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Theoretical lesson nº 9

# Chapter 5

# Reporting and Interpreting Sales revenue, receivables, and Cash

## In the end of this chapter you should be able to…

- ✓ Apply the revenue principle when recording sales **(page 317)**;
- ✓ Analyse the impact of sales discounts and sales returns on the amounts of sales revenues **(page 317)**;
- ✓ Estimate, report and evaluate the effects of uncollectible accounts receivable (bad debts) on financial statements **(page 322)**;
- ✓ Understando the concept of cash, cash equivalents and safeguard cash **(page 331).**

# Revenues from sales



Sales of merchandises

Sales of finished goods

Record in the accounts?

# Revenues from sales



Record in the accounts?

Sales of merchandises

| | | | |
|---|---|---|---|
| D: | Cash / Clients | 10.000 | |
| C: | Sales | | 10.000 |

| | | | |
|---|---|---|---|
| D: | Cost of goods sold and consummed materials | 4.000 | |
| C: | Merchandises | | 4.000 |

# Revenues from sales




## Sales of finished goods

| | | | |
|---|---|---|---|
| D: | Cash / Clients | 10.000 | |
| C: | Sales | | 10.000 |

The cost of goods sold and consumed materials is preciously recognized, when the raw materials were consumed.

# Revenue recognition



Revenue recognition principles…

**Revenue from sales -** shall be recognized when all the following conditions have been satisfied:

(a) the entity has transferred to the buyer the significant **risks** and **rewards** of ownership of the goods;

(b) the entity **retains no effective control** over the goods sold;

(c) the amount of revenue can be **reliably measured**;

(d) it is probable that the **economic benefits associated** with the transaction will flow to the entity.

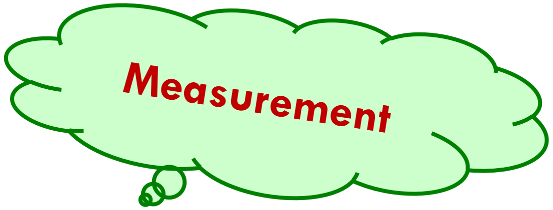
# Revenue recognition



When to recognize the revenue ?

- Sales at prompt payment
- Sales on credit
- Consignment sales
- Sales with installation and posterior inspection
- Sales with maintenance service included
- Sales to a foreign country
- Sales with Customer Loyalty Programmes

# Revenue Measurement




**Revenue from sales -** shall be measured at fair value of the consideration received or receivable.

- **Sale at prompt payment**: amount of cash or cash equivalents received
- **Sale on credit, or on account (normal credit terms):** amount of cash or cash equivalents receivable
- **Sale on credit (financing transaction):** equivalent to the sale at prompt payment or the sale on credit with normal credit terms..

# Revenue Measurement



Sales with financing transaction: interets revenues?

**Interests revenue= 2.000**

| **Sale** | **Receipt** |
|---|---|
| 10.000 | 12.000 |

Trade discounts and Sales returns?

- **Trade discounts:** deduct to the amount of revenue to be recognized (fair value of the consideration received or receivable taking into account any trade discounts)
- **Sales returns:** deduct to the amount of revenue already recognized.

## Revenue of Sales=

| Sales | 29.500 |
| --- | --- |
| Deductions: | |
| Trade discounts | 125 |
| Sales return | 250 |
| | **29.125** |

Amount to present in Income Statement

## Accounts receivable from Clients



Sales on credit

Accounting record

| | | | |
|---|---|---|---|
| D: | Clients | 10.000 | |
| C: | Sales | | 10.000 |

Fair value of the consideration receivable

Accounting record

Receipt from clients: when clients pay

| | | | |
|---|---|---|---|
| D: | Cash | 10.000 | |
| C: | Clients | | 10.000 |

**Sales on credit (normal credit terms)**

| | | | |
|---|---|---|---|
| D: | Cash | 12.000 | |
| C: | Clients | | 10.000 |
| C: | Interest Revenue | | 2.000 |

**Sales on credit (financing transaction)**

## Recognition of impairment losses:

When there is objective evidence that the receivable is impaired because, for example:

- ✓ Financial difficulties of the customer;
- ✓ Failure to fulfill obligations of contract terms;
- ✓ Concessions given to the customer who would not be granted under normal circumstances
- ✓ Probability that the customer goes bankrupt or to a process of re-structuring

# Recognition of impairment losses from clients

## Impairment losses

Accounting record

| | | | |
|---|---|---|---|
| D: | Impairment losses | 6.000 | |
| C: | Clients | | 6.000 |

- ✓ The debt remains to receive
- ✓ The initial amount receivable was 10.000
- ✓ The company expects a loss of 6.000
- ✓ The value to be presented in the balance sheet is 4.000 (which is the amount that the company expects to receive)
- ✓ The loss in the DR will be 6.000 (which is the amount of the estimated loss)

# Recognition of impairment losses from clients

## Reversal of impairment loss

Accounting record

| | | | |
|---|---|---|---|
| D: | Clients | | 3.000 |
| | C: | Reversal of impairment loss | 3.000 |

- ✓ When there is a change in the estimate of loss
- ✓ In the nullification or reduction of an impairment loss (loss) is used an account for reversal of impairment loss(gain)

# Cash and cash equivalents



| | |
|---|---|
| Cash | Cash and Cash deposits |
| Cash equivalents | • Short-term investments<br>• readily convertible into cash (with maturity less than three months)<br>• and are subject to an insignificant risk of changes in value |

**Cash and Cash deposits** are the more vulnerable assets to theft and fraud

Internal control procedures in order to:

✓Ensuring the **reliability** of accounting records

✓Ensuring **protection/safeguard** of cash and cash deposits

How?

Separation of duties!!

# End of chapter 5