1. INTRODUCTION

The purpose of this factsheet is to provide guidance on the accounting and disclosure of stock and work in progress within statutory financial statements. This factsheet will consider the provisions within the Companies Act 2006 and the accounting and disclosure requirements within the related accounting regulations, SSAP 9 Stocks and long-term contracts, Financial Reporting Standard for Smaller Entities 2008 (FRSSE 2008), FRSSE 2015 and Financial Reporting Standard 102 (FRS 102) The Financial Reporting Standard Applicable in the UK and Republic of Ireland. We will also consider the contents of UITF 40 Revenue recognition and service contracts.

It is essential to ensure that the accounting treatment adopted is appropriate as it will have an impact on the taxation treatment in the accounts, especially in respect of work in progress and service contracts which will impact on the timing of income recognition.

This factsheet will not address the specific requirements of International Accounting Standards, particularly IAS 2.

2. LEGISLATIVE REQUIREMENTS

The accounting provisions are contained within two pieces of legislation as there are no specific provisions within the Companies Act 2006:

- The Small Companies and Groups (Accounts and Directors’ Report) Regulations 2008
- The Large and Medium-sized Companies and Groups (Accounts and Reports) Regulations 2008

The Small Companies and Groups (Accounts and Directors’ Report) Regulations 2008

These regulations apply to all companies that qualify as small and are preparing accounts under the provisions available for small companies.

Current assets

23. Subject to paragraph 24, the amount to be included in respect of any current asset must be its purchase price or production cost.

24.—

(1) If the net realisable value of any current asset is lower than its purchase price or production cost, the amount to be included in respect of that asset must be the net realisable value.

(2) Where the reasons for which any provision for diminution in value was made in accordance with sub-paragraph (1) have ceased to apply to any extent, that provision must be written back to the extent that it is no longer necessary.
**Determination of purchase price or production cost**

25. —
(1) The purchase price of an asset is to be determined by adding to the actual price paid less any expenses incidental to its acquisition.

(2) The production cost of an asset is to be determined by adding to the purchase price of the raw materials and consumables used the amount of the costs incurred by the company which are directly attributable to the production of that asset.

(3) In addition, there may be included in the production cost of an asset—
   (a) reasonable proportion of the costs incurred by the company which are only indirectly attributable to the production of that asset, but only to the extent that they relate to the period of production; and
   (b) interest on capital borrowed to finance the production of that asset, to the extent that it accrues in respect of the period of production, provided, however, in a case within paragraph (b), that the inclusion of the interest in determining the cost of that asset and the amount of the interest so included is disclosed in a note to the accounts.

(4) In the case of current assets distribution costs may not be included in production costs.

26. —
(1) The purchase price or production cost of—
   (a) any assets which fall to be included under any item shown in a company's balance sheet under the general item “stocks”; and
   (b) any assets which are fungible assets (including investments), may be determined by the application of any of the methods mentioned in sub-paragraph (2) in relation to any such assets of the same class, provided that the method chosen is one which appears to the directors to be appropriate in the circumstances of the company.

(2) Those methods are—
   (a) the method known as “first in, first out” (FIFO);
   (b) the method known as “last in, first out” (LIFO);
   (c) a weighted average price; and
   (d) any other method similar to any of the methods mentioned above.

(3) For the purposes of this paragraph, assets of any description must be regarded as fungible if assets of that description are substantially indistinguishable one from another. It should be noted that although LIFO is mentioned above it is not an acceptable method under the SSAP.

Hence stock should be included at the lower of cost and net realisable value. Where a provision has been made to reduce the amount to the net realisable value this provision should be reversed if the net realisable value increases. It should never be increased above the level of the original cost.

It is important to note that under FRS 102 the option of using LIFO has been removed.

**The Large and Medium-sized Companies and Groups (Accounts and Reports) Regulations 2008**

These regulations apply to all companies that do not qualify as small or are not preparing accounts under these provisions.

The provisions are contained within Schedule 2 paragraphs 23, 24, 27 and 28 and are the same as for small companies (above) with the addition of the following:

28. —
(3) Where in the case of any company—
   (a) the purchase price or production cost of assets falling to be included under any item shown in the company’s balance sheet has been determined by the application of any method permitted by this paragraph; and
   (b) the amount shown in respect of that item differs materially from the relevant alternative amount given below in this paragraph, the amount of that difference must be disclosed in a note to the accounts.

(4) Subject to sub-paragraph (5), for the purposes of sub-paragraph (3)(b), the relevant alternative amount, in relation to any item shown in a company’s balance sheet, is the amount which would have been shown in respect of that item if assets of any class included under that item at an amount
determined by any method permitted by this paragraph had instead been included at their replacement cost as at the balance sheet date.

(5) The relevant alternative amount may be determined by reference to the most recent actual purchase price or production cost before the balance sheet date of assets of any class included under the item in question instead of by reference to their replacement cost as at that date, but only if the former appears to the directors of the company to constitute the more appropriate standard of comparison in the case of assets of that class.”

Hence where the replacement cost is materially different from the cost included this should be disclosed.

Companies Act 2006 and the related provisions are accessible on the legislation website: http://www.legislation.gov.uk/

3. ACCOUNTING STANDARDS

The relevant accounting provisions are contained within four standards and one UITF:

- FRSSE (2008) – contains the disclosure relevant to companies that qualify for the small company regime.
- FRSSE 2015 will be replacing FRSSE (2008) for accounting periods commencing on or after 1 January 2015, there are no changes in the accounting requirements proposed by this update.
- SSAP 9 Stock and work in progress – applies to all other entities.
- FRS 102 The Financial Reporting Standard Applicable in the UK and Republic of Ireland – this standard applies for all entities adopting UK GAAP for accounting periods commencing on or after 1 January 2015 where the FRSSE has not been used. It will replace SSAP 9.
- UITF 40 Revenue recognition and service contracts provides specific guidance in respect of the accounting treatment for service contracts. This UITF will no longer apply once the provisions from FRS 102 have come in.

Definitions

SSAP 9 contains the following relevant definitions:

“17. Cost is defined in relation to the different categories of stocks as being that expenditure which has been incurred in the normal course of business in bringing the product or service to its present location and condition. This expenditure should include, in addition to cost of purchase (as defined in paragraph 18), such costs of conversion (as defined in paragraph 19) as are appropriate to that location and condition. Hence the cost can be made up of a number of items as noted in paragraphs 18 and 19 below.

18. Cost of purchase comprises purchase price including import duties, transport and handling costs and any other directly attributable costs, less trade discounts, rebates and subsidies.

19. Cost of conversion comprises:
   (a) costs which are specifically attributable to units of production, eg, direct labour, direct expenses and sub-contracted work;
   (b) production overheads (as defined in paragraph 20);
   (c) other overheads, if any, attributable in the particular circumstances of the business to bringing the product or service to its present location and condition.

In respect of point (c) it should be noted that this should be specific rather than general costs.

20. Production overheads: overheads incurred in respect of materials, labour or services for production, based on the normal level of activity, taking one year with another. For this purpose each overhead should be classified according to function (eg, production, selling or administration) so as to ensure the inclusion, in cost of conversion, of those overheads (including depreciation) which relate to production, notwithstanding that these may accrue wholly or partly on a time basis.

21. Net realisable value: the actual or estimated selling price (net of trade but before settlement discounts) less:
   (a) all further costs to completion; and
   (b) all costs to be incurred in marketing, selling and distributing.
22. Long-term contract: a contract entered into for the design, manufacture or construction of a single substantial asset or the provision of a service (or of a combination of assets or services which together constitute a single project) where the time taken substantially to complete the contract is such that the contract activity falls into different accounting periods. A contract that is required to be accounted for as long-term by this accounting standard will usually extend for a period exceeding one year. However, a duration exceeding one year is not an essential feature of a long-term contract. Some contracts with a shorter duration than one year should be accounted for as long-term contracts if they are sufficiently material to the activity of the period that not to record turnover and attributable profit would lead to a distortion of the period’s turnover and results such that the financial statements would not give a true and fair view, provided that the policy is applied consistently within the reporting entity and from year to year.

As can be seen by this definition, although a period of 12 months is noted, it also stipulates that an contract that straddles the year end where it meets specific conditions can be treated as long term.

23. Attributable profit: that part of the total profit currently estimated to arise over the duration of the contract, after allowing for estimated remedial and maintenance costs and increases in costs so far as not recoverable under the terms of the contract, that fairly reflects the profit attributable to that part of the work performed at the accounting date. (There can be no attributable profit until the profitable outcome of the contract can be assessed with reasonable certainty.)

Once the outcome of the project can be assessed in most cases unless there is an alternative it will be assumed that profit is earned evenly over the contract term.

24. Foreseeable losses: losses which are currently estimated to arise over the duration of the contract (after allowing for estimated remedial and maintenance costs and increases in costs so far as not recoverable under the terms of the contract). This estimate is required irrespective of:
   (a) whether or not work has yet commenced on such contracts;
   (b) the proportion of work carried out at the accounting date;
   (c) the amount of profits expected to arise on other contracts.

25. Payments on account: all amounts received and receivable at the accounting date in respect of contracts in progress."

For all contracts you are required to consider the overall profitability by taking the value of the contract and deducting the costs incurred to date and the expected costs that will be incurred to the end of the contract.

The definitions within the other standards are in line with those noted above.

Accounting and disclosure
The standards provide specific guidance on the accounting treatments and disclosure for stock and work in progress.

Stock should be stated at the lower of cost and net realisable value of the separate items of stock or of groups of similar items. This split should be shown in the notes to the accounts, however under FRSSE 2008 and 2015 there is no need to analyse the stock in the notes.

Under SSAP 9 long-term contracts should be assessed on a contract-by-contract basis and reflected in the profit and loss account by recording turnover and related costs as contract activity progresses. Turnover is ascertained in a manner appropriate to the stage of completion of the contract, the business and the industry in which it operates. It should be consistently applied between contracts and accounting periods.

Where it is considered that the outcome of a long-term contract can be assessed with reasonable certainty before its conclusion, the prudently calculated attributable profit should be recognised in the profit and loss account as the difference between the reported turnover and related costs for that contract hence the related costs are taken to cost of sales.
Long-term contracts will appear in the balance sheet in a number of places:

- the amount by which recorded turnover is in excess of payments on account should be classified as ‘amounts recoverable on contracts’ and separately disclosed within debtors;
- the balance of payments on account (in excess of amounts (i) matched with turnover; and (ii) offset against long-term contract balances) should be classified as payments on account and separately disclosed within creditors;
- the amount of long-term contracts, at costs incurred, net of amounts transferred to cost of sales, after deducting foreseeable losses and payments on account not matched with turnover, should be classified as ‘long-term contract balances’ and separately disclosed within the balance sheet heading ‘Stocks’; and
- the amount by which the provision or accrual for foreseeable losses exceeds the costs incurred (after transfers to cost of sales) should be included within either provisions for liabilities and charges or creditors as appropriate.

This treatment is consistent with the requirements of the FRSSE 2008 and 2015 and also FRS 102. For a more detailed look at FRS 102 please refer to Technical Factsheet 181: FRS 102 – making the transition to the new UK GAAP: http://www2.accaglobal.com/pubs/members/publications/technical_factsheets/downloads/181.pdf

UITF 40 introduced an equivalent accounting treatment as that required for long-term contracts for service contracts. The overriding consideration is whether the seller has performed, or partially performed, its contractual obligations. If it has performed some, but not all, of its contractual obligations, it is required to recognise revenue to the extent that it has obtained the right to consideration through its performance similar to the position noted for long-term work in progress. As often with services this may mean looking at the amount of time that has been spent on the assignment at the period end. However, where the substance of a contract is that a right to consideration does not arise until the occurrence of a critical event, revenue is not recognised until that event occurs. This only applies where the right to consideration is conditional or contingent on a specified future event or outcome, the occurrence of which is outside the control of the seller. The amount of revenue recognised should reflect any uncertainties as to the amount which the customer will accept and be able to pay. It may be the case, for example, that even where the contract states that fees are to be calculated on a time basis, the customer will not accept that the time spent is reasonable, hence when determining the amount to be included you can look at what has been achieved in past contracts. This treatment is consistent with the requirements of FRSSE 2008 and 2015.

For a more detailed look at accounting under UITF 40 please view:

- Technical Factsheet 130: UITF abstract 40 – A major change in profit recognition and increase in tax liabilities.
- Technical Factsheet 134: Guidance on the application of UITF 40 Revenue recognition and service contracts.
- Technical Factsheet 135: UITF 40 and taxation.

Under FRS 102, when the outcome of a transaction involving the rendering of services can be estimated reliably, an entity shall recognise revenue associated with the transaction by reference to the stage of completion of the transaction at the end of the reporting period (sometimes referred to as the percentage of completion method). FRS 102 states that the outcome of a transaction can be estimated reliably when all the following conditions are satisfied:

- the amount of revenue can be measured reliably;
- it is probable that the economic benefits associated with the transaction will flow to the entity;
- the stage of completion of the transaction at the end of the reporting period can be measured reliably; and
- the costs incurred for the transaction and the costs to complete the transaction can be measured reliably.
The standard goes on to say that when services are performed by an indeterminate number of acts over a specified period of time, an entity recognises revenue on a straight-line basis over the specified period unless there is evidence that some other method better represents the stage of completion. When a specific act is much more significant than any other act, the entity postpones recognition of revenue until the significant act is executed.

When the outcome of the transaction involving the rendering of services cannot be estimated reliably, an entity shall recognise revenue only to the extent of the expenses recognised that are recoverable.

Where the entity has consignment stock which is in substance an asset of the dealer, the stock shall be recognised as such on the dealer’s balance sheet, together with a corresponding liability to the manufacturer. Any deposit shall be deducted from the liability and the excess classified as a trade creditor. Where stock is not in substance an asset of the dealer, the stock shall not be included on the dealer’s balance sheet until the transfer of title has crystallised. Any deposit shall be included under ‘other debtors’.

4. Examples

The following are examples of the stock and work in progress disclosures required in a set of statutory accounts. The examples of the disclosure are consistent in each standard although some of the amounts included will vary as set out within the accounting explanations above. Please note that under FRS102 the term for stock has changed to inventories and is consistent with international standards.

Turnover
The turnover shown in the profit and loss account represents amounts invoiced during the year, exclusive of VAT.

In respect of long-term contracts and contracts for on-going services, turnover represents the value of work done in the year, including estimates of amounts not invoiced. Turnover in respect of long-term contracts and contracts for on-going services is recognised by reference to the stage of completion.

Stocks
Stocks are valued at the lower of cost and net realisable value, after making due allowance for obsolete and slow moving items. Cost is calculated on a first in, first out basis.

Contracts for services
Where the substance of a contract is that the contractual obligations are performed gradually over time, revenue is recognised as contract activity progresses to reflect the partial performance of our contractual obligations. The amount of revenue included reflects the accrual of the right to consideration as contract activity progresses by reference to value of the work performed.

<table>
<thead>
<tr>
<th>Stocks</th>
<th>20XX</th>
<th>20YY</th>
</tr>
</thead>
<tbody>
<tr>
<td>Raw materials</td>
<td>£32,160</td>
<td>£25,720</td>
</tr>
<tr>
<td>Work in progress</td>
<td>£11,590</td>
<td>£10,430</td>
</tr>
<tr>
<td>Finished goods</td>
<td>£28,132</td>
<td>£23,480</td>
</tr>
</tbody>
</table>

The company holds stocks of imported scientific glassware on consignment from the manufacturer. These remain the property of the manufacturer until sold or at the expiry of six months after shipment. No amounts for the stock or the liability to the manufacturer are entered in the financial statements until the stocks are acquired by this company. A deposit is paid to the manufacturer when consignment stocks are ordered and this is included in other debtors. The amount of consignment stocks held at year end was £9,275 (20YY – £10,355)

The replacement cost of the stock of raw materials is £53,250 which is materially higher than the cost recorded above.
Please note that under FRSSE 2008 and 2015 there is no requirement to analyse the stock in a note. In addition the disclosure in respect of the replacement cost is not required.

Other debtors  

<table>
<thead>
<tr>
<th></th>
<th>20XX</th>
<th>20YY</th>
</tr>
</thead>
<tbody>
<tr>
<td>£</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Trade debtors</td>
<td>3,877</td>
<td>4,429</td>
</tr>
<tr>
<td>Amounts recoverable on contracts</td>
<td>10,000</td>
<td>11,500</td>
</tr>
<tr>
<td>Director's current account</td>
<td>1,750</td>
<td>-</td>
</tr>
<tr>
<td>Other debtors</td>
<td>655</td>
<td>490</td>
</tr>
<tr>
<td>Prepayments and accrued income</td>
<td>1,025</td>
<td>900</td>
</tr>
<tr>
<td></td>
<td>17,307</td>
<td>17,319</td>
</tr>
</tbody>
</table>

Included in other debtors are amounts of £365 (20YY – £490) paid as deposits on consignment stocks.

Creditors: Amounts falling due within one year  

<table>
<thead>
<tr>
<th></th>
<th>20XX</th>
<th>20YY</th>
</tr>
</thead>
<tbody>
<tr>
<td>£</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Bank loans and overdrafts</td>
<td>31,003</td>
<td>26,724</td>
</tr>
<tr>
<td>Trade creditors</td>
<td>9,107</td>
<td>9,285</td>
</tr>
<tr>
<td>Other taxation and social security</td>
<td>6,429</td>
<td>5,504</td>
</tr>
<tr>
<td>Hire purchase agreements</td>
<td>2,750</td>
<td>2,750</td>
</tr>
<tr>
<td>Other creditors</td>
<td>923</td>
<td>975</td>
</tr>
<tr>
<td>Amounts invoiced in excess of amounts recoverable on contracts</td>
<td>3,300</td>
<td>2,400</td>
</tr>
<tr>
<td></td>
<td>52,612</td>
<td>48,538</td>
</tr>
</tbody>
</table>

5. CHECKLIST

<table>
<thead>
<tr>
<th>Issue</th>
<th>SSAP 9</th>
<th>FRSSE 2008</th>
<th>FRS 102</th>
<th>FRSSE 2015</th>
<th>Comment/reference</th>
</tr>
</thead>
<tbody>
<tr>
<td>Ascertain from the activities of the entity which of the following apply:</td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>• The company holds stock.</td>
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<td></td>
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<td></td>
</tr>
<tr>
<td>• The company has long-term contracts.</td>
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<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>• The company has service contracts.</td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>For stock</td>
<td></td>
<td></td>
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<td></td>
</tr>
<tr>
<td>In respect of stock disclose the following:</td>
<td></td>
<td></td>
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<td></td>
<td></td>
</tr>
<tr>
<td>• the accounting policies adopted;</td>
<td></td>
<td></td>
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<tr>
<td>• the total carrying amount of stock; and</td>
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<td></td>
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<td></td>
<td></td>
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<tr>
<td>• the carrying amount in classifications appropriate to the entity.</td>
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<td></td>
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<td></td>
<td></td>
</tr>
<tr>
<td>In respect of stock disclose the following:</td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>• the accounting policies adopted in measuring inventories, including the cost formula used;</td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>• the total carrying amount of inventories and the carrying amount in classifications</td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
</tbody>
</table>
appropriate to the entity;
- the amount of inventories recognised as an expense during the period;
- impairment losses recognised or reversed in profit or loss; and
- the total carrying amount of inventories pledged as security for liabilities.

**For long-term contracts**

Ascertain and disclose the accounting policy adopted.

Where it is considered that the outcome of a long-term contract can be assessed with reasonable certainty before its conclusion, the prudently calculated attributable profit shall be recognised in the profit and loss account as the difference between the reported turnover and related costs for that contract. Ascertain the details and include the relevant amounts within the appropriate headings.

Include the amount by which recorded turnover is in excess of payments on account as ‘amounts recoverable on contracts’ and separately disclose within debtors.

Include the balance of payments on account (in excess of the amounts (i) matched with turnover and (ii) offset against long-term contract balances) as payments on account and separately disclose within creditors.

Include the amount of long-term contracts, at costs incurred, net of amounts transferred to cost of sales, after deducting foreseeable losses and payments on account not matched with turnover, as ‘long-term contract balances’ and separately disclose within the balance sheet heading ‘stocks’.

This balance sheet note shall disclose separately the balances of:
(i) net cost less foreseeable losses; and
(ii) applicable payments on account.

**For contracts for services**

Ascertain and disclose the accounting policy adopted.

Include in revenue the amount of income earned on contracts at the balance sheet date.

Include the amount by which recorded turnover is in excess of payments on account as ‘amounts recoverable on contracts’ and separately disclose within debtors.

Include the balance of payments on account (in excess of the amounts (i) matched with turnover and (ii) offset against service contract balances)
as payments on account and separately disclose within creditors.

| 23.30 An entity shall disclose:
| (a) the accounting policies adopted for the recognition of revenue, including the methods adopted to determine the stage of completion of transactions involving the rendering of services; and
| (b) the amount of each category of revenue recognised during the period, showing separately, at a minimum, revenue arising from:
| (i) the sale of goods;
| (ii) the rendering of services;
| (iii) interest;
| (iv) royalties;
| (v) dividends;
| (vi) commissions;
| (vii) grants; and
| (viii) any other significant types of revenue.

In respect of contracts disclose the following:
(a) the amount of contract revenue recognised as revenue in the period;
(b) the methods used to determine the contract revenue recognised in the period; and
(c) the methods used to determine the stage of completion of contracts in progress.

Present:
(a) the gross amount due from customers for contract work, as an asset; and
(b) the gross amount due to customers for contract work, as a liability.

6. SOURCES OF INFORMATION

Legislation
The legislation can be accessed at the following website:

http://www.legislation.gov.uk

The following legislation should be referred to when required:
- Companies Act 2006
- The Small Companies and Groups (Accounts and Directors’ Report) Regulations 2008
- The Large and Medium-sized Companies and Groups (Accounts and Reports) Regulations 2008

Accounting standards
The relevant standards can be accessed on the Financial Reporting Council website at the following link:
http://www.frc.org.uk/Our-Work/Codes-Standards.aspx

The following standards should be referred to when required:
- SSAP 9 – Stocks and long-term contracts
• UITF 40 Revenue recognition and service contracts
• FRSSE (effective April 2008) – Financial Reporting Standard for Smaller Entities
• FRS 102 – The Financial Reporting Standard Applicable in the UK and Republic of Ireland
• FRSSE (effective April 2015) – Financial Reporting Standard for Smaller Entities