The purpose of IAS 18

Revenue is recognised in the statement of comprehensive income when:

- There is an increase in future economic benefits related to an increase in an asset or a decrease in a liability, and
- This increase in economic benefits can be reliably measured.

Revenue is income that arises in the ordinary course of activities and it is referred to by a variety of different names including:

1. Sales of goods
2. Fees/Revenue derived from rendering of services
3. interest
4. dividends
5. royalties

In relation to 1 and 2, there is also revenue recognition from sales of goods with service agreements.

IAS 18 Revenue defines revenue as
"The gross inflow of economic benefits during the period 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."

It adds that revenue relates only to economic benefits receivable by the entity for its own account. Amounts collected on behalf of a third party, such as sales tax collected on behalf of the government, must be excluded from revenue because they do not result in an increase in equity.

Measurement of revenue

IAS 18 states that revenue must be measured at '<u>the fair value of the consideration received or receivable</u>'.
Broadly speaking, this is the:
Fair market price <u>less</u> any volume rebates (discount allowed for buying in large quantities) or 'trade discount allowed'.
If in a given situation trade discount is not yet decided, revenue cannot be measured reliably and can only be recognized after determining the amount of trade discount.

- If a sale is a cash sale, the revenue is the immediate proceeds of the sale.
- If a sale is a normal credit sale, the revenue is the expected future receipt.

However, in some cases when the payment is deferred, the fair value might be less than the amount of cash that will eventually be received. The difference between the nominal sale value and the fair value of the consideration is recognised as interest income.

This interest income is also known as imputed interest.

Franchising

Franchising is a form of business by which the owner (franchisor) of a product, service or method obtains distribution through affiliated dealers (franchisees).

The franchisor provides the franchises with a licensed right to carry out a business activity under the franchisor's name. The franchisee owns a business which from the outside looks as if it is part of a much larger entity.

The franchisor provides services such as training and marketing and supplies inventory to the franchisee. The franchisee pays a fee for the services.

The franchisor must recognise franchise fees in a way that reflects the purpose for which the fee is charged.

Examples of fee types and recognition:

- Training: as the training is delivered (reflecting the pattern of delivery)
- Supply and installation of assets: On completion of installation of each asset.
- Management service: On a monthly (or any other in respect of frequency of amounts received from franchisee) basis.
- Local advertising: as the advertising is delivered
- National advertising: On a monthly (or any other in respect of frequency of amounts received from franchisee) basis or to reflect advertising activity.
- Quarterly fee (Usually a fixed percentage of franchisee's gross revenue) : As earned in relation to sales made.

Other Cases

Case1: *Fees from the development of customized software*

Rule: Fees from the customised software are recognized as revenue by reference to the stage of completion of the development.

Case2: *Installation fees*

Rule:
If they are incidental to sale of a product, they are recognized when goods are sold.
If they are not incidental to sale of a product, they are recognized as revenue by reference to the stage of completion of the installation.
