

Preparing for Changing Revenue Recognition Guidelines (ASC 606)

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Session Objectives

At the end of this session, you will be able to:

- Explain why revenue recognition rules are changing
- Develop and further your knowledge of ASC 606
- Identify the possible impacts of the new revenue recognition model
- Apply the concepts learned through examples
- Know what to expect from your auditors

Transition Timeline

- Effective for public companies with fiscal years beginning after December 15, 2017
- Effective for non-public companies with fiscal years beginning after December 15, 2018

Transition Methods

	Retrospective Approach	Modified Retrospective Approach
Periods Impacted	All periods presented	Most current period presented
Contracts to Review	Apply the standard to all contracts (open and completed) in each period presented as if it had been in effect since contract inception	Apply the standard to contracts that are in progress (not yet completed) and new at the date of initial application
Adoption Presentation	Cumulative effect of change reflected in opening balance of retained earnings in earliest period presented	Cumulative effect of change reflected in opening balance of retained earnings in the most current period presented

Why Change Revenue Recognition?

- Remove inconsistencies and weaknesses
- Develop a revenue recognition standard based on a single model for all revenue contracts
- Improve comparability of revenue recognition practices across entities, industries, jurisdictions, and capital markets
- Provide more useful information to users of financial statements through improved disclosures

Comparison of Revenue Recognition Methods

Existing Standards

- 100+ sources for revenue guidance
- Fees must be fixed or determinable
- Must have “persuasive evidence” of arrangement
- No recognition of contingent revenue
- Unit of account based on “standalone value”
- No rules on accounting for modifications
- Software industry held to a higher standard (VSOE)
- Capitalizing contract acquisition costs optional
- Revenue disclosures limited to policy discussion

New Standards

- 1 standard for all arrangements, all industries
- Fees can be estimated
- Must have “legally binding” arrangement
- No similar prohibition; subject to estimation
- Unit of account based on “distinct”
- Modification rules can complicate accounting
- Software guidance eliminated
- Capitalizing contract acquisition costs required
- Extensive disclosures required

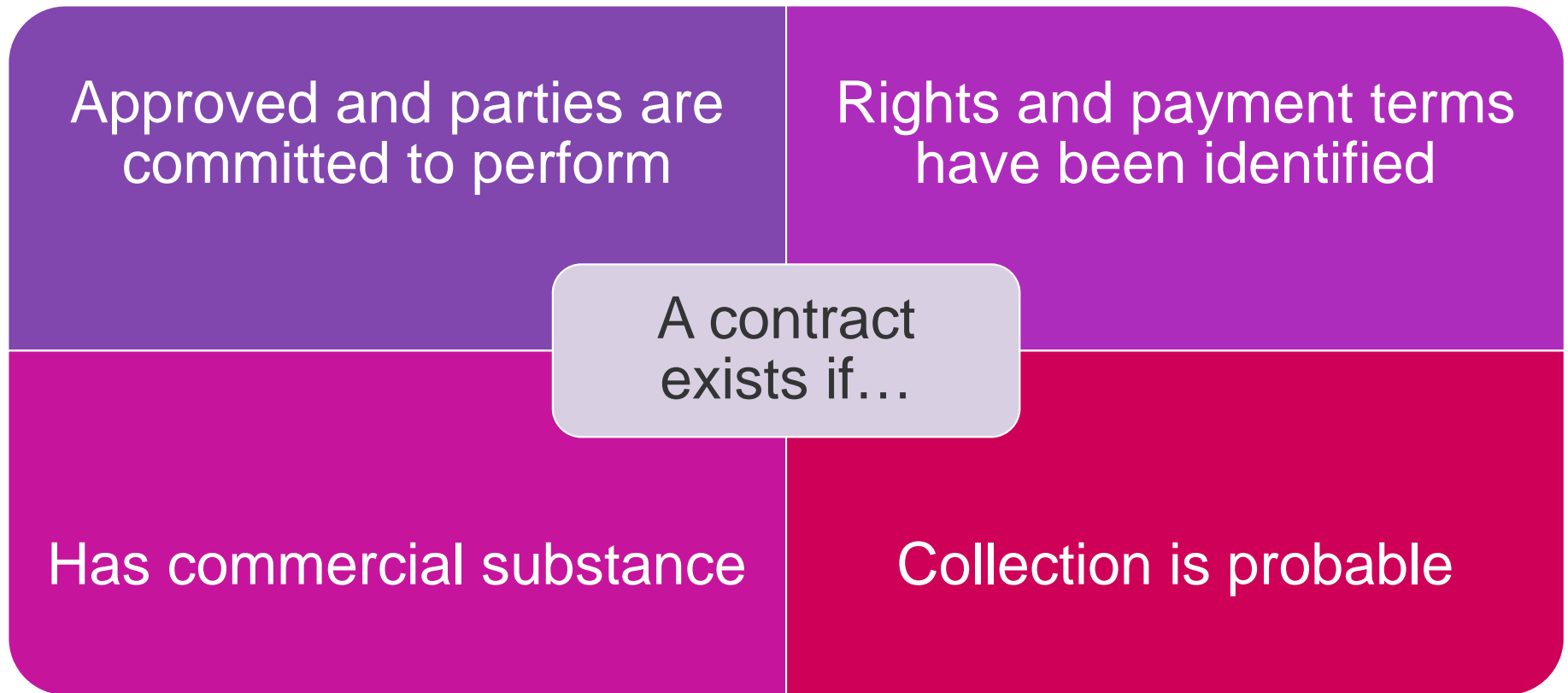
The Five Step Model

- 1 Identify the contract(s)
- 2 Identify the separate performance obligations in the contract(s)
- 3 Determine the transaction price
- 4 Allocate the transaction price to the separate performance obligations
- 5 Recognize revenue when each performance obligation is satisfied



Step 1 – Identifying the Contract

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Contract Terms Example

- ServeCo enters into a contract with a customer to provide monthly services for a three-year period. Each party can terminate the contract at the end of any month for any reason without compensating the other party (that is, there is no penalty for terminating the contract early)
- What is the contract term for purposes of applying the revenue standard?

Combining Contracts

Are two or more contracts entered into at or near the same time with the same customer?

Yes

Are one or more of the following met?

- Contracts were negotiated as a package with a single commercial objective
- Consideration in one contract depends on the other contract
- Goods or services promised in the contracts (or some goods or services) are a single performance obligation

Yes

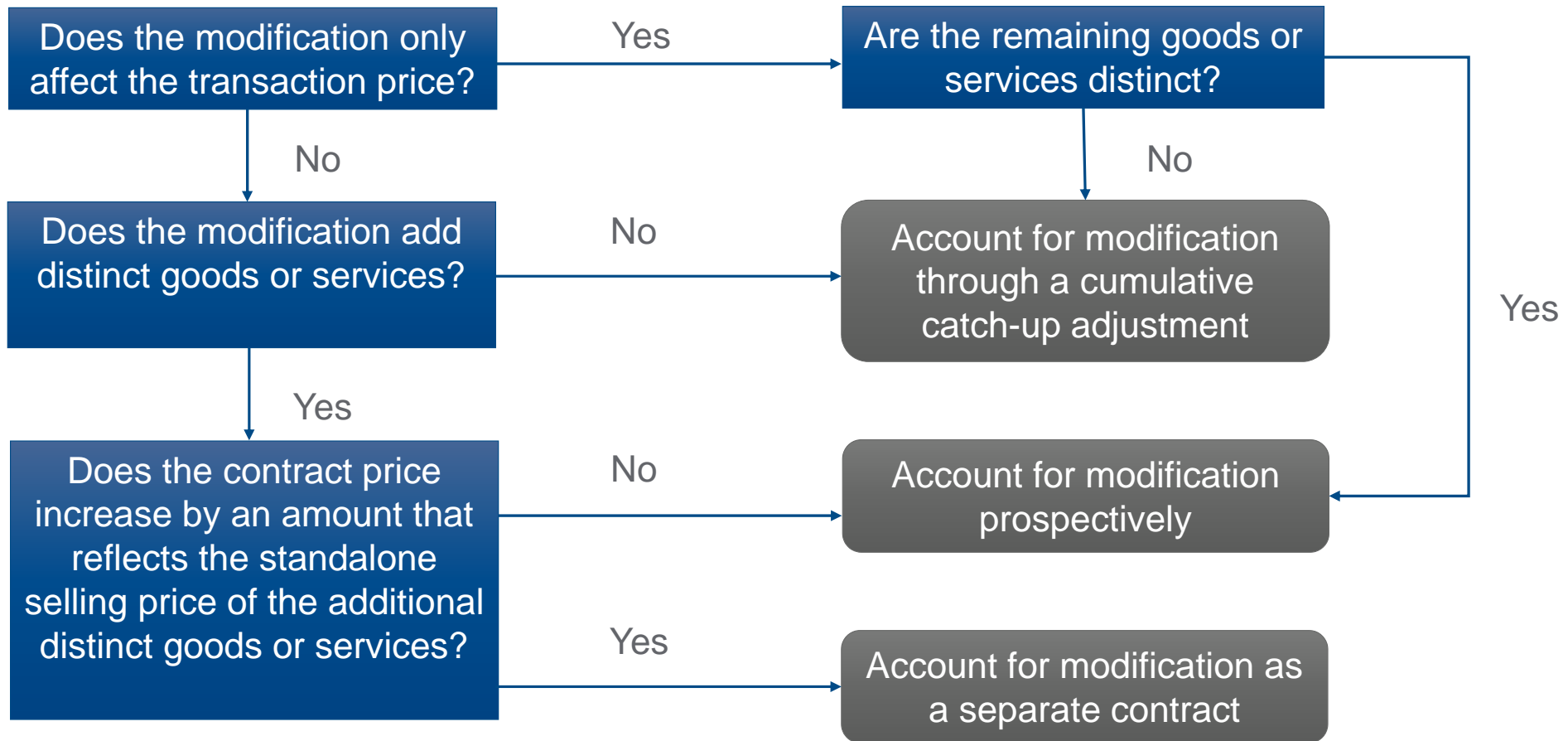
Account for contracts together as a single contract

No

No

Account for as separate contracts

Contract Modifications



Contract Modification Example

- ServeCo enters into a three-year service contract with Customer for \$450,000 (\$150,000 per year). The stand-alone selling price for one year of service at inception of the contract is \$150,000 per year
- ServeCo accounts for the contract as a series of distinct services
- At the end of the second year, the parties agree to modify the contract:
 - Fee for the third year is reduced to \$120,000
 - Customer agrees to extend the contract for another three years for \$300,000 (\$100,000 per year)
- How should ServeCo account for the modification?



Step 2 – Identifying Performance Obligations

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Are promised goods or services distinct from other goods and services in the contract?

Capable of Being Distinct

AND

Distinct Within the Context of Contract

Yes

Performance Obligation

No

Not Distinct – Combine with Other Goods and Services

Identifying Performance Obligations Example

- ServeCo enters into a contract to provide a three-year software license and three years of post-contract customer support (PCS)
- ServeCo never sells the software or the PCS on a stand-alone basis but does occasionally sell PCS separately; however, it does not have VSOE for PCS. PCS updates provided to the customer are mainly to cover bug fixes, minor updates and phone support
- How many performance obligations are there and what are they?



Steps 3 and 4 – Determine/Allocate the Transaction Price

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Transaction price = the amount of consideration to which an entity expects to be entitled in exchange for transferring goods or services to a customer

Variable
consideration

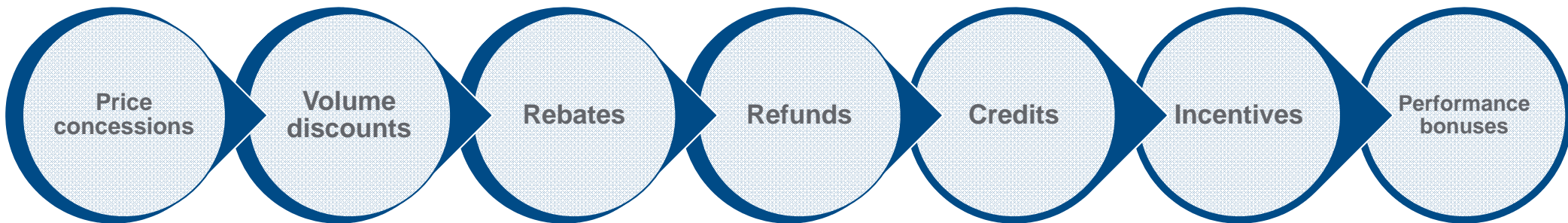
Significant
financing
component

Noncash
consideration

Consideration
payable to a
customer

Allocate based on relative stand-alone selling prices

Variable Consideration



Expected value

Most likely amount

Step 3 - Example

- ServeCo enters into a one-year contract with a customer to provide SaaS services. Contract guarantees the SaaS platform will maintain 99% uptime each month or customer will be entitled to a 5% credit of that month's fees against the next month's payment.
- How does the platform uptime guarantee impact determination of the transaction consideration?

Step 4 – Example

- ServeCo enters into a contract to provide a one-year software license with bundled PCS. ServeCo also bundles perpetual software licenses with the first year of PCS, with subsequent annual PCS renewals sold on a standalone basis at 25% of the initial license fees. The software and PCS are separate performance obligations.
- What is the standalone selling price of PCS associated with the term license?



Step 5 – Recognize Revenue

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- Revenue is recognized as, or when, a customer obtains control – which can be over time or at a specific point in time
- Control is transferred over time if:
 - The customer controls the asset as it is created or enhanced; or
 - The customer receives and consumes the benefits as the entity performs; or
 - There is no alternative use for the asset, and the entity has the right to payment

Step 5 - Example

- ServeCo enters into a contract to provide a customer with a cloud-based solution over an annual period. The customer cannot take possession of the software at any time during the hosting period. The customer pays an upfront fee of \$10,000 and \$2 for each transaction processed, payable on a monthly basis over the term of the arrangement. If the contract is renewed, the customer will pay a similar upfront fee.
- How should ServeCo recognize revenue for this arrangement?

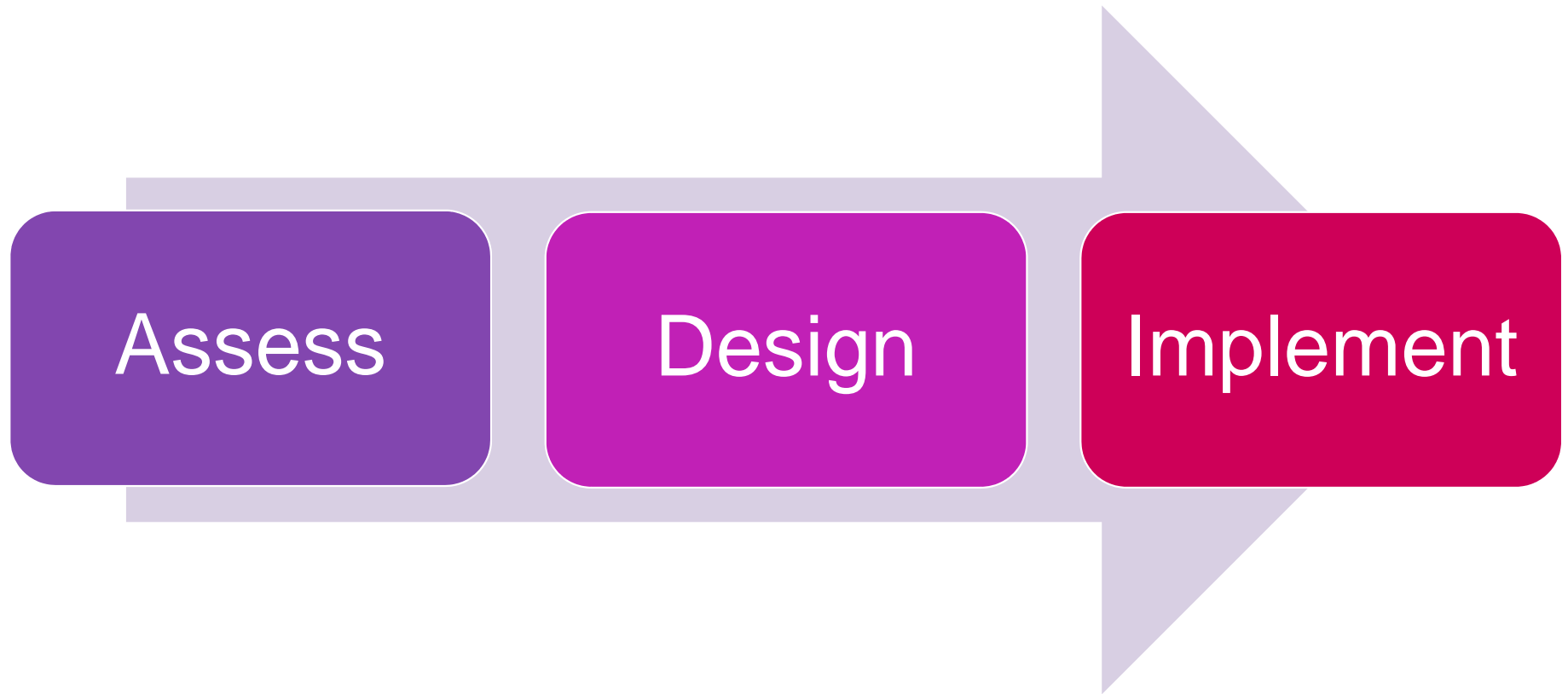


Other Considerations

What Should Companies Be Doing Now?

- Identify a team
- Financial statement audit considerations
- Understand incremental costs of obtaining a contract
- Evaluate business impacts
- Enhance periodic disclosures

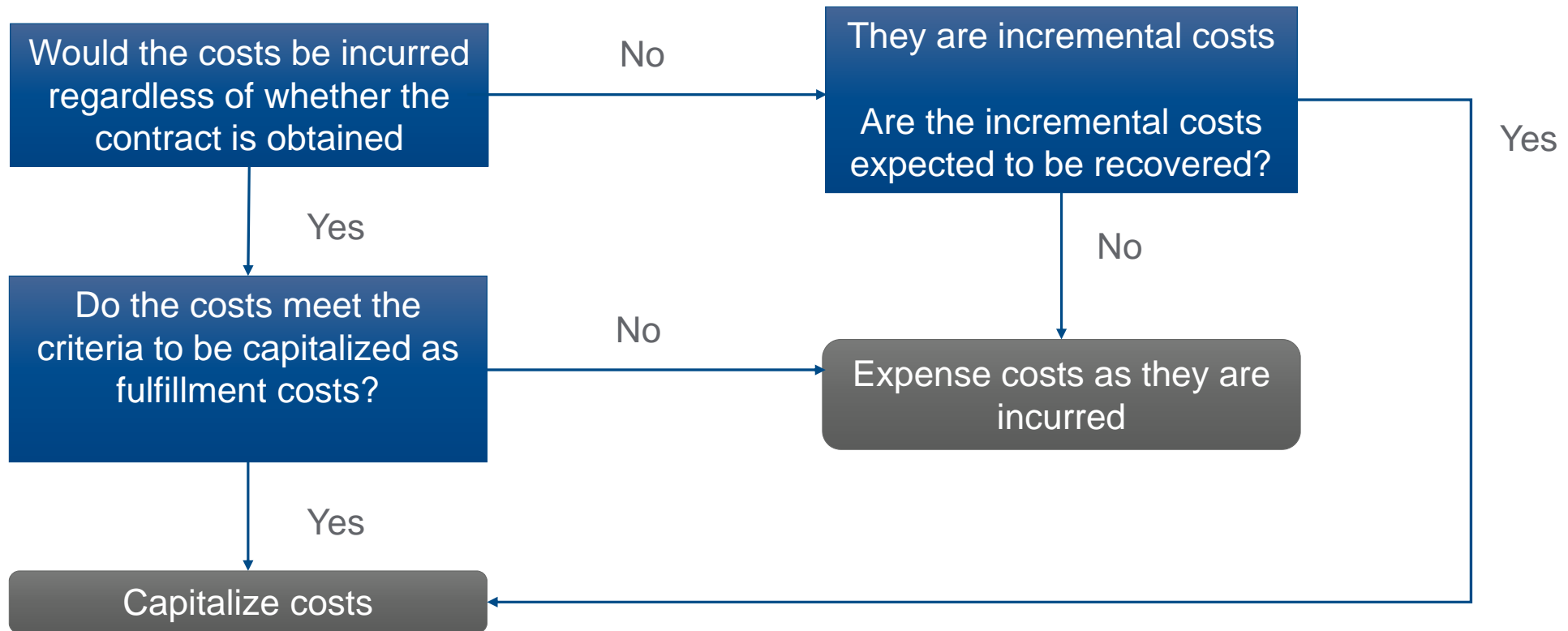
Financial Statement Audit Considerations



What to Expect from your Auditors?

- Implementation of Controls
 - Evaluate new accounting pronouncements
 - Evaluate the impact of new accounting pronouncements
- Inquiry
 - What procedures did the company perform to evaluate ALL contracts?
 - Was the company's team qualified and competent?
 - How did the company ensure completeness of contracts reviewed?
 - How did the company ensure contracts at subsidiaries were considered?
- Testing
 - Expect all significant contracts as well as a sample of contracts to be tested by your auditors utilizing the attributes discussed above.

Incremental Costs of Obtaining a Contract



Evaluate Business Impacts

Accounting and reporting

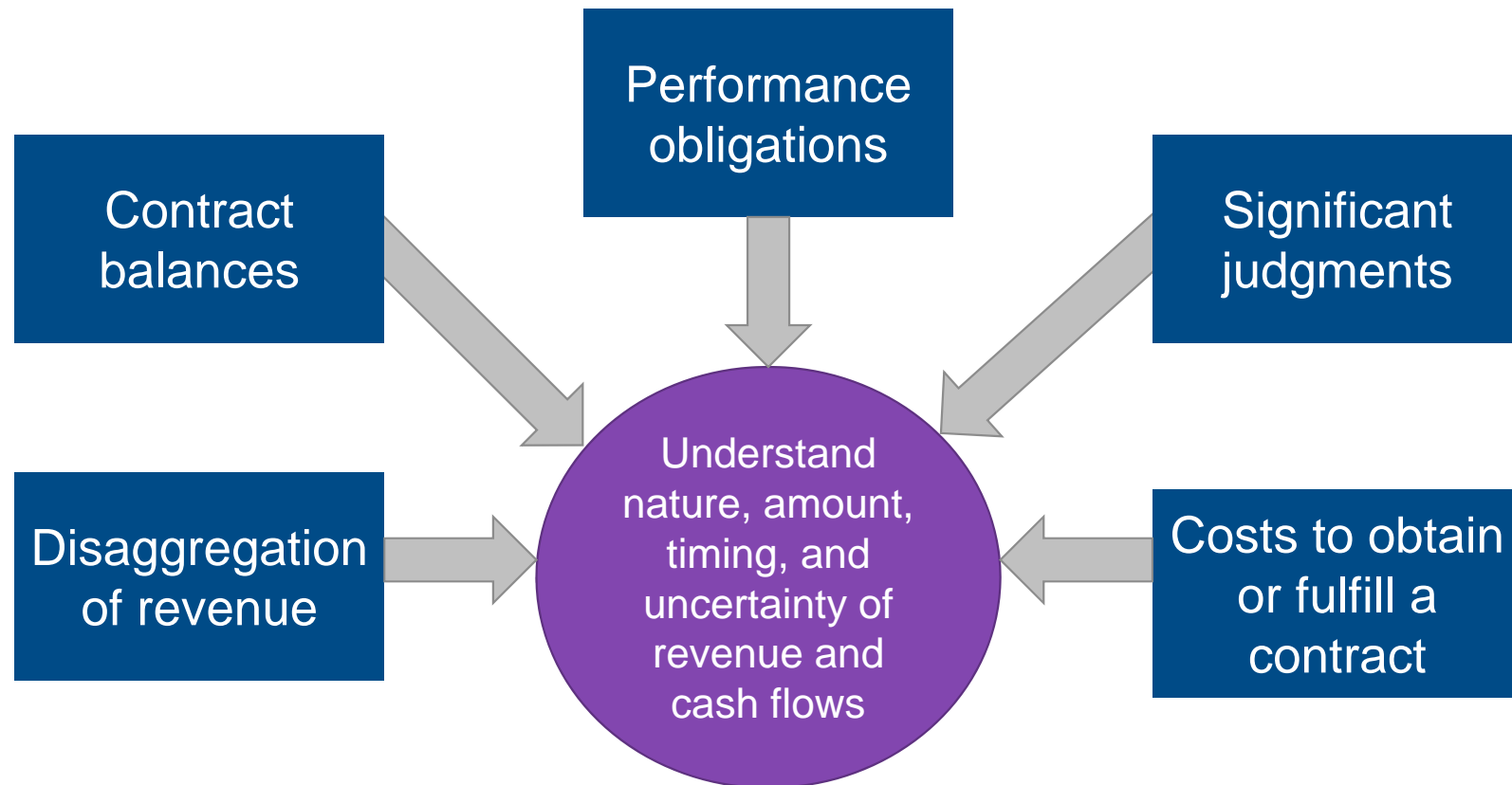
Systems and processes

Tax

Internal Control Environment

Operational Matters

Disclosure Requirements



QUESTIONS?

sage Intacct
ADVANTAGE2017

LEAD THE FUTURE

THANK YOU

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