Revenue Fraud and the Impact of New Revenue Recognition Standards

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Revenue recognition is a hot topic in the accounting industry right now. In May 2014 the Financial Accounting Standards Board (FASB) and the International Accounting Standards Board (IASB) decided to come together and create a new revenue recognition standard. “The new accounting standard for revenue recognition will likely affect every aspect of a business that relates to revenue, from a company’s financial results to compliance with debt covenants to executive compensation.”[1]

The previous revenue recognition standard has been in place for so long that many companies are having trouble adapting to the new rules. This paper includes a discussion on the new revenue recognition standards, why the new standards were needed, ways that companies use revenue recognition to falsify financial statements and a few examples of companies that have employed these fraudulent methods.

Many companies have already felt the effects of the new recognition standard, Accounting Standards Update (ASU) No. 2014-09, *Revenue from Contracts with Customers*, which is effective for public companies for fiscal years beginning after December 15, 2017. Non-public entities do not have to begin reporting under the new standard until fiscal years beginning after December 15, 2018. According to FASB the new standard will:

- Help to eliminate inconsistencies and weaknesses with the old standard
- Provide more details about how to deal with revenue recognition
- Make revenue more comparable across different industries

[1] Knachel, Eric. (December 21, 2016). Revenue Recognition: The Clock Is Ticking. Retrieved from http://ww2.cfo.com/gaap-ifrs/2016/12/revenue-recognition-clock-ticking/.

- Provide more useful information to users of financial statements through improved disclosure requirements
- Simplifies the preparation of financial statements by reducing the number of requirements to which an organization must refer.[2]

New Revenue Recognition Standards

Under the new standard rules about revenue recognition will be more consistent and there will be stricter rules about disclosure requirements. Table 1 shows how the new revenue recognition standard compares to the old standard.

Today	**Under the new guidance…**
There are numerous requirements for recognizing revenue.	There will be consistent principles for recognizing revenue, regardless of industry and/or geography.
Other than disclosures in accounting policies and segment reporting, most companies and other reporting organizations provide limited information about revenue contracts.	The new guidance includes a cohesive set of disclosure requirements that will provide users of financial statements with useful information about the organization's contracts with customers.
Many goods or services promised in a contract with a customer are deemed not to be distinct revenue-generating transactions when in fact those promises might represent separate obligations of the entity to the customer.	Reporting organizations will identify each of the goods or services promised to a customer, determine whether those goods or services represent a performance obligation, and recognize revenue when (or as) each performance obligation is satisfied.
In a multiple element arrangement the amount of consideration allocated to a delivered element is limited to the amount that is not contingent on delivering future goods or services.	Companies will allocate the transaction price to each of the performance obligations in the contract on the basis of the relative standalone selling price of the underlying goods or services, except when a discount or a variable amount of consideration relates entirely to one or more of the performance obligations in the contract.
Accounting for variable consideration differs greatly across industries.	A single model to consider for variable consideration, which includes rebates, discounts, bonuses, or a right of return. Variable consideration will be included in the transaction price to the extent it is probable that a significant reversal in the amount is cumulative revenue recognized will not occur.

Table 1: New Revenue Recognition vs. Old Revenue Recognition[3]

[2] Revenue Recognition (n.d.) Retrieved on January 20, 2018 from http://www.fasb.org/jsp/FASB/FASBContent_C/CompletedProjectPage&cid=1175805486538.
[3] Financial Accounting Standards Board. New Revenue Recognition Standards. Retrieved from http://www.fasb.org/cs/ContentServer?cid=1351027207987&d=&pagename=FASB%2FPage%2FBridgePage#section_3.

Types of Revenue Recognition Fraud

One of the reasons for better revenue recognition standards is many companies use revenue recognition to make their financial reports appear better than they really are. Research by the Committee of Sponsoring Organizations of the Treadway Commission (COSO) indicates that the most common form of fraud is misstatement of revenue, with over 60% of companies studied committing some type of revenue fraud. Most of this fraud is committed in the computer hardware and software, and other manufacturing industries.[4]

There are several ways a company can commit revenue recognition fraud. The most common of these frauds are illustrated in Figure 1. It is easy for a company to get away with such fraud if there are weak internal controls in place or ineffective audits from external auditors.

Fictitious Revenue

The most blatant frauds involve creation of fictitious revenues and related documentation to make revenues look better. McKesson and Robbins is one of the earliest examples of this type of fraud. McKesson and Robbins was bought by Philip Musica in 1924. Musica had a rather shady past that was filled with criminal acts and the use of many fake names. Using the name F. Donald Coster, Musica was able to buy McKesson and Robbins and staffed it with family members to help the company grow. After Musica had the company running he began to create fake purchase orders, inflate inventory numbers, and skim cash from the company sales. When the fraud was discovered, the company had around $10 million in nonexistent inventory on the

[4] Beasley, M.S., Carcello, J.V., Hermanson, D.R., Neal, T.L. (2010). Fraudulent Financial Reporting 1998-2007: An Analysis of U.S. Public Companies. Retrieved from COSO website: https://www.coso.org/Documents/COSO-Fraud-Study-2010-001.pdf.

books and $9 million in fictitious receivables. Many phony purchases and sales were made to a dummy Canadian company that was merely staffed with secretaries that forwarded mail.[5]

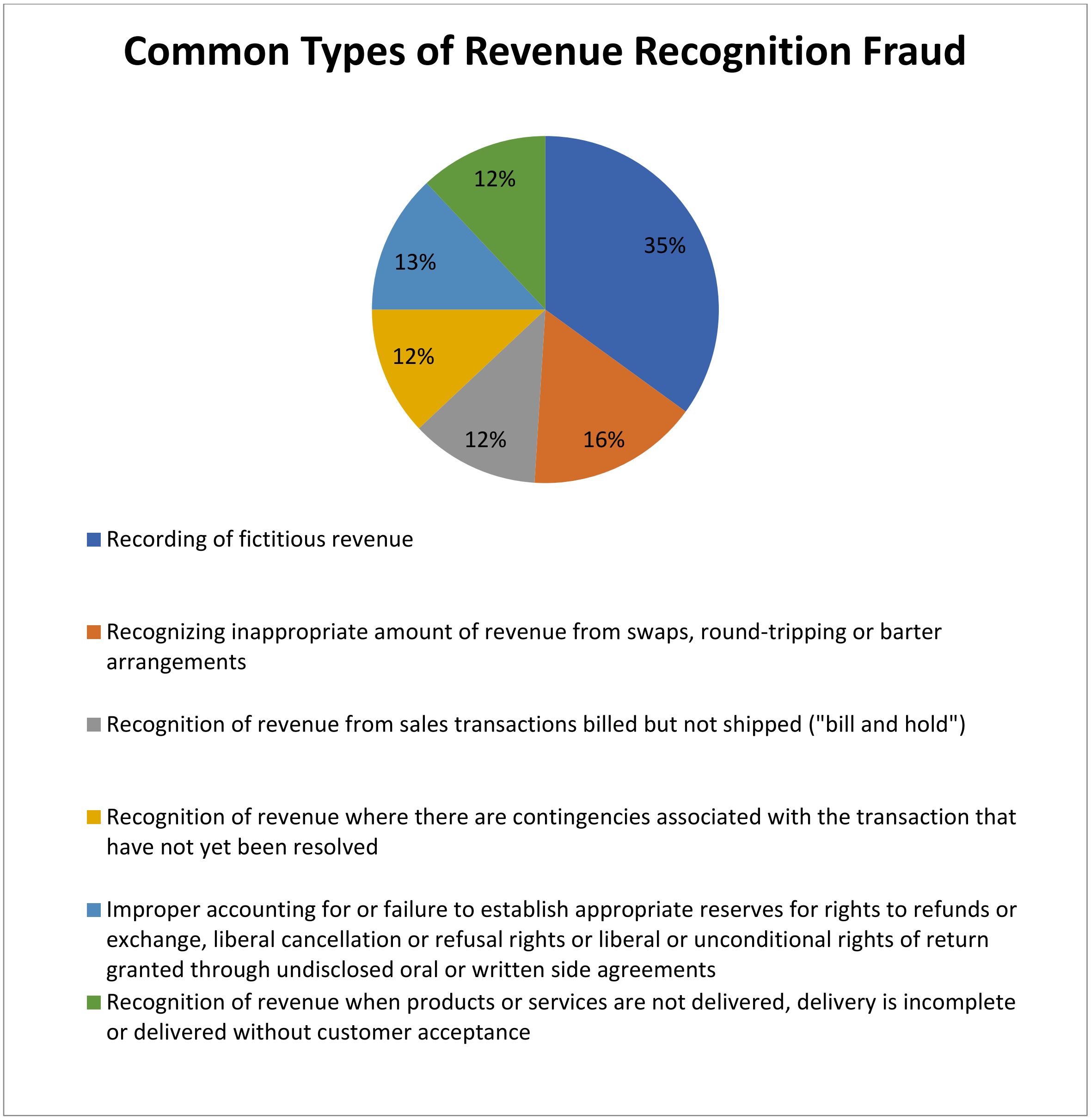

Figure 1: Breakdown of Revenue Recognition Fraud[6]

[5] Fox, Eric. 4 Massive Frauds You've Probably Never Heard Of. *Investopedia.* Retrieved from https://www.investopedia.com/articles/economics/12/four-unknown-massive-frauds.asp.

[6] Common Types of Revenue Recognition Fraud. Retrieved from https://image.slidesharecdn.com/fraud-100426102156-phpapp01/95/fraud-understanding-fraud-and-our-responsibilities-26-728.jpg?cb=1272277416

As a result of the McKesson and Robbins fraud, the American Institute of Accountants issued Statement of Auditing Procedures Number 1, *Extensions of Auditing Procedure*.[7] The statement recommended confirmation of accounts receivable “wherever practicable and reasonable.” Auditors are still required to confirm accounts receivable in most circumstances under U.S. auditing standards. However, major revenue recognition frauds continued despite the confirmation requirement.

ZZZZ Best was a carpet cleaning business created by Barry J. Minkow when he was a teenager. In 1987, ZZZZ Best began to create fictitious revenues by claiming to be receiving millions of dollars in restoration work from insurance companies. Minkow was also accused of filing phony documents with the SEC, attempting to bribe an informant, and announcing phony financial results. To deceive the auditors, Minkow went so far as to use a building under construction to show the auditors examples of ZZZZ Best’s insurance restoration work.

Barry Minkow left no detail to chance. He made sure that two of his employees put up signs around the empty building to make it look as though ZZZZ Best would soon be taking over. They even paid off the security guard and had him greet everyone as well as act as though he was aware of the visit beforehand.[8] The auditors never questioned why all the confirmations came from an insurance adjuster who colluded with Minkow. Of course, confirmations are ineffective if the confirmee colludes with the company being audited. ZZZZ Best once had a

[7] The American Institute of Accountants is the predecessor organization of the American Institute of Certified Public Accountants (AICPA).
[8] Knapp, Michael C. (2018). *Contemporary Auditing: Real Issues and Cases.* Boston, Massachusetts: Cengage Learning.

stock market valuation that exceeded $211 million, most of which was based on revenue that never existed.[9]

In 1965 Stanley Goldblum bought out his partner and took over their company Equity Funding. Goldblum began to buy other companies and he needed money in order to keep the price of Equity Funding stock up in order to pay the owners of the companies he was buying out. It was during this time that Mr. Goldblum began to have the company CFO make fictitious entries in receivable and income accounts. This increased the earnings per share and the price of the company's stock began to rise. Equity Funding was then able to create cash flow by selling policies for fictitious customers.[10]

During the 1980s Regina Vacuum was taken over by a new CEO. This new CEO had controlling interest in the company and planned to do whatever he could to make the company successful. The CEO bought most of his interest in the company by taking on personal debt. In order for him to pay off his own debt he needed Regina Vacuum to be profitable.

The CEO issued phony invoices that were identical to real invoices to larger customers that the CEO believed would not be likely to respond to confirmation requests. When auditors do not receive a confirmation response, they perform alternative procedures, such as examining subsequent cash receipts in payment of the invoice. Because the fake invoices were for the same amounts as valid invoices, the CEO could show the auditors evidence of payment from a valid invoice.

Many of the company's vacuums were also being returned because they were melting after being used, and the company had a warehouse full of the returned products. The CEO

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[9] Akst, Daniel. (1988, January 18). ZZZZ Best Founder Minkow Indicted on Racketeering And Fraud Charges. *The Wall Street Journal.* Retrieved from https://www.wsj.com/articles/SB122651435543121217.

[10] Hancox, David R. Equity Funding: Could It Happen Again? Retrieved from http://davehancox.com/equity-funding/.

moved all of the returned vacuums to another warehouse and made sure that none of the vacuums that were returned were included on the books. Eventually, word spread about how defective the vacuums really were. Before long the CEO could no longer hide the numbers and investors lost around $40 million.[11]

As you can see, altering financial documents and creating fictitious revenue is the most common way for companies to commit revenue recognition fraud. Many companies use more than one method to increase reported revenue.

Conditions of Sale

Another method that companies may use is to increased revenue is to alter the conditions of the sale. This means the customer may be allowed to return the product, the payment terms may be extended, or the items may be exchanged. Once the customer buys the product, the company then records revenue even though these side agreements may be in place. Most of the time these side agreements are kept secret so that no one knows about the fraud taking place. There will always be certain side agreements and customers should have the right to return an item. The problem arises when the company recognizes revenue in the period when such agreements are in place, as revenue should not be recognized unless collectability is reasonably assured.

[11] Putra, Lie D. (2010) Fraudulently Misstating Financial Statements Methods. *Accounting Financial and Tax.* Retrieved from http://accounting-financial-tax.com/2010/02/fraudulently-misstating-financial-statements-methods/.

Round Tripping

Round tripping is another scheme companies have developed to make their revenue appear greater than what it really is. It is called round tripping because the company ends up right where they started, but they can “inflate” revenue just enough to make investors think the company is healthier than it really is. When this type of fraud takes place, one company will approach another company and agree to buy a certain quantity of product at a certain price if the company they are buying from agrees to also buy the same product at the same price from them. Thus, each company is buying the same product at the same price from each other. It would seem as though buying one product and then selling the same amount of the same product would cancel out any revenue because the amount of expense is equal to that revenue. However, in the end the revenue account increases and investors are fooled into believing that the company is doing well because of expanding sales.

Bill and Hold

Another way companies commit revenue recognition fraud is by engaging in a bill and hold transaction. In some cases, customers may be billed for goods that are ready for delivery, but will not be shipped until a later date. For example, a customer may request this arrangement if it does not have physical space for the goods. The selling company is allowed to recognize revenue if control has passed to the seller.

Obviously, this arrangement can be abused as it is difficult to tell when goods have been held for the customer for valid reasons, compared to merely billing a customer for goods that have not yet been shipped. The company that is selling the goods still records the revenue even though ownership of property has not been passed to the customer. Usually the goods are kept in storage, but the goods may be shipped to a different location to make it appear the goods have been shipped, justifying the recording of revenue.

Sunbeam is just one of many companies that used bill and hold transactions in order to make their financial statements appear better than they were. In 1996, “Chainsaw” Al Dunlap took over as CEO and Chairman. In 1997 Sunbeam began to offer lower prices, credit options, and other concessions in order to get customers to buy products. Customers began to write purchase orders sooner than they normally would have. This made it seem as though the customers were not actually requesting the goods on a bill and hold basis. Sunbeam paid several costs for the buyer including insurance, storage, and shipment fees as well as allowing the buyer to return any products that were not sold. These bill and hold transactions, along with other accounting frauds, were used to make it look as though Sunbeam was successfully restructuring the company and inflated the stock price of the company.[12]

Altering Shipping Documents

Another way a company could falsely report revenue is by altering shipping documents. In this way the company can make it appear an item was shipped earlier than it really was. For example, if someone orders $10 worth of products, you would like to record that revenue right now, especially if sales are lower than expectations. One way for a company to do this is to alter the date on the shipping documents. They may not be able to ship the items until a later period but instead they change the paperwork to make it appear the items were shipped and ownership has changed hands.

[12] Accounting Frauds. (2007). Sunbeam. Retrieved from http://www.analyzr.org/tag/bill-and-hold-sales/.

For example, suppose a company with a December 31st year end shipped products in early January of the following year. The sale should be recorded when the goods are shipped. However, by backdating documents, the company can make it appear the goods were shipped in December, allowing revenue to be recognized in the earlier period. Whenever it is close to the year end this type of fraud may be viewed as a quick way to boost revenue before the books are closed for the year. Some companies not only alter their shipping documents, they also alter invoices, financial statements, and even create false journal entries to try and add to their revenue.

Agreements to Sell-Through Product

Agreements to sell-through product are very similar to consignment agreements. One company may consign or ship goods to someone else. In return the person agrees to sell the goods for the company. Most of the time these types are deals are kept secret. They will not appear in the sales agreement because they break the rules of revenue recognition. In this type of situation, the first company records a sale when it cosigns goods to a second party. The second company then sells the goods to a third party. However, because no sale takes place until company two sells to a third party there should not be any revenue recognized by the first company. Again, many companies use this tactic to inflate their revenue even though it violates the principles about when revenue should be recognized.

Upfront Fees

Many companies have upfront fees that must be paid to purchase an item or service. In such cases revenue should only be recognized as it is earned. For example, a lawn mowing service may charge you to cut your grass twice a month. The owner of the company should only record the amount that he has earned after he has cut your grass each time. Revenue should only be recognized when the seller has fully completed their obligation. In the above case the owner of the company is likely to record the amount received for the full month of cutting grass when he receives the payment. While the owner of the grass cutting company may not know any better, large companies do, but they still manipulate the terms of sale to allow additional revenue to be recognized earlier than it should.

Holding Accounting Periods Open

Most of the schemes described previously involve the manipulation of accounting documents and records. When a company keeps the books open past the end of the accounting period they are doing the same thing. Sometimes companies will put off closing their books at year end because they want to record more revenue. To do this they manipulate the books so that it appears certain items were bought in the current year rather than the next. While this may sound easy, companies that do this must be careful to get rid of or cover up any paper trail that says otherwise. They must alter shipping documents, cash receipts, and even bank statements. Companies may engage in such fraud if they know that they are going to have a big inflow of revenue right after the year end.

Failure to Record Sales Provisions or Allowances

A company can inflate their revenue by failing to record sales allowances or reductions. Sales allowances reduces the amount of net revenue a company reports, so many companies are tempted to hide sales returns to make their financial statements appear healthier; Regina Vacuum is one such example. For a company to do this they must make sure that conditions of the sale that allow for such an allowance are hidden. This could mean the company must go back and hide what they may have originally agreed to or even falsify invoices so they can make it look like they have more revenue than they do.

Channel Stuffing

Channel stuffing can be used by companies to inflate revenues towards the end of the accounting period. Usually, when a salesperson or company is trying to meet their quarterly goals they will entice wholesalers or retailers to order more products than they expect to sell in the normal course of business. The salesperson will offer the buyer deep discounts to buy more of the products and there is an understanding that the product can be returned at a later date.

One of the more well-known examples of this type of fraud involved contact lens manufacturer Bausch & Lomb, Inc. In late 1993, the company's distributors were called to a meeting and asked to buy as much as a two-year supply of soft lenses at high prices, or they would lose their distributorship. The company's managers took this action to meet yearly sales targets. Some of the distributors were told that they could return the lenses, which would violate the rules of revenue recognition. The SEC charged that these actions overstated revenue by $42 million and net income by $17.6 million, which represented 11% of income.[13]

While Sunbeam was using bill and hold transactions, they were also making use of channel stuffing in order to convince customers to buy merchandise that they would not need for many months. Using this method of fraud along with several others allowed Sunbeam to look as though it was in better financial standing than it actually was.

[13] Maremont, Michael. (November 18, 1997). Bausch & Lomb, Executives Settle Charges with SEC. Retrieved from www.wsj.com.

Figure 1 shown earlier includes a breakdown of how extensively each type of revenue recognition is used. Table 2 summarizes how the most common accounting frauds are accomplished, along with examples of companies where these methods were used.

Type of Fraud	**How it was accomplished**	**Company Example**
Fictitious Revenue	Company was receiving revenue from fictitious restoration projects. Set up fake sites for auditors to visit.	ZZZZ Best
Bill and Hold	Lowered product cost and paid other fees for customers to entice them to buy earlier than normal. Didn't at first appear as bill and hold.	Sunbeam
Fictitious Revenue	Vacuums that were returned were never put back on the books. CEO stored returned vacuums in an offsite warehouse.	Regina Vacuum
Channel Stuffing	Lowering prices and paying many fees for customers in order to convince them to buy goods before they actually needed them.	Sunbeam

Table 2: Summary of How Major Types of Fraud were Accomplished

As you can see, there are many ways for a company to get away with revenue recognition fraud. Each method is a little bit different from the next but most all of them involve manipulating some type of accounting documents to make the revenue number match the records. Committing such a fraud can be very costly for a company and anyone involved. All of the people involved in the fraudulent actions discussed above were punished for their choices. Many lost their jobs, faced jail time and even had to pay fines. Each company that was involved in these crimes had their reputation tarnished and had to either rebuild their reputation or give up on the company entirely. Many of the people who committed these fraudulent actions would tell you that in the end it was not worth it.

Implementing New Standards

Changes in New Standards

Implementing a new standard is never easy, but in the case of the new revenue recognition standard there may be some difficulties. Many companies have used the old revenue recognition standard for so long that they are unsure about how to implement the new standards or even what effects it will have on their business. Many companies have already begun to implement the new standards but for those who have not they should recognize that this will be a time-consuming process and begin preparing for it now. Since the introduction of the new standards FASB has issued some amendments to help anyone who may have questions, along with creating a Transition Resource Group or TRG to help companies try to understand these new rules. This new standard will affect all companies that have contract with customers, with the exception of certain items such as leases. “The new revenue recognition standard eliminates the transaction- and industry-specific revenue recognition guidance under current GAAP and replaces it with a principle-based approach for determining revenue recognition.”[14]

One of the changes made to the recognition standard deals with collectability criteria. In the past companies were supposed to assess whether or not it was probable that they would receive all consideration promised in a contract. Under the new standards companies only need

[14] AICPA. New Revenue Recognition Accounting Standard-Learning and Implementation Plan. (2017). Retrieved fromhttps://www.aicpa.org/InterestAreas/FRC/AccountingFinancialReporting/RevenueRecognition/DownloadableDocuments/FRC_Brief_Revenue_Recognition.pdf.

to determine whether or not they believe they will be able to collect all of the revenue they are entitled for transferred goods and services.

The second issue that has come about with the implementation of the new recognition standards deals with shipping and handling. In the past, shipping and handling was not accounted for as an additional service. The new revenue recognition standard states that it may now be classified as a performance obligation. Many companies do not want shipping to be considered a performance obligation, because if it is that means that even if the customer were to take control of the goods before they were shipped the company still would not be able to recognize that revenue until all shipping was complete.

FASB issued ASU 2016-10 to help provide some guidance on this issue. Whenever a customer takes control of the goods before they are shipped, but the company is in charge of arranging the shipping, the company can elect to classify the shipping and handling as an expense rather than a separate performance obligation.

The final issue that has been discussed about the new revenue recognition standard deals with licensing. "The new standards require an entity to determine whether a license provides a customer with a right to access an entity's intellectual property (IP), including any updates, etc., or a right to use an entity's IP as it exists at a point in time."[15] This makes it clear when the customer takes control of the asset, because revenue will either be recognized over time or at one point in time.

Many companies were having trouble with issuing licenses because they were unable to differentiate between right to use and right to access. FASB issued ASU 2016-10 to help

[15] Hale, Vicky. (2016, August 30). Comparing the New Revenue Recognition Standards: IFRS 15 and ASC 606. Retrieved from https://www.gaapdynamics.com/insights/blog/2016/08/30/comparing-the-new-revenue-recognition-standards-ifrs-15-and-asc-606/.

companies determine if they were granting a license for functional IP or symbolic IP. Under the new standard functional IP is not something that the company has to continually update or support. The customer can derive value from functional IP without all of the extra support. Some examples include software or media content. Because the company does not have to continually help the customer, this type of revenue can be recognized at one point in time. On the other hand, symbolic IP cannot be maintained without some kind of support. This type of IP requires the company to "keep it up." Some examples include logos or franchise rights. This type of IP is a continual process which means that revenue should be recognized over the time that the IP is being updated and supported by the company.

Steps in Implementing New Standards

In order for companies to properly implement this new standard the AICPA has developed some steps that should be taken, because the way companies implement these standards will determine how many years revenue and direct effects of change in accounting principle will need to be restated. First, companies need to make sure that they are communicating what is going on with internal stakeholders so that everyone is aware of what changes will need to be made. Finally, if there are any questions, management should speak with their auditors to determine what will be impacted by the new standards and how to prepare.

The first step a company should take is to designate one group of people within the company to study and become experts on the new standards being implemented. This group should be in charge of communicating, teaching, and implementing the new standards within the company. It is also important that this group considers all the implications of whatever actions they take regarding the new standard, such as legal, internal audits, tax, IT, financial reporting, and human resource implications. This is a huge undertaking and should be begun as soon as possible.

Next, the group of people in charge of learning about the new standard needs to look at how implementing these new standards will affect the company's financial statements. It is also important that this group determines how other areas will be affected as well, including operations, company contracts, compensation plans, accounting policies, and tax matters. This group should also take the time to meet with the company's auditor so that any new changes that are made can be documented and handled accordingly during the next audit.

The third step a company should take in implementing the new revenue recognition standard is to determine which retrospective approach they will take for periods that require restatement. There are two ways in which a company can apply this retrospective approach. The first is to look retrospectively to each period that is reported and elect one of the following expedients:

- For completed contracts, an entity need not restate contracts that begin and are completed within the same annual reporting period.
- For completed contracts that have variable consideration, an entity may use the transaction price at the date the contract was completed rather than estimating variable consideration amounts in the comparative reporting periods.
- For reporting periods presented before the date of initial application, an entity need not disclose the amount of the transaction price allocated to remaining performance obligations and an explanation of when the entity expects to recognize the amount as revenue.

- For contracts that were modified before the beginning of the earliest reporting period presented, an entity need not retrospectively restate the contract for those contract modifications in accordance with FASB ASC 606-10-25-12 through 25-13. Instead an entity should reflect the aggregate effect of all modifications that occur before the beginning of the earliest period presented when:
    - Identifying the satisfied and unsatisfied performance obligations
    - Determine the transaction price
    - Allocating the transaction price to the satisfied and the unsatisfied performance obligations

The second method that companies may choose is to look retrospectively and let the cumulative effect be accounted for when the standard is implemented. If a company chooses this method they must disclose the change in accounting principle and they must also provide disclosures for items with date of initial application such as the following:

- The amount by which each financial statement line item is affected in the current reporting period by the application of the standard as compared to the guidance that was in effect before the change.
- An explanation of the reasons for significant change.[16]

When a company looks retrospectively they should only include any direct effects of the change in accounting. If the retrospective approach had been followed in prior years it is not necessary to include any indirect effects.

Now, the company must determine what needs to change in order to follow through with their decisions from steps one through three. The fourth step in implementing this new

[16] AICPA. New Revenue Recognition Accounting Standard-Learning and Implementation Plan. (2017). Retrieved from www.aicpa.org/InterestAreas/FRC/AccountingFinancialReporting/RevenueRecognition/DownloadableDocuments/FRC_Brief_Revenue_Recognition.pdf.

standard is to think about the IT implications of using a new revenue recognition standard. There may be a new level of information that is required to properly recognize revenue based on which retrospective approach the company chooses. This step in the process is determined based on the first three steps. The way the company decides to implement the new system could determine whether or not your company's IT needs an overhaul or not. Step five includes deciding which types of disclosures the company needs to produce before they implement the new standard.

Steps six and seven deal with implementing the plan and teaching the employees about what is going to change and how to help make the changes be put into place more smoothly. The sixth step involves making a plan that evolves as the plan is implemented and that follows the first five steps. By developing an evolving plan, you can change things as you need to as the new standard is implemented. The final step in this plan is to educate the stakeholders of the company. Steps two and three can determine when revenue is recognized, so this change needs to be explained to all of the stakeholders so they know what is going on. It may take some time to develop an effective way to deal with these new standards but each company should begin to take these steps immediately.

Although adopting the standard will be time-consuming, many companies seem to be behind in addressing the new standard. A recent PwC survey indicates that 75% of public companies surveyed were assessing the impact of the new standard but had not yet started implementing, and 52% of companies had not even chosen a method of adoption.

However, the standard will not affect all companies equally. Seventy-eight percent (78%) of participants reported that the new revenue recognition standard will have a moderate to high impact on accounting policies/procedures. Survey participants ranked review of current and ongoing contracts as the most difficult task in implementation. However, 64% expect no material impact on the income statement and/or balance sheet.[17]

Is the New Revenue Recognition Standard Better?

FASB believed that issuing a new revenue recognition standard would provide a better guideline for companies to follow but with this new standard there is still potential for companies to fraudulently record revenue, maybe more so than before. The new standard allows for many companies to accelerate their revenues like never before. For example, contractors that receive a bonus for early completion of a job can estimate what they expect the bonus to be and count that as revenue. Companies can also book revenue when they deliver a product and then book the installation revenue later.

This may sound good to a company that is trying to make their financial statements look attractive, but there is another side to this. The new standard allows for companies to make estimates as to what they think their revenues will be. Companies often make these estimates but in fact do not reach them. In the first year of implementation this standard may seem appealing to companies as they can recognize more revenue than they have in past years and accelerate their revenue account, but then next year they have less revenue to recognize and their revenue numbers drastically decrease.

Under the new revenue recognition standards, which is a principles-based model, companies are able to use their judgement more when it comes to certain areas of revenue recognition. Companies will have to use their best judgment when making decisions about different situations as there is no longer any set model to tell them what to do. The most

[17] PwC. 2016 Revenue recognition survey: Readiness update, impacts, and remaining challenges, Retrieved from https://www.pwc.com/us/en/services/audit-assurance/accounting-advisory/revenue-recognition-survey.html.

important thing that these companies need to keep in mind is that they should make sure to document every decision they make and keep it for their own records. This information will become valuable in the future if they should ever see a similar situation again.

While companies may enjoy having more say over what they book as revenue this change could be quite confusing for both investors and auditors. For example, Company A decides that they want to use a retrospective approach under the new standards. This means that they will apply the new standards to past years financial statements and continue with the new standards in the future. Company B decides they want to take the modified retrospective approach. With this method Company B will make an adjustment to retained earnings at the beginning of the year the standard is implemented and follow the standard from that point on. These two choices make it very hard to compare the companies' financial statements. Even within the day to day business there is room for companies to decide whether they want to account for revenue in one way or another. The new standard is allowing companies to use their own judgment more but this will also make it harder to compare the financial statements of companies, even within the same industries.

According to CFO.com "If a company shows revenue improvements, it could be difficult to deduce what portion is organic growth (for example, due to an increase in the customer base and number of subscriptions sold), and what portion is attributable to the new rule."[18] Under the new standards companies can include all revenue received from prepaid items such as subscriptions once it is received, while the old standard only allowed companies to recognize the revenue once it was earned. As stated earlier, this new standard will cause many companies to increase revenues within the first year of implementation.

[18] Coleman, D and Usvyatsky, O. (2018, March 5), *ASC 606: What's the Impact So Far?* Retrieved from www.CFO.com

Christoph Hutton, CEO of SAP, worked with IFRS when this new standard was being developed and he believes "companies should not judge the new standard's importance by its impact on the revenue line in the income statement."[19]

Conclusion

The new revenue recognition standard has taken the old standard and focused it more so that there is a single model with consistent principles and a cohesive set of requirements. For many companies this will allow them to better understand how they should be recognizing revenue. This new standard of revenue recognition paired with the Sarbanes–Oxley Act will surely tighten the leash on any company that should decide to falsely recognize revenue.

Even with these new laws there is still the potential for companies to act corruptly. Only time will tell how well this standard will work. The new standard certainly leaves room for many companies to act corruptly and it will be up to FASB to decide whether or not they need to tighten the standard over time. These new standards will involve a lot of change and work for many companies but it will also allow them to have more control over their revenue accounts. Whether that is a good or bad thing is yet to be seen.

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