2017 Revenue Recognition Review
ASU 2014-09 and Subsequent ASU's

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Scope of ASU 2014-09 – Enforceable Rights & Obligations Between an Entity and Its Customer

Contract or Part of a Contract

ASU 2014-09

Other ASUs

Portfolio of Contracts

Contract 1

Contract 2

Contract 3

Contract 4

De-recognition of non-financial assets

Guarantees (other than product or service warranties)

Insurance contracts issued by insurance entities within scope of ASC Topic 944

Lease contracts

Non-monetary exchanges between entities in the same line of business to facilitate sales to customers

Financial instruments and other contractual rights or obligations (e.g., receivables, debt and equity securities, etc.)

The New Revenue Standard's Core Principle and the Five-Step Model

Core Principle

- **An entity recognizes revenue to depict the transfer of promised goods or services to customers in an amount that reflects the consideration to which the entity expects to be entitled in exchange for those goods or services**

1
- Identify the contract(s) with a customer

2
- Identify the performance obligations in the contract

3
- Determine the transaction price

4
- Allocate the transaction price to performance obligations in the contract

5
- Recognize revenue when (or as) the entity satisfies a performance obligation

Implementation Dates for ASU 2014-09

Public Entities	**Annual reporting periods beginning after 12/15/17 (i.e., 2018 for calendar year entities), including interim periods within that reporting period**
Private Entities	**Annual reporting periods beginning after 12/15/18 (i.e., 2019 for calendar year entities), and interim reporting periods beginning after 12/15/19 (i.e., 2020)**

Implementation Observations from Alphabet, Ford, and Lockheed Martin

- Recommend a dedicated project manager
- This is an issue impacting the entire organization, not just "accounting"
  - Accordingly, involves training and involvement of management, investor/shareholder relations, income tax, information technology, and finance departments
- Cast a wide net over the entire business
- Need some global inventory of contracts, at least by major category

Implementation Observations from Alphabet, Ford, and Lockheed Martin

- Unexpected difficulties identifying the “customer” in many cases (i.e., principal/agent)
- If international operations, need to ensure that accounting is consistent between standalone and consolidated financial statements
- Length of time to implement is much longer than expected so don’t underestimate resources or time!

Implementation Observations from Alphabet, Ford, and Lockheed Martin

- They put all revenue arrangements through 5 step revenue recognition model and didn't exclude any contracts from consideration due to immateriality.
- If your company has significant equity investments, you need to understand their implementation and consistency with your company's reporting.
- Involve external auditors in every step of the process, including your implementation plan, including if there are international operations.

Implementation Observations from Alphabet, Ford, and Lockheed Martin

- DO NOT underestimate the disclosure requirements and recommend that focus on those requirements early; for public companies, there is almost no difference between quarterly and annual disclosure requirements. One of the disclosures is for "backlogs", and getting agreement on this measurement (including with the external auditors) is important.
- 12% of companies are planning/doing full retrospective adjustment (if impact is considered to be material between years) and 42% are planning/doing modified retrospective, but as time period to implementation shortens, more are expected to do modified approach because of time required to go back to prior years.

New Revenue Standard Implementation Discussion

With a narrowing window until required implementation of the new revenue standard, it is time to start a thorough review and documentation of your company's principal revenue transactions to evaluate the impact, if any, from implementation of the new standard.

Brandy Ford, ScanSource

William Turner, Denny's

Brief Overview
Revenue from Contracts with Customers

- **Goal of the new revenue standard (ASU 2014-09) is "comparability" throughout the world <u>and</u> across industries, so the new standard is more grounded in "principles" without industry-specific guidance**

- A SINGLE revenue model applies to ALL revenue contracts with customers

Revenue Recognition – Some Potential Changes

Construction – Type Contracts

- Decoupling of contract revenue and contract cost recognition
- Contract costs not eligible for capitalization are expensed as incurred (new standard also discusses capitalization of contract costs)

Real Estate

- Elimination of specific requirements for full profit recognition
- May result in acceleration of revenue (or gains)

Revenue Recognition – Some Potential Changes

Bundled Goods and Services

- Apply the separation criteria to all contracts
- Determine whether performance obligations in a bundle of goods or services are "distinct"

Significant Financing Component

- Adjust transaction price for contracts with significant financing components

Variable Consideration

- Estimate variable consideration included in the transaction price

Revenue Recognition – Some Potential Changes

Multiple Element Arrangements	• Limitation relating to allocation of revenue to delivered item is eliminated
Estimated Selling Price	• Residual approach is permitted in certain circumstances
Timing of Revenue Recognition	• Evaluate whether each performance obligation is satisfied (a) over time or (b) at a point in time

Revenue Recognition – Some Potential Changes

Separation Criteria for Elements in Software Arrangements

- Vendor-specific objective evidence is no longer required

Licenses

- Specific guidance to determine if distinct license is a promise to:
- Transfer intellectual property at a point in time
- Provide the customer access to intellectual property over time

Contract Costs

- Certain fulfillment and contract acquisition costs are required to be capitalized

Subsequent Revisions to ASU 2014-09

ASU	Title
2016-08	Principal vs Agent Considerations (Reporting Revenue Gross vs Net)
2016-10	Identifying Performance Obligations and Licensing
2016-12	Narrow-Scope Improvements and Practical Expedients

ASU 2016-08: Reporting Principal versus Agent Considerations (Reporting Revenue Gross versus Net)

This ASU provides additional clarification around who is the "principal" and who is the "agent" when there is another entity involved in providing goods or services to a customer.

- **"PRINCIPAL" recognizes revenue <u>gross</u>**
- **"AGENT" recognizes the revenue at its <u>fee or commission earned</u>**

ASU 2016-08: Reporting Principal versus Agent Considerations (Reporting Revenue Gross versus Net)

"Indicators" that the entity CONTROLS the specified good or service (and therefore is the "Principal" in the transaction) include:

(1) The entity is primarily responsible for fulfilling the promise to provide the specified good or service (i.e., primary responsibility for the good or service meeting customer specifications).

(2) The entity has inventory risk before the specified good or service has been transferred to a customer or after transfer of control to the customer (i.e., customer has right of return).

(3) The entity has discretion in establishing the price for the good or service.

ASU 2016-10: Identifying Performance Obligations and Licensing

Performance Obligations – an entity evaluates whether promised goods and services are distinct.

- Immaterial goods or services in the contract can be ignored.

- Clarifies that "shipping & handling":
  - BEFORE customer obtains control of the good, then S&H are not a promised service, rather S&H are activities to fulfill the entity's promise to transfer the good (i.e., no revenue allocated to S&H activity).

  - AFTER customer obtains control of the good, entities can make an accounting policy election to account for S&H as an activity to fulfill the promise to transfer the good rather than as an additional promised service (i.e., no revenue allocated to S&H activity). If revenue recognized before S&H occur, estimated S&H cost should be accrued.

ASU 2016-10: Identifying Performance Obligations and Licensing

Licensing – Licensing implementation guidance determines whether an entity’s promise to grant a license provides a customer with either a right to use the entity’s intellectual property (satisfied at a point in time) or a right to access the entity’s intellectual property (satisfied over time).

- Entity’s promise to provide a customer with a right to use the entity’s intellectual property (i.e., software, drug formulas, films, etc.) is satisfied at the point in time the customer is able to use the license.
- Grant a customer a license to symbolic intellectual property (i.e., brand or trade names, logos, franchise rights, etc.) includes supporting or maintaining the intellectual property during the license period, therefore satisfied over time.

ASU 2016-12: Narrow-Scope Improvements and Practical Expedients

ASU 2014-09 ncludes clarifications and practical expedients related to the implementation of the new Revenue Recognition standard:

Assessing Collectability

The new ASU includes a provision that collectability be "probable" in order to recognize revenue:

- Means that the customer has the "ability and intention to pay the promised consideration".
- If the collectability criterion is not met, revenue can be recognized for the amount received if (a) goods are in control of customer, (b) no additional goods obligated under the contract, and (c) the amount received is nonrefundable.

ASU 2016-12: Narrow-Scope Improvements and Practical Expedients

Presentation of Sales Taxes

The "transaction price" is the amount of consideration to which an entity expects to be entitled in exchange for transferring promised goods or services to a customer, excluding amounts collected on behalf of third parties.

- **Entities can make an accounting policy election to exclude amounts collected from customers for all sales (and similar) taxes from the transaction price.**

ASU 2016-12: Narrow-Scope Improvements and Practical Expedients

Noncash Consideration

ASU 2014-09 states that noncash consideration is measured at fair value, but doesn't specify the measurement date for noncash consideration.

- **The new ASU clarifies that the measurement date for noncash consideration is contract inception.**

ASU 2016-12: Narrow-Scope Improvements and Practical Expedients

Technical Correction

ASU 2014-09 states that if retrospectively adopting, then the entity is required to disclose the effect of the accounting change for each period, including the period of adoption.

- **New ASU clarifies that if retrospectively adopting ASU 2014-09, the entity does not need to disclose the effect of the accounting change for the period of adoption (to do so would require the entity to calculate revenue recognition under prior GAAP).**

ASU 2016-12: Narrow-Scope Improvements and Practical Expedients

Contract Modifications at Transition - ASU 2014-09 includes 2 transition methods: (1) retrospectively to each prior reporting period, and (2) retrospectively with the cumulative effect of adoption at the date of initial application.

- Under either method, contract modifications that occurred before the beginning of the earliest period presented must be evaluated.

Under the new ASU, an entity need not retrospectively restate the contract for the contract modifications. Instead an entity reflects the aggregate effect of all modifications that occur before the beginning of the earliest period presented when:

(a) identifying satisfied/unsatisfied obligations
(b) determining transaction price
(c) allocating the transaction price between satisfied/unsatisfied performance obligations

ASU 2016-12: Narrow-Scope Improvements and Practical Expedients

Completed Contracts at Transition

There was a question under ASU 2014-09 transition considerations as to the definition of a "completed contract":

- **New ASU clarifies that a "completed contract" for purposes of transition is a contract for which all (or substantially all) of the revenue was recognized under legacy GAAP before the date of initial application.**
- **New ASU allows an entity to apply the modified retrospective transition method to either all contracts or only to contracts that are not completed.**

Public Company Transition Options

Transition Approach	2016/ 2017	2018	Date of Cumulative Effect Adjustment
Full Retrospective	Restate for all contracts	Apply to all contracts	January 1, 2016
Retrospective using one or more practical expedients	Restate for all contracts except for contracts or estimates covered by the practical expedients elected by the entity	Apply to all contracts	January 1, 2016
Cumulative effect at the Date of Adoption	No contracts restated; reported on the basis of legacy guidance	Apply to all contracts	January 1, 2018

Issues That Entities May Encounter

Right of Return

Description	Implementation
Return of product by customer due to dissatisfaction with the product in exchange for refunds or a credit against amounts owed and/or product in exchange	Seller may recognize (a) an adjustment to revenue for the product to be returned, (b) a refund liability, and (c) an asset for the right to recover the product

Issues That Entities May Encounter
Repurchase Agreements

Description	Implementation
Seller has an obligation or right to repurchase the asset at a later date	Generally if the seller has an obligation or right to repurchase the asset for an amount greater or equal to its selling price, then the transaction is a financing transaction (and revenue wouldn’t be recognized “when sold”)

Issues That Entities May Encounter
Bill and Hold

Description	Implementation
Results when the buyer is not yet ready to take delivery but does take title and accept billing	Revenue is recognized depending on when the customer obtains control of the product. Control by buyer achieved when <u>ALL</u> of the following met: (1) Reason for bill and hold must be substantive (i.e., customer request) (2) Product must be identified separately as belonging to the customer (3) Product currently must be ready for physical transfer to the customer (4) Entity cannot have the ability to use the product or direct it to another customer

Issues That Entities May Encounter

Consignments

Description	Implementation
A principal-agent relationship in which the company (manufacturer or wholesaler) ships merchandise to the consignee (dealer or retailer) who is to act as an agent for the consignor in selling the merchandise	The consignor recognizes revenue only after receiving notification of the sale and the cash remittance from the consignee (consignor carries the merchandise as inventory throughout the consignment). The consignee records commission revenue (usually some percentage of the selling price)

Issues That Entities May Encounter
Warranties

Description	Implementation
Warranties can be <u>assurance-type</u> (product meets agreed-upon specifications) or <u>service-type</u> (provides additional service beyond the assurance-type warranty)	A separate performance obligation is not recorded for assurance-type warranties (considered part of the product). Service-type warranties are recorded as a separate performance obligation. Companies should allocate a portion of the transaction price to any service-type warranties

Issues That Entities May Encounter
Nonrefundable Upfront Fees

Description	Implementation
Upfront payments generally relate to initiation, activation, or setup activities for a good or service to be delivered in the future	The upfront payment should be allocated over the periods benefitted

Issues That Entities May Encounter
Customers' Unexercised Rights

Description	Implementation
Prepayment from a customer should be recognized as a contract liability related to the future performance obligation. Derecognize the contract liability (and recognize revenue) when it satisfies the performance obligation. "Unexercised Rights" of customers are referred to as "Breakage".	If entity expects to be entitled to a "breakage" amount in a contract liability, entity should recognize the expected "breakage" amount as revenue in proportion to the pattern of rights exercised by the customer. If entity does not expect to be entitled to a breakage amount, entity should recognize the expected breakage amount as revenue when the likelihood of customer exercising its remaining rights become remote

Issues That Entities May Encounter
Customer Acceptance

Description	Implementation
Customer acceptance of an asset means customer has obtained control.	If customer acceptance is included in contract, unless just a formality, then performance obligation is not met until acceptance occurs. If product sent to customer on trial or evaluation basis, customer is not committed to pay until trial/evaluation occurs or some specified time period lapse