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Accounting Matters:
Get Ready for New Revenue Recognition Rules

Pervasive new rules for revenue recognition are coming, and it's time to get prepared. The new rules, issued as a converged standard by the Financial Accounting Standards Board (FASB) and the International Accounting Standards Board (IASB), will fundamentally change accounting for revenue recognition for U.S. companies.

Five-Step, Retrospective Approach

The objective of the new rules is to provide a comprehensive revenue recognition model and more useful information via new disclosure requirements. The new model uses a five-step, principles-based approach that requires companies to:

1. Identify the contract with the customer.
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 (or as) the reporting company satisfies a performance obligation.

The new standard requires a retrospective approach, which can be "fully retrospective" or "modified" for all periods presented. If the company chooses the fully retrospective approach, it can apply the new standard to each period presented in its financial statements. Making this choice means the company would apply the new revenue standard as if it had been in effect since the inception of all its contracts with customers.

Under the modified retrospective approach, companies would apply the new revenue standard retrospectively only to the most current period in its financial statements. An adjustment would be made to the opening balance of retained earnings to recognize the cumulative effect of applying the new standard.

Judgment Required

The standard requires new judgments, estimates and calculations that are not currently required by US Generally Accepted Accounting Principles (GAAP). For example:

- **Performance obligations**: Companies will have to carefully evaluate each contract and identify whether multiple performance obligations exist.

- **Transaction price:** Companies will also have to evaluate their contracts for potential variable consideration, non-cash consideration, consideration payable to a customer, or a significant financing component.

- **Control of goods:** Under the new standard, companies can recognize revenue at the transfer of control while retaining economic risk.

- **Footnote disclosures:** Required footnote disclosures have been expanded to include disclosure of contract assets and liabilities, the nature and type of performance obligations the company extends to customers, and information about remaining or unearned performance obligations at each reporting period.

Timing of the Standard

The new standard will be effective for fiscal years beginning after December 15, 2017, for public companies and December 15, 2018, for private companies. While this may seem far away, it will likely take significant effort to make the required changes.

Depending on the impact of the new revenue standard on the company's business, changes to IT systems, processes, internal controls and personnel could be necessary. It would be wise to meet with your CPA soon to start evaluating how to implement these changes. This will help ensure that your organization has enough time to develop methods to capture the additional information required.

We are committed to your success and we hope you find this information valuable. Contact me today to discuss how this new standard will impact your business.

John E. Oeltjen, CPA, CMP
Partner | Director of Manufacturing and Distribution Services
joeltjen@muellerprost.com
314.862.2070

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