Example of why revenue recognition is significant case study

Business, Company

Revenue refers to inflow of assets which result from mainly sale of goods and services to customers. Revenue helps in determining success of a business. This is the reason why financial specialists use revenue to calculate how long a business will take for the owner to recoup the initial capital (Edwards & Hermanson, 2007). Revenue is also used to determine profitability of business because it is mainly composed of sales. Therefore, if sales are overstated then definitely the profit of the business is overstated. Likewise, if revenue (sales) is understated then the profit is also understated. Therefore, it is significant to know when revenue should be recognized (Gangwar, Sharda & Gangwar, 2009).

Determining when revenue should be recorded

Recording revenue in books of account refers to recognizing revenue in a business. Generally accepted accounting principles provide clear guidance on when accountants should recognize revenue. This has led to international adaptation of revenue recognition principle which provides clear guideline on when either revenue or expense should be recognized. The principle stipulates that revenue should only be recognized when earned but not when money is received. While, expense are recognized when incurred but, not when money has been paid. Various financial statements have shown that several international companies have used revenue recognition principle as a basis of determining profit earned.

Matching concept

It is a concept which allows accountants to associate expenses of a given period to the income of the period (Murthy , 2009). Therefore, net revenue of a given period is calculated by summing up all revenue earned (both received and accrued) minus expenses (both paid and accrued). When accounting for inventory the cost of inventory is determined by summing up all the costs i. e. buying costs plus carriage inwards (SEC , 2007).

Part ii

Apple Co. and Samsung Co. use GAAPS in preparation and presentation of its financial statements. This is explicitly stated for Apple co. in note 1of 2012 financial statement which clearly states that the company used US GAAPS to prepare its financial statements. On the other hand, Samsung co. has clearly stated that its revenue is recognized when earned and expense is recorded when incurred but not when money has been paid an indication that the company uses matching principle. This evidence has been obtained from notes of financial statements of year 2011 and 2012

Samsung co.

Apple co.

The profitability of both companies improved i. e. that of Apple co. increased by 61% while that of Samsung increased by over 100%. This is attributable to higher increase in revenue than the expenses.

It is clear from the above tables that expenses and revenue increased. However, as noted above the increase in revenue was higher than expenses. Therefore, both companies performed better in year 2012 than in year 2011. It is possible to discern a trend for the two companies because Samsung co. which was able to keep its percentage increase in expenses low was able to have very higher percentage increase in income than Apple co. for example

Samsung co. cost of sales increased by 16% while that of Apple co. increased by 36%.

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