REVENUE RECOGNITION FOR MANUFACTURERS

April 11, 2018

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ASC 606 - Overview

- *Revenue from Contracts with Customers* issued in May 2014 (ASU 2014-09)
- Subsequently amended by:
  - ASU 2015-14, Deferral of the Effective Date
  - ASU 2016-08, Principal versus Agent Considerations (Reporting Revenue Gross versus Net)
  - ASU 2016-10, Identifying Performance Obligations and Licensing
  - ASU 2016-12, Narrow Scope Improvements and Practical Expedients
  - ASU 2016-20, Technical Corrections and Improvements to Topic 606
- A single, principle-based revenue standard for U.S. GAAP and IFRS that replaces almost all existing U.S. GAAP and IFRS guidance
- The new revenue standard aims to improve accounting for contracts with customers by:
  - Providing a more robust framework for addressing revenue issues as they arise
  - Increasing comparability across industries and capital markets
  - Requiring better disclosure

ASC 606 – Effective Dates

- Public business entities
  - Fiscal years beginning after 12/15/17 (and interim periods within)
  - Early adoption permitted only as of FYs beginning after 12/15/16 (and interim periods within)

- Nonpublic entities
  - FYs beginning after 12/15/18 (and interim periods within FYs beginning after 12/15/19)
  - Early adoption permitted as of either:
    - FYs beginning after 12/15/16 (and interim periods within), or
    - FYs beginning after 12/15/16 and interim periods within FYs beginning one year after the annual period in which an entity first applies the new standard.

Per ASU 2015-14, Deferral of the Effective Date

OVERVIEW OF THE STANDARD

BDO USA, LLP, a Delaware limited liability partnership, is the U.S. member of BDO International Limited, a UK company limited by guarantee, and forms part of the international BDO network of independent member firms.

ASC 606 – The Five Step Model

Core Principle:

Recognize revenue to depict the transfer of goods or services to customers in an amount that reflects the consideration to which the entity *expects to be entitled* in exchange for those goods or services.

Steps to Apply the Core Principle Are:

STEP 1:	STEP 2:	STEP 3:	STEP 4:	STEP 5:
Identify The Contract	Identify Separate Performance Obligations	Determine Transaction Price	Allocate Transaction Price to Performance Obligations	Recognize Revenue When/As Performance Obligations Satisfied

STEP 1: Identify the Contract

- Contracts can be written, oral, or implied by the entity's business practices
- Contracts with customers must meet FIVE criteria
  - 5th criterion – collectibility – may require judgment and estimates
  - Reassessment required in certain circumstances
- Specific guidelines for combining contracts
- Specific guidelines for contract modifications
  - Separate contract
  - Termination and creation of new contract
  - Continuation of previous contract

STEP 2: Identify Separate Performance Obligations

A performance obligation is a promise to provide goods or services (or a combination thereof) that are either: a) distinct, or b) homogenous, and meets certain criteria

Definition of a ‘Distinct’ Good or Service:

Can the customer benefit from the good or service, either on its own, or with other readily available resources?

(‘readily available resources’ are those that the customer possess or is able to obtain from the entity or another third party)

No → The good or service is not ‘distinct’

(these are then grouped into ‘bundles’ of goods and services that are themselves ‘distinct’)

Yes ↓

Is the promise to transfer a good or service separate from the other promised goods or services in the contract?

Indicators that it is not separately identifiable may include:

- The entity provides a significant service of integrating the goods and services.
- A good or service significantly modifies or customizes the other goods and services.
- A good or service is highly dependent or interrelated with the other goods and services.

No → The good or service is not ‘distinct’

Yes → The good or service IS ‘distinct’

STEP 3: Determine Transaction Price

Definition of Transaction Price:

- The transaction price is the amount of consideration to which an entity expects to be entitled in exchange for transferring promised goods or services to a customer.
  - Excluding amounts collected on behalf of third parties – e.g. sales taxes etc.
- The consideration promised in a contract with a customer can vary in terms of nature and timing, and this affects the determination of the transaction price.
- Specific consideration is given to:

(i)	Variable consideration (including constraints on estimates of variable consideration)
(ii)	The existence of a significant financing component in the contract
(iii)	Non-cash consideration
(iv)	Consideration payable to a customer

STEP 4: Allocate Transaction Price to Performance Obligations

- An entity allocates/splits the transaction price (determined in Step #3) between its performance obligations (identified in Step #2)
- The allocation is based on the relative ‘standalone selling prices’ of each identified performance obligation, being:
  - The price at which an entity would sell a promised good or service separately to a customer.
- Specific consideration is given to:

(i)	Determining the Standalone Selling Price of a Performance Obligation
(ii)	Methods of Estimating the Standalone Selling Price
(iii)	Variable Consideration – Determining Allocation
(iv)	Discounts – Determining Allocation

STEP 5: Recognize Revenue

Revenue is recognized as/when an entity satisfies each performance obligation (i.e., when it transfers 'control' of the goods or services to the customer)

- *Control* - ability to direct use of and obtain substantially all remaining benefits from an asset (or prevent others from doing so)

Revenue is recognized either:

a. Over time, when <u>one</u> of the following criteria is met:

(i)	The customer simultaneously receives and consumes the economic benefits provided by the vendor's performance.
(ii)	The vendor creates or enhances an asset controlled by the customer.
(iii)	The vendor's performance does not create an asset for which the vendor has an alternative use, and the vendor has an enforceable right to payment for performance completed to date.

a. At a point in time, when <u>none</u> of the above criteria is met. ASC 606 provides certain indicators to consider.

KEY CONSIDERATIONS FOR THE MANUFACTURING AND DISTRIBUTION SECTOR

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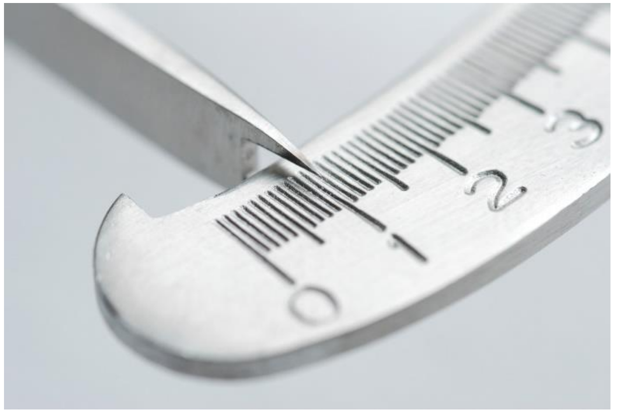
Popular view is that M&D companies do not have to worry – it is just a "tech thing"

This is not true!

M&D companies do need to review the 5 steps and consider the impact on their current business models.

There may not be dramatic changes – but the fundamental thinking has changed and companies will need to investigate and document the impact.



Issue 1: Over Time or Point in Time

Scope of over time recognition has changed:

- Construction contractors are no longer automatically scoped in
- Over time recognition must be assessed first, no longer default to point in time

Over time recognition is required in the following circumstances:

- The customer simultaneously receives and consumes the benefits provided
- The manufacturer's performance creates or enhances an asset (e.g. work in progress) that the customer controls as the asset is created or enhanced
- The manufacturer's performance does not create an asset with alternative use to the manufacturer, and the manufacturer as an enforceable right for payment completed to date.

Third bullet is generally the most challenging for M&D.

Issue 1: Alternative Use/Enforceable Right

- The customer contract/laws/ regulations prevent from selling to another customer
- The manufacturer is pragmatically limited because, for example, the asset is highly unique/customized and significant rework would be necessary

- Manufacturer has right to payment completed to date that at least compensates it for performance completed to date if the customer terminates contract (other than failure to perform)
- An amount that would compensate for performance completed to date includes both the recovery of costs incurred and reasonable profit margin

Both criteria must be met – but if met, over time recognition is required

Example 1: Milestone payments

FACTS:

- An entity enters into a contract with a customer to build an item of equipment. The payment schedule in the contract specifies that the customer must make an advance payment at contract inception of 10 percent of the contract price, regular payments throughout the construction period (amounting to 50 percent of the contract price), and a final payment of 40 percent of the contract price after construction is completed and the equipment has passed the prescribed performance tests. The payments are nonrefundable unless the entity fails to perform as promised. If the customer terminates the contract, the entity is entitled only to retain any progress payments received from the customer. The entity has no further rights to compensation from the customer.

What needs to be considered?

Example 1: Milestone payments (cont.)

New Standard Considerations:

At contract inception, the entity assesses whether its performance obligation to build the equipment is a performance obligation satisfied over time in accordance with paragraph 606-10-25-27.

As part of that assessment, the entity considers whether it has an enforceable right to payment for performance completed to date in accordance with paragraphs 606-10-25-27(c), 606-10-25-29, and 606-10-55-11 through 55-15 if the customer were to terminate the contract for reasons other than the entity's failure to perform as promised. Even though the payments made by the customer are nonrefundable, the cumulative amount of those payments is not expected, at all times throughout the contract, to at least correspond to the amount that would be necessary to compensate the entity for performance completed to date. This is because at various times during construction the cumulative amount of consideration paid by the customer might be less than the selling price of the partially completed item of equipment at that time. Consequently, the entity does not have a right to payment for performance completed to date.

Because the entity does not have a right to payment for performance completed to date, the entity's performance obligation is not satisfied over time in accordance with paragraph 606-10-25-27(c). Accordingly, the entity does not need to assess whether the equipment would have an alternative use to the entity. The entity also concludes that it does not meet the criteria in paragraph 606-10-25-27(a) or (b), and, thus, the entity accounts for the construction of the equipment as a performance obligation satisfied at a point in time in accordance with paragraph 606-10-25-30.

Example 2: Right to Payment for WIP

FACTS:

- An entity enters into a contract with a customer to manufacture items pursuant to the customer's design specifications with an initial order quantity of 1,000. The contract precludes the entity from selling items using the customer's design to any other parties. The contract includes a termination for convenience clause that allows the customer to cancel the contract with 10 days notice. If the customer exercises the termination provision, it takes possession of any finished goods and work in progress, and is required to make payment at the contract rate for any finished goods. The customer must also pay the entity's cost plus a 10% margin for any work in progress. The 10% margin is consistent with the overall margin earned on the contract.

What needs to be considered?

Example 2: Right to Payment for WIP (cont.)

New Standard Considerations:

At contract inception, the entity assesses whether its performance obligation to build the equipment is a performance obligation satisfied over time in accordance with paragraph 606-10-25-27.

As part of that assessment, the entity considers whether it has an enforceable right to payment for performance completed to date in accordance with paragraphs 606-10-25-27(c), 606-10-25-29, and 606-10-55-11 through 55-15 if the customer were to terminate the contract for reasons other than the entity's failure to perform as promised. Because the customer would be required to make payments upon termination that would at least compensate the entity for its performance completed to date (i.e. contract price or price plus a reasonable profit margin), the entity does have a right to payment for performance completed to date.

Accordingly, the entity needs to assess whether the equipment would have an alternative use to the entity. Because the entity cannot sell the items to any other party, the entity does not have an alternative use for the items. **Therefore, the entity's performance obligation is satisfied over time in accordance with paragraph 606-10-25-27(c).** The entity would then need to determine an appropriate measure of progress under the contract. Because of the existence of WIP at any given point in time, and output measure such as units of production would likely NOT be an appropriate measure of progress.

Issue 2: Elimination of Sell-Through Method

Under existing GAAP, companies selling to distributors may be required to use the sell-through method whereby the company waits to record revenue until the distributors “sell-through” to the end customer.

New rules do not require the pricing to be fixed and determinable to recognize revenue. Therefore, companies using the sell-through method may recognize revenue earlier assuming there is an enforceable customer contract in place.

If over-time recognition is not applicable, then revenue is recognized when control transfers to the customer.

Issue 2: Determination of Point in Time

If over-time recognition is not applicable, then revenue is recognized when control of the good or service transfers to the customer.

Indicators of control include, but are not limited to:

- Seller has present right to payment
- Legal title to asset transfers to customer
- Seller transfers physical possession to customer
- Customer has significant risks and rewards of ownership
- Customer has accepted asset

Example 3: Timing of Recognition

FACTS:

- An entity enters into a contract with a distributor to sell medical devices. Pursuant to the contract, the distributor takes title to the devices upon receipt at its warehouse, at which time full payment is due. Distributor has the right to return any damaged devices, but has no general right of return. The entity grants “most favored nation” price protection, which includes a retrospective price match for any unsold inventory purchased within 120 days of a sale of the devices to another distributor at a lower price.

What needs to be considered?

Example 3: Timing of Recognition (cont.)

New Standard Considerations:

The entity assesses at what point in time control of the devices is transferred to the distributor.

As part of that assessment, the entity considers the indicators in paragraph 606-10-25-30 to determine when control transfers to the distributor. **The entity concludes that control transfers upon delivery to distributor's warehouse** based on the following:

- Legal title transfers to distributor upon delivery (shipping terms FOB destination)
- Entity has right to payment upon delivery
- Distributor obtains physical possession upon delivery
- Distributor has significant risks and rewards of ownership, as indicated by no right to return devices

The entity further assesses the amount of revenue to be recognized. Specifically, the entity considers the "most favored nation" price protection, which represents variable consideration, and recognizes a reserve for expected refunds.

Issue 3: Optional Purchases/Volume Discounts

Contracts may include incentives to purchase future products. When entering into contracts – companies must assess if any customer incentives provide **material rights** to the customer that it would not have received without entering into the contract.

Material rights are new concept

A material right represents an option to purchase future goods and services at a discount that is incremental to the range of discounts typically given to those for goods and services to the class of customer in that geographical area or market

If the contract provides a material right, the customer in effect pays in advance for future goods or services. Under ASC 606 – this means that a material right is a separate performance obligation at inception of the contract.

Example 4: Future Price Concessions

FACTS:

- An entity enters into a contract with a customer to sell an industrial floor polisher for $750. As part of the contract, the entity gives the customer the right to purchase 30 gallons of cleaning solvent for use with the purchaser at a 40% discount to its normal list price for the next 30 days. Customers who have not purchased a polisher must pay normal list price for the solvent.

What needs to be considered?

Example 4: Future Price Concessions (cont.)

New Standard Considerations:

The contract provides the customer with the right to purchase additional goods at a discount. As such, the discount represents a material right that must be accounted for as a performance obligation.

In order to estimate the standalone selling price of the discount, the entity estimates an 80 percent likelihood that the customer will purchase the cleaning solvent for a total purchase price of $60 ($100 list price less a 40% discount). Consequently, the estimated standalone selling price of the discount is $48 (discounted price of $60 at an 80% expected redemption rate). Therefore, the entity allocates the original arrangement consideration between the polisher and the discount on a relative standalone selling price basis, which results in $45.11* being allocated to the discount. This amount is recognized in revenue when either the cleaning solvent is purchased or the discount expires unexercised.

* Calculated as $48/($48+$750) x $750 = $45.11

Example 5: Tiered Pricing

FACTS:

- An entity enters into a contract with a customer to sell metal clamps for $10 each for the first 100 clamps purchased. If the customer purchases between 101 and 200 clamps, the price for those clamps drops to $9 each. If the customer purchases more than 201 clamps, any purchases above 200 are priced at $8 each.

What needs to be considered?

Example 5: Tiered Pricing (cont.)

New Standard Considerations:

The entity must determine whether the contract provides the customer with the right to purchase additional goods at a discount. The entity first considers whether another customer would receive similar pricing for a similar order. Specifically, the entity considers whether a customer that places an initial order for more than 200 clamps would pay the $8/clamp price or not.

The entity considers its prior pricing history, and reviews contracts with large volume customers. The entity has a history of pricing its metal clamps based on expected volume purchases, and concludes that the discounted pricing in the contract is consistent with pricing historically provided to other large-volume customers. As such, the discount does not represent a material right that must be accounted for as a performance obligation.

Note, had the tiered pricing scheme resulted in retroactive refunds, those refunds would represent variable consideration that must be assessed and accounted for as the clamps are sold.

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Issue 4: Price Deflation

Sometimes pricing under contracts vary over the term of the contract. In particular, we often see planned price deflation in contracts with customers. These price decreases are designed to correspond with savings that the company will achieve from efficiencies and productivity gains.

Companies must assess such pricing provisions in order to determine whether they represent variable consideration, a material right, or simply payment for performance.

Example 6: Price Deflation

FACTS:

- An entity enters into a contract to sell an electronic component to a customer for $100 per unit. However, the price per unit will decline by 2% each quarter over the remaining 18-month term of the contract. The price decreases are designed to correspond with savings that the entity will achieve from efficiencies and productivity gains as they garner more experience in manufacturing the components.

What needs to be considered?

Example 6: Price Deflation (cont.)

New Standard Considerations:

The entity concludes that the changes in price are substantive and linked to changes in its cost to fulfill the obligation or value provided to the customer.

Presuming that each component is a distinct performance obligation, the entity should ***not*** try to "levelize" the transaction price when allocating it across all of the components to be delivered under the contract. That is, the entity should ***not*** use a straight-line methodology to ensure that every unit sold under the contract is recognized at the same exact transaction price. Instead, the entity should recognize revenue based on stand-alone selling price adjusted for planned price deflation.

Issue 5: Warranties

ASC 606 differentiates "assurance" warranties from "service" warranties

- Assurance – a promise that the item will work as intended
  - Not a distinct performance obligation separate from the item sold
  - Continue to account for under ASC 450

- Service – an additional promise beyond basic performance
  - May be separately priced or included in purchase
  - Treated as a distinct performance obligation
  - Defer a portion of revenue to be recognized as warranty services provided

Note: Even if a warranty is not sold separately, companies will need to evaluate if the warranty provided includes a service component.

Example 7: Warranty

Assumptions

- Company manufactures and sells tires. Each tire sold comes with a life-time warranty, plus free towing services in the event the company's tire gets a flat.
- The state in which the tire is sold requires the company to provide a warranty for the period of time until the tire has 2/32nds of an inch of tread left, which the industry generally estimates to be six years from date of sale, based on average usage.

Current US GAAP treatment

- Revenue is recognized upon delivery, with accrual for expected warranty costs

What needs to be considered under the new standard?

Example 7: Warranty (cont.)

ASC 606-10-55-31 through 33

- If a customer has the option to purchase a warranty separately (for example, because the warranty is priced or negotiated separately), the warranty is a distinct service because the entity promises to provide the service to the customer in addition to the product that has the functionality described in the contract. In those circumstances, an entity should account for the promised warranty as a performance obligation in accordance with paragraphs 606-10-25-14 through 55-22 and allocate a portion of the transaction price to that performance obligation in accordance with paragraphs 606-10-32-28 through 32-41.
- If a customer does not have the option to purchase a warranty separately, an entity should account for the warranty in accordance with the guidance on product warranties in Subtopic 460-10 on guarantees, unless the promised warranty, or a part of the promised warranty, provides the customer with a service in addition to the assurance that the product complies with agreed-upon specifications.

Example 7: Warranty (cont.)

ASC 606-10-55-31 through 33

- In assessing whether a warranty provides a customer with a service in addition to the assurance that the product complies with agreed-upon specifications, an entity should consider factors such as:

  a. Whether the warranty is required by law – If the entity is required by law to provide a warranty, the existence of that law indicates that the promised warranty is not a performance obligation because such requirements typically exist to protect customers from the risk of purchasing defective products.

  b. The length of the warranty coverage period – The longer the coverage period, the more likely it is that the promised warranty is a performance obligation because it is more likely to provide a service in addition to the assurance that the product complies with agreed-upon specifications.

  c. The nature of the tasks that the entity promises to perform – If it is necessary for an entity to perform specified tasks to provide the assurance that a product complies with agreed-upon specifications (for example, a return shipping service for a defective product), then those tasks likely do not give rise to a performance obligation.

Example 7: Warranty (cont.)

NEW STANDARD CONSIDERATIONS:

The warranty is not offered separately to the customer, nor is it priced separately. Thus it does not meet the criteria in ASC 606-10-55-31 to be a distinct performance obligation.

However, the company considers the factors in ASC 606-10-55-33 to assess whether the warranty nonetheless provides the customer with a service. While the state law does require a warranty on the tire, the warranty provided by the company is potentially for a longer period of time than that required by the state. In addition, the promise of towing services at no cost is not a task that must be performed in order to provide the assurance that the tire complies with the agreed-upon specifications. The company concludes that factors 606-10-55-33(b) and 33(c) indicate that the warranty provides the customer with a service.

Therefore, the company allocates the consideration between the two performance obligations, the tire and the service provided beyond a standard warranty. The consideration allocated to the tire is recognized, and the costs associated with a standard warranty are accrued pursuant the guidance in Subtopic 460-10. The consideration allocated to the services is deferred.

Issue 6: Pre-production costs

Certain manufacturers incur and are reimbursed for pre-production costs.

Companies need to evaluate whether their current method of accounting is pursuant to existing GAAP – or via analogy to existing GAAP.

Companies that sell tooling should also reevaluate the income statement presentation of the tooling income.

Example 8: Tooling Costs

FACTS:

- An entity manufactures parts for the car industry, and has entered into a contract with a customer to supply pistons. Each piston is determined to be a distinct performance obligation. To fulfill the contract, the entity must purchase an additional diamond-core cutting machine costing $500,000 and tooling costing $200,000. Furthermore, the entity will incur engineering costs of $100,000 to configure the production line. The entity will receive $1,000,000 from the customer at inception of the contract, to compensate for the set-up costs, as well as $10 per piston. The entity retains title to the equipment, tooling and any intellectual property (e.g., patents) that results from the engineering activities. The entity is also responsible for maintaining and directing the use of the tooling and equipment.

What needs to be considered?

Example 8: Tooling Costs (cont.)

ASC 340-40-25-5

- An entity shall recognize an asset from the costs incurred to fulfill a contract only if those costs meet all of the following criteria:
  a. The costs relate directly to a contract or to an anticipated contract that the entity can specifically identify (for example, costs relating to services to be provided under renewal of an existing contract or costs of designing an asset to be transferred under a specific contract that has not yet been approved).
  b. The costs generate or enhance resources of the entity that will be used in satisfying (or in continuing to satisfy) performance obligations in the future.
  c. The costs are expected to be recovered.

Example 8: Tooling Costs (cont.)

ASC 340-40-25-7

- Costs that relate directly to a contract (or a specific anticipated contract) include any of the following:
  a. Direct labor (for example, salaries and wages of employees who provide the promised services directly to the customer)
  b. Direct materials (for example, supplies used in providing the promised services to a customer)
  c. Allocations of costs that relate directly to the contract or to contract activities (for example, costs of contract management and supervision, insurance, and depreciation of tools and equipment used in fulfilling the contract)
  d. Costs that are explicitly chargeable to the customer under the contract
  e. Other costs that are incurred only because an entity entered into the contract (for example, payments to subcontractors).

Example 8: Tooling Costs (cont.)

New Standard Considerations:

The entity determines that the pre-production activities do not result in control of goods or services being transferred to the customer. Therefore, the pre-production activities are not a promised good or service and therefore cannot be a separate performance obligation within the contract. The entity would include the upfront $1,000,000 payment within the transaction price, initially recording the amount as a contract liability (deferred revenue). A portion of the contract liability would be derecognized, and credited to revenues, as control over each piston is transferred to the customer.

The entity assesses the costs associated with the initial tooling process. The costs of the diamond-core cutting machine are capitalizable under ASC 360. Because the tooling and engineering costs do not relate to the acquisition of a fixed asset, and are thus not capitalizable under ASC 360, the entity further considers whether they should be deferred as costs to fulfill a contract. The entity concludes that these costs do meet the three criteria in ASC 340-40-25-5, and thus should be deferred. The costs are amortized over the expected period of benefit.

EXAMPLE PUBLIC COMPANY TRANSITION DISCLOSURES

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Public M&D Company Transition Disclosures

Boeing Company 2017 10-K:

We are adopting ASU 2014-09, *Revenue from Contracts with Customer (Topic 606)* in the first quarter of 2018 using the retrospective transition method which will require 2016 and 2017 financial statements to be restated. . . .

Most of our defense contracts at BDS and BGS that have historically recognized revenue as deliveries are made or based on the attainment of performance milestones will recognize revenue under the new standard over time as costs are incurred. Certain military derivative aircraft contracts included in our BCA segment will also recognize revenue as costs are incurred. The new standard will not change the total amount of revenue recognized on these contracts, only accelerate the timing of when the revenue is recognized. In addition, the timing of cost of sales recognition for these contracts will be accelerated, resulting in a decrease in inventories from long-term contracts in progress. . .

Public M&D Company Transition Disclosures, cont.

Caterpillar Inc. 2017 10-K:

. . . We will adopt the new guidance effective January 1, 2018 under the modified retrospective approach. Under the new guidance, sales of certain turbine machinery units will change to a point-in-time recognition model. Under current guidance, we account for these sales under an over-time model following the percentage-of-completion method as the product is manufactured. In addition, under the new guidance we will begin to recognize an asset for the value of expected replacement part returns and will discontinue lease accounting treatment for certain product sales continuing residual value guarantees. We do not expect the adoption to have a material impact on our financial statements.

Public M&D Company Transition Disclosures, cont.

Cisco Systems, Inc. Q2 2018 10-Q:

. . . The new standard will primarily impact Cisco's revenue recognition for software arrangements and sales to two-tier distributors. In both areas, the new standard will accelerate the recognition of revenue. The table below details both the current and expected revenue recognition timing in these areas:

	Current Revenue Standard	New Revenue Standard
Software arrangements:		
Perpetual software licenses	Upfront	Upfront
Term software licenses	Ratable	Upfront
Security software licenses	Ratable	Ratable
Enterprise license agreements	Ratable	Upfront
Software support services	Ratable	Ratable
Software-as-a-service	Ratable	Ratable
Two-tier distribution	Sell-Through	Sell-In

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Public M&D Company Transition Disclosures, cont.

Hasbro, Inc. 201710-K:

. . . The Company's revenue is primarily generated from the sale of finished product to customers. Revenue is recognized at the point of time when ownership, risks, and rewards transfer. These transactions are generally not impacted by the new standard. The Company does however offer certain types of variable payments to these customers such as pricing allowances, rebates, coupons and collaborative marketing arrangements. These types of payments are defined as variable consideration under ASU 2014-09. The Company has completed evaluating the quantitative impact related to ASU 2014-09. Based on the analysis performed, revenue recognition from the sale of finished product to our customers, which is the majority of our revenues, is not expected to change under the new standard in the periods following adoption. . . .

NEXT STEPS

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ASC 606 IMPLEMENTATION TIMELINE

Private Companies (12/31 Year End)

PHASE 1 – SCOPING AND GAP ANALYSIS

Identify revenue streams to be impacted. Prepare a “gap analysis” of ASC 605 vs. ASC 606 for those revenue streams addressing:

- Transition method/issues
- Contract costs
- Five steps of ASC 606
- Disclosures

PHASE 2 - TECHNICAL ANALYSIS

Determine specific application of issues identified in Phase 1, including method of determining standalone selling price, pricing controls, identifying specific contracts costs to be capitalized, amortization periods and methodologies and lookback periods for revenue contracts and contract costs. Identify broad systems and business process requirements.

PHASE 3 – SYSTEMS CONFIGURATION AND BUSINESS PROCESSES

Reconfigure systems and business processes based on Phase 2 findings.

PHASE 4 – TESTING/TRANSACTION AUDITING INTERNAL CONTROLS

Run historical transactions through parallel systems and business processes reconfigured for ASC 606. Auditors to perform detail transaction testing.

PHASE 5 – FINANCIAL REPORTING AND DISCLOSURES

Assess results of Phase 4 and record ASC 606 adoption entries and develop disclosures including contract liability rollforwards, summary of remaining performance obligations, etc.

Timeline

- Sept 2017 - April 2018
- April-Sept 2018
- Oct-Dec 2018
- Jan-March 2019

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Initial assessment of effort and overall impact – "phase 0"

- Make a plan and dedicate resources to execute
  - Identify key revenue streams and related contracts
  - Availability of historical data
  - Involve legal counsel and other necessary professionals
  - Consider whether grouping of contracts will work (the portfolio method)
- What are the performance obligations and are they distinct
  - May not result in material allocation
  - Cost/benefit analysis
- Identify costs to obtain and fulfill the contracts
  - How will you obtain historical data?
  - How much impact will it have/is it material?
- Determine adoption method
- Consider internal control changes
- Communication and education
  - Those charged with Corporate Governance
  - Investors, lenders and constituents

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Communication and Education

Due to the potential impact on net income and deferred revenues/costs, entities should communicate potential changes in metrics with both internal and external stake-holders.

- Investors/Lenders:
  - Net Income/EBITDA
  - Company valuations
  - Debt compliance ratio’s (ST/LT Deferred Revenue)

- IRS and Other Tax matters
  - Schedule M adjustments
  - Method of accounting changes (M-3)

- Will we see new metrics provided?
  - Adjusted EBITDA
  - Cash-based metrics if timing of recognition differs

- Internal stakeholders
  - Compensation benchmarks
  - Key metrics
  - Performance indicators

QUESTIONS?

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RESOURCES

Revenue from Contracts with Customers – Manufacturing Industry:
https://www.bdo.com/insights/industries/manufacturing-distribution/revenue-from-contracts-with-customers---manufactur

Conclusion

Thank you for your participation!

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