FINANCIAL ACCOUNTING 700 **Seminar RS 5 – Revenue** ***PH Ferreira***	**DEPARTMENT OF ACCOUNTING** **UP**

Prescribed works:

1.	Standards	The Conceptual Framework (par. 4.37 – 4.39 and 4.47 – 4.48)	-	IASB
		IAS 18	-	IASB
		IFRIC 13	-	IASB
2.	GAAP Handbook Volume 1 - Chapter 11		-	Pretorius, **et al**
3.	Circular 9/2006		-	SAICA

Questions:		**Time**
Question 1	Stage of revenue recognition	± 20 min
Question 2	Settlement discounts	± 23 min
Question 3	Timing of revenue recognition – rendering of service	± 20 min
Question 4	Guarantees, deferred payment, free service	± 35 min
Question 5	Revenue recognition	± 40 min
Question 6	Revenue received in advance	± 25 min
Question 7	Consignment stock, free service	± 23 min
Question 8	Customer loyalty programmes	± 30 min

QUESTION 1

State briefly, with reasons, how and when revenue must be recognised in the following cases:

2.1 Interest on debentures held. Interest is payable annually in arrears.

2.2 Preference dividends on preference shares held. The dividends are cumulative and are normally declared during November for shareholders registered on 31 December. Payment usually takes place in January.

2.3 Ordinary dividends on ordinary shares held. The dividends are normally declared twice a year (interim and final) for shareholders registered on 31 March (final) and 30 September (interim). The dividends are usually paid two weeks after these registration dates.

2.4 Moneys earned by SKUT, a training centre. Fees are received quarterly in advance and training is given over three terms.

2.5 Motor vehicle sales on instalment sale.

2.6 Volume rebates received from suppliers.

2.7 Proceeds on the sale of an item which is not in stock and should still be delivered to the buyer.

2.8 Interest on a participation bond is received in advance at the beginning of each quarter.

2.9 A company receives royalties from another company every two years on a patent. The agreement stipulates that royalties of 5 cents per unit produced must be paid.

QUESTION 2

Shorty Limited is a retailer with a 31 December year-end. It has always been the company's policy to account for settlement discounts granted as other expenses on the date when the debtor settles his account. Furthermore, settlement discounts received from suppliers have always been accounted for as other income on the date when the creditor is paid. The accountant of Shorty Limited is not familiar with the contents of Circular 9/2006, *Transactions giving rise to adjustments to revenue / purchases.*

The following information was extracted from the company's trial balance for the year ended 31 December 2005:

	2005	**2004**
	R	**R**
Trade receivables at year-end	6 200 000	5 000 000
Trade payables at year-end	3 900 000	3 500 000
Settlement discounts granted during the year:		
- On prior year sales	-	35 000
- On sales made during the year	94 000	102 000
Settlement discounts received during the year:		
- On prior year purchases	-	-
- On purchases made during the year (20% of these purchases were still on hand at year-end)	58 000	-

Additional information:

1. It is expected that 30% of the debtors as at 31 December 2005 will settle their accounts early in 2006 in order to qualify for a 5% settlement discount.
2. Shorty Limited intends to settle 80% of the creditors as at 31 December 2005 early in 2006, in order to qualify for a 2% settlement discount. According to inventory records, 75% of the inventory bought from these creditors was still on hand at 31 December 2005.
3. Assume that actual discounts granted / received are always in line with expectations as at the date of the sale / purchase.

REQUIRED:

Advise the accountant of Shorty Limited on the correct treatment of the settlement discounts in the financial statements for the year ended 31 December 2005 (including comparative amounts). Justify your advice and support your answer with the necessary amounts. (15)

Note:
- Limit your answer to advice – disclosure notes are not required;
- Ignore the effect of tax;
- Your answer should comply with International Financial Reporting Standards.

(SOURCE: FRK 700 exam 2006)

QUESTION 3

Your client is an estate agent. The estate agent currently recognises sales commission only when actually received. Legally, commission is payable to the estate agent upon signature of the sales agreement by both buyer and seller and subject to all suspensive conditions having been met and the normal tests of valid contracts having been satisfied. Your client has been recognising commission only on receipt, as sales agreements are sometimes cancelled after the financial year-end.

REQUIRED:

Discuss what you consider to be the appropriate basis for recognising commission.

(SOURCE: Unisa)

QUESTION 4

You are the technical partner at IAS Inc. Your client base consists of small to large corporate entities. The following e-mails from your clients require your immediate attention:

E-mail 1

LAN Limited is a retail outlet. The majority of its income is derived from the sale of various clothing items.

LAN Limited has a policy of refunding the purchases of dissatisfied customers in cash, provided items are returned within two months of date of purchase, even though the company is under no legal obligation to do so. This refund policy is generally known to LAN Limited's customers.

Based on the company's past experience and future expectations, it is estimated that 13% of items sold will be returned under this policy.

The accountant of LAN Limited is unsure as to how the above should be accounted for.

REQUIRED:

Write a memorandum to the accountant of LAN Limited, in which you discuss the appropriate accounting treatment of the above policy in the financial statements of LAN Limited, in accordance with International Financial Reporting Standards. (13)

Note: - Do not discuss any presentation or disclosure requirements.

E-mail 2

Prior to 2006 Sale Limited operated its home appliance retail business exclusively on a cash sale basis. From 1 September 2006, in order to gain greater market share, Sale Limited began retailing all home appliances under the following conditions for the duration of a three month "special" (i.e. 1 September 2006 to 30 November 2006):

- Sale of goods at pre-special cash prices to customers on one year's interest free credit; and
- A free service of the home appliances sold, exactly one year after the date of purchase.

The only journal entry raised in respect of the above sales by the accountant of Sale Limited was as follows:

Dr	Debtors	5 000 000	
Cr	Sales		5 000 000

Sales for three month "special" period

REQUIRED:

Discuss the appropriate accounting treatment of the sales for the three month period to which the "special" relates in the books of Sale Limited.

Note: - Do not discuss any presentation or disclosure requirements.
- Comply with International Financial Reporting Standards in your answer. (10)

(CEV 1 of 2006)

QUESTION 5 **(30 marks)**

You are the audit manager of "Connection Incredible", a company involved with the sale of general computer systems and the development of software specific to individual customers' requirements. The audit senior prepared the following auditing working papers with regard to the sale of a computer system to SBI Investment house, a highly profitable investment management company in South Africa:

Lead schedule:

Pretoria & Co Auditors				**A1**
Client: Connection Incredible Ltd		**Prepared by**: Audit clerk		
Year-end: 31 December 2005		**Date**: 3 February 2006		
Lead schedule: Statement of profit or loss and other comprehensive income				
Account number	**Account description**	**2005**		**2004**
000173827	Profit on sale of computer system	3 000 000		0
000248372	Homepage design	100 000		0
000178738	Maintenance fees earned – SBI Investment house	170 000		0
000032873	Interest on loan from SBI Investment house	(225 000)		0

Working papers:

Pretoria & Co Auditors		**A1**
Client: Connection Incredible Ltd	**Prepared by**: Audit clerk	
Year-end: 31 December 2005	**Date**: 3 February 2006	
Subject: Sale of computer system to SBI Investment house and loan from SBI Investment house.		
1.	**Understanding of transaction:** Connection Incredible sold a computer system to SBI Investment house for an amount of R8 000 000. The computer system has been installed and the system is running according to the customer's requirements. The sale agreement was concluded on 30 June 2005 and by 30 September 2005 the system operated according to SBI Investment house requirements.	
2.	**Financing of transaction:** To assist Connection Incredible with the financing of the system, SBI Investment house has lent an amount of R3 000 000 to Connection Incredible for the period 1 August 2005 to 30 June 2006 which is repayable on 30 June 2006. This loan will attract interest at an annual rate of 18%.	

Working papers (continued):

Pretoria & Co Auditors		**A1**
Client: Connection Incredible Ltd	**Prepared by**: Audit clerk	
Year-end: 31 December 2005	**Date**: 3 February 2006	
Subject: Sale of computer system to SBI Investment house and loan from SBI Investment house.		
3.	**Terms and conditions of transaction:** SBI Investment house would make two payments of R4 000 000 each on 30 September 2006 and 30 September 2007. Any additional maintenance charges would be for SBI Investment house own account. The only maintenance charges paid by SBI Investment house was for services provided on 21 November 2005.	
4.	**Production cost of system development:** The project cost schedules were inspected. The total cost of the system to Connection Incredible amounted to R5 000 000.	
5.	**Home page design:** Connection Incredible charges a standard price of R100 000 for designing a home page. Costs incurred can vary, but they are always less than R100 000. Cost of R28 000 relating to the development of SBI Investment house home page had been incurred by 31 December 2005. The total cost can't be determined, but will be less than R100 000.	

Financial statements:

You inspected the draft financial statements for the year ended 31 December 2005 and noted that the loan of R3 000 000 was netted off against the amount receivable from SBI Investments house resulting in a net debtor of R5 000 000 being disclosed on the statement of financial position. No further mention was made of the loan from SBI Investments house in the financial statements.

The following amounts have been included in the statement of profit or loss and other comprehensive income for the year ended 31 December 2005:

Profit on sale of computer system	R3 000 000
Interest on loan from SBI Investment house	(R 225 000)
Homepage design	R 100 000

REQUIRED:

Discuss the acceptability, in terms of International Financial Reporting Standards, of the accounting treatment of the abovementioned transactions and disclosures in the financial statements of Connection Incredible for the year ended 31 December 2005. You may assume that 18% is a reasonable discount rate.

Note: The implications of IAS 32 and IFRS 9 should not be discussed.

QUESTION 6

You are the recently appointed assistant to the financial director of Plex-Fame Limited. Plex-Fame Limited is a rapidly expanding, diversified, listed entertainment company with operations throughout South Africa and certain states in the United States of America. The operations of Plex-Fame Limited include movie theatres, television production, and a 60% interest in Media Limited, a company that specialises in entertainment-related advertising and promotion.

It is 22 March 1999, the week before the year end of Plex-Fame Limited. You have been asked by the financial director to advise on the appropriate accounting treatment and disclosure of the following items:

Ticket proceeds

The company is staging a South African version of "Miss Saigon", which is to open in August 1999. The smash-hit musical has been running in London for three years and is still playing to sold-out audiences. Plex-Fame Limited started receiving advance bookings in August 1998, and the first 4 weeks of the show's run are completely sold out. Average ticket prices are R65; the show will play seven nights a week. The theatre used for the production has 1 200 seats. As at 22 March 1999, Plex-Fame Limited had included in revenue R1,7 million of interest earned on the funds received from advance ticket sales. In addition to the substantial investment in advertising for this production (R4 million), the company will have invested R15 million in pre-production costs by August 1999 and will incur weekly operating costs of at least R250 000 once the show opens.

REQUIRED:

Prepare a report to the financial director of Plex-Fame Limited in which you discuss the appropriate accounting treatment and disclosure of the above.

You are not required to discuss any taxation implications.

[Source: QE 1999 Part 1 Paper 1]

QUESTION 7 (15 marks)

B-M Ltd manufactures and sells Carcomps (a motorcar onboard computer). During the past few months up to the year-end at 30 June 20X2, sales figures started to decline.

The marketing manager proposed the following strategies to increase the sales of the company approximately two weeks before the end of the year:

1. B-M Ltd will in future supply Carcomps to retailers in the USA on the basis that these foreign retailers need only pay for these items once they have sold the items to third parties (consignment stock). Furthermore a specific additional sales condition applies to these sales transactions in the USA. Customers in the USA may return the Carcomps within two weeks after the transaction date, provided the items and the packaging are in mint condition. Related transactions that took place between 13-30 June 20X2, were the following:

    (a) 350 Carcomps were shipped to a USA retailer at a selling price of $550 each on 13 June 20X2 and received by him on 14 June 20X2. The retailer will sell these Carcomp's at $580 each.

    (b) 120 Carcomps were sold on credit by the USA retailer on 15 June 20X2 and a further 150 Carcomps were also sold by him on credit on 20 June 20X2. The specific sales conditions as set out in (a) above, will apply.

2. From 15 June 20X2 Carcomps will be sold locally (in SA) without the right to return the items within two weeks after the transaction date (as is the case in the USA), and the selling price of R4 125 per Carcomp will now include one free maintenance service at any time within 6 months after the date of the sales transaction. 15% of the selling price of a Carcomp can be attributed to the free service. Transactions on this basis, that took place between 15 and 30 June 20X2, are the following:

    - 440 Carcomps were sold on credit to customers through the retail outlets of the company during the period 16 to 30 June 20X2 (sales occurred evenly). At 30 June 20X2 only 2 of these units were serviced.

3. A contract to sell 150 Carcomps to wholesalers at a fixed price of R2 800 per unit was entered into on 25 June 20X2. These items will be delivered to wholesalers on 5 July 20X2 and the risk and rewards associated with the transaction will be transferred on that date.

Additional information:

1. The Rand traded as follows at the relevant dates:

Dates	**USA $ = R**
13 June 20X2	$1=R9,62
14 June 20X2	$1=R9,70
15 June 20X2	$1=R9,68
20 June 20X2	$1=R9,80
28 June 20X2	$1=R9,78
29 June 20X2	$1=R9,60
30 June 20X2	$1=R9,47

2. The company values inventories on the FIFO basis and maintains a profit margin of 25% on cost, based on a selling price of R4 125. It may be assumed that all units on hand have the same cost.

3. The closing inventories of Carcomps in the warehouses of B-M Limited amounted to R950 400 at year-end, 30 June 20X2, while raw materials amounted to R750 000. No work was in progress at year-end.

4. Due to the fact that this is the first time that Carcomps were sold on a "sale and return basis", it is virtually impossible to determine how many items customers will return.

5. Assume that all amounts are material.

REQUIRED:

a) Calcualte the amounts in respect of transactions 1 – 3 that should be included in revenue for the year ended 30 June 20X2.

b) Present the note in respect of closing inventories as at 30 June 20X2 that would accompany the statement of financial position.

Please note:

- Accounting policy notes are not required.
- Your answer should comply with International Financial Reporting Standards.
- Ignore the time value of money.

QUESTION 8

Part a

Fly Ltd operates an airline between Johannesburg and Cape Town. The company recently introduced a customer loyalty program, in terms of which customers earn air miles when buying tickets. As soon as a customer has accumulated 20 000 air miles, these miles may be exchanged in return for a free ticket. There is reasonable certainty that all customers will utilise their free air miles.

REQUIRED:

Briefly explain how the sale of an airline ticket should be accounted for in terms of IAS 18 and IFRIC 13. Do not address revenue recognition criteria.

Part b

A supermarket operates a customer loyalty program, in terms of which customers earn 1 point for every R100 that they spend. Each of these points may be redeemed for goods to the value of R15 during subsequent visits to the shop. However, a maximum of 20 points may be redeemed in a calendar month. Taking into account that approximately 80% of points awarded to customers are redeemed, the fair value of each point awarded is estimated at R12. The points have no expiry date.

Mr Green, who is a member of the supermarket's customer loyalty program, spent R4 500 at the supermarket on 1 January 20X7. At 1 February 20X7 he bought goods to the value of R2 500 and redeemed 20 of his points as partial payment. At that stage it was expected that, in total, he will redeem approximately 90% of his points and the fair value of each point awarded is estimated at R13,50. At 1 March 20X7 he bought goods to the value of R3 000 and redeemed another 20 of his points. At that stage it was expected that, in total, he will redeem approximately 95% of his points and the fair value of each point awarded is estimated at R14,25.

REQUIRED:

Calculate the amount of revenue that the supermarket should recognise on 1 January 20X7, 1 February 20X7 and 1 March 20X7 respectively.

Part c

A clothing shop operates a customer loyalty program, in terms of which customers earn 1 point for every R100 that they spend. These points may be redeemed at Skyfly Airline as partial/full payment of airline tickets. The clothing shop pays the airline R4,50 for every point that the customers of the clothing shop redeem at the airline. The fair value of a point awarded is estimated at R5, taking into account that approximately 95% of points awarded are usually redeemed. (Assume that the estimate of 95% remains constant throughout.) 10 000 points were awarded during the 20X7 financial year, of which 6 000 were redeemed before the end of the year.

REQUIRED:

1. Regarding the points awarded and redeemed, briefly discuss the correct accounting treatment in the accounts of the clothing shop. Your discussion should include amounts.
2. Assume that the customer loyalty program is operated by the airline instead of the clothing shop. The airline entered into an agreement with the clothing shop in terms of which the clothing shop will award points and collect the consideration relating thereto on behalf of the airline. (The consideration / fair value of each point awarded amounts to R5.) The clothing shop will then pay an amount of R4,50 over to the airline for each point awarded. These points may be redeemed at the airline for free tickets. Briefly discuss how the accounting treatment by the clothing shop will differ from the treatment in (1).

Part d

An airline operates a customer loyalty program, in terms of which air miles are awarded to passengers when they buy tickets. These miles may then be exchanged for free tickets, subject to certain minimum requirements. During the 20X5 financial year, 1 000 000 air miles were awarded. Taking into account that only 70% of air miles granted are usually redeemed, the fair value of each air mile granted amounts to R10. Costs incurred to honor one air mile are estimated at R12. 600 000 of these air miles were redeemed during 20X5. At 31 December 20X5 (year-end) it became clear that, in total, approximately 90% of the air miles awarded during 20X5 will probably be redeemed, instead of only 70%.

REQUIRED:

Briefly discuss the implication of the change in the expected redemption rate from 70% to 90%.