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REVENUE – IAS18

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IAS 18 Revenue

OVERVIEW

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IAS 18 Overview

- Objective / scope / definitions
- Measurement (How much)
- Recognition (When)
  - Sale of goods
  - Rendering of services
  - Interest / royalties / dividends
- Disclosure

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Recognition criteria – *WHEN* to recognise?

Framework: Inflow of FEB probable & Amounts measured reliably +

Sale of goods

1. Risks & rewards of ownership passes;
2. Continuing managerial involvement / effective control ceases
3. FEB are probable
4. Revenue measured reliably
5. Costs measured reliably

Rendering of services

Can the outcome of the transaction be reliably estimated?

YES = Stage of completion

The outcome can be estimated reliably when:

1. The stage of completion can be measured reliably
2. FEB are probable
3. The amount of revenue can be measured reliably

The costs incurred (and to be incurred) can be measured reliably

No = limited to expenses recognised that are recoverable

Use by others of entities assets

1. FEB are probable
2. Amount of revenue can be measured reliably

Interest:

Effective interest rate method

Dividends:

Shareholders right to receive payment is established

Royalties:

Accrual basis in line with the substance of the agreement

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IAS 18 Revenue

OBJECTIVE / SCOPE / DEFINITIONS

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OBJECTIVE

- Income definition per framework:
  - Increase in economic benefits;
  - $\uparrow$ Assets / $\downarrow$ Liabilities
  - = $\uparrow$ Equity (*other than contributions)*

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OBJECTIVE (cont.)

Income includes revenue & gains.

– Revenue – ordinary course of business (ref definition IAS18.7)

– Gains – not ordinary, eg. Profit on sale of FA.

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OBJECTIVE

- What is the primary issue??????

WHEN TO ACCOUNT FOR REVENUE

- Think of concept of accrual accounting

- Be practical – use a timeline (correct periods)!

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SCOPE

- IAS18 par 1:

This Standard shall be applied in accounting for revenue arising from the following transactions and events:

(a) the sale of goods;

(b) the rendering of services; and

(c) the use by others of entity assets yielding interest, royalties and dividends.

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SCOPE - EXCLUSION

IAS18 does not apply to (IAS18.6):

(a) lease agreements (see IAS 17 Leases);

(b) dividends arising from investments which are accounted for under the equity method (see IAS 28 Investments in Associates);

(c) insurance contracts within the scope of IFRS 4 Insurance Contracts;

(d) changes in the fair value of financial assets and financial liabilities or their disposal (IFRS9 & IAS39)

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SCOPE – EXCLUSION (Cont.)

e) changes in the value of other current assets;

f) initial recognition and from changes in the fair value of biological assets related to agricultural activity (see IAS 41 Agriculture);

g) initial recognition of agricultural produce (see IAS 41); and

h) the extraction of mineral ores.

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DEFINITION

- REVENUE: (IAS18.7)
  - Gross inflow economic benefits
  - During the period
  - ***ORDINARY ACTIVITIES***
  - Increase equity (increase Assets / decrease liabilities
  - Not related to contributions

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CLARIFICATION ON GROSS BENEFITS.....

- Only gross inflows received / receivable on the entities OWN ACCOUNT. (IAS18.8)

- Therefore, VAT or GST not included – received on behalf of tax authority.

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IAS 18 Revenue

MEASUREMENT OF REVENUE

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MEASUREMENT

FAIR VALUE OF CONSIDERATION

RECEIVED OR RECEIVABLE!

IAS18.9

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FAIR VALUE?

- Definition (IAS18)

Amount for which an asset could be exchanged, or a liability settled between....

- Knowledgeable,
- Willing parties
- In an arms length transaction

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IFRS 13 DEFINITION

- The **price** that would be
- received to **sell an asset** or
- paid to **transfer a liability** in
- an **orderly transaction**
- between **market participants**
- at the **measurement date**.

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HOW MUCH:

Fair value of consideration received / receivable

Some key aspects to consider:

- Deduct trade, settlement discount and volume rebates
- Present value: extended credit terms
- Barter transactions
- Service component in revenue
- Customer loyalty component in revenue

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FAIR VALUE CONSIDERATIONS

- Net of discounts & volume rebates (IAS18.10)

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FAIR VALUE CONSIDERATIONS

- If financing transaction (ie. Deferred payment terms / interest free credit):
  - Discount revenue!

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EG. DISCOUNT REVENUE

Question

- Sales price = 100 000 (excluding VAT)
- Payment due in 6 months
- Fair discount rate (before tax) = 12 % per annum
  - (assume compounding every 6 months)

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Solution

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DISCOUNT RATE...

Ias18.11 ....

The imputed rate of interest is the more clearly determinable of either:

(a) the prevailing rate for a *similar instrument* of an issuer with a *similar credit rating*; or

(b) a rate of interest that *discounts* the *nominal amount* of the instrument to the *current cash sales price* of the goods or services.

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BARTER TRANSACTIONS

(IAS18.12)

- G/S exchanged for G/S *similar* nature
  – *no revenue* recognition.

- G/S exchanged for *dissimilar* G/S
  – revenue recognition
  – @ fair value of consideration received / receivable.

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IAS 18 Revenue – Class Example

DISCOUNTING OF REVENUE

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Discounting Revenue – Example

- A entered into a sales agreement with C on 1 January 2012
- Terms of the agreement were as follows:
  - Full legal title to the goods would be transferred to C on 1 January 2012
  - Sales price would be settled by a once-off payment of CU855,000 on 30 September 2012 (this includes sales tax / VAT of 14%)
- Majority of A's sales are C.O.D. (cash on delivery)
- Before-tax discount rate for a similar instrument of an issuer with a similar credit rating is 12% nominal annual compounded monthly
- A's reporting date is 30 June

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Discounting Revenue– Solution

- 1 January 2012

  – *Revenue is the fair value of amount receivable i.e. the present value of future cash flows*

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Discounting Revenue– Solution

- 30 June 2012

  - *Finance income earned from transaction date to reporting date*

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IAS 18 Revenue – Class Example

BARTER TRANSACTIONS

SIMPLE EXCHANGE OF DISSIMILAR ITEMS

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Barter transaction – Example 1

- On 29 June 2012 A entered into an exchange transaction with C, a second-hand vehicle retailer
- A agreed to supply an accounting package to C in exchange for two second-hand motor vehicles
- Carrying amount (at cost in terms of IAS 2) and normal selling price of the accounting package was CU300,000 and CU450,000 respectively
- Normal selling price of each vehicle was CU250,000 per vehicle
- Each vehicle cost C an amount of CU205,000
- Ignore VAT or sales tax
- Journalise the transaction for A

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Barter Transaction – Solution 1

Revenue must be measured at the fair value of the goods/services received

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Barter Transaction – Solution 1 cont.

Cost of accounting system excluding VAT

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IAS 18 Revenue – Class Example

BARTER TRANSACTIONS

EXCHANGE OF SIMILAR ITEMS

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Barter Transaction - Example 2

- Chickeroo is an agricultural company specialising in poultry products
- In May 2012 Chickeroo experienced an egg shortage at its KwaZulu Natal production facility
  - Its Cape production facility achieved record egg production numbers
- On 10 May 2012 Chickeroo entered into an agreement with Poul-tru, a competitor
  - Chickeroo gave 2,400 of its Cape eggs to Poul-tru in exchange for 2,400 of Poul-tru's eggs produced in KwaZulu Natal

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Barter Transaction - Example 2 cont.

- Eggs were of the same grade and quality
- Chickeroo's eggs cost CU1.00/egg with a selling price of CU1.50/egg
- Poul-tru's eggs cost CU1.15 with a selling price of CU1.60/egg
- Ignore Value Added Tax or Sales Tax

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Barter Transaction - Solution 2 (a): Should Chickeroo recognise revenue for this transaction?

1. Yes
2. No

Answer:

____

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Barter Transaction - Solution 2 (b): What entry should Chickeroo recognise regarding inventory?

- 10 May 2012

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IAS 18 Revenue

RECOGNITION OF REVENUE

SUMMARY AND COMPONENT APPROACH

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Recognition criteria – ***WHEN*** to recognise?

Framework: Inflow of FEB probable & Amounts measured reliably +

Sale of goods

1. Risks & rewards of ownership passes;
2. Continuing managerial involvement / effective control ceases
3. FEB are probable
4. Revenue measured reliably
5. Costs measured reliably

Rendering of services

Can the outcome of the transaction be reliably estimated?

YES = Stage of completion

The outcome can be estimated reliably when:

1. The stage of completion can be measured reliably
2. FEB are probable
3. The amount of revenue can be measured reliably

The costs incurred (and to be incurred) can be measured reliably

No = limited to expenses recognised that are recoverable

Use by others of entities assets

1. FEB are probable
2. Amount of revenue can be measured reliably

Interest:

Effective interest rate method

Dividends:

Shareholders right to receive payment is established

Royalties:

Accrual basis in line with the substance of the agreement

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Components of Revenue

- Identification of different components is essential!
- Sale of goods / services / interest
- Refer to IAS 18.13.

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IAS18 par 13 (Components)

- The recognition criteria in this Standard are usually applied separately to each transaction.
- However, in certain circumstances, it is necessary to apply the recognition criteria to the separately identifiable components of a single transaction in order to reflect the substance of the transaction.

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IAS18 par 13 (Components) (Cont.)

For example, when the selling price of a product includes an identifiable amount for subsequent servicing, that amount is deferred and recognised as revenue over the period during which the service is performed.

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IAS 18 Revenue – Class Example

REVENUE RECOGNITION
COMPONENT APPROACH

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Components of revenue - Example

Question

- You sell a motor vehicle for CU100,000 (Excluding VAT and sales tax)
- The sales contract includes a 3 year motor plan that covers all maintenance and services.
- The value of the motor plan if sold separately is estimated to be CU30,000
- Assume VAT (sales tax) is charged at 14%

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Components of revenue - Solution

- At sales date:

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Components of revenue – Solution Cont.

- At reporting date 1 – assume full 12 months from transaction date:

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IAS 18 Revenue

RECOGNITION OF REVENUE INTEREST / DIVIDEND / ROYALTIES

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INTEREST / DIVIDEND / ROYALTIES

Above mentioned should be recognised WHEN (refer to par 29)**:**

- Probable that **economic benefits** associated with the transaction will flow to enterprise.
- Amount of revenue can be measured reliably.

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INTEREST / DIVIDEND / ROYALTIES

- **Interest** – time proportion basis that takes the effective yield into account.

- **Royalties** *(charges for the use of long term assets (usually intangible) of the entity, for example patents, trademarks, copyrights)* – accrual basis in accordance with the substance of the agreement.

- **Dividends** – when shareholders' right to receive payment is established.

  (Final = last day to register / Interim = when paid)

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IAS 18 Revenue – Class Example

REVENUE RECOGNITION

INTEREST INCOME USING EFFECTIVE INTEREST RATE METHOD

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Interest Revenue - Example

Question

- You sell land for a value of CU100,000
- Assume the selling price = carrying amount
- The repayment terms will result in a receipt of CU130,000 in 3 years
  - That is, a 30,000 interest component will be implied over three years

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Interest Revenue - Solution

- Time value of money calculation

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Interest Revenue – Solution Journals – year 1

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SOLUTION – YEAR 2 JOURNALS

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SOLUTION – YEAR 3 JOURNALS

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IAS 18 Revenue – Class Example

REVENUE MEASUREMENT

TRADE AND CASH DISCOUNTS

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Trade & cash discounts - example

- A Ltd sells goods with a selling price (ignore VAT) of CU100 000 to X Ltd
- X Ltd is a large customer and is granted a 25% trade discount by A Ltd
- A Ltd has a policy to give all clients a 5% cash discounts on net sales if clients pay for sales C.O.D (cash on delivery)

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Trade & cash discounts - solution

What is the amount that A Ltd will recognise as revenue if X Ltd settles the transaction with cash on delivery date?

a. 100 000
b. 71 250
c. 75 000
d. 95 000

Answer:________________________________

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IAS 18 Revenue – Class Example

REVENUE MEASUREMENT

SETTLEMENT DISCOUNTS

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Settlement Discounts - Example

- A Ltd had sales of CU100 000 on 31 December 2014, all of which were on credit.
- On 31 December 2014 it is expected that 60% of these debtors will settle early and qualify for a 10% settlement discount (i.e. settled within 30 days).
- During January 2015, 60% of the debtors settle within 30 days as expected. The remaining debtors settle during February 2015.
- Assume that time value of money effect is immaterial and ignore VAT.

Required:

1. Calculate the revenue recorded in December in P/L
2. Journalise the complete transaction

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Solution – required 1

- The amount of revenue to recognise in December 2014 equals:
  a. 100 000
  b. 94 000
  c. 90 000

Solution:_________________________

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Solution – required 2

Journal – December 2014 initial recognition

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Solution – required 2 cont.

Journal – January 2015 early settlement receipt

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Solution – required 2 cont.

Journal – February 2015 early settlement receipt

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IAS 18 Revenue – Class Example

REVENUE MEASUREMENT

SETTLEMENT DISCOUNTS WITH CHANGE IN ESTIMATE

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Settlement Discounts with change in estimate - Example

- A Ltd had sales of CU100 000 on 31 December 2014, all of which were on credit.
- On 31 December 2014 it is expected that 60% of these debtors will settle early and qualify for a 10% settlement discount (i.e. settled within 30 days).
- During January 2015, 40% of the debtors actually settle within 30 days and not the 60% expected. The remaining 60% debtors settle during February 2015.
- Assume that time value of money effect is immaterial and ignore VAT.

Required:

1. Calculate the revenue recorded in December in P/L
2. Journalise the complete transaction

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Solution – required 1

- The amount of revenue to recognise in December 2014 equals:
  a. 100 000
  b. 94 000
  c. 90 000
  d. 96 000

Solution:____________________________

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Solution – required 2

Journal – December 2014 initial recognition

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Solution – required 2 cont.

Journal – January 2015 change in estimate

Journal – January 2015 early settlement receipt (40%)

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Solution – required 2 cont.

Journal – February 2015 settlement receipt

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IAS 18 Revenue

APPROACH TO DEALING WITH REVENUE TRANSACTIONS

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PROBLEM SOLVING APPROACH

1. Identify the substance of the transaction
   - Identify the different components / types of revenue
   - If any part of the transaction is not at fair value
     - This could indicate different components of revenue
     - Most common is a financing element (i.e. discounting required = interest income)

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PROBLEM SOLVING APPROACH

2. Consider recognition criteria for all components of revenue

- Sale of Goods = 5 recognition criteria
- Services rendered = outcome of contract?
- Interest = Time apportioned basis
- Dividend = right to receive payment
- Royalties = accrual basis (per agreement)

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PROBLEM SOLVING APPROACH

3. Measurement

- Fair value of consideration received or receivable
- Discounting for financing component
- Barter transaction
- Not at fair value? – look out for missing components / types of revenue

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IAS 18 Revenue

DISCLOSURE

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DISCLOSURE (IAS18.35-36)

Par 35. 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.

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DISCLOSURE (IAS18.35-36) (Cont.)

36. 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.

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Disclosures (illustrative)

1. <u>Accounting policies</u> *(illustrative only)*

- Revenue from the sale of goods consists of wholesale and retail sales to customers, excluding value added tax and agency commissions.
- Revenue from the rendering of services represents the value of work performed to date.
- Royalty revenue is recognised on the accrual basis according to the underlying royalty agreement.

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Disclosures (illustrative)

2. Revenue (or within the profit before tax note)

Revenue comprises the following components:

	2013	*2012*
Sale of Goods	RXXX	RXXX
Services Rendered	RXXX	RXXX
Royalties	RXXX	RXXX
Total revenue	RXXX	RXXX

Included in the revenue from sale of goods is an amount of RXXX that arose from the exchange of goods for building repairs. This exchange was of dissimilar goods and services and therefore resulted in the recognition of revenue.

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IAS 18 Revenue

ILLUSTRATIVE EXAMPLES
SALE OF GOODS

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ILLUSTRATIVE EXAMPLES

- Accompanies, but not part of IAS 18
- Found in book B as Illustrative Examples (IE)
- Previously contained in an appendix
- Gives more detailed guidance to revenue transactions

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BILL AND HOLD SALES

- Bill and hold sales:
  - delivery is delayed at buyer's request, but
  - buyer takes title and accepts billing
- Revenue is recognised provided:
  - it's probable that delivery will be made;
  - item is on hand and ready for delivery;
  - buyer acknowledges the deferred delivery instructions;
  - usual payment terms apply

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GOODS SHIPPED SUBJECT TO CONDITIONS

- Installation and inspection
- Revenue is recognised when buyer accepts delivery and when delivery and inspection are complete.
- HOWEVER, revenue is immediately recognised when:
  - installation process is simple;
  - inspection is performed only for final determination of contract prices (sugar, iron, soya etc).

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LAY AWAY SALES

- Lay away = the goods are delivered only when the buyer makes the final payment in a series of installments
- Revenue recognised when goods are delivered, however
- If experience indicates that most such sales are consummated, revenue may be recognised when:
  - significant deposit is received;
  - provided the goods are on hand, identified and ready to deliver.

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OTHER SOG

- Buyer has negotiated a limited right of return & uncertainty about possibility of return of goods:
- Recognise revenue when:
  - shipment has formally been accepted by the buyer; or
  - the goods have been delivered and the time period for rejection has elapsed.

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OTHER SOG

- Consignment sales = buyer sells goods on behalf of seller.
  - Revenue is recognised by seller when goods are sold by buyer to 3rd party.

- COD's (Cash on Delivery)
  - Revenue recognised when goods are delivered and cash is received.

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IAS 18 Revenue

ILLUSTRATIVE EXAMPLES
SERVICES RENDERED

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OTHER - SERVICES

- Subscriptions to publications
  - straight-line basis over the period in which the items are dispatched.

- Real estate sales
  - when legal title passes to the buyer
  - property may vest in the buyer before legal title passes and therefore the risks and rewards of ownership have been transferred at that stage. In such cases, provided that the seller has no further substantial acts to complete under the contract, it may be appropriate to recognise revenue.

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OTHER - SERVICES

- Advertising commissions:
  - Revenue recognised when the advertisement appears before the public.

- Insurance agency commissions:
  - do not require the agent to render further service - recognised as revenue on the effective commencement or renewal dates of the related policies.
  - further services are required by the agent during life of policy, the commission - deferred and recognised over the period which the policy is on force.

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OTHER - SERVICES

- Admission fees
  - Revenue is recognised when the event takes place.

- Tuition fees
  - Revenue is recognised over the period of tuition

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OTHER – SERVICES
FRANCHISE FEES

- Supply of equipment and other tangible assets:
  - The amount, based on fair value is recognised when items are delivered or title passes.
- Supply of initial and subsequent services:
  - Fees for the provision of continuing services whether part of the initial fee or a separate fee are recognised as revenue as the services are rendered.

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OTHER – SERVICES FRANCHISE FEES (Cont.)

- Initial fee collectable over an extended period + there is uncertainty that it will be collected in full:
  - the fee is recognised as cash installments are received.
- Continuing franchise fees
  - recognised as revenue as the services are provided or the rights used.

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IAS 18 Revenue – Class Example

REVENUE RECOGNITION
SALE OF GOODS WITH INSTALLATION AND TESTING

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Installation and testing – Example

- In May 2014 A Ltd entered into an agreement to develop and install an accounting information system for a client
  - CU1,050,000 was paid on 15 May 2014 including Value Added Tax of 14%
- Installation and testing (a significant part of the contract) were completed on 27 June 2014
- Included in selling price was a full maintenance plan whereby A Ltd agreed to perform monthly maintenance for a period of 2 years after the date of installation
- Such maintenance would normally be charged for separately at CU3,000 per month (excluding VAT)

Required:

1. Journalise the transaction on 15 May 2014
2. Complete the journal on 27 June 2014

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Installation and testing – Solution What entry should A recognise?

- 15 May 2014

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Installation and testing – Solution What entry should A recognise?

- 27 June 2014

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IAS 18 Revenue – Class Example

REVENUE RECOGNITION

GOODS SHIPPED SUBJECT TO CONDITIONS

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Goods shipped subject to conditions - Example

- A Ltd entered into a sales agreement on 6 April 2014 with E Ltd whereby E Ltd would purchase hardware and software for CU650,000
- Agreement was subject to E Ltd obtaining a government tender for the collection of municipal debts
- At 30 June 2014 the tender process was still in progress and the tender had not yet been awarded
- A Ltd's reporting date is 30 June 2014

Required

How much revenue should be recognised in the 2014 reporting period

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Goods shipped subject to conditions - Solution

- 30 June 2014 – revenue recognition

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IAS 18 Revenue – Class Example

REVENUE RECOGNITION

LAY AWAY (LAY-BY) SALES

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Lay away sales - Example

- A Ltd sells a bike for CU3,000 to a customer on a lay away (lay-by) sale (ignore VAT) on 1 January.
- The agreement is that the customer pay three monthly instalments of CU1,000 each.
- The customer will not take delivery until the final instalment is made.
- A Ltd has a long history of lay away sales being consumated successfully.

Required:

Prepare the journals for the following two scenarios:

1. A Ltd will order the bike from its supplier just in time to deliver upon receipt of the third and final instalment from the customer.
2. A Ltd has the bike in stock, and will put aside one of the bikes in stock specifically for the customer.

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Lay Away – Solution 1

- 1 January

- 31 January

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Lay Away – Solution 1 (cont.)

- 28 February

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Lay Away – Solution 1 (cont.)

- 31 March

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Example Refresher for Solution 2

- A Ltd sells a bike for CU3,000 to a customer on a lay away (lay-by) sale (ignore VAT) on 1 January.
- The agreement is that the customer pay three monthly instalments of CU1,000 each.
- The customer will not take delivery until the final instalment is made.
- A Ltd has a long history of lay away sales being consumated successfully.

Required:

Prepare the journals for the following two scenarios:

2. A Ltd has the bike in stock, and will put aside one of the bikes in stock specifically for the customer.

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Lay Away – Solution 2

- 1 January

- 31 January

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Lay Away – Solution 2 (cont.)

- 28 February

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Lay Away – Solution 2 (cont.)

- 31 March