The revenue recognition transition

What emerging growth companies need to know about ASC 606. Authored by Phil Santarelli, CPA, Partner Emeritus, Baker Tilly and Howard J. Heyman, CPA, Partner, Baker Tilly

Accounting Standards Codification (ASC) 606, Revenue from Contracts with Customers, affects virtually every entity that prepares financial statements. The new standard impacts one of the most important numbers in financial statements — revenue — and could impact key financial ratios, sales, contracts, technology systems, accounting and internal controls. Organizations that prepare financial statements under generally accepted accounting principles (GAAP) must act now.

There are important factors to consider if your organization is considering following GAAP. Even pre-revenue companies should consider whether and how contemplated arrangements with customers might be impacted by ASC 606. Emerging companies must understand this issue to avoid providing guidance that may conflict with the new accounting guidance.

Transition timeline

The new standard is now effective for:

1) Fiscal years beginning after **December 15, 2017,** for public companies and certain not-for-profits that have issued conduit debt obligations
2) Fiscal years beginning after **December 15, 2018,** for all other entities

For accelerated filers, the revenue recognized during 2016 may need to be restated as part of the transition in 2018.

If an Emerging Growth Company (EGC) as defined in the JOBS Act has made the initial election to defer application of new accounting standards until the effective date for non-issuers, the effective date is 2018. EGCs nearing the end of the five-year deferral window may need to consult with SEC counsel as to the required effective date.

What is ASC 606?

The Financial Accounting Standards Board (FASB) and the International Accounting Standards Board (IASB) issued new standards on revenue recognition, Accounting Standards Update 2014-09 (Topic 606), *Revenue from Contracts with Customers* (affecting ASC 606) and International Financial Reporting Standards (IFRS) 15. The FASB replaced hundreds of pages of rules-based guidance principally designed for specific industries while the IASB provided the first comprehensive revenue recognition guidance contained in IFRS.

Although the impact on the revenue recognized will vary widely for different organizations and industries, there will be need for significant changes to how revenue is recognized and need for changes and modifications to internal controls, IT systems, contracts and other business processes. Depending on the financial statement impact, there could be effects on compensation arrangements, loan agreements, etc.

The five elements of revenue recognition

ASC 606 provides a structure through which all revenue transactions must be assessed:

1. **Identify the contract with a customer**
   Contracts should be reviewed to consider the accounting implications of structuring, modifications and impacts on the organization.
2. **Identify the performance obligations (promises) in the contract**
   Implied and explicit promises within contracts may complicate the identification of performance obligations and complying with the requirements for identifying separate performance obligations may require changes in business process and internal control over financial reporting.
3. **Determine the transaction price**
   The concept of variable consideration could result in accelerating revenue. Applying the concepts will result in many more judgments by management and will require robust internal controls over financial reporting to provide a consistent and reliable process.
4. **Allocate the transaction price to each performance obligation**
   It requires internal control over financial reporting and consistent application of judgments.
5. **Recognize the revenue when (or as) the reporting organization satisfies performance obligations**
   For performance obligations satisfied over time, complex judgments will be necessary and will need to be revisited with each interim period.

Each element requires an assessment to determine the impact on an organization and will require more judgments and estimates than were necessary under previous revenue guidance.

Scope

There are no scope outs for specific types of entities; however, certain types of transactions have been scoped out:

- Lease contracts
- Insurance contracts
- Financial instruments
- Guarantees
- Nonmonetary exchanges between entities in the same line of business to facilitate sales to customers or potential customers

Developing a strategy

Navigating the complexities of ASC 606 requires specific, extensive expertise. Baker Tilly professionals work with all types of entities to help assess challenges, develop and implement a compliance strategy and evaluate and adjust ongoing management and controls.