New Revenue Recognition Standard Will Likely Affect Most Companies and Require Pre-Adoption Planning

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U.S. companies will need to comply with a new **converged revenue recognition standard** that the **FASB** and the **International Accounting Standards Board** (IASB) issued on May 28. The converged standard—which applies to fiscal years beginning after December 15, 2016—eliminates many existing industry and other accounting guidance related to revenue recognition for U.S. companies and provides the first comprehensive requirements in International Financial Reporting Standards.

The new standard may not affect all U.S. companies equally, but it will require all to evaluate their contracts to determine whether

- the new standard will affect the timing and amount of revenue recognized;
- new contracting processes should be considered;
- internal control over financial reporting and IT systems need to be updated; and
- bonus and incentive plans and other compensation arrangements need to be revised.

The amount and timing of revenue may be affected for the following reasons:

- The new revenue recognition standard requires companies to determine whether goods or services promised in a contract are separate performance obligations that must be accounted for separately if they are distinct, which means that (1) "[t]he customer can benefit from the good or service either on its own or together with other resources that are readily available to the customer" and (2) "[t]he promise to transfer the good or service is separately identifiable from other promises in the contract."
- The amount of revenue that is recognized (i.e., the transaction price) must take into account various factors, including the following:

- Discounts, credits, price concessions, returns, and performance bonuses/penalties that may be considered to be variable consideration. Variable consideration may only be included in the transaction price to the extent that it is “probable” that the variable consideration will not be reversed.

- Any significant financing component in the contract that results from the timing of the customer’s payment differing by more than a year from the transfer date of the promised goods or services to the customer, in which case the transaction price should be adjusted for the time value of money.

- Any noncash consideration being paid by the customer.

- Any consideration payable to the customer, such as vouchers and coupons.

- The timing of revenue recognition will be affected by the following:

- The allocation of revenue to different performance obligations

- The timing of when the entity’s customer obtains control of a good or service because—unless an entity transfers control of a good or service over time, requiring the recognition of revenue over time—the entity is considered to satisfy the performance obligation at a point in time.

A significant requirement in the new revenue recognition standard is the principles-based disclosure requirement, which is intended to enable users to understand the nature, amount, timing, and uncertainty of revenue and cash flows arising from such contracts. This will likely result in robust, qualitative, and quantitative information about contracts on a disaggregated basis for appropriate categories of customers, such as the categories that companies use in their investor presentations, about related revenues, the allocation of the transaction price to performance obligations and significant judgments, and changes in judgments made in applying the new standard to contracts.

The FASB and the IASB have set up a Joint Transition Resource Group for Revenue Recognition to identify potential implementation issues. SEC Chair Mary Jo White has expressed strong support for this implementation group and has stressed the importance of consistently implementing and applying the new revenue recognition standard, which she noted represents “a true success for both FASB and the IASB.”

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