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IAS 18 – Revenue Recognition

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Income V/s Revenue & Gains

- Income is the gross inflow of economic benefits during the period arising in the course of the ordinary activities of an entity when those inflows result in increases in equity, other than increases relating to contributions from equity participants.
- Income includes: Revenue, gain and unrealised gain.

Non-Applicability

This Standard does not apply to:

- Lease agreements (see IAS 17 Leases);
- Dividends from Investments accounted for under the equity method (see IAS 28 Investments in Associates);
- Insurance contracts within the scope of IFRS 4 Insurance Contracts;
- Changes in the fair value of financial assets and financial liabilities or their disposal (see IAS 39 Financial Instruments: Recognition and Measurement);
- Changes in the value of other current assets;
- Initial recognition and from changes in the fair value of biological assets related to Agricultural activity (see IAS 41 Agriculture);
- Initial recognition of agricultural produce (see IAS 41) ; and
- Extraction of mineral ores.

Applicability

- This standard applies to the Accounting for Revenue arising from:

1. The sale of goods;
2. The rendering of services;
3. The use by others of entity assets yielding interest, royalties, and dividends.

Sale of Goods

Conditions for Recognition

- Revenue from the sale of goods shall be recognised when all the following conditions have been satisfied:

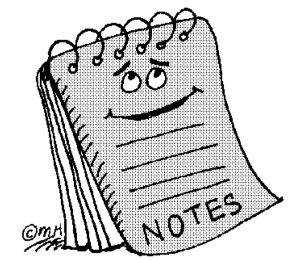
1. the Entity has transferred to the buyer the significant risks and rewards of ownership of the goods;
2. the Entity retains neither continuing managerial involvement to the degree usually associated with ownership nor effective control over the goods sold;
3. the Amount of revenue can be measured Reliably;
4. it is probable that the economic benefits associated with the transaction will flow to the entity; and
5. the costs incurred or to be incurred in respect of the transaction can be measured reliably.

Revenue Recognition under different Situations

1. ‘Bill and hold’ sales.
2. Goods shipped subject to conditions.
3. Lay away sales under which the goods are delivered only when the buyer makes the final payment in a series of installments.
4. Orders when payment (or partial payment) is received in advance for delivery of goods not presently held in inventory.
5. Sale and repurchase agreements (other than swap transactions).
6. Sales to intermediate parties, such as distributors, dealers or others for resale.

   The guidance includes criteria to indicate that an entity is acting as principle which is closely related to *EITF 99-19 – of U.S GAAP Reporting revenue as a gross principle versus Net as an Agent.*

7. Subscriptions to publications and similar items.
8. Installment sales, under which the consideration is receivable in installments.
9. Warranties and Extended warranties.



Explanations

1. **‘Bill and hold’ sales.**

   In which delivery is delayed at the buyer’s request but the buyer takes title and accepts billing.

- Revenue is recognised when the buyer takes title, provided:
  - It is probable that delivery will be made;
  - the item is on hand , identified and ready for delivery to the buyer at the time the sale is recognised;
  - the buyer specifically acknowledges the deferred delivery instructions; and
  - the usual payment terms apply.
- Revenue is not recognised when there is simply an intention to acquire or manufacture the goods in time for delivery.

2. **Goods shipped subject to conditions.**

a) Installation and inspection

Revenue is normally recognised when the buyer accepts delivery, and installation and inspection are complete. However, revenue is recognised immediately upon the buyer's acceptance of delivery when:

1. the installation process is simple in nature, for example the installation of a factory tested television receiver which only requires unpacking and connection of power and antennae; or

2. the inspection is performed only for purposes of final determination of contract prices, for example, shipments of iron ore, sugar or soya beans.

b) On approval when the buyer has negotiated a limited right of return.

If there is uncertainty about the possibility of return, revenue is recognised when the shipment has been formally accepted by the buyer or the goods have been delivered and the time period for rejection has elapsed.

c) Consignment sales under which the recipient (buyer) undertakes to sell the goods on behalf of the shipper (seller).

Revenue is recognised by the shipper when the goods are sold by the recipient to a third party.

d) Cash on delivery sales.

Revenue is recognised when delivery is made and cash is received by the seller or its agent.

3. **Lay away sales under which the goods are delivered only when the buyer makes the final payment in a series of installments.**

Revenue from such sales is recognised when the goods are delivered. However, when experience indicates that most such sales are consummated, revenue may be recognised when a significant deposit is received provided the goods are on hand, identified and ready for delivery to the buyer.

4. **Orders when payment (or partial payment) is received in advance for delivery of goods not presently held in inventory.**

For example: the goods are still to be manufactured or will be delivered directly to the customer from a third party. Revenue is recognized when the goods are delivered to the buyer.

5. **Sale and repurchase agreements (other than swap transactions).**

Under which the seller concurrently agrees to repurchase the same goods at a later date, or when the seller has a call option to repurchase, or the buyer has a put option to require the repurchase, by the seller, of the goods.

For a sale and repurchase agreement on an asset other than a financial asset, the terms of the agreement need to be analyzed to ascertain whether, in substance, the seller has transferred the risks and rewards of ownership to the buyer and hence revenue is recognised. When the seller has retained the risks and rewards of ownership, even though legal title has been transferred, the transaction is a financing arrangement and does not give rise to revenue.

6. **Sales to intermediate parties, such as distributors, dealers or others for resale.**

Revenue from such sales is generally recognised when the risks and rewards of ownership have passed. However, when the buyer is acting, in substance, as an agent, the sale is treated as a consignment sale.

7. **Subscriptions to publications and similar items.**

When the items involved are of similar value in each time period, revenue is recognised on a straight-line basis over the period in which the items are dispatched. When the items vary in value from period to period, revenue is recognised on the basis of the sales value of the item dispatched in relation to the total estimated sales value of all items covered by the subscription.

8. **Installment sales, under which the consideration is receivable in installments.**

- Revenue attributable to the sales price, exclusive of interest, is recognised at the date of sale. The sale price is the present value of the consideration, determined by discounting the installments receivable at the imputed rate of interest. The interest element is recognized as revenue as it is earned, using the effective interest method.

Rendering of Services

Revenue Recognition under different Situations

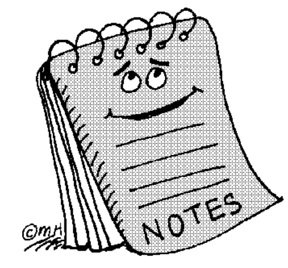
1. Installation fees
2. Servicing fees included in the price of the product.
3. Advertising commission
4. Insurance agency commission.
5. Financial service fees.
   a) Fees earned as services are provided.
      - Fees charged by servicing a loan.
      - Commitment fees to originate a loan when the loan commitment is Outside the scope of IAS 39.
      - Investment management fees.
   b) Fees that are earned on the execution of a significant act.
6. Admission fees
7. Tuition fees
8. Initiation, entrance and membership fees.

9. Franchise fees.
   i. Supplies of equipment and other tangible assets.
   ii. Supplies of initial and subsequent services.
   iii. Continuing franchise fees.
   iv. Agency transaction.
10. Fees from the development of customized software.

IAS 18 provides guidance: fees from the development of customized software are recognised as revenue by reference to the stage of completion of the development, including completion of services provided for post delivery service support.

The basic principle of sop 97-2

- Persuasive evidence
- Delivery has occurred
- The vendor’s fee is fixed or determinable
- Collectability is probable



Explanations

1. **Installation fees**

Installation fees are recognized as revenue by reference to the stage of completion of the installation, unless they are incidental to the sale of a product, in which case they are recognized when the goods are sold.

Bharat Movers Ltd has sold a plant worth $25,000 to Plan Well Inc. This Plant has to be fixed to the ground which involves two stages-

Stage 1 (for which the fees are $2,000)-is the preparatory work where the place is made ready, holes drilled into the ground etc.

Stage 2 (for which the fees are $7500)- is the stage where the machine is actually fixed to the ground by fitting bolts, welding etc.

If only stage 1 has been completed by the year end, which amounts would be reflected in revenue in the financial statements?

2. **Servicing fees included in the price of the product.**

   When the selling price of a product includes an identifiable amount for subsequent servicing (for example, after sales support and product enhancement on the sale of software), that amount is deferred and recognized as revenue over the period during which the service is performed. The amount deferred is that which will cover the expected costs of the services under the agreement, together with a reasonable profit on those services.

3. **Advertising commission**

Media commissions are recognised when the related advertising or commercial appears before the public. Production commissions are recognised by reference to the stage of completion of the project.

4. **Insurance agency commission**.

Insurance agency commission received or receivable which do not require the agent to render further services are recognized as revenue by the agent on the effective commencement or renewal dates of the related policies. However, when it is probable that the agent will be required to render further services during the life of the policy, the commission, or part thereof, is deferred and recognised as revenue over the period during which the policy is in force.

- **Financial Services Fees**

- Origination fees received by the entity relating to the creation or acquisition of a financial asset

Such fees may include compensation for activities such as evaluating the borrowers' financial condition, evaluating and recording guarantees, collateral and other security arrangements, negotiating the terms of the instrument, preparing and processing documents and closing the transaction. These fees are an integral part of generating an involvement with the resulting financial instrument and, together with the related direct costs, are deferred and recognised as an adjustment to the effective interest rate.

- Commitment fees received by the entity to originate a loan .

  If it is probable that the entity will enter into a specific lending arrangement the commitment fee received is regarded as compensation for an ongoing involvement with the acquisition of a financial instrument and, together with the related direct costs, is deferred and recognised as an adjustment to the effective interest rate. If the commitment expires without the entity making the loan, the fees is recognised as revenue on expiry.

b. Fees earned as services are provided.

- Fees charged by servicing a loan.

  Fees charged by an entity for servicing a loan are recognised as

  Revenue as the services are provided.
- Investment management fees.

  Fees charged for managing investments are recognised as revenue as the services are provided.

c. Fees that are earned on the execution of a significant act.
The fees are recognised as revenue when the significant act has been Completed, as in the examples below:

- Commission on the allotment of shares to a client.
  The commission is recognised as revenue when the shares have been allotted.
- Placement fees for arranging a loan between a borrower and an investor.
  The fee is recognised as revenue when the loan has been arranged.
- Loan syndication fees.
  A syndication fee received by an entity that arranges a loan and retains no part of the loan package for itself (or retains a part at the same effective interest rate for comparable risk as other participants) is compensation for the service of syndication. Such a fee is recognised as revenue when the syndication has been completed.

6. **Admission fees**

Revenue from artistic performances, banquets and other special events is recognised when the events take place. When a subscription to a number of events is sold, the fee is allocated to each event on a basis which reflects the extent to which services are performed at each event.

7. **Tuition fees**.

Revenue is recognised over the period of instruction.

8. **Initiation, entrance and membership fees.**

Revenue recognition depends on the nature of the services provided. If the fee permits only membership, and all the services or products are paid for separately, or if there is a separate annual subscription, the fee is recognized as revenue when no significant uncertainty as to its collectibles exists. If the fee entitles the member to services or publications to be provided during the membership period or to purchase goods or services at prices lower than those charged to non-members, it is recognised on a basis that reflects the timing, nature and value of the benefits provided.

9. **Franchise fees.**

Franchise fees may cover the supply of initial and subsequent services, equipment and other tangible assets, and know-how. Accordingly, franchise fees are recognised as revenue on the basis that reflects the purpose for which the fees were charged. The following methods of franchise fee recognition are appropriate:

i. Supplies of equipment and other tangible assets.

   The amount based on the fair value of the assets sold, is recognised as revenue when the items are delivered or title passes.

ii. Supplies of initial and subsequent services.

   Fees for the provision of continuing service, whether part of the initial fee or a separate fee, does not cover the cost of continuing services together with a reasonable profit, part of the initial fee, sufficient to cover the cost of continuing services and to provide a reasonable profit on those services, is deferred and recognised as revenue as the services are rendered.

iii. Fees charged for the use of continuing rights granted by the agreement, or for other services provided during the period of the agreement, are recognized as revenue as the services are provided or the rights used.

iv. Agency transaction.

Transactions may take place between the franchisor and the franchisee which, in substance, involve the franchisor acting as agent for the franchisee. For example, the franchisor may order supplies and arrange for their delivery to the franchisee at no profit. Such transactions do not give rise to revenue.

10. **Fees from the development of customized software.**

Fees from the development of customized software are recognized as revenue by reference to the stage of completion of the Development, including completion of services provided for post-delivery service support.

Accounting for software arrangement with multiple elements

Software arrangement may licenses for many products or services such as additional software products upgrades/enhancement, rights to exchange or return software, post-contracts customer support (PCS) or other services including elements deliverable only on a 'when-and-if-available' basis.

Revenue recognition in the telecommunication sector

There are significant revenue recognition complexities that affect the telecommunication sector and about which IFRS is effectively silent.

Recording revenue for multiple services element ('bundled offers')

IAS 18 refers specifically to situation where the selling price of a product includes an indefinable amount for subsequent servicing, in which case that amount is differed and recognised as revenue over the period during which the services is performed.

A consumer is provided with a package that may include handset, free minutes of talk time, SMS, MMS etc.

There is no specific guidance within IFRS on multiple deliverables it has considered the guidance contained in EITF 00-21 – revenue arrangement with multiple deliverables.

- 'Free' services by way of talk time
- Connection and up-front fees
- Third party content providers
- Number portability
- Accounting for roll-over minutes

Interest, Royalties and Dividends

Conditions for Recognition

Revenue shall be recognized on the following basis:

1. Royalties shall be recognized on an accrual basis in accordance with the substance of the relevant agreement; and
2. Dividends shall be recognized when the shareholder's right to receive payment is established.
3. interest shall be recognized using the effective interest method as set out in IAS 39, paragraphs 9 and AG5-AG8;

IFRIC 13 (Customer Loyalty Programmed)

- **History**

1. Customers loyalty programmed are used by entities to provide customer with incentives to buy their goods and services.
2. The customer can redeem the award credits (points) such as free or discounted goods or services.
3. Award credits (points) may be linked to individual purchases or to continued custom over a specified period.
4. The customer’s loyalty programme may be operated by seller or a third party.
5. The awards offered may include goods or services supplied by the entity itself and/ or rights to claim goods or services from third party.

SIC 31- Barter Transactions involving Advertising Services

- History

  An entity (Seller) may enter into a barter transaction to provide advertising services in exchange for receiving advertising services from its customer (Customer). Advertisements may be displayed on the internet or poster sites, broadcast on the television or radio, published in magazines or journals, or presented in another medium.

  The services exchanged are dissimilar (IAS 18.12) and the amount of revenue can be measured reliably (IAS 18.20(a)). This Interpretation only applies to an exchange of dissimilar advertising services.

Measurement of revenue of advertising services received or provided

- Involve advertising similar to the advertising in the barter transaction
- Occur frequently
- Represent a predominant number of transactions and amount when compared to all transactions to provide advertising that is similar to the advertising in the barter transaction;
- Involve cash and/or another form of consideration (e.g. marketable securities, non-monetary assets, and other services) that has a reliably measurable fair value; and
- Do not involve the same counterparty as in the barter transaction.

IFRIC 15:- Agreement for the construction of real estate.

• The interpretation applies to accounting for revenue and associated expenses by entities that undertake the construction of real estate directly or through subcontractors.

• agreement in the scope of this interpretation are agreement for the construction of real estate. In addition to the construction of the real estate, such agreement may include the delivery of the other goods or services.

Accounting for revenue from the construction of the real estate

- The agreement is a construction contract
- The agreement is an agreement for the rendering of services.
- The agreement is an agreement for the sale of goods.

IFRIC 18:- Transfers of assets from customers

This interpretation applies to all agreement under which an entity receives from a customer, or another party, an item of property, plant and equipment (or cash to acquire or construct such an asset) that the entity must then use either to connect goods or services or both. The interpretation does not apply if this transfer is a government grant within the scope of IAS 20 or the assets is used in a services concession within the scope of IFRIC 12 – services concession arrangement.

The Key issues to consider when applying the interpretation are:

- Was an asset received?
- How should the assets be valued?
- How should the related income be recognised?

Disclosures

An entity shall disclose :

a) The accounting policies adopted for the recognition of revenue, including the methods adopted to determine the stage of completion of transactions involving the rendering of services;

b) The amount of each significant category of revenue recognised during the period, including revenue arising from:

   i. The sale of goods;

   ii. The rendering of services;

   iii. Interest;

   iv. Royalties;

   v. Dividends; and

c) The amount of revenue arising from exchanges of goods or services included in each significant category of revenue.

An entity discloses any contingent liabilities and contingent assets in accordance with IAS 37 Provisions, Contingent Liabilities and Contingent Assets. Contingent liabilities and contingent assets may arise from items such as warranty costs, claims, penalties or possible losses.

Extracts from Financial Statements

DABUR INDIA LIMITED (2008-09)

Revenue Recognition :

Customers of the Group Companies consist primarily of large wholesalers and dealers network who sell directly into the retail channel. Revenue from product sales is recognized when the merchandise is sold or shipped to customers and all four of the following criteria are met :

(i) Persuasive evidence that an arrangement exists

(ii) Delivery of the products has occurred,

(iii) The selling price is both fixed and determinable and (iv) collectibility is reasonably assured.

Provisions for sales discounts, damaged product returns, exchange for expired product are established as a reduction of product sales revenues at the time such revenues are recognized. Certain charge backs and rebate programmes extended to customers pursuant to industry standards are recognized as a reduction from product sales revenues. Besides taxes/duties incidental to sale are recognized as a reduction from product sale revenue.

Interest, Royalty, Dividend :

Dividend is recognized at the point of declaration of Dividend by investee entity. Interest has been accounted for on time proportion basis. Royalty is provided for accrual basis based on agreement of receipts option as per IAS-18.

Thank You

Mumbai, India