ACCOUNTING STANDARD 9- REVENUE RECOGNITION

AS 9 for Revenue recognition is mainly concerned with timing of recognition of revenue in the profit and loss account, amount of revenue arising on a transaction and influence of uncertainties existing regarding the determination of the amount, or its cost on timing of revenue recognition.

There are few exceptions where the special consideration applies: –

- Revenue arising from Construction Contracts
- Revenue arising from hire-purchase, lease agreements
- Revenue arising from government grants and other similar subsidies
- Revenue of Insurance companies arising from insurance contracts

Meaning of revenue

Revenue is nothing but the inflow of cash, receivables or other consideration arising in the course of the ordinary activities of an enterprise.

Accounting standard 9 is concerned with the recognition of revenue arising in the course of the ordinary activities of the enterprise from:

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

A. Sale of goods

Revenue from a transaction involving sale of goods is recognized when the seller has transferred the property in the goods to the buyer for a consideration which mostly coincides with the transfer of significant risk and rewards of ownership.

However, certain situations may arise where the transfer of property does not result or coincide with the transfer of risk and rewards. Revenue in such cases is recognized at the times of the transfer of significant risk and rewards of ownership to the buyer. This may be due to:

- Delay in delivery due to fault from either the buyer or the seller or
- Due to an agreement entered into by the parties as to the timing of transfer of significant risk and rewards of ownership.

B. Rendering of Services

Revenue from service transactions is primarily recognized as the service is performed, either by

- Proportionate completion method or
- Completed service contract method.

Completed service contract method

It is a method of accounting which recognizes 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

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

C. Interest, royalties & dividends

The use by others of such enterprise resources gives rise to:

(**i**) Interest: Revenue is recognized on the time proportion basis after taking into account the amount outstanding and the rate applicable.

For Example: If the interest on FD is due on 30th June and 31st Dec. On 31st March when the books will be closed, though the interest for the period of Jan-March will be received in June, still we have to recognize the revenue in March itself.

(ii) Royalties: Royalty includes the charge for the use of patents, know-how, trademarks, and copyrights. Revenue has to be recognized on the basis of accrual basis and in accordance with the relevant agreement.

For Example: If the royalty is payable based on the number of copies of the book, then it has to be recognized on that basis only.

(iii) Dividends: Revenue has to be recognized when the owner's right to receive payment is established. It is only certain when the company declare the dividends on the shares and the directors actually decide to pay the dividends to their shareholders.

Practical Questions on Accounting Standard 9 : Revenue Recognition

Q.(1)

Y Ltd. used certain resources of X Ltd. In return X Ltd. receives Rs. 10 lakhs and Rs. 15 lakhs as interest and royalties respectively, from Y Ltd. during the year 2007 –2008. State on what basis X Ltd. should recognize their revenue, as per AS 9.

Answer :

As per AS 9 on 'Revenue Recognition', interest of Rs.10 lakhs received in the year 2007-2008 should be recognized on the time basis, whereas royalty of Rs. 15 lakhs received in the same year should be recognized on accrual basis as per the terms of relevant agreement.

Q.(2)

M/s. Sea Ltd. recognized Rs. 5.00 lakhs, on accrual basis, income from dividend during the year 2010-11, on shares of the face value of Rs. 25.00 lakhs held by it in Rock Ltd. as at 31st March, 2011. Rock Ltd. proposed dividend @ 20% on 10th April, 2011. However, dividend was declared on 30th June, 2011. Please state with reference to relevant Accounting Standard, whether the treatment accorded by Sea Ltd. is in order.

Answer

In the given case, the dividend is proposed on 10th April, 2011, while it was declared on 30th June, 2011. Hence, the right to receive dividend is established on 30th June, 2011 only. Therefore, on applying the provisions stated in the standard, income from dividend on shares should be recognized by Sea Ltd. in the financial year 2011-2012 only. Therefore, the recognition of income from dividend of Rs. 5 lakhs, on accrual basis, in the financial year 2010-11 is not in accordance with AS 9.

Q.(3)

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 ` 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.

Answer :

The additional revenue on account of increase in sales price with retrospective effect, as decided by Board of Directors of X Ltd., of ` 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.

AS 10 - Property, Plant and Equipment

Objective

The main objective of AS 10 is to prescribe the accounting treatment for properties, plant, and equipment. It enables the users to understand the accounting treatment for investments made by an entity.

AS 10 do not apply in the following cases

1. Biological assets related to agricultural activities excluding produce on bearer plants.
2. Wasting assets including mineral rights, expenditure on exploration and extraction of mineral oil, natural gas and similar non-regenerative resources.

Agriculture produce is the harvested product of biological assets of an entity.

Bearer plant is a plant which is used in the production and supply of agriculture produce. Following are not bearer plants: –

3. Plants cultivated to be harvested as agriculture produce.
4. Annual crops like wheat, maize etc

Biological assets are living animals or plants.

Recognition of Assets

The cost of an asset that comes under Property, Plant and Equipment as per AS 10 is identified as an asset only if:

- The future economic benefits expected to arise from such an asset would come to the business entity
- Cost of such an asset can be reliably measured

Determination of Cost

As per AS 10, the cost of property, plant and equipment of a business entity may include the:

- initial cost to acquire or construct an item of property, plant and equipment
- Subsequent costs of adding, replacing or servicing the property, plant and

equipment so acquired

Initial Costs

As per AS 10, PPE covers all tangible assets that are held for use or administrative purposes. Here, administrative purposes include all business purposes other than the production or supply of goods or services or giving PPE on rent to others.

Thus, PPE used for administrative purposes include assets used for:

- selling and distribution
- Finance and accounting
- Personnel and other functions of an enterprise

Further, PPE may also include assets acquired for safety or environmental purposes.

Subsequent Costs

While recording items of PPE and their carrying amount in the books of accounts, the business entity does not include the cost incurred on the day to day servicing of such items. Such costs are rather recognized in the statement of Profit and Loss at the time they are incurred.

The day – to day costs of servicing include costs such as labour, small parts and consumables. These day to day servicing costs are basically incurred on account of repairs and maintenance of an item of PPE.

Measurement of Cost

Once assets are recognized as an item under PPE as per AS 10, the business entity can use one of the two models to determine the carrying amount of the assets so acquired.

Cost Model

Once an asset is recognized, the item of PPE may be carried at its cost less accumulated depreciation and any accumulated impairment losses as per the Cost Model.

Here cost of an item of PPE includes:

- Acquisition Cost including import duties and non-refundable purchase taxes less any trade discounts and rebates
- Costs directly associated with bringing the asset to the location as well the condition essential so as to make the asset capable of operation in a way as

planned by the management.

- Costs of dismantling, removing the item and restoring the site on which the asset is located

Revaluation Model

Under the revaluation model, after the asset is recognized, an item of PPE should be carried at a revalued amount. Provided the fair value of such an item of PPE can be reliably measured.

The revalued amount is nothing but the Fair Value of the item of PPE at the date of revaluation less any subsequent accumulated depreciation as well as impairment losses

Depreciation

- Each part of an item of PPE with a cost that is significant in relation to the total cost of the item should be depreciated separately.
- The depreciable amount should be allocated on a systematic basis over its useful life.
- Depreciation charge for each period should be recognised in the Statement of Profit and Loss unless it is included in the carrying amount of another asset.
- Residual value & useful life to be reviewed at each balance sheet date.
- Depreciation method used should reflect the pattern in which the asset's future economic benefits are expected to be consumed by the enterprise.
- Depreciation method to be reviewed at least at each financial year end.
- Depreciation methods include SLM, WDV & Units of Production method.

Derecognition

The carrying amount of an item of PPE should be derecognised on disposal or when no future economic benefits are expected from its use or disposal.

Gain/loss on derecognition should be recognised in Statement of Profit and Loss (unless AS 19 requires otherwise in a sale and leaseback) and should not be classified as revenue.

Gain/loss on derecognition is the difference between net disposal proceeds, if any, and the carrying amount of the derecognised item of PPE.

Practical Questations

Q. 1

A company has purchased plant and machinery in the year 2001-2002 for `45 lakhs. A balance of `5 lakhs is still payable to the suppliers for the same. The supplier waived off the balance amount during the financial year 2004-2005. The company treated it as income and credited to profit and loss account during 2004-2005. Whether accounting treatment of the company is correct. If not, state with reasons.

Solution:

As per AS 10 the cost of fixed assets may undergo changes subsequent to its acquisition or construction on account of exchange fluctuation, price adjustments, changes in duties or similar factors. The treatment done by the company is not correct. `5 lakhs should be deducted from the cost of fixed assets.

Q. 2

ABC Ltd. gave 50,000 equity shares of `10 each (fully paid up) in consideration for supply of certain machinery by X & Co. The shares exchanged for machinery are quoted on Bombay Stock Exchange (BSE) at `15 per share, at the time of transaction. In the absence of fair market value of the machinery acquired, how the value of machinery would be recorded in the books of the company?

Solution:

As per AS-10 fixed asset acquired in exchange for shares or other securities should be recorded at its fair market value or the fair market value of the securities issued, whichever is more clearly evident. Since, the market value of the shares exchanged for the asset is more clearly evident, the company should record the value of machinery at `7,50,000. (i.e., 50,000 shares x 15 per share being the market price)