

## **Does revenue create better picture among its stakeholders?**

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### **Introduction**

SUPERBOND (Pvt) LTD is an adhesive manufacturing company. This company imports the raw materials and processes them in its factory to manufacture the products. It carries out both direct & indirect sales to achieve their annual sales targets. The company's stores are located in close proximity to its head office. When the items are delivered from the stores, the security officer stamps the security seal on the invoice and the accounts copy of the invoice is sent to the Accounts Department. The goods are delivered two or three days after the invoice has been raised. However, the Accounts Department updates the sales ledger based on the invoice date. Therefore it is clear that there is a time gap between date sales actually occurred and the date of revenue recognition.

Not only that but also the company has been identified as having a control weakness in its ERP system. The system has not been designed to provide an automatic restriction on further sales to defaulting customers. Hence there is a high probability for these defaulting customers to make continuous purchases and default payments indefinitely.

### **Discussion of the Issue**

According to the LKAS 18- *Revenue*, there are five conditions which should be satisfied to identify revenue from the sale of goods. But the company's sales procedure does

not comply with the LKAS 18 because it does not recognize its revenue at the point in which the ownership of goods is transferred to the third party. This causes an overstatement of revenue as well as debtors' balances. Therefore, the financial statements of the company do not reflect the correct picture where revenue is concerned.

Since the company has not designed its system properly, there is a possibility that it affects its entire business process. Since defaulting customers are not monitored by the system itself by restricting further sales to them, there is a risk that the company's liquidity position being badly affected.

#### **Conclusions and Recommendations**

- The company should comply with the Accounting standard of revenue recognition prescribed by the CA Sri Lanka (LKAS 18).
- The system should be modified in a way that it restricts the defaulting customers automatically when the approved credit limit is exceeded. Approval of an officer at a higher level should be necessitated when an invoice is needed to be raised for a further sale to such a defaulting customer.