IFRS SCOPE:
Revenue Recognition Accounting

Accounting for revenue correctly is a critical factor in determining the true and fair nature of financial statements of an entity. This is because revenue affects the current financial performance (net income or earnings) and position (net assets) of a company. In other words, not correctly accounting for revenue would lead to a misstatement of the profit and net asset of an entity. Hence, this article is aimed at reiterating the recognition and measurement principles under the International Financial Reporting Standards Framework.

Revenue recognition and measurement is covered under International Accounting Standard (IAS) 18. While other standards exist for specialised revenue transactions, IAS 18 provides the general reporting framework for most types of business sales transactions. Thus, its provisions does not cover transactions with other specific standards. These include accounting for lease transactions, construction contracts, insurance contracts, and dividend from associates, changes in values of financial assets and liabilities and other current assets, changes in fair value of biological assets, initial recognition of agricultural produce and extraction of mineral ores.

IAS 18 defines revenue as '*the gross inflow of economic benefits during the period rising in the course of the ordinary activities of an entity when those inflows result in increases in equity, other than increases relating to contributions from equity participants*'. This means that economic benefit in the form of cash or other asset is received or receivable in the period and that such transactions arise from day to day business activities of the entity. This definition is important as it distinguishes revenue from other gains that an entity may have in a financial period.

It is a fundamental accounting principle that where the equity value of an entity changes between two financial periods without additional contribution from the owners of the business, the entity has earned an income for that period.

This income, defined in the conceptual framework as *increases in economic benefits during the accounting period in the form of inflows or enhancements of assets or decreases of liabilities that result in increases in equity, other than those relating to contributions from equity participants*, comprises of revenue and gains for the period. Gains are generally considered not to be arising from the primary business object of an entity and are usually one off or occasional. Gains are also stated net of related expenses unlike revenue which represents gross economic inflow to the entity.
The standard covers revenue arising from transactions and events relating to:

i. Sale of goods
ii. Rendering of services and
iii. Interest royalties and dividend arising from the use of an entity's assets by others.

Part One: Revenue Recognition Criteria
A. Sale of Goods

Revenue from sale of goods, whether manufactured, purchased for resale or land and properties held for sale, should only be recognised when all of the following has taken place:

i. Significant risk and reward of ownership relating to the goods has been transferred to the customer. This is usually at the point of transferring title or buyer taking possession of the goods. Individual sale transaction however needs to be evaluated in order to ascertain if the risk and reward relating to the goods have been transferred. Other situations that may indicate that the seller still retains the risk include; significant after sale performance still outstanding e.g installation; revenue receipt contingent on resale by buyers.

The Seller retains no continuing managerial involvement of ownership nor effective control over the goods sold.

iii. The amount of revenue can be measured reliably
iv. It is likely that economic benefit of the transaction will flow to the entity i.e probable that revenue will flow to the seller and
v. The cost of the transaction can be measured reliably (including those to be incurred)

B. Rendering of Services

The rendering of services typically involves the performance by the entity of a contractually agreed task over an agreed period of time. The services may be rendered within a single period or over more than one period. Revenue from the rendering of services should be recognised only when the outcome of a transaction can be estimated reliably. This is done by reference to the stage of completion of the relevant transaction at the end of the reporting period.

The outcome of a transaction can be estimated reliably when all the following conditions are satisfied:

a. the amount of revenue can be measured reliably; This can be assumed when all of the following has been determined:

i. each party's enforceable rights regarding the service to be provided and received by the parties;
ii. the consideration to be exchanged; and
iii. the manner and terms of settlement.

b. it is probable that the economic benefits associated with the transaction will flow to the entity;
c. the stage of completion of the transaction can be measured reliably;

i. surveys of work performed;
ii. services performed to date as a percentage of total services to be performed; or
iii. the proportion that costs incurred to date bear to the estimated total costs of the transaction.

d. the costs incurred for the transaction and the costs to complete the transaction can be measured reliably.

Where services are performed by numerous or indeterminate number of service acts, revenue is recognised on a straight line basis over the specified period. In any period where the outcome of transaction involving the rendering of services cannot be determined, revenue should be recognised only to the extent of the expenses recognised and are estimated to be recoverable. Where such expenses are irrecoverable, no revenue should be recognised.

C. Interest, Royalty And Dividend

Revenue arising from the use of any entity's asset by others yielding interest, royalties and dividends are recognised only when:
a. it is probable that economic benefits associated with the transaction will flow to the entity
b. the amount of revenue can be measured reliably.

Therefore, such revenue should be recognised on the following basis:

i. Interest Income are to be recognised using effective interest method as laid down in IAS 39 Financial Instruments recognition and measurement.
ii. Royalties should be recognised on accrual basis in accordance with the substance of the agreement.
iii. Dividend are to be recognised when shareholders right to receive payment is established.

Part Two: Identification of the transaction
Recognition criteria explained above should be applied separately to individual transaction or arrangement except where a single transaction involve multiple deliveries. When such is the case, revenue recognition criteria needs to be applied to each component of the transaction separately. Examples of such situations include:

i. Single sale transaction involving sale of goods and subsequent servicing.
ii. Single sale transaction involving sale of goods and installation services.
iii. Sale of hardware and software as a single product.
iv. Single sale transaction involving sale of software and future maintenance contract.

Other times, multiple deliverables must be recognized as a single transaction in order to reflect its commercial substance. Examples include:

a. Sale of goods with a separate agreement to repurchase the goods at a later date
b. Sale of goods and services with customer loyalty awards

Part Three: Measurement Basis
Having discussed the various recognition criteria, the next issue is to determine the basis for appropriating monetary value to revenue to be recognised in the financial statements. IAS 18 requires that revenue be measured at the fair value of consideration received or receivable net of trade discounts, prompt settlement discounts and volume rebates. It should also exclude amount collected on behalf of another party such as sales tax, Value Added Tax, or Government Sales Tax or amount collected by an entity acting as an agent to a principal seller.

The fair value of consideration received or receivable is readily determined for most over the counter transaction as the amount of cash or other consideration agreed by the parties entering into such sales contract. Where the consideration receivable by the seller is being deferred, such transaction needs to be evaluated in relation to the normal deferral or credit period allowed by the seller for normal business transactions.

Where deferral is beyond normal business credit period, it is most likely that the time value of money be significant. Thus the standard classify such arrangement as a financing arrangement and requires that the sales element be separated from the financing. This is achieved by discounting the consideration receivable to its present value using an imputed interest rate. The imputed rate of interest is the more clearly determinable of either:

i. the prevailing rate for a similar instrument of an issuer with a similar credit rating; or
ii. a rate of interest that discounts the nominal amount of the instrument to the current cash sales price of the goods or services

The difference between the fair value and the nominal amount of the consideration receivable is recognised as interest revenue in accordance with IAS 39.

It is also possible that a sale consideration is settled via exchange of goods of services. Where such consideration involves the exchange of similar goods or services, no sales transaction has occurred hence, no revenue is recognised. If the transaction however involves the exchange of dissimilar goods or services, such transactions generate revenue and the revenue is measured at the fair value of the goods or services received, adjusted by any amount of cash or cash equivalent received in the transaction.

Where the fair value of the goods or services received cannot be measured reliably, the revenue is measured at the fair value of the goods or services given up, adjusted by the amount of any cash or cash equivalents transferred.

Part Four: Disclosure Requirements

The following disclosures are required to be made by an entity in any financial period:

i. the accounting policies adopted for the recognition of revenue, including the methods adopted to determine the stage of completion of transactions involving the rendering of services;
ii. the amount of each significant category of revenue recognised during the period, including revenue arising from:

a) the sale of goods;
b. the rendering of services;
c. interest;
d. royalties;
e. dividends; and

iii. the amount of revenue arising from exchanges of goods or services included in each significant category of revenue.

Part Five: Conclusion

Business entities in Nigeria need to take deliberate steps in complying with the provisions of IAS 18 in line with the transitioning to IFRS reporting framework in Nigeria. A comprehensive review of current software and IT systems needs to be carried out in order to determine the adequacy of such systems for IFRS reporting or necessary modification required. Current recognition criteria under the local GAAP, contract arrangement as well as accounts and ledgers should all be reviewed for compliance.

It is also to be noted that a new standard IFRS 15 on Revenue from Contract with Customers was issued in May 2014. The new standard has an effective date of 1 January 2017 and will replace all the existing reporting standards for revenue except for contracts within the scope of the standards for leases, insurance contracts and financial instruments.

For more clarification and discussion on how we can help your business successfully transit to and comply with International Financial Reporting Standards, please contact the following persons:

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