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Deep Dive #2: Implementing the New Revenue Recognition Standard

Faculty

- Moderator
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- Panelist
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  - Jade Shopp, Partner, Deloitte Advisory Financial Services Industry

Agenda

- Overview of the new revenue standard
- Setting the stage – status of implementation
- Scoping significant contracts
- Accounting for sales of real estate
- Transition
- Impact on internal controls over financial reporting (ICFR)
- Next steps

Overview of the new revenue standard

Jade Shopp, Partner, Deloitte Advisory Financial Services Industry

Overview of the new revenue standard

Core principle: Recognize revenue to depict the transfer of promised goods or services to customers in an amount that reflects the consideration the entity expects to be entitled

Step 1

Identify the contract 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 performance obligations ("PO")

Step 5

Recognize revenue when (or as) the entity satisfies a performance obligation

This revenue recognition model is based on a **transfer of control** approach, which differs from the **risks and rewards** approach applied under current US GAAP.

Scope of the new revenue standard

- Applies to an entity's contracts with customers
- Does not apply to:
  - Lease contracts (ASC 840, ASC 842)
  - Contracts within the scope of the insurance guidance in ASC 944
  - Certain financial instruments and other contractual rights or obligations
  - Guarantees (other than product or service warranties)
  - Nonmonetary exchanges whose purpose is to facilitate a sale to another party
- ***Some key aspects apply to transfer (sale) of nonfinancial assets (e.g., real estate) that do not meet the definition of a business.***

Glossary terms

Contract: An agreement between two or more parties that creates enforceable rights and obligations

Customer: A party that has contracted with an entity to obtain goods or services that are an output of the entity's ordinary activities in exchange for consideration

Effective date & transition options

- **Effective date (public entities)**
  - Annual reporting periods beginning after December 15, 2017, including interim reporting periods therein; early application permitted
- **Transition options**
  - Full Retrospective – restate prior comparative periods
  - Modified Retrospective – apply to contracts not completed as of effective date

cumulative catch-up

January 1, 2018 Initial Application Year	2018 Current Year	2017 Prior Year 1	2016 Prior Year 2
New contracts	New ASU		
Existing contracts	New ASU + cumulative catch up	Legacy GAAP	Legacy GAAP
Completed contracts		Legacy GAAP	Legacy GAAP

Transition options

The following provides some key observations and potential challenges for each transition approach:

	Full retrospective	Modified retrospective
Dual reporting requirements	• Prior two comparative years (potentially three) required to be restated.	• Dual recordkeeping required in the year of adoption.
Comparability	• Full comparability as prior periods are restated. • Cumulative catch-up adjustment recorded on January 1, 2016.	• No comparability between current year and prior periods on primary financial statements. • Year of adoption comparability provided in footnote disclosures. • Cumulative catch-up adjustment will be on January 1, 2018.
System considerations	• The full retrospective method will require information to be prepared and validated before January 2018. Procedural “trial runs” will provide opportunity to fix potential unforeseen or unplanned challenges.	• More time to develop a one-time transition plan with more runway to fix data and system challenges ahead of “go-live” in January 2018.

Disclosure requirements – public entities

Background					
The new revenue standard requires significant additional qualitative and quantitative disclosures for public entities. A public entity is defined in the new revenue standard as (1) a public business entity as defined in ASU 2013-12, (2) a not-for-profit entity that has issued, or is a conduit bond obligor for, securities that are traded, listed, or quoted on an exchange or over-the-counter market, or (3) an employee benefit plan that files or furnishes financial statements to the SEC. This information is provided for illustrative purposes only.					
Required annual disclosures	**Quantitative**	**Qualitative**	**Required on an interim basis?**	**Key decisions and considerations**	**ASC**
1. Disaggregation of revenue	✓	✓	✓	• Determination of disaggregation categories • Choice between quantitative or qualitative reconciliation to segment revenue	606-10-50-5 through 50-7 & 606-10-55-89 through 55-91
2. Contract asset/liability balances	✓	✓	✓	• Consider adjusting more significant estimates	606-10-50-8 through 50-11
3. Nature of performance obligations		✓		• Description of key components of identified Pos	606-10-50-12
4. Amount and recognition timing of transaction price allocated to the remaining performance obligation	✓	✓	✓	• Preferred breakdown of remaining POs • Quantitative or qualitative presentation	606-10-50-13
5. Significant judgments used in determining the transaction price and satisfying performance obligations		✓		• Determination of whether there should be a specific list of judgments to reference when preparing the disclosure or whether the disclosure should be open-ended	606-10-50-18 through 50-19 & 606-10-50-20
6. Assets recognized from the costs to obtain or fulfill a contract	✓	✓		• Capability to identify costs that qualify for capitalization and to determine appropriate amortization period	340-40-50-1 through 50-4
7. Election of practical expedients		✓		• Capability to capture the use of practical expedients and apply practical expedients consistently	606-10-50-22 & 340-40-50-5

Disclosure requirements – non-public entities

Background					
The new revenue standard requires significant additional qualitative and quantitative disclosures for non-public entities. The purpose of the expanded disclosure requirements is to enable users of financial statements to understand the nature, amount, timing, and uncertainty of revenue and cash flows arising from contracts with customers.					
Topic	**Description**	**Freq**	**Quantitative**	**Qualitative**	**ASC**
1. Disaggregation of revenue	Revenues from contracts with customers should be disaggregated based on timing of transfer of goods or services (point in time or over time) and qualitative information about how economic factors affect cash flows.	Annually	✓	✓	606-10-50-5 through 50-7 & 606-10-55-89 through 55-91
2. Contract balances	Opening and closing balances of contract assets, contract liabilities, as well as receivables related to contracts	Annually	✓		606-10-50-8 through 50-11
3. Performance obligations (POs)	When performance obligations are typically satisfied, significant payment terms, nature of goods or services promised, return and warranty obligations.	Annually		✓	606-10-50-12
4. Significant judgments used in determining the timing of satisfaction of performance obligations	Methods used to recognize revenue.	Annually		✓	606-10-50-18 through 50-19 & 606-10-50-21
5. Significant judgments used in determining the transaction price and the amounts allocated to performance obligations	Significant judgments (methods, inputs, and assumptions used) to assess whether estimate of variable consideration should be constrained.	Annually		✓	606-10-50-20 through 50-21

** Certain nonpublic exemptions exist*

Potential impacts of the revenue standard

Potential effects on real estate

Elimination of bright-line tests

- Prescriptive guidance provided by ASC 360-20 (Sales of Real Estate) and ASC 605 (Construction) will be removed:
  - Buyer's financial commitment
  - Collectibility of transaction price
  - Continuing involvement by seller
  - Sales to limited partnerships/joint ventures
  - Guarantee buyer return
  - Partial sales
  - Condominium sales

- Collectibility threshold
  Must be **probable** (not necessarily **reasonably assured**) that the entity will ultimately collect the consideration it is entitled to receive

- Will likely result in **more transactions qualifying as sales of real estate** with **gains being accelerated**

Leases project

What about Common Area Maintenance (“CAM”)?

The lease standard requires separate accounting for lease and non-lease (services) components of a contract

- Payments by tenant to landlord for taxes and insurance are generally considered part of the lease revenue
- Payments by tenant to landlord for common area maintenance are not part of the lease presented and disclosed in accordance with other topics

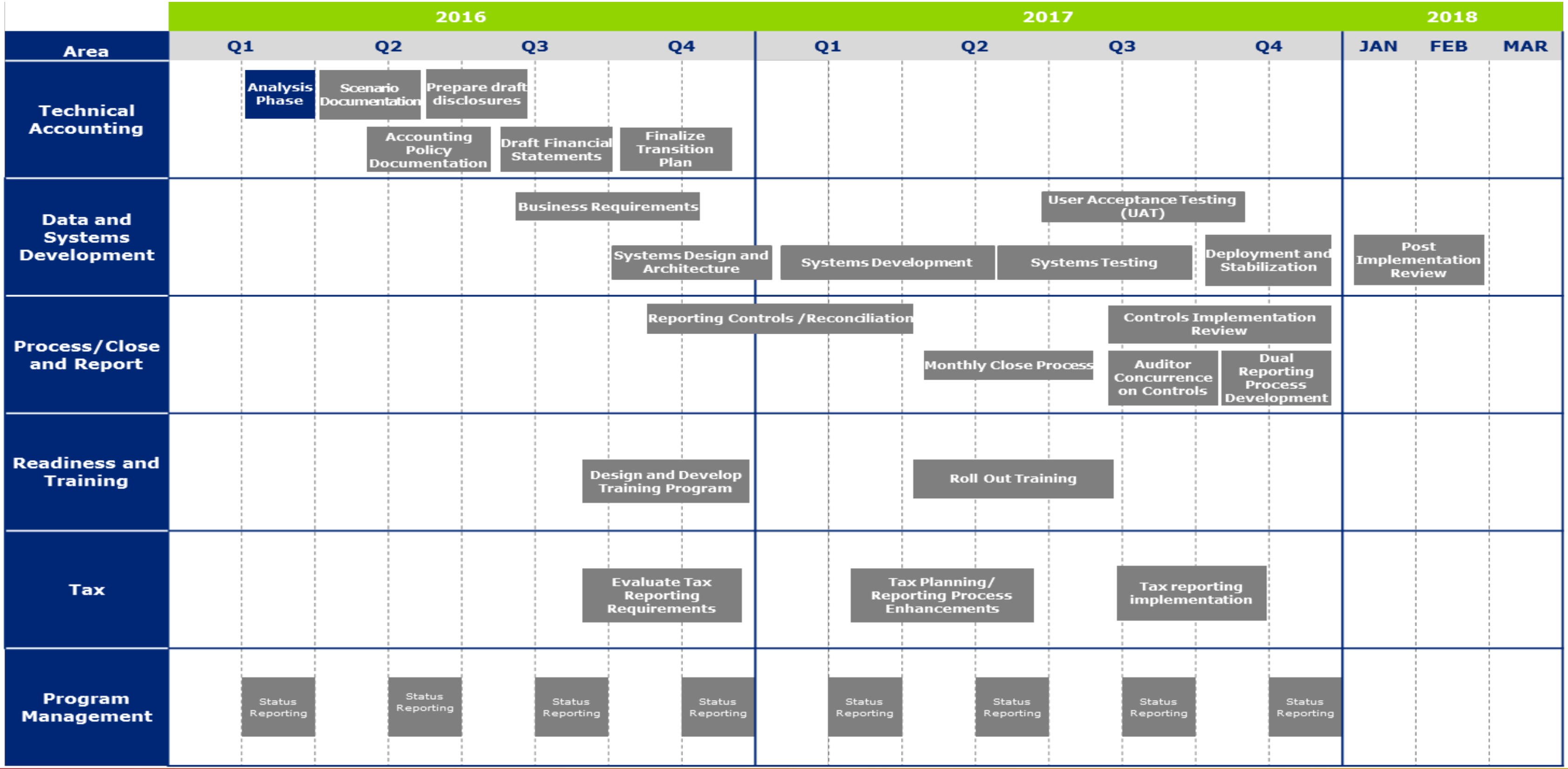
But

BC153: “…it similarly would be **reasonable** for lessors to account for multiple components of a contract as a single component if the outcome from doing so would be the same as accounting for the components separately (for example, a lessor may be able to conclude that accounting for an operating lease and a related service element as a single component **results in the same accounting** as treating those two elements as separate components). The…lessor may need to separately consider **presentation and disclosure** in accordance with other Topics.”

Common components of an implementation

Illustrative revenue recognition roadmap

The following presents the types of activities that are expected to be required in the implementation of the standard:



Phase 1: Assessment illustrative timeline

Below is an illustrative timeline for the proposed assessment activities and related deliverables:

	Activities	Week (1 2 3 4 5 6 7 8)
Program Management & Setup	Establish and perform PMO tasks including status updates	*Weekly status reports*
	Project kick-off meetings with identified stakeholders	*Kick-off materials*
Scoping	Hold workshops with stakeholders to identify significant revenue streams and contracts	*Impact assessment summary*
	Develop central repository for scoped in contracts	*Central repository*
	Hold revenue recognition training	*Training materials*
Contract Analysis	Review and assess contract arrangements against ASC 606	***Contract review summaries***
	Summarize contract reviews	***Summary of key contract terms***
Accounting and Operational Impact Analysis	Hold additional workshops and interviews based on contract reviews	***Contract review documentation***
	Document analysis of potential accounting differences, considerations, and recommendations	***Accounting position summaries***
	Conduct workshops to understand potential impacts on process, data and systems	***Process and data documentation***
	Document high-level observations of potential impacts	***Operational impact analysis***
Executive Summary & Roadmap	Prepare executive summary and conduct closing meeting	***Revenue recognition executive summary & illustrative roadmap***

◆ Milestones/ Work product delivery

▲ Status meetings (steering committee—weekly; executive committee—monthly)

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