Agency Policies and Procedures

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Revenue Recognition for Proprietary Funds

Policy Objectives:

Agency policies and procedures for recognition of revenue are designed to:
- Ensure consistent accounting treatment for revenue transactions agency-wide,
- Guarantee that revenue is recorded as it is earned, and
- Establish when revenue will be considered earned.

Background Information:

The earning process includes purchasing, producing, selling, delivering, administering, cash collecting, and paying. Revenue is generally recognized when it is realized and earned. This approach has often been referred to as the revenue recognition principle. The following criteria must be met to recognize revenue in the accounting period:
- Realization encompasses the two terms realized and realizable. Realized refers to the actual exchange of goods and/or services into cash or receivables. Realizable refers to the situation where goods and/or services are readily convertible into known amounts of cash or claims to cash.
- Revenue will be considered earned when the goods and/or services provided to the customer are substantially completed. This occurs when the entity has accomplished what it must do in order to be entitled to the benefits.

In accordance with the revenue recognition principle:
- Revenue from selling products is recognized at the date of sale, usually interpreted to mean the date of delivery to the customer.
- Revenue from services rendered is recognized when services have been performed and are billable.
- Revenue from permitting others to use assets is recognized as the assets are used.
- Revenue from disposing of assets other than products is recognized at the date of sale.

Revenues are considered deferred when the payment has been received from the customer and the goods or services have not been provided. Deferred revenues are recorded as a liability until the revenue recognition criteria are met. The amount deferred is considered a liability because it represents an obligation to perform a service or to provide goods in the future arising from the receipt of cash.

Authority:

- **Minnesota Statute**
  M.S. § 16A.065 *Prepay Software, Subscriptions, United States Documents* - The commissioner may allow an agency to make advance payments for specific goods or services that are not cost effective to pay in arrears.
  https://www.revisor.leg.state.mn.us/statutes/?id=16A.065
- **Codification of Governmental Accounting and Financial Reporting Standards Number 1600.106 to 1600.116** provides information on revenues recognition.
- **Accounting Principles Board Opinions Number 20** provides guidance on changes in accounting principles, accounting estimates, and accounting entities.

- **2000 Miller Governmental Generally Accepted Accounting Principles (GAAP) Guide** provides guidance on accounting for revenue.
- **National Council on Governmental Accounting Statements Number 1** provides information on governmental accounting and financial reporting principles.

Business Risks:

- If earnings are not recognized and realized when earned, a material misstatement of revenue would occur.
- The matching of expenses to revenues would not be in compliance with Generally Accepted Accounting Principles (GAAP) if revenues are not recognized appropriately.

Policies and Procedures:

1. Division Responsibilities

   A. Generate revenue through the earning process.
   B. Invoice customers through the division's internal billing system.
   C. Provide the revenue amount from sales to the Financial Management and Reporting (FMR) Division accountant on a monthly or quarterly basis as agreed between the division and the FMR Division.
   D. Notify the FMR Division accountant of any items included in the revenue amount that does not meet the criteria of the revenue recognition principle. Such items would be the deferred revenue created from invoices for products to be shipped the following day which is the first day of a new quarter.
   E. Notify the FMR Division accountant of any items included in the receipt amount that does not meet the criteria of the revenue recognition principle such as capital lease payments, or the prepayment of a subscription which has not been invoiced or included in revenue.
   F. Notify the FMR Division accountant of any other adjustments that needs to be made to revenue for proper classification and for any sales analysis that are required. This includes notification as to when the deferred revenue becomes revenue.

2. FMR Responsibilities

   A. Upon receipt of the revenue sales amount from the division, process a transaction in the accounting system. The FMR Division accountant will debit Accounts Receivable through the general ledger and credit the appropriate Sales (Revenue) account.
   B. Upon notification of revenue that is deferred, process a transaction in the accounting system. The FMR accountant will debit the appropriate account, and credit Deferred Revenue.
   C. Upon notification of the receipt amount, the FMR Division accountant will process a debit to Cash and a credit to Accounts Receivable in the accounting system.
   D. Upon notification of items in the receipts not meeting the revenue recognition criteria, the FMR Division accountant will process the appropriate transaction in the accounting system. If the transaction pertains to the prepayment of future revenue that has not been invoiced, the debit will be to Cash and the credit will be to Deferred Revenue.

See Also:

MAPS Operation Manual Policy and Procedures 0604, *Revenue Recognition*