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Statement of Position

Revenue Recognition When Right of Return Exists

January 17, 1975

Recommendation to Financial Accounting Standards Board

Issued by Accounting Standards Division
American Institute of Certified Public Accountants

AICPA
Notes

Statements of Position of the Accounting Standards Division are issued for the general information of those interested in the subject. They present the conclusions of at least a majority of the Accounting Standards Executive Committee, which is the senior technical body of the Institute authorized to speak for the Institute in the areas of financial accounting and reporting and cost accounting.

The objective of Statements of Position is to influence the development of accounting and reporting standards in directions the Division believes are in the public interest. It is intended that they should be considered, as deemed appropriate, by bodies having authority to issue pronouncements on the subject. However, Statements of Position do not establish standards enforceable under the Institute's Code of Professional Ethics.
January 17, 1975

Marshall S. Armstrong, CPA  
Chairman  
Financial Accounting Standards Board  
High Ridge Park  
Stamford, Connecticut  06905

Dear Mr. Armstrong:

The accompanying Statement of Position presents recommendations of the Accounting Standards Division on Revenue Recognition When Right of Return Exists. It was prepared on behalf of the Division by the Accounting Standards Executive Committee for consideration by the Financial Accounting Standards Board and for such action as the Board deems appropriate.

As indicated in the introduction, the Statement is intended to apply, broadly speaking, only to situations in which personal property may be returned, whether as a matter of contract or as a matter of existing practice, either by the ultimate consumer or by a party who resells the property to others. Questions have arisen as to the proper accounting in these circumstances and several alternative accounting methods are presently being followed which can produce materially different results.

This Statement takes the position that if a seller is exposed to the risks of ownership through return of the property, the transaction should not be recognized currently as a sale unless all of certain specified conditions are met. One of those conditions is that the amount of future returns can be reasonably predicted. The Statement sets forth factors to be considered in determining whether or not that condition is met.

The Statement also takes the position that if sales are recognized because the specified conditions are met, provision should be made immediately for any costs or losses which may be expected in connection with any returns.

The Division would appreciate being advised as to the Board's proposed action on these recommendations.

Sincerely yours,

STANLEY J. SCOTT  
Chairman  
Accounting Standards Division
REVENUE RECOGNITION WHEN RIGHT OF RETURN EXISTS

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INTRODUCTION

This Statement of Position presents recommendations on accounting for revenue in certain sales transactions when the right to return the property exists. It was prepared on behalf of the Accounting Standards Division by the Accounting Standards Executive Committee and represents the conclusions of at least a majority of that Committee.

This Statement of Position applies only to situations in which personal property may be returned, whether as a matter of contract or as a matter of existing practice, either by the ultimate consumer or by a party who resells the property to others. It is not intended to cover accounting for revenue in service industries when part or all of the sales proceeds may be returned under cancellation privileges. In addition, the conclusions expressed herein are not intended to apply to transactions involving real estate or lease arrangements, since such transactions are the subject of AICPA Industry Accounting Guides and Opinions of the Accounting Principles Board.

Situations also exist in which, because of unusual price concessions, sales discounts, collection losses, etc., the economic results of the transaction are substantially the same as if the property were returned. Although transactions of this type are beyond the scope of this Statement, the conclusions in this Statement of Position may be equally appropriate in determining the proper accounting for such transactions. These other transactions are mentioned later in this Statement under "Discussion" and, in Appendix A, under "Selected Examples of Industry Practice".
The Division recognizes that this is only one part of the broad conceptual problem related to the measurement and reporting of revenue. Presumably, that problem will be considered by the FASB when it studies the "fundamentals of accounting and reporting," an element of its project, Conceptual Framework for Financial Accounting and Reporting.

This Statement of Position has been prepared and issued because questions have been raised as to the proper accounting when the right of return exists and several alternative accounting methods are presently being followed which can produce materially different results. The Division believes it is necessary and desirable to narrow the available alternatives in this area.
GENERAL BACKGROUND

It is the practice in some industries for customers to be given the right to return goods to the seller under certain circumstances. In the case of sales to the ultimate consumer, the most usual circumstance is that the consumer is dissatisfied with the goods. For sales to customers engaged in the business of reselling the goods, the most usual circumstance is that the customer has not been able to resell the goods to another party. Goods usually can be returned for a full refund of the purchase price, for a credit applied to amounts owed or to be owed for other purchases, or for exchange for other goods.

The right of return can exist either as a matter of contract or as a matter of practice. Such arrangements with customers acquiring for resale are often referred to as "guaranteed sales", and may also be consignments.

Sometimes the returns occur very soon after a sale is made, as in the newspaper and perishable food industries. In other cases a longer time cycle is involved, such as with book publishers and equipment manufacturers. The rate of return varies considerably, from the low percentage of returns usually found in the food industry to the very high rate often found in the publishing industry, where frequently more than half of the items delivered to customers for resale may be returned.

Situations that pose particular problems arise when sales result in significant "overstocking" by customers acquiring goods for resale. In such situations, the recognition of revenue in one
period is often followed by substantial returns in a later period.

In practice, accounting for revenue when the right of return exists has varied considerably among companies and among industries. In some cases no sale is recognized until the goods are unconditionally accepted. In other cases a sale is recognized immediately and an allowance for estimated returns is provided. In still other cases a sale is recognized immediately without providing an allowance for returns and, instead, sales returns are recognized at the time returns take place.

THE DIVISION'S CONCLUSIONS

The Division believes that sales transactions should be analyzed to determine their economic substance. If the seller is exposed to the risks of ownership through return of the property, it should be presumed that the transactions should not be recognized currently as sales unless all of the following conditions are met (and the usual conditions for recording sales not involving right of return have also been satisfied):

(1) The seller's price to the buyer is substantially fixed or determinable at the date of exchange.

(2) Either the buyer has made full payment, or the buyer is indebted to the seller and payment is not contractually or implicitly excused until such time as the product is resold.

(3) The buyer's obligation to the seller would not be changed in the event of theft or physical destruction or damage of the property.
The buyer acquiring for resale has economic substance apart from that provided by the seller; that is, the buyer is not a straw party or a conduit.1/

The seller does not have significant obligations for future performance to bring about resale of the property by the buyer.

The amount of future returns can be reasonably predicted.

The Division also believes that if sales are recognized because the conditions are met, provision should be made immediately for any costs or losses which may be expected in connection with any returns. Amounts of sales revenue and cost of sales reported in the income statement should exclude the portion for which returns are expected. Transactions for which sales recognition is postponed should be recognized as sales when the return privilege has substantially expired. The seller's gross sales and related accounting policies should be disclosed in the financial statements whenever product returns are a significant factor in the seller's operations.

The ability to make a reasonable prediction of the amount of future returns is dependent on the existence of many factors. While it is not feasible to make an arbitrary determination of when a reasonable prediction can be made, since circumstances vary from one case to the next, the existence of the following factors would appear to impair the ability to make a reasonable prediction:

1/ This condition is concerned primarily with buyers which exist "on paper", i.e., which have little or no physical facilities, employees, etc. It is intended to prevent companies from recognizing sales to parties which the sellers have established primarily for the purpose of recognizing such sales.
(1) The susceptibility to significant external factors, such as technological obsolescence or swings in market demand.

(2) Relatively long periods of time before it can be determined that a particular item of property is not returnable.

(3) Absence of historical experience with similar types of sales of similar items of property, or inability to apply such experience because of changing circumstances.

(4) Absence of a large volume of relatively homogeneous transactions.

(5) A significant chance that the selling company's marketing policies and relationships with its customers could change.

Of course, no list can be complete; only general guidelines can be established. Further, the existence of one or more of the above factors may not be sufficiently significant in light of the significance of other factors to prevent making a reasonable prediction.

A reasonable prediction does not require complete knowledge of future events, since it is usually not possible to know with certainty what will occur in the future. It is well established that "Future events and their effects cannot be perceived with certainty." Thus, a reasonable prediction permits some room for doubt.

2/ APB Opinion No. 20, Paragraph 10.
DISCUSSION

Survey of Accounting Literature

Pervasive revenue recognition principles are set forth in APB Statement No. 4. Paragraph 153 states that "The realization principle requires that revenue be earned before it is recorded." APB Opinion No. 10 states that "revenues should ordinarily be accounted for at the time a transaction is completed, with appropriate provision for uncollectible accounts" but provides for recognizing revenue on the installment or cost recovery methods where there is no reasonable basis for estimating the degree of collectibility of revenue. This concept, and others, are discussed in more detail in the AICPA Industry Accounting Guides, Accounting for Retail Land Sales, Accounting for Profit Recognition on Sales of Real Estate, Accounting for Motion Picture Films and Accounting for Franchise Fee Revenue, and in APB Opinion No. 27.

Appendix B presents pertinent quotations from these documents.

The Realization Principle

Accountants have different views as to the realization principle and the point at which revenue should be recognized in income statements. The spectrum of views can be classified as set forth below.

(1) Recognition of increments in value ("holding gains").

(2) Recognition of increments in value tied to an event, usually a transaction with outside parties.
(3) Recognition of revenue when there is a transaction with outside parties and the seller has no further obligations or performance requirements.

(4) Recognition of revenue when an unconditional right to receive the consideration of an exchange exists but there is some uncertainty as to the ultimate amount of consideration to be received.

(5) Recognition of revenue only when reasonable assurance exists that the consideration will be received and it is not refundable.

The point at which revenue is recognized in particular circumstances is sometimes resolved based on the availability of objective evidence which can be subjected to audit, on the extent to which additional conditions must be fulfilled or satisfied, or on the relative degree of uncertainty involved. Selection of decision criteria is also dependent upon whether the accounting is for a single transaction or a large volume of similar transactions.

Types of Risks Which Might be Retained by the Seller

The specific problem to which this Statement of Position is addressed is the problem of revenue recognition when the right of return exists. However, it should be noted that a seller might retain the risks of ownership under a variety of arrangements and types of transactions, some of which do not involve the return of the product, as summarized below.

Product Returned

(1) Return if buyer does not resell product.

(2) Return if buyer is dissatisfied with product.

(3) Return under a trade-in privilege, granted to give buyer protection from a decline in the value of the product.

(4) Return resulting from default by buyer on payment of purchase price.
Return resulting from option of buyer to compel seller to repurchase product.

Product Not Returned

1. Warranties or guarantees as to performance or quality.

2. Collection losses attributable in whole or in part to losses in collateral value of the product sold.

3. Price rebates or other concessions.

The risk of loss to which the seller is exposed might be quantitatively the same in any of the above situations. Further, the nature of the risk might be the same regardless of the form of the transaction through which a loss is realized. For example, a significant decline in the market value of the property could result in the return of the property to the seller. In that case, the seller's loss would be equivalent to the loss in market value and perhaps, in addition, costs associated with the return and disposition of the property. If the property is not returned, the seller might nevertheless incur a loss of the same or greater magnitude; for example, in the form of a collection loss.

Risks can be categorized generally between those which are attributable to internal factors, such as manufacturing defects, and those which are attributable to external factors, such as market demand for a product. To a certain extent these factors are closely related. For example, inferior quality can result in low demand for the product. Because of the interrelationship of factors contributing to the risk of loss, it is possible that different types of losses could all be attributable to a single cause. Poor quality manufacturing could result in expenses under warranties,
returns of products because of user dissatisfaction, returns of products not resold, losses in the collection of receivables or in the guarantee of buyer financing. Thus, it is reasonably evident that the transaction through which a loss is sustained is not necessarily indicative of the nature of all of the risks to which the seller is exposed or of the cause of the loss.

Frequently, sellers limit their exposure to loss when the product is not returned. For example, limits are placed on warranty coverage, and down payments reduce exposure to credit loss in certain financing arrangements. When a product is returned, however, the exposure to loss may be more significant for a given item of property.

Allowances are generally provided for estimated warranty expenses and estimated losses on the collection of receivables. Allowances are also often provided to recognize estimated returns. The use of allowances for returns is questionable, however, if the uncertainties and losses are very significant. Instead, it may be necessary to postpone revenue recognition.

The return of property sold is usually a transaction in which the buyer receives either cash, a credit to be applied to amounts owed the seller, or another piece of property. The loss to the seller will be the same in all cases with respect to the return. The seller will have taken back property of lower value (to the seller) than the amount of refund and will incur handling costs and perhaps costs to restore the property to a salable condition.
If there has been an exchange of properties, the loss to the seller can be considered to be reduced by profit attributable to the property issued, particularly if the buyer is obligated to accept property rather than cash or a credit.

Accounting Alternatives

A seller may retain significant risks of ownership if there is a right to return the property. In line with the accounting treatment accorded in certain other situations in which risks are retained, it may not be appropriate to record the transaction as a sale until circumstances assure that the buyer will not return the property. Rationale for this accounting treatment may be summarized as follows:

1. Realization has not occurred if a "sale" is not an event with economic significance, and other significant economic events must take place in order to provide reasonable assurance that the seller will receive the sales proceeds.

2. Realization has not occurred if there is a significant chance that events which are beyond the control of the seller, such as rapid technological change or large swings in market demand, could occur that would result in a loss of sales proceeds.

3. Transactions in which the buyer has an unconditional right of return may be in substance consignments and should be accounted for as such.

4. Where significant risks of ownership are retained by the seller, objective, verifiable evidence regarding amounts ultimately to be realized as sales proceeds usually cannot be obtained.
Alternatively, recognition of a sale may be appropriate in many circumstances provided an allowance is established which reduces the amount of sales recorded for estimated returns. Arguments in favor of this accounting approach are summarized as follows:

(1) Financial accounting involves the estimation process in many areas. Without estimates financial statements would be less useful and instead would require numerous judgments to be made by the users of financial statements regarding the economic progress of a business entity when in fact management may well be in a better position to make such judgments.

(2) When a sale takes place, frequently many risks are retained by the seller even if the property will not be returned. For example, the retention of a credit risk often includes the retention of risks of ownership in the property sold. Guarantees of quality also result in retention of some risks of ownership. Provided reasonable estimates can be made, retention of these types of risks generally should not preclude recording sales as deliveries to customers are made.

(3) The delivery of property to a buyer, even though subject to return at a later date, is often a significant economic event which entails agreement by the buyer to accept the property and frequently involves passage of title. Thus, it is an event which has an effect on the cash generating ability of the seller, measurement and reporting of which is considered an important objective of financial statements.

(4) If a loss occurs in a subsequent period which was not reasonably foreseeable, it should be given accounting recognition in the period in which it occurs as an economic consequence of activities of that period. A loss which was not reasonably foreseeable should not preclude recognition of a sale.
The choice between these two accounting alternatives appears to be highly dependent upon the degree to which returns of property can be predicted. If prediction is not possible because of the existence of various factors which are highly uncertain, the second alternative, that of recording the sale together with an allowance for estimated returns, is not a practicable approach. On the other hand, if returns can be reasonably predicted, the alternative of not recording a sale seems to postpone unreasonably an important accounting measurement and fails to give recognition to the portion of sales as to which there is reasonable assurance that the property will not be returned.

A third accounting alternative is to record sales without an allowance for estimated returns and to account for returns as they are received. Arguments for this alternative are the following:

(1) Arguments (3) and (4) for the second alternative above.

(2) Returns are accepted to maintain relationships with customers or market strength, and therefore represent a discretionary period cost similar to advertising.

(3) The effect of returns is often insignificant, especially if another item of property is exchanged and gross profit is not lost.

This accounting alternative is acceptable only if future returns and losses are expected to be clearly insignificant.
SELECTED EXAMPLES OF INDUSTRY PRACTICE

These examples are presented in this Appendix only to demonstrate the variety of circumstances and accounting practices that presently exist. This is not an all-inclusive list of those industries in which different accounting alternatives are applied in practice, nor is this Statement of Position intended to be restricted to the industries described herein.

Perishable Foods

Perishable foods, such as bakery products, whether sold to a grocery store, restaurant or institution, are usually sold with the right to return any stale or excess product. For the most part, sales are recorded at the time of delivery with no allowance for returned goods provided. Returns are accounted for as reductions of sales in the period in which the goods are returned. This practice is based on the following industry characteristics:

(1) Orders are based on past experience and knowledge of requirements; the volume of returns is, therefore, not significant in relation to sales.

(2) Some perishable foods, such as stale bakery goods, may be disposed of at discount prices.

To a limited degree, some companies provide allowances for returns when sales are reported. The short time between sale and return permits an easy determination of the amount of allowance.
Rack Jobbers

Retailers often buy merchandise from distributors, known as "rack jobbers", who agree to inspect and restock retailers' shelves periodically with a variety of merchandise, usually within one or more broad classifications, e.g., cosmetics and drugs, records, soft goods. Rack jobbers often provide limited marketing services (for example, determining which brands and quantities should be placed on the retailer's shelves) and thus they may act as both buyer and seller. Title usually passes upon delivery, at which time the retailer is billed.

In most cases turnover is fast, with a relatively low rate of return. Sometimes returns are limited to defective merchandise or specifically priced products, both of which might be returned to manufacturers with little or no loss to the rack jobber. In such cases the removal of the product from the retailer's inventory is followed immediately by a replacement with other merchandise. Thus, the gross profit on the initial delivery is not considered to have been lost and an allowance for returns is often not established as it is not considered to be necessary.

Sometimes rack jobbers must accept returns of slow-moving or seasonal merchandise, which may or may not be returned to manufacturers. In some instances allowances for returns are provided; in others, they are not.
Records and Tapes

Record and tape manufacturers generally sell products to distributors with exchange privileges, unlimited right of return, or limited right of return. Rights granted to distributors are usually passed on to the retailers. Payment is usually required within sixty to ninety days. Although inventory held by retailers may be returned to manufacturers, the manufacturers and distributors usually have no information about retailer inventories. However, high volume and relatively stable rates of return have usually enabled companies to record allowances for returns with reasonable accuracy. This practice is followed by the majority of record companies. Rates of return vary according to type of product, but generally fall in the range of 15% to 30%.

Publishing

Sales in the publishing industry are generally made on a fully returnable basis. In some cases, magazine and paperback shipments made to distributors usually produce an excess that will be returned. The fact that demand for publications often cannot be predicted with accuracy, and the fact that the time lag between the sale and return may be from three months to two years or more make the accounting problem more difficult.

Magazine returns from newsstands may be as high as 65%, returns of hard cover books may be as high as 25% and returns of paperback books may be as high as 60%. The distributorship agreement usually provides for advances to be paid to the publisher in installments with the final payment made at the settlement date.
Four methods of recording sales are found in the publishing industry.

(1) Sales are recorded upon shipment and an allowance for returns is established. This practice is generally followed by publishers of paperbacks, hard cover trade books and magazines.

(2) Sales are recorded upon shipment and returns are recorded when they are received. This practice is sometimes used by publishers of hard cover trade and textbooks, where lower rates of return are involved.

(3) Sales are recorded using the consignment method; i.e., sales of those books remaining in the hands of distributors are not recorded. This method is not a common practice.

(4) If a publisher has recently begun operations or has no relevant experience in the marketing of its new titles, sales are not recorded until the settlement date with the distributor. This is not a common practice.

The allowance for returns is usually established using one of the following methods:

(1) The allowance may be based on historical experience with respect to the percentage of returns over a reasonable period of time. These historical percentages are usually maintained by book title or category of title, or by magazine, and great weight is given to the trend of returns in the last months of the fiscal year. Use of historical data is usually combined with a review of returns actually received and the trend of returns after the balance sheet date.

(2) For new titles, the reserve may be based on management's best estimate if there is sufficient prior experience to judge the success of a new book.
High-Unit-Cost Items

Some manufacturers of certain high-unit-cost products (e.g., mobile homes, trucks, farm machinery, boats) who sell to independent dealers or distributors may be exposed to risks of ownership which may or may not involve return of products.

Financing and other arrangements between the manufacturers and independent dealers vary. In some cases, the manufacturers finance the dealers by providing credit terms that allow the dealers sufficient time to market the product to their customers before paying the manufacturer. The terms under these credit arrangements may or may not require identification of the specific product to be sold prior to remittance to the manufacturers. In other cases, financing is provided to the dealer under "floor plan" financing arrangements either by the manufacturer's captive finance subsidiary or by independent financial institutions. The manufacturer ordinarily guarantees amounts due the financial institutions in the event the dealer is unable to repay amounts borrowed. These financing practices may expose the manufacturer to a potentially significant risk of product returns depending upon other circumstances such as the financial soundness of the dealer and vulnerability of the product to sudden swings in market demand.

Additional existing practices can also influence the selection of an appropriate method of revenue recognition when potential return of a product is involved. For example, contractual arrangements sometimes provide that the manufacturer will grant significant price
allowances to dealers for products which remain unsold after a stipulated period of time. In other cases, significant price concessions to dealers may be granted by the manufacturer even though no contractual obligation to do so exists. Another example relates to the variation in economic relationships and contractual arrangements between manufacturers and dealers. Some dealers may carry only the products of a particular manufacturer whereas others may merchandise the products of a number of manufacturers. Under certain contractual arrangements a manufacturer may impose strict constraints upon a dealer's marketing of the manufacturer's products such as requirements for the manufacturer's approval of customer price allowance, customer credit, advertising and promotional campaigns, etc. On the other hand, dealers in many cases have considerable flexibility in such matters.

Revenue recognition by manufacturers for sales of products to dealers generally coincides with the shipment or delivery of the products to the dealer. In some cases, manufacturers may "warehouse" the product for the dealer pending instructions from the dealer for shipment directly to its customer, for addition of customer directed accessories or for other reasons; however, revenue recognition generally coincides with the passage of title to the dealer in such cases.

The practice of establishing allowances for possible product returns coincident with revenue recognition from the sale varies widely. The determination of an allowance for returns is usually
closely related to the periodic evaluation of the collectibility of receivables or the potential for loss arising from other financing arrangements because changes in demand factors may affect both receivable collectibility and potential returns. In rare instances, revenue is not recognized by the manufacturer until the time of sale by the dealer to the customer. The use of this method generally involves the overall consideration of many factors such as (1) floor plan or other arrangements which defer payment until resale of the product by the dealer, (2) extended periods of time over which dealer financing is offered (e.g., up to one year or more), (3) the offering of significant price allowances and perhaps absorption of certain dealer costs on slow moving items, (4) a lack of consistent relationship between periodic shipments to the dealer and his ultimate sale to the consumer, and (5) the financial soundness of the dealer.

Toys and Sporting Goods

The business of manufacturing and selling toys and sporting goods is seasonal in nature. Often credit terms postpone payment by the buyer until the normal retailing period has begun. In many cases the buyers have the right to return unsold products to the manufacturers. However, many such companies select fiscal years which correspond closely to their natural business cycle and, as a result, the majority of the products which will ultimately be returned will have been returned before the financial statements for the year are issued.
In these industries, the goods are also often returned not because of any contractual or other right, but because of late deliveries, substituted deliveries and similar operating problems. In some cases, although goods are not returned, the seller may also be exposed to the risks of ownership because discounts are permitted in lieu of return privileges. In most instances, sales are recorded upon shipment, although occasionally consignment accounting is used. If sales are recognized immediately the accounting for returns varies. Allowances are provided in some cases and, in other cases, returns are recognized only as they occur.

**Industries Lacking Product Differentiation**

Certain companies are characterized by the lack of product differentiation; that is, the company's products and those of its competitors are basically identical. A few examples are generic drugs, chemicals (fertilizer, polyethylene resins, etc.) and certain consumer goods (detergents, etc.). These companies, therefore, compete within the marketing area. In addition to granting a right of return, in some cases the seller retains the risks of ownership through advance sales, extended terms, price protection, etc. Practices are not uniform.

**Sales to the Ultimate Consumer**

The industry descriptions above are of sales primarily to wholesalers, distributors or retailers, and, as noted, goods may be returned for a variety of reasons. In sales to the ultimate consumer,
the consumer may be given the right of return for reason of dissatisfaction with the product. In most cases, a sale is recognized when the consumer obtains possession, and an allowance for returns may or may not be established.
Pervasive revenue recognition principles are set forth in paragraphs 150 - 153 of APB Statement No. 4:

"Revenue is generally recognized when both of the following conditions are met: (1) the earning process is complete or virtually complete, and (2) an exchange has taken place." (Para. 150)

"Revenue recognized under the realization principle is recorded at the amount received or expected to be received." (Para. 151)

"Revenue is sometimes recognized on bases other than the realization rule.... Sometimes revenue is recognized at the completion of production and before sale is made. Examples include certain precious metals and farm products with assured sales prices. The assured price, the difficulty in some situations of determining costs of products on hand, and the characteristics of unit interchangeability are reasons given to support this exception." (Para. 152)

"The realization principle requires that revenue be earned before it is recorded." (Para. 153)

APB Opinion No. 10 provides for recognizing revenue on the installment or cost recovery methods, under conditions in which there is no reasonable basis for estimating the degree of collectibility of revenue. Paragraph 12 of APB Opinion No. 10 reaffirms the statement in Chapter 1A of ARB No. 43, Paragraph 1, that "Profit is deemed to be realized when a sale in the ordinary course of business is effected, unless the circumstances are such that the collection of the sale price is not reasonably assured."
In making this reaffirmation the Opinion also states that the Board "believes that (otherwise) revenues should ordinarily be accounted for at the time a transaction is completed, with appropriate provision for uncollectible accounts."

The AICPA Industry Accounting Guide, Accounting for Retail Land Sales, states in Paragraph 13 that "The principle of realization presupposes that title will be transferred at or before the time of profit recognition. Delay in conveyance of title may occur in the real estate industry for a variety of reasons and does not require deferring profit recognition for an otherwise acceptable transaction if the purchaser has the right to receive title when the receivable is paid or at the end of the normal contract period. Receipt of option deposits does not constitute a recordable sale under the realization principle." The Guide goes on to state in Paragraph 15: "The Committee believes that recognition of the sale should be deferred until certain conditions are met that indicate that (a) the customer seriously intends to complete the contract and (b) the company is capable of fulfilling its obligations under the contract so that customers cannot later demand and receive refunds for failure to deliver." The Guide sets forth three specific conditions which must be met in order to record contracts as sales. One of the conditions is that "The customer has made the downpayment and each regularly required subsequent payment until the period of cancellation with refund has expired. That period should be the longest of the period
required by local law, established by company policy, or specified in the contract, regardless of whether refunds are available for simple notification, site visitation or otherwise."

The Guide sets forth conditions for distinguishing between the use of accrual and installment sales methods of accounting for revenue. In general, the conditions for use of the accrual method are based on minimum uncertainties with respect to ultimate collection of sales proceeds. Paragraph 20, Item (d), includes the condition that "Collection experience for the project indicates that collectibility of receivable balances is reasonably predictable....." Paragraph 21 amplifies this by saying "The ability to predict collection results of current sales presumes satisfactory experience on prior sales of the type of land being currently marketed in the project over a sufficiently long collection period to indicate the percentage of sales that will be collected to maturity. Since different sales methods may result in different cancellation and collection experience, historical data available must include experience with respect to each type of sales method used, such as telephone sales, broker sales, site visitation sales, etc."

This is reiterated in Paragraph 22 which states, "Thus the Committee concludes that income should be recorded under the accrual method if the company's collection experience can provide information (described in Paragraph 20(d)), that supports a reasonable prediction of whether the required percentage of contracts will pay out to maturity and all other conditions are met. The Committee believes
that condition (d) above is vital to provide assurance that the uncertainties regarding collectibility of the remaining receivables are minimized."

The AICPA Industry Accounting Guide, *Accounting for Profit Recognition on Sales of Real Estate*, states in Paragraph 7, "Revenue (and profit) is conventionally recognized at the time an asset is sold, provided (a) the amount of the revenue is measurable...and (b) the earning process is complete or virtually complete -- that is, the seller is not obliged to perform significant activities after the sale in order to earn the revenue." In Paragraph 8, it is stated, "If no reasonable basis exists to estimate the collectibility of the sales price in a transaction, the installment or cost recovery method of accounting is appropriate." This is followed in Paragraph 9 with the statement that "Uncertainty about collectibility of the sales price may require another method of accounting in which the effective date of the sale is deferred until the uncertainty is satisfactorily resolved." The Guide also states in Paragraph 11 that "Economic substance should determine the timing of recognition, amount, and designation of revenue if the economic substance of a transaction differs from its legal form.... For example, a transaction that is in the legal form of a sale...may be in economic substance... a deposit on or an option to purchase the asset...."

Paragraph 12 continues, "To be accounted for as a sale, a transaction should transfer from the seller to the buyer (a) the usual risks of ownership (for example, obsolescence, unprofitable operations,
unsatisfactory performance, idle capacity and dubious residual value).... Any risk that is retained by the seller in the asset sold should be limited essentially to that of a secured creditor. Otherwise, accounting for a transaction other than as a sale is required." Paragraph 56 of the Guide states the following:

"The Committee concludes that the following contractual provisions...require accounting for the transaction as a financing, leasing, or profit sharing arrangement:

"A seller has an obligation or an option to repurchase the property...."

"A buyer has an option to compel the seller to repurchase the property."

"A seller guarantees the return of the buyer's investment...."

The AICPA Industry Accounting Guide, Accounting for Motion Picture Films, requires that revenue from films licensed for television not be recognized prior to the fulfillment of five conditions, one of which is that "Collectibility of the full license fee is reasonably assured," and another of which is that "The film has been accepted by the licensee in accordance with the conditions of the license agreement." The Guide further says, "Should options or other factors raise doubt about the obligation or ability to perform on the part of either party, revenue recognition should be delayed until such options or factors no longer exist. Insignificant factors, such as the delivery of a print of a previously accepted film, are not a sufficient basis for delaying revenue recognition." With respect to the acceptance condition the Guide states, "However,
certain feature films included in a package may have ratings such that their eventual acceptance by the licensee is so questionable that it would be necessary to delay revenue recognition for such films until unconditionally accepted by the licensee."

The AICPA Industry Accounting Guide, *Accounting for Franchise Fee Revenue*, indicates the conclusion that revenue should not be recognized until the franchisor "has no remaining obligation or intent--by agreement, trade practice or operation of law -- to refund any cash already received or to excuse nonpayment of any unpaid notes...and...any other conditions which affect consummation of the sale transaction have been met."

APB Opinion No. 27 permits recording a lease as a sale in two-party lease transactions without regard to the retention of risks by the lessor, except when the credit risk is so high as to preclude reasonable assurance of collection. With respect to third-party participation transactions and transactions with related companies involving leases which are not the equivalent of sales under paragraph 4 of the Opinion, the retention of risk by the manufacturer or dealer or lessor would prohibit recognition as a sale.
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