ASC 606/IFRS 15:

The Definitive Guide to New Revenue Recognition Rules

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In what has been described as one of the largest changes to GAAP in the past decade, 2014 marked a year in which the Financial Accounting Standards Board (FASB) and the International Accounting Standards Board (IASB) sought to bring consistency across industries, enhance disclosure, and provide simplicity for those preparing and relying on financial statements.

However, for financial accounting professionals, the new, consolidated contract revenue recognition standards—set to replace over 200 specialized and/or industry specific revenue recognition requirements under US GAAP—will mean that while the long-term future may hold easier, more consistent standards, the changes that need to be made in the short term are immense and complex.

Looking at the new standard, Wipfli LLP seeks to provide readers with some perspective on the changes and some of the best practices to prepare for FASB ASC 606 and IASB IFRS 15.

Background: The New Revenue Recognition Standard

A project that traces its roots back to 2002[1], the IASB and FASB have been collaborating on the new contract revenue recognition standard since December 2008 to finalize the standard and prepare those affected by it for its implementation. In 2014, the FASB and IASB jointly announced the new guidelines.

According to the FASB, "The core principle is that an entity should recognize revenue to depict the transfer of 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.[2]"

The new standard aims to[3]:

- Remove inconsistencies and weaknesses in revenue requirements.
- Provide a more robust framework for addressing revenue issues.
- Improve comparability of revenue recognition practices across entities, industries, jurisdictions and capital markets.
- Provide more useful information to users of financial statements through improved disclosure requirements.
- Simplify the preparation of financial statements by reducing the number of requirements to which an entity must refer.

Who Does This New Guidance Impact?

The new guidance affects any reporting organization that either enters into contracts with customers to transfer goods or services or enters into contracts for the transfer of nonfinancial assets—public, private and not-for-profit—excluding those in insurance contracts or lease accounting.

The New Five-Step Model of Revenue Recognition

Step 1 Contract — Identify the Contract With the Customer

The standard defines a contract very broadly, so generally **all transactions with a customer are covered,** with a few notable exceptions (lease agreements, insurance contracts, financial instruments, and certain contractual rights or obligations [derivatives, dividends, etc.), certain nonmonetary exchanges between entities and certain guarantees within the scope of other standards (other than warranties).

Step 2 Obligations — Identify the Performance Obligations in the Contract

The manner in which goods and services are described as separated or bundled no longer determines how said goods or services are to be accounted for under the new standard. Determining what is a "distinct" good or service is critical and requires the good or service to meet two criteria: *being capable of being distinct and being separately identifiable.*

Step 3 Price — Determine the Transaction Price

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

Step 4 Allocation — Allocate the Transaction Price to Separate Performance Obligations

The transaction price is allocated to the separate performance obligations in a contract based on the relative standalone selling prices of the goods or services promised. This allocation is made at contract inception and not adjusted based on subsequent changes in the standalone selling prices of those goods or services.

Step 5 Recognition — Recognize Revenue as Each Performance Obligation Is Satisfied

An entity will recognize revenue when (or over time as) a good or service is transferred to the customer and the customer obtains control of that good or service.

Key Changes

The new standard will affect contract revenue recognition in five different ways[4]:

	Current Standard(s)	New Standard
Industry Reporting Requirements	Numerous requirements for recognizing revenue.	Consistent principles, regardless of industry and/or geography.
Disclosure Requirements	Other than disclosures in accounting policies and segment reporting, most organizations and other reporting organizations provide limited information about revenue contracts.	The new guidance includes a cohesive set of disclosure requirements that will provide users of financial statements with useful information about the organization's contracts with customers.
Evaluating Deliverables/ Performance Obligations	Many goods or services promised in a contract with a customer are deemed not to be distinct revenue-generating transactions, when in fact those promises might represent separate obligations of the entity to the customer.	Reporting organizations will identify each of the goods or services promised to the customer, determine whether those goods or services represent a performance obligation, and recognize revenue when (or as) each performance obligation is satisfied.
Allocating Consideration and Reporting on Performance Obligations	In a multiple-element arrangement, the amount of consideration to a delivered element is limited to the amount that is not contingent on delivering future goods or services.	Organizations will allocate the transaction price to each of the performance obligations in the contract on the basis of the relative standalone selling price of the underlying goods or services, except when a discount or variable amount of consideration relates entirely to one or more of the performance obligations of the contract.
Accounting for Variable Consideration	Accounting for variable consideration (rebate, discounts, penalties, bonuses) varies greatly across industries.	A single model to consider for variable consideration, which includes rebates, discounts, bonuses, or right of return. Variable consideration will be included in the transaction price to the extent it is probable that a significant reversal in the amount of cumulative revenue recognized will not occur.

Effective Dates

Currently, public entities, certain not-for-profit entities, and certain employee benefit plans are expected to adopt ASC 606 in their first reporting period after December 15, 2017 (interim reporting updates required same time), and nonpublic companies must adopt the standard for the following year (period following December 15, 2018—interim reporting updated for periods beginning after December 15, 2019). Early application is permitted for annual reporting periods beginning after December 15, 2016.

Checklist

Build a Team and an Action Plan

Planning for the transition to the new standard requires a discussion between functional groups who will be affected by the change, including finance, sales, IT, legal and internal auditors. The AICPA recommends forming a task force to take the lead on understanding and implementing the new revenue recognition standard.

Educate

Review the final standard and implementation guidance (ASC 606, IFRS 15) in order to understand the complexities and pitfalls that implementation could pose for your organization.

Evaluate Impact

Evaluate the changes from current GAAP to the new revenue recognition standard and evaluate the impact on how your company accounts for existing revenue streams and the results to the company's financial statements.

In addition, evaluate how the standard will affect operational and performance metrics, company contracts, compensation plans, accounting policies, internal controls and tax matters[5].

Determine Retrospective Adoption Method

Determine how you will retrospectively adopt the new revenue recognition standard and how to track the accounting differences for periods that require restatement:

- Full Retrospective Method: The full retrospective method requires organizationsto recast prior-period financial statements as if the guidance had always existed.
- Modified Retrospective Method: The modified retrospective method provides organizations with some relief because prior-year financial statements would not need to be recast. The new standard is applied to all existing contracts as of the effective date and to all future contracts.

The method of retrospective analysis must be disclosed in annual and interim reports.

Analyze and Assess

Learn how the new standard will affect your current and/or ongoing contracts, noting how the new standard will change both revenues and costs as you move from sales orders to performance obligations.

This is the stage in which it pays to be able to see side-by-side analysis of each line item under the current and coming standards. At this stage, an entity will need to consider whether its IT systems, data models, and related enterprise resource planning (ERP) software are able to **capture, track** and **report** information in accordance with the needs of the new standard.

- ✔ Build and Plan
- ✔ Educate
- ✔ Evaluate Impact
- ✔ Determine Method
- ✔ Analyze and Assess
- ✔ Update

Updating Applications and Processes

If your system and processes are not designed to handle the needs of the upcoming standard, it is necessary to find a solution that will be able to not only handle the new standard, but simplify your transition. As mentioned above, the new standard affects multiple departments, which may require changes to operational processes and internal controls.

Future-Proofing With ACS 606-Ready ERP

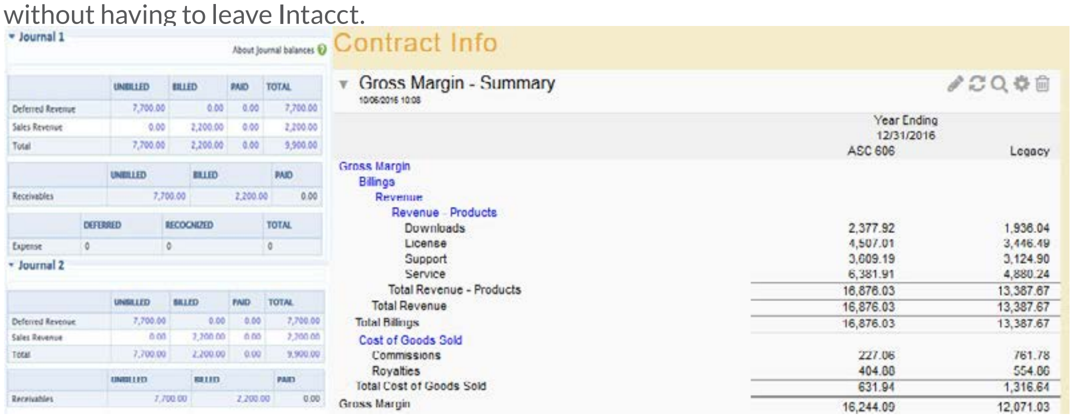
By future-proofing now, organizations can avoid the pain that comes with a last-minute transition or the bad press that comes from a CFO resignation in the wake of deviation from GAAP. For organizations both large and small, any manual effort required to reconcile revenue and report results to auditors, board members, and investors will result in a substantial drag on the business.

If you intend to head into the future with software not designed for the needs of advanced or growing businesses or plan to use a legacy system incapable of handling a change as immense as ASC 606/IFRS 15, you will face pitfalls and challenges.

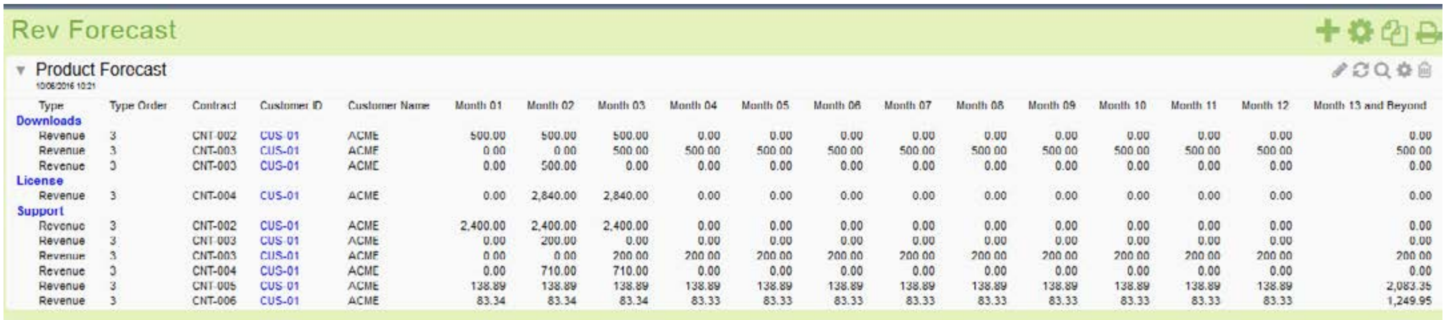
Intacct: The First-to-Market Solution Ready for ASC 606/IFRS 15

In the wake of the new standard, Intacct announced the industry's first solution designed to help companies prepare for the coming challenges. **Intacct's new Contract and Revenue Management** module addresses the upcoming rules, enabling finance teams to:

- **Automate complex processes** for addressing all new ASC 606 and IFRS 15 rules for revenue reallocation and expense amortization.
- **Automatically reallocate revenue and expenses when a contract changes** in one place, without having to click around to make contract changes.
- **Disclose the impact of changes with confidence, with automated dual treatment** at the transaction level, seeing the impact of the new rules without having to leave Intacct.



- **Solve the most onerous requirement for transitioning to the new rules** with automated dual reporting.
- **Clearly see the impact of the new rules on the organization's future results** with revenue and expense forecasts based on both current and new guidelines, seeing the impact both on your financial reports and your Digital Board Book, providing key metrics including Churn, Lifetime Value, Committed Monthly Recurring Revenue, Customer Acquisition Cost, and more.



Rev Forecast

Product Forecast
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Type	Type Order	Contract	Customer ID	Customer Name	Month 01	Month 02	Month 03	Month 04	Month 05	Month 06	Month 07	Month 08	Month 09	Month 10	Month 11	Month 12	Month 13 and Beyond
Downloads																	
Revenue	3	CNT-002	CUS-01	ACME	500.00	500.00	500.00	0.00	0.00	0.00	0.00	0.00	0.00	0.00	0.00	0.00	0.00
Revenue	3	CNT-003	CUS-01	ACME	0.00	0.00	500.00	500.00	500.00	500.00	500.00	500.00	500.00	500.00	500.00	500.00	500.00
Revenue	3	CNT-003	CUS-01	ACME	0.00	500.00	0.00	0.00	0.00	0.00	0.00	0.00	0.00	0.00	0.00	0.00	0.00
License																	
Revenue	3	CNT-004	CUS-01	ACME	0.00	2,840.00	2,840.00	0.00	0.00	0.00	0.00	0.00	0.00	0.00	0.00	0.00	0.00
Support																	
Revenue	3	CNT-002	CUS-01	ACME	2,400.00	2,400.00	2,400.00	0.00	0.00	0.00	0.00	0.00	0.00	0.00	0.00	0.00	0.00
Revenue	3	CNT-003	CUS-01	ACME	0.00	200.00	0.00	0.00	0.00	0.00	0.00	0.00	0.00	0.00	0.00	0.00	0.00
Revenue	3	CNT-003	CUS-01	ACME	0.00	0.00	200.00	200.00	200.00	200.00	200.00	200.00	200.00	200.00	200.00	200.00	200.00
Revenue	3	CNT-004	CUS-01	ACME	0.00	710.00	710.00	0.00	0.00	0.00	0.00	0.00	0.00	0.00	0.00	0.00	0.00
Revenue	3	CNT-005	CUS-01	ACME	138.89	138.89	138.89	138.89	138.89	138.89	138.89	138.89	138.89	138.89	138.89	138.89	2,083.35
Revenue	3	CNT-006	CUS-01	ACME	83.34	83.34	83.34	83.33	83.33	83.33	83.33	83.33	83.33	83.33	83.33	83.33	1,249.95

- **Automate complex subscription billing,** including usage-based billing, with full integration to revenue recognition.
- **Work more closely with other departments** through close, automated integration based on clicks, not scripts, which allows finance to work more closely with sales and related operational departments to ensure contract terms don't create more problems in the future.
- Streamline workflows by **integrating with Salesforce** to provide a single-step process to capture and edit contracts natively in Salesforce. There is no need to import contracts using additional integration software or by rekeying them into Intacct—streamlining processes and eliminating potential errors.

Again, while the new rules are set to simplify recognition between industries in the long term, the short-term challenges mean more work and more risk following the transition to the new rule. The clock is ticking to prepare your organization for the changes that will hit, and the earlier you implement a plan, the easier it will be.

Need to learn more? Contact our team at Wipfli LLP to learn more about the software, skills, and advice you need to remain compliant with this and other standards, as well as to save time and money heading into the future through automation, process improvement and advice.

Resources:

[1] Proposal for Revenue Recognition Project (AccountingWeb)

[2] Accounting Standards Update (FASB)

[3] Revenue Recognition Project Update (FASB)

[4] Why Did The FASB Issue a Standard On Revenue Recognition? (FASB)

[5] New Revenue Recognition Accounting Standard (AICPA)

About Wipfli LLP

With associates and offices across the United States and in India, Wipfli ranks among the top CPA and business consulting firms in the nation. For over 88 years, Wipfli has provided private and publicly held organizations with industry-focused assurance, accounting, tax and consulting services to help clients overcome their business challenges today and plan for tomorrow. Wipfli's Technology Consulting Practice includes hundreds of seasoned professionals who use business applications to provide implementation, training and consultation services to companies of all sizes. The technology consulting practice specializes in combining deep insight with smart technology to help businesses deliver better outcomes. Through the firm's membership in Allinial Global, Wipfli can draw upon the resources of firms around the world, helping businesses whenever and wherever they need it. For more information, visit **wipfli.com.**

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