REVENUE RELATED TO ORDINARY ACTIVITIES ACCORDING TO IFRS AND ROMANIAN REGULATIONS

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Abstract

In this paper I present the differences and similarities between IFRS and Romanian GAAP regarding revenue, respectively between IAS 18 and other standards and MPF Order no. 3055 from 2009. A major problem is the recognition of revenue. In this matter IASB and Minister of Public Finance from Romania have similar, yet some different opinions. For example, IFRS has three revenue standards and four revenue interpretations. In the end I shall debate and investigate the convergence process and the similarities and differences between national and international provisions.

Keywords: income, revenue, IFRS, GAAP, standards

JEL Classification: *M40, M41*

1. Introduction

Income is very important for every person or entity. There is a strong direct relationship between the amount of incomes and the financial position of any entities, their efforts being directed towards maximizing and increasing them.

From the accounting point of view, the incomes and expenses are the components of the profit or loss statement (income statement and statement of comprehensive income), showing the level of performance of any entity.

Based on the importance of income I shall compare in this paper the international and national (Romania) provisions about revenue related to ordinary activities.

International provisions about income come from IASB and FASB, while in Romania they come from the Minister of Public Finance, respectively:

- IASB [8]: IAS 18 – „Revenue", IAS 11 – „Construction Contracts", IAS 20 – „Accounting for Government Grants and Disclosure of Government Assistance" plus six interpretations (IFRIC 12 – "Service Concession Arrangements", IFRIC 13 – „Customer Loyalty Programmes", IFRIC 15 – „Agreements for the Construction of Real Estate", IFRIC 18 – „Transfers of Assets from Customers", SIC 27 – "Evaluating the Substance of Transactions in the Legal Form of a Lease" and SIC 31 – „Barter Transactions Involving Advertising Services);
- FASB (US GAAP): more than 100 standards issued by Financial Accounting Board, Emerging Issues Task Force (EITF), the American Institute of Certified Accountants (AICPA) and US Security and Exchange Commission (SEC);
- Romanian GAAP (MPF) are based on mandatory regulations such as Order no. 3055 from 2009 and Law no. 82 from 1991.

Given the complexity and ampleness of the provisions on incomes I shall continue to treat only the main aspects on revenue that relates to ordinary activities (as a subset of income), focusing on IAS 18 and MPFO no. 3055/2009, highlighting the similarities and differences between these provisions.

2. Revenue Recognition (IASB and FASB point of view)

The revenue recognition is the main problem according to IAS 18. The revenue is a subset of income that includes both revenue and gains. IAS 18 [3] applies to revenue arising from:

- The sale of goods
- The rendering of services (other than construction contracts)
- The use by others of entity assets yielding interest, royalties and dividends.

IAS 18 contains high-level general principles applicable to different industries and transactions. While US GAAP is based on the same principles, it contains more detailed implementation guidance and includes industry specific guidance, such as software, which results in more consistent revenue recognition.

IAS 18 outlines the accounting requirements for when to recognise revenue. Revenue is the gross inflow of economic benefits during the period arising 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. Revenue is measured at the fair value of the consideration received or receivable and recognised when prescribed conditions are met, which depend on the nature of the revenue. 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.

Revenue is recognised when it is probable that future economic benefits will flow to the entity and these benefits can be measured reliably.

Amounts collected on behalf of third parties such as sales taxes, goods and services taxes and value added taxes are not economic benefits which flow to the entity and do not result in increases in equity. Therefore, they are excluded from revenue. Similarly, in an agency relationship, the gross inflows of economic benefits include only the amount of commission.

Therefore, the standard identifies the circumstances in which these criteria will be met and revenue will be recognised. It also provides practical guidance on the application of these criteria.

The revenue recognition process for the sale of goods and services requires completion of the following steps:

- identify the transaction;
- identify the components to be separately accounted;
- allocate the consideration to the components;
- assess the revenue recognition criteria.

Revenue from sale of goods recognition criteria are [1]:

- significant risks and rewards of ownership of the goods are transferred to the buyer;
- the entity retains neither continuing managerial involvement of ownership nor effective control over the goods sold;
- the amount of revenue can be measured reliably;
- it is probable that the economic benefits of the transaction will flow to the entity;
- the costs of the transaction can be measured reliably.

These criteria are similar to the US GAAP requirements; however US GAAP has an additional requirement that persuasive evidence of an arrangement exist. US GAAP standards for revenue are industry specific and some of which can produce conflicting results for economically similar transactions. That is mainly due to the notion of an earnings process is not precisely defined and people often disagree on how it applies to a particular situations [8].

Revenue recognition criteria for rendering of services are as follows:

- when the outcome (amount of revenue, stage of completion and costs) of the transaction can be estimated reliably, revenue are recognized according to the stage of completion (the percentage of completion method) at the end of the reporting period; the stage of completion of a transaction may be determined by various methods such as the cost to cost method (i.e. the proportion that costs incurred to date bear to the estimated total costs of the transaction).
- when the outcome of the transaction cannot be estimated reliably, recoverable contract costs will determine the extent of revenue recognition (i.e. zero profit model).

Royalties are recognized on an accrual basis (substance of the relevant agreements), while dividends are recognized when the right to receive payment is established [6].

Interests are recognized using the effective interest method as set out in IAS 39 - "Financial instruments: Recognition and measurement" [7].

Under US GAAP the accounting for services is addressed in the SEC materials (SAB Topic 13) in ASC 605. Unlike IFRS, the use of the cost-to-cost percentage of completion method is not permitted under US GAAP for transactions outside the scope of ASC 605-35-Construction-Type and Production-Type Contracts. Service revenue should instead be recognized on a straight-line basis, unless evidence suggests that revenue is earned or obligations are fulfilled in a different pattern. Since the cost-to-cost percentage of completion method is not permitted for services, there would be no use of the zero profit model in accounting for services under US GAAP [3].

3. Revenue Recognition according to Romanian GAAP

The main Romanian GAAP for revenue are based on mandatory regulations issued by the Minister of Public Finance such as:

- Order no. 3055 from 2009 [4]
- Law no. 82 from 1991 [5].

On an accrual basis, entities from Romania [4] must disclose in accounting all incomes and expenses, assets and liabilities that results as a result of legal or contractual provisions.

Romanian GAAP refers also to revenue as a subset of income. The category includes both amounts received or to be received or receivable own current activities and gains from any other sources.

Revenues are recorded increases in economic benefits during the accounting period in the form of inflows or increases in assets or reductions in liabilities, which is reflected in increases in equity other than those resulting from contributions of the shareholders.

Revenue is recognized in Income Statement when it can be measured reliably an increasing of the future economic benefits related to increasing decline in value of an asset or liability value. Revenue recognition is performed simultaneously with increasing recognition of assets or debt relief (for example, the net increase in assets resulting from the sale of products or services , or decreasing debt as a result of cancellation of debt).

The Income Statement includes: net sales, current income and expenses, grouped according to their nature, and exercise result (profit or loss). Net turnover is calculated by adding income from the supply of goods and services and other operating income, less trade discounts to customers.

The accrual principle is applied to the recognition of interest including the period, regardless of its maturity. The financial cuts are in the form of settlement discounts granted to settle the debt before the normal deadline for charging. Financial cuts to supplier represents income in the period regardless of the period covered (account 767 "Income from discounts obtained").

Extraordinary items are income or expenses arising from events or transactions that are clearly distinct from current activities and therefore are not expected to recur in a frequent or regular, such expropriation or natural disasters.

Gains represent increases in economic benefits that may arise or result from ordinary activities, but does not differ in nature from revenue from this activity. In the Income Statement, earnings are usually presented on a net basis, excluding costs related to the item "Other operating income".

Revenue can be found under different names such as: sales, services, fees, royalties, rents, grants, interest, dividends.

Amounts collected by an entity on behalf of third parties, including agent contracts, commission agreements or commercial mandate under the law, not income from current activity, although in terms of value added persons acting on their own are considered buyers resellers. In this situation, current income from commissions are the appropriate.

The amount of revenue arising on a transaction is usually determined by agreement between the seller and the buyer / user of the asset, taking into account the amount of any trade discounts.

Revenue (operating income), according to Romanian regulations [4], include:

- revenue from the sale of products and goods and rendering of services. This category also includes proceeds from the sale of housing by entities that are principally engaged in the acquisition and sale of housing.
- income related to cost of production, plus the variation (increase) or below (discount) the value of the actual production cost of supplies and services in progress at the end of the period and the initial stock value products and services progress, not taking into account adjustments for depreciation reflected;
- income from the production of property, representing cost of the work performed by the entity for itself, which is recorded as tangible and intangible;
- income from subsidies, ie subsidies to cover the difference in price and losses and other subsidies that benefit entity;
- other income from the current operation, including income from debt recovery, contractual penalties, liabilities prescribed by law exempt or canceled, as well as other operating income.

Financial income include:

- income from financial assets;
- income from short-term investments;
- income from receivables;
- income from financial assets;
- income from foreign exchange;
- interest income;
- income from discounts received in financial cuts;
- other financial income.

Income from reversal of provisions, namely impairments or impairment highlights distinct depending on their nature.

4. Conclusions

Income refer to amounts that can be received or are received from many activities, such as ordinary activities, financial activities, extraordinary activities, or reasons, such as sales, services, impairments, grants, discounts, recoupment and others.

This paper refers only to revenue (not gains or earnings) from ordinary activities.

Nowadays, globalization and internationalization process has also imposed a pace for convergence. Therefore, once Romania joins the EU, as well as IFRS are increasingly applied in Romania, national regulations consistently and continuously take provisions from IFRS. This phenomenon can only make us happy as an improvement of the national accounting system.

In the next table I shall highlight the similarities and differences between Romanian regulations and international provisions about revenue, respectively between IAS 18 and MPFO 3055.

Table no. 1 Similarities and differences about revenue (IAS 18 versus MPFO 3055)

Subject	IFRS	Romanian GAAP
Revenue is different than income	Subset of income	Subset of income
Composition of revenue	IAS 18: Sales of goods, rendering of goods, interest, royalties, dividends	Similar to IAS 18. Yet, there are no individual standards or regulations, just one for all kinds of revenue or income.
Revenue recognition	Revenue is recognized based on various criteria such as when risk, rewards and control have been transferred to buyers and revenue can be measured reliably.	Similar. There is also a big difference: Romanian MPF only transcribed the criteria for revenue recognition from IAS 18 without additional explanations. Therefore, the professional judgment cannot work properly every time.
Conditions/ Contingencies involved in the sale agreement with customers	One of the criteria in IAS 18 is that it is probable that the economic benefits of the transaction will flow to seller. Recognition should be postponed until the above criterion is met and revenue is reliably measurable.	Similar to IAS 18. A promise of sale does not generate revenue in accounting.
Sale of goods	• it is probable that economic benefits will flow to the entity; • amount of revenue can be measured reliably; • significant risk and rewards has been transferred to buyer; • seller does not continue any managerial involvement (ownership) or effective controls on the goods; • cost of the transaction can be measured reliably.	Similar to IAS 18. Revenues from sales of goods are recorded upon delivery of goods to the buyers of their delivery invoice or other conditions specified in the contract evidencing the transfer of ownership to the goods to customers. The assessment of when an entity has transferred the significant risks and rewards of ownership to the buyer requires an examination of the circumstances of the transaction. In most cases, the transfer of risks and rewards of ownership coincides with the transfer of legal title or the passing of possession. This is the case for most retail sales. In other cases, the transfer of risks and rewards of ownership occurs at a different time from the transfer of legal title or the passing of possession. If an entity retains only an insignificant risk of ownership, the transaction is a sale and revenue is recognized. For example, a seller may retain the legal title to the goods solely to ensure that you receive the amount due. In such a case, if the entity has transferred the significant risks and rewards of ownership, the transaction is a sale and revenue is recognized. Another example is when an entity retains only an insignificant risk of ownership may be a retail sale with a money-back clause if the customer is not satisfied. In such cases, revenue is recognized at the time of sale provided the seller can reliably estimate future returns and recognizes a provision for returns based on previous experience and other relevant factors. For goods supplied under a contract of consignment shall be deemed delivery of goods from consignor to consignee takes place after the goods are delivered to the consignee clients. For goods sent for testing or verifying compliance, it is considered that the transfer of ownership of the assets held at the date of acceptance of the goods by the recipient. Goods sent for verification of compliance are property of provider customers with the right either to purchase or to return them to the supplier. Contract for goods supplied for testing is a provisional agreement that the sale of the goods is subject to satisfactory results from testing the potential client test which aims to establish that goods have characteristics required by the client. For stocks maintained to the customer, it is considered that the transfer of ownership of goods occurs after the customer takes possession of the goods. Stocks to the customer is a regular

		operation that supplier transfers its goods in a warehouse or a customer deposit , which transfer ownership of the assets occurs, according to the contract, the date on which the goods out of the warehouse client, mainly to use in the production process.
Rendering of services	Revenue is recognized on the basis stage of completion (by using percentage of completion method) of the transaction at the balance sheet date can be measured reliably. Straight line method used in percentage completion method can be used. Zero profit method is used when outcome of the transaction cannot be measured reliably.	Similar to IAS 18. The stage of completion of the work is determined based upon the work statements accompanying invoices, records for the reception or other documents showing the state of development and reception services. In case of construction works, revenue recognition is based on the act of acceptance signed by the beneficiary, which certifies that the contractor has fulfilled his obligations under the contract and documentation. The cost of work not received by the beneficiary until the end highlights the revenue as “Income cost of services in progress”.
Interest income	Interest income is recognized using the effective interest method and includes amortization of any discount, premium, transaction costs, or other differences between initial carrying amount and amount at maturity.	Interest income is recognized on the basis of contractual cash flow. Interest shall be recognized periodically and proportionally as income generation, respectively, on an accrual basis.
Rayalties		Royalties and rents are recognized on an accrual basis under the contract
Dividends		Dividends shall be recognized when the shareholder's right to set their charge.

In determining whether an event or transaction is clearly delimits the current activities of the entity, it is considered rather the nature of the item or transaction related work currently undertaken by the entity, rather than the frequency with which it is expected that these events to occur. Therefore, an event or transaction may be extraordinary for one entity, but not for another, due to differences between the current activities of those entities. For example, losses from an earthquake or other natural disaster can be classified by most entities as extraordinary items. Also, expropriation of assets is an extraordinary event.

Income and expenses resulting directly and simultaneously from the same transaction are recognized in the accounts simultaneously through a direct association between the costs and revenues associated with the distinct of these revenues and expenses.

Some entities may engage in customer loyalty programs, awarding points involving their gift. These points can be used for gift purchase goods or services free or reduced price as part of a sale of goods or services, subject to possible additional requirements. Entity accounts for award as an identifiable component of the transaction in which they are granted (“Deferred income”). A corresponding amount is recognized as income to the award when the entity fulfills its obligation to deliver the prizes or the period during which customers can use the award. If it is estimated that the costs required to fulfill the obligation to provide prizes exceeds the consideration received or receivable for them, the date on which the customer redeems, the difference related entity accounted a provision.

Comparing national and international provisions on revenue, we can find more similarities and less differences between these. The natural process of convergence can be easily detected. Of course, I believe that this process will continue and all the provisions will be continuously improved for the satisfaction of the users.

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