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How The New Revenue-Recognition Standards Affect CRE

BY CARRIE ROSSENFELD

IRVINE, CA—The FASB recently changed revenue-recognition standards, introducing many new aspects that will take effect over the next two years. Haskell & White's Hogi Kurniawan explains to GlobeSt.com how they impact developers and brokers.

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IRVINE, CA—The **Financial Accounting Standards Board** recently changed **revenue-recognition standards**, introducing many new aspects that will take effect over the next two years. GlobeSt.com spoke with accounting firm **Haskell & White**'s senior audit manager **Hogi Kurniawan** about the new standards and how they will impact **commercial real estate developers** and brokers over the next two years.

GlobeSt.com: Please explain the new revenue recognition standards that are sure to impact the real estate industry next year.

Kurniawan: The new aspects that will take effect in 2018 for public companies and 2019 for private companies.

The new standards outline five steps to recognizing revenue:

1. Identify the contracts.
2. Identify the performance obligations in the contract.
3. Determine the transaction price.
4. Allocate the transaction price to the performance obligations in the contract.
5. Recognize revenue when the entity satisfies a performance obligation.

In addition, the new standards require significantly expanded disclosures about revenue recognition, including both quantitative and qualitative information that include (1) the amount, timing, and uncertainty of revenue from existing contracts; (2) the estimates, and changes in estimates, used in applying the revenue model; and (3) the assets recognized from costs to obtain or fulfill a contract with a customer.

GlobeSt.com: What is the purpose of these standards, and what will their impact be on developers and CRE brokers?

Kurniawan: The updated guidelines put a greater emphasis on details, judgment and disclosures aiming to improve comparability and increase consistency across industries.

For developers, the new standards include an example describing three cases in which a developer enters into a contract to sell a specified **condominium** unit once **construction** is complete. The developer receives an up-front nonrefundable deposit. In addition, the contract legally obligates the developer to complete construction of the asset and to transfer the specified unit to the customer.

In Case A, the developer does not have an enforceable right to payment for the performance completed to date; in Cases B and C, the developer has such a right. While the developer may determine that its performance under the contract creates an asset that does not have an alternative use for the developer (i.e., the developer cannot use or sell the asset to anyone else), the analysis focuses on whether the developer has an enforceable right to payment for its performance to date.

The example indicates that the developer should consider the legal precedent in the particular jurisdiction to determine whether the rights and obligations under the contract are enforceable. If the developer determines that its rights and obligations are legally enforceable, the entity would recognize revenue over time.

Alternatively, the developer would be required to recognize revenue at the point in time at which control of the specified unit is transferred to the customer. This guidance may delay the recognition of revenue for developers of **multifamily** condominium complexes. The new revenue-recognition model for the sale of real estate differs significantly. The new principles-based approach is largely based on the transfer of control.

As a result, more transactions will likely qualify as sales of real estate, and revenue (i.e., gain on sale) will be recognized sooner than it is under today's accounting. Specifically, the new standards eliminate the requirements for assessing (1) the adequacy of a buyer's initial and continuing investments and (2) the seller's continuing involvement with the property. When evaluating whether it can de-recognize real estate under the new standard, an entity will need to assess whether it is "probable" that it will collect the consideration to which it will be entitled. In addition, rather than preventing de-recognition, a seller's post-sale involvement with the disposed asset may need to be accounted for as a separate performance obligation.

The accounting for management fees and other fees that vary based on performance (e.g., percentage of the property's revenues or **net operating income**) will also change. A **property manager** will have to estimate, at contract inception, the variable consideration to which it will be entitled and for which it is probable that a significant revenue reversal will not occur. This amount will then be recognized in the period as the performance obligation is satisfied.

GlobeSt.com: What alternative solutions would you suggest to decrease the burden on the CRE industry while still maintaining transparency?

Kurniawan: Although the new standards are not effective now, entities should start carefully examining the standards and assessing the impact it may have on their current accounting policies, procedures, systems and processes. The impact may not look significant on the surface, but careful analysis should be performed to truly understand the overall significance of the new standards.

The new standards will necessitate a coordinated team effort and could require top-down changes throughout the organization. In efforts to decrease the burden on CRE brokers and the industry as a whole, engaging all employees from the C-suite down to agents in the field could offset the burden. Ensuring that each employee understands the new standard and its effects on their role will be vital to compliance with the standard and maintaining transparency.

GlobeSt.com: What else should our readers know about these standards?

Kurniawan: Management will need to exercise significant judgment in applying certain requirements under the new standards, including those related to the identification of performance obligations, allocation of revenue and estimating any identified variable considerations. It is important for entities to consider how the standard specifically applies to them as different entities would have a unique set of facts and circumstances.

The new standards allow for either retrospective or prospective application, with certain optional practical expedients available to entities at their discretion. Entities may be required to gather data and assess contracts that commenced several years before the standard's effective date. For retrospective application, entities also will most likely be required to perform dual tracking of revenue balances given the potential difficulty of retroactively recalculating revenue balances when the new standards become effective.

To comply with the **disclosure** requirements under the new standards, entities will have to gather and track information that they may not have previously monitored. The systems and processes associated with such information may need to be modified to support the capture of additional data elements that may not currently be supported by legacy systems. Further, to ensure the effectiveness of internal controls over **financial** reporting, management will want to assess whether it should implement additional controls. Entities may also need to begin aggregating essential data from new and existing contracts since many of these contracts will most likely be subject to the new standards. Ultimately, entities should carefully consider and evaluate all aspects required under the new standards to determine whether any other further modifications may be necessary. Please, consult your CPA.

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Carrie Rossenfeld is a reporter for the West Coast region of GlobeSt.com and Real Estate Forum. She was a trade-magazine and newsletter editor in New York City before moving to Southern California to become a freelance writer and editor for magazines, books and websites. Rossenfeld has written extensively on topics including commercial real estate, running a medical practice, intellectual-property licensing and giftware. She has edited books about profiting from real estate and has ghostwritten a book about starting a home-based business.

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