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RISK ASSESSMENT AND RELEVANT PROCEDURES IN ORDER TO MITIGATE THE RISKS FOR THE REVENUE RECOGNIZED IN LINE WITH IFRS 15

Student PhD Nicolai JIERI
Stefan cel Mare University of Suceava, Romania
colea93@yahoo.com

Abstract
The accounting policies are designed by the accounting team and are mandatory to follow in order to be in compliance with the framework used by the company. More than this, the accounting policies are mandatory to be indicated in the financial statements at the reporting date. We are referring in this research to companies which apply IFRS as a reporting framework. Therefore, IFRS 15 in such financial statements should be described, applied, and disclosed. As an assurance to the financial team that the accounting treatment for the revenues recognized is correct, a control approach should be adopted. The process of control should contain several subphases, such as risk identification, level of the risks identified, set of materiality, and defining the procedures which would address the risks. Through this exercise, the risks identified would be mitigated to the accepted level. Therefore, the conclusions should be taken based on the completed control procedures.

Keywords: *revenue; control; risk assessment; IFRS; reporting; procedures*

JEL Classification*:* *M41*

I. INTRODUCTION

The research is focused on the IFRS reporting framework, especially the study of revenue behavior and the analysis of the rules for their placement in accounting, as well as in the entity's financial statements. As previously mentioned, IFRS reporting is a significant step toward accounting standardization, and it is widely recognized as one of the most helpful images for asset valuation, recognition, and presentation. The authors discovered that companies that use IFRS reporting have a better developed corporate culture that is focused on both quality and market expansion as a result of their research. Since the IFRS reporting structure is always changing, there are always certain difficulties in practice. The main barriers to the adoption of IFRS in Europe, America, and the rest of the world include cultural, mental patterns, legal constraints, educational demands, and political influences, not necessarily technological issues (Obazee, 2007). Implementation challenges, according to Rong-Ruey Duh (2006), include timely interpretation of standards, ongoing IFRS modification, accounting knowledge and experience possessed by users of financial statements, trainers, auditors, and regulators, and management incentives (Ball, Robin & Wu, 2000; Grosu & Socoliuc, 2016). Harmonization and transitioning from one tradition to another is challenging due to historical variations in accounting thought, context, ethos, and practice in Anglo-Saxon, continental, and South American Europe (Nobes, 1983; Ball, 1995).

Despite the fact that IFRS has the potential to improve cross-border comparability, increase reporting transparency, reduce information costs, reduce information asymmetry, and thus increase liquidity, competition, and market efficiency. Researchers (Ball 2006; Choi & Meek 2005; Armstrong, Riedl, Barth & Jagolinzer, 2007; Soderstrom & Sun, 2007) found out that cultural, political and business differences may continue to pose significant obstacles to progress towards a single global financial communication system, as a single set of accounting standards cannot reflect differences in national business practices arising from differences between institutions and cultures. Users perception of IFRS quality is essential for the adoption of this reporting framework. For example, in a survey conducted by McEnroe & Sullivan (2011), individual investors were satisfied with the current US accounting model and don't want to move towards the adoption of IFRS. Similarly, Winney, Marshall, Bender & Swiger (2010) found that small businesses in the US were not prepared for IFRS because they didn't see benefits in moving from the reporting framework to IFRS.

The entity's management is in charge of the financial statements' accuracy and completeness. In this view, the entity's whole management is responsible for establishing rules and levers for identifying and decreasing risks to an acceptable level. The risk of substantial revenue misstatement is the risk of a material misrepresentation in the revenue account, but internal revenue controls can't avoid or detect such misstatements, thus it's a combination of inherent and control risk. Internal auditors should analyze the risk of substantial misrepresentation of revenue and design suitable audit procedures to address the risk. Furthermore, if both the inherent and control risks are high, resulting in a high risk of material misstatement, the risk of detection must be minimized as much as possible to maintain an acceptable level of audit risk.

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However, given that this research is more focused on the details of IFRS 15 “Revenue from Contract with Customers”, the author will further describe the main risks of non-compliance in terms of recognition, measurement and presentation of revenue in financial statements.

II. Practical Aspects Of Assessing Non-Conformity Risks In Revenue Recognition In Accordance With IFRS 15

The role of an internal audit department is to audit revenue by testing various audit statements, including appearance, completeness, accuracy, and limitation. Among these statements, the occurrence may be the most important statement as a significant distortion of revenue, usually due to overvaluation, rather than underestimation. This is because the company usually wants to display higher revenue than it actually is, especially when it has the incentive to over valuate revenue. Also, the most common inherent risk related to revenue is the distortion that may arise due to the incentive or pressure of management to receive a certain level of sales or to obtain a certain level of profit from the bottom line.

Revenue is an important financial element in the profit and loss account, because it is one of the two major business processes of the company, in which another buys. For this reason, revenue is usually the significant element of the financial situation.

When a firm deals with numerous complicated sales transactions in its business, such as those that make it difficult to establish when they happened and complete the sales, the inherent risk is generally significant in revenue audits. The focus in this situation is generally on revenue recognition, as considerable misrepresentation due to error or fraud might readily occur.

The authors here offer a complex case study, following which users will be much more familiar with the matrix of risks on revenues in an entity, as well as their minimization through procedures, to an acceptable level.

Case Study: Consider the company we operate has an IT and telecommunications profile. The IT&TM firm has been operating in the global market for over 50 years, has a solid reputation, and is recognized among the top 20 companies in the sector worldwide. The firm has the following business segments in aggregate lines:

- Managed services - provides network and IT managed services, Network Design & Optimization (NDO) and Application Development & Maintenance (ADM)
- Digital services - provides solutions primarily in the areas of digital Business Support Systems (BSS), Operational Support Systems (OSS), communication capabilities, core clout, and cloud infrastructure.
- Networking - Networking solutions support all radio access technologies and provide hardware, software and related services for both radio access and transportation. Product-related services include design, tuning, network launch, and customer support.
- Emerging and other businesses - Emerging businesses are areas for investment based on the core business of IT&TM and R&D (IoT, iConectiv, Business Media, Red Bee Media). Most of the segment’s revenues are from IPR licensing.

IT&TM operates in several types of markets with different characteristics, influencing the revenue recognition approach, but we distinguish the following types of markets:

- Flexible market - IT&TM legal entity established in the country; stable currency, stable currency available on the market; lower interest rates, flexible financing options; zero to low risk of public disturbances or safety; tax legislation and laws are not rigid; free trade is encouraged and cash repatriation is possible; favorable results, low uncertainty; presence of global customers.
- Divided market - IT&TM legal entity established in the country; devaluation of the local currency, lack of stable currency; increasing interest and expensive financing options; there are business opportunities; medium to high risk of disturbances or public safety; tax legislation and laws are not rigid; free trade is encouraged and cash repatriation is possible; favorable results, medium uncertainty; global customers may be present.
- Direct market - IT&TM is not established in the country as a legal entity; devaluation of the local currency, lack of stable currency; raising interest rates and expensive financing options; small market with limited growth opportunities; high to very high risk of disturbances and safety issues; rigid tax legislation and laws; there are restrictions on free trade and repatriation of cash; favorable results, high uncertainty; global customers are not likely to be present.

The sales process is divided into three stages:

1. Qualifying the opportunity, i.e., identifying and managing any potential offers or events that generate revenue;
2. Negotiation with the client, i.e., the pre-sale process where the packages of proposals are offered to the client, which will be the basis of the potential contract. This stage includes the strategic pricing of products and the creation of price lists for customers;
3. The signing of the agreement: if the client agrees with the offers made by the client, an agreement will be signed.

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Task: Based on the above example, it is necessary to present the most important risks that may arise from the perspective of non-compliance with the recognition of revenue, considering the provisions of IFRS 15, for the IT&TM entity.

There should be no limits in terms of knowledge of the business with which the IT&TM company operates in the internal control and/or internal audit departments. All of the aforementioned information was provided by the author in order to show the entity's profile on the one hand, but also to emphasize that any risk identification begins with a proper understanding of the conditions on the other.

It is not essential to have quantitative information to identify the risks of non-compliance with the recognition principles; the risk may be determined from knowledge about the entire business, as well as the revenue generating cycle. As a first step after the general understanding of the business, the financial control department should ensure that a contract already signed enters into the performance phase of the performance obligation which should include no less than the following phases:

- Structuring the contract in the workflow, i.e. identifying the different deliverables in the contract with customers and translating them into system structures to ensure accurate revenue accounting;
- Evaluation of accounting treatment, i.e. performs an IFRS 15 assessment (5-step assessment according to the IFRS 15 model) for contracts in the scope;
- The configuration of the accounting treatment, when the above evaluation is completed, the accounting treatment for the identified performance obligations is established in each workflow in the accounting system (Entry Form);
- Execution and acceptance, once the client's firm commitment has been reached (order received), the agreed goods and/or services will be delivered to the customer (performance obligation) and revenue will be recognized.

Depending on the business model described, in order to improve internal control and/or audit functions, those departments would formulate a risk that needs to be reduced to an acceptable level by applying the procedures to be performed at least on the reporting date, which would preferably happen quarterly to have enough time to address potential deficiencies in a timely manner.

The risks identified in terms of revenue recognition for IT&TM have been identified and formulated as follows:

- *Risk 1:* "Ven-1" - Revenues are recorded at the incorrect value of the transaction - Accuracy assertion.
- *Risk 2:* "Ven-2" - Revenues are recognized in the incorrect period - Assertion of the separation of financial years.

It is known that the IT&TM entity applies the IFRS reporting framework, as IFRS 15 is based on a 5-step model, it is necessary to divide and allocate the above risks at each step of the model proposed by IFRS 15, so that it is stated the correct set of procedures for reducing internal audit risks to an acceptable level:

Table 1. Identification of the risks regarding the recognition of revenue under IFRS 15

"5-step" revenue recognition model according to IFRS 15	**Identified risks**
Step 1 "Identify the contract(s) with a customer"	"Ven-1.1" - Revenue is recognised for a contract that does not meet the criteria for establishing a contract with a customer [IFRS 15.9] "Ven-1.2" - Revenue value and schedule are incorrect because two or more contracts do not meet the criteria to account for a combination of contracts [IFRS 15.17]
Step 2 "Identify the separate performance obligations in the contract"	"Ven-2.1" - Agreed goods or services are not properly identified as performance obligations [IFRS 15.22] [IFRS 15.27a-b] [IFRS 15.29a-c] "Ven-2.2" - A substantive right exists and has not been identified as an obligation to enforce [IFRS 15.B40] "Ven-2.3" - Revenues are improperly recorded because goods/services are improperly identified or aren't identified as part of a separate set of goods/services. [IFRS 15.23a-b]
Step 3 "Determine the transaction price"	"Ven-3.1" - Revenues are not accurate because the variable consideration component of the transaction value is incorrect. [IFRS 15.47] "Ven-3.2" - Revenues are not accurate because the value payable to a component of the customer in the transaction amount is incorrect. [IFRS 15.47] "Ven-3.3" - Revenues are not accurate because the consideration of a

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"5-step" revenue recognition model according to IFRS 15	**Identified risks**
	significant financing component for a customer component of the transaction amount is incorrect. [IFRS 15.47]
Step 4 "Allocate the transaction price to the separate performance obligations"	"Ven-4.1" - The allocation of the transaction amount, including any variable consideration, to multiple performance obligations is inaccurate [IFRS 15.76] [IFRS 17.81] "Ven-4.2" - The determination of the independent retail price is inaccurate. [IFRS 15.76] [IFRS 15.78-9]
Step 5 "Recognise revenue when the entity satisfies a separate performance obligation"	"Ven-5.1" - Revenue is inaccurate because the transfer of control (i.e. when the customer gains control of the asset) has been incorrectly measured for each performance obligation [IFRS 15.31] "Ven-5.2" - Revenues recorded do not represent actual transactions that have taken place. "Ven-5.3" - The revenues recorded during that period are incorrect because the measure of progress towards meeting the performance obligation is incorrect.

Source: Prepared by the author based on the case study

Based on the risks identified and presented in Table 1, the finance department must formulate a set of procedures and apply them so that the risks are reduced to an acceptable level.

III. PROCEDURES TO REDUCE RISKS TO AN ACCEPTABLE LEVEL

In terms of revenue recognition in accordance with IFRS 15, it is clear that identifying risks by the internal audit and/or internal control departments is insufficient; it is also necessary to outline the procedures to be performed for each identified risk, so that it is reduced to an acceptable level.

The author suggests the following procedures for the IT&TM entity (see Case Study, section II):

1. Receive the purchase order and verify that the purchase order has been recognized in the product sales flow system. Identify the product sales flow number and the purchase order number.
2. Verify that all goods and services in the purchase order have been accurately recorded in the "product sales flow" system.
3. Verify with which customer the order is associated by identifying the customer program assignment plan ID.
4. Verify to which fulfillment assignment ID the purchase order is related, it is identified in the transaction recognition and valuation structure of the transaction revenue recognition (each ID has a separate tab for IFRS 15 assessment).
5. Once the above information has been retrieved, evaluate the order using the IFRS 15 "5 Steps" model, based on the same evaluation made by the specialized system.

Starting from procedure nr. 5 related to the "5 Steps" model of IFRS 15, we define the following procedures to be performed:

5.1 Step 1 "Identify the contract(s) with a customer" - Make sure there is a firm commitment by verifying a single set (or a combination of approved contractual documentation) to be in writing or by the IT&MT approved documentation process, resulting in all parties being committed to fulfilling the obligations. All the criteria described in will be met in order to be able to reserve orders. The contract documentation will take the following shape:

- The contract includes terms;
- The framework contract includes the terms of the contracts along with the purchase order received (the actual appeal is made through the purchase order);
- Additional amending act concluded during the contractual period, including the agreed amendments (scope, prices, and termination) to (a) or (b).

*5.2 Step 2 "*Identify *the separate performance obligations in the contract"* - Verify that the correct governance flow has been selected based on the solution type. The type of good (s) and/or service (s) agreed may be a standard solution or a complex solution. The goods and services of the Standard Solution are always considered a separate performance obligation because they are distinct from one to another, while a complex Solution is always classified as a performance obligation.

5.3 Step 3 "Determine the transaction price" - Determine the transaction price for the order by checking if the order is linked to a fixed or variable price transaction, but also check the following: whether the transactions include penalty conditions or customer compensation based on contractual penalty conditions; if there is a significant funding component; if there is a consideration to be paid to the customer.

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5.4 Step 4 "Allocate the transaction price to the separate performance obligations" - Determine the transaction price for the order by checking if the order is linked to a fixed or variable price transaction, but also check the following: make sure that the transaction price has been allocated to the correct independent selling price for each performance obligation identified in the order; if there is no incentive related to the order, then the system will match the prices in the customer price list, therefore the customer price list is used to check the price of the goods and / or services agreed in the order; if there is an order-related incentive (incremental discount), then the total price will not be equal to the prices on the customer price list. Therefore, the client's net price list should be used to verify the specific price for each identified performance obligation.

5.5 Step 5 "Recognize revenue when the entity satisfies a separate performance obligation" - Determine if there is approval from the customer of the delivered good and/or service regarding the agreed compliance in the contract. Identify the period of transmission of the performance obligation and compare it with the time of recognition of revenue in the accounting of the IT&MT entity.

IV. CONCLUSIONS

Internal control and/or internal audit functions are becoming more prevalent in organizations with a diverse activity profile, operating in a variety of markets and sectors. Internal audit's mission is to give independent assurance that a company's risk management, governance, and internal control procedures are functioning properly. In this context, the author considered it is necessary that in the research on IFRS 15 "Revenue from Contracts with Customers", in addition to the analysis and presentation of its key provisions, include the application part as a set of implementing measures for practitioners. Risks are present everywhere, both in business and in daily life, so identifying them is not enough. There are always procedures and ways to reduce the risks to an acceptable level to create the necessary comfort in terms of compliance.

Considering revenue fraud is essential. The entity's alerts highlight authority requirements and guidance on the responsibilities of an internal auditor in considering fraud along with an audit of the financial statements. These responsibilities are primarily related to the planning and conduct of the audit to obtain reasonable assurance about whether the financial statements are free from material misstatement, whether due to errors, omissions or fraud. In general, two types of misstatement are typically relevant to the auditor's consideration of fraud in an audit of financial statements: (a) misstatements resulting from fraudulent financial reporting and (b) misstatements resulting from misappropriation of assets.

Management must be aware of and diligently prepare for the three conditions that are generally present when fraud occurs: management or other employees have an incentive or reason to commit fraud; there are circumstances that provide an opportunity for fraud to be committed (such as the absence of controls, the existence of ineffective controls or the ability of management to override established controls) and; those involved in initiating and committing fraud are able to rationalize the commission of a fraudulent act.

Alerts should provide examples of fraud risks related to improper revenue recognition, such as: management's cancellation of the entity's controls over revenue recognition resulting in misstatement of revenue; premature recognition of revenue; registration of fictitious revenue; incorrect transfer of revenue in an earlier or later period; incorrect use of a portfolio approach to mask the results of an individual contract or a group of contracts with unfavorable results; non-recognition of unsigned or non-formal contracts or contracts involved in the entity's normal business practices; failure to identify all material performance obligations; handling estimates used in revenue accounting, such as (a) determinations of variable value, including coercive estimates of variable value (for example, management must assess the likelihood that a significant reversal of the value of accrued revenue recognized will not occur with the associated uncertainty with the variable consideration is subsequently resolved), (b) reserves for estimated returns and (c) estimates of independent selling prices of bundled goods and/or services.

The case study submitted by the authors can serve to create an internal control policy for users so that they can improve their internal control and/or audit function responsible for revenue recognition in accordance with IFRS 15.

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