Planned Re-Exposure of Revised Revenue Recognition Standard

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Along with after-tax profits and EBITDA, revenue is among the most critical measures of a company's health and growth potential. Therefore, when changes take place in rules governing accounting for revenue, it is a highly significant event.

That is the case now, as the joint effort by the Financial Accounting Standards Board (FASB) in the U.S. and the International Accounting Standards Board (IASB) move closer to issuing a global standard for revenue recognition that will significantly alter how companies account for their revenues.

The planned re-exposure of a revised Revenue Recognition Exposure Draft (ED) will give companies, auditors, preparers and analysts another opportunity to weigh in on this extremely important accounting area.

Background to Current Developments

The Revenue Recognition Accounting Project is part of the larger effort by the two Boards to integrate U.S. Generally Accepted Accounting Principles (GAAP) and current IASB accounting standards into global accounting standards known as the International Financial Reporting Standards (IFRS). According to the Boards, the revenue recognition effort was designed to eliminate inconsistencies in the two sets of existing standards; improve comparability across businesses, industries, jurisdictions and capital markets; offer a more robust framework for addressing revenue recognition issues; and simplify the preparation of financial statements.

This project, begun several years ago, resulted in the release of an Exposure Draft on Revenue Recognition in June 2010, with a several-month comment period. The Boards received extensive comments from nearly 1,000 interested parties, and as a result, the Boards deliberated further for several months into 2011. After making significant alterations to the original ED based on these comments, the Boards jointly announced in June that they will re-expose the revised ED, most likely in the third quarter this year, with an additional four-month comment period. Further refinements and alterations to the ED are likely following the comment period, with the release of the final Revenue Recognition standard now anticipated before the end of 2012.

The New Exposure Draft

The proposed revenue recognition standard provides guidance for companies on how to account for the "amount, timing and uncertainty of revenue and cash flows arising from…contracts to provide goods or services to customers."

The Boards said the core principle of the new standard is that revenue recognition should reflect the "consideration" a business "expects to receive" in exchange for the transfer of goods or services to customers. Applying this principle, the Boards say, will require a business to: (1) identify contract(s) with a specific customer; (2) identify the separate performance obligations in the contract; (3) determine the

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transaction price; (4) allocate the transaction price to the separate performance obligations; and (5) recognize revenue when the entity satisfies each performance obligation.

In announcing their intent to re-expose the proposed revenue recognition standard, the Boards provided a comparison of the most important changes they have made to the original Exposure Draft. This comparison is organized according to the five major requirements above. In addition to changes in the five key areas, the Boards made changes to the ED in the following areas: warranties; breakage and prepayments for future goods and services; tests for determining if a performance obligation is onerous; licensing and rights to use; sale and repurchase of an asset; and costs of obtaining a contract. (See reference below, Summary of Revenue Recognition Model as of April 26, 2011, for a review of the revisions to the original ED.)

Moving Forward on the Standard

Clearly, the changes embodied in the new standard are complex and represent a major shift in revenue accounting. Given the substantial amount of time the Boards are providing for the second comment period, it is also clear that the Boards expect further significant comments on the standard before it is published in its final form.

The reason for this lengthy deliberation and comment process is, of course, the importance the standards-setting bodies attach to revenue recognition.

"It is important that we get this right, [the] first time," said Sir David Tweedie, chairman of the IASB, in June in announcing the planned re-exposure of the revised ED. "That is why the Boards and staff have undertaken an unprecedented level of outreach to get us to this point, and why we are keen to treble-check that our conclusions are robust and can be implemented with minimal disruption."

Adjusting to the New Standard

Because of the major changes that companies will be required to make in revenue recognition, it is important to set up systems, processes and procedures to implement the new standard when it becomes effective. In a recent analysis of the anticipated "revenue recognition convergence" of FASB and IFRS rules, accounting firm Deloitte stated the following:

> "Changing your revenue policy could impact many aspects of your organization, including accounting processes and supporting systems and controls; sales commissions; financial planning and budgeting; product pricing and bundling; contract management; and legal matters."

To prepare for these changes, companies should consider the following:

- Identify and assess the revenue streams that may be affected by the new standards.
- Consider whether your systems are able to deal with these changes.
- Assess the impact on your company's financial controls.
- Determine if the accounting changes affect the company's compensation and bonus structure.
- Assess how the changes affect the company's budgeting and forecasting processes.
- Ascertain whether the changes affect the way investors assess the company's performance.
- Assess whether the internal resources are available to deal with all of these changes.

In addition, Deloitte suggests that companies view the changed revenue recognition standard as an "opportunity to revisit your go-to-market approach." Because under the proposed new standard, the accounting will better reflect the underlying economics of a transaction, Deloitte suggests that firms:

- Consider if there are ways to "extract more value" from the firm's products and services by tying the firm's revenues to customers' performance.

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- Consider the impact of the new rules when entering long-term contracts.

The bottom line: Changes in revenue recognition are going to heavily impact your organization's overall business once they become effective, and it is critically important to begin addressing systems, processes and other issues that will need to be adjusted when the rules become effective.

Some firms may find that they don't currently have the expertise or capacity to address the coming changes in revenue recognition, and CFOs at these firms may wish to consider outsourcing these activities to a professional services firm that can provide the needed additional resources and expertise.

References and Additional Reading

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Revenue Recognition Convergence: Squeezing Your Company into the One-size-Fits-All Approach; Deloitte; 2011; http://www.bit.ly/nnaEis

Revenue Recognition Exposure Draft: Proposed Accounting Standards Update (Update to Topic 605: Revenue from Contracts with Customers); Financial Accounting Standards Board; June 24, 2010; http://www.bit.ly/rrFqiZ

Summary of Revenue Recognition Model as of April 26, 2011; Financial Accounting Standards Board; http://www.bit.ly/qT4sAM

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