

## Revenue recognition of SLFRS for SME (Rendering of services)

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### Introduction

Ayurveda Health Resort (Pvt) Ltd is a limited liability Company incorporated in Sri Lanka under the Company Act No 07 of 2007. The principal activity of the Company is operating of Hotel and Ayurveda Health Care Centre. The Company provides hotel facilities to foreigners and local customers. Usually company collects advances from the customers before they arrive to the hotel. Company revenue recognition method is as follows when company received an advance amount it is considered as service income of the company.

### Discussion of the Issue

When customers (foreigners) arrive to Hotel they should deposit advance money to the company bank account. This money is considered as revenue of the company. Therefore, company has accounted these cash deposits as follows.

Bank Account	Dr	
Revenue Account		Cr

According to this method of revenue recognition, company has failed to recognize revenue for the accounting period correctly. Hence their statement of comprehensive income shows inaccurate gross profit margin. As a result of this error their statement of financial position is shown an inaccurate

point on the reporting date. Because the advanced received from the customers do not show in their current liabilities as well as their gross profit margin is overstated. Not only that, computation of tax is not correct, and also management cannot take a correct decision to recognize revenue and profit for the period correctly. According to the SLFRS for SMEs (Section 23.14) it should be recognized as advance received.

### **Conclusions and Recommendations**

We recommended this cash receipt should be recognized according to the section 23 of SLFRS for SMEs. According to the SLFRS for SMEs when the outcome of a transaction involving the rendering of services can be estimated reliably, an entity shall recognize revenue associated with the transaction by reference to the stage of completion of the transaction at the end of the reporting period. The outcome of a transaction can be estimated reliably when all the following conditions are satisfied.

- The amount of revenue can be measured reliably.
- It is probable that the economic benefits associated with the transaction will flow to the entity.
- The stage of completion of the transaction at the end of the reporting period can be measured reliably.
- The costs incurred for the transaction and the costs to complete the transaction can be measured reliably.

When service are performed by an indeterminate number of acts over a specified period of time, an entity recognizes

revenue on a straight-line basis over the specified period unless there is evidence that some other method better represents the stage of completion. When a specific act is much more significant than any other act, the entity postpones recognition of revenue until the significant act is executed.

When the outcome of the transaction involving the rendering of services cannot be estimated reliably, an entity shall recognize revenue only to the extent of the expenses recognized that are recoverable.

When we analyze this case, we reviewed that requirements of recognition of revenue of rendering service have not been satisfied. Therefore recognizing this cash deposits as revenue of the company is incorrect. Therefore it is advised to consider this cash deposits as advanced received from customers until rendered the service.