

Income recognition of the transaction on sale or return basis

M.M.K.A.P Karunarathna & K.N. Wijesinghe
kasunparis@gmail.com&nayomi@kln.ac.lk

Introduction

One of the fertilizer selling companies has transferred a fertilizer stock to its agent sales on return basis and the company have recognized this amount as their revenue to their financial statements.

The company has transferred RS.2, 000,000.00 fertilizer stock to their dealer on the sales or return basis at the end of the last month of the period. The company has recognized the total RS.2, 000,000.00 as their sales income. But the dealer has confirmed that he has sold RS.1, 000,000.00 stocks only to the customers at the end of the period.

Discussion of the issue

The company has recorded unrealized sales revenue in the financial statements of the company. Therefore profit of the company has overestimated. According to the I.KAS 18 "Revenue" all of the following conditions should be satisfied to recognized a sales revenue they are

- 1) The entity has transferred to the buyer the significant risks and reward of ownership of the goods.
- 2) The entity retains neither continuing managerial involvement to the degree usually associated with ownership nor effective control over the goods sold.
- 3) The amount of revenue can be measured clearly and reliably.
- 4) It is probable the economic benefits associated with the transaction will flow to the entity.

5) The cost incurred or to be incurred in respect of transaction can be measured reliably.

When transfer goods to the dealer on sales or return basis the above condition 01 & 02 are not satisfied. So the company cannot recognize the total 2,000,000.00 as sales revenue for the year until the dealer sells the total fertilizer stock to the customers. But in this case the dealer has sold only the half of the stock. Therefore the ownership of the goods has not transferred to the dealer and the company has significant risk and rewards of ownership of the half of fertilizer stock. And also the company has continuing managerial involvement to the degree usually associated with ownership and the company has control over the unsold half of the stock, because the company has transferred the goods on sales or return basis. Therefore the above condition 01 & 02 are not satisfied. So the company cannot recognize the total as sales revenue of the period.

Conclusions and Recommendations

According to the IAS 18, the company can recognized only the half of the goods sent to the dealer as the sales revenue to the period. The balance half of the goods should not recognized as the sales revenue to the period. Because the dealer is still not sold the half of the stock to the customers.

The following reversal entry can be passed to correct the issue

Sales	Dr	1,000,000.00
	Debtors	Cr. 1,000,000.00

Further, cost of above unsold stock need to be adjusted in closing stock and cost of sales

Stock A/c	Dr.	Trading A/c	Cr.
-----------	-----	-------------	-----