

# Revenue Recognition

The Achtung in 'Percentage of Completion' and 'Instalement/Gross Profit' methods

## Purpose:

There are two methods for estimating costs at the start of a long term project. Both methods assume that costs will match (1) the actual completion rate, (2) the money spent on materials, and (3) the materials consumed. In actuality, all three values may be different.

## What do you do when all three are not the same?

Under the instalment/gross profit method of revenue recognition, the first year's expense was:

\$500,000

If what you recognize as expense is different than (1) what you spend in cash on materials bought and (2) what you actually do use up, how do you account for it in your accounting records, which of course must balance?

## Instructions:

Record the journal enties at year end to account for the nine following conditions

|                            |         | Bought more<br>550,000 | Bought same as recorded cost<br>500,000 | Bought less<br>480,000 |
|----------------------------|---------|------------------------|---|------------------------|
| Used more                  | 510,000 | a                      | b                                       | c                      |
| Used same as recorded cost | 500,000 | d                      | e                                       | f                      |
| Used less                  | 490,000 | g                      | h                                       | i                      |

| Category | Criteria                                      | Mark |
|----------|---|------|
| Thinking | One mark for each 100% correct journal entry. | /9   |

| Revenue Recognition   |      |                     |      |         |         |    |
|---|------|---------------------|------|---------|---------|----|
| Reconciliation of expenses recognized to actual purchases and usages of materials |      |                     |      |         |         |    |
|   | Date | Particulars         | P.R. | Debit   | Credit  |    |
| 1   | a    | Materials Expense   |      | 500,000 |         | 1  |
| 2   |      | Work in Progress*   |      | 10,000  |         | 2  |
| 3   |      | Materials Inventory |      | 40,000  |         | 3  |
| 4   |      | Cash                |      |         | 550,000 | 4  |
| 5   |      |                     |      |         |         | 5  |
| 6   | b    | Materials Expense   |      | 500,000 |         | 6  |
| 7   |      | Work in Progress*   |      | 10,000  |         | 7  |
| 8   |      | Materials Inventory |      |         | 10,000  | 8  |
| 9   |      | Cash                |      |         | 500,000 | 9  |
| 10  |      |                     |      |         |         | 10 |
| 11  | c    | Materials Expense   |      | 500,000 |         | 11 |
| 12  |      | Work in Progress*   |      | 10,000  |         | 12 |
| 13  |      | Materials Inventory |      |         | 30,000  | 13 |
| 14  |      | Cash                |      |         | 480,000 | 14 |
| 15  |      |                     |      |         |         | 15 |
| 16  | d    | Materials Expense   |      | 500,000 |         | 16 |
| 17  |      | Materials Inventory |      | 50,000  |         | 17 |
| 18  |      | Cash                |      |         | 550,000 | 18 |
| 19  |      |                     |      |         |         | 19 |
| 20  |      |                     |      |         |         | 20 |
| 21  |      |                     |      |         |         | 21 |
| 22  | e    | Materials Expense   |      | 500,000 |         | 22 |
| 23  |      | Cash                |      |         | 500,000 | 23 |
| 24  |      |                     |      |         |         | 24 |
| 25  |      |                     |      |         |         | 25 |
| 26  |      |                     |      |         |         | 26 |
| 27  |      |                     |      |         |         | 27 |
| 28  | f    | Materials Expense   |      | 500,000 |         | 28 |
| 29  |      | Materials Inventory |      |         | 20,000  | 29 |
| 30  |      | Cash                |      |         | 480,000 | 30 |
| 31  |      |                     |      |         |         | 31 |
| 32  |      |                     |      |         |         | 32 |
| 33  |      |                     |      |         |         | 33 |
| 34  | g    | Materials Expense   |      | 500,000 |         | 34 |
| 35  |      | Materials Inventory |      | 60,000  |         | 35 |
| 36  |      | Work in Progress*   |      |         | 10,000  | 36 |
| 37  |      | Cash                |      |         | 550,000 | 37 |
| 38  |      |                     |      |         |         | 38 |
| 39  |      |                     |      |         |         | 39 |
| 40  | h    | Materials Expense   |      | 500,000 |         | 40 |
| 41  |      | Materials Inventory |      | 10,000  |         | 41 |
| 42  |      | Work in Progress*   |      |         | 10,000  | 42 |
| 43  |      | Cash                |      |         | 500,000 | 43 |
| 44  |      |                     |      |         |         | 44 |
| 45  | i    | Materials Expense   |      | 500,000 |         | 45 |
| 46  |      | Materials Inventory |      |         | 10,000  | 46 |
| 47  |      | Work in Progress*   |      |         | 10,000  | 47 |
| 48  |      | Cash                |      |         | 480,000 | 48 |
| 49  |      |                     |      |         |         | 49 |
| 50  |      |                     |      |         |         | 50 |

\* Represents inventory not yet expensed due to recognition method, but not present either, as it has been used. This is a short term asset account, and would have to be disclosed and explained in the notes to the financial statements due to the Full Disclosure Principle.