AS 9 – Revenue Recognition

Introduction:

When an entrepreneur assumes huge risk and sows the resources of time, money and knowledge into one venture, what does he expect to reap in the long run ??

Though the main harvest may differ from entrepreneur to entrepreneur, revenue is definitely an indispensible yield through which he measures the success of his decisions. Recognition of such revenue is to be done as per Accounting Standards.

Recognizing Revenue:

As per Accounting Standard, AS 9, Revenue is categorized into 3 categories

- Generated from sales
- Generated from services
- Use of resources

Other gains e.g., gains from forex fluctuations, disposal of assets, unrealized gain from natural increase in agricultural or forest products etc are not covered under the definition of "revenue" in the said standard. There are exclusive standards for the same which will be dealt with in the forthcoming articles.

The thumb rule to recognize Revenue is that it should be "measureable and receivable" else the recognition should be postponed to the extent of uncertainty.

"Measurable" means the amount payable for the product sold or service rendered must be quantifiable.

"Receivable" indicates the existence of reasonable certainty about the "recoverability" from the customer/client, be it cash or credit sales.

In case any uncertainty crops up after recording credit sales, it is appropriate to make a separate provision, i.e Provision for Bad and Doubtful Debts, indicating the uncertainty than to alter the already recognized revenue figures.

The key criteria for recognizing revenue in the books of accounts is as follows:

1. Sale of goods:

- Cash sales - for e.g., a shopper at a retail outlet buys goods, pays for it and takes immediate delivery. Here the bill is issued and revenue is recognized at that point in time since all the activities of sale, payment and delivery happen simultaneously.

- Now imagine another situation where the events occur on different dates.

25th March 2012	Customer places order for purchase of goods and makes advance payment.
1st April 2012	Instructs for delivery of goods and accepts billing
5th April 2012	Goods reach the premises of the customer

20th April 2012	Customer settles his dues i.e balance amount of the invoice.

Now the question arises as to the point of time when the sales should be recognized in the books of the seller. Is it to be considered in the financial statements for the year ending on 31st March 2012 or to be deferred to next year?

Sales shall be recognized when:

Property in the goods is transferred to buyer for a consideration

Or

Significant Risks and Rewards of ownership is transferred to

And

Amount to be received is certain

Even if possession of the goods has not been taken by the buyer but he is responsible for any loss or damage to the goods, then the ownership is said to be transferred to the buyer and is sufficient to record the said transaction as sales even if the seller retains goods for future delivery.

Based on the said criteria, sales in the above stated case, is to be recorded at the point of time the customer accepts the billing of the sale of goods i.e on 1st April, 2012.

2. **Rendering of services:**

The service to be rendered may consist of execution of a single task or multiple tasks.

- Where performance of a single task is involved, **Completed Service Contract Method** is adopted i.e revenue is recognized on completion of the said task. e.g: installation charges for a machine. Since partial installation cannot be considered as installation, the fees is to be recognized only after completion of the service.

- However when service rendered is of a continuous nature or involves execution of more than one task which spans over a period of several accounting periods, then **Proportionate Completion Method** is adopted i.e revenue is appropriated to the extent of completion of contract in the concerned period. e.g Loan Management fees should be recognized over the period of life of the loan, tuition fees should be recognized over the period of instruction.

- It is worthwhile to note that if the contract of rendering of services pertains to the construction of an asset i.e construction contract then AS-9 is not applicable, instead "AS 7 – Construction Contracts" is applicable which prescribes the percentage of completion method for recognizing contract revenue.

3. **Use of resources:**

- Interest: is recognized on time basis considering the outstanding amount and the rate applicable. e. g: Let us assume that surplus cash of Rs. 1,00,000 of the enterprise is invested in 180 day fixed deposit at 7.5% p.a on 1st March 2012. Interest income to be considered uptil 31st March 2012 shall be Rs. 636.99 and Rs. 3061.64 shall be considered in the August 2012 on the date of maturity of the fixed deposit.

- Royalty: is the charge for use of intellectual property rights like know how, patents, copyrights and trademarks. Royalty is recognized in accordance with the terms of the relevant licence agreement e.g., as a percentage of sales arising from the use of such right , else such royalty income shall be apportioned over the period of the use of such right on some systematic basis.

- Dividend: is the return on investment in shares and is recognized when the right to receive dividend is established i.e declared by the shareholders at the General Meeting.

Conclusion:

In order to present a true and fair view of the business it is important that the revenue recognition criteria is adhered to. Invariably a suitable revenue recognition policy must be developed to reduce ambiguity in identifying and recording a revenue transaction. Finding ingenious ways like predating a revenue transaction or postponing the same without correct justification would amount to "window dressing" or presenting "a better than actual state" of the financial position of the enterprise.

Such a house built of cards must crumble – it is a matter of "when" and "how" !!!

- ***Bhavya Parvathi. K., ACA***