AS 9: Revenue Recognition

IPCC Paper 1: Accounting Chapter 1 Unit 2

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Applicability

This standards was issued in 1985

It is applicable to corporates as well all non corporate enterprises
This standard deals with

Basis of Revenue Recognition

And

Timing of Recognition
What is Income?

**Income**

**Revenue** – Applies to:
- Sale – Fees
- Rendering of Services, Interest, Royalty, Dividend

**Gain**

Other items that meet the definition of Income – may or may not arise in the course of ordinary activities. Disposal of Non Current assets.

Increases in economic benefits in an accounting year in form of inflows, Increase in Assets or decrease in liabilities that result in increase in Equity.
<table>
<thead>
<tr>
<th>Revenue</th>
<th>Gain</th>
</tr>
</thead>
<tbody>
<tr>
<td>From Ordinary Activities</td>
<td>Not Necessarily from ordinary activities</td>
</tr>
<tr>
<td>Presented as Gross</td>
<td>Presented at Net of cost and related expenses</td>
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If a Vehicle is sold for Rs. 7,50,000 net of VAT, with a cost of Rs. 7,00,000. presentation in Statement of Profit & Loss will be as under

| Revenue from sale Rs. 7,50,00 on Income side | Gain of Rs. 50,000 on Income side. |

Classification of an item as Revenue or Gain depends of the nature of business of the enterprise. An Item may be classified as revenue for an enterprises, but the same may be classified as gain for other enterprise.
Definitions

4.1 Revenue is the Gross inflow of cash, receivables or other consideration arising in the ordinary activities of an enterprise from:
- The sale of goods,
- The rendering of services, and
- From the use of enterprise resources yielding interest, royalties and dividends.

4.2 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.

4.3 Proportionate completed 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.
Scoped Out – Not applicable to

(i) Revenue arising from construction contracts; (Which standard applies to ?)

(ii) Revenue arising from the hire-purchase, lease agreements; AS 19

(iii) Revenue arising from the government grants and other similar subsidies; and As 12

(iv) Revenue of insurance companies from insurance contracts.
Conditions for Recognition - 1

Revenue is **measurable**, and

**Reasonable certainty** as to the ultimate collection at the time of sale of goods, or rendering of services.
Conditions for Recognition - 2

- Para 11 of AS 9
- ‘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.”
Sale of Goods – timing – Key issue Risk & Reward

**WHEN to recognise revenue ??**

A key criteria: When the seller *transfers* goods to buyer for a consideration.

**Transfer**, in most cases, means transfer of significant *risks and rewards of ownership* to the buyer.

*However, the parties may agree that the risk will pass at a time different from the time when ownership passes.*
Revenue Involving Sale of Goods -1

- Revenue is recognised when the property in the goods are transferred by the seller to the buyer.

- Normally transfer of property coincides with the transfer of risk and reward.

- If they do not coincide, then when the SIGNIFICANT risk and reward is transferred to the buyer.

- In some cases, delivery and transfer of risk and reward associated with the ownership of goods coincides. However, this may not happen always.
Sale of Goods -2- Measurement

Under what circumstance sale is recognised at NRV ?? How measured ?

NRV is the estimated SP in the ordinary course of business less estimated cost of completion & the estimated cost necessary to make the sale

In case of Forward contract or Government guarantee or where market exists and negligible risk of failure to sell:

The Goods are valued at NRV & recognised in the profit and loss account and appropriately described.
Certain Issues - 1

- Sales on Approval
- Guarantee – Normal – Abnormal
- Cash on Delivery
- FOB Destination & shipping point
- Sale to intermediate
- Sale & Buy Back – substance over form
Certain Issues - 2

Consignment sale ??
Certain Issues - 3

VAT, Excise, Trade Discount

Installment sales

Agent - Commission

Warranty to be deducted from Revenue?
Revenue from service transactions is recognised as the service is performed either by:

- Proportionate Completion method
- Completed Service Contract method.

Standard permits both the methods.
## Rendering of Services - 2

<table>
<thead>
<tr>
<th>Percentage Completion - same as As 7</th>
<th>Completed Service Contract method</th>
</tr>
</thead>
<tbody>
<tr>
<td>Revenue is recognised in stages. Based on some systematic method.</td>
<td>Revenue is recognised only on completion of the contract</td>
</tr>
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</table>
Use by others of Enterprise resources yielding Interest, Royalties and Dividends

- **Interest**
  - Charges for the use of cash resources or amount due to the enterprise;

- **Royalty**
  - Charges for the use of such assets as know-how, patents, trade-marks, and copyrights.

- **Dividend**
  - Rewards for holding of investments in shares.
Recognition

Source of Interest, Royalties and Dividends

Domestic
Foreign
Recognition- Source: Domestic

• When to Recognise –

1. Interest: On time proportionate basis, considering amount determined by amount outstanding and rate applicable.

In case of Debt securities – Discount or premium considered as accruing over a period of maturity.
Recognition- Source: Domestic

2. Royalties:
   - On accrual basis as per terms of agreement
   - On other Rational and systematic basis, considering the substance of the transactions.

3. Dividends:
   Recognised only when owner’s RIGHT to receive is established i.e. on approval of shareholders in company AGM.
Recognition of Income from foreign countries may need to be postponed as:

1. Exchange permission is required and
2. Uncertainty in remittance is anticipated.
Postponement of Revenue Recognition – Oh really ???

- As a result of uncertainties
  - When the consideration is NOT determinable within reasonable limits, or/and
  - When ability to assess the ultimate collection with reasonable certainty is lacking,
- For Example, for escalation of price, export incentive, interest etc.
Effect of Postponement

- In which period should the postponement be recorded?

- The postponement due to effect of uncertainties should be recorded in the period in which it is PROPERLY Recognised. In other words, when uncertainties get over, revenue should be recognised.

- If the revenue recognition is postponed, make proper disclosure.
Uncertainty at the time of sale V/s subsequent uncertainty

If uncertainty of revenue arises subsequent to recognition, How do we treat?

A) Do we adjust the amount of the revenue originally recorded??

Or

B) Do not adjust Revenue but create a separate provision to reflect the uncertainty.

Answer: B – Provision for Doubtful Debts
Uncertainties – Summarised-1

- Revenue should be recognised when it is measurable and no uncertainties of collection at the time of recognition.

- When it is not possible to assess the ultimate collection, the revenue is not recognised and the recognition is deferred + coupled with proper disclosure.

- 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 instalment.
Uncertainties – Summarised-2

- When uncertainties get resolved, revenue should be recognised.

- Till such time the amount received is treated as Liability.

- You must understand the difference between – uncertainty of collection at the time of sale AND uncertainties, subsequent to the sale or rendering of services. Refer to slide no…
ASI-14 (Revised)- How Revenue is presented in Statement of Profit and Loss.

• Manner of Disclosure of excise duty in the presentation of revenue from sale transaction in Statement of P & L:

  • Turnover (Gross) XX
  Less: Excise Duty (X)
  Turnover (Net) X
Sample Disclosures from published accounts – Tata Steel 2011-12

- **Revenue Recognition**
- (i) Revenue from sale of goods is recognised net of rebates and discounts on transfer of significant risks and rewards of ownership to the buyer. Sale of goods is recognised gross of excise duty but net of sales tax and value added tax.
- (ii) Revenue from services rendered is recognised on pro-rata basis in proportion to the stage of completion of the related transaction.
- (iii) Export incentive under various schemes notified by the Government has been recognised on the basis of credits afforded in the pass book/amount received.
Lesson Summary

• Revenue to be recognised when measurable and risk & rewards associated with ownership gets transferred.

• Revenue Gross (still net of VAT, GST, Excise & Trade Discount). Cash discounted is not an off set against revenue, but is recognised and presented as expense.

• Gain Net of cost and related expenses.

• Service – Two permissible methods – percentage completion & completed service method.
Home work

• What are the recognition criteria of revenue?

• How uncertainties of collection at the time of sale & those arising subsequently are dealt with?

• In case of sale on installment, when the revenue is recognised?

• Tip ....

• Read Appendix attached to AS 9, which is illustrative only, meaning not forming integral part of the Standard. It carries various examples.
MCQ

- Revenue from sale of goods is recognised net of
  - A) VAT
  - B) Cash Discount
  - C) Both VAT & Cash Discount
  - D) None of above

- Answer a)
Thank You & Best Wishes