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Accounting & Auditing Update

Are You Ready for the New Revenue Recognition Standard?

By Bruce L. Blasnik, CPA, CGMA, Partner

We've been hearing about the new revenue recognition standard for quite some time. It was way back in September 2002 that the Financial Accounting Standards Board (FASB) and the International Accounting Standards Board (IASB) agreed to work together on a revenue recognition standard intended to clarify the principles for revenue recognition and result in a single, converged standard under U.S. GAAP and IFRS.

After much deliberation and two exposure drafts, ASU 2014-09, *Revenue from Contracts with Customers*, was issued in May 2014. Once effective, ASU 2014-09 will become ASC Topic 606, replacing the current ASC Topic 605 in its entirety.

Effective Dates: Private and Public Companies

The once deferred, and now presumably final, effective date of the new standard for private companies is for periods beginning after December 15, 2018 (calendar year 2019). The effective date is one year earlier for public companies. Public companies must apply the standard to interim periods in the year of adoption; private companies are only required to apply the new standard at year-end in the year of adoption.

While 2019 may seem like it's still quite a ways off, retrospective application is required. This means that 2018 will need to be restated — either in its entirety, or by recognizing the cumulative effect adjustment as of December 31, 2018 (for calendar year companies). And, 2018 is less than a year away! You shouldn't wait until the last minute to evaluate the impact of the new standard on your business, which may be quite significant.

Transactions Involved

The new revenue recognition standard affects all public, private and not-for-profit companies that enter into contracts with customers for the transfer of goods, services or nonfinancial assets unless they are scoped out. Companies/transactions that are scoped out include: leasing, insurance contracts, financial instruments and guarantees (other than product or service warranties).

Single Standard

ASC Topic 606 will eliminate myriad revenue recognition pronouncements and industry specific guidance (ASC Topic 605 has 26 industry-focused subtopics) with a single principles-based standard that applies to substantially all industries. The disparate revenue recognition policies that now exist for similar transactions across different industries should be eliminated.

New Five-Step Process

Under ASC Topic 606, the current four core principles of revenue recognition (evidence of an arrangement, delivery has occurred, price is fixed or determinable and collectability is reasonably assured) are replaced with a five-step process:

1. Identify the contracts (written, verbal or implied)
2. Identify the performance obligations
3. Determine the transaction price
4. Allocate the transaction price to the performance obligations
5. Recognize revenue when or as the performance obligation is satisfied

For each of the above five steps, there are several considerations and criteria to be applied or evaluated in arriving at a conclusion regarding how much and when to recognize revenue.

Revenue Recognition Likely Changes: Industries/Transactions

For many companies and many types of transactions, revenue probably won't change under the new standard. But for certain industries and certain types of transactions, a change in revenue recognition is more likely. These include, among others:

- Contractors or others that use the completed contract method
- Software companies
- Healthcare providers
- Multiple deliverable arrangements (such as equipment or software, plus set-up training and/or support)
- Contracts with volume discounts or pricing incentives
- Rebate and coupon programs

While the basic definition of revenue is not changing[1], the pattern of revenue recognition under the new standard will change for some companies/transactions. Surprisingly, the new revenue recognition standard may result in accelerated revenue recognition for some companies as compared to existing standards. This is because the concept of *recognizing revenue for the amount realized* ***upon completion of the earnings process*** has been replaced with the concept of *recognizing revenue in the amount the entity is expected to be entitled to* ***as goods or services are transferred***.

Enhanced Disclosures

The new standard also expands and enhances disclosures related to revenue — although non-public companies may elect out of certain of the new disclosures.

Likely Consequences

The implications to companies are potentially far-reaching. Debt covenants and bonus plans can be affected. Company policies, procedures and internal controls over revenue recognition and contract management may have to be revised. The wording or provisions of customer contracts may need to change. Additionally, IT/ERP systems may need to be modified, and budgeting and planning processes and financial reporting models may also be affected.

Act Now

Don't wait. The time to start planning is now. For more information about the new revenue recognition standard, please contact your PKF O'Connor Davies' engagement partner or Bruce Blasnik, Assurance Services Partner in our Commercial and Health Care groups, at bblasnik@pkfod.com or 203.323.2400.

[1] FASB Statement of Financial Accounting Concepts (SFAC) No. 6, Elements of Financial Statements, defines revenue as "… inflows or other enhancements of assets of an entity or settlements of its liabilities (or a combination of both) from delivering or producing goods, rendering services, or other activities that constitute the entity's ongoing major or central operations."

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