



Revenue Recognition FASB ASU 2014-09

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Objective

- ▶ To identify the basic 5 steps of the new revenue recognition standard.

Why the New Standard?

- ▶ **FASB rules based**
- ▶ **New innovations = new rules**
- ▶ **Industry rules don't always align**
- ▶ **Convergence with IFRS**



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Application Date

- ▶ **Nonpublic entities (FASB definition) – first annual reporting period beginning after December 15, 2018**
 - 12/31/2019 year-ends
- ▶ **Public entities 1 year earlier**
- ▶ **Comparative financials**
 - 12/31/2018 year ends will need to be calculated under both old and new standards

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5 Step Process

- 1. Identify the contract with the customer**
- 2. Identify the performance obligations within the contract**
- 3. Determine the transaction price**
- 4. Allocate the transaction price to the performance obligations**
- 5. Recognize revenue when performance obligation met**



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Identify the Contract

- ▶ **Written, oral, or implied (customary business practice)**
- ▶ **Commercial substance**
- ▶ **Both parties approved and committed to satisfying their obligations**
- ▶ **Each party's rights identifiable**
- ▶ **Payment terms identified**
- ▶ **Probable consideration will be collected**
 - Ability and intent

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Multiple Contracts

- ▶ **Combine multiple *legal* contracts into one *accounting* contract when:**
 - Contracts are negotiated as a package with a single commercial objective
 - Consideration for one contract depends on price/performance of other contract OR
 - Goods/services of multiple contracts are a single performance obligation

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Contract Modification

- ▶ **Change in scope or price approved by both parties**
- ▶ **If additional distinct goods or services added and price increase = stand-alone selling price, then separate contract**
- ▶ **If additional distinct goods or services added but price \neq stand-alone selling price, then terminate old contract and create new**
- ▶ **If no distinct goods or services added, then adjust transaction price**

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Identify Performance Obligations

- ▶ **(A series of) good(s) or service(s) that is (are) distinct**
- ▶ **Distinct**
 - Customer can benefit by itself or with readily available resources
- ▶ **Vendor promise must be separately identifiable**



Obligation

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Material Right

- ▶ **Would not receive right without entering into contract**
- ▶ **Option to acquire additional goods/services**
 - Must be for less than stand-alone price



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Incremental Costs of Obtaining Contract

- ▶ **Setup of account ≠ performance obligation**
- ▶ **Incremental costs – would not have been incurred without contract**
- ▶ **Record as asset; amortize**
 - Practical expedient: less than one year amortization, expense when incurred



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Example



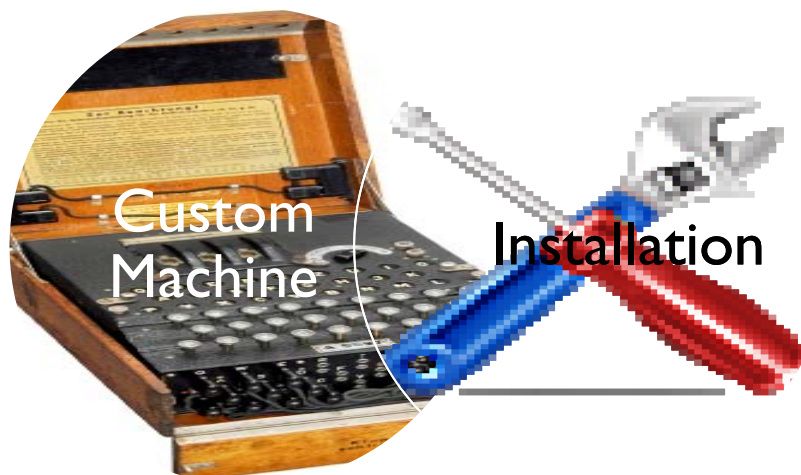
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Installation

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Example



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Transaction Price

- ▶ **Consideration entity *expects* to receive**
- ▶ **Excludes amounts for third parties**
 - Sales tax
- ▶ **Variable Consideration**
 - Expected value method
 - Most likely method
- ▶ **Constraint**
 - Limited to amounts where it is probable a significant revenue reversal will not occur
- ▶ **Consider time value of money**

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Example – Before Constraint

| First 10 days | 11-15 Days | 16 + Days |
|---------------|-------------|-------------|
| 5% discount | 3% discount | No discount |
| \$95 | \$97 | \$100 |
| 15% | 40% | 45% |

► **Expected value:**

- $\$95 * 15\% +$
- $\$97 * 40\% +$
- $\$100 * 45\% =$
- $\$98.05$

► **Most likely:**

- \$100 (45% is largest percent)

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Example - Constraint

► **\$98.05 > \$95 and \$97**

- $\$98.05 < \100

► **% of amounts less than \$98.05**

- $15\% + 40\% = 55\%$
- Probable amount will be less than \$98.05

► **% of amounts less than \$97**

- 15%; not probable amount will be less than \$97
- Constrained amount for expected value

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Allocating Transaction Price

▶ **Stand-alone selling prices**

- Allocate proportionately
 - No stand-alone selling price
 - Adjusted market assessment (what would they pay)
 - Expected cost plus margin
 - Residual approach (only if sold to different customers for wide range of prices or not yet sold separately)

▶ **Discount**

- Typically proportionate
 - If regularly sold stand-alone, and regularly sell a bundle at a discount, and the bundle discount approximates this discount, then you can allocate discount proportionate to just bundle

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Material Right – Allocation Transaction Price

- ▶ **Stand-alone price, if any**
- ▶ **Estimate discount obtained from exercising right**
 - Subtract any other available discounts
- ▶ **\$1,000 discount with right; \$100 discount otherwise; 50% chance of using discount**
 - $\$1,000 - \$100 = \$900 * 50\% \text{ chance of using} = \450 price

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Recognizing Revenue

- ▶ **Satisfied at a point in time, or**
- ▶ **Satisfied over time**
 - Customer simultaneously receives and consumes benefit
 - Performance creates/enhances asset the customer controls OR
 - Does not create an asset with alternative uses to the seller



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Recognizing Revenue Over Time

- | | |
|------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------|------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------|
| <ul style="list-style-type: none"> ▶ Output methods <ul style="list-style-type: none"> ▪ Milestones ▪ Time elapsed ▪ Units produced ▪ Units delivered | <ul style="list-style-type: none"> ▶ Input methods <ul style="list-style-type: none"> ▪ Resources consumed ▪ Labor hours expended ▪ Costs incurred ▪ Time elapsed |
|------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------|------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------|
-
- ▶ **Cannot use cost of goods when goods are received significantly before services related to them**
 - ▶ **Material right to purchase = revenue when additional goods/services purchased**

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Concerns

- ▶ **Loyalty program – material right?**
- ▶ **Give away “free” – performance obligation?**
- ▶ **Discounts for early payment = variable consideration**
- ▶ **Explicit right of return – refund liability?**
- ▶ **Warranty – performance obligation?**
- ▶ **Option to purchase additional goods/services – material right?**
- ▶ **Nonrefundable up front fees – performance obligation?**

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Bill and Hold

- ▶ **Revenue upon change of control**
- ▶ **Bill and hold must:**
 - Substantive reason for bill and hold
 - Product identified separately as belonging to customer
 - Product ready to transfer as is
 - Entity can't have ability to use/redirect product



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Gift Cards

- ▶ **Escheat liability first, if any**
- ▶ **Determine expected “breakage” income**
 - Allocate proportionately as gift cards expected to be used are used OR
- ▶ **Wait until remote gift cards will be used**
 - Recognize all breakage income



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Disclosures

- ▶ **Most quantitative disclosures for public entities only**
- ▶ **Revenue between 1) point in time and 2) over time**
- ▶ **Qualitative disclosure about recording revenue**

Disclosure

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Construction Industry

- ▶ **Potentially multiple performance obligation**
- ▶ **Determine faithful depiction of transfer of control**
- ▶ **Constructing hospital**
 - Overall management as well as goods/services: engineering, site clearance, foundation, etc.
 - Capable of being distinct
 - Not distinct because significant integration
 - One performance obligation
 - If use input method of cost, no real change

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Health Care Organization

- ▶ **Collection of consideration probable to have contract**
- ▶ **Transaction price – variable consideration – constraint**
- ▶ **Emergency room patient**
 - Admitted with no agreement from patient to pay
 - Services provided
 - Determine self-pay; expect to receive some consideration (variable)
 - Contract
 - Revenue in amount of expected value

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Nonprofit Industry

- ▶ **No change to contributions**
- ▶ **No change to determination of exchange versus contribution**
- ▶ **Is a government grant a “customer”?**

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To Do

- ▶ **Walk through 5 step process on normal contracts and transactions**
- ▶ **Compare to existing revenue recognition**
- ▶ **Accounting system review**
- ▶ **Train sales department**
- ▶ **Consider internal control changes**

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Resources

▶ AICPA – Revenue Recognition

- <http://www.aicpa.org/InterestAreas/FRC/AccountingFinancialReporting/RevenueRecognition/Pages/RevenueRecognition.aspx>

▶ FASB – Revenue Recognition Project

- <http://www.fasb.org/jsp/FASB/Page/BridgePage&cid=1351027207987>

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Thank You!

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