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SALES, SERVICES AND DEBTS RECEIVABLE

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ABSTRACT

The adoption of the Accounting Standardization System required the adjustment of audit procedures in each area. Sales and receivables were one of those areas. This work aims to explore this aspect.

First, we address the main aspects in the accounting area and then we leave suggestions for audit testing and control.

Keywords: Accounting Standardization System, NCRF 27, Sales Record, Control customer debt.

1.0 SALES, SERVICES AND DEBTS RECEIVABLE - Accounting Aspects

The main accounts of the 1st degree of the Accounting Standardization System that are linked with this area are as follows:

- 71 – Sales
- 72 – Provision of services;
- 21 – Customers
- 75 – Exploitation subsidies

Account 71 - Sales includes the sales represented by the invoicing that must be deducted from VAT and other taxes and incidences where they are included in it.

Account 72 — Rendering of services refers to the works and services rendered that are specific to the main objectives or purposes of the entity. You can integrate the applied materials, in case they are not billed separately.

Account 75 — Operating Subsidies account includes subsidies related to income, as established in NCRF 22 — Subsidies and other Support from Public Entities or other applicable regulations.

Account 21 — Customers records movements with buyers of goods, products and services. With regard to advances, it must be taken into account if the price is not fixed. If this is fixed,

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27.6 – Advances on account of sales must be credited, which registers the deliveries made to the entity in relation to supplies of goods and services whose price has been fixed in advance. Upon issuing the invoice, these amounts will be transferred to the respective accounts under item 211 — Customers c/c. If it is not fixed, 218 — Advances from customers must be credited, which records deliveries made to the entity relating to supplies.

It is in this area that one of the most critical phases in business management is located. Effectively, companies must implement measures that not only increase sales (in other words, turnover if services are included), but that simultaneously know to whom they are selling. Thus, it is not only important to increase income, but also to know the collection rights and safeguard that they are actually received.

Accounts receivable include rights arising from the normal activity of the company, as well as rights arising from other transactions, such as loans granted to equity holders, sales of non-current assets, claims on the State and personnel. Thus, in accordance with Ordinance No. 218/2015 of July 23 – Accounts Code, Class 2 – Accounts Receivable and Payable is intended to record transactions related to customers, suppliers, personnel, the State and other public entities, financiers, shareholders, as well as other operations with third parties that do not fit in the previous accounts or in other specific classes. This class also includes deferrals (to allow recording of expenses and income in the periods to which they refer) and provisions

One of the most relevant aspects in accounting terms is the recognition of revenue, which is dealt with in NCRF20. Revenue is understood to be "the gross inflow of economic benefits during the period arising in the course of the ordinary activities of an entity when those inflows result in increases in equity, other than increases relating to contributions by participants inequity". Revenues, therefore, come from the sale of goods, the provision of services and the use by others of assets of entities that produce interest, royalties, dividends

With regard to measurement, revenue "is measured at the fair value of the consideration received or receivable taking into account the amount of any commercial and quantity discounts granted by the entity". If a receipt is deferred, and if the fair value is less than the nominal amount, the difference must be recognized as interest income.

Regarding debts receivable and in accordance with NCRF27, the amount initially recognized is that contained in the document that titles the sale, generally the invoice, less discounts. After initial recognition, these accounts must be measured at the end of the period at cost or amortized cost. If measured at amortized cost, they must comply with paragraph 12 of NCRF27, namely: meet all the following conditions: a) Be in cash or have a defined maturity; b) The returns for the holder are i) of a fixed amount, ii) of a fixed interest rate during the life of the instrument or a variable rate that is a typical market index for financing operations (such as Euribor) or that includes a spread on that same index; and c) Does not contain any contractual clause that could result in the holder losing the face value and accrued interest (excluding typical cases of credit risk). Amortized cost is a general rule used in measuring non-current assets, using the effective rate method, less any impairment losses

The following diagram illustrates the accounting movement in the customer account:

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Customers	
Customer opening balance	Receipts
Credit sales and services	Discounts
	Returns
	Final customer balance

Note: cash sales go directly to Cashiers and banks

When the amount that is expected to be actually received is less than the amount recorded, the respective impairment must be accounted for, as prescribed by NCRF12 "an entity must assess at each reporting date whether there is any indication that an asset may be impaired. If any indication exists, the entity shall estimate the recoverable amount of the asset." In the event of impairment, the company must debit account 65.1 - Impairment losses on debts receivable and credit account 219 - Accumulated impairment losses, in accordance with the provisions of Ordinance No. 218/2015 of July 23 - Code of Accounts 219, 229, 239, 269 and 279 - Accumulated impairment losses - these accounts record the accumulated differences between the amounts recorded and those resulting from the application of the measurement criteria of the corresponding assets included in class 2, which can be subdivided in order to facilitate control and enable presentation balance sheet of the net amounts. Annual impairment losses will be registered in accounts 651 — Impairment losses — In debts receivable, and their reversals (when the situations that gave rise to the losses no longer exist) are registered in accounts 7621 — Reversals of impairment losses — In debts to receive. When the conditions of uncollectibility are verified that allow the derecognition of the assets to which the impairments relate,

With regard to presentation, receivables are presented in the balance sheet at the net amount of accumulated impairments and duly separated between current and non-current assets.

2.0 SALES, SERVICES AND DEBTS RECEIVABLE - Audit Aspects

The audit objectives are linked to obtaining sufficient evidence about each assertion (statements provided by the management bodies) underlying the financial statements and include:

- Test accounting procedures and internal control measures and verify that they are adequate and that they are actually being applied;
- Check that the value of sales and services provided for the period under examination and is not found:
  - Overvalued through illegitimate credits due to sales not made or services not provided;
  - Undervalued due to sales or instalments made in the period, but deferred to subsequent periods.
- Determine whether the account balances represent legitimate debts and rights of the company, originating from sales transactions and/or services rendered and are conveniently valued in accordance with the NCRF;
- Discounts, rebates, sales or service returns are properly presented in the financial statements;

- Impairments for debts receivable are in accordance with the risks estimated by the company, based on objective criteria;
- Accruals and deferrals are correctly recorded;
- The valuation of transactions in foreign currency and debts receivable in foreign currency in force on the closing date were updated at the respective exchange rate;
- The appropriate cut in operations was carried out, that is, sales, deductions from sales and receipts are accounted for in the current year;
- All pertinent information related to this area is properly disclosed in the annexe.

As Almeida (2017) points out, one of the essential aspects of internal control in this area is adequate segregation of functions, with regard to the approval of the sale, accounting, collection and custody of credit instruments.

Thus, the control of debts receivable must be managed by a separate accounting system, with monthly reconciliations between the balances shown in the customer files and the balances in the balance sheets.

The process begins when the customer requests the supply of certain merchandise or product to the sales department. The latter must issue a purchase order, in quadruplicate and pre-numbered. An analysis of the customer's credit limits, the prices charged to the customer and the availability of inventory must also be carried out. Once verified and approved, a copy of the purchase order is sent to the warehouse. Upon dispatch, a delivery note is issued to the customer, in quadruplicate. The original goes with the merchandise to be signed by the customer and a copy is filed in the warehouse, another for the invoicing department and the other for accounting. The invoicing department issues the invoice, based on the purchase order and delivery note. The invoice must be issued in quadruplicate, the original for the customer, one copy filed with the billing department, one for accounting, and one for the billing section. The accounting records the sale and when payment is received from the customer, the customer's debt will be settled.

It is evident that we are in the presence of a complex circuit that most companies (namely micro-entities) do not have the resources to implement. It is up to the auditor to test and supplement with substantive procedures. Substantive procedures include testing of detail and analytical procedures.

With regard to analytical procedures, the first step must be to understand the expectations about the evolution of the business. Then, balances for the year should be compared with balances from previous years to verify the reasonableness of the assumptions made by management. In a third step, ratios and trends should be used, with the gross margin and the average period of receipts being particularly relevant. If the gross margin is lower than expected, it may indicate that sales were inflated, possibly due to an error in cutting operations. On the other hand, if the average collection period increases, it may indicate increased difficulties in the collection, with the consequent need to reinforce customer impairments.

A possible framework for an analytical procedure in this area is as follows:

ratio	*Formula*	*N*	*N-1*	*N-2*	*N (sector)*
Average receipt period (days)	Customers /(Business Volume x 1.23) x 360				
Gross Margin	% Gross Margin / Turnover				
Impairment losses	% Impairments / Turnover				
Rotation of accounts receivable	Turnover x 1.23 / Accounts Receivable				

Regarding the substantive tests of detail, the following can be mentioned:

a) Vouching and tracing

Vouching is an audit test that starts from the final documents to reach the initial documents. Thus, in the case of sales, invoices are selected and we try to verify if there are purchase orders that support them

Tracing is the opposite of vouching, it starts with purchase orders to arrive at invoices

b) Operations cut

The thesis of cutting off operations to sales and receipts from customers is intended to obtain reasonable assurance those sales and the respective debts are accounted for in the periods in which the transactions took place and the inherent withdrawals of inventories and recognition of expenses are accounted for in the same period

c) Circularization

Confirmation of customer balances and other information can be done through circularization. This external proof is one of the most used to determine the validity of the amount of debts receivable. This external confirmation is obtained through a direct written response to the auditor by a third party (the confirming party), on paper, electronically or otherwise.

ISA505 states that audit evidence is most reliable when it is obtained from sources independent of the entity. On the other hand, evidence obtained directly by the auditor is more reliable than evidence obtained from an audit obtained indirectly or by inference.

External confirmations can be positive or negative:

- Positive confirmation request – the third party (generally debtor) is asked to respond directly indicating whether they agree or disagree with the information contained in the request or providing the requested information. It is a type of confirmation that brings greater benefits, being recommended for those debtors from which the auditor wishes to obtain a formal response;
- Request for negative confirmation – the third party is asked to respond directly to the auditor only if they disagree with the information presented in the request. This is less persuasive audit evidence than positive confirmations. This confirmation is recommended when internal control over debtors' accounts can be considered acceptable; there are many small balances and the auditor is almost certain that the debtors surveyed will not give too much importance to the confirmation request addressed to them.

In practice, a combination of the two forms is used, applying the positive for large and significant balances and the negative for non-significant balances

d) Analysis of unusual balances

In view of the existence of unusual balances (such as, for example, customers with credit balances and a large number of invoices issued near the end of the year), it should be verified whether the company performs compensation between debtor and credit balances, the classification of the debt between current and non-current and, by sample, if the balance on the balance sheet coincides with the balance on your individual record.

e) Assess the adequacy of impairment

The procedures that are used by the company to estimate the impairment must be investigated, proving its reasonableness. Also check whether the company uses fiscal and/or economic criteria.

An important map that must be drawn up is the map that shows the age of customer balances, highlighting those that are overdue at the balance sheet date

Some of the steps that should be followed to test for impairment are indicated:

- Compare the impairment balance at the end of the year with the balance at the end of the previous year, as well as verify the movements that have taken place;
- Prove the reasonableness of the impairment;
- Circulate lawyers in order to find out what cases exist in court

3.0 CONCLUSION

The study of the area of sales and debts receivable is fundamental as it is an area linked to the liquidity of companies. Auditing is essential to ensure its reliability and prevent fraud or deviations that could compromise the organization's operation. Its applicability is not legally required in many cases, but it is recommended.

For future studies we intend to carry out a case study.

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http://www.cnc.min-financas.pt/snc2016.html

Observation:

NCRF - Accounting Standard for Financial Reporting (Norma Contabilística de Relato Financeiro)

