Accounting Standard (AS) 9: Revenue Recognition

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Course Summary:

This course attempts to discuss revenue recognition criteria as per Accounting Standard-9. This course is mainly designed keeping in view the CBCS syllabus for the 1st Semester undergraduate students of commerce of the University of Kalyani, West Bengal.

Course Content:

(a) Meaning of Revenue.
(b) Circumstances under which AS-9 does not apply.
(c) Revenue recognition criteria in case of sale of goods.
(d) Revenue recognition criteria in case of the rendering of services.
(e) Revenue recognition criteria in case of use by others of enterprise resources.
(f) The uncertainty and revenue recognition.
(g) Disclosure requirement.

The Accounting Standard (AS) 9-'Revenue Recognition' is concerned with the bases of recognition of revenue in the profit and loss account of the enterprise.

Revenue arises in the course of ordinary activities of the business from-

-sale of goods,

-rendering of services, and

-use by others of enterprise resources earning interest, royalties and dividends.

Important considerations of this accounting standard are - the timing of recognition of revenue, amount of revenue arising on a transaction and the influence of uncertainties regarding the determination of the amount or its associated cost on the timing of recognition of revenue.

Paragraph 4.1 of the Accounting Standard (AS) 9 'Revenue Recognition' defines revenue as "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".

In the following circumstances AS 9 does not apply-

i) Revenue arising from construction contracts (AS 7);
ii) Revenue arising from hire-purchase and lease agreements (AS 19);
iii) Revenue arising from government grants and other similar subsidies (AS 12);
iv) Revenue of insurance companies arising from insurance contracts.

Following transactions are also not covered under the definition of revenue as per AS 9:

1. Realised/unrealised gain resulting from disposal/holding of fixed assets. In other words gain arising from either sale of fixed assets or appreciation in the value of fixed assets.
2. Unrealised gains arising from the restatement of the carrying amount of an obligation.
3. Realised gains resulting from the discharge of obligation at less than its carrying amount.
4. Realised or unrealised gain resulting from changes in the foreign exchange rate during the translation of foreign currency financial statements.
5. Unrealised gain due to change in the value of the current asset and increase in the value of herds, agricultural or forest product.

Revenue Recognition Criteria:

In Case of Sale of Goods:

In case of sale of goods, revenue is recognized when all the following three conditions are satisfied-

i. Property in goods is transferred from seller to buyer for a consideration;
ii. Significant risk and reward of ownership are transferred from seller to buyer; and
iii. There exist no significant uncertainties regarding the amount of sale.

Some additional considerations:

1. Revenue is recognized when ownership has already been transferred but delivery is delayed at the buyer's request.
2. Where installation and inspection is an essential part of the sale, revenue is recognized after inspection and installation is complete.
3. Cash on delivery should be recognized when cash is received by the seller or his agent.
4. In the case of consignment sale revenue is recognized when goods are sold to a third party.
5. In the case of sales on approval basis, revenue is recognized when-
   - The buyer formally conveys his acceptance, or
   - Act in such a way that it indicates his acceptance or
   - The Time period for rejection is over.
6. In case of subscriptions for publications, revenue shall be deferred and recognized either by following straight-line basis overtime or on the basis of the sale value of item delivered in relation to the total sales value of items covered by the subscription.

In Case of Rendering of Services:

In the case of the rendering of services, revenue is recognized either by following the proportionate completion method or completed service contract method. It is also to be ensured that no significant uncertainties exist regarding the collection of the amount of consideration at the time of performance of service.

Some additional considerations-

1. Installation fee should be recognized as revenue after completion of installation and the equipment is accepted by the customer provided that the installation is not incidental to the sale of the product.
2. Advertising agency commission should be recognized as revenue when the related advertisement appears before the public.
3. Insurance agency commission should be recognized on the effective date of renewal of the policy.
4. Financial service can be provided in one act or over a period of time and should be recognized accordingly.
5. In case of tuition fees revenue should be recognized over the period of instruction.
6. In case of admission fee for any event, revenue should be recognized when that particular event takes place. In the case of more than one event revenue should be allocated to each event by following a rational and systematic basis.
7. If the membership fee only permits membership and for all other services there are separate charges, membership fee should be recognized on receipt basis. Subscription for other services should be recognized on a systematic and rational basis considering the timing and nature of services rendered.

In the case of Use of Enterprise Resources by others:

Interest, royalties and dividends are earned from permitting others to use enterprise resources.

Interest is calculated on a time proportion basis after taking into account the applicable rate of interest and the amount outstanding. Any discount or premium associated with the instrument should be treated over the period to maturity of the instrument.

Royalty is charged for allowing others to use intangible assets, such as patents, copyrights, know-how or trademark of the enterprise. Revenue is recognized by following accrual basis of accounting and in accordance with relevant agreement.

The Dividend is received on the share of other enterprise held as an investment. It is recognized as revenue only when the right to receive dividend is established. In other words, when the dividend is declared and the Directors decided to pay the dividend.

The Uncertainty and Revenue Recognition:

Revenue should be recognized only when there is no uncertainty regarding the collectability of the amount. Otherwise, revenue recognition should be postponed to the extent of the uncertainty involved.

If uncertainty as to the collectability of the amount arises in the future period, it is appropriate to make separate provision for the same instead of making any adjustment to the original amount recorded as revenue.

If uncertainty regarding the determination of revenue results in postponement of revenue recognition, it should be recognized only when it is reasonably determinable and should be treated as revenue of the year in which it is properly determined.

Disclosure Requirement:

1. Situations under which revenue recognition has been postponed due to significant uncertainties.

2. Disclosure of Excise Duty.

Possible Questions:

A. Short Answer Type Questions: (Marks: 2)
1. What is meant by Recognition of Revenue?
2. What are the primary sources of revenue as per AS-9?
3. State the methods of measuring service performance as per AS-9.
4. State two circumstances where AS-9 does not apply.
5. What is called as a charge for the use of know-how?
6. What is the basis of recognizing interest as revenue as per AS-9?

B. Medium Answer type Question: (Marks: 5)
1. What is meant by revenue as per AS-9? What are the areas where AS-9 does not apply?
2. What conditions are to be satisfied with recognizing revenue in case of sale of goods?
3. What conditions are to be satisfied with recognizing revenue in case of the rendering of services?
4. State about the influence of uncertainties on recognition of revenue?

Suggested Readings:
1. Hanif & Mukherjee, Financial Accounting, Tata Mcgraw Hill.
2. Debarshi Bhattacharya, Financial Accounting, Lawpoint Publications, 2018.
3. Mukherjee & Mukherjee, Financial Accounting, Vol.1, Pearson.
4. Accounting Standards-9 ‘Revenue Recognition’.

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