Guidance Note on
Accounting by E-commerce Entities

The Institute of Chartered Accountants of India
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Foreword

In recent times we have witnessed a rise in the number of online transactions involving buying and selling of products or online services over the internet. In the E-commerce process, the buyers and the sellers are a mere click-of-the-mouse away and business is transacted involving technologies such as internet banking, mobile commerce, electronic fund transfer, etc. In view of these unique features, varied accounting practices being followed across the companies. In the above scenario, a need was felt by the Research Committee of the Institute in bringing out guidance for the benefit of all stakeholders at large.

The Research Committee has revised 'Guidance Note on Dot-Com companies' as the 'Guidance Note on Accounting by E-commerce Entities'. The old guidance note dealt with accounting treatment of various revenue and expense items peculiar to the dot-com business. However, the revised guidance note deals with accounting by e-commerce entities in respect of accounting issues relating to revenue and expense recognition.

I would like to congratulate CA. Anuj Goyal, Chairman, Research Committee, CA. Kemisha Soni, Vice-Chairperson, Research Committee, and other members of the Research Committee for their contribution in development of this Guidance Note.

I am confident that this endeavour of the Research Committee will go a long way in establishing sound principles on Accounting for E-commerce entities and providing requisite guidance to the members as well as others concerned stakeholders.

New Delhi — **CA. Atul Kumar Gupta**
January 28, 2021 — **President, ICAI**

Preface

E-commerce is the activity of electronically buying or selling of products or online services over the internet. The online transactions can be conducted via mediums like computers, tablets, and smartphones. Most of the transactions are being done through online mode being ease in doing transactions by the consumers. In the above scenario, there was need felt for providing guidance for recording transactions conducted online.

Research Committee had already issued 'Guidance Note on Accounting by Dot-com companies' which dealt with accounting issues related to dot-com companies. Moreover, a need was felt to revise the above guidance note and provide more guidance in the form of e-commerce entities. The Committee has out come out with a revised guidance in the form of **'Guidance Note on Accounting by E-commerce entities'** which deals with accounting by e-commerce entities in respect of certain issues relating to revenue and expense recognition. The revised guidance note deals with key issues of e-commerce entities and aims at providing guidance on various accounting issues unique to e-commerce. This Guidance Note applies to companies preparing financial statements under Companies (Accounting Standard) Rules 2006, as amended under Section 133 of the Companies Act, 2013. It also applies to entities such as LLPs, Partnership firms.

I would like to convey my sincere thanks to CA. Atul Kumar Gupta, President, ICAI and CA. Nihar N. Jambusaria, Vice-President, ICAI for providing unflinching guidance on various activities of the Committee. I would like to convey my sincere thanks to CA. Kemisha Soni, Vice-Chairperson, Research Committee for her constant support and co-operation.

I would like to take this opportunity to express my gratitude and thanks to CA. Babu Abraham Kallivayalil, Past Chairman, Research Committee and CA. Satish Kumar Gupta, Past Vice-Chairman, Research Committee for initiating the task of revising this Guidance Note in a timely manner for the benefit of all.

I would also like to acknowledge the invaluable contribution made by CA. M.P. Vijay Kumar, CCM who spared his valuable time for providing significant inputs and for representing the draft Guidance Note before the Council, CA. Santosh Maller, Resource Person for formulating the draft of this Guidance Note, and other members for their invaluable support in this endeavour of the Research Committee. I am also thankful to the branches of ICAI, members at large and to various representatives of industry for giving their invaluable comments and suggestions on the exposure draft on the said Guidance Note.

I also appreciate the untiring efforts made by Dr. Amit Kumar Agrawal, Secretary, Research Committee, CA. Amit Agarwal, Senior Executive Officer and CA. Swati Yadav, Project Associate, Research Committee in finalising the Guidance Note.

I believe and trust that this Guidance Note would be immensely useful for the members of the Institute as well as others concerned.

New Delhi	**CA. Anuj Goyal**
January 27, 2021	**Chairman, Research Committee**

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Guidance Note on Accounting by E-commerce Entities

(*The following is the text of the Guidance Note on Accounting by E-commerce entities, 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 entities in respect of certain issues relating to revenue and expense recognition.

2. Some of the accounting issues in e-commerce entities have arisen due to the new business models being used in such entities. 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 entities.

E-commerce

3. E-commerce (electronic commerce) is the activity of electronically buying or selling of products or online services 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.

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 Wikipedia, etc.

6. Another form of e-commerce is electronic retailing 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. Internet commerce companies sell products and services over the websites on the Internet and include on-line dealers. Mode of payments to e-commerce entities by customers may take various forms, such as, debit card, credit card, net banking, electronic wallet payment, cash against delivery or any other mode.

7. E-commerce entities may operate in various major market segments, for example:

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

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.

B2C sites sell products or services directly to consumers. A large number of e-commerce entities 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, urban clap, swiggy, zomato, uber eats, red bus, IRCTC, rediff.com, jaldi.com, indiatimes.com, zipahead.com, and fabmart.com.

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.

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

8. An entity can earn revenue in many ways such as :

1. Sale of the product directly to consumer.
2. B2C and B2B can also earn by subscription mode.
3. Online advertising.

Elements of e-commerce transaction

9. 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;
- way for the people to visit the place (Web browser);
- a way to accept orders, e.g., an on-line form;
- a way to accept consideration for the transaction – e.g., through electronic mode of payment.

10. Further, the entities may use more traditional 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)].

11. 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.

Scope

12. This Guidance Note aims at providing a perspective on the various accounting issues which are unique to the e-commerce. In case of entities normally carrying on businesses other than e-commerce, the recommendations contained in this Guidance Note should be applied for recording e-commerce transactions undertaken by them.

This Guidance Note applies to companies preparing financial statements under Companies (Accounting Standards) Rules, 2006, as amended, under Section 133 of Companies Act, 2013.

This Guidance Note also applies to entities such as Limited Liabilities Partnership firms and Partnership firms that prepare financial statements under the Accounting Standards issued by the ICAI.

This Guidance Note deals with specific accounting aspects and does not deal with other generic accounting issues commonly faced across industries. This Guidance Note deals with the key issues of e-commerce companies.

Revenue Recognition

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

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

14. 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 entity and, hence, it is important to determine when does the 'risk and rewards' under Companies (Accounting Standards) Rules, 2006, as amended, under Section 133 of Companies Act, 2013. This is an important issue for business-to-customer as well as business-to-business models.

15. The basic principles of revenue recognition as set out in Accounting Standard (AS) 9, 'Revenue Recognition', notified under Companies (Accounting Standards) Rules, 2006, as amended, under Section 133 of Companies Act, 2013 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 entity from the sale of goods, from the rendering of services, and from the use by others of entity 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."**
>
> **"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.

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."

Under AS 9 principles, apart from the general criteria, revenue is recognised either on the transfer of property in the goods or transfer of significant risk and rewards of ownership. In evaluating the point at which the risks and rewards of ownership transfer from the seller to the buyer, one of the key considerations is the shipment terms.

Membership and subscription

16. 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.

17. The membership/registration fees received by an e-commerce entity 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.

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

19. AS 9 contains guidance on the recognition of non-refundable fees as revenue.

20. 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.

21. 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. Under AS 9, revenue recognition from these sources will depend on the nature of the services being provided. AS 9 states that entrance fee received is generally capitalised. If the membership fee permits only membership and all other services or products are paid for separately, or if there is a separate annual subscription, the fee should be recognised when received. If the membership fee entitles the member to services or publications to be provided during the year, it should be recognised on a systematic and rational basis having regard to the timing and nature of all. The capitalised/ deferred membership fee may be presented in a separate line item such as, “deferred membership fees”, under liabilities in the balance sheet.

22. 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.

23. 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.

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

25. 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 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, 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.

26. 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 entity should periodically review the status of this account to ascertain the extent of fulfilment or otherwise of the conditions.

27. 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.

Merchandising activities

28. 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.

29. 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.

30. 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. Often, there may be regulatory restrictions on whether an entity can sell its products directly to end-customers. This 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.

31. 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 entity:

- 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 entity is merely engaged in providing the service of bringing the purchaser and the seller together.

32. Where an e-commerce entity 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 entity 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.

33. 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

34. 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.

35. 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.

36. Common example is that of an e-commerce entity purchasing traded goods from a wholesaler. E-commerce entity 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 entity 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 entity may assess the above criteria to be significant and reflect the gross billing to its customers as its revenue.

Auctions

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

38. Under AS 9, listing fees are the up-front fees that the e-commerce entity 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. 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 entity 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.

Shipping and handling activities

39. 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.

40. In determining accounting treatment under AS 9, one of the considerations would be 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.

Multiple element arrangements

41. A multiple element arrangement generally exists where an e-commerce entity 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.

42. AS 9 does not provide any specific guidance on multiple-element sale arrangements. However, various past pronouncements of the ICAI have stated that it is appropriate to 'unbundle' the separate elements of the arrangement or contract. For this purpose, entity-specific fair values in respect of which objective evidence is available should be used, i.e., what the entity would have received had it sold each item/ service separately. Entity-specific objective evidence of fair value is determined in respect of transactions with unrelated parties. For example, an e-commerce entity may agree to host another entity's website and also provide web maintenance service for a fixed fee of ₹ 15 lakh for a term of one year and six months, respectively. If the e-commerce entity has evidence that in its recent transactions, it has charged separate fees for web hosting and web maintenance of ₹ 12 lakh for one year and ₹ 6 lakh for six months, respectively, then revenue in respect of the composite service now being provided should be recognised in the ratio of 2:1, i.e., ₹ 10 lakh from web hosting over one year and ₹ 5 lakh as revenue from web maintenance services over a period of six months.

Right of Returns

43. 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 coupons 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 coupons, 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.

44. Paragraph 10 of AS 9 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.**

45. 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.**

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 appropriate to recognise the sale but to make a suitable provision for returns based on previous experience.**
>
> **(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, in case of sales with customers' right to return in exchange for cash, AS 9 requires recognition of revenue 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 a consignment basis.

Right of Return in exchange for cash

46. In cases where such right of return is provided in exchange for cash, under AS 9, 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.

Example: Right of return in exchange of cash under AS

Arc, an online 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 an acceptable condition.

Arc has sold shirts of sale value of ₹ 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 ₹ 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.	1000	Cash received at the time of sale
Sales	Cr.	1000	Revenue recognised to the full extent

At the time of Year end

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

In the following financial year

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

Right of return against goods or services or coupons

47. Under AS 9, in the case of right of return in exchange of goods or services or coupons 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/ coupons

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 cash on return but get goods or coupons 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 ₹ 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 ₹ 1,000. The accounting entries will be as under:

<u>At the time of making the sales:</u>

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

<u>At the end of the year:</u>

No journal entry

The reason would be that though 10% of ₹ 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 ₹ 1000 i.e. ₹ 100 and cost would be 80% of ₹ 100 i.e. ₹ 80.)

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

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

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

Consignment arrangements

48. 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 recognised 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.

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 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.

Significant financing component

49. 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 realisation 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.

50. AS 9 does not provide any specific guidance on how to account for arrangements with extended financing to the customers and revenue is recognised at the contractual value of the consideration receivable.

Warranties

51. 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.

52. The accounting treatment of sale of an extended warranty by an online retailer is illustrated below:

> Example:
>
> 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 ₹ 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 ₹ 400 per valid claim.
>
> 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 ₹ 120 is not recognised (recognition is deferred) and the same is recognised annually. Thus, annual revenue of ₹ 40 (₹ 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.

Advertising services

53. 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'.

54. An e-commerce entity'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.

55. Entities may enter into agreements whereby they agree to host advertisements for customers, without any minimum guaranteed impressions. For example, an entity may enter into an agreement with another entity to host a banner advertisement containing details of products/services offered by that entity. 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.

Revenue from transactions involving exchange for non-cash consideration

56. E-commerce entities sometimes enter into arrangements with non-cash consideration, for example, advertising barter transactions. For instance, the entity may exchange rights to place advertisements on each other's' on-line properties, i.e., websites or web pages. This may take the form of a barter transaction involving exchange of advertising time for products or services.

Historically, some entities in high-growth industries allegedly engaged in transactions in which goods or services were transferred back and forth between the same entities in an attempt to show higher transaction volume and gross revenue.

57. AS 9 does not prescribe any specific guidance with respect to measurement of non-cash consideration. However, as per Paragraph 29 of Accounting Standard (AS) 13 Accounting for Investments states as follows:

> **29. If an investment is acquired, or partly acquired, by the issue of shares or other securities, the acquisition cost should be the fair value of the securities issued (which in appropriate cases may be indicated by the issue price as determined by statutory authorities). The fair value may not necessarily be equal to the nominal or par value of the securities issued. If an investment is acquired in exchange for another asset, the acquisition cost of the investment should be determined by reference to the fair value of the asset given up. Alternatively, the acquisition cost of the investment may be determined with reference to the fair value of the investment acquired if it is more clearly evident.**

Other services

Revenue from maintenance of websites including web hosting

58. 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

59. 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 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 entity should determine the time at which the delivery of the content is considered to be complete and recognise the corresponding revenue.

Website/ mobile application development costs

60. New website or mobile application development costs of an entity, 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.

61. 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 capitalised until implementation. Upon implementation, the asset is amortised 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.

62. 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 entity becomes open to the users should be expensed in the period in which they are incurred.

63. An e-commerce entity 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.

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

Rebates, Discounts, Gift vouchers, Loyalty and other sales incentives

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

66. 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 entity.

67. 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.

Point and loyalty programmes

68. Point and loyalty programmes have varied features and may be structured in different ways. In some cases, an e-commerce entity 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 entity may have an arrangement with a retail store to issue reward points to the customers of the retail store based on the minimum volume of purchases made by the customers. The customers can redeem these points while purchasing merchandise through the e-commerce entity's application until a specified period of time. In some cases, the e-commerce entity may itself award the points in order to encourage its members to take actions that will generate payments from business partners to the company.

69. 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:

- 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.

70. Loyalty programmes are not directly dealt with by Accounting Standard (AS 9), Revenue Recognition. 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 entity from the sale of goods, from the rendering of services, and from the use by others of entity 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."**

71. AS 9 does not provide any specific guidance on accounting for customer loyalty schemes. 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. Under AS 9, such sales of goods and services may be considered as multiple element transactions; initial sale and future sales against redemption of the benefits under the loyalty programmes (often referred to as "Deferment Model").

72. However, many retailers in India do not treat transactions of sale of goods or service under loyalty programmes differently from normal sales without such loyalty programmes so far as revenue recognition is concerned. Appropriate provision is made, as marketing expense, towards the cost of meeting obligation arising under the loyalty programmes. This was also the practise generally followed internationally (referred to as "Provision Model").

73. Under Accounting Standards framework, 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 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.

74. 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.

75. View that is now emerging post issuance of Ind AS, that the Deferment Model accounting is more appropriate. It is also consistent with the principles of 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.

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

77. Under AS 9, 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 under AS 9 as an acceptable alternative.

78. 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 under AS 9

Entity A awards 80 points with each purchase of goods of ₹ 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 ₹ 60 can be obtained. If the entity provides these goods itself, its cost is ₹ 12. The Entity has sold goods of ₹ 150 under the Scheme. It has thus, awarded 120 points in connection with sale of goods of ₹ 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 ₹ 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 ₹ 6 (₹ 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
Deferred revenue (liability)	Cr.	6	Fair value of the award [7.2 *(100/120)]
Sales	Cr.	144	₹ 150-₹ 6

At the end of year 1:

Since 50 points have been redeemed, the entity will recognise revenue of ₹ 3 (50/100*₹ 6). ₹ 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 (liability)	Dr.	3	[50/100*₹ 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 ₹ 12 when it redeems 1000 points, accordingly, for 50 points the cost is worked out to ₹ 0.60 i.e. (50/1000*12):

Cost of Goods Sold	Dr.	0.60	[50/1000*₹ 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 ₹ 4 i.e. (60/90*₹ 6). As ₹ 3 has already been recognised, the entity recognises a further ₹ 1 of the revenue. The entries in year 2 will be as follows:

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

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

Cost of goods sold	Dr	0.12	(10/1000*₹ 12)
Inventory	Cr	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 ₹ 6, ₹ 4 has been recognised as revenue in the earlier years, the balance of ₹ 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 (liability) Dr.	2	Total deferred revenue: ₹ 6.00 Less: recognised in Year 1: ₹ 3.00 Less: recognised in Year 2: ₹ 1.00 Balance: ₹ 2.00
Sales Cr	2	

Accordingly, the impact of using the Deferment Model is that ₹ 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 ₹ 150. The related costs of redemption are recognised correspondingly in the respective period when the redemption occurs.

Provision Model under AS 9:

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: [₹ 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.	0.60	(50/1000*₹ 12)
To Inventory Cr.	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:

As mentioned above, this option is available under AS 9

Example: Awards credits – identification of fair value under AS

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

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

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

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 ₹ 4 as under:

Normal sale price of the toy without voucher	₹ 18
Less: Sale price of toy using voucher (Retail price of ₹ 20 less the face value of the voucher ₹ 6)	₹ 14
Redemption value of the voucher	₹ 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 ₹ 2 (₹ 4*50 %) and that of the toy to ₹ 18 (₹ 20 minus ₹ 2 being the fair value of the voucher)

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

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

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

79. The same principles under AS 9 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.

80. In case Provision Model is adopted under AS 9, 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.

81. 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.

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

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

The AS 9 accounting of self-administered programmes is illustrated below.

84. 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.

85. 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.

86. 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.

> Example: Award credits redeemable by another entity – self administration
>
> Entity A awards 80 points with each purchase of goods of ₹ 100 through its website/ mobile application. These points can be exchanged for goods supplied by Entity A or Entity B. Entities A and B are not related parties and are acting on a principal-to-principal basis. 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 ₹ 60 can be obtained either in Entity A or Entity B. If Entity A provides these goods, its cost is ₹ 12 and if they are provided by Entity B, Entity A will have to pay ₹ 40 to Entity B. Entity A has sold goods of ₹ 150 under the Scheme. It has, thus, awarded 120 points in connection with sale of goods of ₹ 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 under AS 9

First of all, value of the Award Credits will need to be worked out. Value of 1000 points is ₹ 60 so, value per point is ₹ 0.06. Thus, value of 120 points works out to ₹ 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 ₹ 3.6 (₹ 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	150.00	Cash received at the time of sale
Deferred revenue	Cr	3.60	Fair value of the award [7.2 *(60/120)]
Sales	Cr	146.40	₹ 150 – ₹ 3.60

Marketing Expense Dr	1.60	Amount to be paid to Entity B (₹ 40* 40/1000)
Provision for Redemption in Entity B Cr	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 ₹ 1.80 (30/60*₹ 3.6). ₹ 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	1.80	(30/60*₹ 3.6)
Sales Cr	1.80	

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

Cost of Goods Sold Dr	₹ 0.36	(30/1000*₹ 12)
Sales Cr	₹ 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 ₹ 40 for every 1000 points redeemed. As only 20 points have been redeemed, the payment by Entity A to Entity B works out to ₹ 0.80.

Provision for Redemption in Entity B Dr	. 0.80	₹ (40 * 20/1000)
Cash/Bank Cr	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 ₹ 2.53 i.e. (38/54 * ₹ 3.60). Of this, ₹ 1.80 has already been recognised, Entity A will recognise a further ₹ 0.73 of the revenue. The entries in year 2 in the books of Entity A will be as follows:

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

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

Cost of goods sold Dr	0.12	(10/1000*₹ 12)
Inventory Cr	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 ₹ 3.60, ₹ 2.53 has been recognised as revenue in the earlier years, the balance of ₹ 1.07 of deferred revenue is recognised in year 3. Further, there will be corresponding cost which entity incurs – that cost is ₹ 12 for 1000 points and accordingly, for 12 points, it works out to ₹ 0.144 (12/1000*12).

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

Deferred revenue Dr	1.07	Total deferred revenue: ₹ 3.60 Less: recognised in Year 1: ₹ 1.80 Less: recognised in Year 2: ₹ 0.73 Balance: ₹ 1.07
Sales Cr	1.07	

Accordingly, the impact of using the Deferment Model is that ₹ 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 ₹ 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 AS 9

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	150	Cash received at the time of initial sale
Sales Cr	150	Revenue recognised fully
Marketing expense Dr	2.32	Cost of goods to be used for redemption in own store (0.72) + amount to be paid to Entity B (₹ 40 *40/1000) = 1.60
Provision for marketing expense Cr	0.72	Expected cost of goods to be used for redemption of 100 points: [₹ 12*100 points/1000 points]
Provision for redemption in Entity B Cr	1.60	Amount to be paid to Entity B (₹ 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	₹ 0.36	(30/1000*₹ 12)
To Inventory Cr	₹ 0.36	

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

87. 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.

88. 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

89. 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.

90. 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.

Customer shops in Website A which issues 100 points worth ₹ 100 under scheme of Rewards Ltd.

Website A passes the obligation to Rewards Ltd. at ₹ 98 thus earning an income of ₹ 2

Customer chooses to redeem the points at Website B

Website B redeems 100 points by selling goods worth ₹ 100 to the customer and intimates Rewards Ltd. of the redemption

Rewards Ltd. compensates Website B by paying ₹ 95

Income of Rewards Ltd. = ₹ 3 (₹ 98 - ₹ 95)

91. Rewards Ltd has similar arrangements with multiple website. The 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 ₹ 1 and for each point issued, the issuing electronic retailer, Website A, will pay ₹ 0.98 to Rewards Ltd. and in doing so will earn ₹ 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 ₹ 1, it will receive compensating cash from Rewards Ltd. amounting to ₹ 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 ₹ 10, it issues points with face value of ₹ 1:

Cash/Bank	Dr	10	Cash received at the time of sale
Sales	Cr	9	Revenue attributed to sale of product
Other Income	Cr	0.02	Difference between obligation of ₹ 1 less the amount at which the liability is passed on to Rewards Ltd. ₹ 0.98 = ₹ 0.02. As Website A has no further obligations, it can recognise this income at the time of initial sale

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

Liability	Dr	0.98	
Cash/Bank	Cr	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 ₹ 1 at ₹ 0.95:

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

92. 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

93. 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.

Equity Based Consideration

94. 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.

95. Under Companies (Accounting Standards) Rules, 2006, as amended, there is no accounting standard that specifically deals acquisition of goods or services from vendor in exchange of equity instruments as consideration. However, ICAI's Guidance Note (GN) on Accounting for Share-based Payments deals with share-based payment transactions, including those towards acquisition of goods or services from vendor. The Guidance Note is similar to Ind AS 102 with regards to share-based payment transactions with non-employees (for example, customers or vendors). Under this GN, 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).

96. Paragraph 22 and 23 of the GN on Accounting for Share-based Payments states as follows:

> **"22 To apply the requirements of paragraph 17 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.**
>
> **23 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 44-47."**

97. For equity-settled share-based payment transactions, the entity shall measure the goods or services received, and the corresponding increase in equity, directly, at the fair value of the goods or services received, unless that fair value cannot be estimated reliably. If the entity cannot estimate reliably the fair value of the goods or services received, the entity shall measure their

value, and the corresponding increase in equity, indirectly, by reference to1 the fair value of the equity instruments granted. An entity shall measure the fair value of the services received by reference to the fair value of the equity instruments granted, because typically it is not possible to estimate reliably the fair value of the services received. The fair value of those equity instruments shall be measured at grant date.

98. In case of share-based payment 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.

Inventory accounting

99. In the initial set years, an e-commerce entity 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.

100. 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.

101. 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 from revenue recognition.

- **Mode of payment**

  Certain logistics provider collect cash from the respective customers and aggregate the same and deposit it into the entity's bank account, by which the entity 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.

102. 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

103. 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 entity. However, advertisement expenses are expensed as incurred.

Cash handling

104. 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.

105. Handling of large volumes of cash, which 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 entity could also institute simple but effective steps like surprise cash counts, expanding cash insurance, etc. for controlling this risk.

Disclosure

106. Besides the disclosure of the significant accounting policies as per the requirement of Accounting Standard (AS) 1, 'Disclosure of Accounting Policies', the bases for arriving at the fair values in respect of the following should be disclosed in the financial statements of an e-commerce entity:

(i) Different elements comprising a multiple arrangement.

(ii) Advertising barter transactions.

(iii) Equity based consideration.

In addition, the entities shall provide the disclosures as per the other accounting standards.

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, entity 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.

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.

Glossary

E-commerce	Electronic commerce
E-tailer	Electronic retailer
B2B	Business to business
B2C	Business to consumer
C2C	Consumer to consumer
C2B	Consumer to business
HTML	Hypertext Markup Language