Chapter 15

Revenue Recognition

Reference: IAS 18 and IFRIC 13

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1. Introduction (IAS 18.1)

Income, which is defined in the Framework, may be divided into the following two categories:
- revenue (see below for definition); and
- gains

A gain is a type of income, but is not part of revenue and is thus not covered within the ambit of IAS 18. Gains include, for instance, the surplus on the revaluation of property, plant and equipment.

There are five *types of revenue*, which are generally referred to in three categories as follows:
- sale of goods;
- rendering of services; and
- use of the entity's assets:
  - interest income;
  - royalty income; and
  - dividend income.

There are different *recognition criteria* for each of the different types of revenue, each of which will be discussed separately. It is interesting to note before continuing, that a transaction frequently includes more than one type of revenue, although this may not be immediately obvious. What is important to remember is that the substance of the transaction must be recognised rather than the legal form (i.e. despite a legal document stating that a transaction is a sale with no interest charged to the customer, we may need to recognise the transaction as a sale and interest income).

Similarly, although some measurement aspects are common to all types of revenue, some types of revenue have their own specific measurement techniques.

2. Definitions (Framework and IAS 18.7 - .8)

Income (as defined in the Framework)
- an increase in economic benefits
- during the accounting period
- in the form of inflows or enhancements of assets or decreases in liabilities
- that results in increases in equity, other than those relating to contributions from equity participants.

Revenue (IAS 18)
- the gross inflows of economic benefits
- during the period
- arising in the course of ordinary activities of an entity
- when those inflows result in increases in equity, other than increases relating to contributions from equity participants.

Please note that the main differences between the definition of revenue and income are that:
- *revenue is an income earned through ordinary activities and*
- *should always be reflected as a gross amount (i.e. never netted against related expenses).*

Fair value (IAS 18)
- the amount for which an asset could be exchanged (or a liability settled)
- between knowledgeable, willing parties
- in an arm's length transaction.

3. Measurement: general (IAS 18.9 - .12; .13; .18; .22 and .34 and Circular 9/2006)

3.1 Overview

According to IAS 18, revenue should be measured at the *fair value* of the *consideration* received or receivable.

The 'fair value' is the amount agreed upon between the buyer and the seller. This then means that the amount of revenue should:
- be net of discounts offered;
- be net of rebates offered, where the rebates have been offered to reduce the selling price;
- be net of transaction taxes (and other receipts on behalf of third parties); and
- exclude interest income earned on extended credit terms offered.

The consideration refers to the manner of settlement (payment) and may take the form of cash or could be received in the form of another asset or services received (barter transaction).

It frequently happens that a single revenue transaction combines multiple revenue types (e.g. a sale may be combined with a service or interest income may be hidden in the transaction). The transaction must be measured based on its substance rather than its form.
If the inflow of economic benefits becomes improbable *after* the revenue has been recognised, the amount that is no longer probable of being received should be recognised as an expense rather than as an adjustment to revenue (e.g. a doubtful or bad debt expense).

3.2 Discounts offered (IAS 18.9 - .10)

There are a variety of discounts that you could offer on a revenue transaction:
- trade discount or bulk discount: this is usually offered to regular customers or customers buying in bulk; and
- cash discount: this may be offered to encourage an immediate cash payment;
- settlement discount: this may be offered to encourage early settlement of the invoice.

The amount of revenue recognised will be net of trade and bulk discounts only(i.e. the marked price less discounts offered). Cash discount is an indication of interest income in list price applicable on credit sale, if such discount is offered across the board to all customers. In such circumstances, revenue may be recorded net of cash discounts. However, if cash discount is offered to some selected customers, it indicates credit risk management. Therefore, this discount should not be netted off.

Example 1: discounts

An entity sold inventory. Details of the sale was as follows:	**C**
• Marked price (no VAT is charged on these goods)	9 000
• Trade discount	1 000

Required:
Show the ledger accounts (ignore the cost of sale journal entry) assuming:
A. The customer pays in cash on transaction date and receives a cash discount of C500.
B. The entity has agreed to allow an early settlement discount of C400: the customer pays within the required settlement period.
C. The entity has agreed to allow an early settlement discount of C400: the customer does not pay within the required settlement period.

Solution to example 1A: discounts including a cash discount

Bank			
Sale (1)	7 500		

Sales (income)			
		Bank (1)	7 500

(1) The marked price is reduced by the trade discount and the cash discount: 9 000 – 1 000 – 500 , assuming this cash discount is offered to all customers.

Solution to example 1B: discounts including a settlement discount

Debtor (asset)

Sale/ Settlement disc allowance (1)	8 000	Bank (2)	7 600
		Settlement disc allowance (3)	400

Sales (income)

		Debtor (1)	7 600

Settlement discount allowance (negative asset)

Debtor (3)	400	Debtor (1)	400

Bank

Debtor (2)	7 600		

(1) The sale is recognised at the marked price less the trade discount and the estimated settlement discount: 9 000 – 1 000 – 400 = 7 600. The settlement discount is an *estimated* discount until the customer pays within the required period, at which point the discount becomes an *actual* discount. Until then, the debtor's account is debited with the full amount receivable and an allowance for possible settlement discount of C400 is credited (this reduces the carrying amount of the debtors presented in the statement of financial position).

(2) Since the debtor paid within the required settlement period, the debtor earned his settlement discount and only has to pay C7 600.

(3) Since the debtor pays within 20 days, the settlement discount becomes a reality (i.e. the *estimated* discount becomes an *actual* discount). The settlement discount allowance is thus transferred to the debtors account (thus reducing the debtors account to zero).

Solution to example 1C: discounts including a settlement discount

Debtor (asset)

Sale & finance income (1)	8 000	Bank (2)	8 000

Sales (income)

		Debtor (1)	7 600

Settlement discount allowance (negative asset)

Finance inc (3)	400	Debtor (1)	400

Finance income (income)

		Settlement disc allowance (3)	400

Bank

Debtor (2)	8 000		

(1) The sale is recognised at the marked price less the trade discount and the estimated settlement discount: 9 000 – 1 000 – 400 = 7 600. The settlement discount is an *estimated* discount until the customer pays within the required period, at which point the discount becomes an *actual* discount. Until then, the debtor's account is debited with the full amount payable and an allowance for possible settlement discount of C400 is credited (this reduces the carrying amount of the debtors presented in the statement of financial position).

(2) The debtor does not pay within the required settlement period and thus has to pay C8 000 (i.e. thus forfeits the settlement discount of C400, which the entity had offered).

(3) Since the debtor does not pay within the required settlement period, the debtor forfeits his discount and the entity recognises it as finance income. The settlement discount allowance is thus transferred to income, and is recognised as finance income (not part of sales income).

3.3 Rebates offered (IAS 18.9 - .10 and Circular 9/2006)

The entity that is earning the revenue, may offer its customer a rebate of sorts. There are many different types of rebates possible. The rule is, however, that if the rebate is offered as a reduction of the selling price, then the revenue must be reduced by the rebate. Some rebates, although connected to the revenue, are not really a direct reduction in the selling price but a refund of certain of the customer's costs. In this case, the rebate offered should be recognised as an expense instead.

Example 2: rebate

An entity sells inventory for cash. The details thereof were as follows:	**C**
• Marked price (no VAT is charged on these goods)	9 000
• Rebate given to the customer	1 000

Required:
Show the ledger accounts (ignoring the cost of sale journal) assuming that the terms of the agreement made it clear that:
A. the rebate was a reduction to the selling price of the inventory; and
B. the rebate was a refund of the customer's expected selling costs.

Solution to example 2A: rebate reduces revenue

Bank			
Sale (1)	8 000		

Sale			
		Bank (1)	8 000

(1) The rebate reduces the revenue: 9 000 – 1 000

Solution to example 2B: rebate does not reduce revenue

Bank			
Sale (1)	8 000		

Sale			
		Bank & rebate (1)	9 000

Rebates (Expense)			
Sale (1)	1 000		

(1) The revenue is measured at 9 000 even though only 8 000 is received. This is because the rebate of C1 000 is not connected to the revenue but the customer's future expected selling costs. The rebate is recognised as an expense instead.

3.4 Transaction taxes and other third party receipts (IAS 18.8)

The fair value will also be net of transaction taxes. In many cases the total invoice price will include the transaction tax. In such a case, the invoice price, excluding the transaction tax must be calculated. If the transaction tax is VAT levied at 14%, the revenue excluding VAT will be calculated as follows:

Invoice price (including VAT) x 100 / 114

This is because the entity has only earned the portion excluding VAT and the remainder is owing to the tax authorities. Any amounts received by the entity on behalf of a tax authority should not be recognised as revenue but rather as a liability owed to the tax authority.

This principle above applies equally to amounts collected by an agent on behalf of any other party. A typical example of this sort of arrangement would be an estate agent collecting rentals on a property on behalf of the property owner.

Example 3: collection of revenue by agents

Estate Agent Limited provides a service to a client whereby it collects monthly rentals of C15 000 on the last day of each month. The agent is entitled to a commission calculated at 10% of the rental and the remainder is paid over to the property owner on the first day of the next month.

Required:
Provide the journal entries to show the collection of the rental and the revenue earned in the accounting records of Estate Agent Limited.

Solution to example 3: collection of revenue by agents

		Debit	Credit
Bank	*Given*	15 000	
Revenue	*15 000 x 10%*		1 500
Rental liability to property owners	*15 000 – 1 500*		13 500
Recording the collection of rentals and the portion of revenue			
Rental liability to property owners		13 500	
Bank			13 500
Recording the payment of the amount due to the owners			

3.5 Extended credit terms (IAS 18.9 and .11 and Circular 9/2006)

Where a revenue transaction is entered into with a customer who is offered extended credit terms, the measurement of the revenue must reflect the time value of money, if material.

This means that, even if the revenue transaction states that there is no interest charged (or reflects a very low interest charge), interest income should be separated from the total revenue to be received and measured using the effective interest rate method, apportioned for time.

For example, a sale on extended credit, where the legal documents are entitled 'SALE' and include a clause to the effect that no interest is charged and another clause that states that the customer need only pay for the goods in three years time, is in substance two transactions:

- Sale of goods: to be measured at the cash price (or present value of future receipts);
- Interest income: to be measured using the effective interest method, apportioned over time, using an imputed rate of interest (a market interest rate or simply the rate that discounts the future receipts to the cash sales price).

In other words, in the above example, the statement by the seller that there is no interest included in the sale agreement is assumed to be nonsense: income from a sale and income from interest is recognised.

The following is a basic example. A more complex example is included under 'measurement: interest income'.

Example 4: sale on extended credit terms

On 30 June 20X1 Howa Limited sells goods to a customer on extended credit terms. The customer is required to pay C1 000, in full and final settlement, on 30 June 20X2. The cash sales price is C909 (present value using a discount rate of 10%).
The financial year-end is 31 December.

Required:
Provide all related journal entries in Howa Limited's general journal assuming that:
A. The effects of the extended credit terms *are not* considered to be material.
B. The effects of the extended credit terms *are* considered to be material.

Solution to example 4A: sale on extended credit terms – not material

20X1 Journals		Debit	Credit
30 June 20X1			
Accounts receivable		1 000	
Sales income			1 000
Recording the sale of goods (extended credit terms immaterial)			
20X2 Journals			
30 June 20X2			
Bank		1 000	
Accounts receivable			1 000
Recording the receipt of the amount due by the customer			

Solution to example 4B: sale on extended credit terms – material

20X1 Journals		Debit	Credit
30 June 20X1			
Accounts receivable	*Given*	909	
Sales income			909
Recording the sale of goods (extended credit terms material)			
31 December 20X1			
Accounts receivable	*(1 000 – 909) x 6 / 12; OR*	45	
Interest income	*(909 x 10% x 6/12)*		45
Recording the interest earned on sale on extended terms: 300 / 10 x 6m			
20X2 Journals			
30 June 20X2			
Accounts receivable	*(1 000 – 909) x 6 / 12; OR*	46	
Interest income	*(909 x 10% x 6/12)*		46
Recording the interest earned on sale on extended terms: 300 / 10 x 4m			
Bank		1 000	
Accounts receivable			1 000
Recording the receipt of the amount due by the customer			

3.6 Consideration (IAS 18.10 - .12)

The 'consideration' is generally received in the form of cash or cash equivalents, in which case this is normally the revenue that is recognised. However, when a barter transaction takes place, revenue is received in the form of goods or services.

3.6.1 The exchange of goods and services that are similar

When the goods and services that are exchanged are similar (similar value and nature), then no profit or loss can be made and the earnings process is considered to be incomplete. No entry is required for such a transaction. Therefore if two milk supply companies exchanged inventory in order to meet the demands in various locations on a timely basis no transaction will be recorded because no revenue has been generated by the exchange.

3.6.2 The exchange of goods and services that are dissimilar

When the goods and services that are exchanged are not similar, then a transaction *has* occurred and revenue will have been generated. Revenue should be measured at the fair value of the goods or services received (adjusted for any cash or cash equivalents that change hands). If the fair value of the goods and services received cannot be ascertained then the revenue will be measured at the fair value of the goods and services given up, (adjusted for any cash and cash equivalents that changed hands).

Example 5: exchange - fair value is known

Goods with a fair value of C100 and a cost of C80 were given to a customer who repaired a machine in return. The fair value of the repair is C120.

Required:
Calculate the amount of sales revenue and show the related journal entries.

Solution to example 5: exchange - fair value is known

	Debit	Credit
Cost of sales (E)	80	
Inventories		80
Recording the cost of sale		
Repairs (E)	120	
Revenue - sales (I)		120
Recording the sale (FV of the service received given as C120)		

Example 6: exchange - fair value is unknown

Goods with a fair value of C100 and a cost of C80 were given to a customer in exchange for a machine in return. The fair value of the machine is not known.

Required:
Show the related journal entries

Solution to example 6: exchange - fair value is unknown

		Debit	Credit
Cost of sales (E)		80	
Inventories			80
Recording the cost of sale			
Machine: cost (A)	*Fair value of goods given up*	100	
Sales (I)	*Fair value of goods given up because fair value of goods received is unknown*		100
Recording the sale (FV of the machine – assumed value)			

Example 7: exchange - fair value is unknown and cash given

C30 in cash was given to and inventory with a fair value of C100 (and a cost of C80) was sold to a customer in exchange for a machine of unknown fair value.

Required:
Calculate the amount of sales revenue and show the related journal entries.

Solution to example 7: exchange - fair value is unknown and cash given

		Debit	Credit
Cost of sales (E)		80	
Inventories			80
Recording the cost of sale			
Machine (A)	*Fair value of assets given up: 100 + 30*	130	
Bank	*Given*		30
Revenue - sales (I)	*Fair value of goods sold*		100
Recording the sale			

Example 8: exchange - fair value is unknown and cash received

Inventory with a fair value of C100 (and a cost of C80) was sold to a customer in exchange for a machine of unknown fair value and C30 in cash.

Required:
Calculate the amount of sales revenue and show the related journal entries.

Solution to example 8: exchange - fair value is unknown and cash received

		Debit	Credit
Cost of sales (E)		80	
Inventories			80
Recording the cost of sale			
Machine (A)	*Fair value of assets given up: 100 - 30*	70	
Bank	*Given*	30	
Revenue - sales (I)	*Fair value of goods received incl cash: 70 + 30*		100
Recording the sale			

3.7 Substance over form (IAS 18.11 and .13)

A common example of a transaction that, in substance, actually involves more than one transaction, is a sale that takes place on extended credit terms, either without charging interest or charging an unusually low rate of interest. The substance of the single transaction is, in fact, that two transactions have occurred:

- a sale has taken place: which is measured at the present value of the cash received;
- interest at a market related rate is being charged: which is measured as the amount to be received less the present value thereof (measured using the effective interest rate method and apportioned over time).

An example of this calculation is included under 'measurement: interest income'.

Another typical example is where a single amount is paid for an item, where a 'free service' is included with the item purchased.

4. Revenue from sales (IAS 18.14 - .19)

4.1 Recognition: sales (IAS 18.14 – 19)

Revenue from the sale of goods may only be recognised when *all* of the following five criteria have been met:

- The significant risks and rewards associated with ownership have been transferred from the seller to the buyer;
- Managerial involvement to the extent normally associated with ownership of an asset must have ceased, as should the effective control thereof;
- Revenue is reliably measurable;
- Costs related to the sale are reliably measurable; and
- It is probable that future economic benefits resulting from the sale will flow to the entity.

It may happen that only a portion of the risks and rewards of ownership are transferred from the seller to the buyer. Revenue may, however, only be recognised once at least a *significant* portion (i.e. almost all) of the risks and rewards have been transferred. If a significant portion of the risks and rewards *have not yet been* transferred, the revenue from the sale must not yet be recognised. Recognition of this revenue is deferred (delayed) until a significant portion of the risks and rewards are transferred. When considering whether the risks and rewards have been transferred, the main factor is generally the passing of legal title from seller to buyer.

Some examples in IAS 18 where significant risks and rewards *have not yet been transferred*:

- the sale of goods subject to the installation of the asset, where the installation thereof is a substantial part of the contract and has not yet been performed;
- the sale of goods on condition that the buyer manages to sell the asset (a consignment sale) and where the buyer has not yet been able to sell the goods;
- the sale of goods subject to approval (buying/ selling on 'appro') such that the buyer may return the goods before a certain date and where the buyer has not yet formally approved the goods and the time period for rejection has not yet elapsed;
- the sale of goods on a lay away (lay-bye) basis, requiring the buyer to pay all instalments before taking possession of the goods, and where all instalments have not yet been received. If, however, the entity has experience that suggests that most buyers pay all instalments, then the revenue may be recognised as soon as a significant portion of the instalments has been received (and of course, assuming that the goods are on hand and ready for delivery);
- when the seller retains an obligation for unsatisfactory performance, which covers the buyer further than normal warrantee provisions;
- the buyer has the right to rescind the contract due to terms that are stated within the contract and the seller is unsure of the probability of return.

Some examples in IAS 18 where significant risks and rewards *have been transferred include*:

- where a seller retains only the legal title to the goods and where this is retained solely to ensure collection of the amount due by the customer (i.e. the customer has been given all other risks and rewards of ownership)
- where a seller makes a sale whereby he offers a refund if the customer is unsatisfied and where the seller is able to reliably estimate the potential effect of refunds and recognises a liability for these potential future refunds (IAS 37 should be applied in this regard).

Revenue and its related costs must be recognised simultaneously and in the same period. If the costs relating to the revenue are not yet reliably measurable, then the recognition of the revenue must be deferred until they are reliably measurable. Any amounts received should then be recognised as a liability until such time as the costs are reliably measurable.

If the seller provides a guarantee but cannot reliably estimate the provision for refunds, then revenue may not be recognised until after the guarantee period expires.

Example 9: sale where payment not yet received

Inventory with a cost of C80 is sold to a customer for C100.

Required:
Discuss whether the sale should be recognised assuming the:

A. seller retains physical possession of the inventory until all instalments are received (lay away sale);
B. seller allows buyer to take possession of the inventory immediately and pay the sales price in instalments (instalment sale).

Solution to example 9A: sale where payment not yet received – lay away sale

The risks and rewards have not been transferred to the buyer (the seller is still responsible for safe-keeping and insurance of the inventory and thus still has all the risks and since the buyer does not have possession of the inventory, the buyer cannot yet reap the rewards associated with it and thus the rewards have not yet transferred either). The sale may therefore not be recognised.

Solution to example 9B: sale where payment not yet received – instalment sale

The risks and rewards have been transferred to the buyer (the buyer now has possession of the inventory and is therefore responsible for safe-keeping and insurance thereof and is also able to reap the rewards associated with the inventory). The sale must therefore be recognised.

Example 10: sale where legal title retained

Dash Limited sold a truck to Walker Limited for C100 000. Walker Limited is to pay the sales price in instalments over a period of six months but took possession of the truck on the date that the sale agreement was signed. In order to ensure that full payment would be received, Dash Limited retained legal title.

Required:
Discuss whether the sale should be recognised by Dash Limited.

Solution to example 10: sale where legal title retained

Since the only reason that Dash Limited retained legal title to the truck was to ensure that full payment would be received, the significant risks and rewards of ownership of the truck are considered to have transferred to Walker Limited. The sale should therefore be recognised by Dash Limited on the date that the sale agreement is signed, being the date that Walker Limited took possession of the truck.

4.2 Measurement: sales (IAS 18.9 - .12)

The measurement of a sale of goods simply follows the general measurement guidelines: it shall be measured at the fair value of the consideration received or receivable.

5. Revenue from services (IAS 18.20 - .28)

5.1 Recognition: services (IAS 18.20)

Revenue from services rendered is recognised when all of the following criteria are met:
- the revenue can be reliably measured;
- the costs can be reliably measured (costs incurred to date and costs still to be incurred);
- it is probable that the economic benefits expected will flow to the entity; and
- the stage (percentage) of completion can be reliably measured.

Example 11: revenue from services

Scrubbers Limited signed an agreement with a blue chip company whereby it is to scrape and re-plaster 50 buildings for a total contract price of C80 000. The cost to Scrubbers Limited of performing this job is expected to be C50 000. Scrubbers Limited has entered into many such contracts and has a good cost projection system. At 31 December 20X1, Scrubbers Limited had scraped and re-plastered 30 buildings.

Required:
Discuss whether Scrubbers Limited may recognise any revenue in the financial statements for the year ended 31 December 20X1.

Solution to example 11: revenue from services

- The revenue can be reliably measured:
  It is stipulated in the contract at C80 000
- The costs can be reliably measured:
  The costs incurred to date will be supported by invoices and the future costs are reliably measurable based on a past history of similar contracts and with a good cost projection system.
- It is probable that the economic benefits will flow to Scrubbers Limited:
  The customer is a blue chip company, so it is unlikely that the customer will default on payment.
- The stage of completion can be reliably measured:
  A variety of methods of calculating the stage of completion are allowed, of which either the ‘cost method’ or the ‘number of services method’ would be suitable. The cost method can be used since the costs are reliably measurable. The number of services method can be used, assuming that the work on each building is similar , since we know that 30 of the 50 buildings have been completed.

A portion of the revenue should therefore be recognised at 31 December 20X1 since all recognition critreria are met. The revenue to be recognised is therefore C48 000 (C80 000 x 30 / 50 buildings).

5.2 Measurement: services (IAS 18.21 – 28)

Apart from the general measurement considerations, services are peculiar in that they take a period of time to be completed. It may happen, therefore, that financial statements need to be prepared before a service has been completed. It is therefore necessary to be able to estimate the stage of completion.

5.2.1 Stage of completion (IAS 18.21 – .24)

The stage of completion may be difficult to estimate in practice. The following are the three methods available:
- surveys of work performed;
- services already performed as a percentage of the total services to be performed; and
- the costs incurred to date as a percentage of the total costs to be incurred.

Although IAS 18 specifically excludes revenue from construction contracts, the principles applied to the recognition of revenue from the construction contract (IAS 11) are the same.

Example 12: revenue from services: stage of completion

Scrubbers Limited signed an agreement whereby it is to scrape and re-plaster 50 buildings. The total contract price is C80 000. The expected contract cost is C50 000.

The following details are available as at year-end, 31 December 20X3:
- according to the surveyor, C50 000 of the work had been done and may be invoiced;
- according to Scrubbers Limited, 30 buildings had been scraped and re-plastered;
- costs of C35 000 have been incurred to date (the total expected cost remains C50 000).

The contract is satisfactorily completed during March 20X4 (according to both the surveyor and Scrubbers Limited), after a further cost of C15 000 has been incurred.

All 50 buildings had been scraped and re-plastered by the end of 20X4.

Required:
Show the revenue related journal entries for 20X3 and 20X4 assuming that the percentage of completion is based on:
A. surveys of work performed
B. services already performed as a percentage of total services to be performed
C. costs incurred to date as a percentage of total expected costs.

Solution to example 12A: revenue from services: stage of completion

20X3		**Debit**	**Credit**
Debtor (A)	*Given*	50 000	
Revenue from services (I)			50 000
Revenue from services: surveyed value			
20X4			
Debtor (A)	*80 000 – 50 000*	30 000	
Revenue from services (I)			30 000
Revenue from services: total contract price –survey value in prior year			

Solution to example 12B: revenue from services: stage of completion

20X3		**Debit**	**Credit**
Debtor (A)	*30 / 50 buildings x 80 000*	48 000	
Revenue from services (I)			48 000
Revenue from services: services performed method			

20X4		Debit	Credit
Debtor (A)	*50 / 50 buildings x 80 000 – 48 000*	32 000	
Revenue from services (I)			32 000
Revenue from services: services performed method			

Solution to example 12C: revenue from services: stage of completion

20X3		Debit	Credit
Debtor (A)	*35 000 / 50 000 x 80 000*	56 000	
Revenue from services (I)			56 000
Revenue from services: costs to date method			
20X4			
Debtor (A)	*(35 000 + 15 000) / 50 000 x 80 000*	24 000	
Revenue from services (I)	*– 56 000*		24 000
Revenue from services: costs to date method			

5.2.2 Indeterminate number of acts (IAS 18.25)

In some instances, it may happen that the service to be rendered involves the performance of an unknown number of 'acts' over a certain period of time, in which case the above methods of estimating the stage of completion would not be appropriate. In such a case, it is acceptable to recognise the revenue on the straight-line basis over the period that the 'acts' will be performed. If, however, there is one very significant 'act' that will be performed during this period, then revenue should not be recognised before this 'act' has been performed.

Example 13: revenue from services: unknown number of acts

Plastic House of Beauty is a Hollywood-styled company offering cosmetic surgery. Miss Terry purchased a three-year contract from Plastic House of Beauty for C60 000. The contract requires that Plastic House of Beauty maintains Miss Terry's complexion in flawless condition for a period of three years.

Required:
Explain when the receipt of C60 000 should be recognised in the accounting records of Plastic House of Beauty assuming that

A. the contract requires free treatment for blemishes as and when they occur;
B. the contract requires free treatment for blemishes as and when they occur plus a complete plastic surgery makeover, valued at C54 000.

Solution to example 13A: revenue from services: unknown number of acts

Since there are an indeterminate number of acts to be performed over a period of three years with no one significant act, the C60 000 must be recognised evenly over the period of three years.

Solution to example 13B: revenue from services: unknown number of acts

Since there is one significant act, being the plastic surgery makeover, the revenue from this act must be recognised on the date that this act is performed. The balance of C6 000 relating to the indeterminate number of acts should be recognised evenly over the period of three years.

5.2.3 Outcome not reliably measurable (IAS 18.26 - .28)

If the outcome is not able to be reliably estimated (i.e. recognition criteria not met), the costs are recognised as they are incurred but revenue is only recognised to the extent of the costs that the entity believes will probably be recovered.

Example 14: revenue from services: unknown outcome

Fiddlers Limited signed an agreement for a total contract price of C80 000:
- At year-end (31 December 20X3) Fiddlers Limited had completed 40% of the contract (based on the costs incurred to total expected costs) but estimates that it will not complete the project on time.
- Costs of C35 000 have been incurred to date (the total expected cost remains C87 500).

Required:
Calculate the revenue that may be recognised (using the number of services performed to date) and show all related journal entries assuming that the contract stipulated that, if the contract is not completed on time:
A. the customer would only be liable to pay C20 000
B. the customer would only be liable to pay C50 000
C. the customer would not be forced to pay the contract price at all.

Solution to example 14A: revenue from services: unknown outcome

20X3	**Debit**	**Credit**
Contract costs (E)	35 000	
Creditors/ bank		35 000
Costs incurred on the contract		
Debtors (A)	20 000	
Revenue from services		20 000
Revenue recognised on the contract 40% x 80 000, but limited to 20 000, being the probable amount that would be recovered		

Solution to example 14B: revenue from services: unknown outcome

20X3	**Debit**	**Credit**
Contract costs (E)	35 000	
Creditors/ bank		35 000
Costs incurred on the contract		
Debtors (A)	32 000	
Revenue from services		32 000
Revenue recognised on the contract: 40% x 80 000 (not limited because the probable amount recoverable is more: 50 000)		

Solution to example 14C: revenue from services: unknown outcome

20X3	**Debit**	**Credit**
Contract costs (E)	35 000	
Creditors/ bank		35 000
Costs incurred on the contract		

No revenue is recognised because it is currently not probable that the costs will be recovered.

6. Revenue from use by others of the entity's assets (IAS 18.29 - .34)

6.1 Overview

It may happen that entities or persons outside of the business use the assets owned by the business. In this instance, the business would charge some type of fee. The fees that are classified as revenue for the purposes of this standard include:
- interest income;
- royalty income; and
- dividend income.

6.2 Recognition: use of entity's assets (IAS 18.29)

Interest, royalties and dividend income may be recognised when:
- it is probable that economic benefits associated with the transaction will flow to the entity; and
- the amount of the revenue can be measured reliably.

6.2.1 Recognition: interest income (IAS 18.30)

Interest income must be recognised when an entity makes a sale, for example, on extended credit terms, even where low or no interest is charged.

6.2.2 Recognition: royalty income (IAS 18.30)

Royalty income to be recognised depends on the terms of the royalty agreement. This impacts on the amount of revenue to be measured.

6.2.3 Recognition: dividend income (IAS 18.30)

Dividend income must be recognised when the right to receive the dividend has been established. This is usually the last date to register as a shareholder (i.e. the last day to acquire shares in order to receive the dividend payout). This affects the probability of the inflow of economic benefits.

Example 15: dividend income

Shareholder Limited owns shares in Share Limited on 28 December 20X1, on which date Share Limited declared a dividend of C1 per share. This dividend is to be paid on 31 January 20X2 to those who are registered as shareholders of Share Limited as at 15 January 20X2.

Shareholder Limited was a registered shareholder of 10 000 shares on:
- 28 December 20X1 (declaration date);
- 31 December 20X1 (its year-end); and on
- 15 January 20X2 (last date to register).

Shareholder Limited sold the shares on 29 January 20X2 (before dividend payment date).

Required:
Should this dividend income be recognised in Shareholder Limited's financial statements ended 31 December 20X1? Explain and provide the journals that would be necessary for the recognition thereof (if any).

Solution to example 15: dividend income

The dividend income may not be recognised in Shareholder Limited's financial statements ended 31 December 20X1 because the right to receive the dividends will only be established on 15 January 20X2. Since Shareholder Limited still owns the shares on 15 January 20X2 (being the last day to register as a shareholder), the right to the dividend is established. The dividend income is therefore recognised as revenue on 15 January 20X2. The dividend will be paid to Shareholder Limited even though it sold the shares before payment date.

20X2 Journals	**Debit**	**Credit**
15 January 20X2		
Debtors	10 000	
Revenue from dividends (I)		10 000
Dividend income: 10 000 x C1		
31 January 20X2		
Bank	10 000	
Debtors		10 000
Receipt of cash dividend		

6.2.4 Recognition: pre-acquisition dividend income (IAS 18.32)

IAS 18 states that where dividends are declared by a company in which the entity is invested, where this declaration of dividends is funded by profits earned prior to the investor having acquired his investment (pre-acquisition profits), this dividend should be deducted from the cost of the investment rather than be recognised as revenue. The logic behind this is that if the dividends are to be paid from pre acquisition profits, these are not in actual fact earned by the investor but were rather bought. If dividends are received and have not been earned (i.e. pre-acquisition dividends), they are treated as a reduction in the purchase price of the investment.

Example 16: pre-acquisition dividends

Red Limited purchased 100 shares in Blue Limited on 1 January 20X5 for C50 per share. On 2 January 20X5, the directors of Blue Limited declared and paid a dividend of C10 per share to all the shareholders registered on this date.

Required:
How should the purchase of the shares and the dividend be accounted for in the books of Red Limited? Show the related journal entries.

Solution to example 16: pre-acquisition dividends

Since the dividend is declared only a day after Red Limited invested in Blue Limited's shares, the dividend is clearly being funded by profits earned by Blue Limited before 2 January 20X5. Red Limited has therefore not earned these dividends and therefore the dividend to be received is set-off against the cost of the investment (instead of being credited to income). The transaction must be recorded on the last day to register for the shares, being 2 January 20X5.

1 January 20X5	**Debit**	**Credit**
Investment in Blue Ltd	5 000	
Bank		5 000
Purchase of 100 shares in Blue Ltd @ C50		
2 January 20X5		
Dividend receivable/ Bank	1 000	
Investment in Blue Ltd		1 000
Receipt of cash dividend		

The cost of the investment in Blue Ltd will therefore be measured at C4 000 and not at C5 000 originally paid for the shares, as per IAS 18.

6.3 Measurement: use of entity's assets (IAS 18.30 - .34)

6.3.1 Measurement: interest income (IAS 18.30(a) and .31 - .32)

Interest income is measured on the effective interest rate method, apportioned over time.

In the case of a sale on extended credit where low or no interest is charged, despite the legal form (being low or no interest), the substance of the transaction includes two transactions: the sale of goods (or lending of money) and the financing of the sale.

The sale of goods:

- The revenue from the sale is measured as:
  - the present value of the future cash receipts or
  - the normal cash sales price, if this is available.
- This amount is recognised based on the recognition criteria relevant to the revenue from the sale of goods.

The interest income:

- The total interest income is measured as:
  - The difference between the total cash that will be received and
  - the present value thereof (revenue from the sale of goods).
- The portion of the total interest income to be recognised in each year is measured:
  - using a combination of the effective interest rate method and a time basis.

  The effective interest rate method entails using the interest rate that was used to calculate the present value multiplied by the amount still outstanding.

  This is then apportioned based on the period over which the amount was still outstanding.

This is best explained by way of example.

Example 17: sales income and interest income

A customer purchases an item, on 2 January 20X1, to be paid for over a period of 3 years:

End of year 20X1	40 000
End of year 20X2	50 000
End of year 20X3	29 700

The present value of these payments (using a discount rate of 10%) amounts to 100 000.
All the recognition criteria are met. The year end is 31 December.

Required:

A. Calculate the amount of sales revenue from the sale transaction and interest revenue from the financing transaction to be recognised over the period of three years.

B. Show the related journal entries for the year ended 31 December 20X1, 20X2 and 20X3

Solution to example 17A: sales income and interest income (calculations)

Year	(a) (a) + (b) – (c) Amount outstanding at the beginning of the year		(b) (a) x 10% x 1 year Interest recognised per year	(c) given Repayment at the end of the year
1	100 000	(given)	10 000	(40 000)
2	70 000		7 000	(50 000)
3	27 000		2 700	(29 700)
	0		19 700	119 700

Notice that the receipt of C119 700 over the three years constitutes interest revenue of C19 700 (recognised over the 3 years) and sales revenue of C100 000 (recognised in 20X1).

Solution to example 17B: sales income and interest income (journals)

20X1 Journals	Debit	Credit
1 January 20X1		
Debtors (A)	100 000	
Sales (I)		100 000
Sales revenue recognised at the beginning of 20X1		
31 December 20X1		
Debtors (A)	10 000	
Interest (I)		10 000
Interest revenue recognised over the period of 20X1		
Bank	40 000	
Debtors (A)		40 000
Receipt of first instalment in 20X1		

20X2 Journals	Debit	Credit
31 December 20X2		
Debtors (A)	7 000	
Interest (I)		7 000
Interest revenue recognised over the period of 20X2		
Bank	50 000	
Debtors (A)		50 000
Receipt of instalment in 20X2		
20X3 Journals		
31 December 20X3		
Debtors (A)	2 700	
Interest (I)		2 700
Interest revenue recognised over the period of 20X3		
Bank	29 700	
Debtors (A)		29 700
Receipt of instalment in 20X3		

Example 18: sales income and interest income: apportioned over time

A customer purchases an item, on *1 April 20X1*, to be paid for over a period of 3 years as follows:

On 31 March 20X2	40 000
On 31 March 20X3	50 000
On 31 March 20X4	29 700

Assume that the present value of these payments (using a discount rate of 10%) amounts to 100 000.
All the recognition criteria are met. The company's year end is 31 December.

Required:
Show the related journal entries for the year ended 31 December 20X1 to 20X4.

Solution to example 18: sales income and interest income: apportioned over time

The previous effective interest rate table provided in example 17A is still relevant, but the interest must now be apportioned on a time basis since the transaction took place on 1 April 20X1 (i.e. the transaction date did not coincide with the year-end). The interest must simply be apportioned for the number of months falling in each year.

20X1 Journals	Debit	Credit
1 April 20X1		
Debtors (A)	100 000	
Sales income (I)		100 000
Sales revenue recognised at the beginning of 20X1		
31 December 20X1		
Debtors (A)	7 500	
Interest income (I)		7 500
Interest revenue recognised over 20X1: 10 000 x 9/12		

20X2 Journals	Debit	Credit
31 March 20X2		
Bank	40 000	
Debtors (A)		40 000
Receipt of first instalment in 20X2		
31 December 20X2		
Debtors (A)	7 750	
Interest income (I)		7 750
Interest revenue recognised over the period of 20X2: 10 000 x 3/12 + 7 000 x 9/12		
20X3 Journals		
31 March 20X3		
Bank	50 000	
Debtors (A)		50 000
Receipt of second instalment in 20X3		
31 December 20X3		
Debtors (A)	3 775	
Interest income (I)		3 775
Interest revenue recognised over the period of 20X3: 7 000 x 3/12 + 2 700 x 9/12		
20X4 Journals		
31 March 20X4		
Bank	29 700	
Debtors (A)		29 700
Receipt of third instalment in 20X4		
31 December 20X4		
Debtors (A)	675	
Interest income (I)		675
Interest revenue recognised over the period of 20X4: 2 700 x 3/12		

6.3.2 Measurement: royalty income (IAS 18.30(b) and .33)

Royalties may be earned by a business through the use by another of, for example, a patented formula belonging to the business. Royalties should be measured based on the accrual system with reference to the substance of the relevant agreement.

Example 19: royalty income

Yewser Limited produces cold-drinks under licence to Trademark Limited. The terms of the agreement are such that a royalty of C2 is payable by Yewser Limited to Trademark Limited for every can of cold-drink sold at 31 December of a year, with a minimum royalty payment of C100 000 in any one year, irrespective of the cans produced and sold. The following information was relevant in 20X1 and 20X2:

	Cans produced	Cans sold
12 months ended 20X1	80 000	70 000
12 months ended 20X2	30 000	35 000

Required:
Show the journals relating to the royalty income earned in the books of Trademark Limited for the years ended 31 December 20X1 and 20X2.

Solution to example 19: royalty income

20X1 Journals		**Debit**	**Credit**
Debtors/ bank (A)	*70 000 cans (sold) x C2*	140 000	
Revenue from royalties (I)			140 000
Royalty income			

20X2 Journals		**Debit**	**Credit**
Debtors/ bank (A)	*35 000 cans (sold) x C2 = C70 000, but minimum annual payment is C100 000*	100 000	
Revenue from royalties (I)			100 000
Royalty income			

6.3.3 Measurement: dividend income (IAS 18.30(c) and .31 - .32)

Dividends may be earned as a result of an investment of cash in the shares of another business. Dividends should be measured at the dividend per share declared multiplied by the number of shares owned by the entity on the last date to register for these shares (i.e. last date to acquire these shares for purposes of receiving the dividend).

Example 20: dividend income

Kombuis Limited owns 10 000 shares in Food Limited on 3 January 20X2, on which date Food Limited declared a dividend of C1 per share. This dividend is to be paid on 31 January 20X2 to those who are registered as shareholders of Food Limited as at 15 January 20X2. Kombuis Limited sold 2 000 shares on 11 January 20X2.
The dividend was paid by Food Limited on 31 January 20X2.

Required:
Provide any journal entries necessary in the books of Kombuis Limited. Ignore the journal entries regarding the sale of the shares

Solution to example 20: dividend income

The dividend may only be recognised as revenue on 15 January 20X2, being the last day to register as a shareholder.

15 January 20X2	**Debit**	**Credit**
Debtors	8 000	
Revenue from dividends (I)		8 000
Dividend income: (10 000 – 2 000) x C1		
31 January 20X2		
Bank	8 000	
Debtors		8 000
Receipt of cash dividend		

7. Revenue from customer loyalty programmes (IFRIC 13)

7.1 Overview

Many businesses have customer loyalty programmes in place to reward regular customers. The business will offer incentives for customers to buy their goods or services. Normally, the customer receives ‘points’ or ‘award credits’ for buying goods and services, which can be redeemed (exchanged) for free or discounted goods or services. Such programmes can come in a variety of ways, including situations where the programme is operated by a third party and not by the company at all.
IFRIC 13 was issued in July 2007 and entities must apply this interpretation for annual periods beginning on or after 1 July 2008.

7.2 Recognition and measurement

In terms of the interpretation, award credits must be accounted for as a separately identifiable component of the sales transaction, with the fair value of the total consideration received or receivable being allocated between the award credits and the other components of the sale. The award credits shall be measured by reference to their fair value (i.e.: the amount for which the award credits could be sold separately). The recognition of the revenue relating to the award credits differs depending on whether the entity or a third party supplies the awards.

7.2.1 If the entity supplies the awards

The revenue allocated to the award credits will be recognised when:
- the award credits are redeemed; and
- the entity fulfils its obligations to supply awards.

The amount of revenue recognised shall be based on the number of award credits that have been redeemed in exchange for awards, relative to the total number expected to be redeemed.

Example 21: Entity supplies the awards

A local retail store has a customer loyalty programme that awards points to customers in possession of a store card. Each C10 spent is awarded with one award point. Each award point can be redeemed for items in the retail store to the value of C1. The store sold C100 000 worth of goods to customers with store cards during 20X7. It expects that 95% of the points earned on these sales will be redeemed by customers in the future.
- 50% of the pointes earned in 20X7 were redeemed in 20X7.
- 30% of the points were redeemed in 20X8.
- 10% of the points were redeemed in 20X9.

In 20X9, management revised their estimate to that of only expecting 90% of the points earned in 20X7 to ever be redeemed.

Required:
Provide the journal entries for 20X7, 20X8 and 20X9 relating to the points earned in 20X7. Ignore all cost of sales journal entries.

Solution to example 21: entity supplies the awards

There are 10 points awarded in 20X7 (C100 000 / C10 x 1 point). Each point is worth C1 and therefore C10 000 of the total revenue of C100 000 must be deferred since these relate to the sales of customer loyalty points.

In 20X7 and 20X8, only 95% of these points are expected to be redeemed: 9 500 points. In 20X9, however, this estimate of points that will be redeemed drops to only 90%: 9 000 points.

20X7		**Debit**	**Credit**
Bank	*Given*	100 000	
Revenue from sales (I)	*Balancing*		90 000
Deferred revenue (L)	*C100 000 / C10 x C1*		10 000
Sales made in 20X7; customer loyalty points earned thereon are deferred			
Deferred revenue (L)	*50% x 10 000 points / 9 500 points x C10 000*	5 263	
Revenue from sales (I)			5 263
Sales from customer loyalty points that are redeemed			

20X8		**Debit**	**Credit**
Deferred revenue (L)	*(80% x 10 000 points / 9 500 points x C10 000) –*	3 158	
Revenue from sales (I)	*5 263 revenue already recognised*		3 158
Sales from customer loyalty points that are redeemed			
Deferred revenue (L)	*(90% x 10 000 points / 9 000 points x C10 000) –*	1 579	
Revenue from sales (I)	*(5 263 + 3 158 revenue already recognised)*		1 579
Sales from customer loyalty points that are redeemed			

7.2.2 If a third party supplies the awards

The recognition of the revenue will depend on whether the consideration allocated to the award credits is to be collected for the entity's own account or on behalf of a third party.

7.2.2.1 Collecting revenue for the entity's own account

Revenue relating to the award credits shall be recognised when the entity fulfils its obligations in respect of the awards (i.e. redeemed the 'points' by giving the awards).

The revenue shall be measured as the gross consideration allocated to the award credits.

7.2.2.2 Collecting revenue on behalf of a third party

Revenue relating to the award shall be recognised when the third party:
- becomes obliged to supply the awards ;and
- becomes entitled to receive the consideration for doing so (normally as soon as award credits are granted).

The revenue will be measured as the net amount retained for its own account (i.e. the difference between the consideration allocated to the award credits and the amount payable to the third party for supplying the awards).

If the customer can choose to claim awards from either the entity or a third party, then it is possible that the revenue may only be recognised when the customer chooses to claim awards from the third party.

Example 22: third party supplies the awards

A local retail store has a customer loyalty programme that awards points to customers in possession of a store card. Each C10 spent is awarded with one point. Each point can be redeemed for items in a local pharmacy to the value of C1. The retail store sold C100 000 worth of goods to customers with store cards during 20X7. The retail store paid the local pharmacy C0,75 per point. The consideration earned from these sales is for the benefit of the retail store.

Required:
Provide the journal entries for 20X7 in the books of the retailer.

Solution to example 21: third party supplies the awards

20X7		**Debit**	**Credit**
Bank	*Given*	100 000	
Revenue from sales (I)	*Balancing*		90 000
Deferred revenue (L)	*C100 000 / C10 x C1*		10 000
Sales made in 20X7; customer loyalty points earned thereon are deferred			

20X7 continued …		**Debit**	**Credit**
Loyalty programme exp	*C100 000 / C10 x C0.75*	7 500	
Bank			7 500
Payment to local pharmacy for participating in loyalty programme			
Deferred revenue (L)	*100% x 10 000 points x C1*	10 000	
Revenue from sales (I)			10 000
Deferred revenue from loyalty points is recognised immediately as the retailer's obligation to the customer are fulfilled			

7.3 Onerous contracts

If at any time the unavoidable costs of meeting the obligations to supply the awards are expected to exceed the consideration received and receivable for them, then entity shall recognise an onerous contract liability in accordance with IAS 37. The liability will be equal to the excess.

8. Disclosure (IAS 18.35)

8.1 Accounting policies

The entity should disclose the following under accounting policies:
- accounting policy for recognising revenue (e.g. revenue from the rendering of services is recognised based on the stage of completion); and
- the methods used to calculate the stage of completion in respect of the recognition of services rendered (e.g. the stage of completion is calculated using costs incurred to date as a percentage of total costs expected to be incurred).

8.2 Statement of comprehensive income and supporting notes

The total revenue recognised must be disclosed in the statement of comprehensive income (this is a disclosure requirement of the Framework and not a requirement of IAS 18). This amount should be supported by a note that details the amount of revenue recognised per significant category of revenue including the following:
- sale of goods;
- rendering of services;
- interest;
- royalties; and
- dividends

The amount of revenue for each of the above categories that was earned through the exchange of goods and services should be separately disclosed.

8.3 Sample disclosure involving revenue

Company name
Statement of comprehensive income (extracts)
For the year ending 31 December 20X2

	Note	20X2 C	20X1 C
Revenue	15	Xxx	xxx
Cost of sales		(xxx)	(xxx)
Cost of distribution		(xxx)	(xxx)
Cost of administration		(xxx)	(xxx)
Cost of other operations		(xxx)	(xxx)
Finance costs		(xxx)	(xxx)
Profit before tax		Xxx	xxx
Tax		(xxx)	(xxx)
Profit for the period		Xxx	xxx
Other comprehensive income		Xxx	xxx
Total comprehensive income		Xxx	xxx

Company name
Notes to the financial statements (extracts)
For the year ended 31 December 20X2

2. Accounting policies

2.1 Revenue recognition and measurement

2.1.1 Revenue in general

Revenue is measured at the fair value of the consideration received or receivable. Revenue represents the amounts receivable for goods and services provided in the normal course of business, net of discounts and refundable transaction taxes.

2.1.2 Sales revenue

Sales income is recognised when the goods are delivered and the title has passed (when risks and rewards have passed).

2.1.3 Interest revenue

Interest income is recognised on a time basis, by reference to the principle outstanding and the effective interest rate applicable, which is the rate that exactly discounts estimated future cash receipts through the expected life of the financial asset to the asset's carrying amount.

2.1.4 Dividend revenue

Dividend income from investments is recognised when the right to receive payment has been established.

2.1.5 Service revenue

Income from services rendered is recognised when the revenue, costs and the outcome can be reliably measured. Where the outcome of the contract cannot be measured reliably the revenue is recognised to the extent of costs incurred to date, and to the extents of costs recoverable. When it is expected that the costs of service contracts will exceed the revenue, the loss is recognised immediately.

Revenue from services is measured on the stage of completion basis. The percentage of completion is measured by the portion of costs incurred to date as to the total expected costs.

15. Revenue

	20X2 C	20X1 C
Revenue comprises of:		
Sale of goods	Xxx	xxx
Rendering of services	Xxx	xxx
Interest income	Xxx	xxx
Royalty income	Xxx	xxx
Dividend income	Xxx	xxx
	Xxx	xxx

9. Summary