Navigating the World of Revenue Recognition

CROSSCOUNTRY CONSULTING

HIGHLIGHTS

The FASB's revenue recognition standard (issued jointly with the IASB) replaces all 150+ pieces of US GAAP revenue literature in existence today. Unlike today's fragmented world of revenue recognition, the standard provides for a single 5-step model to be applied to almost all customer contracts.

The revenue model will have to be applied to every type of contract (or possibly even every individual contract) that an entity has. A number of new estimates and judgments will be needed.

2018 effective date (2019 for non-public companies) with a choice of either *retrospective* or *modified retrospective* adoption. Regardless of the transition option selected, a period of parallel reporting will be required.

Significantly expanded disclosures, which could require new IT systems and manual processes to support the accumulation of additional data.

For many, implementation will require significant effort and will have wide-ranging impacts throughout the organization, including accounting, financial planning, tax, internal audit, legal, investor relations, IT, sales, etc.

THE 5-STEP MODEL IN A NUTSHELL

STEP 1 — IDENTIFY THE CONTRACT WITH A CUSTOMER

- Applies only to contracts with customers, with a contract defined as an "agreement between two or more parties that creates enforceable rights and obligations"
- A written contract may no longer be a requirement for revenue recognition
- Potential differences surrounding treatment of contract modifications

STEP 2 — IDENTIFY THE PERFORMANCE OBLIGATIONS

- A promised good or service is accounted for as a separate performance obligation (PO) if it is ***distinct***
- The concept of ***distinct*** is new, so this could be an area of significant change for a number of contracts

STEP 3 — DETERMINE THE TRANSACTION PRICE

- While it may sound straightforward, this step incorporates a couple of significant changes from current practice:
- ***Variable consideration*** included when probable that a significant revenue reversal will not occur
- ***Time value of money*** considered when a significant financing component exists

STEP 4 — ALLOCATE THE TRANSACTION PRICE TO THE PERFORMANCE OBLIGATIONS

- Allocate transaction price based on ***standalone selling price*** of each performance obligation
- No hierarchy like under today's guidance to determine best estimate of selling price. ***Residual approach*** is allowed in certain situations
- In multiple-element arrangements, amount allocated to delivered item(s) is no longer limited to non-contingent amount

STEP 5 — RECOGNIZE REVENUE WHEN (OR AS) PERFORMANCE OBLIGATIONS ARE SATISFIED

- Revenue is recognized for each PO as control of the underlying good or service is transferred, which could occur ***over time*** or at a ***point in time***
- For POs satisfied over time, more robust guidance related to determining the appropriate measure of progress
- For POs satisfied at a point in time, revenue is recognized when ***control***, rather than ***risks and rewards of ownership***, is transferred

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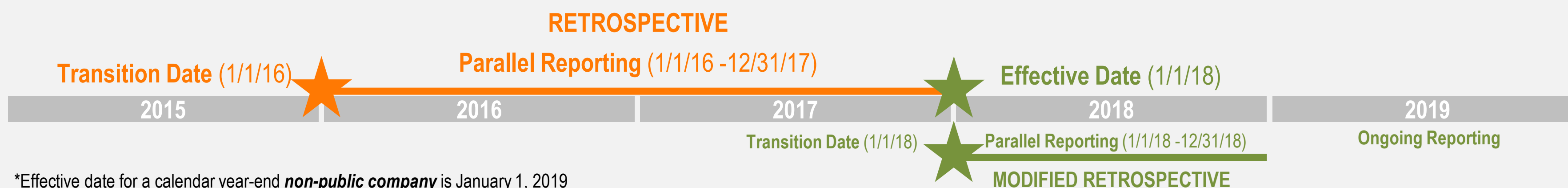
TRANSITION OPTIONS (CALENDAR YEAR-END PUBLIC COMPANY)



CROSSCOUNTRY'S IMPLEMENTATION METHODOLOGY

PROJECT SET-UP, INVENTORY AND ASSESSMENT

- **Establish** project team, steering committee & overall project governance structure
- **Identify** and document all types of contracts and associated revenue recognition policies
- **Perform** high-level assessment of accounting differences and resulting impacts on systems, processes, controls, etc.
- **Assess** and **select** transition method
- **Establish** project plan for remainder of implementation effort

TECHNICAL ANALYSIS

- **Apply** the revenue model to each type of contract and determine whether any differences exist
- **Document** conclusions and coordinate with auditors for sign-off

PROCESSES, SYSTEMS & CONTROL UPDATES

- For each contract type requiring different revenue recognition, **update** processes & systems in order to comply with the guidance
- **Update** controls & SOX documentation
- **Create** parallel reporting solution

CALCULATION

- **Calculate** transition date adjustments & input into parallel reporting solution
- **Maintain** dual ledgers during the parallel reporting period

DISCLOSURES

- **Prepare** skeleton disclosures (i.e. disclosures without the numbers) & identify data gaps
- **Develop** new processes & systems to capture additional required information

OTHER BUSINESS IMPACTS

- Tax – **Identify** tax planning opportunities
- FP&A – **Update** budgeting templates & performance measures
- IR – **Educate** investor community on the guidance
- Legal – **Modify** customer contracts to align with revenue recognition goals
- Sales – **Manage** the required changes in sales behavior
- HR – **Reconsider** staff bonuses and incentive plans
- Etc.

TRAINING: **Prepare & deliver** customized training throughout the implementation period to all impacted groups throughout the organization

PROJECT MANAGEMENT

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