

Hey! What's New? 2025-66

Evaluating Fraud Risks Related to Revenue Recognition

According to Gregory Jenkins, CPA, "identifying and assessing the risks of material misstatement due to fraud are among the most challenging aspects of auditing in recent years." Writing for the *Journal of Accountancy*, he says that "potential reasons include difficult economic and industry conditions during the post-pandemic era; changes in the workforce, including labor shortages (i.e., fewer employees doing more work); challenges associated with extensive remote-work arrangements for employees at organizations, including less oversight of employees; and disruptions to global supply chains and associated inflationary pressures."

Auditing standards, including, in the US, AU-C Section 315 and AU-C Section 240, are principles-based and allow auditors to exercise professional judgment in applying them. "That said, because revenue may be particularly susceptible to fraud and a number of past financial reporting frauds have centered on improper revenue recognition, AU-C Section 240.26 includes a requirement that "When identifying and assessing the risks of material misstatement due to fraud, the auditor should, based on a presumption that risks of fraud exist in revenue recognition, evaluate which types of revenue, revenue transactions, or assertions give rise to such risks."

Jenkins believes that discussing the following matters may be helpful when assessing the risk of fraud due to improper revenue recognition more broadly:

Entity background: He suggests obtaining a clear understanding of the entity's business objectives and associated business risks, strategies used to achieve those objectives and performance measures used by the entity that involve revenues. "An additional consideration that may be relevant is whether the entity has received private-equity investments. If so, management may be under pressure to inflate revenues so that the company appears to provide an acceptable return on investment to the private-equity firm. Finally, consider whether an entity's revenues may be susceptible to manipulation to achieve a particular result for the owners' personal income taxes."

Disaggregated revenue streams: "The types of revenue vary considerably across industries, so it is important to understand the following aspects of the entity's revenue streams: the nature of the revenue, amounts, volume of activity, complexity, levels of subjectivity and estimation, whether company specialists are used, key accounting policies and the existence of related-party transactions."

Results of risk assessment procedures: Results from risk assessment procedures that are specific to revenue may provide insights that are useful in assessing fraud risks related to revenue. For example, Jenkins says, "consider your understanding of the client's processes related to each revenue stream, including how revenue transactions are initiated, authorized, processed, recorded and reported. Other helpful information may come from considering the potential impact of changing or unique industry conditions, results from preliminary analytical procedures and your understanding of compensation arrangements for management and other employees when they include incentives tied to revenue targets."

Influence of information technology: Obtain an understanding of changes in the entity's information technology environment related to revenues. "Organizations of all types and sizes may have artificial intelligence or bots embedded in their accounting systems. Auditors need to understand how these emerging technologies can mitigate risks or potentially present new risks of misstatement."

Fraud triangle: "Consider each of the three legs of the fraud triangle (i.e., incentives or pressures to perpetrate fraud, opportunities to commit fraud and attitudes or rationalizations to justify fraud) for each material revenue stream. Also keep in mind the 'could factor' as it relates to revenue. For example, consider the following questions from the perspective of 'if management were to commit fraud': What could go wrong in the revenue process? How could fraud be perpetrated and concealed? What points in the revenue process are susceptible to manipulation? What is the likelihood and magnitude of a potential misstatement in revenues based on your understanding?"

Jenkins stresses that "addressing the presumed risks of fraud due to improper revenue recognition requires professional judgment and a sound understanding of a client's business. Begin by challenging your understanding of the entity and carefully consider how changes, or the lack thereof, in the entity or its industry affect your risk assessment."

Finally, he advises, "maintain your professional skepticism and be open to challenging what you know about a client. Change is constant — remaining aware of those changes affecting clients is essential if auditors are to respond effectively to risks of fraud."

For a whole lot more advice, see [Evaluating fraud risks related to revenue recognition](#).