Quadrant II – Transcript and Related Materials

Programme: Bachelor of Commerce (Third Year)

Subject: Commerce

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Paper Title: Accounting Major IV-Financial Reporting

Unit: II- Accounting Pronouncements

Module Name: Accounting Standards (AS)- 9 Revenue Recognition

Module No: 15

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Welcome Students. In the previous module you have learnt Accounting Standard (AS) 18 Related Party Disclosures. This is module 15 and, in this module, you will learn Accounting Standard 9- Revenue Recognition.

1 Accounting Standard (AS) -9 Revenue Recognition

Revenue recognition is mandatory for all business entities from accounting periods commencing on or after 1st April 1993. What does this standard deal with? This standard explains, when the incomes will be recognised as revenues in the Profit and loss statement of an entity.

2 What do you understand by the term revenue?

Revenue means an inflow of cash, receivables or other consideration arising in the course of ordinary activities of the business entity. And where does this arise from? It arises from the following activities:

- Sale of goods:
  The entity derives revenue out of sale of goods on transfer of risk, rewards and possession to the other party that is the buyer. Transfer of risk means transfer of responsibility of the product, transfer of reward denotes

transfer of benefit of usage and transfer of possession signifies transfer of control.

- Rendering of services:
  Rendering of services is recognised as revenue when the service is performed. That means here the amount may be received as agreed in the contract with the party.
  - Proportionate Completion Method: Revenue is recognised proportionately based on the acts performed. Thus, no uncertainty exists about the collection of the amount.
  - Completed Service Contract Method: The entire amount is recognised on completion of the contract.
- Other sources such as interest, royalty and dividend:
  - Interest is recognised on the basis of time.
  - Revenue from royalty depends on the terms of the agreement.
  - Revenue from dividend is recognised when dividend is declared.

3 Revenues not covered under AS-9

The following revenues are not covered in Accounting Standard-9:

- Construction contracts (AS 7)
- Hire purchase, lease agreements (AS 19)
- Govt. grants and subsidies (AS 12)
- Insurance companies (IRDA Act)
- Profit or Loss on sale of fixed assets
- Realized/unrealized gains resulting from changes in forex rates

Examples:

Let us now look at some practical examples on revenue recognition:

Example 1: Sale on approval basis

Goods worth ₹ 5,50,000 sold on approval basis on 03/11/19. Period of approval was 3 months. Buyer sent approval for 80% on 02/02/2020. No communication received for remaining goods upto 31/03/2020.

Solution:

In this example, the formal time for approval was three months i.e. upto 3rd February 2020. Formal approval for 80% of the goods was received well in time that accounts to ₹ 4,40,000. However, no approval was received for the balance amount of ₹ 1,10,000. But, since the time for approval was over, it is termed as deemed acceptance and the entire amount of ₹ 5,50,000 will be recognised as revenue in the books of accounts for the year 2019-2020.

Example 2: Sale on consignment basis

On 20/02/2020, goods worth ₹ 2,10,000 were sent on consignment basis, of which 25% is unsold and lying with the consignee 31/03/2020.

Solution:

In this case a sale of upto 75% only will be recognised as revenue i.e. ₹ 1,57,500 for the year 2019-2020. This is because in case of consignment sale revenue is recognised only when goods are sold to the third party.

Example 3: Delivery of goods

On 20/03/2020, goods of ₹ 80,000 were sold, however the delivery was made on 15th April 2020 at the request of the buyer.

Solution:

In this case, the seller has sold goods to the buyer on 20th March 2020, but the delivery of the goods is delayed on the request of the buyer. So, though the goods are not delivered physically to the buyer, yet there is no uncertainty regards the amount of consideration that will be derived. Hence the entire amount of ₹ 80,000 is considered as revenue for the year 2019-2020 and recorded in the Trading A/c.

Example 4: Revenue on advertisement

Amt. towards advertisement-₹ 45,000

Case i.

Advertisement issued on 20/03/2020

Case ii.

Advertisement issued on 03/04/2020

Solution:

An amount to be received towards advertisement of ₹ 45,000 under two situations is discussed here.

Consider case i, the advertisement is issued on 20th March 2020. The revenue of ₹ 45,000 is recognised during the period 2019-2020.

While in case ii, the advertisement is issued on 3rd April 2020. This amount will be recorded in the next financial year 2020-2021. This is because the revenue on advertisement is recognised when the advertisement appears before the public.

To summarise, AS-9 provides guidelines on when revenue from sale of goods, rendering of services and other sources i.e. interest, royalty and dividend is to be recognised in the books of accounts.