Accounting considerations for e-commerce

January 2, 2013
E-Commerce – Business Considerations

- Internet advertisement currently represents about 3.0% of all the segments of the advertising market. The internet advertising segment is expected to be the fastest growing segment with an expected growth rate of about 35%; Internet penetration was at 10.2% in India, making India the world’s third largest population of internet users after China and the United States, as compared with 78.3% in the United States.

- E-Commerce services are generally offered through Internet, mobile Internet, voice and SMS

- Growth and scalability is significantly dependent to adapt to technological developments or industry

- Growth based on - performance, reliability and availability of website and network infrastructure which are critical to success and ability to attract and retain paid advertisers and maintain adequate user service levels.
E-Commerce – Business Considerations

- website and servers are vulnerable to telecommunications failures, computer viruses, hacking, defacement, physical or electronic break-ins and similar disruptions, which could lead to accessing difficulties, service interruptions, delays, loss of data, inability to accept and/or fulfill user requests or inaccurate data being processed or displayed.

- misuse of service platforms, including, among others, third parties assuming identity and circulating spam e-mails or viruses

- The data of users and paid advertisers may be misappropriated by employees or sub-contractors and as a result, cause to breach contractual obligations in relation to such confidential information.

- High reliance on third-party computer systems, service providers and software companies. Any interruption or deterioration in performance of these third-party systems and services could have a material adverse effect on business

- Exposed to Risks Associated with Online Security and Credit Card Fraud.
Accounting Considerations

- Revenue Recognition.
- Expenses Recognition.
- Development Cost
Revenue Recognition
## Revenue Recognition

<table>
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<tr>
<th>Potential Differences</th>
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| Membership and Subscription  
  • Non-refundable fees |  
  • Recognition of non-refundable fees as revenue on receipt of fees would not be appropriate in instances where the products delivered or services performed do not represent the culmination of the revenue earnings process.  
  • Alternative 1 - the initial membership fee is of the nature of an entrance fee which should be capitalised and revenue from rendering of services or supply of products should be recognised on the basis specified in this regard in AS 9  
  • Alternative 2 - recognition of such non-refundable fees should be generally deferred and the same should be recognised systematically over the period(s) during which fees are earned. |
Revenue Recognition

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<td>Merchandising Activities</td>
<td>Financial Statement</td>
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| • Gross vs. Net Consideration | • 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. |
### Revenue Recognition

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<td><strong>Auctions</strong></td>
<td>• 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.</td>
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<td>• Transaction fees are for facilitating the transaction and are usually based on a percentage of the revenue earned by the seller from the on-line sale. Such fees should be recognised as revenue by the dot-com company upon completion of the transaction or at the time when no further vendor obligations remain to be performed as per the terms with the vendor.</td>
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### Revenue Recognition

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<td><strong>Shipping and Handling:</strong></td>
<td>• If invoiced to the customers at a composite rate 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.</td>
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<td>• 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 dot-com companies. Some companies display the charges separately whereas some do not.</td>
<td>• 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. 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.</td>
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<td>• 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.</td>
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| **Multiple element contract –** | • it is appropriate to ‘unbundle’ the separate elements of the arrangement or contract. For this purpose, company-specific fair values in respect of which objective evidence is available should be used, i.e., what the company would have received had it sold each item/service separately. Company-specific objective evidence of fair value is determined in respect of transactions with unrelated parties.  
• In the absence of availability of sufficient company-specific objective evidence of fair values for the allocation of revenue between various elements, it would be appropriate to defer recognition of the entire revenue from the contract until (a) sufficient company-specific objective evidence comes into existence, or (b) all elements of the arrangement are delivered, whichever is earlier. |

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

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<td><strong>Advertising Service:</strong></td>
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<td>• company’s obligations typically include guarantees of minimum number of impressions or click-throughs (Impressions are the number of times that an advertisement appears in pages viewed by users of the dot-com company’s on-line sites)</td>
<td>• It is appropriate to recognise revenue on the basis of the number of impressions or ‘click-throughs’ unless another systematic and rational basis of revenue recognition is more representative of the services rendered. To the extent the minimum guaranteed impressions are not met, recognition of the corresponding revenue should be postponed until the guaranteed impression levels are achieved.</td>
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<tr>
<td>• host advertisements for customers, without any minimum guaranteed impressions</td>
<td>• 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.</td>
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<td><strong>Advertising Service:</strong></td>
<td>• Revenue from advertising barter transactions should be recognised only when the fair values of similar transactions are readily determinable from the entity’s history. It would be appropriate to consider fair values of transactions that have occurred not later than six months preceding the sale of similar advertising to unrelated buyers.</td>
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<td>• advertising barter transactions - A barter transaction may involve exchange of advertising time for products or services</td>
<td>• Where, however, reliable estimates of fair value are not available, it may not be appropriate to recognise revenue and the associated costs involved in barter transactions</td>
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<td><strong>Other services:</strong></td>
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<td>• Revenue from maintenance of websites including web hosting</td>
<td>• 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</td>
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<td>• Content Selling</td>
<td>• the content should generally be considered to be sold when it is delivered to the purchaser. Therefore, keeping in view the terms of individual arrangements and the other relevant facts involved, the dot-com company should determine the time at which the delivery of the content is considered to be complete and recognise the corresponding revenue</td>
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Revenue Recognition – Ex. MakeMy Trip.com

- The revenue from rendering these services is recognized in the income statement at the time when significant risk and rewards are transferred to the customer.

   Example - 1) on the date of departure for tours and packages 2) date of check in for hotel booking business and 3) on the issuance of the ticket in the case of sale of airline tickets.

- Income from the sale of airline tickets is recognized as an agent on a net commission earned basis, as the Group does not assume any performance obligation post the confirmation of the issuance of an airline ticket to the customer. Similarly, any commission earned on hotel reservations booked is being recognized on a net basis as an agent on the date of check in.

- In case where the Company purchase airline tickets and assumes inventory risk, income from the sale of such airline tickets is accounted on gross basis as the Group is determined to be the primary obligator in this arrangement.
Revenue Recognition – Ex. MakeMy Trip.com

- Incentives from airlines are recognized when the performance obligations under the incentive schemes are achieved. Income from tours and packages, including income on airline tickets sold to customers as a part of tours and packages is accounted on gross basis as the Group is determined to be the primary obligor in the arrangement i.e., the risks and responsibilities are taken by the Group including the responsibility for delivery of services.

- Income from other sources, primarily comprising advertising revenue, income from sale of rail and bus tickets and fees for facilitating website access to a travel insurance company are being recognized as the services are being performed.

- Income from the sale of rail and bus tickets is recognized as an agent on a net commission earned basis, as the Group does not assume any performance obligation post the confirmation of the issuance of the ticket to the customer.
Revenue Recognition – Ex. MakeMy Trip.com

• Revenue is recognized net of cancellations, refunds, discounts and taxes. In the event of cancellation of airline tickets, revenue recognized in respect of commissions earned by our company on such tickets is reversed and is net off from our revenue earned during the fiscal period at the time the cancellation is made by our customers. In addition, a liability is recognized in respect of the refund due to our customers for the gross amount charged to such customers net of cancellation fees.

• The revenue from the sale of tours and packages and hotel reservations is recognized on the customer’s departure and check-in dates, respectively. Cancellations, if any, do not impact revenue recognition since revenue is recognized upon the availing of services by the customer.
Recognition and Measurement of Cost
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- Accounting for website development costs:
- Expenditures when developing, enhancing and maintaining its own web site. The web site may be used for various purposes such as promoting and advertising products and services, providing electronic services, and selling products and services.

- The expenditures for purchasing, developing, maintaining and enhancing hardware (e.g., web servers, staging servers, production servers and Internet connections) related to a web site are not accounted for under this Standard but are accounted for under AS 10.

- Developing a web site by an enterprise for its own use is not a start-up activity to the extent that an internally generated intangible asset is created. Expenditures incurred in the planning stage of a web site’s development are recognised as an expense when incurred.
## Recognition and Measurement of Cost

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<td>• Accounting for website development costs:</td>
<td>• Expenditures incurred in Application and Infrastructure Development and Graphical Design and Content Development stages should be recognised as an intangible asset if, and only if, in addition to complying with the general requirements for recognition and initial measurement of an intangible asset, an enterprise can demonstrate the web site will generate probable future economic benefits.</td>
</tr>
<tr>
<td>• Expenditures when developing, enhancing and maintaining its own web site. The web site may be used for various purposes such as promoting and advertising products and services, providing electronic services, and selling products and services.</td>
<td>• Challenges where the web site is developed solely or primarily for promoting and advertising an enterprise’s own products and services</td>
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<td>• expenditure to maintain or enhance the web site after development has been completed should be recognised as an expense when it is incurred</td>
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| Rebates, discounts and other sales incentives | • Company 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  
  • 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.  
  • 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 |
## Recognition and Measurement of Cost

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| **Point and loyalty programmes** | • incentives under a point and loyalty programme are specific in relation to a particular customer, the cost of providing the incentives should be shown by way of deduction from the value of the turnover in the statement of profit and loss  
• In respect of incentives under a point and loyalty programme which are general in nature, i.e., they are not related to specific customers, a general provision therefor should be made in the statement of profit and loss based on an appropriate estimate of the costs | Financial Statement |
# Recognition and Measurement of Cost

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<td><strong>Equity Based Consideration</strong></td>
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| Equity-based consideration to fund expenditures | • Where fair value of the product, service or asset acquired is available, the product, service or asset should be recorded at the said fair value.  
• Where fair value of the product, or service or asset is not available but the fair value of the equity transferred is available, the product, service or asset should be recorded at the fair value of the equity consideration. |
Costs - Ex. MakeMy Trip.com

• Advertising and business promotion costs primarily comprise of internet, television, radio and print media advertisement costs as well as event driven promotion cost for Group’s products and services. Such costs are the amount paid to or accrued towards advertising agencies or direct service providers for advertising on websites, television, print formats, search engine marketing and any other media. Advertising and business promotion costs are recognized when incurred.

• Website development costs incurred by the Group, having finite useful lives, are measured at cost less accumulated amortization and accumulated impairment losses. Cost includes expenses incurred during the application development stage. The costs related to planning and post implementation phases of development are expensed as incurred.
Technical Literatures

- Accounting by Dot-Com Companies – issued in February 2001

- Technical Guide on E-Commerce – Considerations for audit of Financial Statements

- Accounting Standard (AS) 26 “Intangible Assets”
Examples of E-Commerce entities

- Rediff.Com, Google, Yahoo and likes
- MakeMy Trip Limited, Expedia, Yatra, Travel Guru, and likes
- Zynga Inc.
- Just Dial
- Matrimony.Com
- Flipkart and others
- Indian Railways
- Redbus services and others
Questions?

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