[Pharma accounting neither true nor correct](#)

The 'return' effect --

(The Hindu – Business Line 11 Nov 2012)

There are divergent practices for recording likely return of goods sold. This affects comparability of revenue in the pharma industry.

The Institute of Chartered Accountants of India recently released an advisory on accounting for sales return. It opined that an entity should recognise a provision for likely sales return at the best estimate of the loss expected, including any incremental cost needed to resell the goods, on the basis of past experience and other relevant facts.

This will significantly impact pharmaceutical companies, which are obliged to accept goods returned on expiry, near-expiry, or damage, under trade practices or contractual arrangements.

MEASUREMENT

The local GAAP requires recognising revenue upon transfer of significant risks and rewards, net of returns. There is uniformity in the recognition of revenue within the pharmaceutical industry, but there are divergent practices for recording likely return of goods, which distorts measurement of returns. This affects comparability of the revenue and profits of various entities within the industry. The practices include:

Upon physical receipt of goods.

Upon confirmation by the company on acceptance of goods after physical receipt.

Period-end provision to ensure all returns receivable from customers are recorded.

Recording likely returns of unsold or damaged goods in terms of agreements with chemists and dealers based on past trends and estimates.

Thus, the liability recorded by entities would vary depending on the practice they follow. Furthermore, it is the accounting for likely return of goods that poses the most significant challenge, as it is based on the management's best estimates according to past trends, and is in addition to actual returns.

ACCOUNTING

The accounting of sales returns would be governed by the contractual obligations the entity has entered into with customers, dealers, trade practices and the legal requirements.

PRESENTATION

There are divergent practices for presentation of likely sales returns. Some entities present it as a deduction from sales or revenue; others present it as part of expenses. It is likely that sales returns also impact the balance sheet — that is, the debtors, inventory and liability.

IMPACT

While the measurement directly impacts profit, the accounting could impact the true and fair view of the accounts, and the presentation would impact revenue . This, in turn, would impact intra-firm comparison and ratio analysis. These practices also impact performance bonuses, incentive for employees and customers, which are linked to profit and revenue. A robust policy for recording sales return is a must. This would ensure:

Better compliance with accounting standards and other laws, including VAT and direct taxes.

Better comparability and analysis of the industry;

Improved incentive and commission policy for employees, customers and trade.

It has been suggested that a company should account for the estimated likely sales returns based on its experience, past trends, and underlying facts and circumstances. Such likely returns should be netted out from "sales" and disclosed as "provision for likely sales return". Such a provision should be reviewed at each balance-sheet date, and adjusted to reflect the current best estimates of the management.