

In my last article on Financial statement fraud, I had emphasized on various ways the financial statement fraud can be done in brief. In this, I would present various way in which revenue recognition can be done at the advantage of the company for meeting various objectives.

As per research done by one of the big audit firm, revenue recognition is the major ways for fabricating the books. Revenue recognition fabrication can be done in two ways

- 1) Actual revenue recorded not in conformity of accounting standard
- 2) Fraudulent revenue recognized.

As per Accounting Standard 9 – Revenue to be recognized if it satisfy the following criteria

In a transaction involving the sale of goods, revenue to be recognized when:

- (i) the seller of goods has transferred to the buyer the property in the goods for a price or all significant risks and rewards of ownership have been transferred to the buyer and the seller retains no effective control of the goods transferred to a degree usually associated with ownership; and
- (ii) no significant uncertainty exists regarding the amount of the consideration that will be derived from the sale of the goods.

In a transaction involving the rendering of services, performance should be measured either under the completed service contract method or under the proportionate completion method, whichever relates the revenue to the work accomplished. Such performance should be regarded as being achieved when no significant uncertainty exists regarding the amount of the consideration that will be derived from rendering the service.

Thus the people plays with the rule of the game to increase sales.

With increase concentration of companies to meet the earning guidance, shareholder expectation, analyst expectation people are resorting to fraudulent means and if not fraudulent they are tweaking the rules for their advantage.

There are various ways in which the revenue recognition standard are tweaked. Some of them are

1. Recognising sales before actual delivery of goods to the customer's.
2. Recognising sales on the receipt of purchase order pending dispatch
3. Recognising sales when goods are dispatched but not reached the customer premises
4. Recognising sales when goods were sent to agent for delivering the same to the customer
5. Recognising full sales when there is a provision for return
6. Recognising of sales without providing for guarantee/ warantee

7. Recognising of sales in the current quarter whereas delivery happened after the cut off period
8. Recognising sales by getting into agreement with the customer to return the goods if not sold completely.
9. Recognising sales by altering the estimates, provision and cost in case of services.
10. Recognising other income as sales
11. Recognising sales of capital assets as sales.
12. Recognising cash discounts as sales
13. Recognising fictitious sales
14. Not recognising the current quarter sales and keeping them in reserve for future know as cookie jar reserve
15. Recognising sales even though there is a doubt / uncertainty over recovery
16. Recognising test samples given to customer as sales
17. Recognising sales by asking dealer to stock more and return after a cut off period
18. Recognising sales by over billing and thereafter the credit memo raised not reduced from sales and accounted differently

Thus it can be seen that there are various ways by which the sales can be improved by tweaking the sales policy at their advantages. it would be very difficult to identify the genuine sales out of total sales without proper investigation and since for accuracy of statement people would rely on the audit report. In the era of sample verification and random checking it is quite possible that the items listed above can be missed by the auditors.

there is no exhaustive list, it depends on one person imagination. Important thing is that more and more companies are resorting toward sales fabrication for achieving sales target. The reason for doing so may be incentive and or pressure.

Top management are rewarded based on book performance who are having more motivation to resort to such practices. It would be very difficult to identify by a laymen, investor, shareholders etc if the first line of defense i.e auditors are not following the proper guidelines for audit.

We (investor / shareholder, creditors) are always at the mercy of the management for following right practices.

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