REVENUE RECOGNITION (AS - 9)

1. **Mean** gross inflow of consideration arising in the course of ordinary activities, such as:
   - **a.** Sale of goods.
   - **b.** Rendering the services.
   - **c.** Use of the enterprises resources by others giving interest, dividend and royalties.

2. **[illegible]**
   - **a. Revenue is recognised:**
     - **i.** When sale is completed. (Refer to next point)
     - **ii.** When certainty exists regarding amount of consideration.
     - **iii.** When certainty exists regarding collection of consideration.
   - **b. Sale is completed, if:**
     - **i.** The ownership in goods is transferred for a price Or
     - **ii.** All significant risks & rewards have been transferred and no effective control is retained.

3. **[illegible]**
   - **a. Completed service method (CSM):**
     - **i.** To be recognised only when rendering of services is fully or substantially completed.
     - **ii.** More than one act is involved, revenue to be recognised on execution of all those acts.
   - **b. Proportionate completion method (PCM):** Recognise revenue proportionately with the degree of completion of services. (Similar to AS -7)
   - **c. Revenue on rendering of services is recognised:**
     - **i.** Either under CSM Or PCM.
     - **ii.** Only when certainty exists regarding amount of consideration.
     - **iii.** Only when certainty exists regarding collection of consideration.

4. **[illegible]**
   - **a.** Revenue from sale or rendering services should be recognised at the time of the sale or rendering services.
   - **b.** However, if at the time of sale or rendering services there is significant uncertainty in collection of the revenue, then the revenue recognition is to be postponed.
   - **c.** In such cases it will be recognised only when it becomes certain that collection will be made.

5. **[illegible] Bill** Revenue should be recognised.

6. **[illegible] to conditio**
   - **a. Installation:** Revenue to be recognised when goods are installed and accepted by the buyer.
   - **b. Sale on approval:** When buyer confirms his desire to buy the goods.
   - **c. Warranty Sales/Money back sales:** Recognise revenue immediately but a provision for warranties/returns to be made.
   - **d. Consignment sales:** Revenue to be recognised only when the goods are sold by consignee.
   - **e. Subscriptions for publication:** If publications to be delivered vary in value from period to period revenue should be recognised on the basis of sales value of items to be delivered. If not, revenue should be recognised on straight-line basis over the time.

7. **R[illegible] to condit**

a. **Installation fees:** To be recognised when the installation has been completed and accepted.

b. **Advertising commission:** To be recognised when the advertisement appears before public.

c. **Insurance agency commission:** To be recognised on commencement of the policies.

d. **Financial services commission (For arranging loans etc.):** To be recognised when a loan is accepted by borrower.

e. **Tuition fees:** To be recognised over the period of tuition.

f. **Entrance and Membership Fees:** Entrance fees is generally capitalised and membership fees should be recognised over the time of service provided.

8. **R[illegible] from** On time proportion basis.

9. **R[illegible] from** On accrual basis.

10. **R[illegible]enue from Di** When dividend is declared.

11. **[illegible]** (Like travel agents, commission agents), the revenue is commission and not the gross inflow (Sales revenue).

12. **[illegible]ation:** When uncertainty of collection arises after the revenue is recognised, it is better to make provision rather to adjust the already recognised revenue.

13. **[illegible] brie**

a. Consideration not measurable - Postpone recognition.

b. Collectibility is uncertain now - Postpone recognition.

c. Uncertainty arises later - make a provision (do not adjust revenue)

ILLUSTRATIO

Q.No. The management decided on 31.03.2007 to increase the sale price retrospectively from 1.1.07. As a result, company has to receive Rs.25 lakhs in respect of sales made from 1.1.07 to 31.3.07 and the accountant want's to recognise this revenue for the year ending 2006-2007. Suggest.

Ans: AS-9 states that where there is uncertainty about the collection of any claim/revenue, it's recognition is to be postponed. It is to be considered as revenue of the period in which it's collection becomes certain or it is actually collected. How ever, if the company is certain about the ultimate collection, then additional revenue arising out of the price revision may be recognised in 2006-2007.

Q.No. Advice to Jindal Ltd. about the treatment for the year ended on 31st March, 2007. A claim lodged with the Railways in March 2004 for loss of goods of Rs.2,00,000 had been passed for payment in March 2007 for Rs.1,50,000. No entry was passed, when the claim was lodged (2004).

Ans: AS-9 states that where there is uncertainty about the collection of any claim, revenue recognition is to be postponed. It is to be considered as revenue of the period in which it's collection becomes certain or it is actually collected. In this case it may be assumed that collectability of claim was not certain in the earlier periods. This is supported by the fact that only Rs.1,50,000 were collected against a claim of Rs.2,00,000. Therefore the recognisation of revenue in current year is to be made.

Q.No. Sales include Rs.200 lakhs representing royalty receivable for supply of know-how to a company in Iraq. As per agreement the amount is to be received in US Dollars. However, permission was denied to the company in Iraq for remitting the same.

Ans: AS-9 states that where there is uncertainty about the collection of any claim/revenue, it's recognition is to be postponed. It is to be considered as revenue of the period in which it's collection becomes certain or it is actually collected. Here the revenue was already recognised. When the uncertainty arises subsequent to the recognisation, it is more appropriate to make a separate provision rather than to adjust the amount of revenue already recognised.

Q.No.4: HLL Ltd. receives orders all over the country, the documents including transport bills are sent through the bank for collection. At the end of current year, it is found that documents covering the dispatch of goods worth Rs.1 crore were still lying with the banks not cleared by the customers though normal collection period of 20 days has expired. Should revenue be recognised?

Ans: According to AS-9, revenue can be recognised if the sale is completed & there is a certainty about the collection of revenue. Since the documents were not cleared by the customer even after the expiry of the normal period of collection, there is an uncertainty in respect of collection. Hence, revenue should not be recognised in this case. It is to be considered as revenue of the period in which it's collection becomes certain or it is actually collected.

Q.No.5: Sale of goods costing Rs.54,000 with a profit margin of 10% on cost is included in the inventory as delivery of goods was postponed at buyer's request.

Ans: Though the delivery was postponed at buyer's request, revenue should be recognised i.e. mere postponement of delivery at buyer's request does not alter the period in which revenue should be recognised. Thus, Rs.54,000 should be excluded from inventory, and the amount of Rs.59,400 should be included in sales with corresponding increase in Debtor's balances.

Q.No.6: MUL Ltd. entered into a contract with H Ltd. to dispatch goods valuing Rs.1 lakh every month for six months upon receipt of entire payment. H Ltd. accordingly made the payment. In 3rd month due to a natural calamity H Ltd. requested MUL Ltd. not to dispatch until further notice. MUL Ltd. accounted Rs.2 lakhs as sales and transferred the balance to advance receipt against sales.

Ans: Though the delivery was postponed at buyer's request, revenue should be recognised i.e. mere postponement of delivery at buyer's request does not alter the period in which revenue should be recognised. MUL Ltd. should recognise Rs.6,00,000 as sales and pass necessary corrective entries.

Q.No.7: A Ltd. sells "muscle-flexer on money-back if not fully satisfied" basis. Under the scheme, the customer has an option to return the item within 30 days. The company follows a policy of not recognising sales whose return period has not expired on the balance sheet date. Comment.

Ans: The Company's policy is not in accordance with AS-9. The Company should recognise fully revenue on such sales and make provision for returns based on past experience.

Q.No.8: The Pakistan Ltd. has recognised Rs.7.5 lakhs on accrual basis income from dividend on shares held by it as at 31st March, 2007. The dividends on the shares were declared at the rate of 15% on 15th June, 2007. Whether the treatment is correct?

Ans: As per AS-9 dividend is recognised in the books of investor when the right to receive is established, in this case it is 15.06.2007 and therefore the dividend income should be recognised by Pakistan Ltd. during the year 2007-2008. Treatment followed by company is incorrect.

Q.No.9: Congress Ltd. used certain resources of NDA Ltd. In return NDA Ltd. received Rs.10 lakhs and Rs.15 lakhs as interest and royalties respectively from Congress Ltd. during the year 2006-07. You are required to state whether and on what basis these revenues can be recognised by NDA Ltd.

Ans: As per AS-9 theses revenues should only be recognised when no significant uncertainty as to its measurability or collectability exists. These revenues are recognized on following bases:

a. **Interest:** On a time proportion basis based on the amount outstanding at the rate applicable.
b. **Royalties:** On an accrual basis in accordance with the terms of the relevant agreement.

Q.No.10: The NDA Ltd. has recognized Rs.75 lakhs on accrual basis income from dividend on securities and units of mutual funds of face value of Rs.50 lakhs held by it as at the end of the financial year 31st March, 2001. The dividends on the securities and mutual funds were declared at the rate of 15% on 15th June, 2001. The dividend was proposed on 10-4-2001 by the declaring company. Whether the treatment is as per the relevant accounting standard?

Ans: No, the treatment is not as per accounting standard-9. As per AS – 9 dividend is recognized in the books of investor when the right to receive is established. In this case right to receive is established on 15-6-2001, hence dividend is deemed to be accured on 15-6-2001and, therefore, the dividend income should be recognized by NDA Ltd. during the year 2001-02.

Q.No.11: Media advertising obtained advertisement right for one day world cup cricket tournament to be held in May/June 2002 for Rs. 250lakhs.

By 31st March, 2002, they paid Rs.150 lakhs to secure these advertisement rights. The balance Rs.100 lakhs was paid in April 2002.

By 31st March, 2002, they processed advertisement for 70% of the available time for Rs.350 lakhs. The advertiser paid 60% of amount by that date. The balance 40% was received in April 2002.

The advertisement for balance 30% time was procured in April 2002 for Rs.150 lakhs.

The advertiser paid the full amount while booking the advertisement. 25% of the advertisement time is expected to be available in May 2002 and balance 75% in June 2002.

Calculate the profit/ loss for the month of April, May, June 2002.

Ans: As per AS – 9. In a transaction involving the rendering of services, performance should be measured either under the completed service contract method or under the proportionate completion method, whichever relates the revenue to the work accomplished. Such performance should be regarded as being achieved when no significant uncertainty exists regarding the amount of the consideration that will be derived from rendering the service. Further, appendix to AS – 9 states that revenue from advertising should be recognized when the service is completed. In this case the service as regards advertisement is deemed to be completed when the related advertisement appears before the public.

As the 25% of the advertisement appeared in May 2002 and 75% in June 2002, therefore the revenue with 250 lakhs [i.e. (350 +150) – (150 + 100)], should be apportioned in 25% and 75% ratio which will be 62.5 lakhs in May 2002 and 187.5 in June 2002.

Q.No.12: A company is engaged in the business of Ship building and Ship repair. On completion of the repair work, a work completion certificate is prepared and countersigned by ship owner (customer). Subsequently, invoice is prepared based on the work completion certificate describing the nature of work done together with the rate and the amount. Customer scrutinizes the invoice and any variation is informed to company. Negotations take place between the company and customer. The negotiations may result in a deduction being allowed from the invoiced amount either as a lump sum or as a percentage of the invoiced amount. The accounting treatment followed by the company is as follows:

a. When the invoice is raised, the customer's account is debited and repair income account is credited with the invoiced amount.

b. Deduction, if any, arrived after negotiation is treated as trade discount by debiting the ship repair income account.

c. At the close of the year, negotiation in respect of certain invoices has not been completed. In such cases, based on the past experience, a provision for anticipated loss is created by debiting the profit and loss account. The provision is disclosed in Balance Sheet.

Following two aspects are settled in the negotiations:

a. Errors in billing arising on account of variation between the quantities as per work completion certificate and the invoice and other clerical error in preparing the invoice.

b. Disagreement between the company and customer about the rate/cost on which prior agreement has not been reached between them.

Comment:

i. Whether accounting treatment of deduction as trade discount is correct? If not, give the correct Accounting treatment.

ii. Whether the disclosure of the provision for anticipated loss in balance sheet is correct? If not, give the correct accounting treatments.

Ans:

a. As per AS – 9 recognition of revenue when the invoice is raised to the customers is almost correct, however the treatment of deduction as trade discount is not as per AS -9. Considering the treatment provided by AS -4; the correct treatment of the difference between the invoice amount and finally settled amount should be as under.

The adjustment of the difference between the invoiced amount and the amount finally settled against 'Ship Repair Income' account is in order. Events occurring up to the date of approval of the accounts by the board of directors should be taken into consideration determining the amount of the adjustment to be made in this regard. The description of the difference as "trade discount" is not appropriate.

b. In respect of ship repair jobs for which negotiation between the ship owners and the company are not over, the accounting treatment is not appropriate. Instead, the amount of difference between the invoiced amount and the amount likely to be finally settled (as estimated on the basis of past experience) should be adjusted in the 'ship repair income' by a corresponding credit to the accounts of the respective ship owners. Consequently, the amount of the sundry debtors included in the balance sheet would be net of adjustment for such difference. In other words, the amount of the difference would be neither shown under the head 'provisions' nor shown as a deduction from the sundry debtors in the balance sheet.

Q.No.13: NDA Limited entered into an agreement with Induga Limited for sale of goods costing Rs.4 lakhs at a profit of 20% on cost. The sale transaction took place on 15th February, 2004. On the same day NDA Limited entered into another agreement with Induga Limited for repurchasing the same goods at Rs.5.40 lakhs on 15th August, 2004. State the treatment of above transaction in the financial statements of NDA Limited for the year 2003-04. The pre-determined repurchase price covers, inter alia, the holding cost of Induga Limited. Give the journal entries in both the parties books.

Ans: In this case NDA Limited concurrently agrees to repurchase the same goods from Induga Limited at a later date. Also, the repurchase price is pre-determined and covers Induga Limited purchasing and holding costs. Hence, the transaction between NDA Limited and Induga Limited on 15th February, 2004 should be accounted for as financing transaction rather than as sale. The resulting cash inflow of Rs.4.80 lakhs is not revenue as per AS-9.

Journal entries in the books of NDA Limited

15 – 2 – 2004	Bank A/c	Dr. Rs.4.80 lakhs	
	To Advance from Induga Limited A/c		Rs.4.80 lakhs
	(Being amount received from Induga Ltd. as per sale and repurchasing agreement.)		
31-3-2004	Financing Charges A/c	Dr. Rs.15,000	
	To Advance from Induga Ltd. A/c		Rs.15,000
	(Financing charges Rs.4.80 lakhs for 1.5 months i.e. Rs.60,000 x 1.5/6)		
31-3-2004	Profit and loss A/c	Dr. Rs.15,000	
	To Financing Charges A/c		Rs.15,000
	(Being amount transferred to profit and loss account)		

A. Disclosure in the Balance Sheet:

1. Balance Sheet of NDA Limited as on 31-3-2004 (Extract)

Asset (under the head 'Current Assets, Loans and Advances'):

Goods lying with Induga Limited (Under sale and repurchase agreement)	Rs.4.00 lakhs
Liabilities (under the head 'Secured Loans'):	
Advance from Induga Limited	Rs.4.80 lakhs
Add: Accrued finance charges	Rs.0.15 lakhs
	Rs. 4.95 lakhs

2. Notes to accounts:

a. Goods lying with Induga Limited costing Rs.4 lakhs to be repurchased after 6 months at Rs.5.40 lakhs.

b. Goods sold to Induga Limited for Rs.4.80 lakhs (cost Rs.4 lakhs) on repurchase agreement. The difference between sales price and repurchase price is treated as financing charges and allocated proportionately in the current accounting period.

Journal entries in the Books of Induga Limited

15-2-2004	Advance to NDA Ltd. A/c Dr.	Rs. 4.80 lakhs	
	To Bank A/c		Rs.4.80 lakhs
	(Being amount paid to NDA Ltd. as per sale and repurchase agreement)		
31-3-2004	Accrued Finance income A/c Dr.	Rs. 0.15 lakhs	
	To Finance income A/c		Rs.0.15 lakhs
	(Financing charges on Rs.2,40,000 for 1.5 months i.e. 16,000 x 1..5/6)		
31-3-2004	Financing income A/c Dr.	Rs. 0.15 lakhs	
	To Profit and loss A/c		Rs.0.15 lakhs
	(Being financing charges received transferred to profit and loss account)		

B. Disclosure in the Balance Sheet

1. Balance sheet of Induga Ltd. as on 31-3-2004 (Extract)

Assets (under the head 'Current Assets, Loans and Advances'):

Advance to NDA Ltd. (under sale and repurchase agreement)	Rs. 4.80 lakhs
Accrued Finance income	Rs. 0.15 lakhs

(This advance is fully secured by goods of NDA Ltd. market value of Rs.4.80 lakhs lying with the company as security)

2. Notes to Account: Rs. 4.80 lakhs paid to NDA Limited against the sale and repurchase agreement against the security of goods of NDA Limited whose market value is Rs.4.80 lakhs.

Q.No.14: Comment on the following:

a. Sales are recognised as soon as an order is received.

b. Inter-divisional transfers are recorded as sales.

c. Sales of T .V. made subject to installation of antenna is recognised as soon as the goods are despatched from the shop.

d. Advertising commission is recognised as soon as an advertisement is booked.

e. Insurance claim lodged with railways are recognised as soon as the claim is filed.

Ans:

a. Accounting policy followed is not correct. Sales should be recognised only when risk and rewards of ownership are transferred to the buyer.

b. Inter-division sales are not revenue and should not be recognised in the revenue statement.

c. The revenue should normally be booked as soon as goods are despatched from the shop. However, if the acceptance of T.V. sets depends on the acceptance by the customers on its installation then revenue should be recognised only when the antenna is installed and accepted by the customers.

d. Advertisement commission should be recognised only when the advertisement appears before the public and not when the advertisement is booked.

e. Insurance claim should be recognised only when it is measurable and it is certain that the amount will be received.

Q.No.15: XYZ Ltd. decided on 31.12.04 to increase the selling price of its goods by 20% with effect from 1.10.04. The company had already intimated to customers that the increase could be implemented retrospectively. Sales made during the quarter, October to Decembers amounted to Rs. 10,00,000. The company wants to take the revenue of Rs. 2,00,000 resulting from the increase as recognised for the year 2004. Comment. What would be the position, if the increase was arbitrary on the part of the company and the customers were not intimated before hand?

Ans: As the intention of the company was made known to the customers at the time of sale it appears that the revenue of the Rs. 2,00,000 can be recovered from the customers. Therefore, it can be recognised as the revenue. However if the decision to increase the price was arbitrary on the part of the company it appears that the customers may not pay the increased amount with retrospective effect. Therefore the company should not recognise Rs. 2,00,000. The revenue will be recognised as and when the amount will be received from the customers.

Q.No.16: ABC Ltd. has paid a royalty amount of Rs. 5,00,000 to for Ltd. for using a technical know- how received from the latter. How this amount be recognised by PQR Ltd.?

Ans: As per AS - 9 royalty income should be recognised in accordance with the terms of the relevant royalty agreement. In case of PQR Ltd, the royalty income of Rs. 5,00,000 should be recognised over the period when the technical know- how is used by ABC Ltd.

Q.No.17: R Ltd. has 1000 shares of S Ltd. as on 31.3.04. On 14.4.04, S Ltd. declare a dividend of Rs. 3 per share for the year 2003-04. R Ltd. wants to recognise this dividend income of Rs.3000 in the financial statement, for the year 2003-04, as the dividend had been declared before the preparation of balance sheet. Advise.

Ans: Dividend income should not be recognised for the year 2003-04. As per AS-4; the dividend income should be recognised only when right to receive dividend is established. As the dividend was declared on 14-4-2004 the right to receive dividend was established in the year 2004-05. Therefore it should be recognise in the year 2004-05.

Q.No.18: X Ltd. received an amount of Rs. 2,00,000 towards after sales service, contract under which the services are to be provided during next years. It is expected that X Ltd. would incur a cost of Rs. 20,000, Rs. 40,000 and Rs. 40,000 on providing services during 3 years respectively. Find out the amount to be recognised by X Ltd.

Ans: X Ltd. should not recognise the entire amount of Rs. 2 lakhs in the 1st year. Rather, it should be recognised over a period of 3 years in the ratio of the cost incurred in providing the services i.e. in the ratio of 2:4:4. Thus, it should recognised Rs. 40,000, 80,000 and 80,000 in the 1st, 2nd and 3rd year respectively.

Q.No.19: During the months of January and February, 2004 a number of exhibitions are planned by Trade Fair Authority of India, to be held at Pragati Maidan, New Delhi. The authority has sold the advertising rights for these exhibitions to ABC Ltd. for an agreed amount of Rs. 200 lots. It is expected that out of the total advertising space available, it would be 40%

and 60% over the months of January and February respectively. ABC Ltd. has sold these advertising rights to its clients as follows:

a. 80% of the total space was sold for Rs. 300 lacs during the month of November and balance 20% space was sold during December for Rs. 120 lots.

b. 70% the amount agreed was received immediately at the time of booking and the balance was payable in the first week of January, 2004.

Show the calculation of revenue to be recognised during different months given that ABC Ltd. paid the amount of Rs. 200 lots to, the authority on November 1, 2003.

Ans: As per AS-9 the revenue from advertisement should be recognised only when the service is complete. In the given case, the event is to take place in January and February 2004. ABC Ltd has received an advance of Rs. (70% x 300) 210 lakhs in the month of November and 84 lakhs (70% x 120) in the month of December. These advance received will not be recognised as revenue for the month of November and December. The revenue and cost will be recognised as follows:

Particulars	Total	January	February
Revenue	420	168	252
Cost	200	80	120
Profit	220	88	132

Q.No.20: X Ltd. is engaged in manufacture of Cement. In the Profit and Loss Account for the year ended 31st March, 2007, it discloses its revenue from sales transactions (turnover) net of excise duty. The excise duty collected and paid on sales transactions and that related to difference between Closing stock and Opening stock is, however, disclosed in the "Notes to Accounts".

Ans: By virtue of Accounting Standards-Interpretation 14, pertaining to 'Disclosure of Revenue from Sales Transactions', the amount of turnover should be disclosed in the following manner on the face of the statement of profit and loss:

Turnover (Gross)	xx
Less: Excise Duty	xx
Turnover (Net)	xx

The above method of disclosure is aimed at ensuring uniformity in the manner in which turnover is disclosed by different enterprises. Hence, X Ltd. Needs to show the Excise Duty amount on the face of the statement of profit and loss in the above manner.

Q.No.21: Victory Ltd. purchased goods on credit from Lucky Ltd. for Rs. 250 crores for export. The export order was cancelled. Victory Limited decided to sell the same goods in the local market with a price discount. Lucky Limited was requested to offer a price discount of 15%. The Chief Accountant of Lucky Ltd. wants to adjust the sales figure to the extent of the discount requested by Victory Ltd. Discuss whether this treatment is justified.

Ans: No, the treatment adopted by Lucky Ltd. is not correct. AS-9 on 'Revenue Recognition' defines 'Revenue' as the gross inflow of cash, receivables or other consideration arising in the course of the ordinary activities of an enterprise from the sale of goods, rendering of services, and the use by others of enterprise resources yielding interest, royalities and dividends. In the present case, Lucky Ltd is giving a price discount of 15% on Rs. 250 crores to Victory Ltd. A price discount cannot be netted off from the revenue. It is the gross inflow of Rs. 250 crores that Lucky Ltd. should recognize. Adjusting the sales figure with the amount of discount is not in consonance with the requirements of AS 9.

Q.No.22: Excel Ltd. is a Manufacturing Company in durable consumer goods with an annual turnover of Rs.1,000 lakhs. The Company receives orders from its commission agents all over the country, but goods are dispatched directly to the customers. The documents including Transport bills are sent through the bank for collection.

At the end of 6th year, it is found that documents covering the dispatch of goods worth Rs.100 lakhs were still lying with the banks not cleared by the customers even though the normal collection period of 20 days from the date of dispatch has expired. Should Revenue be recognised in the above case?

Ans: As 9 on 'Revenue Recognition' state that in a transaction involving sale of goods, revenue should be recognised only when the following conditions have been fulfilled:

a. The seller of goods has transferred to the buyer the property in the goods for a price or all significant risks and rewards of ownership have been transferred to the buyer and the seller retains no effective control of the goods transferred to a degree usually associated with ownership; and

b. No significant uncertainty exists regarding the amount of the consideration that will be derived from the sale of the goods.

In the instant case, these conditions can be evaluated with reference to the intention of the parties for retaining the shipping documents, any explicit term in the contract, etc. Applying these tests to the facts of the case, since the transport bills were sent through the bank for collection, it may be said that the seller has retained effective control over his ownership. However, since the documents were not cleared by the customer even after the expiry of the normal period of collection, there is an uncertainty in the realization of the sale proceeds. The amount also appears to be quire material being 10% of total turnover. Hence, revenue should not be recognised in this case.

Q.No.23: Charan Ltd. sells agricultural products to its dealers. One of the conditions of sale is that interest is payable @ 2% p.m. for delayed payment. Percentage of interest recovered is only 10% on such overdue outstanding due to various reasons. During the financial year the company wants to recognize the entire interest receivable. Do you agree with the treatment?

Ans:

a. Provisions of AS: As per AS – 9, interest shall be recognized on time proportion basis taking into account, the amount outstanding and the rate applicable.

b. Analysis: Here, the interest is incidental to the sales transaction. If at the time of raising the claim of interest, it is unreasonable to expect ultimate collection, revenue recognition should be postponed.

c. Past experience of the Company shows that only 10% of the interest overdue on outstandings is actually recovered.

d. Conclusion: Hence, the Company should not recognize the entire interest receivable. It should be recognized only on cash basis in the instant case.

Q.No.24: Sambhu Ltd. is engaged in the business of construction of roads and bridges. For the year ended 31st March, the Company has earned Rs.25 lakhs as Interest on Short – Term Deposit with their Banks. These deposits are made out of advances received from the customers towards project work yet to be done. While calculating Progress Payments at the year – end, the interest of Rs.25 lakhs earned was considered as part of the funds received for the project. Is the treatment given by ABC Ltd. with regard to the interest earned on Short – Term Deposit correct?

a. Analysis: As per AS – 9, interest earned on Short – Term Deposits cannot be treated as part of advances received/Progress Payments received for the contracts that are to be commenced only later.

b. Conclusion: The interest earned should be recognized as revenue in the year in which it is earned.

Q.No.25: Mahesh Ltd's accounting year ends on 31st March. One of its subsidiaries has declared dividend in April 2004 in respect of its accounting year ending 30th November 2003. The Company concerned is to receive a dividend of Rs.10,000. The audit of the Holding Company for the year ended 31st March 2004 is in progress. Do you think that the dividend can be accounted for by the Holding Company in its accounts for the year ended March 31, 2004?

Ans:

a. Provision of Companies Act: Note (f) under the Horizontal Form of the Balance Sheet in Schedule VI (Part IA) of the Companies Act states that Dividends declared by Subsidiary Companies after the date of the Balance Sheet should not be included unless they are in respect of period which closed on or before the date of the Balance Sheet.

b. Analysis: In the present case, the Subsidiary's relevant accounting year ended on November 30, 2003 and the dividend relates to that financial period i.e. prior to the Balance Sheet date of the Holding Company. The subsidiary has declared the dividend in April 2004 when the audit of the Holding Company is in progress.

c. As the Subsidiary's accounting period fell before the end of the accounting period of the Holding Company, the dividend declared in April 2004 should be accounted for in the accounts of the Holding Company for the year ended 31st March 2004.

d. Conclusion: As per AS – 9, dividends should be recognized as revenue when the owner's right to receive payment is established. Hence, the view stated in the above explanation is also supported by AS – 9 and AS – 5.

Q. No.26: Baidyanath Ltd. has taken a Transit Insurance Policy. Suddenly during the current financial year, the percentage of accident has gone up to 7%. So, the Company wants to recognize the claims made as revenue in the current financial year in accordance with relevant AS. Do you agree?

Ans:

a. Provisions of AS: As per AS – 9, when the claim made is in the course of ordinary activities of the Company, it can be recognized as revenue only if it is measurable and there is no uncertainty as to its ultimate collection at the time of raising the claim.

b. If the ability to assess the ultimate collection with reasonable certainty is lacking at the time of raising the claim then revenue recognition should be postponed to the extent of uncertainty involved.

c. Analysis: In the given case, the increase in percentage of accidents does not constitute certainty of claim collection and is not a valid reason for revenue recognition. There are other uncertainties in the settlement of insurance claims.

d. Conclusion: The Company should postpone revenue recognition. It is preferable to recognize revenue on receipt basis, unless there is absolute certainty of claim admissibility.

- **i. AS – 1:** The following should to be disclosed as per provisions of AS – 1.
  - The significant accounting policies adopted in revenue recognition,
  - Changes, if any, in the accounting policies adopted.
- **ii. AS – 9:** The enterprise should disclose the circumstances in which revenue recognition has been postponed pending the resolution of significant uncertainties.

Q.No.27: Hire Purchase Sales have been treated as Outright Sales. Comment.

a. Analysis: In a Hire Purchase Transaction, the property in goods passes to the buyer only when the last instalment is paid and the other conditions of Hire Purchase agreement are satisfied. In a Hire Purchase sales, the basic condition for full revenue recognition i.e. transfer of ownership is not satisfied.

b. Treatment of Hire Purchase sales as Outright Sales would result in taking profit in accounts, which has remained unrealized. It is a violation of the generally accepted accounting principles. This also affects the true and fair view of the accounts.

c. Conclusion: The Auditor should qualify his report, indicating the amounts involved in overstating sales and profits.

Q.No.28: Kabardi Ltd. purchases goods on behalf of its customers for execution of work under a Works Contract against which it receives full payment and necessary declaration form under Central Sales Tax Act to be passed on to the supplier. The Company follows the practice of treating the same as its purchases and accordingly debits to its Profit and Loss Account. Discuss whether the accounting treatment is proper.

Ans: There can be two possibilities in the instant case viz.,

Situation 1	Situation 2
a. The Company acts as the agent of the customer. **b.** Disclosure should be made to this effect that the material purchased belongs to	**a.** The Company is the owner of the materials purchased in substance and has the right, (though a restricted one) to use the materials, for all practical

the customer. **c.** Where ownership of goods vests with the customers and the Company merely purchases the goods on behalf of its customers in the capacity of an agent for execution of works under a works contract for which it receives full payment. **d.** Hence these purchases cannot be treated as the purchases of the Company and so, the debit to its Profit and Loss Account is NOT correct.	purposes. **b.** If the terms of Works Contract provide for factor linked payment by customer and in substance the materials acquired by the Company belongs to the Company only, irrespective of the legal form of ownership, the Company is CORRECT in debiting its Profit and Loss Account.

(For reference in examination point of you)

REVENUE RECOGNITION PRINICPLES FOR SPECIFIC SERVICES

Nature of service rendered	Revenue Recognition Principle
Installation Fees Plant Installation Fees	**a.** Where installation fees is other than incidental to the sale of a product, they should be recognized as revenue only when the equipment is installed and accepted by the customer. **b.** Plant installation fees is generally incidental to the sale of the machinery and should be recognized as revenue only when the machinery is installed and accepted by the customer.
Advertising/ Insurance Agency Commission	**a.** Revenue should be recognized only when the service is completed. **b.** For advertising agencies, media commission will normally be recognized when the related advertisement or commercial appears before the public and the necessary intimation is received by the agency. **c.** For production commission, i.e. production of advertisement material, the revenue will be recognized when the project is completed.
Insurance Agency Commission	Insurance Agency Commission should be recognized on the effective commencement or renewal dates of the related policies.
Financial Service Commission	**a.** Charges for financial services may be made either as (a) a single amount; or (b) in stages over the period of the service or the life of the transaction to which it relates. **b.** Such charges may be settled in full when made or added to a loan or other account and settled in stages. **c.** The recognition of such revenue should therefore have regard to: **i.** Whether the service has been provided "once and for all" or is on a "continuing" basis; **ii.** The incidence of the costs relating to the service; **iii.** Time of receipt of payment for services rendered. **d.** Commission charged for arranging or granting loan or other facilities should be recognized when a binding obligation has been entered into. **e.** Commitment, facility or loan management fees which relate to continuing obligations or services should normally be recognized over the life of the loan or facility, having regard to: **i.** The amount of the obligation outstanding;

	ii. The nature of services provided; and **iii.** The timing of the costs relating thereto.
Origination Fees with ongoing involvement	**a.** An enterprise may receive Origination Fees relating to the creation or acquisition of a financial instrument, held by it as an investment. **b.** These fees are an integral part of generating an ongoing involvement with the resultant financial instrument. **c.** These are deferred and recognized as an adjustment to the effective yield of the financial instrument, together with the related direct costs.
Commitment fees to originate or purchase a loan –a ongoing involvement	**a.** Commitment Fees to enter into a specific loan agreement is a compensation for an ongoing involvement with the resultant financial instruments. **b.** These are deferred and recognized as an adjustment to the effective yield of the financial instrument, together with the related direct costs. **c.** Where the commitment expires without the enterprise making the loan, the fees is recognized as revenue, on expiry. **d.** When it is unlikely that a specific lending arrangement will be entered into, the commitment period, if the fees is earned for services provided.
Fees charged for servicing a loan	Fees charged for servicing a loan are recognized as Revenue
Financial Service Fees earned on the execution of a significant act	**a.** Commission for allotment of shares to a client is recognized as Revenue when the shares have been allotted. **b.** Placement fees for arranging a loan between a borrower and investor are recognized as Revenue when the loan has been arranged. **c.** Loan syndication fees are recognized when the syndication has been completed. However when the syndicator retains a portion of a loan, the proportionate fee is deferred and recognized as revenue as an adjustment to the effectively yield of the loan/investment.
Franchising Fees	**a.** Franchising Fees for supplies of equipment & other tangible assets, based on fair value of assets sold are recognized upon delivery/passing of title. **b.** Franchising Fees for supplies of initial or subsequent services are recognized as revenue as the services are rendered. **c.** Continuing Franchising Fees charged for use of continuing rights or for other services are recognized as revenue as the services are provided/rights are used.
Fees from development of customized software	Development Fees for Customised Software i.e., made as per client's requirements, are recognized as Revenue based on the stage of completion of development, including completion of services provided for post – delivery service support.
Admission Fees	**a.** Revenue from artistic performances, banquets and other special events should be recognized when the event takes place. **b.** When a subscription to a number of events is sold, the fee should be allocated to each event on a systematic and rational basis.

Admission Fees for Film Festival	**a.** Revenue from the admission fees for film festival should be recognized only when the film festival has been organized. **b.** If there are a large number of films being shown in the film festival and many catergories of films e.g. documentary, information section, competition section, etc., Admission Fees should be allocated to various categories on a systematic and rational basis.
Tuition Fees	Revenue should be recognized over the period of instruction.
Entrance Fees and Membership Fees	**a.** Revenue recognition from these sources will depend on the nature of the services being provided. **b.** Entrance fee received is generally captialised. **c.** If the membership fee permits only membership and all other services or products are paid for separately, or there is a separate annual subscription, the fee should be recognized when received. **d.** When the membership fee entitles the member to services or publications to be provided during the year, it should be recognized on a systematic and rational basis, based on the timing and nature of all services provided.

The End