Financial Poise

New Revenue Recognition Standards to Impact Wide Array of Business Practices

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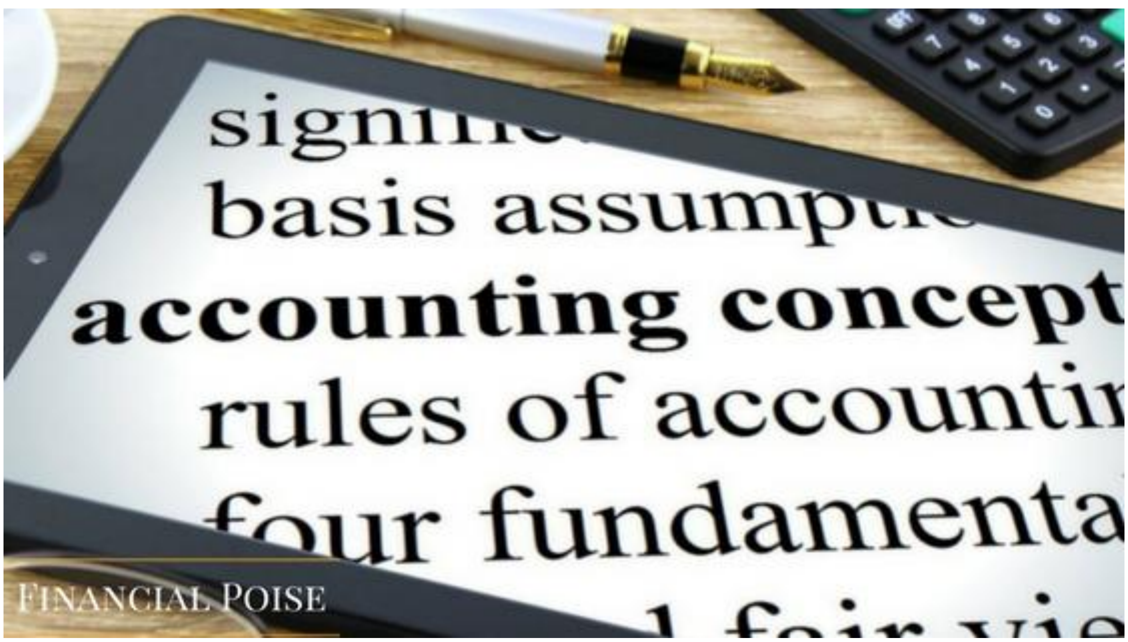

The **Financial Accounting Standards Board** (FASB) recently changed revenue recognition standards, introducing many new aspects that accountants need to understand as they advise their clients in 2017.

Even though these standards won't take effect until 2018 (for public companies) and 2019 (for private companies)—assuming calendar year-end—the new rules are vast The FASB's changes go beyond the financial statements and affect standard operating procedures (SOPs).

New Standards Change Amount, Timing of Recognition

While no two industries are the same—and SOPs can vary greatly from business to business within each industry—the new standard paints every sector of the economy with a broad brush. This means uniform accounting practices now apply to areas that have traditionally followed very different guidelines.

This new approach puts a greater emphasis on more details, judgment and disclosures.

Existing revenue recognition guidance lacks consistency across industries and fails to address certain types of arrangements (such as gross versus net revenue for principal vs. agent consideration). This new standard is aimed at improving comparability and eliminating gaps in guidance.

Depending on an entity's existing business model and revenue recognition practices, the new standard could have a significant impact on the amount and timing of revenue recognition. This, in turn, could impact key performance measures and debt covenant ratios, and ultimately could affect contract negotiations, business activities, and budgets.

A New Burden on Managers and Bookkeepers Alike

As a result, chief executives and CFOs not only have to reassess the way they run their companies, many may have to implement changes at the middle management and point-of-sale levels as well. These situations could have wide-reaching effects on ongoing resource management, business processes and policies, and current IT infrastructure.

One change that companies may not expect (even if revenue recognized does not change under the new standards) is related to the practice of inventory management for retailers and manufacturers.

Instead of using one line item within the financial statements to disclose a company's stockpile of goods, the inventory will have to be broken out into much greater detail to comply with the new standards. If products sold have associated rights of return, the estimated inventory that companies expect to be returned will have to be disclosed as a separate line item from the regular inventory.

Disclosures Could Drastically Reshape Financial Statements

Disclosures such as this could drastically reshape the company's financial statements.

There will be more assets, liabilities and disclosures to weigh and consider. It presents an enormous challenge for the auditors who are charged with reviewing all of this new information; nonetheless, they are important.

For a loan officer or a venture capitalist, knowing this type of data will give a clearer picture of the nature, amount, timing, and uncertainty (if any) of the revenue that companies have with their customers, which could alter the valuation of the underlying business or impact the amount being borrowed.

Given the significant changes, adequate training and education are an important element for companies to consider. Whether the solution is to increase staffing with more CPAs or invest in employee education and/or advanced information technology, decisions will need to be made in 2017 for public companies to be ready by 2018.

CPAs should guide this preparation process. We call it **STEP: STudy, Evaluate, Prepare.**

Best Practices: How to Use STEP

The first phase: Learn everything you can about the new revenue recognition standards and understand the background. The update to the revenue recognition standard issued in the spring of 2014 as Accounting Standards Update (ASU) 2014-09. There are five final amendments that were issued in 2016 with regards to the new standards:

1. ASU No. 2015-14, Revenue from Contracts with Customers (Topic 606) – Deferral of the Effective Date
2. ASU No. 2016-08, Revenue from Contracts with Customers (Topic 606) – Principal vs. Agent Considerations (Reporting Revenue Gross Versus Net)
3. ASU No. 2016-10, Revenue from Contracts with Customers (Topic 606) – Identifying Performance Obligations and Licensing

4. ASU No. 2016-12, Revenue from Contracts with Customers (Topic 606) – Narrow-Scope Improvements and Practical Expedients
5. ASU No. 2016-20, Technical Corrections and Improvements to Topic 606 – Revenue from Contracts with Customers

Financial statement preparers and auditors must learn the details of the new standard and the amendments that have occurred since the new standard was put in place in 2014, understand the transition methods available upon adoption and review the new disclosure requirements.

More importantly, companies should get a clear understanding of how the new standard is different compared to current practice. Getting a 10-minute overview of the standards is not going to be enough.

The second phase: Any changes that may have an operational or financial impact should be evaluated. This includes identifying the key revenue streams and contracts, reviewing the business's current accounting policies and how they compare to the new standards, as well as communicating these analyses with various internal (such as upper management) and external stakeholders (such as shareholders and bankers).

The last phase: Once everyone is on board, the preparation for adoption of the new standards can begin. Detailed timelines have to be established to execute any changes required as a result of the new standards. New accounting policies and procedures may have to be developed or, at the very least, existing ones will have to be modified.

Revenue Recognition Is a Team Effort

Even some of the more subtle changes could require full top-down changes at an organization. This will include the cooperation of lower-level employees as well as the C-suite executives. For some who don't think the changes will affect them, they might want to be reminded that their bonuses may be impacted if revenue is the major driver in the calculation.

Author Biography

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Previously, Hogi was an audit manager for a Big Four firm and an audit manager for over eight years at one of the largest public accounting, consulting, and technology firms in the U.S., working with both public and private companies.

Hogi has more than ten years of public accounting experience in multiple disciplines, including audit, mergers and acquisitions, revenue recognition matters and complex debt/equity financing transactions for both public and private companies in a variety of industries (manufacturing, retail, software and distribution) with annual revenues up to $1 billion. He can be reached atHKurniawan@hwcpa.com or (949) 450-6200.