The Evaluation and the Accounting of Income Based on IAS 18

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Abstract
In this paper our goal is to depict the income accounting in the context of the IAS 18 "Revenue". The article starts off with a definition of the income from a balance sheet and income statement perspective.
We did a comparative analysis of the income evaluation rules, through IAS 18 and the accounting legislation in force in Romania, trying to put in the spotlight both the similarities and differences between IAS 18 and the Romanian legislation in the matter.
The center of attention was focused on the aspects that regard the recognizing of the incomes made from good selling, starting with the conditions imposed by paragraph 14th of IAS 18. The explanations related to the way of applying these rules have been sustained by real examples that come out of the economic activity of Romanian companies.
The case studies are inspired by sales on credit and sales that have commercial discounts. The sales on credit depict: the method of the current update by the rate attributed to a similar instrument used by an issuer and the method of the current update based on the price obtained in the conditions of an immediate cashing. The sales that have a commercial discount were exemplified starting with the invoice, as a justifying document based on which the incomes are being introduced in the accounting. The accounting of commercial discounts was analyzed comparatively: in the Romanian accounting system, the French one and the American one.

Keywords: IAS 18, income, evaluation, recognizing, accounting.

Introduction

It may be stated that the vision of the Romanian accounting legislation is similar to that of the international accounting standard IAS 18. However, there are some differences which will be presented, categorized according to the main characteristics of income, as follows: definition, recognition and evaluation, as well as the accounting treatment for certain cases.

Definition of Income

According to IAS 18 income is represented by the growth, recorded throughout a financial period, of certain future economic advantages taking the form of either inputs or increases in assets or reduction of debts, which led to an increase in equity, other than the contributions of equity participants.

Income is recognized in the profit and loss account if it corresponds to the definition above and if this increase can be measured reliably. (Source: International Accounting Standards, Editura Economica Publishing House, Bucharest, 2003. page. 403).

Remark: IAS 18 defines income through elements from the balance sheet: an increase in assets, a decrease of debts, an increase in equity, other than that induced by contributions to the social equity.

The IAS 18 standard uses the concept of income and states that it is generated by ordinary activities of the company such as: sales income, fees, interest, dividends and royalties.

As regards the definition of income, the Romanian accounting legislation shows a similar perspective to that of the IAS 18 standard, meaning that income is defined based on the increase of assets and the reduction of liabilities.
Amounts or values that are received or are going to be received from current activities, as well as earnings from any other sources are included in the category of income.

Regarding the classification of income generated by current activities, the Romanian legislative text states similar rules to those of the IAS 18 standard. Income generated by current activities can be found under various names, such as: sales, commissions, interest, dividends.

Although income generated by royalties is not nominally stated, it is still included in the profit and loss account as current activities.

The Evaluation of Income

According to IAS 18 income included in the business figure is evaluated at « *the fair value of the means of payment received or of the deliverables that are going to be cashed...taking into account the total of any trade discounts and the quantitative rebate allowed by the company».* (Source: International Accounting Standards 2002, Economic Publishing House, Bucharest 2002, IAS 18 “Income from Current Activities”, paragraphs 9 and 10).

Under certain circumstances, when the sale is performed on credit, the value of the deliverables that are going to be cashed in the future is larger than the face value. In order to establish the fair value of the means of payment it is necessary to calculate the present value of the deliverable either by using an interest rate, or by associating it with a similar instrument of another issuer which involves the same degree of risk, or which actualizes the face value with the current sale price of goods and services. The difference between the fair value and the face value of the payment means is recognized as an income generated by interest.

We may conclude that as regards the evaluation of income IAS 18 lays stress on measuring the modifications affecting assets and liabilities generated by the transaction.

The Romanian accounting legislation uses the term fair value only when evaluating goods received free of charge, reevaluating tangible fixed assets or evaluating financial instruments.

In Romania, the evaluation of income is almost immediate for accountants, because the amount written in the sales invoice is recorded as an income. IAS 18 states that in the case of transactions involving exchange of goods and services of a similar nature, the operation does not generate income. When the exchange refers to goods and services which are not similar, the operation is considered being income generating.

The income is evaluated at the fair value of the goods and services received, out of which any amount transferred in cash or equivalents of cash is deducted. When this value cannot be established reasonably, the basis of income evaluation is represented by the fair value of the transferred goods, out of which any transfer of cash or cash equivalents has been deducted.

The Romanian accounting legislation does not allow such a treatment of the exchange of goods and services and regardless of the form of payment, the delivery is recorded separately from the entry.

The legal, tax and accounting regulations state that for any transaction an invoice should be elaborated. The invoice is the trade document that describes the general terms of the transaction taking place between the supplier, who is selling, and the client, who is buying.

Accounting of Income Resulting from Sale of Goods

This section in accounting ensures the recording of income generated by sale of goods and merchandise, influencing the result of the core activity.

The international IAS 18 norm ”Income from current activities” states that income stemming from sale of goods must meet five conditions in order to be recorded in accounting:

- the company has transferred to the buyer the main risks and advantages that result from the property of the goods;
- the company does not reserve the right to take part in the managing or the effective control over the transferred goods;
- the size of the income can be measured reliably;
- it is probable that the future advantages associated to the operation will be in favor of the company;
- the costs of the transaction can be measured reliably.

Notes and Comments

In this regard, there are no differences between the conditions imposed by international accounting standards and those applied by Romanian companies. However, when IAS 18 considers that the transfer of property rights is not perfect, companies that fall under the terms of this provision must not recognize an income at the moment of delivery.

One situation refers to the sale that is dependent on a re-sale. In other words, within the trading relation between seller and buyer, clauses can arise, according to which the buyer gains property over the goods only when he manages to re-sell them.

This occurs in case of companies that trade cosmetics products through sales agents. For each agent there is a separate administration, for material or cash warranties, and the act of delivery is merely a transfer document between two administrations. When the agent sells the products and deposits with the company the equivalent of the sale price minus his commission, the input will be recorded by the company as an income from sale of goods.

The second case, mentioned by the norm, refers to the sale that obligates the supplier because of an execution that was not performed and not covered by warranty clauses. Let us assume that a machinery manufacturer, in order to distinguish himself from his competitors, admits that for any delivery to grant his customer a trial period, during which he will not have to pay, but will be using the respective good in order to evaluate its performance level. Until the trial period expires, it is considered that the risks and advantages have not yet been transferred to the buyer, and the seller will not be recording any income. In order to benefit from this advantage, Romanian trading companies have agreed to the custody transfer method, based on the certification and the minutes, both elaborated for this purpose.

The third situation falling under this category is represented by goods that are delivered with the obligation of installation, this operation being an important part of the contract that is not yet executed by the seller. The common practice for Romanian trading companies is that the mere issuing of the invoice, which attests to the delivery (not the recording of an advanced payment) imposes the recording of the sales income. In addition, for such a situation the law does not allow the substitution of the fiscal invoice with another delivery document.

The fourth situation is that in which the buyer can cancel the purchase because of reasons stated by a contractual clause. This could imply that for the contracts with the condition of returning the goods, the supplier should not record the sale income until he will receive the confirmation from the buyer regarding the total or partial acceptance of the goods. Romanian trading companies proceed to delivering the goods in the presence of a delegate of the buying company who signs for the receipt and the invoice is recorded with incomes, even if the contract contains conditions regarding the possibility of returning the goods.

The last situation provided by the norm is that in which the company holds an insignificant risk which results from the property right, but, unlike those previously presented, the transaction represents a sale and the income is recognized. This is the case of trading companies that promote sales by introducing coupons in the merchandise package. Coupons are introduced selectively in packages, giving the customer the right to acquire a similar product free of charge. A trading company prints a predefined number of coupons, so that a percentage of its annual production can be destined for free deliveries. The probability of a customer returning to the store is uncertain, due to quitting or because packages containing coupons stay in stock. Such a practice does not represent an obstacle to recording the income at the moment of the sale. If the seller is capable of appreciating the equivalent of the gratuities, it is enough for him to constitute a provision for them.

In the spirit of these regulations, the income and expenditure corresponding to a transaction are simultaneously recognized, according to the principle of connecting expenditure to income. When expenditure cannot be measured reliably, any means of payment received in account of the sale is recognized as a debt, an example being advance payment received from customers.

Particular Cases Regarding the Recording of Income from Sale of Stockable Values

The sale is made on credit, which involves a significant interval (of 30, 60, 90 days). The first way to actualize the amounts corresponding to the credit granted is based on the rate attributed to a similar instrument of another issuer. Example: On December 1st year N, company ”X” has sold to another company, “Y”, finished products of a total value of 80,000 lei. The payment outline is presented in the following table:

Table 1: Credit rates payment outline

Upon goods reception	40%
December 31st year N+1	20%
December 31st year N+2	20%
December 31st year N+3	20%
Total	100%

It is estimated that company “Y” could have obtained a bank loan with a rate pf 10%.
Solution: The face value of the deliverable is 80 million lei, excluding the value added tax. In order to reflect it in accounting, the present value of the deliverable is calculated by using the following formula:

$$3200+ 1600/ 1.1^{3} + 1600/1.1^{2} + 1600/1.1 = 7179 \text{ RON}$$

Table 2: Actualizing the current value based on the rate attributed to a similar instrument of another issuer

Year	%	Annual Rate -RON-	Current value -RON-	Interest -RON-
N	40%	3.200	3.200	-
N+1	20%	1.600	1.202	398
N+2	20%	1.600	1.322	278
N+3	20%	1.600	1.455	145
Total	100%	8.000	7.179	821

Note*:* In the formula used to calculate the present value, the exponents are placed in a descending order, because, as for any credit, the sum of interests decreases annually.

Accounting Analysis*:*

At the initial moment of the transaction, i.e. December year N, the transaction is reflected by the following accounting record:

« Clients »		«Income from product sales»		«Income recorded in advance»	
8.000 RON			7.179 RON		821 RON

As rates are received, income generated by interest is recognized, for the first rate in year N+1:

«Income recorded in advance»		« Income generated by interest »	
398 RON			398 RON

Similarly, income generated by interest corresponding to years N+1 and N+2 will be recorded, by placing the amounts presented in table 2 in the formula.

The second way to actualize the amounts corresponding to the credit awarded to the customer is based on the price that can be obtained in exchange for the products, should the payment be performed immediately. Assuming that the company would have obtained the amount of 6,570 RON, the rate is determined by using the following formula:

$3,200 + 1,600(1+x)^3 + 1,600(1+x)^2 + 1,600\ (1+x) = 6,570$ RON

The result is that the yearly interest rate is of 20%. The components of the annual rate is presented:

Table 3: The Actualization of the Current Value Based on the Price Obtained in Case of Immediate Payment

Year	%	Annual Rate -RON-	Current Value -RON-	Interest -RON-
N	40%	3.200	3.200	-
N+1	20%	1.600	926	674
N+2	20%	1.600	1.111	489
N+3	20%	1.600	1.333	267
Total	100%	8.000	6.570	1.430

The accounting formulas of the transaction are performed similarly to the previous case, by using the values in table no. 3.

Note

According to common practice with Romanian trading companies, the way to approach sales with payments in installments is different from the one stated by IAS. In order to evaluate the deliverable, the starting point is the present value of the goods sold, which is divided by the number of installments established in the contract. The interest rate is always applied to the amount of credit left to be paid. When it is necessary, the value added tax, which is collected at the moment of the delivery, is added. Based on the payment outline, revenue generated by interest is recognized.

Sales made through credit contracts concluded between the client and an authorized customer are accepted by many traders. This is generally applied in cased of long term asset sales. In these circumstances, the client opens a credit line with the authorized creditor, based on the proforma invoice issued by the seller. At the moment of delivery, the fiscal invoice is issued and signed by the client. The seller then returns the invoice to the creditor and the money is inputted. Because the seller does not establish credit relations with the client, he is advantaged by the creditor. Based on the conventions concluded between the trading unit and the creditor, the latter does not pay the invoice integrally, but holds a discount of 1.5% up to 4% of the amount sent to the account of the seller.

Example: SC Power Net Center SRL, trades in household appliances. At the end of the day, the company has invoices issued on CEC credit amounting to 11,900 lei, including VAT 19%. According to a convention, the creditor is going to withhold a percentage between 2% and 4%, depending on the date the invoices are going to be given. Power Net Center is going to record their respective invoices as follows:

« Clients »		**«Income from sale of products»**		**«Collected VAT»**	
11.900 RON			10.000 RON		1.900 RON

Upon the date of the payment, the company will receive an amount with 2.5% less:

« Bank Accounts »		««Expenditure regarding granted discounts»»		« Clients »	
11.602.50 RON		297.50 RON			11.900 RON

Observation: We have not approached the amount withheld by CEC as interest, since the seller does not have the capacity of debtor in the credit account. Also, it has not been highlighted with commissions, because it does not appear under the payment section of the account draft and it has not diminished the tax base , since the invoice is issued under the name of the client.

Sales that grant trading discounts are frequent in business practice, and have an important role in maintaining the client portfolio. When they are established at the moment of delivery, the sales invoice will be recorded as usual, by reflecting the income, adjusted with the trading discount. We will apply this rule for a company that has issued an invoice with trading discounts:

Supplier: S.C Argpan S.A Curtea de Argeş		INVOICE No..............Date........			Buyer: S.C Alfa S.A. Piteşti	
Product Name	U.M.	qnt.	Unit Price (without VAT) - lei -	Value - lei -	VAT %	VAT Value
G 005	to	1,000	32	32,000	19	6,080.00
Rebate: 2%				- 640		-121.60
				31,360		5,958.40
Remise 5%x 31,360				-1,568		- 297.92
TOTAL	x	x	x	29,792	x	5,668.48
Signature and stamp of supplier		Signature of receipt		Total: 35,452.48 lei		

Fig. 1 Invoice Involving Trade Discounts

Theoretically, trade discounts are calculated in a certain order: first the rebate, followed by the other two. In practice, these are negotiated. In the case outlined, the respective percentages were applied to the previous net income. The seller will reflect the income at the level of the last net income written in the invoice, and the value added tax is diminished accordingly.

A particular case is represented by the accounting of trade discounts that are awarded after the delivery. Let us assume that invoice no.8494171/06.30 year N was issued for the gross amount of 38,080 lei. At 08.15. year N, the seller has issued a different invoice for the trade discounts, amounting to 2.627,52 lei. In this case, the invoice that contains the trade discounts will be recorded in accounting as follows:

« Clients »		**«Income from sale of goods»**		**«Collected VAT»**	
-2,627.52 RON			-2,208.00 RON		- 419.52 RON

Observations

In the case of this accounting formula the possibility of crediting the **«**Clients**»** account in correspondence with the debit of the income and collected VAT accounts was excluded. The reasons are linked to the necessity of correlating the value added tax from the sales journal with the one reflected in the credit of the **«**Collected VAT**»** account.

Certain authors have emphasized this aspect as an unfavorable one, arguing that the rectification operation has the meaning of amounts that are subtracted from other amounts. Obviously, the amounts must be subtracted, because they are based on invoices in red. If we admit that the trade discounts awarded in the initial phase do not lead to distinct records, for later cases they represent o return to previous trade documents and have the purpose of rectifying the credit side of the income accounts.

The relation of correspondence between the credit of the «Clients» account and the debit of the sales income accounts is inspired from the French accounting plan, in which, in case of later discounts, the following formula is elaborated:

«Trade Discounts»		***«Clients»***	
2.208 RON			2.208 RON

Account 709 «Awarded Trade Discounts» ensures the transparency of the accounting information, because it has the role of delineating the trade discounts. It is rectification account, and its debit balance will rectify the sales income, at the end of the financial year, so that the profit and loss account will only reflect the net sales. (Source: Claude Perochon and Louis Dubrulle - Financial Accounting, Economică Publishing House, Bucharest 2002, page 140).

In the American accounting system there is an account called «Returned sales and awarded discounts», which has the purpose of informing management about substandard products and unsatisfied customers. It is an income rectification account and has a debit balance.(Source: Belverd E. Needles, Jr., Henry R. Anderson, James C. Caldwell – Basic Accounting Principles, Fifth Edition, page 183).

In the Romanian accounting plan, any substitution has the result of altering the credit sides of the sales income accounts.

Conclusions

Within the current paper we have set a goal of analyzing the current treatment regarding the accounting of income provisioned by IAS 18, the differences and similarities between these treatments and the Romanian accounting regulations.

Differences regarding concepts were identified in the case of income evaluation. Thus, in the case of sales performed on credit, IAS 18 states that the income generated by interest be determined residually, as a difference between the fair value and the the face value of the payment instrument.

In Romanian accounting, in the case of deliverables, the evaluation is based on the present value of goods sold, which is divided by the number of installments established by the contract. The interest rate is always applied to the amount that is left to reimburse.

IAS 18 states that in the case of exchange transactions involving goods and services of a similar nature, the operation does not generate income. The Romanian Legislation does not allow such a treatment of the exchange of goods and services and regardless of the payment method, the delivery is highlighted separately from the input.

As regards regonising income, IAS 18 considers that if the transfer of the property right is not perfect, the companies that fall under the authority of these statements must not recognise an income at the moment of delivery.

In the common practice of Romanian companies, if the risks and advantages have not been trasferred to the buyer, the method of custody transferring is applied, based on the authorization and the minutes. In this siituaition, the seller will not record an income.

Judging by the way the case studies were solved, we may reason that, in Romania, accounting is connected to fiscal aspects.

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