Accounting Standard(AS)-9

REVENUE RECOGNITION

Introduction

This Standard deals with the **bases/criteria** for recognition of revenue in the statement of profit and loss of an enterprise. It **concerns with** the recognition of revenue arising in the course of the ordinary activities of the enterprise from:

- the sale of goods,
- the rendering of services, and
- the use by others of enterprise resources yielding interest, royalties and dividends.

This standard **does not deal with** the following aspects of revenue recognition to which special considerations apply:

1. Revenue arising from construction contracts. (AS 7 on CC)
2. Revenue arising from hire-purchase, lease agreements.
3. Revenue arising from government grants and other similar subsidies.
4. Revenue of insurance companies arising from insurance contracts.

Definitions

Revenue is the gross inflow of cash, receivables or other considerations arising in the course of the ordinary activities of an enterprise (i) from the sale of goods, (ii) from the rendering of services, and (iii) 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.

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.

Sale of goods

Revenue from sale transaction is recognised when the following conditions are satisfied.

Basic Conditions:

- Property in goods is transferred from seller of goods to the buyer for a price.
- All significant risk and reward of ownership have been transferred to buyer and seller retains no effective control.
- No significant uncertainties exist regarding amount of consideration derived from the sale of goods.

Special Cases:

1. Delivery is delayed on buyer's request and buyer takes title and accepts billing.
2. Delivery subject to conditions,
   a. Installation and inspection i.e. goods are sold subject to installation, inspection etc.
   b. Sale on approval.
   c. Guaranteed sales i.e. Delivery is made giving the buyer an unlimited right to return.
   d. consignment sales i.e. a delivery is made whereby the recipient undertakes to sell the goods to third party on behalf of the consignor.
   e. Cash on delivery sales.
   f. Warranty sales.

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.
4. Special order and shipments i.e. where full 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 party.
5. Sales to intermediate parties i.e. where goods are sold to distributors, dealers or others for resale.
6. Subscriptions for publications.
7. Instalment sales.

**Trade discounts and volume rebates given should be deducted in determining revenue.*

Rendering Services

Revenue from service transaction is recognised when following conditions are satisfied:

Basic Conditions:

- Service is measured either through Completed Service contract method or proportionate completion method.
- No significant uncertainties exits regarding collection of amount of consideration at the time of performance of service.

(Normally, services comprise of performance of more than one act. The number of acts may be determinable or non-determinable).

Special Cases:

1. Installation fees.
2. Advertising and insurance agency commissions.
3. Financial service commissions.
4. Admission fees.
5. Tuition fees.
6. Entrance and membership fees.

Use of Enterprise resources by others Yielding

Interest

- Charges for the use of cash resources or amount due to company.
- Revenue is recognised on time proportion basis, and
- Determined by the amount outstanding and the rate applicable.

Royalties

- Charges for the use of intangible assets such as know-how, patents, copyrights or trademarks etc.

- Revenue is recognised on accrual basis in accordance with the terms of the relevant agreement.

Dividends

- Rewards from the holding of investments in shares.

- Revenue is recognised in the statement of P&L when the owner's right to receive payment is established.

*No significant uncertainty as to measurability or collectability should exits.

Examples of **items not included** within the definition of "revenue" for the purpose of this Standard:

1. <u>Realised gains resulting from the disposal of, and unrealised gains resulting from the holding of, non-current assets.</u>

   Eg, appreciation in the value of fixed assets. Machinery with book value of Rs. 1,00,000 is sold for Rs. 1,20,000 and a piece of land having book value of Rs. 10,00,000 is revalued at Rs. 15,00,000. The realized gain of Rs. 20,000 and the unrealized gain of Rs. 5,00,000 are <u>not considered as revenue</u> although, the first one will increase profit as other income and second one is directly shown as increase in the equity by increasing revaluation reserve.

2. Unrealised holding gains resulting from the change in value of current assets (eg. Bond investment), and the natural increases in herds and agricultural and forest products. (when such assets are sold, the realised gain will be shown as other incomes not revenue)

3. Realised or unrealised gains resulting from changes in foreign exchange rates and adjustments arising on the translation of foreign currency financial statements.

4. Realised gains resulting from the discharge of an obligation at less than its carrying amount.

Eg. A trade debt of Rs. 10,00,000 is settled at Rs. 9,50,000 leading to a realized gain of Rs. 50,000.

5. <u>Unrealised gains resulting from the restatement of the carrying amount of an obligation</u>.

Eg. A trade debt of Rs. 5,00,000 is restructured and creditors agree for a payment of Rs. 4,75,000.

Effect of uncertainties on Revenue Recognition

Recognition of revenue depends on two most important aspects:

- Revenue is measurable and,

- At the time of sale or the rendering of the service, it would not be unreasonable to expect ultimate collection.

    - When the uncertainty as to ultimate collectability arises at the time of raising any claim, revenue recognition is postponed and it may be appropriate to recognise revenue only when it is reasonably certain that the ultimate collection will be made. Eg, claim for escalation of price, export incentives, interest etc.

(Where there is no uncertainty as to ultimate collection, revenue is recognised at the time of sale or rendering of service even though payments are made by instalments).

- When the uncertainty as to collectability arises subsequent to the time of sale or rendering services, it may be appropriate to make a separate provision to reflect the uncertainty instead of making adjustment in the originally recorded amount of revenue. (Provision for doubtful debt).

- When the amount of consideration receivable is not determinable within reasonable limit, the recognition should be postponed.

(**When recognition of revenue is postponed due to the effect of uncertainties, it is considered as revenue of the period in which it is properly recognised**)

Sometimes **uncertainty may be limited to exact amount of revenue.**

Eg. there is certainty that the amount of fertilizer subsidy expected to be received from government would be received but the amount could be anywhere between Rs. 8,00,000 to Rs 10,00,000. This type of uncertainty should not result in non-recognition of the whole of the amount. In this case, revenue of Rs. 8,00,000 should be recognized.

Disclosure

In addition to the disclosures required by Accounting Standard 1 on ‘Disclosure of Accounting Policies’ (AS 1), an enterprise should also **disclose the circumstances in which revenue recognition has been postponed** pending the resolution of significant uncertainties.