that purchase the entity's goods or services from the customer). Consideration payable to a customer also includes credit or other items (for example, a coupon or voucher) that can be applied against amounts owed to the entity (or to other parties that purchase the entity's goods or services from the customer). An entity shall account for consideration payable to a customer as a reduction of the transaction price and, therefore, of revenue unless the payment to the customer is in exchange for a distinct good or service (as described in paragraphs 26–30) that the customer transfers to the entity. If the consideration payable to a customer includes a variable amount, an entity shall estimate the transaction price (including assessing whether the estimate of variable consideration is constrained) in accordance with paragraphs 50–58.**
>
> **71. If consideration payable to a customer is a payment for a distinct good or service from the customer, then an entity shall account for the purchase of the good or service in the same way that it accounts for other purchases from suppliers. If the amount of consideration payable to the customer exceeds the fair value of the distinct good or service that the entity receives from the customer, then the entity shall account for such an excess as a reduction of the transaction price. If the entity cannot reasonably estimate the fair value of the good or service received from the customer, it shall account for all of the consideration payable to the customer as a reduction of the transaction price.**
>
> **72. Accordingly, if consideration payable to a customer is accounted for as a reduction of the transaction price, an entity shall recognise the reduction of revenue when (or as) the later of either of the following events occurs:**
>
> **(a) The entity recognises revenue for the transfer of the related goods or services to the customer; and**
>
> **(b) The entity pays or promises to pay the consideration (even if the payment is conditional on a future event). That promise might be implied by the entity's customary business practices.**

191. The above guidance for accounting for the consideration payable to a customer applies regardless of whether the purchaser receiving the consideration is a direct or indirect customer of the entity. Therefore, all the purchasers of an entity's products along the distribution chain i.e., distributors, dealers, retailers, re-sellers and end-customers would be covered under this requirement. For example, electronic retailers may offer coupons to end-consumers. This applies to revenue from rendering of services, as well as entities that derive revenue from sales of goods.

EXPOSURE DRAFT

192. To determine the appropriate accounting treatment, an entity must first determine whether the consideration paid or payable to a customer represents

- A payment for a distinct good or service that is purchased from the customer,
- A reduction of the transaction price, or
- A combination of both.

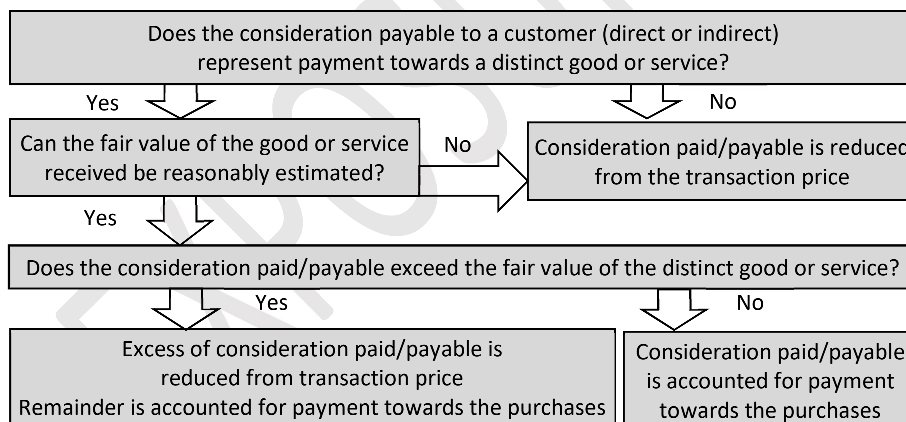
193. For a payment by the entity to a customer to be treated as something other than a reduction of the transaction price, the good or service provided by the customer must be distinct.

194. The amount of consideration received from a customer for goods or services and the amount of any consideration paid to that customer for goods or services may be linked even if they are separate events.

195. If the payment to the customer is in excess of the fair value of the distinct good or service received, the entity must account for such excess as a reduction of the transaction price. Commercially, an entity would not pay more that the fair value of the goods or service purchased. If there is an excess payment, it would represent an incentive that the entity is offering its customers and, therefore, reduced from the transaction price. The remainder of the amount of consideration paid/payable to the customer is treated as purchases.

196. If the entity cannot reasonably estimate the fair value of the good or services received from the customer, then the standard requires the entire consideration payable to the customer as a reduction from transaction price.

197. The following diagram illustrates the requirements:



198. Payments made to customers that are not specified in the contract may represent consideration payable to a customer. The determination of how broadly payments within a distribution chain should be evaluated requires judgment.

199. The consideration payable to a customer that is to be treated as a reduction from transaction price is recognised as a reduction of revenue at the later of:

- When the related sales are recognized, and
- When the entity promises to provide such consideration.

EXPOSURE DRAFT

200. For instance, if goods are sold along with cash discount coupons that are delivered to the retailers, the discount would be recognised when the coupons are issued. However, if the coupons can be used on a new range of products that have not yet been sold to retailers, the discount would be recognised upon sale of the product to a retailer.

201. However, Ind AS 115's definition of variable consideration is broad and includes amounts such as coupons or other forms of incentives provided to the customer. Ind AS 115 requires that all potential variable consideration be considered and reflected in the transaction price at contract inception and reassessed as the entity performs. Therefore, if there is a history of providing this type of consideration to its customers, the requirements on estimating variable consideration would require that such amounts be considered at contract inception, even if the entity has not yet provided or explicitly promised this consideration to the customer.

202. Therefore, entities will need to consider the requirements on variable consideration to determine the appropriate timing of recognition of consideration payable to a customer. In certain cases, significant judgement may be needed to determine the appropriate timing of recognition.

Example: Consideration payable to a customer – Price protection

A company sells a product to its customers for Rs.100 per product and agrees to reimburse the dealers for the difference between the purchase price and any lower price offered by a certain direct competitor during the three-month period following the sale. The company has recent experience with similar promotions of similar products. On a probability-weighted basis, the company estimates it will reimburse the customer Rs.5 per product.

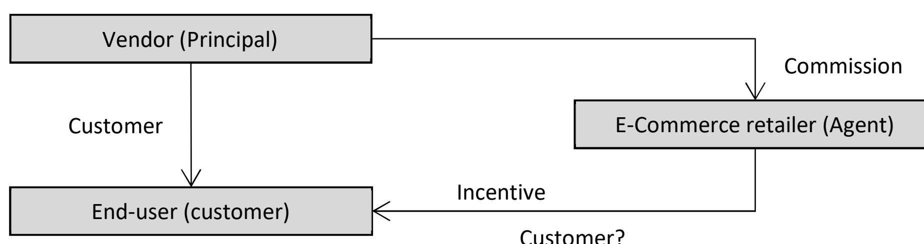
How does the company account for the potential refund?

The consideration expected to be repaid to the customer is excluded from revenue and recorded as a liability at the time of sale. Management concludes based on its recent experience that it is highly probable that recognizing Rs.95 per unit would not result in significant reversal of cumulative revenue upon resolution of the uncertainty. Therefore, the retailer recognizes revenue of Rs.95 per unit and a refund liability of Rs.5 per unit.

203. Under Companies (Accounting Standards) Rules, 2006, such costs are expensed as incurred as marketing and sales promotion expense. However, there can be some diversity in practice over whether customer incentives are treated as reduction in revenue, an expense, or a reduction from revenue under AS 9, depending on the type of incentive.

Customers outside the distribution chain of an entity

204. In certain cases, there could also be situations in which the requirements would apply to payments made to any customer of an entity's customer outside the distribution chain if both parties are considered the entity's customers. Such a situation may arise in e-commerce sector, wherein an e-commerce retailer, selling the products of its vendors (principal) on its website/application, is incentivizing the customers who purchase the products through its website/application.



EXPOSURE DRAFT

205. In such an arrangement with a principal (the vendor), an agent (the ecommerce retailer) and an end-customer, an agent may conclude that its only customer is the principal or it may conclude that it has two customers – the principal and the end-customer. Regardless of this assessment, an agent's payment to a principal's end-customer that was contractually required based on an agreement between the entity (agent) and the principal would represent consideration payable to a customer. In other words, the incentives that the e-commerce retailer is required to pay to the end-customer as contractually agreed with the principal (vendor) would be reduced from it transaction price (the commission / margin on the re-sale of the products).

206. Absent similar contract provisions that clearly indicate when an amount is consideration payable, the entity will need to evaluate their facts and circumstances to determine whether payments made to an end-customer would be considered a reduction of revenue or a marketing expense for the e-commerce retailer.

> Example: Consideration payable to a customer – E-commerce companies
>
> E-commerce retailer E markets and incentivizes the end-customers to buy the merchandise of Company A by providing cash discounts and cash backs during the festive season. When the customers purchase A's products on E's website/application during the festive period they get additional cash discounts and cash backs. E earns its commission from A when customers buy its goods on E's website/ application. However, the customers are not direct customers of E in the distribution chain.
>
> Depending on the facts and circumstances, E may conclude that both A and the end-customer are the customers of E or it may conclude that only A is its customer. Judgement will be needed to make this assessment whether payments made to an end-customer would be considered a reduction of revenue or a marketing expense for E.

Equity Based Consideration

207. Many e-commerce companies use equity-based consideration to fund expenditures as cash is not an available alternative to attract new business relationships, alliances, or supplier agreements.

208. Under Companies (Accounting Standards) Rules, 2006, when a product, service or an asset is acquired in exchange of equity shares by an e-commerce company, it should be recorded as below:
(i) Where a value is placed by the parties to the transaction in respect of a product, service or asset acquired in exchange of equity shares and the transaction is between unrelated parties, the said product, service or asset should be recorded at the value so placed, since presumably the said value will represent the fair value thereof.
(ii) Where the value is not placed by the parties to the transaction in respect of the product, or service or asset acquired in exchange of equity shares or the transaction is between the related parties, the product, service or asset should be recorded on the following basis, since in case of transactions between related parties, the value placed may not necessarily represent the relevant fair value:
(a) Where fair value of the product, service or asset acquired is available, the product, service or asset should be recorded at the said fair value.
(b) Where fair value of the product, or service or asset is not available but the fair value of the equity transferred is available, the product, service or asset should be recorded at the fair value of the equity consideration.

209. In the above cases, where the value of the products, services or assets acquired is in excess of the face value of the equity shares transferred, the difference should be credited to share premium account.

210. For the purpose of the above, 'fair value' is the price that would be agreed to in an open and unrestricted market between knowledgeable and willing parties dealing at arm's length who are fully informed and are not under any compulsion to transact.

EXPOSURE DRAFT

211. The related parties are those parties that are considered to be related as per Accounting Standard (AS) 18, 'Related Party Disclosures', under Companies (Accounting Standards) Rules, 2006.

212. Under Companies (Indian Accounting Standards) Rules, 2015, Ind AS 102 'Share based Payments' deals with such arrangements. Under Ind AS 102, all equity-settled transactions are measured at fair value. All equity-settled share based payment transactions with non-employees are normally measured using a 'service date model' (i.e. the transaction is recorded at the fair value of the goods or services received at the date they are received).

213. Ind AS 102 states as follows:

13 To apply the requirements of paragraph 10 to transactions with parties other than employees, there shall be a rebuttable presumption that the fair value of the goods or services received can be estimated reliably. That fair value shall be measured at the date the entity obtains the goods or the counterparty renders service. In rare cases, if the entity rebuts this presumption because it cannot estimate reliably the fair value of the goods or services received, the entity shall measure the goods or services received, and the corresponding increase in equity, indirectly, by reference to the fair value of the equity instruments granted, measured at the date the entity obtains the goods or the counterparty renders service.

13A In particular, if the identifiable consideration received (if any) by the entity appears to be less than the fair value of the equity instruments granted or liability incurred, typically this situation indicates that other consideration (ie unidentifiable goods or services) has been (or will be) received by the entity. The entity shall measure the identifiable goods or services received in accordance with this Standard. The entity shall measure the unidentifiable goods or services received (or to be received) as the difference between the fair value of the share-based payment and the fair value of any identifiable goods or services received (or to be received). The entity shall measure the unidentifiable goods or services received at the grant date. However, for cash-settled transactions, the liability shall be premeasured at the end of each reporting period until it is settled in accordance with paragraphs 30–33.

214. In accounting for equity-settled transactions with non-employees, the entity must adopt a rebuttable presumption that the value of the goods or services received provides the more reliable indication of the fair value of the transaction. The fair value to be used is that at the date on which the goods are obtained or the services rendered. This implies that, where the goods or services are received on a number of dates over a period, the fair value at each date should be used, although in the case of a relatively short period there may be no great fluctuation in fair value.

215. If 'in rare cases' the presumption is rebutted, the entity may use as a surrogate measure the fair value of the equity instruments granted, but as at the date when the goods or services are received, not the original grant date. However, where the goods or services are received over a relatively short period where the share price does not change significantly, an average share price can be used in calculating the fair value of equity instruments granted.

216. Ind AS 102 requires the following equity-settled transactions to be measured by reference to the fair value of the equity instruments issued rather than that of the goods or services received:

- all transactions with employees (except where it is impossible to determine fair value); and
- transactions with non-employees where, in rare cases, the entity rebuts the presumption that the fair value of goods or services provided is more reliably measurable.

217. There will also be situations where the identifiable consideration received (if any) from non-employees appears to be less than the fair value of consideration given. In such cases, the cost of the

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unidentifiable goods or services received, if any, must be accounted for in accordance with Ind AS 102 by determining the fair value of the equity instruments.

Inventory accounting

218. In the initial set years, an e-commerce company may cater to retail customers and often carry significant inventory whilst focussing on increasing their revenues through aggressive customer acquisition. However, one of the key challenges for operational success is their inventory management process and ability to effectively manage loan working capital. Such companies may build up inventory in the hope to achieve higher volumes, which is expected to compensate for the low margin on sales. A constant change in the product portfolio and freebies could lead to challenges in the management of the inventory records.

219. If an entity does not have a strong control environment to monitor its inventory, then such an entity may face the issue of write-down of inventory balances as at the reporting date. Further, ascertaining cost versus net realisable value, whichever is lower, becomes a challenge as the margins on such inventory portfolios are slim, which may add to the inventory write down provision.

Therefore, it becomes extremely important to maintain, monitor and control inventory for an effective inventory management.

220. Often the biggest impediment in the sector is unreliable third party logistics and delays due to poor surface transport. It is important to have a well drafted agreement with logistics providers as the following accounting aspects could have an impact:

- **Accounting for revenue**
  Certain logistics provider take over the risk and rewards when such goods are collected from the companies' warehouses, which could remove the delay and hassle of evidencing delivery form revenue recognition.

- **Mode of payment**
  Certain logistics provider collect cash from the respective customers and aggregate the same and deposit it into the company's bank account, by which the company could mitigate its risk associated with handling the cash.

- **Cost recognition**
  There are various ways a logistics provider is paid, per piece basis, monthly based on volumes, etc. It is critical that companies understand such arrangements as the related volume discount earned or monthly charges paid would need to be accounted appropriately.

221. Many logistics provider also provide warehousing and inventory management. It is important for companies to have an effective control and monitoring mechanism when the goods are with a third party.

Advertisement cost

222. To get customers to visit an e-commerce site and make a purchase involves heavy cost due to advertisement and marketing. Considering such advertisement and marketing costs are significant, the accounting challenge around such expense is that most companies would like to defer such costs in their financial statements based on the commercial view that these costs may have enduring benefits to the company. However, under both, Companies (Accounting Standards) Rules, 2006 and Companies (Indian Accounting Standards) Rules, 2015, advertisement expenses are expensed as incurred.

Cash handling

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223. Cash handling is one critical issue that affects most of the e-commerce companies. A lot of companies allow customers to pay cash on delivery.

224. Handling of large volumes of cash, wich is inherently susceptible to pilferage, can be a constant challenge. It can, however, be curtailed by effective monitoring and segregation of duties. Many companies may institute controls to ensure cash deposits are made daily with effective receipts and checklists. The aid of an effective internal audit would be critical. The company could also institute simple but effective steps like surprise cash counts, expanding cash insurance, etc. for controlling this risk.

Disclosure

225. Besides the disclosure of the significant accounting policies as per the requirement of Accounting Standard (AS) 1, 'Disclosure of Accounting Policies' under Companies (Accounting Standards) Rules, 2006, the bases for arriving at the fair values in respect of the following should be disclosed in the financial statements of an e-commerce and cloud service company:
(i) Different elements comprising a multiple arrangement.
(ii) Advertising barter transactions.
(iii) Equity based consideration.
In addition, the companies shall provide the disclosures as per the other accounting standards.

226. Companies under Companies (Indian Accounting Standards) Rules, 2015 shall follow the disclosure requirements of all the Ind AS standards, including, Ind AS 115 "Revenue from Contracts with Customers", Ind AS 1 "Presentation of Financial Statements" and Ind AS 102 "Share-based Payments".

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Appendix

Illustrative List of Activities Performed at Planning Stage

1. Develop a business, project plan, or both. This may include identification of specific goals for the website (for example, to provide information, supplant manual processes, conduct e-commerce, and so forth), a competitive analysis, identification of the target audience, creation of time and cost budgets, and estimates of the risks and benefits.

2. Determine the functionalities (for example, order placement, order and shipment tracking, search engine, e-mail, chat rooms, and so forth) of the website.

3. Identify necessary hardware (for example, the server) and web applications. Web applications are the software needed for the website's functionalities. Examples of web applications are search engines, interfaces with inventory or other back-end systems, as well as systems for registration and authentication of users, content management, usage analysis, and so forth.

4. Determine the technology necessary to achieve the desired functionalities. Factors might include, for example, target audience numbers, user traffic patterns, response time expectations, and security requirements.

5. Explore alternatives for achieving functionalities (for example, internal versus external resources, custom-developed versus licensed software, company owned versus third-party hosted applications and servers).

6. Conceptually formulate and/or identify graphics and content.

7. Invite vendors to demonstrate how their web applications, hardware, or service will help achieve the website's functionalities.

8. Selection of external vendors for consultants.

9. Identify internal resources for work on the website design and development.

10. Identify software tools and packages required for development purposes.

11. Address legal considerations such as privacy, copyright, trademark and compliance.

Illustrative List of Activities Performed at Website Development Stage

1. Acquire or develop the software tools required for the development work (for example, HTML editor, software to convert existing data to HTML form, graphics software, multimedia software, and so forth).

2. Obtain and register an Internet domain name.

3. Acquire or develop software necessary for general website operations, including server operating system software, Internet server software, web browser software, and Internet protocol software.

4. Develop or acquire and customise code for web applications (for example, catalogue software, search engines, order processing systems, sales tax calculation software, payment systems, shipment tracking applications or interfaces, e-mail software and related security features).

5. Develop or acquire and customise database software to integrate distributed applications (for example, corporate databases, accounting systems) into web applications.

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6. Develop HTML web pages or develop templates and write code to automatically create HTML pages.

7. Purchase the web and application server(s), Internet connection (bandwidth), routers, staging servers (where preliminary changes to the website are made in a test environment), and production servers (accessible to customers using the website). Alternatively, these services may be provided by a third party via a hosting arrangement.

8. Install developed applications on the web server(s).

9. Initial creation of hypertext links to other websites or to destinations within the website. Depending on the site, links may be extensive or minimal.

10. Test the website applications (for example, stress testing).

Illustrative List of Activities Performed at Graphics and Content Development Stages

1. Create initial graphics for the website. Graphics include the design or layout of each page (that is, the graphical user interface), colour, images and the overall 'look and feel' and 'usability' of the website. Creation of graphics may involve coding of software, either directly or through the use of graphic software tools. The amount of coding depends on the complexity of the graphics.

2. Create content or populate databases. Content may be created or acquired to populate databases or web pages. Content may be acquired from unrelated parties or may be internally developed.

3. Enter initial content into the website. Content is text or graphical information (exclusive of graphics described in (1) above) on the website which may include information on the entity, products offered, information sources that the user subscribes to, and so forth. Content may originate from databases that must be converted to HTML pages or databases that are linked to HTML pages through integration software. Content also may be coded directly into web pages.

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