

Revenue Recognition Developments Series – FASB ASU 2014-09, *Revenue from Contracts with Customers (Topic 606)*

Due to the importance of revenue and the complexity of the FASB's Accounting Standards Update 2014-09, Miller Cooper will be issuing its "Revenue Recognition Development Series" to assist our clients in understanding the newly issued revenue recognition literature. While the new literature may not look like a significant change at first glance, the changes are significant and most entities that provide goods and services to customers will be impacted in some manner by the new literature.

In Volume 1 of the Revenue Recognition Development Series, we provide a high level overview of the new literature. Subsequent topics in the Revenue Recognition Development Series will include a deeper look into applying the "Five Steps" to recognizing revenue, impacts on different industries, the enhanced requirements of the financial statement disclosures, and implementation issues to watch for.

Miller, Cooper & Co., Ltd.

Overview

Revenue is an important performance indicator to both preparers and users of financial statements in assessing an entity's performance and prospects. It is used as a measure to assess past, current and future performance, as well as the financial health of an entity.

With the globalization of the world's financial markets, the Financial Accounting Standards Board (FASB) and International Accounting Standards Board (IASB) initiated a joint project in October 2002 to set out to develop a common revenue standard to remove inconsistencies and weaknesses in the revenue requirements; improve comparability across entities, industries, jurisdictions and capital markets; provide more useful information through improved disclosures; and reduce the number of accounting literature sources the reporting entity must refer, to a single standard.

To achieve this common revenue standard, the FASB issued in May 2014, its final revenue recognition standard, Accounting Standards Update 2014-09, *Revenue from Contracts with Customers (Topic 606)*, (ASU 2014-09) in three parts ([Part 1](#), [Part 2](#), and [Part 3](#)), which culminated in the creation of a new topic, Topic 606, within the FASB Accounting Standards Codification.

Main Provisions

ASU 2014-09 changes the revenue recognition model from a risks and rewards model (current GAAP) to a model that focuses on when the control of goods or services are transferred to the customer. The core principle of the new standard is that an entity should recognize revenue to reflect the transfer of promised goods or services to customers in an amount the entity expects to be entitled to. To achieve the core principle, an entity should apply the following steps:



Source: FASB In Focus, May 28, 2014, Accounting Standards Update No. 2014-09, Revenue from Contracts with Customers (Topic 606)

ASU 2014-09 also provides updated guidance on:

- Incremental costs of obtaining a contract;
- Costs to fulfill a contract; and
- Disclosures

Incremental costs of obtaining a contract – The incremental cost of obtaining a contract, if expected to be recovered, should be recognized as an asset. The costs are allowed to be expensed as incurred, if the expected life is less than one year. For example, commissions paid to a sales representative. Assume the commission is determined to be incremental in obtaining the contract and the commission is only paid when a contract is finalized, those costs would be capitalized as an asset and recognized over the term of the agreement.

Costs to fulfill a contract – If not covered by other accounting standards, an entity may recognize an asset from the costs to fulfill a contract if all of the following are met: (1) relates directly to a contract; (2) generates or enhances resources of the entity that will be used to satisfy performance obligations; and (3) are expected to be recovered. For example, a company enters into a contract to sell internet services to a customer, the company sends a technician to the customer’s home with supplies to connect the customer to the internet. The labor and material costs incurred to perform the setup are direct costs that relate to the customer contract and to satisfying the company’s performance obligation with the customer. The company expects to recover those incurred costs over the term of the contract and determines it is appropriate for those costs to be capitalized as an asset and recognized over the term of the agreement.

Disclosures – ASU 2014-09 expands and enhances the disclosure requirements for revenue related items. It provides a set of disclosure requirements about the nature, amount, timing and uncertainty of revenue and cash flows arising from contracts with customers, including quantitative and qualitative information.

Disclosures – (Continued)

Additionally, ASU 2014-09 may result in the recognition and presentation of a contract asset or liability for the difference between the goods or services transferred to the customer (entity's performance) and the consideration paid by or unconditionally due from the customer (customer's performance).

Lastly, nonpublic entities (e.g. private companies, not-for-profits, and employee benefit plans) meeting certain criteria, may elect to not provide certain disclosures, which will provide considerable disclosure relief to those entities.

Summary of Main Differences from Current GAAP

Current GAAP (Topic 605)	ASU 2014-09 (Topic 606)
Number of industry specific requirements.	Industry specific guidance does not exist.
Multiple models for addressing variable consideration received.	Single model addressing variable consideration (which includes rebates, discounts, bonuses, or right of return).
Many goods or services promised in a contract with a customer are treated as a single revenue transaction (i.e., bundled). Those goods or services promised represent separate obligations of the selling entity to the customer.	The selling entity will now need to identify each of the goods or services promised in a contract to determine whether those items represent a performance obligation. If identified as a performance obligation, revenue is recognized when, or as, each performance obligation is satisfied.
For multiple-element arrangements, the allocation of consideration is limited to the amount of consideration for a delivered element that is not contingent on delivering future goods or services.	The selling entity allocates the transaction price to each performance obligation based on the standalone selling price of the goods or services.
Limited disclosures.	Expanded disclosures.

Impact on Industries

While the revenue recognition for point of sale transactions should not change, many companies (e.g. construction, software, and wireless companies) are expecting to record revenues differently under ASU 2014-09. While total contract revenues that are expected to be collected will remain the same, the timing of when that revenue is recognized in the financial statements is expected to be different. Contractual obligations and requirements (e.g., bank covenants, bonus programs, and earnout and buyout provisions) may also be affected by this change in the timing of revenue recognition.

Transition

ASU 2014-09 provides for two methods of transition. Entities may choose to use (1) a full retrospective method or (2) a modified retrospective approach (apply the standard prospectively to new contracts after the effective date and record a cumulative adjustment to the opening balance of retained earnings for all existing contracts).

Effective Date

ASU 2014-09 is effective for:

- Public entities with annual periods beginning after December 15, 2016 (including interim periods) and early adoption is prohibited.
- Nonpublic entities with annual periods beginning after December 15, 2017 (e.g. December 31, 2017 year-end would adopt ASU 2014-09 effective January 1, 2018).
- Nonpublic entities may elect to early adopt in the same period as public entities (e.g. December 31, 2016 year-end would adopt ASU 2014-09 effective January 1, 2017).

Next Steps

While the effective date is more than two years away, entities need to act now in order to be ready by the effective date. Implementation will include obtaining an understanding of the 700 pages of guidance contained in ASU 2014-09; designing an implementation strategy; and evaluating the impact on the entity. The implementation may require modifications to the entity's IT infrastructure, including changes to the accounting system, and training throughout many levels within the entity. An additional item for management to consider is how certain contracts are written and what changes may need to be made for them to comply with the new literature.

To assist entities in implementing, the FASB and IASB created the Joint Transition Resource Group for Revenue Recognition (TRG). The TRG will inform the FASB and IASB of any potential implementation issues that could arise when entities implement the new standard. The FASB and IASB encourage stakeholders to submit potential implementation issues as soon as possible by preparing a [submission form](#).

Contact Us

Entities are encouraged to meet with their Miller Cooper Principal to discuss ASU 2014-09, in order to evaluate its potential impact on the entity's significant revenue streams and determine what should be communicated to relevant stakeholders as implementation strategies are developed further.

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