What is the Revenue Recognition Principle?

Worksheet

Revenue is recognized when a company satisfies a performance obligation by transferring control of a good or service to a customer, in an amount that reflects the consideration the company expects to receive.

Questions

1. A company receives $12,000 upfront for a 1-year service contract. How much revenue should it recognize in month 1?

A) $12,000
B) $1,000
C) $6,000
D) $0

2. Under the revenue recognition principle, revenue is recorded when

A) Cash is received
B) An invoice is sent
C) A performance obligation is satisfied
D) The contract is signed

3. What is the first step of the 5-step revenue recognition model?

A) Allocate the transaction price
B) Identify the contract
C) Recognize revenue
D) Determine the transaction price

4. Cash collected for a service not yet performed is recorded as

A) Revenue
B) Deferred revenue (a liability)
C) An expense
D) Retained earnings

5. A software company sells a 1-year subscription for $1,200, billed upfront. How is revenue recognized?

6. A furniture store sells a $2,000 sofa on credit; the customer picks it up immediately but pays in 60 days.

7. A construction firm signs a $500,000 contract to build a warehouse over 10 months, with progress reasonably measurable. After 4 months, 30% of the work is complete.

8. Define: What is the revenue recognition principle?

9. Define: What accounting standard governs revenue recognition today?

10. Define: What are the 5 steps of revenue recognition?

Answer Key

1. B) $1,000 - 12,000/12 = $1,000 recognized as the service is delivered each month.

2. C) A performance obligation is satisfied - Revenue recognition ties revenue to delivering the promised good or service, not to cash timing.

3. B) Identify the contract - The model starts by identifying that a valid contract exists.

4. B) Deferred revenue (a liability) - It's a liability (deferred/unearned revenue) until the obligation is satisfied.

5. The service is delivered over 12 months, so revenue is earned over time, not upfront Monthly revenue recognized = 1,200 / 12 = $100 per month At month 3, recognized revenue = 100 3 = $300; the remaining $900 sits as deferred revenue

6. Control of the sofa transfers at pickup, so the performance obligation is satisfied immediately Revenue of $2,000 is recognized at the point of sale, not when cash is collected The $2,000 is recorded as accounts receivable until paid

7. Because progress is measurable, revenue is recognized over time using the percentage-of-completion method Revenue recognized so far = 500,000 30% = $150,000 The remaining $350,000 will be recognized as work continues

8. Revenue should be recorded when earned - when a performance obligation is satisfied - not necessarily when cash is received.

9. ASC 606 (US GAAP) and IFRS 15, both based on a 5-step model.

10. Identify the contract, identify performance obligations, determine the transaction price, allocate the price, recognize revenue.