What is the Realization Principle?

Worksheet

The realization principle states that revenue should be recognized when it is earned (goods delivered or services performed) and realizable (collection is reasonably assured) - regardless of when cash is actually received.

Questions

1. Under the realization principle, when is revenue recognized?
A) When cash is received
B) When it is earned and realizable
C) At the start of the contract
D) At year-end only

2. A contractor has incurred $400,000 of a $800,000 estimated total cost on a $2,000,000 contract. How much revenue should be recognized?
A) $400,000
B) $800,000
C) $1,000,000
D) $2,000,000

3. A customer pays a deposit before any service is performed. How should the business record it?
A) As revenue immediately
B) As unearned revenue (a liability)
C) As an expense
D) It should not be recorded

4. The realization principle is most closely associated with which accounting method?
A) Cash-basis accounting
B) Tax-basis accounting
C) Accrual-basis accounting
D) Break-even accounting

5. A construction company signs a $1,500,000 contract. By year-end it has incurred $300,000 of the $1,000,000 total estimated cost. How much revenue should it recognize?

6. A software company delivers a product on Dec 28 but the customer pays on Jan 15. Under the realization principle, when is revenue recognized?

7. A retailer receives a $5,000 customer deposit in November for goods to be delivered in January. How much revenue is recognized in November?

8. Define: What does the realization principle say?

9. Define: Is the realization principle part of cash-basis or accrual-basis accounting?

10. Define: What happens to cash received before revenue is earned?

Answer Key

1. B) When it is earned and realizable - Revenue is recognized once it is earned and collection is reasonably assured, regardless of cash timing.

2. C) $1,000,000 - % complete = 400,000/800,000 = 50%; Revenue = 50% 2,000,000 = $1,000,000.

3. B) As unearned revenue (a liability) - Cash received for work not yet performed is a liability (unearned revenue) until earned.

4. C) Accrual-basis accounting - Accrual accounting recognizes revenue when earned, which is the realization principle.

5. % complete = 300,000 / 1,000,000 = 30% Revenue recognized = 30% 1,500,000 = $450,000

6. Revenue is earned when the product is delivered (Dec 28), not when cash is received. So revenue is recorded in December, even though payment arrives in January.

7. The goods have not been delivered - revenue is not yet earned. $0 is recognized in November; the $5,000 is recorded as unearned revenue (a liability) until delivery in January.

8. Revenue is recognized when it is earned and realizable, not simply when cash is received.

9. Accrual-basis accounting.

10. It's recorded as unearned revenue (a liability) until the goods/services are delivered.