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IMPACT OF ASC 606 AND IFRS 15 STANDARDS ON REVENUE RECOGNITION:
What Do These Changes Mean to You?

ASC 606/IFRS 15 is massively impacting most industries, and it is not just a finance issue. If you are a public company, 2018 is your year of reckoning, if you are a private company, January 2019 is the target year. We are in the 11th hour, and many companies are on double-time!

In a nutshell, the revenue is recognized when the goods and services are provided to the customer in proportion to the value transferred to the customer. For example, if you have a 36-month agreement, then one-third of the revenue is recognized annually.

The Five Steps for the new Revenue Recognition Standards:
- Step 1 – Identify the contract with the customer.
- Step 2 – Identify the performance obligations in the contract.
- Step 3 – Determine the transaction price.
- Step 4 – Allocate the transaction price.
- Step 5 – Recognize the revenue as the company satisfies the performance obligation.

Let’s take a quick peek at what this means to you?

In Step 1, this is a commercially valid contract or agreement as in a Sales Order or Sales Contract supported by a Purchase Order, Statement of Work (SOW) signed by an authorized signer.

There are some key criteria for recognizing this step, “*collectability*” is one of them. Does the company reasonably expect to collect receivables (consideration) from the customer? Collectability determines the probability to recognize the revenue.

Also, keep in mind contract modifications. Contracts are often modified, extended, or terminated. These factors contribute to the recognition of revenue as well.

A good example of a contract is your mobile phone bill. You enter into an agreement with your mobile service carrier for two years. They commit to providing call minutes, data, storage, and insurance for a monthly fee. Similar contracts exist for software, services, machinery, media and other models.

Step 2 identifies the performance obligations. The impact of this step looks at your current practices for negotiating and agreements. Long-standing industry practices are affected by ASC 606, and the legal components of contracts and related performance obligations should be taken into consideration.

These regulations may impact your legal contracts and agreements to gain clarity on your performance obligations. For example, bundling and unbundling of components such as financial components, i.e., interest, maintenance, services, warranties, etc. may force revisions to your contracts.

In Step 3 – Determine the Transaction Price, this is the net value of the contract. Long-standing business practices and processes are affected. For example, post-contract support (PCS) has been a staple of the technology, software, and services industry. Under the new guidelines, PCS is taken into consideration as to how much revenue is recognized at the time of software delivery. The new rules will make it more challenging for cloud and other as-a-service deliverables.

In Step 4, once you have confirmed the contract, obligations, and price, allocate the price to the obligations. For a three-year subscription model, does it include the 24x7 help desk support, upgrades, and warranties?

THE 5 STEPS

You may recognize service revenues could be recognized earlier under the new regulations than in the past. It may be easier to unbundle services as they are easier to identify services from other deliverables. Today, the rules for implementation and integration are complex.

Revenue recognition is not just affecting technology, software, and services; it also impacts automotive, machinery, construction, biotech, media, oil and gas. Validate for your industry whether traditional practices such as Bill-and-Hold are impacted. One client of ours is considering this arrangement as two price components (obligations), production, and storage, allowing some flexibility in their revenue recognition practices.

Recognize the revenue in Step 5. Once the performance obligations are satisfied, how will you recognize the revenue in SAP RAR (Revenue Accounting and Recognition)? Or possibly as some customers are electing, performing the revenue recognition outside of SAP and managing top-side entries. This approach may work for 2018, but is not a scalable, long-term solution.

Recent surveys have indicated that there is a mad rush to meet the deadlines. One estimate suggests that standardizing these practices from a systems perspective may still be a few years away.

What other impact does ASC 606 and IFRS 15 have on your other business practices and internal controls for budgeting, planning, commissions, cash flow, cost flow, and other legacy processes?

The new rules require analysis, interpretation, and judgment. To be successful, partner with an experienced company like Titan Consulting. We understand the Revenue Recognition Standards and their impacts on your business, processes, and systems such as SAP RAR. Our focused support helps you hit the mandates for 2018 or 2019.

Yes, the deadline for the new revenue recognition rules is already here. However, you still want to implement the best system processes and practices for your industry and company.

Do you need help evaluating the impact and options of these new regulations? Our Advisory Services team can assess your Revenue Recognition requirements and recommend safe and efficient methods for adapting to ASC 606 and IFRS 15. For help, contact Warren Norris, warren@titanconsulting.net, 972.679.5183; or, contact your Titan Consulting Director. You can also see additional information on our Advisory Services page at www.titanconsulting.net.