# REVENUE: ASPE 3400

## Presenting Revenue: Gross vs. Net Revenue

- The amounts collected on behalf of the principal by an agent are not revenue. Instead, revenue is the amount of commission
- The **principal** is the person who:
    - sets the prices
    - owns the inventory
    - is responsible for inventory risk after the sale
    - bears the ultimate credit risk of customer not paying
- The **agent** is the person who:
    - Earns a fixed fee per transaction
    - Earns a percentage of the sales
- Example:
    - An agent makes a sale of $1,000 on behalf of a principal and remits $950
    - The agent will report *revenues* of $50 (rather than revenues of $1,000 and COGS of $950)
    - The principal will report revenues of $1,000 and show COGS of $50
- Reporting revenue gross vs. net has no effect on the overall net income

## Identification of the transaction (Multiple Deliverables)

- it is necessary to apply the recognition criteria to the **separately identifiable components** of a single transaction in order to reflect the substance of the transaction
    - when a component of a sale
        - has stand-alone value (i.e. it may be sold separately alone); and
        - the fair value of that component can be objectively measured
    - the revenue recognition criteria (below) are assessed for each of the above mentioned component separately
    - revenue for the components can be accounted for using the:
        1. **residual value method** – whereby the fair value of one component is measured, and the other component is measured at the residual amount of the proceeds
            - use this method when FV for one component is not determinable
        2. **relative value method** – the proceeds is allocated to the components based on their relative fair value
            - use this method when FV for all components are determinable
    - Example: A fitness club sells a $1,000 annual gym membership. In addition to annual usage of the gym, the $1,000 also entitles the user 10 hours with a fitness trainer.
        - Stand-alone value ; The monthly usage and the fitness trainer time both have stand-alone value because a person can buy it separately
        - Fair Value; can be objectively because, they are also separately sold
        - $1,000 will be allocated to the components using either the relative value or the residual value method
        - The rev rec criteria will be assessed separately for the annual membership and the fitness trainer time
        - The annual membership will be recognized on a straight line basis over monthly
        - The fitness trainer time will be recognized as the trainer spends the time with the user

## Revenue Recognition

Revenue from sale of goods and service is recognized when **performance is achieved** provided that at the time of performance **ultimate collection is reasonably assured**

## Sale of Goods

- In a transaction involving the **sale of goods**, performance is achieved when the following conditions are met:
    1. the seller of the goods has transferred to the buyer **the significant risks and rewards of ownership**, in that all significant acts have been completed; and
    2. the seller retains no **continuing managerial involvement** in, or **effective control** of, the goods transferred to a degree usually associated with ownership; and
    3. reasonable assurance exists regarding the **measurement of the consideration** that will be derived from the sale of goods, and the **extent to which goods may be returned**
- When refunds are offered, as long as the future returns can be reasonably estimated based on past track record or other relevant factors, a revenue can be recognized (net of the provision for the return)
- Examples of a significant risk of ownership being retained by a seller are:
    - when there is a liability for unsatisfactory performance not covered by normal warranty provisions;
    - when the purchaser has the right to cancel the transaction
    - when the goods are shipped on consignment

## Rendering of services

- In the case of rendering of services and long-term contracts, revenue is recognized using either the **percentage of completion method** or the **completed contract method**, whichever relates the revenue to the work accomplished
- Such performance is achieved when **reasonable assurance** exists regarding the **measurement of the consideration** that will be derived from rendering the service or performing the long-term contract.
- **Percentage of completion method**
    - The percentage of completion method is used when performance consists of more than one act
    - revenue would be recognized proportionately by reference to the performance of each act.
    - Revenue recognized under this method would be determined on a rational and consistent basis such as
        - basis of sales value
        - associated costs
        - extent of progress
        - number of acts
        - Amounts billed are not an appropriate basis of measurement unless they reflect the work accomplished
    - When several acts are performed over time, and when no single act is more significant than the other, revenue is recognized on a straight line basis

- **Completed Contract Method**
  - The completed contract method would only be appropriate when:
    - **performance consists of the execution of a single act;** or
    - when the enterprise **cannot reasonably estimate the extent of progress** toward completion.

## Performance

- For **both goods and services**, performance is achieved when **all** of the following criteria have been met:
  - **persuasive evidence** of an arrangement exists;
  - **delivery** has occurred or services have been rendered; and
  - the **sellers' price to the buyer** is fixed or determinable

- **persuasive evidence of an arrangement**
  - we examine the arrangement to determine if in substance it is a revenue transaction (rather than what it may be called)
  - some things that we consider to see if persuasive evidence of revenue arrangement exist are as follows:
    - customary business practices – what binds the customer (i.e. signature on invoice)
    - side arrangements – could override the original arrangement
    - consignment arrangements – revenue cannot be recognized until the goods are sold by the consignee
    - rights to return the product/requirements to repurchase the product – revenue can only be recognized when returns can be reasonably estimated
- **Delivery**
  - delivery is not considered to have occurred unless the product has been delivered to the site specified by the customer
  - things to consider if delivery has occurred include:
    - bill and hold arrangements (can recognize sale when goods ready for delivery)
    - customer acceptance of product (need to wait till acceptance)
    - layaway sales arrangements (i.e. cash deposits – these are deferred revenues – delivery occurs when the service for the deposit performed)
    - non-refundable fee arrangements (upfront fees – these are deferred revenues– delivery occurs when the service for the deposit performed)
    - licensing and similar fee arrangements (recognize over licence term)

- **Seller's price to buyer is fixed**
  - Consider the following to determine if the seller's price to the buyer is fixed or determinable:
    - cancellable sales arrangements (price may not be fixed till cancellation period ends)
    - right of return arrangements (cannot recognize revenue unless you can predict the returns – for new products this is hard to do)
    - price protections and/or inventory credit arrangements (cannot recognize revenue unless you can predict these amounts)
    - refundable fee for service arrangements (revenue recognized length of contract, if you can estimate the refunds/cancellations – otherwise wait till the cancellation period ends)

## Interest, royalties and dividends

Revenue arising from the use by others of enterprise resources yielding interest, royalties and dividends is recognized when **reasonable assurance exists regarding measurement and collectability**. These revenues shall be recognized on the following bases:

- interest: on a time proportion basis
- royalties: as they accrue
- dividends: when the shareholder's right to receive payment is established

## Effect of Uncertainties

- **uncertainties due to collection**
  - When there is uncertainty as to ultimate collection, it may be appropriate to recognize revenue only as cash is received
  - Gross profit = total gross profit * (cash received/total sales price)

- **Uncertainties due to measurement of revenue**
  - Examples
    - when payment relating to goods sold depends on the resale of the goods by the buyer
    - significant and unpredictable amounts of goods could be returned (occurs when the market for the product is untested)
  - under both cases, revenue would not be recognized until the revenue can be more reliably measured (i.e. when the buyer has sold the goods, or when the return period ends)

## Payments by a vendor to a customer

- **From customer's view point:**
  - cash received by a customer from a vender is normally treated as a reduction to the purchase price (rather than revenue)
    - However, if the cash is a receipt for goods or services delivered by the customer to the vendor, the customer recognizes the cash as revenue
  - If the cash is meant to reimburse the customer for the costs to re-sell the vendor's products, the customer treats the cash as a reduction to the costs to sell the vendor's product

- **From vendor's view point**
  - Cash paid by a vendor to a customer is normally treated as a reduction to the selling price (rather than an expense)
  - Cash paid by a vendor to a customer is expensed when the following conditions are met:
    - The vendor receives, or will receive, an identifiable benefit (products or services) in exchange for the consideration
      - i.e. vendor could have entered into a transaction with a party other than the purchaser of its products or services in order to receive this benefit
    - The vendor can reasonably estimate the fair value of the benefit identified under condition

## Comparison to IFRS

- under IFRS, the revenue recognition criteria are slightly different
- under IFRS, the completed contract method is not allowed