

Revenue recognition



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Generally Accepted Accounting Principles:

Generally Accepted Accounting Principles (GAAP) are general guidelines, which instruct firms on how to form their financial statements and how to accurately measure their profit levels. Generally Accepted Accounting Principles (GAAP) forms a conceptual framework that defines the nature and purpose of accounting and provides a theoretical framework regarding the manner in which transactions should be treated. The principles governing accounting procedures, however, may be amended or changed over time, and this may mean that new rules are devised regarding how transactions should be measured, reported, and presented to users (Hodgdon et al, 2009). There should be consistency in the principles used for accounting purposes to promote reliability in financial statements and ensure that all transactions are treated equally by all firms, otherwise there are high chances of financial statements being inaccurate (Wustemann & Kierzek, 2005). The essay will describe the principles of revenue recognition, the difference between “ income” and “ revenue”, measurement issues between historical cost and value, matching of revenue and expenses, and the differences between the previous conceptual framework and the amendments made in the new revenue recognition model. The essay will conclude with a summary of the main points made in the answer and an analysis of whether the new proposed model has caused concern to respondents.

The principles of accounting form a framework that enables users to properly understand the data included in financial statements and make it useful. It enhances the relevancy of the information, makes it free from error, neutral,

and comparable to the financial statements of other firms. One of the current issues prevailing in accounting standards includes the issue of the principles of revenue recognition. (Schipper et al, 2009).

iAS 18 and New Proposals Made:

There are two main revenue recognition standards which include iAS 18 Revenue and iAS 11 Construction Contracts. However, the main problem with these revenue recognition models is that they may be difficult to comprehend and their application may also be a hassle. Moreover, iAS 18 does not thoroughly provide guidance on the topic of revenue recognition arrangements which have multiple elements. The IASB has decided to revise the accounting standard on revenue recognition as inconsistencies and weaknesses exist in the standard. The proposals for improvement in iAS 18 include removing inconsistencies and weaknesses in the existing revenue recognition framework, improving the standard of comparability of revenue recognition practices across industries, disclosing more vital information in financial statements, and the simplification of the preparation of financial statements.

One of the main important distinctions made in the revenue recognition model is the distinction between “ income” and “ revenue”. Income is defined as the economic benefits that a firm may generate in the course of an accounting period which include an increase in the inflows or the value of assets or the decrease liabilities that in turn increases equity. This does not include the additional contributions made by existing and new equity holders. However, revenue is defined as the income that arises in the course of ordinary activities of an entity such as the sale of goods etc. The

prevailing issue in accounting standards is when to recognize revenue and how to measure it reliably. According to the new accounting standard, revenue is recognized through the selling goods, the provision of services, and third party's using the entity's assets which results in yielding interest, royalties, and dividends. Another major issue in the revenue recognition model is how to measure assets or liabilities and whether to measure them at cost price or at value. Using the cost method may be considered reliable as the cost is known, yet the problem arising in the use of cost is that it relies on past figures (Cairns, 2006). Using the value method may be considered more useful or reliable as it uses up-to-date information but may not always be accurate as the current value of assets or liabilities may vary in measurement from firm to firm (Cairns, 2006).

According to IAS 18 (Olsen & Weirich, 2010) revenue shall be measured at fair value which is the amount at which an asset or liability can be settled between two knowledgeable willing parties in a transaction conducted at arm's length. There are various conditions which result in the recognition of sales, such as when the entity has transferred to the buyer the significant risks and rewards associated with the ownership rights of the goods, the entity holds no managerial or controlling rights over the goods sold, the revenue generated and calculated from the sales can be measured reliably, the entity will benefit from the economic benefits of the transaction, and the costs incurred with respect to the transaction can be reliably calculated (Olsen & Weirich, 2010).

Problems with Proposed Standard:

The costs associated with each of the transactions must be matched to the revenue generated and these costs are categorized as expenses. Each sale results in the occurrence of an expense which must be recognized in coordination with the revenue generated and put in its respective category in order to ensure the balancing of the income statement. However, the new proposed standard has given rise to significant feedback from users which includes the suggestion that while the recognition of revenue generated through selling goods, includes the transfer of control or an assessment of whether risks and rewards have been transferred, it should also include a collectability clause (Olsen & Weirich, 2010). However, other respondents have asked “transfer of control” to be particularly defined before it is included in the model (Wagenhofer, 2013).

While the new revenue recognition model provides a detailed basis for accounting standards and has defined a wide scope for the proper classification of transactions, the feedback received has suggested that the model is too complex and confusing for immediate implementation as it is inconsistent with previous frameworks and would require practice and getting used to in implementation. Moreover, other users have also mentioned that the model requires additional information regarding the meaning of certain rules and terms in order to be accurately implemented and used within all firms such as the meaning of “collaborator”. It is suggested that the Board review the new accounting principles that it has introduced and provide detailed explanations and examples of how to appropriately apply the standards to financial statements. It is also highly suggested that in order to improve the applicability of the new revenue recognition model, the inconsistencies between the previous model and the <https://assignbuster.com/revenue-recognition/>

new model must be removed, the terms used in the new model must be clarified, and the suggested additions may be made.

References

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