Compliance with BAS 18 in respect of Revenue Recognition: A Study on Some Selected Companies in Bangladesh

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Abstract

Revenue recognition is one of the most important issues in the area of Accounting. This paper examines the revenue recognition criteria adopted and pronounced by ICAB in BAS 18 (adopted IAS 18) and analyzes the distinctions between the revenue recognition criteria in IAS 18 and those in US GAAP. In this study an attempt has been made to review the practices by some selected pharmaceutical and chemical companies in Bangladesh in recognizing the revenues and to observe the compliance with the established criteria.

Key Words: Revenue, IAS, GAAP, established criteria.

Introduction

For many businesses, the revenue figure is seen as a key measure of the level of economic activity. That is because it reflects the extent to which the business has been busy supplying goods or services to customers. Users can therefore compare the entity's current level of economic activity under a contract with a customer with past activity levels and with that of its competitors as part of their assessment of the business' performance. Such market share information, coupled with the analysts' own assessments about the sector's prospects and the entity's competitiveness, also provides the basis for their forecasts about the entity's future performance.

When recognizing revenues accountants have to follow some established criteria such as US GAAP or IFRSs/IASs. In Bangladesh, the criteria for revenue recognition are well established. In addition to some other rules and regulations, BAS 18 is applicable for revenue recognition.

Objectives of the Study

The main purpose of the present study is to have a deep insight into revenue recognition criteria. To be specific the study has the following objectives:

i) To review the revenue recognition criteria IAS 18 adopted by ICAB as BAS 18;
ii) To analyze the distinctions between revenue recognition criteria in IAS 18 and those in US GAAP;
iii) To review the practices of revenue recognition by some selected companies and put forward some recommendations.

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Methodology

This study is explorative and descriptive in nature. An attempt has been made to include the latest information regarding revenue recognition criteria. Both primary and secondary data have been used. The primary data have been collected through questionnaire survey. The respondents of the survey have been selected from among the executives in accounting department of the respective companies. The samples have been selected on random basis. The secondary data have been collected from published materials.

Literature Review

In Conceptual Framework developed by International Accounting Standards Board (IASB) and adopted by Institute of Chartered Accountants of Bangladesh (ICAB) it is mentioned that revenue arises in the course of the ordinary activities of an entity and is referred to by a variety of different names including sales, fees, interest, dividends, royalties and rent.
Weygandt, Kieso and Kimmel (2007, p.13) have said in their book *Accounting Principles* "Revenues are the gross increase in owner's equity resulting from business activities entered into the purpose of earning income." They have also mentioned that companies recognize revenue in the accounting period in which it is earned.

In January 1999, the AICPA published Audit Issues on Revenue Recognition. The publication brings together in one source the audit and accounting guidance on revenue recognition for sales of goods and services in the ordinary course of business. Its primary objective is to help auditors fulfill their professional responsibilities with regard to auditing assertions about revenue. A related objective is to help other members of the financial community, including preparers of financial statements and audit committees, appreciate the importance of accurate revenue recognition.
In an article titled *A Fresh Look at Revenue Recognition* it has been said that the FASB (Financial Accounting Standards Board) and the IASB (International Accounting Standards Board) are making progress toward a better, more consistent way for companies to recognize and measure their revenue. The author has discussed the proposed model, as outlined in the discussion paper issued on December 19th 2008, entitled, "Preliminary views on revenue recognition in contracts with customers" (IASB, 2008) and asks how this differs from current practice. (Pounder ,2009, pp.16-61)
In November 2011, the IASB and FASB jointly published a new exposure draft (ED), 'Revenue from contracts with customers'. The core principle of the new ED is essentially the same as the previous one, and broadly consistent with the current standards: in effect, an entity recognizes revenue as it delivers goods and services to a customer. However, although the new ED retains the same overall 'five step' approach outlined in the previous ED, much of the detail has changed, so all IFRS reporters should consider its impact on them (Barden, 2011).
IASB has proposed to revise the rules on revenue recognition, which aim to increase the confidence of investors and analysts outline the weaknesses in the existing standards addressing this topic: IAS 18 "Revenue" and IAS 11 "Construction Contracts (Collings, 2012).

IAS 18 "Revenue", sets out the accounting treatment of revenue arising from certain types of transactions and events. Revenue arises in the course of an entity's ordinary activities and is referred to by a variety of different names including sales, turnover, fees, interest, dividends, royalties and rents. IAS 18 identifies the primary issue as determining when to recognize revenue and sets out the criteria that should be used for determining whether or not revenue should be recognized (PricewaterhouseCoopers, 2003, p.168).

Summary of BAS 18/IAS 18

Objective of BAS 18/IAS 18

The objective of BAS 18/IAS 18 is to prescribe the accounting treatment for revenue arising from certain types of transactions and events.

Key Definitions

Revenue: Revenue is the gross inflow of economic benefits (cash, receivables, other assets) arising from the ordinary operating activities of an entity (such as sales of goods, sales of services, interest, royalties, and dividends). [BAS18.7/IAS 18.7]

Fair Value: Fair value is the amount for which an asset could be exchanged, or a liability settled, between knowledgeable, willing parties in an arm's length transaction.

Measurement of Revenue

Revenue should be measured at the fair value of the consideration received or receivable. [BAS 18.9/IAS 18.9] An exchange for goods or services of a similar nature and value is not regarded as a transaction that generates revenue. However, exchanges for dissimilar items are regarded as generating revenue. [BAS18.12/IAS 18.12]

If the inflow of cash or cash equivalents is deferred, the fair value of the consideration receivable is less than the nominal amount of cash and cash equivalents to be received, and discounting is appropriate. This would occur, for instance, if the seller is providing interest-free credit to the buyer or is charging a below-market rate of interest. Interest must be imputed based on market rates. [BAS 18.11/IAS 18.11]

Recognition of Revenue

Recognition, as defined in the IASB *Framework*, means incorporating an item that meets the definition of revenue (above) in the income statement when it meets the following criteria:

- it is probable that any future economic benefit associated with the item of revenue will flow to the entity, and
- the amount of revenue can be measured with reliability

BAS/IAS 18 provides guidance for recognizing the following specific categories of revenue:

Sale of Goods

Revenue arising from the sale of goods should be recognised when all of the following criteria have been satisfied: [BAS 18.14/IAS 18.14]

- the seller has transferred to the buyer the significant risks and rewards of ownership
- the seller retains neither continuing managerial involvement to the degree usually associated with ownership nor effective control over the goods sold
- the amount of revenue can be measured reliably
- it is probable that the economic benefits associated with the transaction will flow to the seller, and
- the costs incurred or to be incurred in respect of the transaction can be measured reliably

Rendering of Services

For revenue arising from the rendering of services, provided that all of the following criteria are met, revenue should be recognised by reference to the stage of completion of the transaction at the balance sheet date (the percentage-of-completion method): [BAS 18.20/IAS 18.20]

- the amount of revenue can be measured reliably;
- it is probable that the economic benefits will flow to the seller;
- the stage of completion at the balance sheet date can be measured reliably; and
- the costs incurred, or to be incurred, in respect of the transaction can be measured reliably.

When the above criteria are not met, revenue arising from the rendering of services should be recognised only to the extent of the expenses recognised that are recoverable (a "cost-recovery approach". [BAS 18.26/IAS 18.26]

Interest, Royalties, and Dividends

For interest, royalties and dividends, provided that it is probable that the economic benefits will flow to the enterprise and the amount of revenue can be measured reliably, revenue should be recognised as follows: [BAS 18.29-30/IAS 18.29-30]

- interest: using the effective interest method as set out in BAS 39/IAS 39
- royalties: on an accruals basis in accordance with the substance of the relevant agreement
- dividends: when the shareholder's right to receive payment is established

Disclosure [BAS 18.35/IAS 18.35]

An enterprise should disclose:

(a) accounting policy for recognizing revenue
(b) amount of each of the following types of revenue:
    - sale of goods
    - rendering of services
    - interest
    - royalties
    - dividends

(c) within each of the above categories, the amount of revenue from exchanges of goods or services

Revenue Recognition: BFRS/BAS (IFRS/IAS) vs. GAAP

SL. No.	Point of Difference	BFRS/BAS (IFRS/IAS)	GAAP
1.	The Concept of Revenue	BAS 18 defines revenue as follows: "Revenue is the gross inflow of economic benefits during the period arising in the course of the ordinary activities of an enterprise when those inflows result in increases in equity, other than increases relating to contributions from equity participants." Revenue includes both revenues & gains.	US GAAP defines revenues as: "…inflows or other enhancements of assets of an entity or settlements of its liabilities (or a combination of both) from delivering or producing goods, rendering services, or other activities that constitute the entity's ongoing major or central operations." There is separate definition for Gains.
2.	Applicable Authoritative Guidance	The primary BFRS guidance applicable to revenue recognition accounting includes: • BAS 18 – "Revenue" • BAS 11 – "Construction Contracts" • BFRIC 13: Customer Loyalty programmes • SIC 31: Revenue -Barter Transactions Involving Advertising Services	Some examples of the US GAAP and SEC guidance applicable to revenue recognition accounting include: •SAB 101-"Revenue Recognition" (amendment by SAB 104) •EITF 00-21–"Revenue Arrangements with Multiple Deliverables" • FAS 48 – "Revenue Recognition When Right of Return Exists" • FAS 5 – "Accounting for Contingencies" • EITF 99-19 – "Reporting Revenue Gross as a Principal versus Net.. • EITF 01-09 – "Accounting for Consideration Given by a Vendor … • EITF 99-17 – "Accounting for Advertising Barter Transactions" • ARB 43 – "Restatement and Revision of Accounting Research … • SOP 81-1 – "Accounting for Performance of Construction.. • SOP 97-2 – "Software Revenue Recognition"

			• FAS 66 – "Accounting for Sales of Real Estate"
3.	Sale of goods	Revenue from the sale of goods should be recognized when all the following conditions have been fulfilled: - The entity has transferred to the buyer the significant risks and rewards of ownership of the goods, - The entity retains neither continuing managerial involvement to the degree usually associated with ownership nor effective control over the goods sold, - The amount of revenue can be measured reliably, - It is probable that the economic benefits associated with the transaction will flow to the entity, and - The costs incurred or to be incurred in respect of the transaction can be measured reliably.	Revenue should not be recognized until it is realized or realizable and earned. As per SAB 104 SAB 101), revenue is "realized or realizable" and "earned" only when all of the following conditions are met: - Persuasive evidence of an arrangement exists, - Delivery has occurred or services have been rendered, - The seller's price is fixed or determinable, and - Collectability is reasonably assured.
4.	Recognizing Revenue from Service Transactions	If the criteria of BAS 18 are met, BFRS requires that revenue from service transactions "be recognized by reference to the stage of completion of the transaction at the balance sheet date". This means that revenues from service transactions should be recognized on a percentage of completion basis, presuming reliable indicators of progress towards completion exist.	Under US GAAP, the percentage of completion method is only applicable to entities engaged in performing long-term construction contracts and, in specific circumstances, to developers of software. Under US GAAP, service providers should first determine whether the services they provide are within the scope of specific accounting literature (e.g., SOP 81-1, FTB 90-1).
5.	Rights of Refund on Service Transactions	Under BFRS, a service arrangement that contains a right of refund must be considered to determine whether the outcome of the contract can be estimated reliably. When reliable estimation is not possible, revenue is recognized only to the extent of the costs incurred.	Under US GAAP, a right of refund may prelude recognition of the revenues from a service arrangement until the right of refund expires.

Contd. table

6.	Recognizing Revenue from LT Construction Contracts	BFRS allows Percentage of Completion only. Completed Contract method is prohibited. BFRS requires the percentage of completion method without which the outcome cannot be reasonably estimated. If the outcome cannot be reasonably estimated, the zero-profit (cost recovery) method should be used.	Under US GAAP percentage of completion method is preferred but not required. Completed Contract method should be used if revenues and costs are difficult to estimate.
7.	Problem with current models under GAAP & BFRS/BAS	Lack of guidance.	Too many rules and standards; Inconsistency among standards.

Convergence Joint Project by IASB and FASB

The FASB and IASB are currently conducting a joint project to develop concepts for revenue recognition and a standard based on those concepts.
The goals of the project are as follows:

1. Converging U.S. and international standards.
2. Eliminating inconsistencies in the existing conceptual guidance.
3. Providing conceptual guidance that would be useful in addressing future revenue recognition issues.
4. Eliminating inconsistencies in existing standard-level authoritative literature and accepted practices.
5. Filling voids in guidance that have developed over time.
6. Establishing a single comprehensive standard on revenue recognition.

Analysis and Findings

Primary data as well as secondary data, regarding revenue recognition have been collected from twelve pharmaceutical companies through questionnaire survey and analyzing annual reports. These twelve pharmaceutical companies have been selected on random basis. On the basis of collected information it can be said that all the twelve sample pharmaceutical companies, named Advanced Chemical Industries Ltd., Ambee Pharmaceuticals Ltd., Beacon Pharmaceuticals Ltd., Beximco Pharmaceuticals Ltd., Kohinoor Chemicals Co. (Bangladesh) Ltd., Libra Infusions Ltd., Orion Infusion Ltd., Pharma Aids Ltd., Reckitt Benckiser (Bangladesh) Ltd., Renata Ltd., Square

Pharmaceuticals Ltd., The IBN SINA Pharmaceutical Industry Ltd. recognize the revenues in the same manner. The revenue recognition criteria followed by the selected companies are discussed below:

- In compliance with the requirements of BAS 18: "Revenue", revenue from receipts from customers against sales is recognized when products are dispatched to customers, that is, when the significant risk and rewards of ownership have been transferred to the buyer, recovery of the consideration is probable, the associated costs and possible return of goods can be estimated reliably, and there is no continuing management involvement with the goods.
- Interest income is recognized when accrued on a time proportion basis; that is accrual basis is followed in recognizing interest income.
- Cash Dividend income is recognized when the right to receive payment is established.

Conclusion and Recommendation

Whatever the type, each and every organization earns revenue. Revenue should be recognized with due care, otherwise there will be a possibility of producing and providing distorted financial information. Consequently, the users of accounting information will lose their reliance on the provided information and the objectives of financial reporting will not be fulfilled.

Based on the collected information, it can be concluded that the financial reporting practices of the selected companies in respect of revenue recognition are found to be satisfactory. But after reviewing the annual reports of the selected companies it can also be said that more detailed disclosure is needed in the notes accompanying the financial statements to comply with paragraph 35 of the Bangladesh Accounting Standard 18 (BAS 18).

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