

It's Here! The New Revenue Recognition Standard

After more than a decade of effort, the FASB has issued its comprehensive new revenue recognition standard, ASU No. 2014-09, *Revenue from Contracts with Customers*. The new standard is the result of a joint project between the FASB and the International Accounting Standards Board (IASB) to converge and improve the financial reporting of revenue globally. ASU No. 2014-09 will supersede the revenue recognition requirements in *Accounting Standards Codification* Topic 605, *Revenue Recognition*, most of the industry-specific guidance throughout the Industry Topics of the Codification, and some of the cost guidance included in Subtopic 605-35, *Revenue Recognition—Construction-Type and Production-Type Contracts*. ASU 2014-09 affects any entity that either enters into contracts with customers to transfer goods or services or enters into contracts for the transfer of nonfinancial assets unless those contracts are within the scope of other standards (for example, insurance contracts or lease contracts). The new standard takes effect in 2017 for public entities (early application is not permitted) and in 2018 for nonpublic entities (early application is permitted but no earlier than the public entity effective date), and will be applied retrospectively to each prior reporting period presented with practical expedients provided. The FASB has decided to move the revenue recognition guidance from its current Topic 605 to a newly created Topic 606, *Revenue from Contracts with Customers*. A transition resource group is being set up to identify potential implementation issues and help companies adjust to the new standard before its effective dates. It is interesting to note that the new standard was passed by an affirmative vote of only five of the seven members of the FASB, with Vice Chairman James Kroeker abstaining, and Harold Schroeder actually dissenting because he believes that certain of its key requirements are not consistent with the standard's core principle for revenue recognition.

As we are all aware, existing revenue recognition guidance in U.S. GAAP is comprised of broad revenue recognition concepts together with numerous revenue requirements for particular industries or transactions, which sometimes results in different accounting for economically similar transactions. The overall objectives of the new revenue recognition standard are to remove inconsistencies 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 financial statement users, and simplify the preparation of financial statements by reducing the number of requirements to which an entity must refer.

The core principle of the new standard is that an entity should recognize revenue to depict the transfer of promised goods or services to customers in an amount that reflects the consideration (i.e., payment) to which the entity expects to be entitled in exchange for those goods or services. To achieve this, an entity will apply the following new five step principles-based approach to recognizing revenue:

- Step 1 Identify the contract(s) with a customer.
- Step 2 Identify the performance obligations in the contract.
- Step 3 Determine the transaction price.
- Step 4 Allocate the transaction price to the performance obligations in the contract.
- Step 5 Recognize revenue when (or as) the entity satisfies a performance obligation.

The new standard also includes enhanced disclosure requirements intended to provide financial statement users with comprehensive information about the nature, amount, timing, and uncertainty of

revenue and cash flows arising from a reporting entity's contracts with customers. In this respect, a reporting entity will be required to provide information about:

- Revenue recognized from contracts with customers, including a breakout of revenue into appropriate categories;
- Contract balances, including the opening and closing balances of receivables, contract assets, and contract liabilities;
- Performance obligations, including when the reporting organization typically satisfies its performance obligations and the transaction price that is allocated to the remaining performance obligations in a contract; and
- Significant judgments, and changes in judgments, made in applying the requirements to those contracts.

In addition, a reporting entity is also required to provide quantitative and/or qualitative information about assets recognized from the costs to obtain or fulfill a contract with a customer.

"This will change the way people should be thinking about recognizing and analyzing revenue," said FASB member Marc Siegel in an interview. "Today in U.S. GAAP you've got a process where you have to understand where the earnings process is completed. That's a little bit of a nebulous concept. The new standard will have companies analyzing assets and liabilities associated with contracts from customers, and the revenue will fall out as those performance obligations, those liabilities, are satisfied by the seller. I think that's a little bit of a change in process that people need to understand as they're thinking about the revenue transactions and implementing the new standard going forward."

FASB Chairmen Russell Golden added, "The revenue recognition standard represents a milestone in our efforts to improve and converge one of the most important areas of financial reporting. It will eliminate a major source of inconsistency in GAAP, which currently consists of numerous disparate, industry-specific pieces of revenue recognition guidance. The issuance of this standard is a major first step, but it is not the end of the process. Through the transition resource group and a robust implementation period, the FASB and the IASB will work to ensure that reporting organizations are able to make a smooth transition to the new requirements by 2017."

Beginning this fall, Surgent McCoy will present live 8-hour seminars that will bring you up-to-date on the new revenue recognition standard. Contact your local state society for dates and locations for the course, "Revenue Recognition: A New Day is Dawning" (RERE).

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