

Improper Recognition of Commission Income from Importing Vehicles to the Permit Holders as Sales Income

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Introduction

ABC (Pvt) Ltd as the Sole agent for X kind of vehicles in Sri Lanka is dedicated to servicing the needs of their customer by providing them with a range of vehicles and attending to their requirements with impeccable after sales services. ABC (Pvt) Ltd merged with DEF PLC in the beginning of the last financial year (2013/14). Therefore, they had an objective to show a good performance in this financial year (2014/15).

The principal activity of the Company is importing and distribution of brand X kind of vehicles and spare parts and operating workshops for vehicle repairs. Furthermore, sales can be classified in to four main categories, they are,

- Permit sale of vehicles (Acting as intermediary when importing the vehicles by permit holder)
- Vehicle sales (Locally purchased and sale)
- Sales income earned from repairs
- Sale of spare parts

According to the nature of the sales, company earns high profit margins from the permit sales when compared to the vehicle sales, because the permit sale transactions contain large amount as local handling charges (Referring to the annex – Rs. 2 Mn) which is normally known as “the commission charge”. On the other hand, local vehicle sales of the company earns a slight profit margin since it has vehicle purchase cost in respect to the sale.

Discussion of the Issue

When checking revenue of permit sales, we identified few transactions which did not have custom declaration forms to the customer’s name, and also there was high receipts amounts from that customers, exceeding the value of the invoice. Then we further investigate on those matters. Finally, we found that the company have recognized some of their local vehicle sales as permit sales.

As per the LKAS 1 – Presentation of financial statement, point number 15, financial statements should present fairly the financial position, financial performance and cash flow of an entity. Fair representation requires the faithful representation of the effects of transactions, other events and conditions in accordance with the definitions and the recognition criteria for assets liabilities, income and expenses set out in the frame work.

Furthermore, according to the LKAS 1, point number 7, Material omissions and misstatements of items are material if they could, individually or collectively, influence the economic decisions that users make on the basis of the financial statements. Materiality depend on the size and the nature of the omission or misstatement judge in the surrounding circumstances. The size and the nature of the item, or combination of both, could be the determining factors.

Implication of the Issue

As a result of this issue the statement of comprehensive income and the statement of financial position of the ABC (Pvt) Ltd will be affected in the following ways.

- The company's profits shown in the statement of comprehensive income will be overstated
- The receivable and the payable balance will be overstated in the statement of financial position

Conclusion and Recommendation

It is recommended to revers all the local sales which recorded as permit sales and record those transactions as vehicles sales, incorporating its cost of sales.