ASC Topic 606 is fast approaching! Are you ready for changes in your revenue recognition?

We'll provide the bridge to accomplish your objectives!

MRH ACCOUNTING & CONSULTING

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The new revenue recognition standard, *Revenue from Contracts with Customers* (Topic 606), is scheduled to become effective for years beginning after December 15, 2017 for public companies and after December 15, 2018 for private companies. Are you prepared? You may want to ask yourself these questions:

1. Have you considered how the new standards will affect your business?
2. Have you assigned one or more people in your company to become champions on the implementation of the new guidance?
3. Have you reviewed your contracts to determine how the new standard will apply to your current contract provisions?
4. Have you deceided which method you will use to transition to the new guidance (full retrospective or modified retrospective)?
5. Have you determined the impact the change will have on your financial statements, performance metrics, debt covenant ratios, earnings estimates?
6. Have you identified the key risks with implementing the standard?
7. Have you evaluated whether you will need to make changes to your IT systems and internal controls?
8. Have you started drafting the interim disclosures that will be needed before the standard is effective?

And perhaps the most important question:

Do you have the internal resources to accomplish all of the objectives listed above?

How can we help?

Our focus is to take the workload off of you and your staff so you can concentrate on the day-to-day operations of your company while helping to ensure your audit goes as smoothly and efficiently as possible. We have over 40 years of combined expertise in variety of industries with both private and public entities, so we are very familiar with interpreting and applying complex accounting guidance. We also have extensive experience as financial statement auditors, so we understand the format and extent of documentation that your auditors need to gain comfort with your financial statements.

If you need help or have any questions about the new revenue recognition guidance, please don't hesitate to contact us.

Lisa Swanson, CPA/ABV, CVA
Blue Abaco Consulting, Inc.
(813) 336-3660
lswanson@blue-abaco.com

Michael Heald, CPA
MRH Accounting & Consulting, LLC
(407) 970-0791
mheald@mrhaccounting.com

The following provides a brief summary of the basic terms of *Revenue from Contracts with Customers* (Topic 606) as well as some of the more complex areas of the standard that you may need to consider when analyzing your contracts.

How will I recognize revenue under the new standard?

How much revenue will I recognize?

The amount of consideration you expect to be entitled in exchange for transferring promised goods or services to a customer, not including amounts collected on behalf of third parties such as sales taxes.

When do I recognize the revenue?

Revenue is recognized when you satisfy your performance obligations under the contract by transferring control of the promised goods or services to the customer. This can be at a point in time or over a period of time, depending on the terms of the contract.

Will this apply to all my contracts?

The guidance only applies to your *contracts with customers*, but not if they are within the scope of other standards. For instance: leases, financial instruments and insurance.

What steps do I need to take to apply the revenue principles?

Step 1: Identify the contract(s) with a customer.

- The parties to the contract have approved the contract (can be written or oral) and each are committed to performing their obligations
- Each party's rights regarding the goods or services to be transferred can be identified
- Payment terms can be identified
- The contract has commercial substance (i.e. the risk, timing, or amount of the company's future cash flows is expected to change as a result of the contract)
- It's probable that the consideration to which you are entitled will be collected (i.e. likely to occur)

Under the new guidance some companies may need to recognize revenue earlier than they have in the past. For instance, the requirements for a contract may still be met under the new standard if the company has an oral agreement but they haven't yet received approval from the legal department. Also, if they haven't received signatures from both parties, it could still meet the requirements for a contract under the new standard.

Some companies, such as those in the healthcare industry, may be recognizing less revenue under the new standard. In the past, revenue for healthcare companies could be recorded based on established rates, regardless of whether they expected to collect the full amount. The new standard requires that they assess the collectibility of the consideration prior to recognizing them as revenue.

Step 2: Identify the performance obligations in the contract (the distinct goods or services that have been promised).

- It could be a distinct good or service or a series of distinct goods or services that are substantially the same and that have the same pattern of transfer to the customer.

There is a new provision which requires companies to evaluate a good or service to determine whether it is "separately identifiable from other promises in the contract." One indicator that a promise is not separately identifiable is that the goods or services are highly interdependent or highly interrelated. This is a new concept that may require companies to account for bundles of goods or services as a single performance obligation. Significant judgment may be needed when making this determination.

Step 3: Determine the transaction price: The amount of consideration you expect to be entitled to in exchange for the promised goods or services in the contract (may be fixed or variable).

- If the price is variable, and you don't expect a significant reversal in the revenue recorded when the variability is resolved, then you must estimate it using either an "expected value" (probability-weighted) approach or a "most likely amount" approach, whichever you expect to be more predictive of the amount to which you will be entitled.
- Significant financing components must be adjusted for the time value of money.
- Non-cash consideration must be measured at fair value.
- Payments made to the customer is recorded as an adjustment to the transaction price unless it is payment for a distinct good or service.

Step 4: Allocate the transaction price to the performance obligations in the contract.

- Generally, the transaction price would be allocated to each performance obligation on a relative stand-alone basis.
- Other allocation approaches include:
  - Allocating a discount to some (but not all) of the performance obligations
  - Allocating variable consideration to some (but not all) of the performance obligations, or
  - Allocating changes in the transaction price to the performance obligation.

Step 5: Recognize revenue when (or as) the entity satisfies a performance obligation.

- A performance obligation is satisfied when you transfer control of the good or service to the customer (from the customer's perspective).
- Can the customer direct the use of and obtain substantially all of the remaining benefits from the good or service? If so, they are considered to have control.
- If a performance obligation is recognized over time, revenue recognition will be measured as the progress towards completion of the performance obligation. Measurement methods include:

  Output methods: Revenue is recognized based on measurement of value transferred to customer

  Input methods: Revenue is recognized based on company's efforts to satisfy the performance obligation

Revenue might be recognized earlier under the new guidance. Currently, companies are unable to recognize revenue that is contingent on a future event. The new revenue recognition guidance would require companies to include an estimate of the value of variable consideration if they consider it probable that it won't result in significant reversals of revenue in subsequent periods.

How do I transition to the new revenue recognition standard?

Your choices are:

Full retrospective method	Apply the standard retroactively to all prior reporting periods presented in the financial statements.

Pros

- Easier to compare periods
- More informative for investors
- Companies can begin determining the restatement amount related to prior periods now

Cons

- May take more time and effort
- Larger amount of data needs to be gathered and analyzed

Modified retrospective method	Recognize the cumulative effect of initially applying the standard as an adjustment to opening retained earnings of the annual reporting period that includes the date of initial application.

Pros

- May take less time to implement
- Less data needs to be gathered and analyzed

Cons

- Due to the disclosure requirements, two sets of accounting records will be needed. You will need to disclose the financial statement line items that changed under the new guidance versus the amount that would have been recorded under the current guidance.
- Less informative for investors.
- There is a potential that some revenue will get lost in the transition if you recognize less revenue under the new guidance than you would have under the current guidance.

Remember, if you decide to use the modified retrospective method, you'll need to apply the new guidance to contracts in place or incomplete on the date of application as well as new contracts that are entered into subsequent to that date.

What are some of the complex areas in the new guidance that I may not be aware of?

Certain portions of the new standard are more complex because they require management's judgment and additional documentation. Some of these areas include:

Portfolio approach: When determining the proper accounting, can you group certain contracts together instead of accounting for each one individually? Possibly! If they have similar characteristics and the outcome isn't expected to be materially different than if you had applied the guidance to each contract or performance obligation separately. Be prepared to document how you determined the difference wouldn't be material.

Price concession: Did you provide a price concession (do you expect to accept less than the contractual amount) or have you accepted the customer's credit risk (the risk of collecting fees)? When you offer your customer a concession in the price of a good or service, it's considered variable consideration which will affect the amount of revenue you recognize. Credit risk isn't measured as part of the transaction price but it is considered when determining if the revenue should be recognized in accordance with ASC 606. Also, if you accept the customer's credit risk, you may need to recognize bad debt expense. (Price concessions are especially relevant for healthcare and energy sectors).

Implied promises: Have you promised your customer something that is not in the written contract or is it common for you to do so? Even if a promise isn't explicitly stated in the contract it may be implied by your customary business practices, policies or statements. You will need to use your judgment to decide whether the customer has an expectation that you will provide a good or service not stated in the contract.

Warranties: If a law requires you to pay for products that cause harm or damage, it doesn't rise to a performance obligation. But, if the warranty you give to your customer offers them a service in addition to the guarantee that the product complies with agreed-upon specifications it may be a performance obligation. If the customer can buy the warranty separately from the good or service, it would be a performance obligation. In that case, the transaction price will need to be allocated between the product and the warranty service. If the warranty is not purchased separately, then judgment will be needed to assess whether the warranty provides a service that is considered a separate performance obligation.

Material rights: If you give your customer the option to buy additional goods or services (e.g. renewal options, loyalty programs, sales incentives), it would be considered a separate performance obligation if it gives the customer a material right that they wouldn't have received without entering into the contract. For example, if you give your customer an incremental discount they wouldn't receive if they didn't enter into the contract. Revenue from a material right is recognized when the goods and services are transferred or the option expires. The material right is not required to be significant and incremental in relation to other discounts in the same contract.

Variable consideration: If the consideration promised includes a variable amount, you'll need to estimate the amount of consideration you will be entitled to in exchange for transferring the promised goods or services to your customer. For instance, you may have a variable price due to discounts, rebates, refunds, performance bonuses, penalties or other items. The guidance allows the amount of variable consideration to be estimated by either the expected value (sum of probability weighted amounts in a range of possible amounts) or the most likely amount (the single most likely amount in a range of possible amounts). Use the method that best predicts the consideration the company is entitled to. Once the method is chosen it should not be changed over the life of the contract.

Variable consideration should only be included in the transaction price if it's considered probable that a significant reversal in revenue won't occur when the uncertainty is resolved. You will need to update the estimated transaction price each reporting period to reflect current assessments of the amount of consideration you expect to be entitled to.

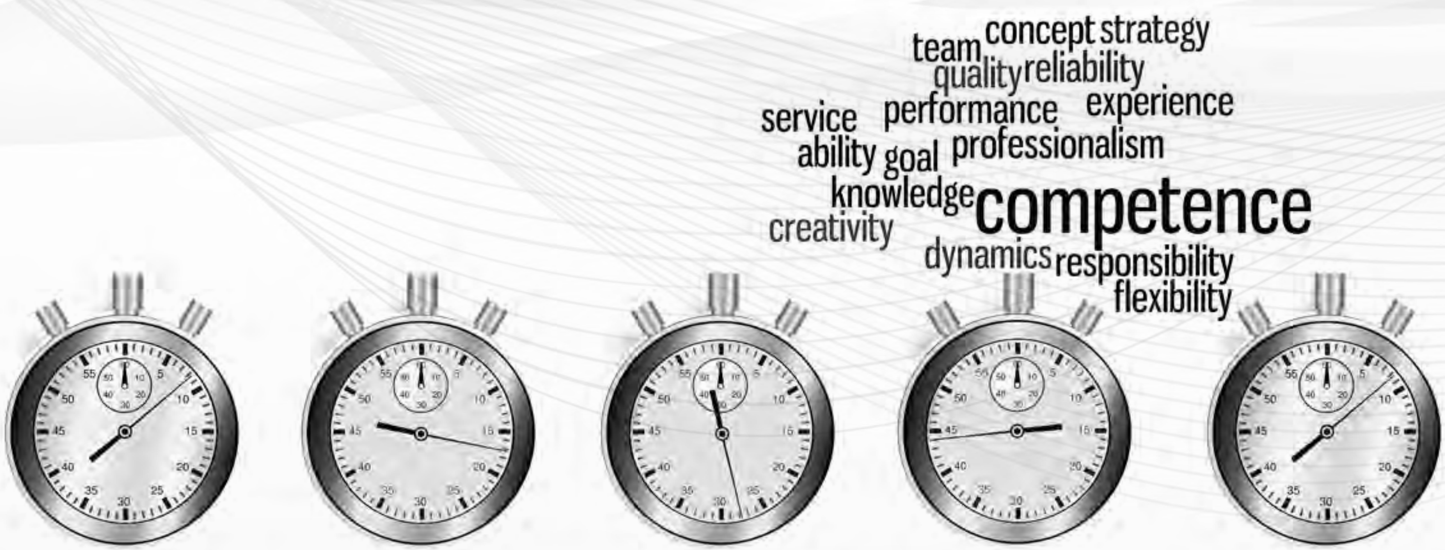
Right of return: You will need to estimate the amount of consideration you expect to be entitled to (excluding products you expect to be returned). Any amounts you don't expect to receive will not be recognized as revenue when you transfer the product to the customer. Rather, you would recognize a refund liability receivable. Each reporting period you would update your assessment of the amount you expect to be entitled to and make a change to the transaction price and the amount of revenue recognized.

The items listed above are only a few of the complex areas in ASC 606 that will require judgment. Since revenue is usually the largest line item in the income statement, revenue recognition is considered a high-risk area. That's why understanding the new revenue recognition guidance and applying it correctly is so important.

Do not hesitate to contact us if you would like to discuss anything mentioned above in more detail or if you need help with implementing the new revenue recognition standard.

We are available to help you with issues such as:

- Determining how the new standard will affect your company including:
    - Contract review
    - Determining and documenting the accounting and reporting impact of applying the new standard
    - Determining potential impact on performance metrics, debt covenant ratios and earnings estimates
    - Documenting conversion process and risks associated with implementing the standard
- Consulting with management about available transition methods and the benefits and challenges of each method
- Assisting management with the necessary interim and final disclosures
- Creating and maintaining a database for historical and future contracts



CONTACT

Lisa Swanson, CPA/ABV, CVA
Blue Abaco Consulting, Inc.
(813) 336-3660
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