Financial & Professional Services Industries

Revenue from Contracts with Customers -- Frequently Asked Questions

The Financial Accounting Standards Board (FASB) has recently issued a new Accounting Standards Update that addresses revenue recognition under U.S. Generally Accepted Accounting Principles (GAAP). The new rules are an attempt to standardize the revenue recognition process across different industries and geographic locations. The Standard was the result of a multi-year effort to develop uniform worldwide guidelines and produce a converged revenue recognition standard by the FASB and the International Accounting Standards Board (IASB).

Who does this standard apply to?

- All entities that enter into contracts with customers/clients to provide services or goods
  - Engineering and architecture firms
  - Insurance brokers
  - Printing and publishing entities
  - Law firms
  - Consulting firms
  - Auto dealerships
  - Funeral homes and mortuaries
  - Marketing and advertising firms
  - Training and educational services
  - Financing services
  - Custom and produce brokers
  - Licensed and bonded warehouses
  - Transportation and logistics companies
- The standard applies to all financial statements that are required to be GAAP compliant
  - Required by regulatory requirement, *i.e.* Arizona Departments overseeing: construction, transportation, insurance brokerage industry, and franchisors.
  - Lending Institutions typically require GAAP financial statements.
  - Investors typically require GAAP financial statements.
- Large tax payers > ~ $25M

Can we issue statements with a GAAP departure?

No. According to the AICPA, given the significance and pervasiveness of revenue recognition to most companies, it may difficult to avoid an adverse opinion in an audit. In addition, it may be difficult in a compilation and review to conclude that a standard modification of the report is adequate.

What is the general impact to my industry?

- Increased disclosure requirements in the financial statement footnotes
- Upon application presentation of the transition methodology
  - Full retrospective
  - Modified approach
- New considerations of metrics used to assess
  - Profitability
  - Compensation packages (bonuses based on GAAP revenue, etc.)
- Financial covenant considerations
  - Debt service coverage ratios
  - EBIDTA
- Changes in processes to gather information required to be compliant
- Changes in internal controls

When do we need to be compliant by?

- Annual periods beginning after December 15, 2018
  - Calendar year end December 31, 2019
  - Fiscal year end March 31, 2020
  - Fiscal year end June 30, 2020
  - Fiscal year end September 30, 2020
- However, given the transition methods allowed, it will be necessary to restate the prior period's information (i.e. December 31, 2018 for a calendar year end entity).
- Start now!

What are the first steps, and when do we need to get started?

- Create an implementation team to look at the different services provided and where information is stored
- Assess current environment, which requires the entity to review "Contracts" with customers and apply the five-step model

    - Contracts do not have to be written agreements. Contracts are defined within the scope of the standard as "an agreement between two or more parties that creates enforceable rights and obligations."
        - Contracts can be created simply by scheduling a procedure or other industry norms that creates rights and obligations.
        - Without a contract revenue cannot be recognized until cash is collected.
- Industry specific application of the Five-step model:
    - Step 1: Determine if you have a contract
    - Step 2: Identify performance obligations
    - Step 3: Determine transaction prices
    - Step 4: Allocate transaction prices to performance obligations
    - Step 5: Recognize revenue

- Develop internal controls and policies
- Implement, educate internal stakeholders and roll out
- Plan transition, which could determine readiness by Dec 2018 or 2019
- Monitor, adjust and adopt

What are the risks if we don't comply with the new standard?

- Decreased comparability between peers
- Increased interest rates on debt or equity financing
    - Difficulty in obtaining financing
- Difficulty in maintaining licensure if not compliant based on regulatory requirements
- Expectation of GAAP compliance by Board of Directors (or equivalent)
- Decrease in appeal to potential buyers = less money on buyout
    - Merger and Acquisition
    - Due diligence issues
- Current noncompliance could result in future challenges

BeachFleischman has industry experts who are available to consult with you and assist your company with designing a plan to implement the new standard. For more information, contact your BeachFleischman Relationship Manager.