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The New Revenue Recognition Standard

Accountants and finance professionals around the world will be affected by the new revenue recognition standard. IMA's technical committees provided feedback on exposure drafts and continue to advocate for members.

Greetings from the world of Professional Advocacy! IMA's technical committees—the Financial Reporting Committee (FRC), Small Business Financial and Regulatory Affairs Committee (SBFRC), and Technology Solutions and Practices (TS&P) Committee—continue to advocate on behalf of members on issues that impact the management accounting profession. Within the last year, these groups have expanded their outreach. While continuing to submit comment letters to standards setters and regulatory bodies, new efforts also include participation in roundtables, appointments to standards setters' advisory groups, columns in *Strategic Finance*, and presentations at IMA conferences and webinars.

One recent issue that the committees have addressed is the revenue recognition standard issued jointly on May 28, 2014, by the Financial Accounting Standards Board (FASB) and the International Accounting Standards Board (IASB). During the course of the standard's development, the FRC and SBFRC provided the Boards with comment letters aimed primarily at ensuring that implementation challenges would be minimal.

The standard is effective globally for all but a few industries, so most of us in the accounting and finance profession will be impacted by it. Here's an overview of some of the key points you should be aware of.

Scope of the Standard

The standard is applicable to all contracts with customers. It defines a customer as a party that has entered into a contract with an entity for the purpose of acquiring goods or services that are the output of the entity's ordinary activities in exchange for consideration. A collaborator or a business partner isn't considered a customer.

Recognition and Measurement

The recognition and measurement guidelines in the standard are based on certain key principles. Specifically, revenue should be recognized where promised goods or services are transferred to customers. The amount of revenue recognized is equal to the consideration that the entity expects to receive for those promised goods or services.

The standard lays out a five-step approach for recognizing and measuring revenue:

1. Identify the contract with the customer. A contract is defined as an agreement that has all of the following characteristics:
   - It is between two or more parties,
   - It creates enforceable rights and obligations, and
   - It is either a written or verbal arrangement or an arrangement implied by the entity's ordinary practices when conducting business.
2. Identify the separate performance obligations in the contract. An entity generally must account for each performance obligation separately.
3. Determine the transaction price based on the terms of the contract and the entity's customary business practices.
4. Allocate the transaction price to the separate performance obligations in a contract. If a contract has only one performance obligation, the transaction price is allocated entirely to that obligation. If there are multiple obligations, an entity must determine an appropriate allocation to those multiple performance obligations.

5. Recognize revenue as the entity satisfies a performance obligation, which is satisfied when a promised good or service is transferred to the customer. This can happen over time or at a single point. The transfer to a customer occurs when the customer obtains control of the item, which means the customer is able to both direct the use of the item and obtain basically all of the remaining benefits from the item. Certain types of arrangements or contract terms pose challenges in determining when a customer obtains control over a promised good or service. The standard provides implementation guidance to assist entities in evaluating these types of arrangements or contract terms.

Presentation and Disclosure

An entity is required to present a contract liability, a contract asset, or a receivable in its financial statements once either party to the contract has performed its obligation (i.e., the transferring of a promised good or service or a payment being made). Whether an entity presents a contract liability, a contract asset, or a receivable depends on the facts and circumstances. For instance, if a customer makes a payment before the entity transfers the promised good or service to the customer, the entity must present a contract liability on its balance sheet.

Qualitative and quantitative disclosures about the revenue and cash flows arising from contracts with customers are required. The objective of the disclosures is to provide users of financial statements with enough information to understand the nature, amount, timing, and uncertainty of those revenue and cash amounts.

Implementation

The most crucial step for businesses is the implementation of the standard. Adopting the new model for measuring and recognizing revenue may seem daunting. The effects of the new standard reach beyond the finance function and, in some cases, may affect the way relationships with customers are structured. Users of financial statements analyze revenue very closely, so entities should focus on establishing effective revenue recognition policies and practices that will provide a solid foundation in the future.

As a result of the potential wide-ranging effects of the new standard, the implementation effort should be comprehensive and involve several functions outside the traditional finance function, including IT, legal, sales, marketing, human resources, investor relations, and the C-suite.

Throughout the implementation effort, an entity should engage in frequent communication with key stakeholders (e.g., audit committees, investors, lenders, regulators), especially if it anticipates significant changes in the amount, timing, and presentation of revenues.

The Boards established a transition resource group to advise on implementation issues. (Allan Cohen, a current FRC member, is a member.) Its first meeting, on July 18, involved a discussion to inform Board members about four issues that are affected by the standard: (1) gross vs. net revenue, (2) gross vs. net revenue: amounts billed to customers, (3) sales- and usage-based royalties in contracts with licenses and goods and services other than licenses, and (4) impairment testing of capitalized contract costs.

Effective Date

The standard is effective for public companies for annual reporting periods beginning after December 15, 2016, and any interim periods that fall within that reporting period. Early application isn't permitted. The Boards have indicated that they won't consider any request for changing the effective date until constituents absorb the guidance and determine challenges with retroactive applicability.

For nonpublic companies, the standard takes effect for annual reporting periods beginning after December 31, 2017, and any interim and annual periods after that date. A nonpublic entity is allowed to adopt the guidance early, but not before the mandatory adoption date for a public entity.

Next Steps

IMA will continue to advise members about implementation of the revenue recognition standard. Be on the lookout for the September 30, 2014 webinar, "Revenue Recognition: The Challenges Ahead," with three other live events to follow. The comment letters issued by IMA's technical committees on this and other issues are available at www.imanet.org/about_ima/advocacy_activity. Please contact me at lmills@imanet.org to share your thoughts on how you would like to obtain additional information about the standard. **SF**