

**Statement of
Financial Accounting Standards
No. 32**

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Financial Accounting Standards Committee

Statement of Financial Accounting Standards No.32

Accounting for Revenue Recognition

I Introduction

- (1) This Statement establishes accounting standards for revenue recognition resulting from the following transactions and events:
 - (a) the sale of goods;
 - (b) the rendering of services; and
 - (c) the use of enterprise assets by others generating interest, royalties and dividends.
- (2) Revenue referred in this Statement is defined as the gross inflow of economic benefits to an enterprise during the accounting period resulting in increases in equity. Such inflows arise from the sale of goods, the rendering of services and providing of enterprise assets for use by others. Although contributions from shareholders also increase equity, they are not revenue.
- (3) This Statement is not applicable to revenue arising from the following transactions:
 - (a) lease contracts (should follow the Statement of Financial Accounting Standards No. 2, *Accounting for Leases*);
 - (b) dividends received from investments accounted for under the equity method (should follow the Statement of Financial Accounting Standards No. 5, *Long-Term Investments in Equity*)

Securities);

- (c) construction contracts (should follow the Statement of Financial Accounting Standards No. 11, *Long-term Construction Contracts*);
- (d) insurance contracts of insurance enterprises;
- (e) changes in fair value or disposals of financial assets and financial liabilities;
- (f) changes in the value of other current assets; and
- (g) the extraction of mineral ores.

II Explanation

- (4) Revenue is usually recognized when it is realized or realizable and it is earned. Only when all of the following four conditions are met, can revenue be regarded as realized or realizable and earned:
 - (a) there is persuasive evidence that the transaction exists;
 - (b) the merchandise is delivered and the associated risk and rewards have been transferred, services have been rendered, or assets have been provided for use by others;
 - (c) the selling price is fixed or determinable; and
 - (d) the collectibility can be reasonably assured.
- (5) Goods include merchandise that is produced or purchased by an enterprise for the purpose of sale, such as products produced by a manufacturing company, merchandise purchased by a retail company, or land and other assets held for sale.
- (6) The rendering of service usually involves the performance of a contractually agreed task by an enterprise during the term of the

contract.

- (7) The revenue generated from the use of enterprise assets by others includes:
 - (a) Interest arising from the use of enterprise cash or cash equivalents by others, or from amounts due to the enterprise;
 - (b) dividends from an enterprise's equity investments; and
 - (c) royalties from the use of other assets of an enterprise by others (such as franchises, trademarks, copyrights, computer software, etc.).
- (8) Revenue includes the gross inflow of economic benefits received or to be received by an enterprise. Amounts collected by an enterprise on behalf of third parties are not economic benefits that flow to the enterprise and do not increase the enterprise's equity; therefore, they are excluded from revenue. For example, while the commission collected by an enterprise from the principal in an agency relationship is revenue, the amount collected on behalf of the principal is not revenue because it does not increase the enterprise's equity.
- (9) The revenue recognition criteria are usually applied separately to each transaction. But if individual transaction comprises of several identifiable transactions and events that are related to one another, the substance of the transaction should be reflected. For example, if a deal to sell goods includes future service and if the amount for the future service is identifiable, the amount should be deferred initially and be recognized as revenue over the period during which the service is performed. Conversely, when an enterprise sells goods and, at the same time, it enters into a separate agreement to repurchase the goods in the future, thus negating the substantive effects of the transactions. In such case, two transactions should be jointly considered and revenue should not be recognized at the time of sale.

- (10) Revenue and expenses relating to the same transaction or event should be recognized concurrently according to the matching principle. Expenses include expected future warranty and other expenses (including contingencies) to be incurred after goods are delivered, services are rendered or assets are provided for use by others. If expenses cannot be reliably measured, then the related revenue cannot be recognized. Thus, the amount already received is considered as advance payment and should be recognized as a liability.

Measurement of Revenue

- (11) Revenue should be measured at the fair value of the consideration received or receivable. As consideration is usually in the form of cash or cash equivalents, the amount of revenue is the amount of cash or cash equivalents received or receivable. However, if the timing of the inflow of cash or cash equivalents is deferred, the fair value of the consideration may be less than the nominal amount of cash or cash equivalents received or receivable. For example, when an enterprise sells goods, it may provide interest-free credit to the buyer or accept a note receivable bearing a below-market interest rate from the buyer. When the afore-mentioned arrangement effectively constitutes a financing transaction, the fair value of the consideration is the present value of future cash flows discounted by using an imputed rate of interest.

Sale of Goods

- (12) The assessment of when an enterprise has transferred the significant risks and rewards of ownership to the buyer requires an examination of the circumstances of the transaction. Usually the transfer of risks and rewards of ownership coincides with the transfer of the legal title or the delivery of goods. This is the case for most retail sales. But, sometimes, the transfer of risks and rewards of ownership occurs at a different time from the transfer of legal title or the delivery of goods.
- (13) If an enterprise still has to bear significant risks after the goods are

delivered, the transaction is not a sale and revenue is not recognized. Following are the examples:

- (a) when the enterprise assumes an obligation that is beyond ordinary warranty provisions if the buyer is not satisfied with the goods;
 - (b) when payment for the sale of specific goods is not received until the buyer has resold the goods;
 - (c) when the goods have been delivered but not yet installed, and the installation of the goods is a significant part of the transaction;
 - (d) when the buyer has the right to cancel the transaction for a reason specified in the sales contract, and the enterprise cannot evaluate the probability of return;
 - (e) when the buyer is not a real economic entity; that is, the buyer is a paper (fictitious) company that was established by the enterprise to facilitate false sales transactions.
- (14) If an enterprise does not bear significant risks after the goods are delivered, then sales revenue can be recognized. For example, in an installment sale, an enterprise has transferred significant risks and rewards, but still retains the legal title of the goods solely to protect the collectability of the amount due; as such, revenue is recognized. Another example is a retail sale when a refund is offered if the customer is not satisfied. Revenue is recognized if an enterprise can reasonably estimate future returns based on past experience and other relevant factors and, at the same time, a liability for estimated returns is recognized.
- (15) When it is probable that economic benefits related to a transaction will flow to an enterprise, revenue is recognized. In some cases, this may not be probable until the consideration is received or until an uncertainty has been removed. For example, if an enterprise is uncertain when a foreign government will grant permission to remit

the consideration from a sale, revenue is recognized only when such uncertainty is removed. Nevertheless, when the collectability of the related receivables that had been previously recognized as revenue becomes uncertain, the uncollectable amount should be recognized as an expense, rather than as an adjustment of the amount of revenue originally recognized.

Rendering of Services

- (16) When an enterprise provides service, it should adopt the percentage of completion method to recognize revenue in the accounting periods, which can provide more useful information on the extent of service activity and performance during each period.

Under the afore-mentioned percentage of completion method, revenue is recognized based upon the degree of completion.

- (17) An enterprise can usually reliably measure the amount of revenue if the other parties to the transaction have agreed to all of the following conditions:

- (a) each party's enforceable rights to the service transaction;
- (b) the consideration of the transaction; and
- (c) the manner and terms of settlement.

After the service contract is signed and before the service is completed, an enterprise should constantly review the original estimates and the amount of revenue recognized, and make necessary revisions. However, such revisions do not necessarily indicate that the outcome of the transaction cannot be estimated reliably.

- (18) The degree of completion of a service transaction may be determined by a variety of methods. According to the nature of the transaction, an enterprise should adopt a method that can reliably measure the services performed. The methods usually include:

- (a) evaluate the degree of work performed;
- (b) measure the percentage of service performed over total services to be performed; or
- (c) measure the percentage of costs incurred over estimated total costs. The estimated total costs include costs already incurred and costs to be incurred in the future.

Progress payments and advances received from customers do not necessarily reflect the degree of services performed.

- (19) When the outcome of the service performed by an enterprise cannot be estimated reliably, the possibility of recovery of incurred costs should be considered for revenue recognition. If it is probable that the incurred costs can be recovered, then revenue is recognized only to the extent of the expected recoverable costs incurred. If it is not probable that the costs incurred can be recovered, then revenue should not be recognized and the costs incurred should be expensed in the current period.
- (20) When the outcome of service performed by an enterprise is estimated to bear a loss, the full amount of the loss should be recognized immediately. However, if the loss is estimated to be smaller in future years, the difference should be reversed and recognized as a gain in that year.

Interest, Royalties and Dividends

- (21) Under the interest rate method, the effective yield is the rate of interest required to discount the stream of future cash flow expected over the life of the asset to equate to the asset's initial carrying amount. Interest revenue includes the amortization of discount, premium or other difference between the debt security's initial carrying amount and its maturity value.

III Accounting Standards

- (22) The revenue recognition criteria are applied separately to each transaction. But if individual transaction comprises of several identifiable components or several transactions that are related to one another, then revenue should be recognized according to the substance of the transaction.

Measurement of Revenue

- (23) Revenue should be measured at the fair value of the agreed-upon consideration (after taking into account the amount of any trade discounts and volume discounts) between the enterprise and its buyer or user.
- (24) If the consideration is in the form of accounts receivable, an imputed rate of interest should be applied to determine its fair value. But if the accounts receivable matures within one year, because the difference between the fair value and the maturity value is insignificant and the transaction volume is frequent, based on the cost-benefit analysis, the fair value need not be used to measure the accounts receivable. The afore-mentioned imputed rate of interest is the more clearly determinable of either:
- (a) the market interest rate of a similar financial instrument of an issuer with a similar credit rating; or
 - (b) the interest rate that discounts the nominal amount of the accounts receivable to be equal to the current cash sales price of the goods or services.

The difference between the fair value and the nominal amount of the consideration should be recognized as interest revenue by applying the interest rate method. However, if the outcome of the amortization by applying the straight-line method is not significantly different, the straight-line method may be applied.

- (25) If goods and services are exchanged for similar goods or services,

such exchange is not regarded as a transaction that generates revenue. If goods and services are exchanged for dissimilar goods or services, such exchange is regarded as a transaction that generates revenue. Accordingly, revenue is measured at the amount of the fair value of the goods or services received, plus (or minus) any cash or cash equivalents received (or paid). If the fair value of the goods or services received cannot be measured reliably, then revenue is measured at the fair value of the goods or services given-up.

- (26) Revenue can be recognized only when it is probable that the economic benefits associated with a transaction will flow to an enterprise. Nevertheless, the amount of receivables that relate to previously recognized revenue determined to be uncollectable should be recognized as an expense, rather than as an adjustment to previously recognized revenue.

Sale of goods

- (27) Revenue from the sale of goods should be recognized if all of the following conditions are met:
- (a) the enterprise has transferred significant risks and rewards of ownership of the goods to the buyer;
 - (b) the enterprise neither continues managerial involvement of the goods sold, nor maintains effective control;
 - (c) the amount of the revenue can be measured reliably;
 - (d) it is probable that the economic benefits related to the transaction will flow to the enterprise; and
 - (e) the costs incurred and to be incurred associated with the transaction can be measured reliably.

Rendering of services

- (28) When the transaction outcome of rendering of services can be reasonably estimated, revenue should be recognized according to the

degrees of completion of the transaction on the balance sheet date. The transaction outcome can be reasonably estimated if all of the following conditions are met:

- (a) the amount of the revenue can be measured reliably;
 - (b) it is probable that the economic benefits related to the transaction will flow to the enterprise;
 - (c) the costs incurred and to be incurred associated with the transaction can be measured reliably; and
 - (d) the degree of completion for the transaction can be measured reliably on the balance sheet date.
- (29) When the outcome of the service performed by an enterprise cannot be reasonably estimated, the possibility of recovery of the incurred costs should be considered in recognizing revenue. If it is probable that the incurred costs can be recovered, revenue is recognized to the extent of the recoverable incurred costs; if it is not probable that the incurred costs can be recovered, revenue should not be recognized and the incurred costs should be expensed in the current period. When the uncertainties that prevented the outcome of the transaction being estimated reliably no longer exist, revenue should be recognized in accordance with paragraph 28.
- (30) When the outcome of service performed by an enterprise is estimated to bear a loss, the full amount of the loss should be recognized immediately. However, if the loss is estimated to be smaller in future years, the difference should be reversed and recognized as a gain in that year.
- (31) When the services should be performed over a specified period of time by an indeterminate number of acts, revenue should be recognized by using the straight-line method over the specific period of time unless there is evidence that some other method better represents the degree of completion. However, if a particular task is far more important than any other tasks, the recognition of revenue

should be postponed until the particular task has been completed.

Interest, Royalties and Dividends

- (32) Revenue arising from enterprise assets used by others generating interest, royalties and dividends should be recognized as revenue when all of the following conditions are met:
- (a) it is probable that the economic benefits related to the transaction will flow to the enterprise; and
 - (b) the amount of the revenue can be measured reliably .
- (33) Interest, royalties and dividends should be recognized as revenue in accordance with the following bases respectively:
- (a) interest should be recognized over the period by applying the interest rate method; however, if the straight-line method generates similar results, it may be applied;
 - (b) dividends should be recognized on the ex-dividend date or the shareholder meeting date; moreover, the selection of the ex-dividend date or the shareholder meeting date should be applied consistently; and,
 - (c) royalties should be recognized on the accrual basis in accordance with the substance of the relevant contract.

If interest has accrued before the acquisition of an interest-bearing investment, the first interest receipt should be allocated between pre-acquisition and post-acquisition periods. Only the post-acquisition portion can be recognized as interest revenue. If the dividends on an equity investment are declared from the pre-acquisition net income, such dividends should be deducted from the cost of the equity investment. If it is difficult to allocate the dividends, the dividends should be recognized as revenue, unless the dividends are obviously a recovery of the cost of the equity

investment.

If equity investment is measured at fair value through profit and loss, the cash dividends received after the investment was made (including the cash dividends received during the year of the investment), should be recognized as investment revenue. The cash dividends received from other investments during the year of investment should be treated as the recovery of the investment cost. In the subsequent years, cash dividends received should be recognized as investment revenue on the shareholder meeting date or the ex-dividend date. However, if the accumulated cash dividends received exceeds the accumulated net income for the time period starting from the year of investment to the prior year end, then the excess amount received should be treated as the recovery of the investment, rather than as investment revenue.

When stock dividends are received from the investee company's using retained earnings and/or additional paid-in capital, the stock dividends should not be recognized as investment revenue. Instead, the investor company shall note the number of stock increased on the ex-dividend date, and recalculate the cost per share or book value per share in accordance with the total number of stock owned after receiving stock dividends.

Contingencies

(34) The contingencies as specified in paragraph 10 of this Statement should follow the rules specified in the Statement of Financial Accounting Standards No. 9, *Contingencies and Subsequent Events*.

Disclosures

(35) An enterprise should disclose the following items in its financial statements:

- (a) the accounting policies for revenue recognition, including the methods to determine the degree of completion for the transactions related to the rendering of services;

- (b) the amount of each major category of revenue recognized during the financial statement reporting period including revenue arising from:
 - (i) the sale of goods;
 - (ii) the rendering of services;
 - (iii) interest;
 - (iv) dividends;
 - (v) royalties; and
- (c) the amount of revenue arising from exchanges of goods or services included in each of the afore-mentioned major category of revenue.

IV Notes

- (36) After this Statement becomes effective, the Interpretations of Financial Accounting Standards No.1, *Revenue Recognition for Installment Sales* is no longer applicable.
- (37) This Statement was issued on June 13, 2002. The first revision of this Statement was on September 22, 2005.

The provisions of the first revision shall be effective for financial statements for the fiscal year beginning on or after January 1, 2006. Earlier adoption is not permitted.

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| The provisions of this Statement need not be applied to immaterial items. |
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