The new revenue standard’s implementation date has arrived for public entities.¹ The standard substantially replaces all existing guidance for recognizing revenue, including more than 200 pieces of industry-specific guidance. Financial statement preparers are scrambling to meet the implementation deadline and get confirmation that the judgments being made are correct. The American Institute of CPAs recently hosted a conference covering current U.S. Securities and Exchange Commission (SEC) developments. SEC officials provided insights on two revenue recognition topics for manufacturers based on recent consultations. While the SEC conclusions only apply to public companies, these decisions sometimes become industrywide practices that nonpublic companies follow by analogy.

Preproduction Arrangements

A representative from the SEC’s Office of the Chief Accountant (OCA) highlighted a pre-filing consultation on the treatment of a preproduction arrangement for the design of a specialized good that the registrant anticipated manufacturing and selling to a customer. In this case, the registrant concluded the design activities did not transfer control of a good or service and, therefore, were not a performance obligation under Accounting Standards Codification (ASC) 606. The registrant concluded that the periodic information provided to the customer related to the design activities was not detailed enough to enable the customer to avoid having to reperform the design work, for example, if the design efforts were not successful or if the counterparty selected another manufacturer for the specialized good.

The registrant determined the preproduction design activities should be accounted for as research and development expenses and that payment received should be accounted for as an advance for the future sale of the specialized good. The OCA did not object to this accounting based on the specific facts and circumstances. The OCA also did not object to the registrant applying the ASC 606 transition guidance rather than the guidance in ASC 250 on changes in accounting principles.

Other registrants have historically considered preproduction as a nonrevenue arrangement that could be accounted for as an advance payment for future sales or as a contra-expense under a cost reimbursement model. The OCA would not object if registrants continued to apply their historical nonrevenue models to preproduction arrangements. Registrants that historically applied a nonrevenue model and are considering either applying a revenue model under ASC 606 or making changes to their historical nonrevenue model, including any change to the historical timing or payment presentation in the income statement, should consult with the SEC.

¹ The new revenue standard defines a public entity as any one of these:
• A public business entity
• A not-for-profit entity that has issued, or is a conduit bond obligor for, securities traded, listed or quoted on an exchange or over-the-counter market
• An employee benefit plan that files or furnishes financial statements to the SEC
Shipping & Handling

The SEC official also covered the expense classification for shipping and handling costs, which the accounting standards update (ASU) does not address. Entities will need to apply reasonable judgment in determining the appropriate classification for those shipping and handling activities that are accounted for as activities to fulfill the promise to transfer the good. The SEC would not object to classification of these expenses within cost of sales or if an entity continued to apply its previous classification policy for these costs, which could potentially be outside cost of sales. However, registrants should consider disclosure for significant shipping and handling charges reported outside of cost of sales, including the amount and line item on the income statement where they are reported.

BKD has prepared a library of BKD Thoughtware® on revenue recognition issues. Visit our Hot Topics page to learn more. If you have questions about the revenue recognition rules, contact your BKD advisor.

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