Revenue is one of the most important figures to both preparers and users of financial statements—and is one of the most difficult to get right.

Now in a Second Edition, Wiley Revenue Recognition helps you confidently navigate and address the uncertainties in this intricate area of accounting. Accounting expert Steven Bragg provides not only a detailed view of the current accounting rules and regulations pertaining to revenue recognition, but also describes the exact sources of this information, how a company’s treatment of revenue recognition is to be disclosed alongside the financial statements, and what policies, procedures, and controls can be used to enforce it in a consistent manner.

Filled with new examples and disclosures throughout, this invaluable guide features cutting-edge coverage of:

- SEC Staff Accounting Bulletin 104, EITF 07-6, IAS 18, SIC 31, IFRIC 12,13, and 15
- The concepts of sale recognition when collection is uncertain
- When the right of product return exists
- The new GAAP Codification references
- Expanded coverage of IFRS and SEC reporting issues
- Complying with Sarbanes-Oxley by revealing key controls over revenue recognition
- All aspects of revenue recognition, including control systems, supported by extensive examples
- The most complex revenue recognition concepts
- Descriptions of control points throughout the book
- Revenue recognition for various industries, including franchising, construction, motion pictures, not-for-profits, real estate, recording and music, services, and software

Wiley Revenue Recognition is a thorough introduction to every aspect of revenue recognition—how to account for it, report it, and set up systems and controls to ensure that the rules are properly followed. With practicable, workable advice, this authoritative guide will assist you in consistently recognizing revenue in the correct amounts, at the right time, and in accordance with generally accepted accounting principles.

STEVEN M. BRAGG, CPA, has been the chief financial officer or controller of four companies, as well as a consulting manager at Ernst & Young and auditor at Deloitte. He is the author of over thirty books primarily targeted toward controllers and their needs. He received a master’s degree in finance from Bentley College, an MBA from Babson College, and a bachelor’s degree in economics from the University of Maine.
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PREFACE

Revenue recognition is of critical importance to anyone in the business world, since it drives a large part of the perception of a company’s value, which is reflected in its stock price. This in turn impacts the returns of investors and any earnings of employees that are tied to stock options. Given these pressures, it should be no surprise that the outer boundaries of revenue recognition rules are constantly being explored by company managers, which has led to the bulk of all cases of financial fraud.

Revenue Recognition not only provides a detailed view of the current accounting rules and regulations pertaining to revenue recognition, but also describes the exact sources of this information, how a company’s treatment of revenue recognition is to be disclosed alongside the financial statements, and what policies, procedures, and controls can be used to enforce it in a consistent manner.

Revenue recognition rules vary not only by type of transaction, but also for some industries. Accordingly, the chapters of this book are clustered into transaction-related revenue recognition rules, and then into industry-related revenue recognition rules. Chapters 1 through 5 cover revenue recognition for transactions, including general principles, when collection is uncertain, when there is a right of return, and when there are multiple deliverables. These chapters include commentary about the revenue recognition positions of the Securities and Exchange Commission, as well as international financial reporting standards.

Chapters 6 through 13 then address revenue recognition for the following industries:

- Franchising
- Construction
- Motion pictures
- Not-for-profits
- Real estate
- Recording and music
- Services
- Software

Chapter 14 addresses a variety of miscellaneous topics too small for separate chapters, such as loan guarantee fees, sales with guaranteed resale values, advertising barter transactions, sales incentive plans, and so on.

This book is intended to be a source book for all aspects of revenue recognition—how to account for it, report it, and set up systems and controls to ensure that the rules are properly followed. Hopefully, Revenue Recognition will assist you in consistently recognizing revenue in the correct amounts, at the right time, and in accordance with generally accepted accounting principles.

Steven M. Bragg
Centennial, Colorado
March 2010
ABOUT THE AUTHOR

Steven Bragg, CPA, CMA, CIA, CPIM, has been the chief financial officer or controller of four companies, as well as a consulting manager at Ernst & Young and auditor at Deloitte & Touche. He received a master’s degree in finance from Bentley College, an MBA from Babson College, and a bachelor’s degree in economics from the University of Maine. He has been the two-time president of the Colorado Mountain Club, and is an avid Alpine skier, mountain biker, and certified master diver. Mr. Bragg resides in Centennial, Colorado. He has written the following books:

Accounting and Finance for Your Small Business
Accounting Best Practices
Accounting Control Best Practices
Accounting Policies and Procedures Manual
Billing and Collections Best Practices
Business Ratios and Formulas
The Controller’s Function
Controller’s Guide to Costing
Controller’s Guide to Planning and Controlling Operations
Controller’s Guide: Roles and Responsibilities for the New Controller
Controllership
Cost Accounting
Cost Reduction Analysis
Essentials of Payroll
Fast Close
Financial Analysis
GAAP Guide
GAAP Policies and Procedures Guide

FREE ONLINE RESOURCES BY STEVE BRAGG

Steve issues a free bimonthly accounting best practices newsletter and an accounting best practices podcast. You can sign up for both at www.stevebragg.com, or access the podcast through iTunes.
OVERVIEW OF REVENUE RECOGNITION

The principles guiding recognition of revenues for financial reporting purposes are central to generally accepted accounting principles (GAAP) and International Financial Reporting Standards (IFRS) and in most instances are unambiguous and straightforward. In fact, the underlying principles have not changed in decades. However, as business transactions have become more complicated over time, GAAP and IFRS have expanded to include detailed rules for certain types of revenue recognition issues. Revenue recognition for GAAP is now aggregated under Topic 605 of the Accounting Standards Codification, while the same topic is somewhat more dispersed among IFRS source documents. This book summarizes these issues by topic and industry, covering such industries as motion pictures, software development, franchising, and real estate, while also addressing such cross-industry topics as situations when there is a right of return, or if collection is uncertain.

Each chapter begins with an overview of the topic, definitions of key terms, and a discussion of the key revenue recognition issues. If GAAP or IFRS mandates or recommends disclosure of revenue recognition information alongside the financial statements, then these disclosures are also noted, along with examples. Finally, a number of policies, procedures, and controls are covered that can support the systems needed to accumulate and report revenue transactions. These supporting systems are quite necessary, in light of the fraudulent reporting problems that are discussed later in this chapter.

REVENUE RECOGNITION GENERAL GUIDELINES

Revenue, whether from the sale of product or provision of services, is to be recognized only when it has been earned. According to the Statement of Financial Accounting Concepts No. 5 (CON 5), Recognition and Measurement in Financial Statements of Business Enterprises,

...(a)n entity’s revenue-earning activities involve delivering or producing goods, rendering services, or other activities that constitute its ongoing major or cen-
tral operations, and revenues are considered to have been earned when the entity has substantially accomplished what it must do to be entitled to the benefits represented by the revenues.

In other words, in order to be recognized, revenue must be realized or realizable, and it must have been earned.

CON 5 notes that “the two conditions (being realized or realizable, and being earned) are usually met by the time product or merchandise is delivered or services are rendered to customers, and revenues from manufacturing and selling activities and gains and losses from sales of other assets are commonly recognized at the time of sale (usually meaning delivery).” Moreover, “if services are rendered or rights to use assets extend continuously over time (for example, interest or rent), reliable measures based on contractual prices established in advance are commonly available, and revenues may be recognized as earned as time passes.” In other words, for most traditional and familiar types of transactions, the point at which it is appropriate to recognize revenue will be quite clear.

The SEC’s Revenue Recognition Criteria

The Securities and Exchange Commission (SEC), reflecting on the conceptual foundation for revenue recognition, observed in Staff Accounting Bulletin 104 (SAB 104), that

Revenue generally is realized or realizable and earned when all of the following criteria are met:

1. There is persuasive evidence that an arrangement exists,
2. Delivery has occurred or services have been rendered,
3. The seller’s price to the buyer is fixed or determinable, and
4. Collectibility is reasonably assured.

Note that while SEC rules and “unofficial” guidance are not necessarily to be deemed GAAP for nonpublic companies, to the extent that these provide insights into GAAP standards, they should always be viewed as relevant guidance and followed, absent other, contradictory rules established under GAAP. In the absence of any other source found in the GAAP rules, SEC pronouncements may represent the best thinking on the subject and are considered authoritative for all reporting entities.

With regard to the four criteria set forth above, consideration should be directed at the following discussion, which is drawn partially from SAB 104.

Persuasive Evidence of an Arrangement

First, regarding persuasive evidence of an arrangement, attention must be paid to the customary manner in which the reporting entity engages in revenue-producing transactions with its customers or clients. Since these
transactions are negotiated between the buyer and seller and can have unique or unusual terms, there are (and can be) no absolute standards. Thus, for an enterprise that traditionally obtains appropriate documentation (purchase orders, etc.) from its customers before concluding sales to them, advance deliveries to customers, even if later ratified by receipt of the proper paperwork, would not be deemed a valid basis for revenue recognition at the time of delivery.

Example

The Minnetonka Motor Company has a new plastic engine available to ship to customers before the end of the current fiscal year. Wilson Trucks places an order for the new engine, and Minnetonka delivers the engine prior to the end of the year. Minnetonka’s customary business practice is to require a signed sales agreement that must be signed by an authorized customer representative. Minnetonka issues the sales order, but the only person at Wilson authorized to sign the agreement is its president, who is on vacation. Wilson’s purchasing manager has orally agreed to the contract and stated that it is highly likely that the president will sign the agreement upon his return from vacation.

Based on this scenario, the SEC does not believe that Minnetonka can recognize revenue in the current fiscal year, on the grounds that this arrangement has departed from Minnetonka’s current business practice. In particular, the sales agreement is subject to a subsequent approval, which has not yet been obtained.

When evaluating purported revenue transactions, the substance of the transactions must always be considered, and not merely their form. It has become increasingly commonplace to “paper over” transactions in ways that can create the basis for inappropriate revenue recognition. For example, transactions that are actually consignment arrangements might be described as “sales” or as “conditional sales,” but revenue recognition would not be appropriate until the consigned goods are later sold to a third-party purchaser.

Example

The Brass Fittings Company, maker of finely machined plumbing fittings, enters into an arrangement with Monaco Plumbing to deliver its products to Monaco on a consignment basis. The agreement specifically states that Monaco is the consignee, and that title to the products does not pass from Brass to Monaco until Monaco uses the fittings in its operations. Brass delivers product to Monaco and wants to recognize revenue at the time of shipment.

Based on this scenario, the SEC would not allow revenue recognition by Brass Fittings, on the grounds that products delivered to a consignee under a consignment arrangement are not sales and do not qualify for revenue recog-