Chartered Accountancy – BL 01

Financial Accounting

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MBA (PIM-SJP), B.Sc. (Acct.) Hons. Gold Medal Winner, ACA, SAT, ACMA (UK), CGMA (UK), CA Prize Winner for AFR subject in Strategic Level II, CA First in Order of Merit Prize Winner in CAB II Level, CIMA Strategic Level Aggregate Prize Winner.

1

SLFRS 15 Revenue from Contracts with Customers (01-01-2018)

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Assume: You as the SELLER

3

DSI

This is Brian

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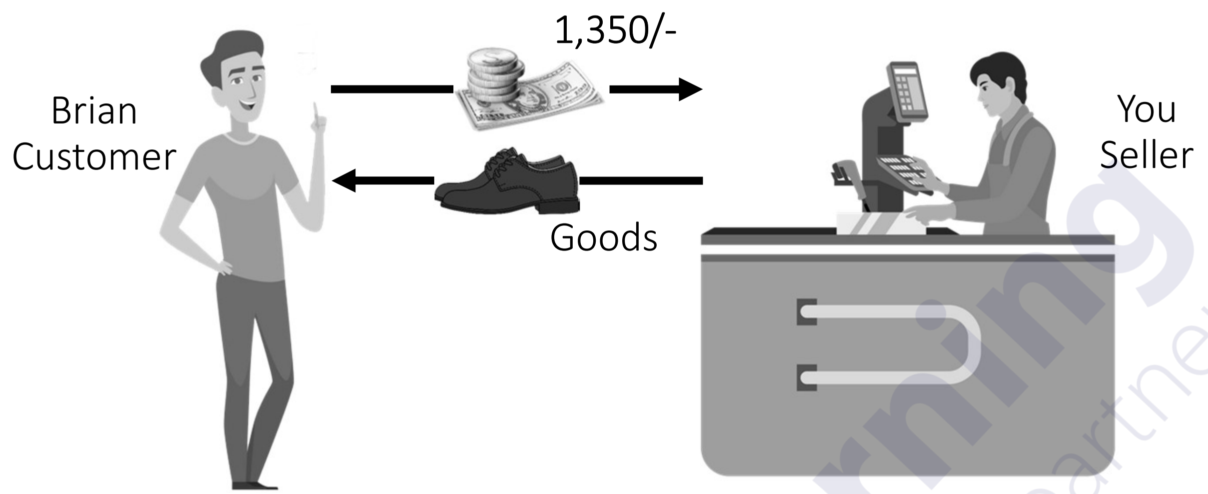

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When shall DSI recognize revenue?

A
By 10.15
Shoes were selected

B
By 10.16
Invoice was raised

C
By 10.17
amount was paid

D
By 10.18
Shoes were accepted

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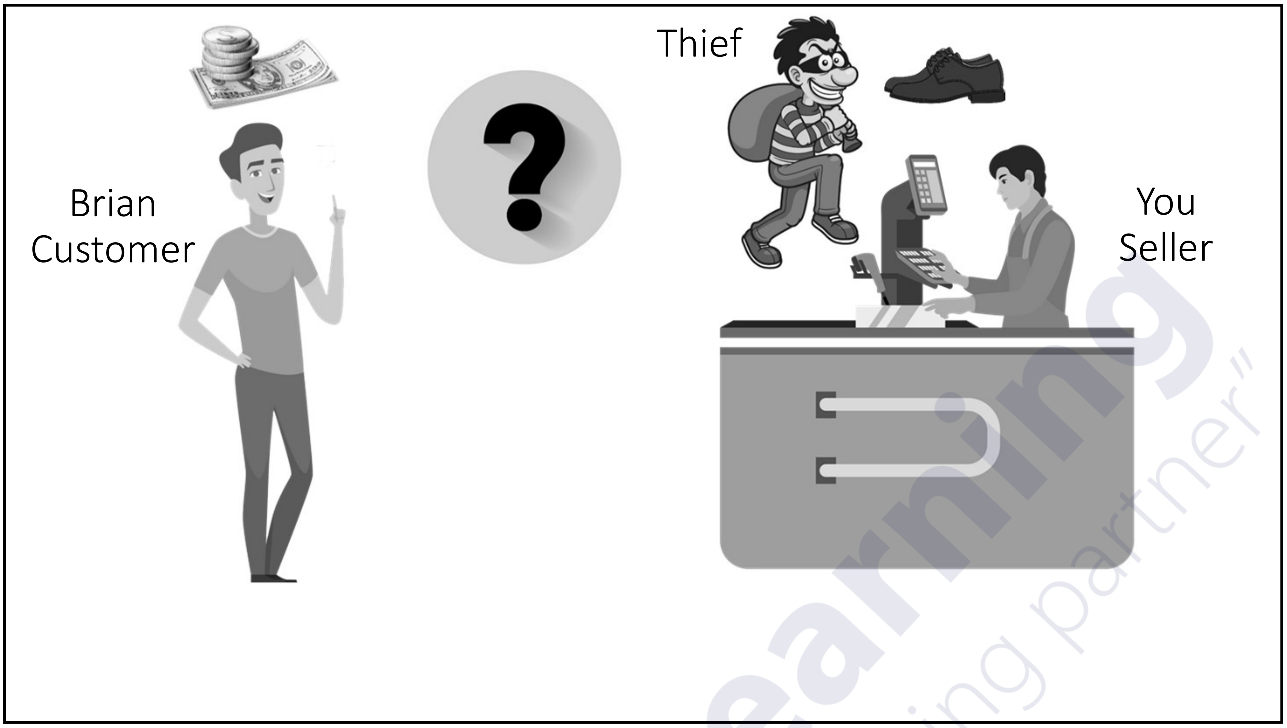
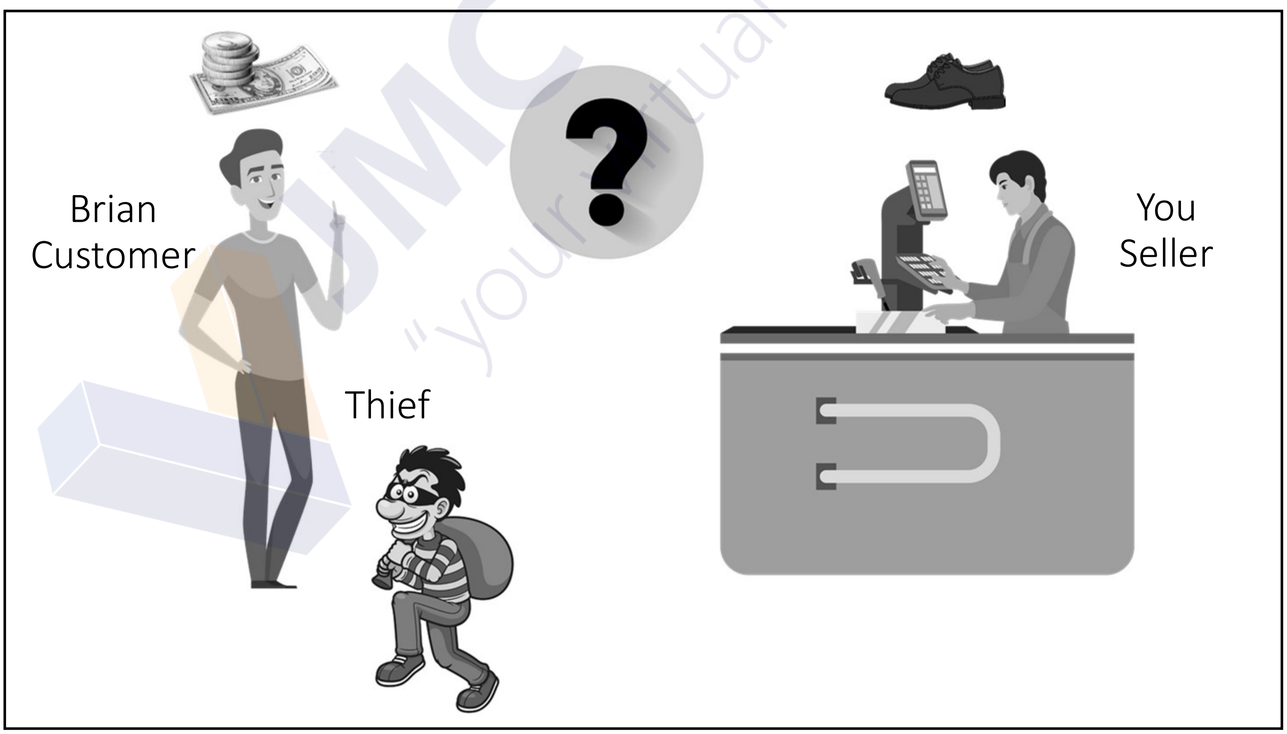

Thief
Brian
Customer
You
Seller

7


Brian
Customer
Thief
You
Seller

8

When shall DSI recognize revenue?

A
By 10.15
Shoes were selected

B
By 10.16
Invoice was raised

C
By 10.17
amount was paid

D
By 10.18
Shoes were accepted

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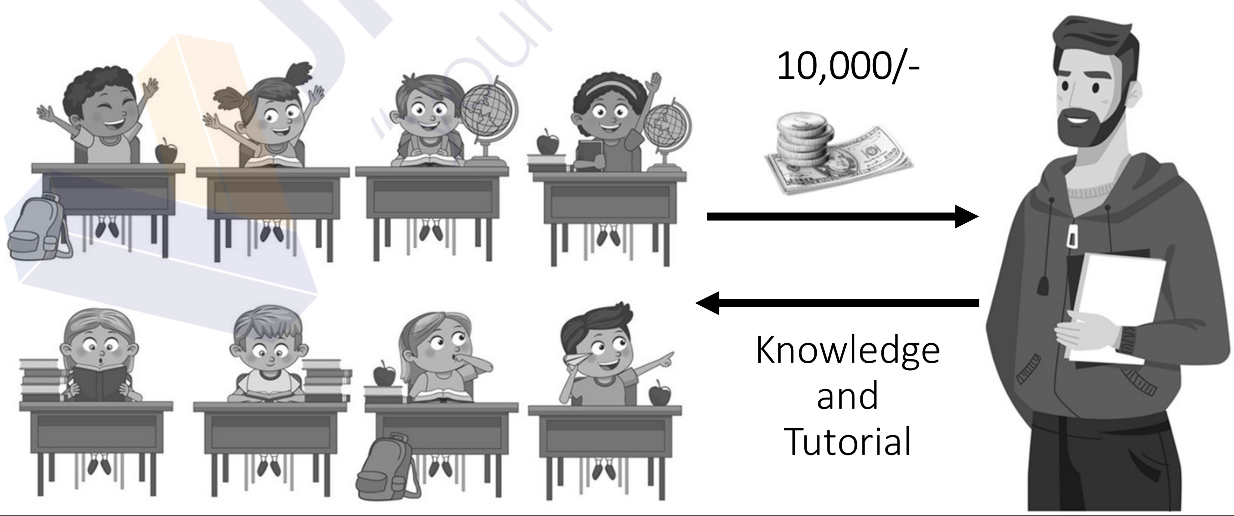
If Education was provided over a period of 2 moths, when shall revenue be recognized?



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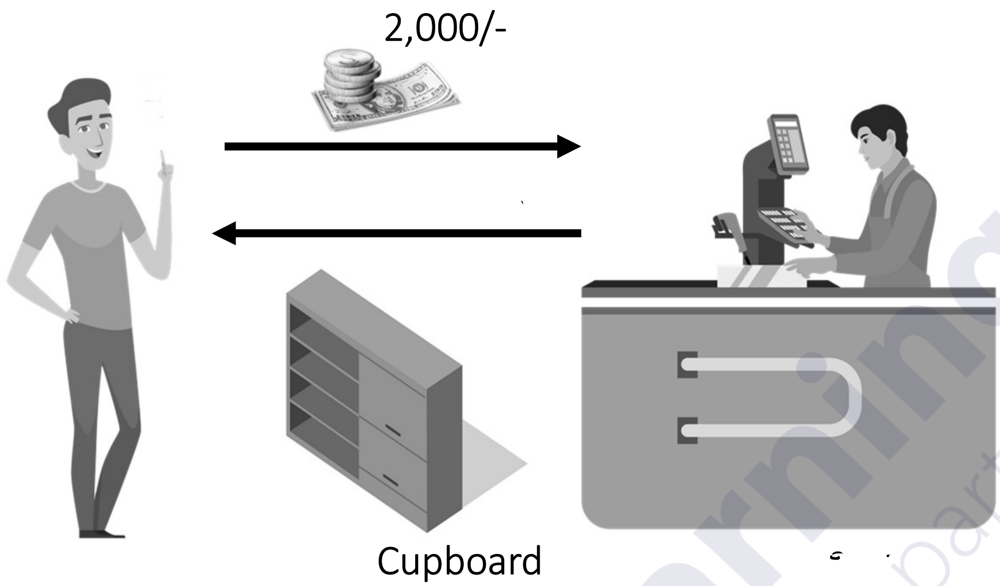

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Not Revenue
It’s
Disposal
of PPE

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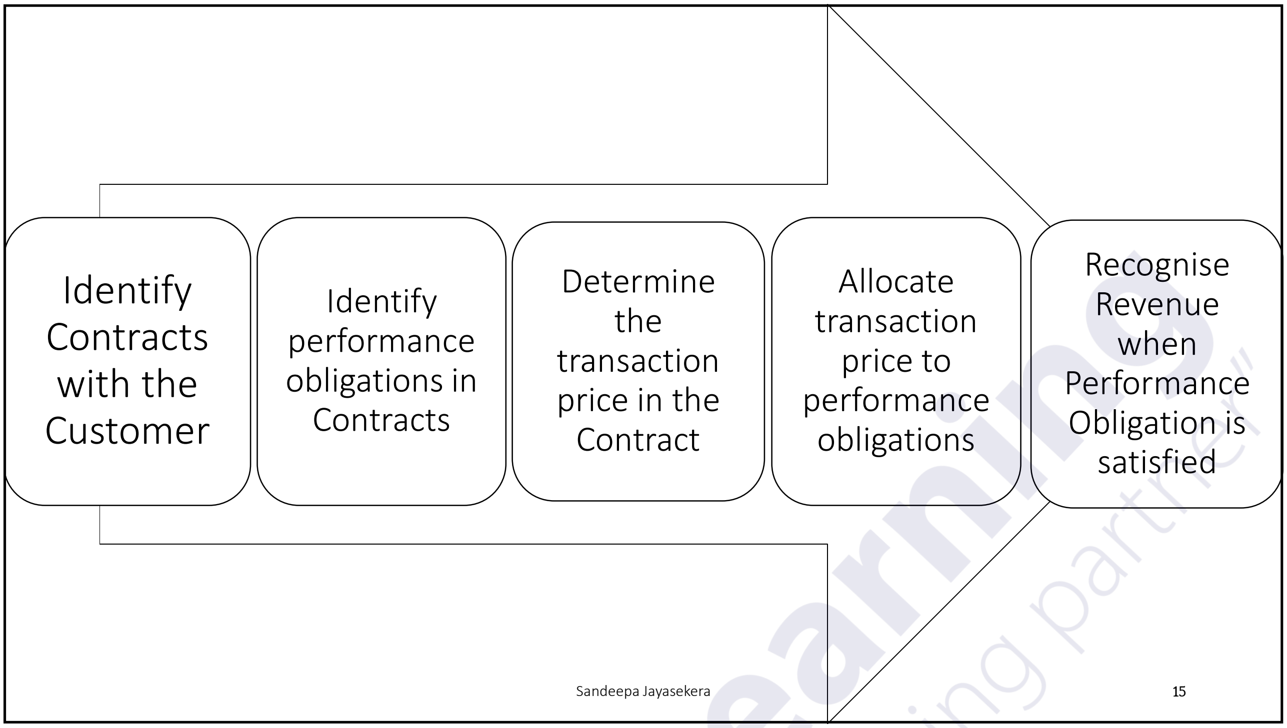
Revenue Definition

Business

Income

Revenue Recognition
05 Step Model


Identify Contracts with the Customer
Identify performance obligations in Contracts
Determine the transaction price in the Contract
Allocate transaction price to performance obligations
Recognise Revenue when Performance Obligation is satisfied
Sandeepa Jayasekera
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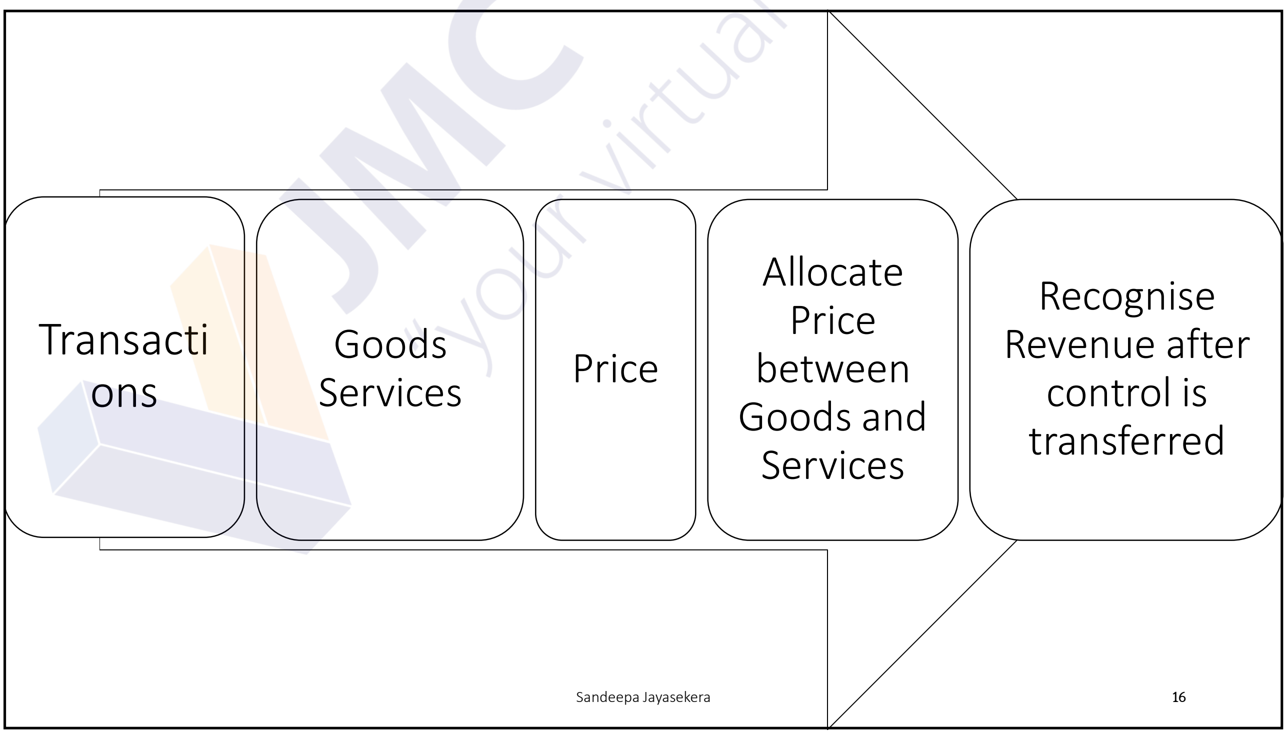
15


Transacti ons
Goods Services
Price
Allocate Price between Goods and Services
Recognise Revenue after control is transferred
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Step 01

Identify the Contracts with a Customer

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Criteria to be satisfied to identify a Contract	Commercial Substance	Change in risk or amount of future cashflows as a result of the contract	
	Approved	In Writing	
		Orally	
		Implied	
	Rights of parties	Seller	Cash
		Customer	Goods & Services
	Payment Terms	Time of payment	
		Instalments	
		Penalties or incentives	
	Recoverability		

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Step 02

Identify the Performance Obligations in a Contract

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Obligation

- Can the customer get satisfied from the relevant performance obligation on its own?
- Can that obligation be separately identifiable from other obligations in the contract?

Yes — Not interdependent → Distinct Obligation → Accounted separately

No — Interdependent → Bundled Obligation → Accounting for by bundling together as a single obligation

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Question 01

Amal (Pvt) Ltd. is engaged in the sale of air conditioners. On 01/01/20X1 an air conditioner worth Rs. 500,000/- was sold, where it was agreed to install at an additional charge of Rs. 10,000/-.

- Identify the Performance Obligation in relation to the above transaction.
- Explain whether such obligations are distinct obligations or bundled obligations.

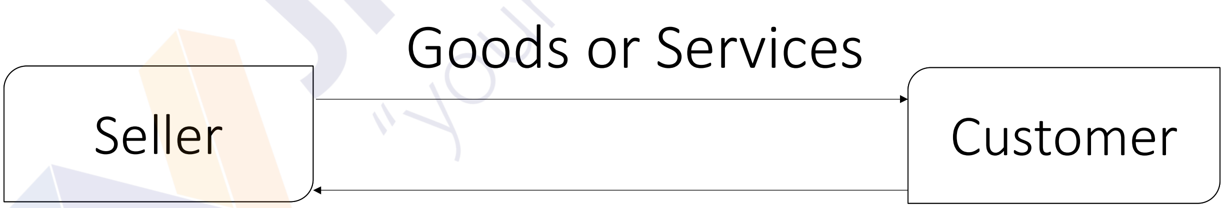
Question 02

Wasantha (Pvt) Ltd. is engaged in the sale of computers. On 01/03/20X0 a computer sale transaction was initiated, where it was agreed to sell Rs. 1,000,000/- worth computer hardware, install Rs. 400,000/- worth operating software in the computers and to charge Rs. 100,000/- for a one-year service.

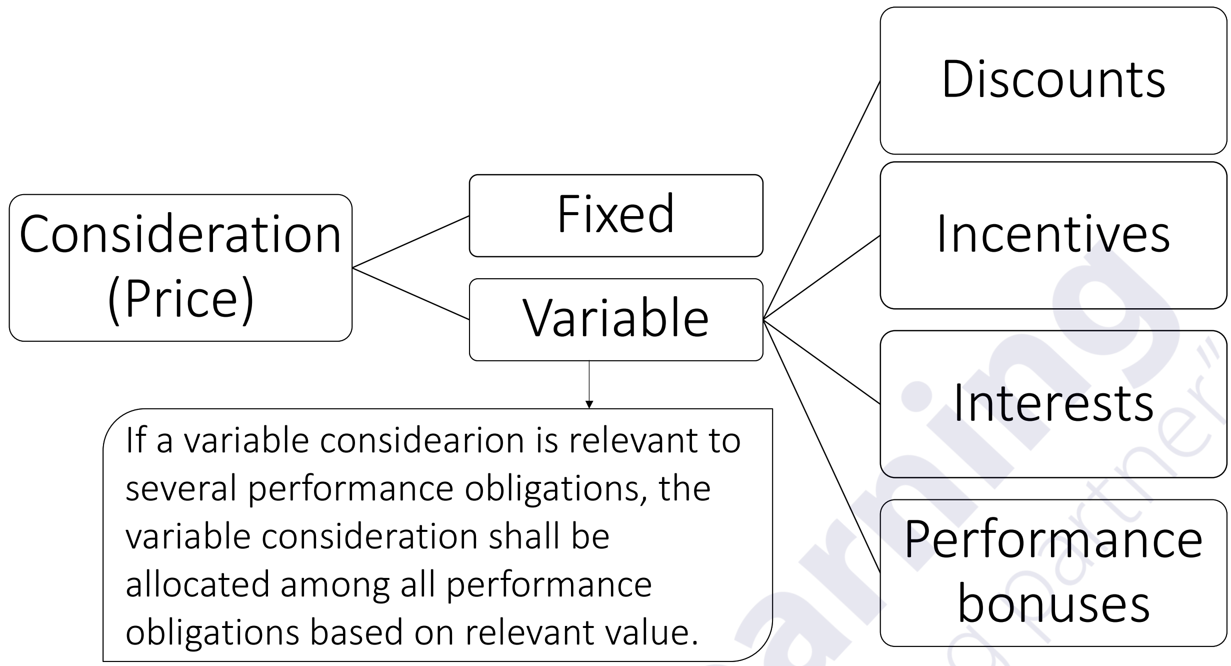
- Identify the performance obligations in relation to the above transaction.
- Explain whether such obligations are distinct obligations or bundled obligations.
- Explain how such revenue should be recognized.

Step 03

Determine the Transaction Price



Consideration (Price) = Amount expected to receive



Question 03

MY PC entity is engaged in the sale of computers. Damith entered into a contract with MY PC to purchase 10 computers for his own business. According to such contract, MY PC agreed to a one-year service period.

One computer was Rs. 100,000/-, while the service period was worth Rs. 250,000/-. A discount of Rs. 200,000/- was given for entire transaction.

- Identify the performance obligations of the above transaction.
- Separate the Distinct Obligations and Bundled Obligations.
- Compute the value of each obligation.
- Explain how the revenue should be recognized.

Question 04

OIT (Pvt) Ltd is a company engaged in the production and sale of software. The company developed an accounting software and charged Rs. 1,000,000/- for the software and Rs. 500,000/- for the one year service period. Rs. 1,200,000/- will be charged, if both the software and the service period is obtained.

- Saman obtained both the software and the after sales service. In relation to this transaction, explain the performance obligations, value of each obligation and how revenue needs to be recognized.

Step 04

Allocate the Transaction Price to Performance Obligations

Total Consideration

Is there a Stand-alone Selling Price?

No

Yes

Adjusted Market Price or

Cost plus a margin Price or

Residual Price

Allocate Price to Performance Obligations

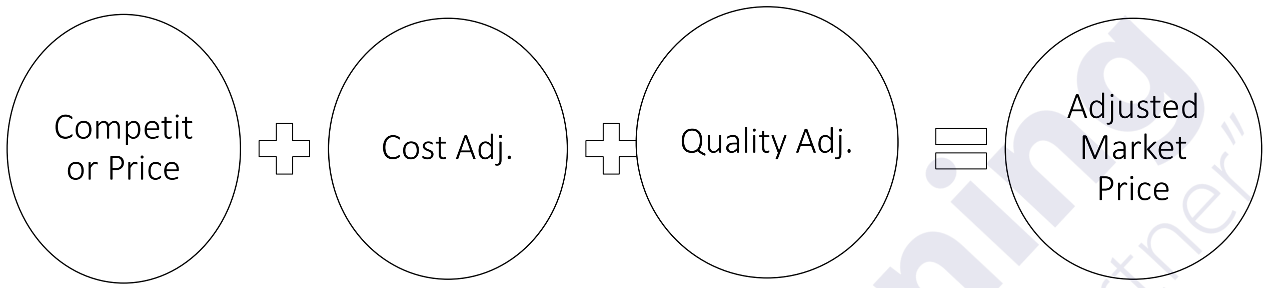
Stand-alone Selling Price is

The Price charged

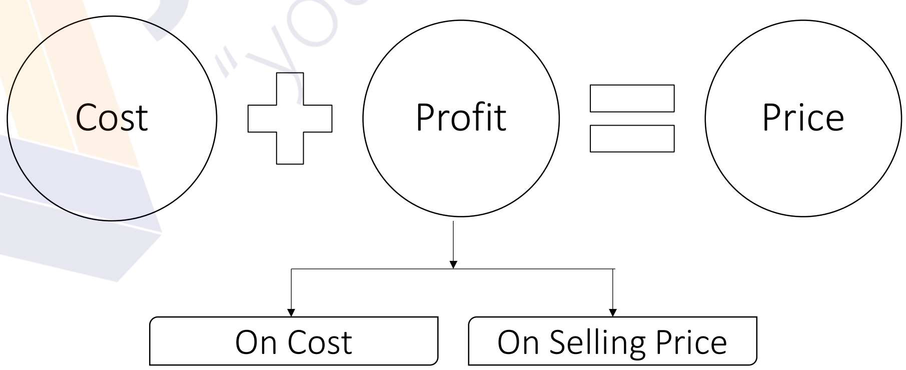
If good or service is

Sold separately

Adjusted Market Assessment Approach



Expected Cost plus a margin Approach



Residual Approach

(This can be used only in limited occasions)

- Total Selling Price
- − Stand-alone Selling Price
- − Adjusted Selling Price
- − Cost plus profit margin Price
- = Residual Price

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Step 05

Recognise Revenue when a Performance Obligation is satisfied

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At what point should Revenue be recognized?

Seller → When Control of Goods/Services transferred → Customer

- At a point in time
- Over time

Control

- Economic Benefits
  - Enjoy 100% benefits
  - Prevent others enjoying benefits
- Use of asset
  - Directing the use
  - Prevent others from directing the use

- Transfer of Control
  - At a point in time
    - Transfer of physical possession
    - Customer has accepted the asset
    - Transfer of risks and rewards
    - Transfer of legal title
  - Over time
    - Receive and consume goods/services simultaneously
    - Asset is in the control of the customer
    - No alternative uses and having an enforceable right to receive payments

Question 05

Namal (Pvt) Ltd. is engaged in software development. Chathura (Pvt) Ltd. entered into a contract with Namal (Pvt) Ltd. to develop a software for payroll processing of its company. According to this contract, Namal (Pvt) Ltd. agreed to develop the software, purchase hardware, provide staff training and to provide a one-year service period.

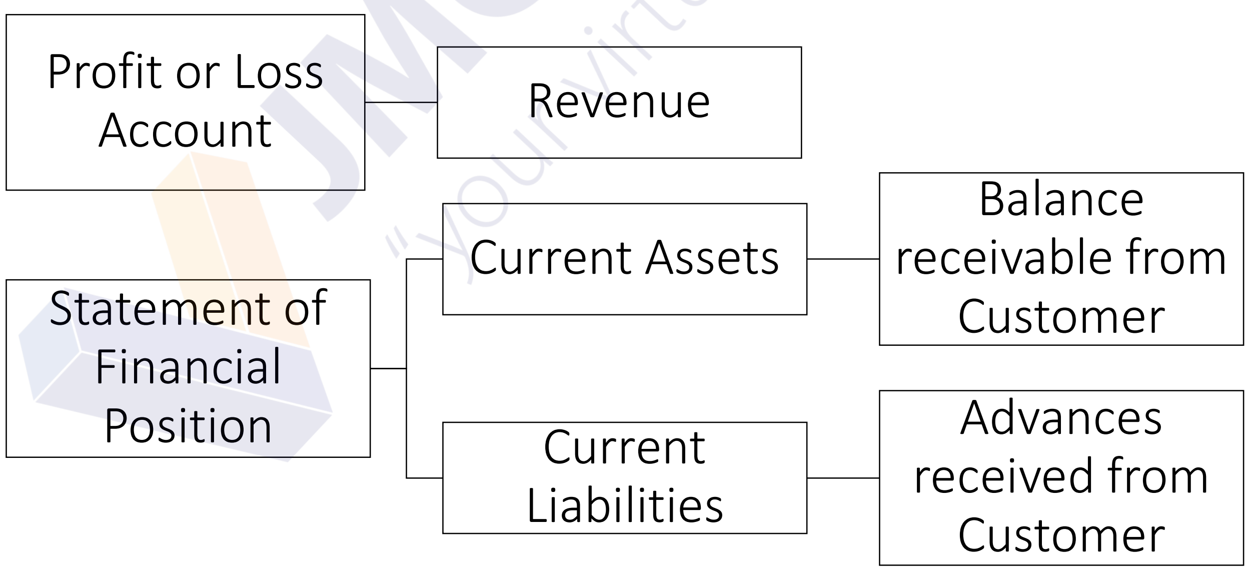
Value of the total software contract is Rs. 1,000,000/-. If Namal (Pvt) Ltd. provides the above services separately, the market prices are as follows:

Question 05

Software Development	400,000
Purchase of Hardware	400,000
Staff Training	100,000
One-year service period	100,000

The company commenced the software development on 01/01/20X1 and it was completed on 01/03/20X1. Hardware was purchased on 05/03/20X1 and a hardware unit with the developed software was installed in the office premises of Chathura (Pvt) Ltd. on 15/03/20X1. From that date onwards, staff training was provided for a period of one week. It was agreed to provide a one-year service from 22/03/20X1 to 22/03/20X2. Explain the performance obligations, prices of performance obligations and how revenue should be recognized.

Presentation



Disclosures

- Contract Assets and Contract Liabilities
  - Opening Balances
  - Closing Balances
  - Information about Obligations
- Revenue
  - Revenue generated from various categories
- Judgements
  - Changes in the judgements
  - Allocation of Price
  - Revenue Recognition point

LKAS 02 Inventory

What is an Inventory?

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Held for Sale in the Ordinary Course of Business
Finished Goods

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In the Production for such Sale
Work in Progress
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In the form of Materials and Supplies to be consumed in the Process of Manufacturing or Rendering of Services
Raw Materials

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What is included in the Cost of an Inventory?

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Purchase Cost

Conversion Cost

Other Cost

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Purchase Cost

Cost incurred to purchase an inventory

- Purchase price
- (-) Trade discounts
- (-) Rebates
- Direct taxes (Import duties, tariff and PAL)
- Direct costs incurred to purchase the items (Transport, clearing, handling etc.)

Conversion Cost

Cost incurred to convert the raw materials to finished goods

- Direct materials
- Direct Labour
- Direct Other
- Variable Production Overheads
- Fixed Production Overheads

Other Cost

Other costs incurred to bringing the inventory to current condition and location

- Design Cost

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Basis used to allocate Fixed Production Overheads to units

Actual Production = Normal Capacity ⇒ Based on Actual Production

Actual Production > Normal Capacity ⇒ Based on Actual Production

- This will enable recognition of advantage reduced cost with volume increase

Actual Production < Normal Capacity ⇒ Based on Normal Capacity

- Fixed cost which are not absorbed for units are charged to profit or loss

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Question 01

Monthly capacity of Shenaya Ltd. is 10,000 units.

The fixed production overheads per month is Rs.1,000,000.

Calculate the fixed production overheads per unit for following three scenarios.

1. If monthly production is 10,000 units
2. If monthly production is 5,000 units
3. If Monthly production is 12,000 units

Question 02

Isuru Ltd. Is manufacturing garments. Following information is applicable for their productions for the month of March 20X2.

The cost of opening raw materials is Rs.1,500,000/-.

During the month of march Taka 2Million worth of raw materials were purchased from Bangladesh (01 Taka = 4 LKR). the supplier has given a 10% trade discount. Further, the government has given a subsidy of Rs.200,000. Company has paid 12% VAT and 2% Import duties on purchase cost net of trade discounts. The freight charge was Rs.100,000, insurance cost was Rs.25,000. The clearance charges were Rs.15,000 and handling charges were Rs. 70,000. The raw material warehouse cost per month is Rs.50,000/-.

Question 02

Entire opening stock was utilized for the production. 80% of the purchases were used for the production.

During the month company started manufacturing 10,000 units. By the end of the month 8,000 units were completed and 50% was completed in the 2,000 units.

Employee wages are paid based on the number of units manufactured. Per unit Rs.300/- is paid. Per garment Rs.50 other direct cost is incurred for zipper, lables and buttons.

The monthly depreciation of the factory building is Rs.300,000. The machine depreciation is Rs.200,000. The normal monthly capacity is also 10,000 units. The designers are paid with Rs.20 per unit manufactured. During the year 8,000 units were sold.

Question 02

Calculate the total cost and per unit cost of

1. Raw material purchase cost
2. Raw material closing stock
3. Raw material consumption
4. Conversion cost
5. Other costs
6. Cost of work in progress stock
7. Total production cost
8. Cost of closing finished goods

Items **excluded** from the cost of an inventory

- Abnormal Waste
- Warehousing cost on finished goods
- Administration Overheads
- Marketing overheads

Inventory Measurement Techniques

Inventory can be measured at cost.

Sometimes it may be practically difficult to measure the inventory from item to item.

Then these inventory measurement techniques are used.

- Standard Costing
- Retail Price Method

Standard Costing

- A standard cost for an inventory item can be decided using the prior experience, price quotations and agreements etc.
- The inventory and cost of sales can be measured using the standard cost determined.
- However, the standard cost determined shall be revised frequently to reflect the current status.

Standard Costing − Actual Cost = Variance ➡ Charged to Profit or Loss

Standard Costing

Standard Costing

Standard Material Cost per Unit	XX
Standard Labour Cost per Unit	XX
Standard Other Cost per Unit	XX
Standard Variable Production Cost per Unit	XX
Standard Fixed Production Overheads per Unit	XX
Standard Production Cost per Unit	XXX

Question 03

Tharik Ltd. is applying standard costing to measure the inventory. The budgeted raw material cost per month is Rs.1,000,000. Per unit 2 Kilo grams of raw materials are used. 4 labour hours are used per unit and the cost per hour is Rs.100. The standard variable production overhead cost is Rs.50. The monthly fixed production overheads cost is Rs.500,000. The expected monthly capacity is 5,000 units.

Calculate

1. Standard production cost per unit.
2. If the actual production cost per month is Rs.4,000,000/-, calculate the variance.

Retail Price Method

- This method is used when there's large volume of exclusively interchangeable items.
- Mostly the retailers such as supermarkets are using this method.

Cost of Inventory = Sale Value of Inventory − Profit

Question 04

The market value of inventory and profit margins of Cargills Limited as at 31/3/20X9 are as follows.

Vegetables and fruits Rs.12,000,000 (Profit on selling price is 20%)

Dry rations Rs.15,000,000 (Profit on cost is 25%)

Other goods Rs.20,000,000 (Profit on selling price is 15%)

Calculate the cost of closing inventory.

Cost Formula

- For tailor made items the cost of inventory and cost of sales can be measured on each item separately.
- However, if there's similar items in a large volume, the cost of closing inventory and cost of sales is calculated using cost formula.

Cost Formula

- First in First out method (FIFO)
- Weighted Average Cost method (WAC)

A company can use either of these methods

Cost Formula

	FIFO	WAC
Assumption	Firstly, received or manufactured stock are first issued.	Stocks are issued reflecting the entire stock on inventory. All the stock are stored in one location.
Closing Inventory	Value reflects the latest purchased or manufactured stock.	Reflects a weighted average cost of inventory remaining in warehouse.
Cost of Sales	Except the last received stock which is in closing stock, the remaining cost is reflected.	A weighted average cost of remained inventory is reflected.
Inventory Valuation	Always reflect a real cost of an inventory	Collection of costs averaged on weight, are reflected than an actual cost.

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Formats used for Cost Formula

Format for First in First Out

Date	Purchases			Sales			Balance	
	Units	Unit Cost	Total Cost	Units	Unit Cost	Total Cost	Units	Total Cost

Format for Weighted Average Cost Method

Date	Purchases			Sales			Balance		
	Units	Unit Cost	Total Cost	Units	Unit Cost	Total Cost	Units	Unit Cost	Total Cost

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Question 05

Nethmy Ltd. is selling mobile phones. Following details are relevant for the January 20X1.
Opening stock is 300 units at Rs.12,000

Purchases

Date	Units	Unit Cost
10th January	600	15,000
22nd January	600	14,000
28th January	600	16,000

Question 05

Sales

Date	Units	Unit Selling Price
2nd of January	100	20,000
12th January	500	20,000
23rd January	600	20,000

Calculate the Closing Stock, Cost of Sales and Gross Profit under

1. First in First out method
2. Weighted Average Cost Method

Question 06

Following details are relevant for the inventory of Shan Ltd. during the month of May 20X1.

Opening stock is 1,200 units at Rs.10 each.

Purchases

Date	Units	Unit Cost
09th May	1,500	9
18th May.	1,500	11
25th May	1,500	12

Question 06

Sales

Date	Units	Unit Selling Price
10th May	2,500	15
20th May	1,400	15
30th May	1,000	15

Calculate the Closing Stock, Cost of Sales and Gross Profit under

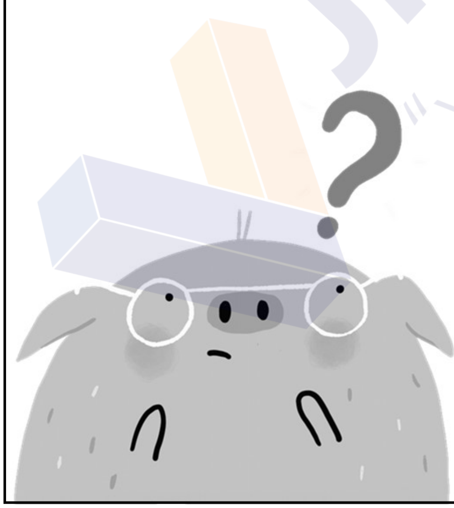
1. First in First out method
2. Weighted Average Cost Method

Net Realizable Value (NRV)

The net cash flow expected realize from a sale of an inventory is the net realizable value. Net Realizable Value can be assessed either item by item or batch wise.

Net Realizable Value = Expected Selling Price of an Inventory − Expected cost to complete the inventory − Expected cost to Sell the Inventory

Generally, the Net Realizable Value is higher than the cost. Main reason is companies are keeping a profit margin above the cost.



At what value an Inventory shall be measured?

Cost	Net Realizable Value
	

Lower Value (Prudence Concept)

Instances where the Net Realizable Value can be Lower than the Cost

- Drop in selling price or increase in cost
- Damaged inventory
- Obsolete inventory
- Reducing the selling price as a marketing strategy (Dumping)
- Manufacturing or purchase defects

If the NRV is lower than the cost what is the Accounting Treatment?

A provision will be made for the difference

Dr Inventory NRV Loss Expense

Cr Inventory NRV Loss Provision

If, later on the Inventory is sold at a higher value than the cost, the NRV Loss provision shall be reversed.

Dr Inventory NRV Loss Provision

Cr Inventory NRV Loss Expense

Question 07

1. There's an Inventory costing Rs.500,000 with Arun Ltd. Company is expecting to sell this inventory at Rs.600,000. It's expected that a selling expense of Rs.25,000 will occur. Calculate the value at which inventory shall be carried at.
2. Dulaj Ltd. has a finished goods inventory costing Rs.700,000 and work in progress inventory costing Rs.100,000. 70% of the work is completed in this inventory. 10% profit margin on selling price is expected. 2% selling cost is expected to be incurred. Calculate the value at which inventory shall be carried at.

Cost of Sales

The cost of items sold during the period is cost of sales

Opening Inventory	XX
+ Purchases	XX
	XXX
(-) Closing Stock	(XX)
Cost of Sales	XX

Question 08

Shalika Ltd. is manufacturing water dispensers. 1,000 units were there in the opening stock costing Rs.15,000 each. Rs.20,000 worth of 2,000 units were purchased during the year. 2,500 units were sold for Rs.30,000.

Calculate the closing stock, cost of sales and gross profit.

Accounting for Inventory

Opening Inventory

Recognized as an expense in the current year cost of sales

Opening Inventory $\uparrow$ Cost of Sales $\uparrow$ Gross Profit $\downarrow$

Opening Inventory $\downarrow$ Cost of Sales $\downarrow$ Gross Profit $\uparrow$

Accounting for Inventory

Closing Inventory

Recognized as an reduction of expense (income) in the current year cost of sales

Closing Inventory $\uparrow$ Cost of Sales $\downarrow$ Gross Profit $\uparrow$

Closing Inventory $\downarrow$ Cost of Sales $\uparrow$ Gross Profit $\downarrow$

Accounting for Inventory

The closing stock of a particular year is becoming the next years opening stock. It is assumed that opening stock is first sold. Thus, the cost of opening stock is charged to cost of sales.

Dr. Cost of Sales (Trading Account)
Cr. Inventory

The purchases during the year are also transferred to cost of sales.

Dr. Cost of Sales (Trading Account)

Cr. Purchases

Accounting for Inventory

Closing Inventory

The closing inventory available as at the reporting date is obtained either a physical verification or through continuous inventory records. Such closing inventory is unsold; thus it will be an asset as well as reduction of cost of sales.

Dr. Inventory

Cr. Cost of Sales (Trading Account)

Question 09

Charitha invested Rs.20,000 to commence a business. The amount was deposited in a bank account. Following transactions were occurred.

Credit purchases	50,000
Payments to creditors	45,000
Credit Sales	48,000
Receipts from Debtors	39,000
Purchase of Non-Current Assets	20,000
Other Expenses	13,000

Rs.30,000 worth of a Bank overdraft facility has been obtained. The cost of closing stock is Rs.21,000. Prepare the profit or loss and statement of financial position.

Carriage Inward and Carriage Outward

Carriage Inward	Transportation cost incurred to bring inventory from supplier's location to business.	Added to the cost of Purchase
Carriage Outward	Transportation cost incurred to deliver inventory from business to customers	Recognized as a selling and distribution expense

Question 10

The opening inventory of Sanduni Ltd. as at 01 August 20X1 is Rs.34,000. For the year ended 31 July 20X2 inventory worth of Rs.150,000 were purchased and the carriage inward was Rs.5,000. The total sales during the year was Rs.325,000. The carriage outward was Rs.4,000. The administration and selling overheads were Rs.75,000. Prepare the profit or loss for the year ended 31 July 20X2.

Damaged or Impaired Inventory

Following situations may occur for the inventory

1. Inventory theft
2. Stock loss
3. Stock damages
4. Disposal of unsellable stock
5. Expiries and obsolescence of stock

The losses occurred due to above reasons shall be recognized.

Inventory Write-off

Due to a theft, damage or loss, if inventory shall be eliminated, following write-off entry shall be passed.

Dr. Inventory write-off (Other Expenses)

Cr. Inventory

Provision for Inventory Impairment

If the impaired inventory can be sold and realize a cash flow, up to that value an inventory impairment provision shall be recognized.

Dr. Inventory impairment loss expense (Other Expenses)

Cr. Inventory impairment provision

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Question 11

Kalinga PLC is selling refrigerators. The opening stock as at 1 April 20X8 was Rs.4,000,000. Rs.10,000,000 worth of inventory were purchased during the year. Of which Rs.2,000,000 worth of inventory were stolen and Rs.1,000,000 worth of inventory were technically obsolete. The obsolete inventory can be sold at Rs.600,000. The total sales during the year was Rs.15,000,000. The cost of closing stock was Rs.250,000.

Prepare the profit or loss for the year ended 31 March 20X9.

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