11 ACCOUNTING STANDARD – 9
REVENUE RECOGNITION

Quote:
Be miserable. Or motivate yourself. Whatever has to be done, it's always your choice.

1. WHAT IS REVENUE?

Revenue is Gross inflow of cash, receivables or other consideration arising in the course of the 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.

Examples on Revenue Nature Transactions

Revenue Nature	Non-Revenue Nature
Example 1 ST Ltd is a real-estate developer and builder. It is into the business of buying and selling properties. In 20X1, ST Ltd purchased a unit of land for ₹ 150 crore. It sold off that land after few months at a price of ₹ 240 crore. In the above case, the sale of land is a transaction that happens in the ordinary course of business (as he is a real estate developer and builder - properties will be an item of inventory in the financial statements) for ST Ltd. Hence, it should recognise a revenue of ₹ 240 crore when the land is sold.	**Example 2** Entity XY sells a machine being used at its factory at a price of ₹ 2 lakh. The carrying value of the machine is ₹ 1.80 lakh. The sale of the machine does not increase the revenue of XY but is an example of a capital receipt since transaction does not take place in the normal course of business. Such gain on sale of ₹ 20,000 (₹ 2 lakhs - ₹ 1.80 lakhs) is recognised as a part of profit & loss statement under Gain/(Loss) on disposal of asset.

Example 3	Example 4
Trip Deal is a website that allows people to book airlines tickets. As a part of the business, it agrees to buys 100 tickets from an airline on a particular date and resells those tickets to customers. However, Trip Deal bears the loss for any unsold tickets. In the above example, the risks and rewards relating to tickets are borne by Trip Deal. Hence, sales made for the tickets will be fully recognized as part of its revenue. Any unsold tickets will be charged as loss by the entity.	DL Ltd, a pharma company, has been conducting research on new medicine for the last 2 years to increase the immunity levels of the people consuming it without any side effects. During the current year, it decides to sell the outcome of the research undertaken so far to another competitor, GH Ltd for ₹ 50 crore. DL has already incurred ₹ 30 crore on the ongoing research. In the above example, the sale of the research findings does not represent an increase in revenue. This is because DL Ltd's business is not to sell these research findings in the ordinary course of business. The amount of ₹ 50 crore will be a part of Other Income in the profit & loss statement.

2. MEASUREMENT OF REVENUE:

Revenue is recognised at the nominal amount of Consideration Receivable (i.e., Agreed Price).

(a) Any trade discounts or rebates shall be deducted and revenue is measured net of these items.

(b) With regard to exchanges of goods or services (barter transactions):

- When goods or services are of a **similar nature**, then the exchange is not regarded as a revenue generating transaction and **the revenue cannot be recognized**.
- When goods or services are of a **dissimilar nature**, then the exchange is regarded as a revenue generating transaction and the revenue is recognized in amount of **fair value of goods/services received** (adjusted by the amount of any cash transferred).

3. RECOGNITION OF REVENUE

AS 9 specifies revenue recognition criteria for 3 basic revenue generating scenarios:

- Sale of goods
- Rendering of services
- Interest, Royalties and Dividends

4. REVENUE FROM SALE OF GOODS

Revenue from sale of goods is recognized when all of the following conditions are satisfied:

1) The entity has transferred to the buyer the significant Risks & Rewards of ownership of the goods.
2) The entity retains neither continuing managerial involvement to the degree usually associated with ownership nor effective control over the goods sold
3) The amount of revenue can be measured reliably
4) It is probable that the economic benefits associated with the transaction will flow to the entity
5) The costs incurred or to be incurred in respect of the transaction can be measured reliably.

AS 9 sets the practical guidance on recognition of revenue from various situations when selling goods.

The summarized list is as follows:

Transaction	Revenue Recognition
Bill and Hold Sales	When the buyer takes title (i.e., Ownership)
Goods Shipped Subject to Conditions	
– installation & inspection	When the buyer accepts delivery and installation & inspection is completed.
– on approval	When the buyer formally accepts the shipment
– with limited right of return	When the goods were delivered and time for return lapsed.
– consignment sales	After the consignee sells goods to the final customer.
– cash on delivery sales (e.g., Amazon/Flipkart)	When delivery is made and cash is received by the seller.
Lay Away Sales (a system of paying a deposit to secure an article for later purchase.	When the delivery is made.
Subscriptions to Publications	In line with the period over which the items are dispatched.
Sale of Goods with right to repurchase by seller	Case 1: Seller is sure that he will repurchase No sale should be recognised, it is considered as loan transaction. Case 2: Seller is sure that he will not repurchase Sale should be recognised

Example 5

XY Ltd sells goods worth ₹ 50 lakh on 20 February 20X1 to AB Ltd. AB Ltd is facing storage capacity constraints at their warehouse. AB Ltd instructs XY Ltd to hold the goods at XY Ltd's warehouse and arrange for delivery on 15 March 20X1. However, all the risks and rewards associated with the sold goods are deemed transferred to AB Ltd.

In the current scenario, delivery of goods sold is delayed at the request of buyer. XY Ltd can recognize revenue for sale of goods to AB Ltd on 20 February 20X1 provided that the goods sold to AB Ltd are held in XY Ltd's warehouse separately and are not clubbed with other inventory.

Example 6

M/s XY sells goods worth ₹ 5 lakh on 30th of March 20X1 to M/s FT under Sale on approval basis. Under the arrangement, FT can return the goods back to XY within next 3 months. XY cannot reasonably determine whether FT will give the acceptance of goods before the expiry of 3 months. Under these circumstances, XY cannot recognize revenue until the goods are accepted by FT or on completion of 3 months, whichever is earlier.

Example 7

On 1st January 20X1, M/s KJ sells goods at invoice value of ₹ 5 lakhs to M/s TH. At the time of sale, M/s KJ has agreed to repurchase these goods back from M/s TH on 31st March at a price of ₹ 6 Lac. You are required to do the accounting for above transactions in the books of M/s KJ.

Solution

This is a **Sale and Repurchase agreement**. In these kinds of transactions, Revenue is not recognized since ultimate control over goods is not transferred. It is treated as a Finance Arrangement.

1st Jan 20X1:

Bank A/c To Loan from M/s TH A/c (Being borrowing made under the Sale & Repurchase arrangement)	Dr.	₹ 5 lakhs	 ₹ 5 lakhs

31st March 20X1

Interest expense A/c To Loan from M/s TH A/c (Being interest cost recognised on the borrowing)	Dr.	₹ 1 lakhs	 ₹ 1 lakhs

31st March 20X1:

Loan from M/s TH A/c To Bank A/c (Being repayment of loan taken from TH)	Dr.	₹ 6 lakhs	 ₹ 6 lakhs

5. REVENUE FROM RENDERING OF SERVICES

Here, can the outcome of the transaction be estimated reliably?

- **If yes,** then the revenue can be recognized by the reference to the stage of completion of the transaction at the end of the reporting period.
- **If not,** then the revenue can be recognized only to the extent of the expenses recognized that are recoverable.

When can the outcome of the transaction be estimated reliably? It is when all the following conditions are satisfied:

- The amount of revenue can be **measured reliably**
- It is probable that the **economic benefits** associated with the transaction will flow to the entity (Certainty of Collection)
- The **stage of completion** of the transaction at the end of the reporting period can be measured reliably and
- The **costs** incurred for the transaction and the costs to complete the transaction can be measured reliably.

STANDARD ALSO PERMITS RECOGNITION AS PER COMPLETED SERVICE CONTRACT METHOD.

AS 9 sets the practical guidance on recognition of revenue from various situations **when rendering services:**

Transaction	Revenue Recognition
Installation Fees	With reference to the stage of completion.
Servicing Fees	If subsequent services are included, then defer the revenue for the subsequent services.
Advertising Commissions	
– Media Commissions	When the related advertisement appears before the public.
– Production Commissions	With reference to the stage of completion.
Insurance Agency Commissions	
– Agent Renders Further Services	Defer over the period during which the policy is in force.
– Agent Does Not Render Further Services	At the date of policy commencement or renewal.
Financial Services/Banking Services	
– Earned As Services Are Provided	When related service is provided.

– Earned On Execution of Significant Act	When related significant act has been completed.
Admission Fees	When the event takes place or allocate proportionally to individual events.
Tuition Fees	Over the period of instruction.
Entrance and Membership Fees	
– No additional services provided	Immediately when membership starts.
– Additional services provided	Defer over the membership period on some reasonable basis.
Franchise Fees	On the basis reflecting the purpose for which the fees are charged.
Fees from Development of Customized Software	With reference to the stage of completion, including the post-delivery service support stage.

6. REVENUE FROM INTEREST, ROYALTIES AND DIVIDENDS

Revenue arising from the use by others of entity assets yielding interest, royalties and dividends shall be recognized when:

- It is probable that the economic benefits associated with the transaction will flow to the entity&
- The amount of the revenue can be measured reliably.

Revenue shall be recognized on the following bases:

1. **INTEREST:** The recognition of revenue from interest on TIME PROPORTION BASIS.
2. **ROYALTIES:** shall be recognized on an ACCRUAL BASIS in accordance with the substance of the relevant agreement.
3. **DIVIDENDS:** shall be recognized when the SHAREHOLDER'S RIGHT TO RECEIVE payment is established (i.e. When Dividend is declared by Paying Co.)

7. POSTPONEMENT OF REVENUE RECOGNITION

Revenue recognition shall be postponed when:

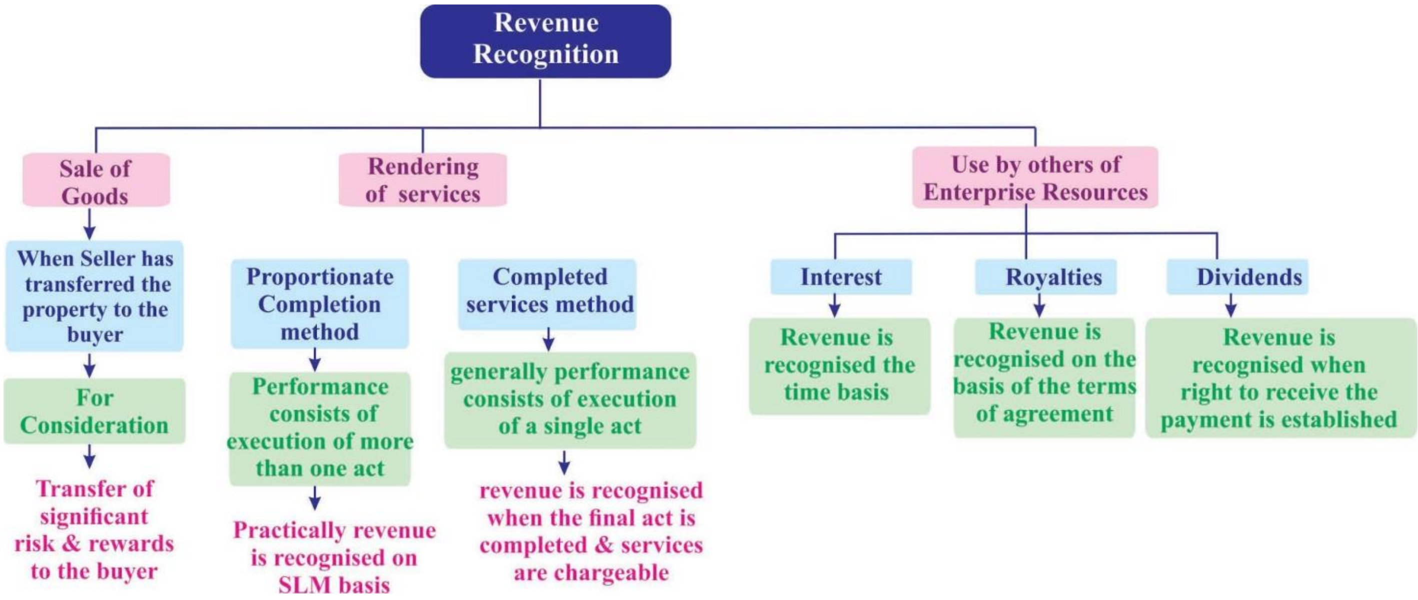
- The Consideration is not determinable or
- The amount of consideration is not certain to be collected
- When uncertainties gets over, Revenue should be recognized.
- If uncertainty about the ultimate collectability of revenue arise after the initial recognition, then enterprises should not reverse the revenue already recognized, it should create a proper Provision.

Case 1 – At the date of Transaction, there is no probability of collection – Do not recognise the revenue.
Case 2 – Initially Revenue was recognised because conditions of recognition satisfied. After some time, probability of collection reduced, Do Not Reverse Revenue, Create Provision for bad debts.

8. PRESENTATION OF TURNOVER:

Turnover should be presented in the following manner:

Turnover	Gross
Less:	GST
Turnover	**(Net)**



9. IMPORTANT KEY POINTS

1. **What is Gross Inflow?**

Gross Inflow is depends on following:

a) If there is transaction of Principal & Agent
- Gross Inflow for Principal would be amount charged from customers without deducting Commission
- Gross inflow for agent will be Commission receivable from principal

b) If there is transaction of Principal to Principal
- Gross Inflow for P1 will be amount charged from P2
- Gross Inflow for P2 will be charged from Customer

2. Interest income can be treated as "Revenue" if an Entity's Main Operating business is Financing Activity. E.g. Banks, NBFC
3. Revenue can be Royalty received by transferring "technical know how or patents" to other party if such transfer is a part of Ordinary Business.
4. Dividend can be Revenue if entity is an Investment entity (Mutual Fund Companies)

5. **Exchange Transaction**

(a) **Exchange of Similar G/S to Facilitate sales with similar business entities** - It's not a revenue transaction

(b) **Exchange of dissimilar G/S** - Revenue will be equal to Fair value of Consideration receivable.

e.g.: A ltd. provided consultancy service for Infrastructure & Interior to a builder & in Consideration A Ltd. will get 1 5BHk flat with garden facing. Revenue for A Ltd. would be Fv/MP of 5 BHK Flat.

6. **Rendering of Service -** Is the outcome of Service Probable?

(a) **YES -** Revenue is recognised on the basis of %(PCM) or Completed Service Method

(b) **NO** - Revenue = Cost incurred till date of which recovery is probable

7. **How to identify that outcome is probable?**

All 4 Conditions must be satisfied:

(a) Revenue amount is measured reliably. Price is mutually agreed between seller/buyer.

(b) Certainty of collection of revenue

(c) Percentage of Completion can be measured reliably.

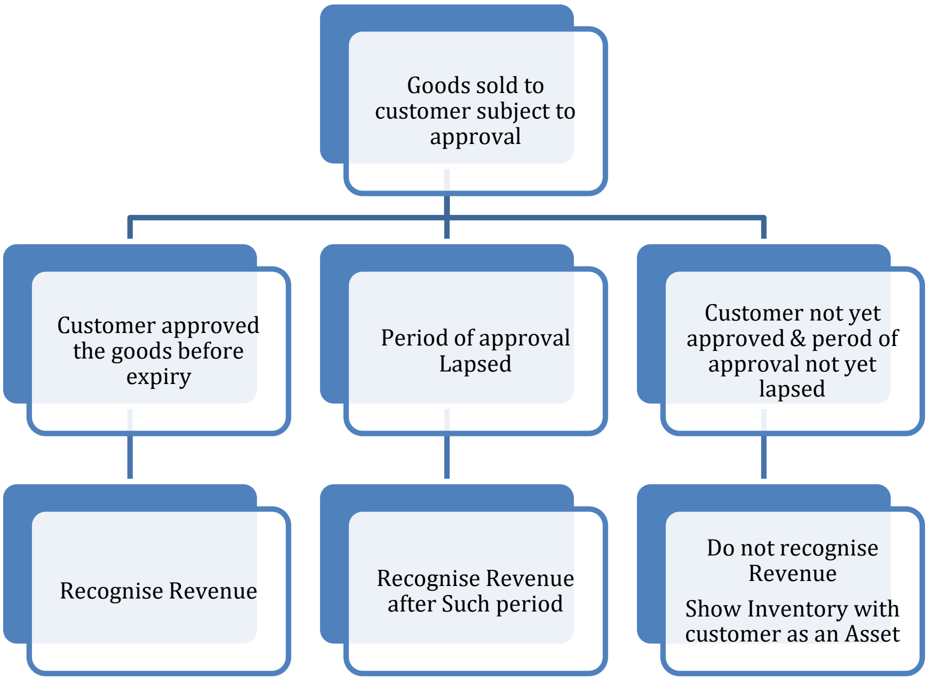
(d) Cost should be measured reliably.

8. If at the time sale, No Revenue is recognized because of Uncertainty of collection then Inventory with costumer is the Inventory of Seller only.
9. When seller arrange any transit Insurance while delivering the goods at customer's place.
In Case of any damage or loss of goods before they reached customer's Locations, it means seller doesn't transfer significant risk & rewards of ownership of goods.

Seller shall recognise revenue only when goods will reach customer's Place.

10. In case of " Principal – Agent" transaction, Principal shall recognize revenue only when Agent will sale the goods to ultimate customer.

11. Goods sold to customer subject to approval



12. If seller is charging Interest on delay Payments from Customer, then such Interest will from part of Revenue.

13. **Installation**

Case 1:- Installation is very simple, customer can also do the same: Recognise the Revenue immediately. Do not wait for actual Installation.

Case 2:- Installation is Complicated & Requires Significant assistance of Seller: Recognise Revenue only when Installation is completed

14. Subscription Income: Recongnise the revenue over the period of contract as under:

SLM basis if services or products are delivered in same quantity every month/year.	If variable delivery of services or products then deferred in proportion of the value of delivery every month/year.

15. **Advertisement commission:**

Recognise the revenue on accrual Basis when advertisement is published. Any amount collected from customer for which advertisement is not yet published will be treated as liability.

16. In case of **Retrospective Price revision**, if Seller has right to recover the additional amount from customer then Revenue shall be recognised only when there is certainty of ultimate collection of such amount.

10. MCQ's from ICAI Material

1. Which of the conditions mentioned below must be met to recognize revenue from the sale of goods?
   (i) the entity selling does not retain any continuing influence or control over the goods;
   (ii) when the goods are dispatched to the buyer;
   (iii) revenue can be measured reliably;
   (iv) the supplier is paid for the goods;
   (v) it is reasonably certain that the buyer will pay for the goods;
   (vi) the buyer has paid for the goods.
   (a) (i), (ii) and (v)
   (b) (ii), (iii) and (iv)
   (c) (i), (iii) and (v)
   (d) (i), (iv) and (v)

2. Consignment inventory is an arrangement whereby inventory is held by one party but owned by another party. Which of the following indicates that the inventory in question is a consignment inventory?
   (a) Manufacturer cannot require the dealer to return the inventory
   (b) Dealer has the right to return the inventory
   (c) Manufacture is responsible for the pricing of goods and any changes in the pricing can only be approved by the manufacturer.
   (d) Manufacture is responsible for the holding the goods and any changes in the pricing can only be approved by the dealer

3. Which of the following transactions qualify as revenue for M/s AB Enterprises?
   (a) Sales of ₹ 20 lakhs made under consignment sales.
   (b) Sale of an old machine amounting ₹ 5 lakhs
   (c) Services provided to the customer in the normal course of business. Sales recorded is ₹ 50,000.
   (d) Sales of ₹ 25 lakhs made under consignment sales

4. The Accounting Club has 100 members who are required to pay an annual membership fee of ₹ 5,000 each. During the current year, all members have paid the fee. However, 5 members have paid an amount of ₹ 10,000 each. Of these, 3 members paid the current year's fee and also the previous year's dues. Remaining 2 members have paid next years' fee of ₹ 5,000 in advance.
   Revenue from membership fee for the current year to be recognised will be:
   (a) ₹ 5,25,000
   (b) ₹ 5,10,000
   (c) ₹ 5,00,000
   (d) ₹ 5,15,000

5. Flix Net International offers a subscription fee model to allow the paid subscribers an annual viewing of movies, sports events and other content. It allows users to register for free and have access to limited content for one month without any charges. The customer has a right to cancel the subscription within a month's time but is required to pay for 1 year subscription fee after the free period.

XY has subscribed for free viewing on 1st March 20X1. After 1 month, he has agreed to pay the annual membership and has paid ₹ 1,200 on 31st March 20X1 for the subscription that is valid up to 31st of March 20X2.

Revenue that can be recognized by FlixNet for the year ended 31st March 20X2 is

(b) ₹ 100

(c) ₹ 1,200

(d) Nil

(e) ₹ 1,100

ANSWERS	1	2	3	4	5
	c	c	c	c	b

Student Notes:-