2014 ACCOUNTING STANDARDS UPDATE

ADDRESSING THE NEW REVENUE RECOGNITION STANDARD

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NOTE: Some information contained in this brochure has been updated. Please contact us for a copy of the updated brochure.
contactSD@schneiderdowns.com

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REVENUE RECOGNITION STANDARDS

2014 ACCOUNTING STANDARDS UPDATE

In May 2014, the Financial Accounting Standards Board (FASB) released its long-awaited Accounting Standards Update (ASU) on Accounting for Revenue from Contract with Customers.

This ASU creates a common set of revenue recognition standards between U.S. Generally Accepted Accounting Principles (U.S. GAAP) and International Financial Reporting Standards (IFRS). The ASU supersedes the revenue recognition requirements in Topic 605, Revenue Recognition, and most industry-specific guidance throughout the Industry Topics of the Codification. Additionally, this Update supersedes some cost guidance included in Subtopic 605-35, Revenue Recognition—Construction-Type and Production-Type Contracts.

The impact of this new standard will vary from industry to industry but could result in significant changes to U.S. GAAP followed today. Key changes from existing revenue recognition policies include:

- A new criteria for when to recognize revenue for contracts with customers
- Revenue being recognized when the customer obtains control of a good or service
- Control of a good or service passing either at a point in time or over a period of time based on defined criteria
- Required identification and segmentation of contracts into distinct performance obligations
- Required determination of a transaction price (factoring credit risk, time value, and variable consideration) allocated to distinct performance obligations
- Changes to accounting for contract costs
- Revision of presentation in the financial statements, and
- Establishment of new disclosure requirements

The ASU creates the following five-step process for the recognition of revenue:

Step 1 - Identify the contract with a customer

Step 2 - Identify the separate performance obligations in the contract

Step 3 - Determine the transaction price

Step 4 - Allocate the transaction price to the separate performance obligations

Step 5 - Recognize revenue when each separate performance obligation is satisfied

STEP 1

Identify the contract with a customer

Under the ASU, a contract is an agreement between two or more parties that creates enforceable rights and obligations. An entity is required to apply the requirements to each contract that meets the following criteria:

- Approval and commitment of the parties
- Identification of the rights of the parties
- Identification of the payment terms
- The contract has commercial substance
- It is probable that the entity will collect the consideration to which it will be entitled in exchange for the goods or services that will be transferred to the customer.

In addition, the ASU provides guidance for accounting for contract modifications as well as situations where combination of contracts for purposes of accounting under the ASU is required.

STEP 2
Identify the separate performance obligations in the contract

Under the ASU, a performance obligation is a promise in a contract with a customer to transfer a good or service to the customer. If an entity promises in a contract to transfer more than one good or service to the customer, the entity should account for each promised good or service as a performance obligation only if it is (1) distinct or (2) a series of distinct goods or services that are substantially the same and have the same pattern of transfer.

A good or service is distinct if both of the following criteria are met:

- It is capable of being distinct—The customer can benefit from the good or service either on its own or together with other resources that are readily available to the customer.
- It is distinct within the context of the contract—The promise to transfer the good or service is separately identifiable from other promises in the contract.

A good or service that is not distinct should be combined with other promised goods or services until the entity identifies a bundle of goods or services that is distinct.

STEP 3
Determine the transaction price

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. The ASU provides guidance for accounting for contract prices that include variable consideration, which require new estimates to be made in order to account for the transaction price. In addition, the ASU explains the impact on the transaction price for contracts with significant financing components, contracts with noncash consideration and contracts containing consideration payable back to the customer.

STEP 4
Allocate the transaction price to the separate performance obligations

For a contract that has more than one performance obligation, an entity is required to allocate the transaction price to each performance obligation in an amount that depicts the amount of consideration to which the entity expects to be entitled in exchange for satisfying each performance obligation.

To allocate an appropriate amount of consideration to each performance obligation, an entity must determine the standalone selling price at contract inception of the distinct goods or services underlying each performance obligation and would typically allocate the transaction price on a relative standalone selling price basis. If a standalone selling price is not observable, an entity must estimate it. The ASU explains when and how to allocate any discounts or variable consideration that relate to more than one performance obligation within a contract and the impact on timing of revenue recognition.

STEP 5
Recognize revenue when each separate performance obligation is satisfied

Under the ASU, an entity will recognize revenue when, or as, it satisfies a performance obligation by transferring a promised good or service to a customer. A good or service is transferred when, or as, the customer obtains control of that good or service.

An entity transfers control of a good or service over time and, therefore, satisfies a performance obligation and recognizes revenue over time if one of the following criteria is met:

- The customer simultaneously receives and consumes the benefits provided by the entity's performance as the entity performs.
- The entity's performance creates or enhances an asset that the customer controls as the asset is created or enhanced.
- The entity's performance does not create an asset with an alternative use to the entity, and the entity has an enforceable right to payment for performance completed to date.

If a performance obligation is not satisfied over time, an entity satisfies the performance obligation at a point in time. To determine the point in time at which a customer obtains control of a promised asset and an entity satisfies a performance obligation, the entity would consider indicators of the transfer of control, which include, but are not limited to, the following:

- The entity has a present right to payment for the asset.
- The customer has legal title to the asset.
- The entity has transferred physical possession of the asset.
- The customer has the significant risks and rewards of ownership of the asset.
- The customer has accepted the asset.

For each performance obligation that an entity satisfies over time, an entity shall recognize revenue over time by consistently applying a method of measuring the progress toward complete satisfaction of that performance obligation. Appropriate methods of measuring progress include output methods and input methods. As circumstances change over time, an entity should update its measure of progress to depict the entity's performance completed to date.

The ASU is effective for public companies with annual reporting periods beginning after December 15, 2016 and nonpublic companies with annual reporting periods after December 15, 2017.

Schneider Downs stands ready to assist you in complying with the provisions of this new ASU. We would be happy to meet with you to review the provisions of this ASU and to provide comparisons to existing U.S. GAAP. Services we can provide include, but are not limited to, the following:

- Review and impact analysis - A review of your contracts and identification of the most significant impact the new ASU will have on your business
- Assistance with identification of separate performance obligations contained within your contracts and how to determine a standalone selling price
- Advice on treatment of variable components within your contracts and allocation of transaction price to each separate performance obligation
- Analysis on if you will be required to recognize revenue over a period of time or at a point in time
- Review of implementation and financial statement disclosure requirements that will require accumulating new information for disclosure within your financial statement footnotes
- Assessment of your internal control environment and recommendations for process changes to most efficiently comply with the new requirements
- Assessment of your accounting systems and IT framework

The provisions of the ASU could have a significant impact to your business and may result in different timing of revenue recognition compared to today. Understanding the impact to your business, preparing the stakeholders of your financial information for the changes and updating your internal processes and procedures now will result in a smooth and efficient transition to the new requirements.

For more information, contact Don Applegarth at dapplegarth@schneiderdowns.com or (412) 697-5348 or Michael Renzelman at mrenzelman@schneiderdowns.com or (614) 586-7203.

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