Revised Revenue Recognition Exposure Draft

What does it mean for you?

What does the revised revenue recognition exposure draft (revised ED) issued by the Financial Accounting Standards Board (FASB) in November 2011 mean to you? It very likely means that major changes are ahead for how your company accounts for its revenue transactions. The following points capture just some aspects of the proposed revenue recognition model that indicate significant changes are on the way.

1. Accounting for industry-specific transactions with a general revenue recognition model

The comprehensive revenue recognition model proposed in the revised ED would be applicable to all industries and entities. If industry-specific revenue recognition guidance is currently used by an entity, then that entity is more likely to be significantly affected by the proposed model. Examples of industries that currently have extensive industry-specific revenue recognition guidance that would be replaced by the proposed model include software, real estate and construction.

2. Using the revenue model to account for sales of some nonfinancial assets

The recognition and measurement guidance in the proposed model would apply to sales of certain nonfinancial assets that an entity does not sell as part of its normal revenue-generating activities. For example, a manufacturing company that sells a piece of equipment used in its manufacturing process would use the proposed model to determine the timing and amount of any gain or loss recognized on that sale.

3. Including variable consideration in the transaction price used to measure revenue

Estimates of the amount of variable consideration an entity expects to be entitled to would be necessary. The amount of variable consideration recognized as revenue, however, would be limited to those amounts to which the entity is reasonably assured of being entitled. High hurdles based on experience with variable consideration would have to be cleared by an entity to conclude that it is reasonably assured of being entitled to variable consideration.

4. Incorporating the time value of money in the transaction price used to measure revenue

The time value of money (to the extent it represents a significant financing component in the contract) would need to be taken into consideration in determining the amount of revenue that would be recognized with respect to transactions that have deferred payment terms and transactions that require prepayments by the customer. A practical expedient would allow an entity to ignore the time value of money if the period between payment of substantially all of the consideration and transfer of the promised goods or services is one year or less.

5. Addressing collectibility in recognizing revenue and presenting uncollectible amounts

Whether collectibility is reasonably assured would not be taken into consideration when determining whether or when revenue should be recognized. However, amounts recognized as revenue that an entity concludes are uncollectible would be reflected as a reduction of revenue and presented adjacent to revenue as a contra-amount. This presentation may have a significant effect on an entity's gross margin.

6. Recognizing a liability and a loss for onerous performance obligations

A liability and corresponding loss would be recognized for an onerous performance obligation. The amount of the liability and loss would be the excess of the lowest cost to settle the performance obligation over the transaction price allocated to the performance obligation. An onerous performance obligation liability would only be recognized for a performance obligation that takes more than one year to satisfy.

7. Capitalizing certain contract costs

If specific criteria are met, an entity would be required to capitalize certain costs, such as sales commissions and set-up costs, unless a practical expedient is utilized that would allow the expensing of such costs if the related amortization period would have been one year or less. Capitalized costs would be subject to impairment testing and the amortization period would correspond to the period over which goods or services are transferred to the customer, which may be longer than an initial contract term.

8. Providing many more disclosure requirements

Even if the timing and amount of revenue recognized by an entity is not expected to change significantly, the information disclosed about its revenue-generating transactions would significantly increase given the extensive new interim and annual disclosure requirements.

9. Applying the proposed model on a retrospective basis

While there would be some permitted practical expedients, the transition method that would be used to adopt the proposed model would be retrospective application, which would require recasting financial statements for all periods presented. Retrospective application would likely require a significant amount of effort because it may effectively require an entity to dual-account for its revenue transactions for the two- to three-year period leading up to the adoption of the new guidance.

What should you do now?

A final Accounting Standards Update on revenue recognition is not expected until the end of 2012 or beginning of 2013, with the effective date not expected to be earlier than 2015 for public entities and 2016 for nonpublic entities. With that said, it is not too early to apply the proposed model to existing contracts with customers to gain an understanding of how the recognition, measurement and disclosure of revenue would be affected. Doing so will help provide you with an understanding of the changes that would be needed to internal controls over financial reporting, the upgrades that would be needed to financial reporting systems to provide the additional information necessary to account for and disclose revenue transactions under the proposed model, and the effects the proposed model may have on revenue trends and the ability to comply with existing debt covenants.

If additional information about the proposed model is needed to gain an appropriate understanding of how your entity's recognition, measurement and disclosure of revenue would be affected, please refer to our white paper, FASB and IASB Issue Revised Exposure Draft on Revenue Recognition.

Once you understand the effects of the proposed model, you may want to provide feedback to the FASB. The FASB welcomes and acts upon feedback from its constituents and has requested comments on the proposed model be sent to them by March 13, 2012. Comments can be made using the FASB's electronic feedback form or sent in the form of a written letter via email to director@fasb.org.

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