ACCOUNTING STANDARD – 9

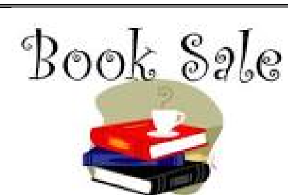
REVENUE RECOGNITION

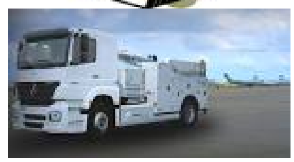
Purpose:

- Recognizing revenue arising in the course of the ordinary activities of the enterprise.

Scope:

- The **SALE** of goods.
- The **RENDERING** of services.
- The **USE BY OTHERS** of enterprise resources yielding interest, royalties and dividends.





Non-Applicability:

- Revenue arising from **construction contracts**. [covered under AS-7]
- Revenue arising from **hire-purchase, lease agreements**. [covered under AS-19]
- Revenue arising from **government grants** and other similar subsidies. [covered under AS-12]
- Revenue of insurance companies arising from **insurance contracts**.

Revenue	Revenue is the **gross inflow** of cash, receivables or other consideration arising in the course of ordinary activities of an enterprise from: • The sale of goods, • The rendering of services, and • The use by others of enterprise resources yielding interest, royalties and dividends.
REVENUE RECOGNITION IN SALE OF GOODS	• The **PROPERTY** in **GOODS** in **TRANSFERRED** for a **PRICE**. 

	⌗ All significant **RISKS AND REWARDS** have been **TRANSFERRED** and no effective control is retained.  ⌗ **NO** significant **UNCERTAINTY EXISTS** regarding the amount of consideration.  ⌗ It is reasonable to **EXPECT ULTIMATE COLLECTION** of consideration.
REVENUE RECOGNITION IN RENDERING OF SERVICES	⌗ Service is recognised either on **COMPLETED SERVICE** or **PROPORTIONATE COMPLETION METHOD**. ⌗ No significant uncertainty exists regarding amount of consideration. ⌗ It is reasonable to expect ultimate collection of consideration.
	➢ **Completed service method** recognizes revenue only when service complete or substantially complete. In such cases there is more than one act involved and revenue is recognised on execution of all those acts. ➢ **Proportionate completed method** recognizes revenue proportionate with the degree of completion of services. ➢ In such cases there is more than one act involved and revenue is recognised on execution of certain acts.
REVENUE RECOGNITION IN USE OF ENTERPRISE RESOURCES BY OTHERS	⌗ Interest: Revenue is recognised on the **time basis** determined by the amount outstanding and the rate applicable. ⌗ Royalty: Revenue is recognised in accordance with the terms of the relevant **agreement (accrual basis)**. ⌗ Dividends: Revenue is recognised only when a **right to receive payment** is established. Note:- When interest, royalties and dividends from foreign countries require exchange permission and uncertainty in remittance is anticipated, revenue recognition may need to be postponed.
DISCLOSURE REQUIREMENTS	⌗ When recognition of revenue is postponed due to the effect of uncertainties, an enterprise should disclose the circumstances in which revenue recognition has been postponed.

P.1 The stages of production and sale of a producer are as follows (all in Rupees):

Stage	Activity	Costs to date	Net Realisable Value
A	Raw Materials	10,000	8,000
B	WIP 1	12,000	13,000
C	WIP 2	15,000	19,000
D	Finished Product	17,000	30,000
E	For Sale	17,000	30,000
F	Sale Agreed	17,000	30,000
G	Delivered	18,000	30,000
H	Paid For	18,000	30,000

State and explain the stage at which you think revenue will be recognized and how much would be gross profit and net profit on a unit of this product?

Ans: According to AS – 9, sales will be recognized only following two conditions are satisfied:
1. The sale value is fixed and determinable.

2. property of the goods are transferred to the customer.

Both these conditions are satisfied only at Stage F when sales are agreed upon at a price and goods allocated for delivery purpose.

Gross Profit will be determined at Stage E, when goods are ready for sale after all necessary process for production is over i.e. Rs. 13,000 (30,000 – 17,000).

Net Profit will be determined at Stage H, when goods are delivered and payment collected i.e. Rs. 12,000 (30,000 – 18,000).

P.2 A public sector company is trading gold in India for its customers, after purchasing gold the price of gold is fixed within 120 days as per rules and regulations of Indian Bullion Market by the customer. At the close of year, price of some gold was not fixed on March 31, 2010. The details are given below:

Quantity of Gold = 10,000 TT Bars

Gold Rate as on March 31, 2010 = Rs. 275 per TT Bar

Gold Rate was fixed on June 26, 2010 before the finalization of accounts of company = Rs. 273 per TT Bar

Calculate the amount of sales regarding 10,000 TT Bars to be booked in the company's account for the year ended March 31, 2010.

Ans: We need to refer to AS 5 along with AS 9. In this case, since gold is an item which has ready market hence they should be valued at the market price. So, as event occurring after the balance sheet date, the price of gold is fixed at Rs. 273 per TT Bar, gold will be valued at that rate.

P.3 X Limited has recognized Rs. 10 lakhs on accrual basis income from dividend on units of mutual funds of the face value of Rs. 50 lakhs held by it as at the end of the financial year 31st March, 2011. The dividends on mutual funds were declared at the rate of 20% on 15th June, 2011. The dividend was proposed on 10th April, 2011 by the declaring company.

Whether the treatment is as per the relevant Accounting Standard? You are asked to answer with reference to provisions of Accounting Standard. [M-04]

Ans: Paragraph 8.4 and 13 of Accounting Standard 9 on Revenue Recognition states that dividends from investments in shares are not recognised in the statement of profit and loss until a right to receive payment is established.

In the given case, the dividend is proposed on 10th April, 2011, while it is declared on 15th June, 2011. Hence, the right to receive payment is established on 15th June, 2011. As per the above mentioned paragraphs, income from dividend on units of mutual funds should be recognised by X Ltd. in the financial year ended 31st March, 2012.

The recognition of Rs. 10 lakhs on accrual basis in the financial year 2010-2011 is not as per AS 9 'Revenue Recognition'.

P.4 Arjun Ltd. sold farm equipments through its dealers. One of the conditions at the time of sale is, payment of consideration in 14 days and in the event of delay interest is chargeable @ 15% per annum. The Company has not realized interest from the dealers in the past.

However, for the year ended 31.3.2011, it wants to recognise interest due on the balances due from dealers. The amount is ascertained at Rs.9 lakhs. Decide, whether the income by way of interest from dealers is eligible for recognition as per AS 9? [M-06]

Ans: As per AS 9 "Revenue Recognition", where the ability to assess the ultimate collection with reasonable certainty is lacking at the time of raising any claim, the revenue recognition is postponed to the extent of uncertainty inverted. In such cases, the revenue is recognized only when it is reasonably certain that the ultimate collection will be made.

In this case, the company never realized interest for the delayed payments make by the dealers. Hence, it has to recognize the interest only if the ultimate collection is certain. The interest income hence is not to be recognized.

P.5 The Board of Directors of X Ltd. decided on 31.3.2011 to increase sale price of certain items of goods sold retrospectively from 1st January, 2011. As a result of this decision the company has to receive Rs.5 lakhs from its customers in respect of sales made from 1.1.2011 to 31.3.2011. But the Company's Accountant was reluctant to make-up his mind. You are asked to offer your suggestion. [N-07]

Ans: As per para 10 of AS 9 'Revenue Recognition', the additional revenue on account of increase in sales price with retrospective effect, as decided by Board of Directors of X Ltd., of Rs.5 lakhs to be recognised as income for financial year 2010-11, only if the company is able to assess the ultimate collection with reasonable certainty. If at the time of raising of any claim it is unreasonable to expect ultimate collection, revenue recognition should be postponed.

P.6 Explain Revenue as per AS-9?

Ans: Revenue is the gross inflow of cash, receivables or other consideration arising in the course of the ordinary activities of an enterprise from the sale of goods, from the rendering of services, and from the use by others of enterprise resources yielding interest, royalties and dividends.

Revenue is measured by the charges made to customers or clients for goods supplied and services rendered to them and by the charges and rewards arising from the use of resources by them.

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

P.7 What are the Methods of accounting in recognizing Revenue under Service Contracts?

Ans: ***Completed service contract method*** is a method of accounting which recognises revenue in the statement of profit and loss only when the rendering of services under a contract is completed or substantially completed.

Proportionate completion method is a method of accounting which recognises revenue in the statement of profit and loss proportionately with the degree of completion of services under a contract.

CASE STUDIES – APPLICATION OF THE STANDARD TO A NUMBER OF COMMERCIAL SITUATIONS

A. Sale of Goods

1. ***Delivery is delayed at buyer's request and buyer takes title and accepts billing***

Revenue should be recognised notwithstanding that physical delivery has not been completed so long as there is every expectation that delivery will be made. However, the item must be on hand, identified and ready for delivery to the buyer at the time the sale is recognised rather than there being simply an intention to acquire or manufacture the goods in time for delivery.

2. Delivered subject to conditions

a. installation and inspection i.e. goods are sold subject to installation, inspection etc.

Revenue should normally not be recognised until the customer accepts delivery and installation and inspection are complete. In some cases, however, the installation process may be so simple in nature that it may be appropriate to recognise the sale notwithstanding that installation is not yet completed (e.g. installation of a factory-tested television receiver normally only requires unpacking and connecting of power and antennae).

b. on approval

Revenue should not be recognised until the goods have been formally accepted by the buyer or the buyer has done an act adopting the transaction or the time period for rejection has elapsed or where no time has been fixed, a reasonable time has elapsed.

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.

e. cash on delivery sales

Revenue should not be recognised until cash is received by the seller or his agent.

3. Sales where the purchaser makes a series of instalment payments to the seller, and the seller delivers the goods only when the final payment is received

Revenue from such sales should not be recognised until goods are delivered. However, when experience indicates that most such sales have been consummated, revenue may be recognised when a significant deposit is received.

4. Special order and shipments i.e. where payment (or partial payment) is received for goods not presently held in stock e.g. the stock is still to be manufactured or is to be delivered directly to the customer from a third part.

Revenue from such sales should not be recognised until goods are manufactured, identified and ready for delivery to the buyer by the third party.

5. Sale/repurchase agreements i.e. where seller concurrently agrees to repurchase the same goods at a later date.

For such transactions that are in substance a financing agreement, the resulting cash inflow is not revenue as defined and should not be recognised as revenue.

6. Sales to intermediate parties i.e. where goods are sold to distributors, dealers or others for resale.

Revenue from such sales can generally be recognised if significant risks of ownership have passed; however in some situations the buyer may in substance be an agent and in such cases the sale should be treated as a consignment sale.

7. Subscriptions for publications

Revenue received or billed should be deferred and recognised either on a straight line basis over time or, where the items delivered vary in value from period to period, revenue should be based on the sales value of the item delivered in relation to the total sales value of all items covered by the subscription.

8. Instalment sales

When the consideration is receivable in instalments, revenue attributable to the sales price exclusive of interest should be recognised at the date of sale. The interest element should be recognised as revenue, proportionately to the unpaid balance due to the seller.

9. Trade discounts and volume rebates

Trade discounts and volume rebates received are not encompassed within the definition of revenue, since they represent a reduction of cost. Trade discounts and volume rebates given should be deducted in determining revenue.

B. Rendering of Services

1. Installation Fees

In cases where installation fees are other than incidental to the sale of a product, they should be recognised as revenue only when the equipment is installed and accepted by the customer.

2. Advertising and insurance agency commissions

Revenue should be recognised when the service is completed. For advertising agencies, media commissions will normally be recognised when the related advertisement or commercial appears before the public and the necessary intimation is received by the agency, as opposed to production commission, which will be recognised when the project is completed. Insurance agency commissions should be recognised on the effective commencement or renewal dates of the related policies.

3. Financial service commissions

A financial service may be rendered as a single act or may be provided over a period of time. Similarly, charges for such services may be made as a single amount or in stages over the period of the service or the life of the transaction to which it relates. Such charges may be settled in full when made or added to a loan or other account and settled in stages. The recognition of such revenue should therefore have regard to:

a. whether the service has been provided "once and for all" or is on a "continuing" basis;

b. the incidence of the costs relating to the service;

c. when the payment for the service will be received. In general, commissions charged for arranging or granting loan or other facilities should be recognised when a binding obligation has been entered into. Commitment, facility or loan management fees which relate to continuing obligations or services should normally be recognised over the life of the loan or facility having regard to the amount of the obligation outstanding, the nature of the services provided and the timing of the costs relating thereto.

4. Admission fees

Revenue from artistic performances, banquets and other special events should be recognised when the event takes place. When a subscription to a number of events is sold, the fee should be allocated to each event on a systematic and rational basis.

5. Tuition fees

Revenue should be recognised over the period of instruction.

6. Entrance and membership fees

Revenue recognition from these sources will depend on the nature of the services being provided. 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 services provided.

IMPORTANT NOTES

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