Techniques Applied for Accounting of Revenues with Deferred Payments

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Abstract

In accounting of the entities it is not always clear difference between income and gains. Gains arising from transactions that are associated with the operations that are not ordinary and that can sometimes be significant. For example, the headquarters of a company in wich it operates can be sold later to realize a profit from the sale. An investment company can own because they can generate revenue through sales. When properties are sold, the resulting gain will be included in the total turnover. Such a society will include properties held in current assets category. Normally, other business records and property and property held any gain from their sale will be reflected in an account that is not part of the turnover. The paper describes specific aspects of accounting of revenues from sales with deferred payments.

Key words: revenue, deferred payments, fair value.
J.E.L. classification: M41, G32

1. Introduction

Often, cash is not charged immediately when a transaction occurs generating income. More likely it is that cash to be received shortly thereafter, the delay being dependent on commercial terms practiced in society and industry (IASB, 2014a, p.4) . In such circumstances, by expanding commercial terms, the buyer's obligation need not be reduced because the effect is insignificant. If, however, the customer was offered an extended period without paying interest to settle the obligation (longer than normal commercial terms), the effect is likely to be significant, in which case the customer requirement will be reduced. As the company has cash available for their own use, cash payments that will be made in the future is worth less at the time of sale and therefore must be evaluated properly.

This paper aims to present some practical aspects concerning the calculation of revenues from sales with deferred payments.

2. Sales with deferred payments

Establishing a customer payment due date is normally easy to do. However, there are cases less clear. For example, an enterprise may decide to grant his client a period of greater credit than normally practiced (which for example can be 30 days). In this case the enterprise will have to update the value of future cash flows. The problem is to decide what interest rate is used in this update. In International Financial Reporting Standards are two methods. Entity must choose the one that is easier to determine (KMPG, 2014, p.5).

In most cases, the means of payment in the form of cash or cash equivalents, in which case the amount of revenue is the amount of cash or cash equivalents received or to be received. The following situations should be treated separately.

If the inflow of cash or cash equivalents is deferred (eg when granting a loan provider on a longer period), the fair value of the means of payment may be lower than the cash received or receivable, because this case the final amount to be collected includes a financing element. The difference between the fair value and the nominal amount of the means of payment is recognized as interest income (IASB, 2014b, p.12).

Example (Author processing)

Company A1 provides to Company A2 an equipment for which it is established that the payment period is 12 months from the date of delivery (ie, supplier credit is granted for 12 months). In these circumstances, the equipment price is fixed at 11,000 monetary units (MU). By default, this price includes a financing element (for the period of 12 months).

For this transaction the fair value of the means of payment is obtained by updating subsequent cash receipts using an interest rate that is most commonly obtained by dividing the interest reference market for financing similar or interest rate with which the updating value nominal yield value that the asset would have been sold payment on the spot.

Thus, in our example, if the interest rate financing MU market would be 10% per annum, the fair value of the means of payment would amount placed today this interest rate would result in 12 months 11,000 MU (capital and interest). This amount is obtained by multiplying by a factor of 11,000 MU update 0.90909.

Equipment price = 11,000 MU

The fair value = 11,000 x 0.90909 = 10,000 MU

Interest = 11,000-10,000 = 1,000 MU

Accounting entry will be:

Table no. 1 Sales on credit vendor

Debit	Credit	Amount –MU-
Customers	%	11,000
	Revenue from sale of finished products	10,000
	Interest income	1,000

Source : Author processing

3. Specific issues regarding the evaluation of revenues from sales with deferred payments

One of the important aspects about recognition of revenues from sales with deferred payments is the allocation of income resulting from transactions that take place over several financial years, to avoid simplistic treatment of recognition between the money was collected. In this respect use is made of two fundamental principles: the principle of accrual which requires linking costs with revenues appropriate and prudence in which profits are not reflected in advance, while loss provisions are recorded as soon as the losses are foreseen (PWC, 2014, p.7).

The most widely used time recognition of income upon sale is being considered at the moment that can be identified more precisely during the sale procedure. In fact, it must set the time at which were transferred significant risks and rewards and have removed most of the elements of uncertainty related to the realization of the transaction (Nicolae, 2010, p.299).

In some cases goods are sold but keeping the title to them what was done to collect the amount due from the buyer. In such circumstances, if it is proved that a seller has transferred substantially all the risks and benefits, the transaction can be treated as a sale and therefore the related income recognized (Nicolae, 2015, p.127).

Suppose that a company organizes a reception for which you must buy a certain quantity of wine but without knowing exactly how it will consume. The company will buy wine through a contract that can return leftover wine. When you register a seller of wine this income?

Revenue recognition must be made upon delivery of goods only if their value can be reasonably estimated (IASB, 2011, p. 16). If this estimate can not be made, then revenue must be recognized when received belongings.

Another example is a company that sells products through mail order, where the customer has the right to return the goods within 14 days. If future income can be estimated reliably, then the recognition will take place when the goods are delivered. Of the total recognized income will decrease one percent. This procedure is similar to the provision for bad debt recognition, where a company can estimate a value for these customers based on the experience of previous years.

Similarly, the company discussed can estimate the percentage of goods that are expected to be returned.

4. Case study on the accounting of revenues with deferred payments

We have the following information available (Author processing) :

On 1 January of financial year N the total price of goods sold 26,000,000 MU:

- 5,000,000 MU at the delivery date,
- 3 increments 7,000,000 MU collectible dates: 31.12.N, N+1 and N+2 .

It is estimated that the company-client market could get a credit equivalent to a variable interest rate:

- Financial year N : 12% interest,
- Financial year N+1 : 10.5% interest,
- Financial year N+2 : 8% interest.

The fair value = 5,000,000 + 7,000.000/1.12 + 7,000,000/ 1.12 x1.105 + 7,000,000 / 1.12 x 1.105 x 1.08 = 22,143,246 MU

Total interest = = 26,000,000 – 22,143,246 = 3,856,754 MU

Table no. 2 Total invoiced

Debit	Credit	Amount –MU-
Customers	%	26,000,000
	Revenue from sale of finished products	22,143,246
	Income in advance	3,856,754

Source : Author processing

Table no. 3 Cash advance

Debit	Credit	Amount –MU-
Balances with banks	Customers	5,000,000

Source : Author processing

Interest on financial year N = 22,143,246 -5,000,000 = 17,143,246 x 12 % = 2,057,190 MU

Table no. 4 Registration on current interest income in the financial year N

Debit	Credit	Amount –MU-
Income in advance	Interest income	2,057,190

Source : Author processing

Table no. 5 Collection of rate 1

Debit	Credit	Amount –MU-
Balances with banks	Customers	7,000,000

Source : Author processing

Interest on financial year N+1 = 12,200,436 x 10.5% = 1,281,046 MU

Table no. 6 Registration on current interest income income in the financial year N+1

Debit	Credit	Amount –MU-
Income in advance	Interest income	1,281,046

Source : Author processing

Table no. 7 Collection of rate 2

Debit	Credit	Amount –MU-
Balances with banks	Customers	7,000,000

Source : Author processing

Interest on financial year N+2 = 6,481,482 x 8% = 518,518 MU

Table no. 8 Registration on current interest income income in the financial year N+2

Debit	Credit	Amount –MU-
Income in advance	Interest income	518,518

Source : Author processing

Table no. 9 Collection of rate 3

Debit	Credit	Amount –MU-
Balances with banks	Customers	7,000,000

Source : Author processing

4. Conclusion

Accounting for revenues from sales with deferred payments may lead to a different size of revenues recognized in the statement of comprehensive income as compared to the accounting treatment required by the tax code. We believe that conservative accounting treatment required by the tax code may be advantageous for recognizing revenue under uncertainty generated by developments in the general economic environment.

Rate (or rates) should be a rate (or some installments) before tax that reflects current market assessments on:

-the time value of money; and

-risks specific to the asset for which the estimates of future cash flows have not been adjusted.

Sales in installments sellers may represent an interesting alternative for the purchaser such as supplier allows a cash payment spread over a period of time in the future. For vendor it is necessary that the selling price is higher to protect from loss of value - money generated for inflation.

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