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Review Article

Financial and Accounting Chicanery. Will the New Revenue Standard Address the Revenue Realization Issues

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Abstract - *In the recent past, firms have been employing questionable accounting practices, financial engineering, complicated risk metric, and outright fraud in an effort to conceal losses and inflate profits. The new revenue recognition standard is a collaboration between the FASB (Financial Accounting Standard Board) and the IASB (International Accounting Standard Board). The FASB and the IASB jointly issue the IFRS 15 (International Financial Reporting Standard 15 and ASC 606 (Accounting Standard Codification 606) revenue from a contract with customers. The core principle of IFRS 15 and ASC 606 is to recognize and depict the transfer of promised goods or services to customers in the amount that reflects the consideration to which the entity expects to be compensated in exchange for those goods or services.*

Keywords - *Chicanery, Revenue, Financial And Accounting.*

I. ACCRUAL BASED EARNINGS

Accounting for revenue has become a highly contested issue for firms, external users of financial information, auditors, and investors. It is coming under intense scrutiny and also becoming complex. Revenue guidelines and the subsequent regulations are under continuous review, and firms in different industries are adopting new business models involving a wide range ofcustomer relationships with long-term financial implications. Revenue recognition guidelines by nature could be controversial, and strictly adhering to the criterion would violate the overriding objectives of revenue recognition principles in the period revenue-generating activities of the company are performed. Revenue is vital information to the users of financial statements in assessing the operation of the firms and their ability to generate profit. Revenue recognition requirements standards are different under the IFRS (International Financial Reporting Standard). and the US GAAP (the United States Generally Accepted Accounting Principles). US GAAP requires that revenues be recognized once the delivery of goods and services have occurred, and there is persuasive evidence of the sale, fees are determinable, and collectability is reasonable. In contrast, IFRS requires revenues to be recognized only when the ownership of goods and services has been transferred, and revenue can be measured reliably. IFRS (International Financial Reporting Standard) considers receivables to be financial agreements, and therefore all future receivables should be discounted using the appropriate discount rate to determine the value of the revenue. The US GAAP allows construction contract revenues to be recognized using the percentage completion method. International Financial Reporting Standard prohibits the use of the percentage contract method. The International Accounting Standards Board (IASB) and the US Financial Accounting Standards (FASB) jointly issued new revenue, IFRS 15 Revenue, from contracts with customers that will supersede virtually all revenue recognition requirements in IFRS and US GAAP. Based on controversial inconsistencies, use of judgment, and other concerns in the existing revenue recognition requirement under both IFRS and US GAAP, the Boards decided to develop a joint revenue standard that would:

- To furnish a more robust framework for addressing revenue recognition issues.
- To get rid of inconsistencies and weaknesses in the current revenue recognition literature.
- To enhance comparability of revenue recognition practices across industries, entities within those industries, jurisdictions, and the capital market. To minimize the complexity of applying revenue recognition requirements by bringing down the volume of relevant standards and interpretations.

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Hanson (2013) states that the joint revenue recognition project between the FASB (Financial Accounting Board) and IASB(International Accounting Standard Board) will fundamentally change the basis of revenue recognition. The two standard-setting groups are collaborating on developing a final convergence standard for revenue recognition.

Hanson (2013) says that "it is my hope that the PCAOB (Public Company Accounting Oversight Board) will soon devote substantial resources to the standard audit project in the area of revenue recognition and that we will be able to issue a proposal on auditing revenue with sufficient lead time to allow new accounting and auditing standards to become more effective at or around the same time". On September 16th, 2014, the PCAOB issued Staff Audit Practice Alert No 12 to address significant audit deficiencies noted by PCOAB Inspection Staff in which auditors did not perform significant auditing procedures with respect to revenue. The Inspection Staff noted instances where the auditors did not perform sufficient audit procedures to review the company's contracts and, as a result, did not sufficiently understand contractual terms and conditions such as transfer of title, risk of loss, delivery, and acceptance terms. Revenue recognition often involves accounting estimates, such as estimates of future obligations under the terms of sale in the contract. The practice alert states that if the accounting estimates are a fair value measurement, the auditor should apply the requirements of AU Section 328 (Auditing Fair Value Measurement and Disclosure). For other estimates, such as when auditing accounting estimates used in recording revenue in transactions involving performance obligation, the auditor should use AU342. IFRS 15 specified the accounting treatment for all revenues arising from contracts with customers. It applies to all entities that enter into a contract to provide goods or services to their customers unless contracts are in the scope of other IFRSs such as IAS 17 leases.

SAB 101 provides the criteria for revenue recognition income statement presentation and requires disclosures concerning revenues reported in the financial statements. On May 28, 2014, the Financial Accounting Standard Board (FASB) and International Accounting Standard Board (IASB) jointly adopted a converged accounting standard on Revenue Recognition. The new Revenue Recognition guidelines replace nearly all previous US GAAP and International Financial Reporting Standard (IFRS) guidelines that require significant flexibility and changes in the way US companies recognize revenue in their financial statements. The new revenue recognition standard that replaces most of the detailed guidance on revenue recognition framework will apply to almost all firms reporting under IFRS and US GAAP. It requires that firms across all industries use a new five-step model to recognize revenue from customer contracts. It will affect different firms in different ways. The new standard is one of the most important reporting metrics that will impact many firms in different ways. Firms that sell products and services in a bundle or those that are engaged in major projects such as in telecommunication, software, engineering, construction, and real estate could see significant changes to the timing of revenues. The new standard requires any company or business that enters into a contract with customers to transfer goods or services into a contract for the transfer of nonfinancial assets unless the contract is within the scope of other standards. The new

standard the IASB (International Accounting Standard Board), IFRS 15 (International Financial Reporting Standard No.15), and US-Based FASB (Financial Accounting Standard Board) specify how and when an IFRS reporter will recognize revenue as well requiring such firms to provide users of financial statements with more information and relevant disclosures. This standard provides a single, principle-based five-step model to be applied to all contracts with customers.

ASU 2014-09 is a result of a convergence project between the two Boards. Russell Golden, the Chairman of the FASB, states that the new revenue recognition standard represents a milestone that will eliminate a major source of inconsistency in the US-GAAP, which currently consists of numerous desperate industry-specific pieces of revenue recognition guide. As firms work to adopt the FASB's new revenue standard (ASU2014), it is imperative that the internal considerations mandate of Sarbanes Oxley Act section 404 be the focal point. Security filing data show that revenue recognition is one of the most common accounting issues that trigger a material weakness. These data emphasize the importance of focusing on internal control and the impact of adopting the new revenue standard. The SEC Chief Accountant Wesley Bricklersays" it is hard to think of an area more important than ICFR (Internal Control over Financial Reporting).

In 2009 General Electric (GE) settled accounting fraud with the Securities and Exchange Commission in which its accounting staff worked diligently to conceal the negative impact its inability to meet predetermined earnings projections would have in its financial statement. On April 4, 2009, GE settled the accounting fraud charges for allegedly misleading investors with improper hedging accounting revenue recognition scheme by accelerating revenue recognition from its locomotive and aircraft spare part business. On December 18, the SEC charged Digital Media Company and its three executives for their role in an accounting fraud that artificially inflated the company revenue and misstated its operating income to the investors**.** Green (2003) notes that understanding when revenues are recognized is the first step to comprehending the quality of the revenue stream. He argues that revenues of the highest quality are those that are recognized after the customer has received, accepted, and paid for the product or services without any further performance requirements or

contingency. The former SEC chairman, Arthur Levitt, identified revenue recognition guidelines as a popular way for companies to manage earnings prematurely. He argues that premature revenue recognition reduces the quality of reporting earnings, particularly if those revenues never materialize.

(Green 2003)Corporate executives tend to believe that manipulating earnings and presenting a fraudulent financial report to meet a predetermined level of earnings would increase firm value, earnings per share, market price per share, and favourable bond rating. This may have a short-term effect, but in the long run, it will have an exactly opposite effect on firm value, etc. Sarbanes-Oxley Act examines the role of the board of directors in constraining earnings management (Klein 2002). Sarbanes-Oxley Act enacted provisions that deal with the rules governing corporate governance in general and the board of directors, in particular, that should include likely constraint earnings manipulation. Sarbanes-Oxley Act reiterates the importance of ensuring that financial statements are free of material misstatements due to error or fraud. The Sarbanes -Oxley Act is the most sweeping regulatory reform since the creation of the SEC in 1943. The Act mandates that the SEC regularly and systematically review the disclosures of companies that have securities on a national securities exchange and particularly those firms that have issued material restatements of financial results or those that have experienced significant volatility in their stock price as compared to other listed companies. The Act also mandates that each periodic SEC financial statement report should be accompanied by a written statement by the issuer's Chief Executive Officer and Chief Financial Officer certifying that the report fully complies with the 1934 Act and that information contained in the periodic report "fairly presents, in all material respects, the financial condition, and results of the issuer".The PCAOB (Public Company Accounting Oversight Board) notes in the alert that misstatement of revenue is a common ploy in many financial fraud cases. According to PCAOB, a 2010 report of a- ten- year study by the COSCO (Committee of Sponsoring Organization of the Tradeway Commission) of Accounting and Enforcement Action by Security Exchange Commission found that 61% of 347 cases involve gaming or fabricating revenue, is the most common method used to improve the appearance of financial statements.

Fama and Jensen (1983) argue that separating the positions of the chief executive officer and the chairman of the board would improve board monitoring and organizational performance by providing an independent check on the chief executive officer position. They further state that firms that have the same person holding these two positions are less likely to have effective monitoring, which reduces the likelihood of constraining earnings manipulation. Visvanathan (2008) reports that much attention has been focused upon the role of the board of directors and audit committees in overseeing the activities of corporate executives in particular instances of earnings manipulations. Management can significantly alter the earnings to deceive the investors and Wall Street that earnings or certain financial goals have been met. Visvanathan (2008) says that much of the attention is focused on accrual type earning management such as aggressive revenue recognition, misstatement of inventories, and accounts receivable. Receivables should be recorded at the present value of the receivables of the future cash receipts using a realistic discount rate or cost of capital. However, because the difference between present and future of accounts receivable often is immaterial, therefore APB 21 excludes accounts receivable from the general rule that receivable be recorded at present value. The accounts receivables are initially valued at the exchange price agreed upon by the buyer and seller. Ross (2005) states that in many cases of fraud, companies try to manage their appearance by inappropriately reporting fictitious revenue and by failing to report expenses as they occur. The author argues that without egregious transgressions, companies can take full advantage of two types of legitimate latitude, operational freedom and reporting freedom accorded them by the Generally Accepted Accounting Principles.

The infamous Enron, a natural gas trading company, used varieties of accounting techniques such as the mark to market, structured financing vehicles, and special purpose entities. Enron employed a mark-to-market accounting technique to recognize revenue. Mark-to-market is defined as the act of assigning value to an asset based on its present value or current market value of future cash inflows. Enron would recognize revenue using the present value of future cash flows of long-term contracts the company signed and matched the expense and using the present value of future cost. Enron reported unrealized gains and losses in the market later on as part of earnings as they occurred.

Structured financing was utilized by Enron to hedge against credit risk, interest risk, and liquidity risk exposures. Enron failed to report the varieties of the structured financial vehicles in its financial statements, which were designed to permit Enron to recognize the financial benefits of the structured finance immediately even though the federal income tax benefits would not occur until significantly over into the future. Structured finance is a form of securities securitization in which corporations and financial institutions package assets, loans, and mortgages into a standardized security-backed by those assets, loans, or mortgages that can be traded like any other securities. The corporation and financial institutions act as servicing agents for the securitized assets.

II. CONCLUSION

Accrual-based accounting can be complex, challenging, and difficult to manage. Without the proper or adequate infrastructure in place to manage the accrual-based accounting, mistakes and abuse of the accrual accounting are likely to occur. In the phase of confusion, accrual accounting eventually leads to accounting and financial statement deceptions. On the other hand, accrual accounting helps firms to create budgets and predict sales which are essential to the operational activities of firms. Accrual accounting the firms a better sense of their overall financial health.

In most instances, an entity will be able to make estimates of stand-alone selling prices that represent management's best estimate considering observable inputs. However, it could be more difficult if goods or services are not sold independently by the entity or others. Current IFRS does not explicitly address the accounting for multiple-element arrangements, which has resulted in diversity in practice. IFRS 15 provides detailed requirements for transactions with multiple elements but does not eliminate the need to exercise judgment to determine the appropriate performance obligations and allocate the consideration to those performance obligations.

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