15.515 Recitation Session 3:

Revenue Recognition, A/R Concepts and Inventory Valuation

Agenda

1. Review of Revenue Recognition
2. A/R Concepts and Inventory
3. Problems
4. Questions
Revenue Recognition

KEY QUESTIONS

• Has revenue been earned?
  • e.g. warranty, deferred revenue/income, discounts, price protection policies

• If sales are on credit, is the cash collectible?

CRITERIA FOR REVENUE RECOGNITION

• A significant portion of the production and sales effort has been completed
• The amount of revenue can be objectively measured
• The major portion of the costs has been incurred, and the remaining costs can be reasonably estimated
• The eventual collection of cash is reasonably assured
Inventory

\[ \text{Inv}_{EB} = \text{Inv}_{BB} + P^1 - \text{COGS} \]

Cost Flow Assumptions

1. **Specific Identification**
   Used when specific products can be tracked (e.g. cars)

2. **FIFO: First In, First Out**
   Cost of goods sold are assumed to be equal to the costs of the oldest available units in the financial records

3. **LIFO: Last In, Last Out**
   Cost of goods sold are assumed to be equal to the costs of the most recently purchased units in the financial records

4. **Averaging**
   COGS are assumed to be equal to a per-unit weighted average cost at the end of the period

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1 Purchases, production