

Fasb revenue recognition



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Legal Plan Services offers an intangible product to its Intangible means that the product can not be touch in any way. The are receiving services from a lawyer by signing a monthly, semiannual or yearly subscription fee contracts. The customers are buying in advance a certain amount hours of legal advice from a lawyer that they may used when needed. If a case was too complex and required more hours that stipulates the contract, the customers have an automatic 25% discount from the lawyer’s regular hourly rate.

The generally accepted accounted principles (GAAP) establish the standards, rules and procedures which accountants must follow when realizing bookkeeping and accounting work. The GAAP framework is developed through a series of assumptions, principles and constraints. Two important principles Legal Plan Services should keep in mind are revenue recognition principle and the matching principle for expenses. The revenue recognition principle stipulates that revenues should be recognized when the work is realizable and earned. Receiving cash does not imply the business has performed the work. “ Expenses are recognized not when the work is performed, or when the product is produced, but when the work or product actually makes its contribution to revenue” (Wikipedia). Administration expenses do not follow the matching principles since they are not directly linked to the creation of specific revenue, they are considered period costs. The best way for Legal Plan Services to present a report that clearly presents the amount of revenues and expenses in a reliable, comparable and consistent manner is through the financial statement called income statement. The income statement is divided into two parts within the report. At the top of the report revenues are illustrated, while the bottom part gives

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the user information about the expenses the company incurred. In the income statement the company should include notes to the statement to explain the practices utilized for creating revenues and recognizing expenses.

The company has serious flaws in both its revenue and expense recognition methodology. The company is collecting money from customers for a service they will provide in the near future. This event behaves like unearned revenue. Unearned revenue is sometimes referred to as deferred revenue (Weygandt & Kieso & Kimmel, 97). In the ledger of the company the journal entry would be a debit to cash and a credit to unearned revenue. At the time the company provides the service the journal entry would be a debit to unearned revenue and a credit to earned revenue. Unearned revenue is a liability which is reflected in the company's balance sheet. The current practice is misleading to users of the financial statement since income is being inflated by being recognized before it is earned.

A flaw within the expense recognition scheme is categorizing payments to law firm providers as a period cost. The law providers are performing the work for the clients. An exact correlation has to be established each instance a work is performed with the source that generated the revenue. The compensation method for sales associate which creates a commission advance receivable is not a legitimate accounting practice. The company is creating an asset out of an expense. My recommendation is to eliminate this method.

Legal Plan Services needs a complete restructure of its accounting system. The nature of the transactions might be a little complex, but in reality the subscription system is no different than a magazine subscription scenario. A

good method to implement to facilitate the matching between revenues and expenses is a job costing system. Immediate remedial actions are necessary to fix the accounting department. If the company continues its current practices they may face serious consequences such as fines, lawsuits or criminal fraud charges brought against them. The practices could also hurt the reputation of the business if they become public knowledge which could lead to a loss of important revenue generating accounts.

Legal Plan Services provides a great intangible product to the customers. The company is lowering the cost of buying legal advice by offering subscription based plans. Currently there are some issues with the accounting practices of the company. The accounting profession follows certain rules based on generally accepted accounting principles (GAAP). The two areas of concern are revenue and expense recognition.

The company is recognizing revenue before it has earned it. When a business receives cash, it does not necessarily mean they created a revenue. At the time the lawyers actually provide the service the revenue creation occurs. In order to fix the problem the accounting department has to recognize the subscription packages as unearned revenue. This does not affect the cash position of the company. The unearned revenue will turn into earned revenue when the service to the customer is provided.

The expenses the company is incurring are not being recorded properly. An expense has to enter the accounting books to match the sales related to them. Right now the company pays the lawyers providers, but when the payment is made there is no way to know within the accounting system what customer caused the expense.

The company must immediately fix these accounting problems. Our financial

statements are not reflecting true economic activity. It is reflecting more sales than we actually have obtained. Continuing with these practices could lead to serious consequences such as fines, litigation and fraud allegations. The problem has simple solution which can be implemented immediately. It is in the company's best interest to restructure its accounting practices.

Works Cited

Weygandt, Jerry J. and Kieso, Donald E. and Kimmel, Paul D. Accounting Principles, 6th edition. John Wiley & Sons. (2002): 1-1138.

Wikipedia. com. April 29, 2007. May 10, 2007.