REVENUES AND EXPENSES

Ing. Jana HINKE, Ph.D.
hinke@kfu.zcu.cz

REVENUES

- Conceptual Framework
- IAS 18 – Revenues
- IAS 11 – Construction Contracts

In specific cases:

- IAS 17 – Leases, IAS 24 – Related Party Disclosures, IAS 32 and 39 Financial Instruments …….
- IFRS for SMEs – Section 23

DEFINITION OF REVENUES

- IAS 18 REVENUES:

= is the gross inflow of economic benefits during the period arising in the course of the ordinary activities of an enterprise when those inflows result in increases in equity, other than relating to contributions from equity participants.

Revenues can be recognised according to the Conceptual Framework:

a) It is probable that future economic benefits will flow to the entity,
b) These benefits can be measured realibly:

- IAS/IFRS recognition of revenues – right time and amount
- IAS/IFRS – revenues are not connected with taxes!

Revenues

- IAS 18 Revenues require separate recognition of different kind of revenues:

  a) Revenues for the sale of goods,

  b) Revenues from services,

  c) Revenue from interest, dividends and royalties

Revenues for the sale of goods,

1) The enterprise has transferred to the buyer the significant risks and rewards of ownership of the goods,
2) The enterprise retains neither contining managerial involvement to the degree normally associated with ownership nor effective control over the goods sold,
3) The amount of revenue can be measured reliably,
4) It is probable that the economic benefits associated with the transaction will to the enterprise; and
5) The costs incurred or to be incurred in respect of the transaction can be measured realibly.

Revenues from services

1) The amount of revenue can be measured reliably,
2) It is probable that the economic benefits associated with the transaction will flow to the enterprise,
3) The stage of completion of the transaction at the reporting period can be measured reliably and;…
4) The costs incurred for the transaction and the costs to complete the transaction can be measured reliably.

- It is necessary to have an effective system of internal bookkeeping…
- Methods of recognition revenues – the percentage of completion = IAS 11 Construction contracts
- Initial steps = revenues in the amount of actual spent expenditures
- Other methods = revenues on linear bases

Revenue from interest, dividends and royalties

1) It is probable, economic benefits will flow to entity,
2) The amount of revenues can be measured reliably.

Methods of recognition:

- Interests: linear time base with effective interest rate
- Royalties: accrual bases,
- Dividends: the right to received the payment.

Interests

- Interests during one accounting period = linear interest
- Interests during more accounting period = amount discounted to present value:

  - discounted interest

  - premium interest

Recognition revenues for the sale of goods

<u>3 basic methods:</u>

a) Recognition of revenue at the moment of sale

b) Recognition of revenue before sale

c) Recognition of revenue after sale

Recognition of revenue at the moment of sale

- All criteria must be fulfilled and we receive invoice,
- In case entity receive invoice and criteria are not met, it is necessary to use deferred income account
- Usually with deliery are criteria met
- Specific cases are solved with std

- **Sales with agreement of buyback** – according to IAS 18 revenue can not be recognised,

- **Sales with right to return goods:**

  - risk of return is not significant = recognise immediately,

  - more often situation = provision according to IAS 37

Recognition of revenue before sale

- In case of construction contracts
- E.g. Construction industry, software company, ….
- Two basic methods:

a) Methods of percentage of completion

b) Methods of zerro profit

Methods of percentage of completion

- It is used when we can assess the percentage of completion estimate reliably.
- Revenues and expenses are recognised continuously.
- This method recognised revenues connected with expenses not payments.
- How to establish the percentage of completion:

Methods of percentage of completion

= different accounting policies can be used to estimate the percentage completion.

The policy used will vary from company to company and therefore exam question to exam question.

There is also variability between a single company with more than one project.

Method of zerro profit

- In case the completion of project is not possible to establish reliably.
- Revenue is recognised only in the amount of expenses that can be paid back.
- Expenses are recognised as they ocurred.

Recognition of revenue after sale

In case of installment selling:

Three basic methods:

a) Accrual method

b) Installment method

c) Method of repaying expenses

- **Accrual method**

- The same accounting principle as in the Czech Republic; revenues are recoginesed immediately with expenses;

- **Installment method**

- Receivable is distinguished between revenue and deferred income – it is recognised according received installments.

- **Method of repaying expenses**

- Profit is recognised as soon as the installments will be higher than expenses recorded.

Revenues from services,

- It depends on above mention criteria
- How are solved long-term services???
- **Most common methods**:

a) Method of specific service,
b) Method of proportional service,
c) Method of complete service.

a) **Method of specific service** - revenues are recognised after certain aspect…

b) **Method of proportional service –** service with similar aspects – revenues can be recognised linearly…

<u>Method of percentage of completion</u> - most common is method Cost to Cost

Method of complete service.

- Revenues is recognised after their completion = method of zerro profit
- In case that service is composed from separate activities in indefinite time horizont.

Section 23 – IFRS for SMEs

Recognition and valuation of revenues

Distinguish:

a) Revenues for the sale of goods,

b) Revenues from services,

c) Revenue from interest, dividends and royalties

- Also the same solution as in IAS 11: Construction Contracts
- Define disclosure requirements

EXPENSES

- Definition of Conceptual Framework:

  Expenses are recognised when a decrease in future economic benefits related to a decrease in an asset or an increase of a liability has arisen that can be measured reliably. This means, in effect, that recognition of expenses occurs simultaneously with the recognition of an increase in liabilities or a decrease in assets (for example, the accrual of employee entitlements or the depreciation of equipment).

RECOGNITION OF EXPENSES

- Expense can be recognised if there is expected economic outflow and it can be measured realibly.

- <u>Recognition of expenses:</u>

a) The principle when present offers to future
b) The principle of increasing liabilities

Valuation of expenses

- Valuation is primarily connected with assets and liabilities!!!
- Expenses and revenues are connected with changes in assets and liabilities!
- Valuation of assets and liabilities influence expenses and revenues!

Classification of expenses

1) Operating expenses

- **Classification based on nature:** depreciation, material, wages...
- **Classification based on purposed:** production costs, administrative costs, ……

2) Financial expenses – expenses connected with financial activities..

- **Production costs**= costs of goods sold, … (so it depends on the time of sale)
- They include:

a) Direct material

b) Direct wages

c) Production overheads

- **Administrative costs** = wages of administrative employees, consumption of office material, depreciation of administratie assets, accounting and legal services…..

- **Sales costs** = wages of employees in sale department, advertisiment, transportation costs,….

- **Other operational cost** = costs connected with research, loss from sale of long-term asset, …

Extraordinary items

- Till 2004 IAS/IFRS tried to eliminate extraordinary items ….
- Differences from the Czech Republic?
- Till 2005 extraordinary items are abolished!!!
- Why???

- Different division of costs and expenses:
- Division in Cash-Flow Statement:

Členění výdajů v přehledu C-F:

a) Operating activity
b) Investment activity
c) Financial activity

Income tax

- IAS 12 – Income tax
- Two kind of income tax:

a) <u>Current tax</u>

b) <u>Deferred tax</u>

- it is not paid

- connected with accounting principles: caution principle, accrual principle, …

Current tax

- According to IAS 12 an entity must record current tax as a liability (usually short-term) and cost of the current period.

- Installment payment are recorded as receivables and their are offset against the final liability.

Costs and expenses

There is no special section:

a) Section 25 – Borrowing cost

b) Section 29 – Income tax

Borrowing cost

- Borrowing cost is recognised as an expense in current period x IAS/IFRS full version!!!!

Thank you for your attention