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WEBINAR RECAP

READY FOR REVENUE RECOGNITION? IMPLEMENTATION LESSONS LEARNED FOR TECH COMPANIES

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On May 28, 2014, the Financial Accounting Standards Board (FASB) and the International Accounting Standards Board (IASB) issued converged guidance on recognizing revenue in contracts with customers. The new guidance—FASB ASC 606 or IFRS 15, the IASB's comparable standard—replaces substantially all existing U.S. GAAP on this topic.

The goal of the standard was two-fold: 1) to improve accounting for contracts with customers; and 2) to develop a single revenue standard for U.S. GAAP & International Financial Reporting Standards (IFRS) globally. In other words, it's meant to serve as the standard framework for recognizing revenue across industries worldwide.

We recently examined how the new standard affects tech companies, as well as important lessons learned from those who've already adopted it, in our webinar, "*Ready for Revenue Recognition? Implementation Lessons Learned for Tech Companies*."

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Here are the key considerations:

REVENUE RECOGNITION OVERVIEW

- The new standard impacts virtually all tech companies following U.S. GAAP.
- Nonpublic companies must apply the new revenue standard to annual reporting periods beginning after Dec. 15, 2018. That gives private companies less than six months to prepare before the transactions are to be recorded in accordance with the new rules.

DIFFERENCES BETWEEN THE NEW & OLD GAAP REQUIREMENTS FOR RECOGNITION OF REVENUE

- The new standard has several changes that significantly affect tech companies. These include the elimination of sell-through accounting when product is sold through distributors; less onerous accounting consequences for extended payment terms and specified upgrades; a new framework of identifying and allocating sales proceeds to various elements of customer contracts; changes in accounting for sales commission; and more. All tech companies, regardless of size or subsector, need to be prepared to adopt the new standard in a thoughtful and methodical manner.
- Companies in subsectors with specialized guidance or industry practices, such as software, will be especially impacted. For example, software companies, under legacy GAAP, had restrictive rules that governed whether they could recognize license revenue upon delivery. Under the new standard, however, those restrictions, such as the requirement to maintain Vendor Specific Objective Evidence of Fair Value (VSOE) of undelivered elements, are no longer present.
- Companies will need to investigate and document the impact of the new standard, regardless of whether they expect dramatic changes. Because the fundamental thinking around accounting has changed, all tech companies need to analyze the new standard, even if they expect no changes upon adoption. It is not prudent to jump to the conclusion that the new standard will not have any impact without a detailed analysis of the new requirements.

IMPLEMENTATION "LESSONS LEARNED"

There's a reason why FASB has given companies a long runway of over four years to prepare to adopt ASC 606.

Here are some best practices for companies planning to implement the new standard:

- **Don't wait to get started.** One of the most common mistakes is underestimating the time required for adoption and/or oversimplifying certain aspects of the new standard. This often leaves companies scrambling at the last minute to get everything in order.
- **Build a project plan with dates and project leads early on.** Having a realistic timeline and adequate staffing is vital to meeting the rapidly approaching compliance deadline.
- **Initiate discussions between accounting, auditing, and tax personnel.** Reach out to professionals for assistance with technical positions and keep them looped in throughout the process.
- **Examine how the new standard will affect your commission expense accounting.** This is one area that tech companies repeatedly overlook in their initial assessments. The new standard eliminates the policy election present in legacy GAAP to expense commission costs as incurred, and now requires that companies expense their contract costs as they deliver their goods or services to the customer (except for those that qualify for an expedient). This may lead to the deferral and amortization of a portion of commission expense over the life of customer relationship in certain circumstances.
- **Prepare all required disclosures ahead of time.** The new standard requires significantly expanded disclosures about revenue recognition. Thus, companies must find effective ways to keep track of all the changes to ensure they are updating their stakeholders with the necessary information.
- **Consider the implications of the new standard beyond accounting.** Companies should consider how the new standard may potentially affect their pricing models, sales commission plans, contract deals, term licenses, and more.
- **Understand how the new standard will affect tax accounting methods.** Companies and tax professionals will need to evaluate the impact of the new standard over any tax accounting method change that may be necessary.

PREPARING FOR ADOPTION

We recommend that companies follow a 5-phase process in adopting the new standard:

1. **Scoping and Gap Analysis:** Companies should take a complete inventory of their revenue streams and prepare a "gap analysis" of the new and legacy U.S. GAAP requirements.
2. **Technical Analysis:** Companies should determine the specific application of the issues identified in Phase 1, including a method of determining standalone selling price, pricing controls, identifying the specific contract costs that may need to be capitalized, as well as assessing whether any business process changes may need to be implemented.
3. **Systems Configuration and Business Processes:** Companies should consider the need to reconfigure their systems and business processes based on Phase 2 findings. Many of those that have already adopted the new standard had to make certain changes to their information system configurations, and such an assessment should be performed early in the process.
4. **Testing/Transaction Auditing Internal Controls:** Companies should run historical transactions through parallel systems and business processes reconfigured for ASC 606. They should work with their auditors to perform detailed transaction testing.
5. **Financial Reporting and Disclosures:** Finally, companies should assess the results of Phase 4 and develop the disclosures required.

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It's important that companies stay up to date with the latest FASB guidance and communicate regularly with their external audit and/or tax partners throughout the process.

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