

Revenue Recognition In Practice: Theoretical, Calculative And Accounting Differences Between Ias 18 And Ifrs 15/Asc 606

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ABSTRACT

Accounting Standards plays an eminent role in regulation the Principles, Guidelines and Rules for Financial Statement framework. Prior to the advent of Global Accounting Standards, there were inconsistencies in the Accounting Standards of different countries as each countries practiced its respective Accounting Standards. It is due to this differences that the gave rise for one Global Financial Language, hence in 2014 IASB (that handles IFRS) and FASB (that handles the US GAAP) collaborated to develop the Global Accounting Standards. In order to assess the Financial Performance and Positioning of any entity, Revenue plays a vital role. Therefore, there are certain guidelines set by the ASC/ IFRS for the prompt recognition of Revenue. This article clarifies on how the Revenue is recognized based IAS and ASC/ IFRS guidelines.

Keywords: Financial Statement, Indian Accounting Standard, Revenue Recognition, Performance obligation, IFRS.

1. INTRODUCTION

With the advent of Globalization, there was a need to bring up a Global Financial Language that can be Internationally followed. This not only assists in defined the Framework for the Financial Statements but eases the quality and comparability between Entities and also Industries. One such core concept is 'Revenue Recognition' as this is a fundamental look-out criteria of every Stakeholder. Revenue derives the profit and performance metrics, hence its recognition also must be consistent, aligned and reliable. The Revenue Recognition has 2 methods based on IAS 18 i.e.,

1. Cost of Acquiring Customer

This states that if the cost is incremental in nature and the firm prefer to recover it, then it is capitalized as contract cost asset and it further will be amortized over the period of time. However, if the firm decides to not recover it, then it shall be expensed.

2. Residual Method

This method is to determine the Standalone selling price (SSP) during the transaction price allocation. The allocation can be via SSP to the item or Residual amount to the performance obligation remaining.

This practice of Revenue Recognition was inconsistently practiced amid entities and various industries. Therefore, to address this IASB and FASB developed a standard for recognizing the revenue (ASC 606 and IFRS 15). This Revenue Recognition process includes the 5-step model as mentioned below:

• Step 1: Identify the contract with a customer

This step states that the contract shall exists when it has few key criteria i.e., Approval, Commitment, Prominent Rights, Prominent Payment Terms, Commercial Parameters and probable Collective Activities involved.

• Step 2: Identify the performance obligations

The clear identification of Goods and Services that shall be accounted for, shall be determined under the Performance Obligation.

• Step 3: Determine the transaction price

Under this step, Transaction price refers to the amount for which the company is expected to be entitled in exchange for transferring the Goods and Services.

• Step 4: Allocate the transaction price to the performance obligations

Allocation based on the selling prices (stand-alone) for each of the performance obligation.

• Step 5: Recognize revenue when (or as) the entity satisfies a performance obligation

Recognition of Revenue for a certain period of time based on, when the asset control is transferred.

These modern Accounting Standards are targeted the Entities to present a clear picture of Revenue, with explanation to Contract Balances (i.e., Contract Assets and Contract Liabilities). This results in prompt representation of Revenue ascertainment in Financial Statement and in turn gaining the confidence of the investors.

2. LITERATURE REVIEW:

- **Kabir & Su (2022- Australia & New Zealand)** conducted research on the impact of Revenue Recognition practices in Australian and New Zealand list entities. Based on the analysis, two third disclosed measurable impact due to this standard. The main pointers impacted were cost of goods sold, contract liabilities and profit after tax. At the end, the author states that the impact was more higher on the firms with that deal with complex contract and not the simple retail sales.
- **Napier & Stadler (2020)** studied on the **Real Effects of IFRS 15**. The study targets on the impact of IFRS 15 on accounting, capital market and its effects. The author has used a combined method of primary and secondary data analysis for the study. The results of the research states that, clear accounting and information effects changes in the financial reports.
- **Bernouly & Wondabio (2019)** focused on the research of IFRS 15 impact on telecom financial statements (PT XYZ case). The case study was done on an Indonesian Telecom industry in focus to impact of IFRS 15 on measurement, recognition, presentation and disclosure of revenue. Quantitative approach was used for this research. The study concludes that there is a need for cross functional coordination and not alone the accounting/ finance team.
- **Jieri, Brînzaru (Tanasă), Grosu, & Mihailă (2021/2022)** studied on Revenue disclosures under IFRS 15. The author calls the implementation of IFRS 15 a radical change for the industries. Further adds that, it assists in the disclosure of various aspects of revenue i.e., contract balances, performance obligation, contract cost etc. This gives a disaggregated version of revenue resulting in better financial reporting and planning.

3. RESEARCH QUESTIONS

The following research questions guided this study:

- What is the conceptual difference between Revenue Recognition between IAS 18 and ASC 606/ IFRS 15?
- How is Revenue Recognition calculated based on the IAS 18 and ASC 606/ IFRS 15?

4. RESEARCH OBJECTIVE

The following are the research objectives based on the problems identified:

- To provide a clear illustration of the Revenue Recognition with a mock scenario.
- To reveal the Revenue Recognition accounting flow.

5. RESEARCH METHODOLOGY

The author has used conceptual, descriptive and comparative analysis. To complement the theory, numerical illustration of a mock scenario is displayed with calculation that applies for both IAS 18 and ASC 606/ IFRS 15. The article further dives into the comparison with regards to the accounting impact for both of the Accounting Standards. As the study is conceptual in nature, there is no primary data or statistical techniques applied. It only targets to provide a structured difference and practice of now new accounting standards (ASC 606/ IFRS 15) differs from the old (IAS 18)

6. NUMERICAL ILLUSTRATION OF IAS 18 VS IFRS 15 / ASC 606: CONCEPTUAL ANALYSIS

Customer (Harry and Co) enters a 12 months Internet Service plan from 1st July 22 to 30th June 23 with SkyNet Operator. Below are the plan terms:

1. Fixed monthly fee is INR 1000
2. SkyNet receives a free modem during the service purchase.
3. SkyNet sells the same modem for INR 3000 and same monthly prepayment plans without the modem is 800 per month
4. How does SkyNet recognize the revenue for this plan in consideration to IAS 18 and IFRS 15/ ASC 606?

Revenue Recognition under IAS 18

Under IAS 18, the Revenue Recognition is identified based on the components of single transaction (i.e., Internet Service Plan + Modem). However, IAS 18 does not hold clear guidelines on how these components are to be identified and how the allocation of selling price takes place. As a result of this, different practices were applied.

- **Option 1 – Cost of Acquiring Customer**

Revenue: Month Plan	Full Amount
Revenue: Modem	Zero

• **Option 2 – Residual Method**

Revenue: Month Plan	Full Amount
Revenue: Modem	Zero

Revenue Recognition under ASC 606/ IFRS 15

Revenue Recognition with respect to ASC 606/ IFRS 15 follows 5 step model.

• **Step 1: Identify the Contract**

Contract	Charges
Modem	Free
Internet Services	INR 1000 per month for 12 months

• **Step 2: Identify Performance Obligation**

Obligation to deliver Modem
Obligation to deliver Internet Services for 1 year

SkyNet sells the same monthly prepayment plans without the Model for INR 800 per month so that standalone selling price shall be $12 \times 800 = 9600$.

SkyNet sells the same Modem in the market for INR 3000

Therefore, the total Standalone Selling Price (SSP) is $9600 + 3000 = 12600$.

• **Step 3: Determine the Transaction Price**

The Transaction price is INR 12000 that is offered to the customer (Harry and Co)

• **Step 4: Allocation of the Transaction Price**

Contract	Performance Obligation	Transaction Price	SSP	Ration %	Allocation
Modem	Immediate	0	3000	$(3000/12600) \times 100 = 23.81\%$	$12000 \times 23.81\% = 2857.2$
Internet Services	Monthly Period	12000	$800 \times 12 = 9600$	$(9600/12600) \times 100 = 76.19\%$	$12000 \times 76.19\% = 9142.8$
		12000	12600	100%	12000

• **Step 5: Recognize Revenue upon satisfaction of performance obligation**

Contract	Modem	Internet Service
July- 2022	2857.2	761.9
August- 2022	0	761.9
September- 2022	0	761.9
October- 2022	0	761.9
November- 2022	0	761.9
December- 2022	0	761.9
January- 2023	0	761.9
February- 2023	0	761.9
March- 2023	0	761.9
April- 2023	0	761.9
May- 2023	0	761.9
June- 2023	0	761.9

NOTE: $9142.8/12 = 761.9$

Revenue Recognition for 6 months:

Contract	Revenue Recognition Under IAS 18	Revenue Recognition Under ASC 606/ IFRS 15
Modem	0	2857.2
Internet Services	$1000 \times 6 = 6000$	$761.9 \times 6 = 4571.4$
Total revenue for 2022	6000	7428.6

Accounting under IAS 18

Year	Accounting	Amount
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		Dr	Cr
2022	Receivables A/C	12000	
	To Deferred Revenue Account (Liability)		6000
	To Revenue A/C		6000
2023	To Deferred Revenue Account (Liability)	6000	
	To Revenue A/C		6000

NOTE: The issue under this accounting is the Revenue being classified as Liability

Accounting Under ASC 606/ IFRS 15

Year	Event	Accounting	Amount	
			Dr	Cr
2022	Revenue Invoice is Accounted	Receivables A/C	12000	
		To Contract Clearing A/C (place holder account)		12000
2022	Initial Event of Contract	Contract Asset A/C	12000	
		To Contract Liability A/C		12000
2022	Billing of Performance Obligation	Contract Clearing A/C (place holder account)	12000	
		To Contract Asset A/C		12000
2023	Satisfaction of Performance Obligation	Contract Liability A/C	7428.6	
		To Contract Revenue A/C		7428.6

7. FINDINGS

- For the same contract, the total revenue recognition remains the same, however the period of recognising the revenue is different.
- The illustration involves Internet service and modem as per ASC 606/ IFRS 15, however there is no defined guideline on recognizing the modem as per IAS 18 and hence only Internet service plan is considered in the same.
- Under IAS 18, the balances are displayed as **trade receivables or unearned income**. However, under ASC 606/IFRS 15, the same scenario results in explicit **contract assets** and **contract liabilities**, showcasing the difference between performance completed and consideration billed/received.
- With regards to the impact on profit, ASC 606/IFRS 15 displays the **period-by-period profit** pattern. However, under IAS 18, some revenue and related margins are deferred.

8. DISCUSSION

The author is with the view that, ASC 606/ IFRS 15 is better performance obliged then that of the IAS 15. The seems clear shift from risk and reward model to performance obligation, and this results in disaggregated revenue recognition. Based on analytical perspective, difference in the period for recognising the revenue plays a key role in the ratio analysis. The modern accounting standards (ASC 606/ IFRS 15) provides better transparency and consistency with positive impact on financial output.

9. LIMITATIONS

The limitation of this study is that it does not take into consideration the real time data of the companies but a sample scenario to ease the understanding of the Revenue Recognition concept based on IAS 18 and ASC 606/ IFRS 15. Also, the volume of scenarios can different from Entities and Industries. The main aim of the author is to simplify the concept and calculation spec of Revenue Recognition.

10. RECOMMENDATIONS

The author recommends the real-time data form different Entities and Industries. This further shall be better assessed with variable statical tools for better view of the process and impact for the Revenue Recognition under ASC 606/ IFRS 15. Likewise, further analysis is recommended to be targeted towards the other aspects of modern Accounting Standards i.e., Lease Accounting, Impairment, Equity Presentation etc.

11. CONCLUSION

The modern Accounting Standards gives a unified framework. This gives a consistent control allowing professional judgement. The 5-step model ensure to cover all the aspects of recognizing the revenue that results in better handling of complex arrangements. The ASC/ IFRS targets to enhance transparency, improved quality and better disclosure. This ultimately assists stronger decision and gaining investor confidence.

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