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FINANCIAL REPORTING STANDARDS IMPLEMENTATION COMMITTEE

FRSIC Consensus 8

Revenue Recognition for Shipping Freight Services Companies

Introduction

FRSIC Consensus 8 “Revenue Recognition for Shipping Freight Services Companies” was developed by the Financial Reporting Standards Implementation Committee (“FRSIC”) and issued by the Malaysian Institute of Accountants (“MIA” or “Institute”) on 27 March 2008.

The Consensus contained herein is issued as part of the Institute’s initiatives to promote best practices in compliance with the highest standards in financial accounting.

FRSIC CONSENSUS 8**REVENUE RECOGNITION FOR SHIPPING FREIGHT SERVICES COMPANIES**

FRSIC Consensus is guidance issued by MIA and shall be regarded as best practice. It should be read in conjunction with the respective applicable accounting standards.

Members of MIA are expected to observe compliance to the consensus issued. In exceptional circumstances where departure is necessary, members shall be prepared to justify the departure.

FRSIC Consensus need not be applied to immaterial items. Nothing in the FRSIC Consensus is to be construed as amending or overriding the accounting standards or other statements adopted or issued by the MASB and other relevant laws.

The Issue

1. FRS 118, Revenue deals with accounting for revenue arising from the following transactions and events:
 - the sale of goods;
 - the rendering of services; and
 - the use by others of entity assets yielding interest, royalties and dividends.
2. FRS 118 paragraph 20 states that when the outcome of a transaction involving the rendering of services can be estimated reliably, revenue associated with the transaction shall be recognised by reference to the stage of completion of the transaction at the balance sheet date.
3. It has been widely practiced by shipping freight companies in Malaysia to include revenues from incomplete services of liner voyages in its operating profit as at balance sheet date. The freight receivables are recognised once cargoes have been loaded onto the vessels, and their relevant discharging costs are accrued in the income statement. Guidance is therefore necessary to address whether this industry practice is in compliance with the requirements of FRS 118.

Consensus and Basis of Consensus

4. In relation to rendering of services, the Committee noted the principles set out in FRS 118 paragraph 20, which requires revenue to be recognised by reference to the stage of completion of the transaction when all of the following conditions are satisfied:
 - a) the amount of revenue can be measured reliably;
 - b) it is probable that the economic benefits associated with the transaction will flow to the entity;
 - c) the stage of completion of the transaction at the balance sheet date can be measured reliably; and
 - d) the cost incurred for the transaction and the costs to complete the transaction can be measured reliably.
5. It is clear from the principles articulated in FRS 118 that the performance of a service is the critical event for revenue recognition.
6. The Committee agreed that where performance of service takes place over more than one accounting period, revenues should be recognised on services that have been rendered as at balance sheet date. Therefore, recognising revenue by reference to the stage of completion as at balance sheet date of a transaction is the most appropriate method.
7. FRS 118 paragraph 24 provides various methods to be used to determine stage of completion. The key to the determination of which method to use is that revenue should relate only to services that has been performed and should not include elements relating to services that has yet to be carried out.
8. The Committee further discussed on the provision of FRS 118 paragraph 26 which highlighting the practical problem when services are performed by an indeterminate number of acts over a specified period of time. In this instance, the standard allows revenue to be recognised on a straight-line basis over the specified period unless there is evidence that some other method better represents the stage of completion.
9. In addition, the Committee emphasised the importance of scrutinising the terms of each transaction to determine the point or points in time when revenue should be measured and reported. Typically, where there are one or more specific acts in a contract that is more significant than the rest of the acts under the contract, recognition of revenue is postponed until the significant act has been carried out as provided in FRS 118 paragraph 25.

10. Based on the above, the Committee concluded that recognising revenue from uncompleted voyages is inconsistent with the general principle of FRS 118, which requires recognition of revenue only to the extent of service that has been performed. Companies which provide shipping freight services shall therefore, apply FRS 118 paragraph 20 for revenue recognition.

Issuance Date of this Consensus

11. This Consensus is issued on March 27, 2008.

References

FRS 118 "Revenue"