

The Role of Revenue Recognition Disclosures in Revenue Restatements

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Evidence from earnings restatement research suggests that revenue misreporting is a common form of financial misreporting; however, previous findings (Callen et al., 2005 and Stubben, 2006) only identify subsets of firms, namely loss firms and growth firms, that may be more likely to manipulate revenue. Taking a broader approach, I hypothesize and find that firms are more likely to misreport revenue if they have more complex revenue recognition practices. This suggests that either 1) both the incentives and the opportunity to misreport revenue are important in determining which firms will misreport revenue, or 2) revenue misreporting is driven by complexity and is unintentional. I explore these two explanations further by testing whether revenue misstating firms with more complex revenue recognition are less likely to have AAER enforcement actions, an indication of intent. Logistic regression results suggest that AAERs are less likely for revenue restatement firms with more complex revenue recognition; however, the results depend on how revenue recognition complexity is measured. Taken together, these findings suggest that revenue recognition complexity is an important determinant of revenue restatements and managers are either victims of, or successfully hide behind revenue recognition complexity.