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New Revenue Recognition Standard – Effective Date Quickly Approaching

By Annette Tolentino

By now you may have already heard about the new revenue recognition standard, FASB ASC 606. For public companies, this new standard will be effective in 2018 and for private companies, in 2019. The software industry has been called out as one of the industries that will be most impacted. What do you need to know about the new standard? Here are few things:

- The new standard is more principles-based, which eliminates the transaction and industry-specific revenue recognition guidance.

- The core principle of the new standard is to recognize revenue when the goods or services are transferred to customers in an amount that reflects the consideration the entity expects to be entitled in exchange for those goods and services.

- There is a new five-step model to achieve the core principle of determining revenue recognition:
    1. Identify the contract – contracts can be written, oral or implied; must have commercial substance; collectability is probable; create enforceable rights and obligations.
    2. Identify performance obligations – a performance obligation is a promise in a contract with a customer to transfer a good or service to a customer. Management judgment will need to be used to distinguish and identify each performance obligation within a contract.
    3. Determine transaction price – the amount of consideration (payment) to which an entity expects to be entitled in exchange for transferring promised goods or services to a customer. To determine the transaction price, an entity should consider the effects of variable consideration, constraining estimates of variable consideration, the existence of a significant financing component, noncash considerations, and consideration payable to the customer.
    4. Allocate transaction price – an entity should allocate the transaction price to each separate performance obligation, identified in step 2 above, in an amount that represents the standalone selling price would be for the entity that sells the good or service as a separate performance obligation.
    5. Recognize revenue – an entity should recognize revenue when (or as) the entity satisfies a performance obligation by transferring a promised good or service to a customer. An asset is transferred when (or as) the customer obtains control of that asset. For each performance obligation, an entity would determine whether the entity satisfies the performance obligation over time by transferring control of a promised good or service over time. If the entity does not satisfy a performance obligation over time, the performance obligation is satisfied at a point in time.

- Management will need to use significant judgments which will require robust documentation, especially if an audit of your company is required.

- More financial statement disclosures are required and will be company specific.

- Companies may need to revisit and rethink certain business practices and agreements (i.e. loan agreements as debt covenants may be affected).

- Company’s existing internal controls systems most likely need to be updated to provide accurate and required data.

At this point, public companies should be ready to implement the new standard. Private companies still have some time, but are expected to have analyzed the impact of the new standard on their business and develop plans for the transition. There are plenty of resources out there to help with this transition – one being your local accounting firm. The key is to make sure you’re geared up for adoption because it’s coming faster than you may think.

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