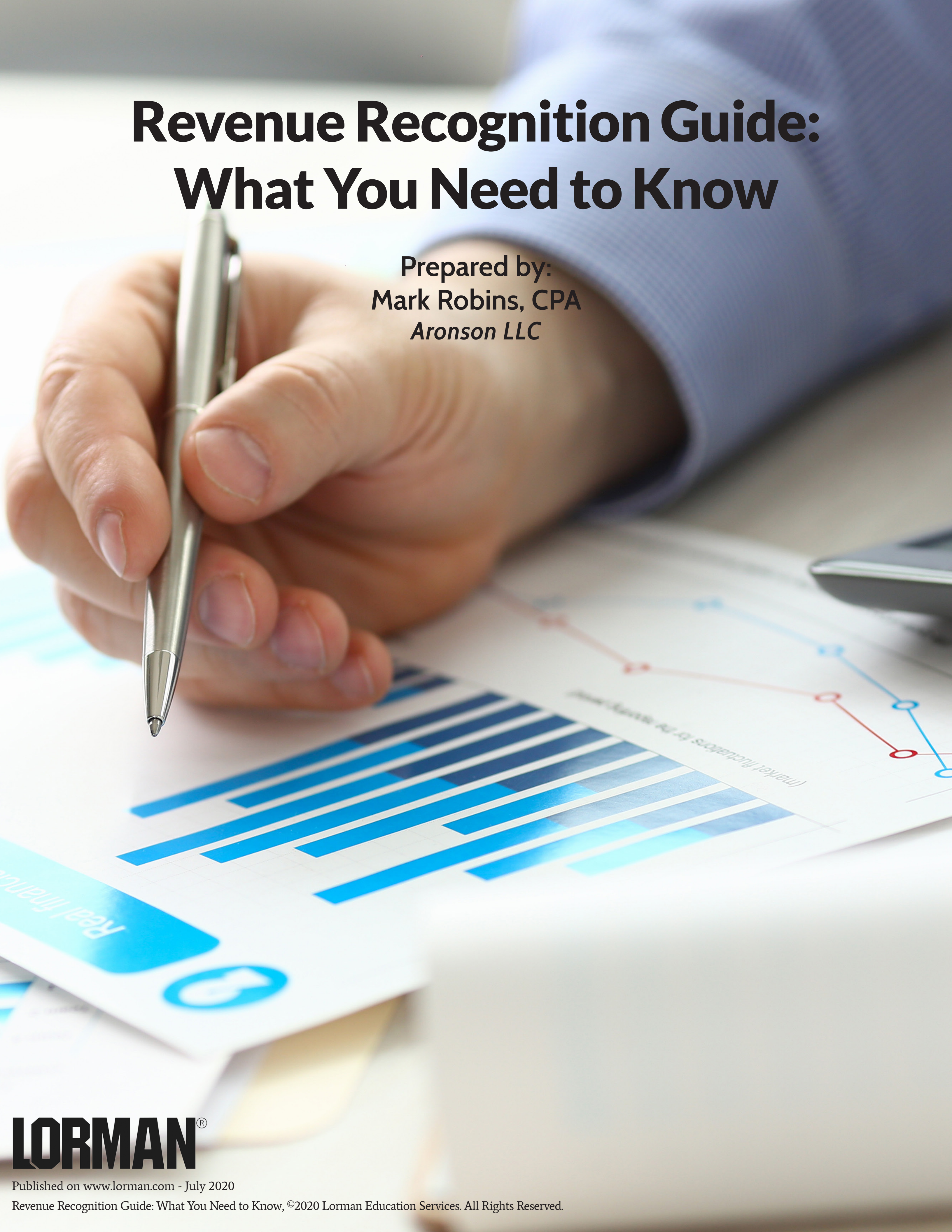

Revenue Recognition Guide: What You Need to Know

Prepared by:
Mark Robins, CPA
Aronson LLC

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Revenue Recognition Guide

WHAT YOU NEED TO KNOW

How is revenue recognition changing?

Shifts to a logical, principles-based model that introduces more judgment.

Introduces the concept of "expected" consideration– fixed and variable (estimated) portions are included in the transaction price.

Shifts to recognition of revenue based on the transfer of control as obligations are satisfied.

Requires expanded disclosures to provide users with more details on the current and future impacts from applying an organization's revenue recognition policies.

Why is the revenue standard changing?

ASU 2014-09 *Revenue from Contracts with Customers*, consolidates substantially all revenue recognition guidance into a single place.

Improves comparability by requiring use of the same guidance regardless of organization type or industry.

Increases consistency with International Financial Reporting Standards (IFRS).

Does the new revenue standard impact you?

YES, if anyone outside of your organization relies on your financial statements and they are presented using accounting principles generally accepted in the United States of America (U.S. GAAP), then you are impacted.

Nearly all public and privately held entities regardless of size or industry are impacted. This includes nonprofits who engage in exchange transactions.

Will your financial statements be impacted?

- Absolutely.
- Depending on your revenue streams, contract structures, and attributes, there may be a substantial change in the timing of your revenue recognition.
    - Even if the timing of revenue recognition does not change substantially, going through the process of validating it will change.
    - The related policies governing your revenue recognition and contract costs will change.
- Expanded financial statement disclosures will be required to describe the nature of the revenue, the amount being recognized, the associated timing, and the uncertainty of related cash flows.

If the timing of recognizing your revenue isn't changing substantially, why should you care?

There is still work to be done.

Whether or not there is an adjustment to revenue recognition or contract costs, there is a more extensive 5-step process required to validate the revenue being recognized.

The required revenue disclosures document the 5-step, principles-based process, including any judgments made.

If you don't have the appropriate adjustments or disclosures, the financial statements cannot be relied upon.

Failure to recognize revenue in accordance with the new standard may result in financial statements that are not GAAP compliant, which may cause debt covenant violations and the inability to access cash or refinance.

What is required to recognize revenue and contract costs in accordance with the new standard?

In order to recognize revenue, there is a 5-step process which must be completed in order:

1. Identify contracts with customer(s)

Establish that you have a contract. The legal form of a contract is emphasized over customary business practices. A contract is considered to exist when there is an obligation to compensate for performance.

2. Identify all performance obligations

What goods and/or services have you promised to transfer to the customer? Are they distinct within the context of the contract?

3. Determine the transaction price

What do you expect to receive from the customer in exchange for transferring promised goods or services? This may require estimates for variable forms of expected consideration.

4. Allocate the transaction price

For each performance obligation, determine the standalone selling price.

5. Recognize revenue

Determine when a customer gains control of the goods or services–at a point in time or over time. If over time, what is the best measure of progress?

6. Hidden 6th Step: Identify contract costs

Identify the incremental contract costs. These include costs to fulfill or obtain a contract. Certain incremental costs must now be capitalized under the new standards.

Are there other impacts?

Consider:

- The way you bid and structure a contract, including how you define deliverables.
- The way you structure your commission and bonus agreements.
- How financial ratios may fluctuate, including those used for loan covenants, by investors, the Board of Directors, or management.
- How financial forecasts can be impacted, such as those used in valuations, budgets, or for strategic planning purposes.
- Practices that are implied and not explicitly stated in contracts need to be documented and evaluated.
- Changes to accounting processes and the internal control structure.

The revenue recognition change applies to me, now what?

1

To initially assess the extent of the impact, the revenue transactions and supporting arrangements need to be evaluated for each major revenue stream in accordance with the 5 steps. The extent of this assessment will depend upon which adoption method is chosen.

2

Implementing the new standard and establishing new policies and procedures requires a significant investment of time. The investment is ongoing as revenue recognition is a continual, more judgmental process, not a one-time effort.

3

The principles-based model of recognizing revenue requires more judgment instead of reliance on checklists and industry practices.

4

Making judgments requires a coordinated approach across many departments including accounting, sales, contracts, legal, and human resources.

5

Resource-strapped companies will find it difficult to execute the initial implementation process and the changes needed going forward, along with all of their other responsibilities.

Revenue Recognition Under ASC 606

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WHAT DOES THE NEW REVENUE RECOGNITION STANDARD MEAN FOR YOU?

The most comprehensive accounting change to impact businesses is here - are you ready for ASC 606?

What?

- New revenue recognition standard
- Labeled ASU 2014-09 *Revenue from Contracts with Customers* (ASC 606)
- Principles-based approach that addresses today's and future transactions

Why?

- To remove inconsistencies in US GAAP with a single contract-based model
- To strengthen clarified framework globally and allow for international alignment
- To increase comparability across entities and industries
- To eliminate blackholes where no guidance exists

Who?

- Entities that have contracts with customers to transfer goods/services

When?

Public Entities

- Effective for annual reporting periods beginning after December 15, 2017

Nonpublic Entities

- Effective for annual reporting periods beginning after December 15, 2018

What Will Be Impacted?

Accounting Processes

- Internal controls, processes & resources
- Policies
- Compliance
- Forecasting
- Indirect rates/Cost allocations

Financial Statements

- Fluctuation in earnings
- Dual reporting
- Tax implications
- Covenant compliance
- Small business status
- Financial ratios

Customer Contracts

- Sales & proposal strategies
- Compensation agreements
- Treatment of "free" add-ins
- Legal review
- Treatment of modifications

Technology Systems

- Accounting software updates
- Contract setup in the system
- Changes to revenue calculation guidelines
- System mapping and configuration

Interested in Learning More?

For more information on Aronson's Financial Advisory services surrounding revenue recognition, contact David Semendinger, Aronson partner, at dsemendinger@aronsonllc.com or 240.364.2667.

Revenue Recognition Under ASC 606

Contract Attributes Causing Complexities

- Warranties
- Undefined Price or Scope
- Non-substantive Termination Clause
- Advanced or Delayed Payment Terms
- Customer Options
- Discounts and Price Concessions
- Principal vs. Agent
- Shipping & Handling
- Cost Plus Elements
- Contract Modifications
- Variable Consideration
- Working at Risk

Noteworthy Components of the 5-Step Process

1 Identify Contract with Customers

- Multiple contracts with a single objective to be combined
- Termination clauses may be problematic

2 Identify All Performance Obligations

- Introduction of "distinct"
- Obligations with minimal costs can be ignored
- Implicit obligation must be considered

3 Determine Transaction Price

- Big shift from fixed/determinable price to expected entitled value
- Introduction of variable consideration
- Significant financing components

4 Allocate Transaction Price

- VSOE goes away
- Focus is on (estimated) stand alone selling price
- Contract modifications must be assessed for "distinctness"

5 Recognize Revenue

- Introduction of the concept of transfer of control
- The passage of control is assessed from the customer's point of view

Treatment of Incremental Contract Costs

- Costs to obtain or costs to fulfill a contract will need to be capitalized under certain circumstances.

Important Considerations of The Tax Cuts and Jobs Act

Companies should analyze The Tax Act in conjunction with ASC 606 to understand the critical impacts which include:

- Deviations to the timing of when some taxpayers recognize income for tax purposes
- Revisions to tax accounting methods
- Adjustments to the financial statement disclosures

Industries Brace For Impact

- Manufacturing
- Software & Technology
- Real Estate
- Aerospace & Defense
- Construction
- Not-for-Profit
- Telecommunications

Revenue Recognition Under ASC 606–Nonprofit

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- Principles-based approach that addresses today's and future transactions

Why?

- To remove inconsistencies in US GAAP with a single contract-based model
- To strengthen clarified framework globally and allow for international alignment
- To increase comparability across entities and industries
- To eliminate blackholes where no guidance exists

Who?

- Nonprofit entities that have contracts with customers to transfer goods/services
- Organizations that have exchange transaction revenue
- Contributions are generally scoped out

When?

Nonprofit entities that have issued, or are conduit bond obligors for, securities that are traded, listed, or quoted

- Effective for annual reporting periods beginning after December 15, 2017

All other nonprofit entities

- Effective for annual reporting periods beginning after December 15, 2018

What Will Be Impacted?

Accounting Processes

- Internal controls, processes & resources
- Policies
- Compliance
- Forecasting
- Indirect rates/Cost allocations

Financial Statements

- Fluctuation in earnings
- Dual reporting
- Tax implications
- Covenant compliance
- Financial ratios

Customer Contracts

- Sales & proposal strategies
- Compensation agreements
- Treatment of "free" add-ins
- Legal review
- Treatment of modifications

Technology Systems

- Accounting software updates
- Contract setup in the system
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- Advanced or Delayed Payment Terms
- Customer Options
- Discounts and Price Concessions
- Principal vs. Agent
- Shipping & Handling
- Cost Plus Elements
- Contract Modifications
- Variable Consideration
- Working at Risk

Noteworthy Components of the 5-Step Process

1 Identify Contract with Customers

- Can be written, oral, or implied
- Enforceable rights and obligations
- Multiple contracts with a single objective to be combined
- Termination clauses may be problematic
- Collectibility must be considered

2 Identify All Performance Obligations

- Introduction of "distinct" goods or services
- Ability to disregard immaterial obligations
- Implicit obligation must be considered

3 Determine Transaction Price

- Consideration of non-refundable upfront fees
- Introduction of variable consideration
- Significant financing components

4 Allocate Transaction Price

- Focus is on (estimated) stand alone selling price
- Contract modifications must be assessed for "distinctness"
- Allocating variable consideration
- Allocating discounts

5 Recognize Revenue

- Introduction of the concept of transfer of control
- The passage of control is assessed from the customer's point of view

Treatment of Incremental Contract Costs

- Costs to obtain or costs to fulfill a contract will need to be capitalized under certain circumstances.

Important Considerations of The Tax Cuts and Jobs Act

Those organizations with for-profit subsidaries should analyze The Tax Act in conjunction with ASC 606 to understand the critical impacts which include:

- Deviations to the timing of when some taxpayers recognize income for tax purposes
- Revisions to tax accounting methods
- Adjustments to the financial statement disclosures

Classifying Contributions & Exchange Transactions

The FASB issued a proposed accounting standards update, clarifying the scope and the accounting guidance for contributions recieved and contributions made. The proposed ASU improves guidance on classifying contributions and exchange transactions, and is expected to be released in 2018 and will be effective in conjunction with ASC 606.