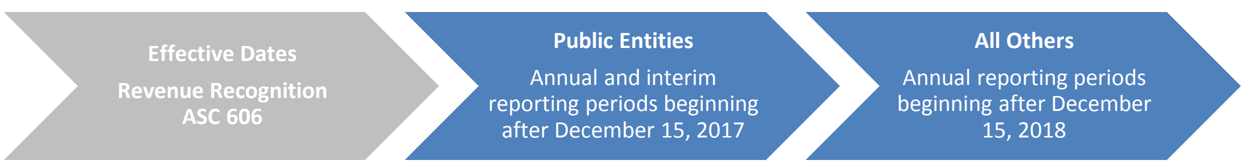
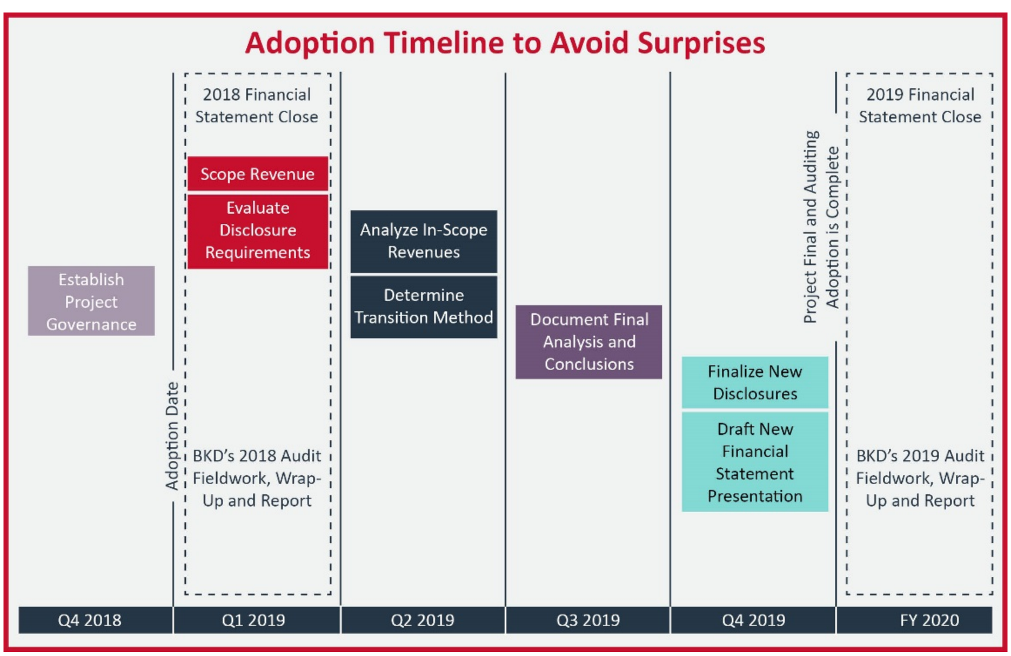
Revenue Recognition: The Countdown Begins for Private Companies & NFPs

The countdown begins now for a successful implementation of the new revenue standard, Accounting Standards Codification (ASC) 606. The overriding refrain from public companies across all industries that have adopted the new revenue rules is do not underestimate the time and resources needed. Implementation will be a significant undertaking regardless of an organization's size. The effect on each industry and entity will vary depending on existing revenue sources, current accounting elections and extent of change from existing industry accounting standards or practices. Even if revenue recognition timing does not change, there is a more extensive five-step process required to validate the revenue being recognized. All entities will face increased disclosure requirements, as well as having to redraft accounting policies under the new principles and update internal controls for the increases in management's judgments. This is not a task only for the accounting department. Changes may affect sales agreements, long-term compensation arrangements, compliance with debt covenants and key financial ratios.

The effort needed demands a clearly defined action plan. Do not wait until the 2019 audit cycle or you may not be able to properly comply with the standard's requirements, risking financial statements not compliant with generally accepted accounting principles.

This paper will provide a high-level, quarter-by-quarter action plan to help ensure a smooth and efficient transition. Collaborating early and often with your auditor will help you avoid any unpleasant surprises. Schedule regular time to evaluate progress and discuss challenges, judgments and conclusions. Whether or not you are an audit client, BKD can help.





Details for each quarter are included in the Appendix.

BKD CPAs & Advisors

Conclusion

The adoption of ASC 606 will be complex and likely will require significant hours to implement correctly. BKD can help educate your team, provide implementation tools and assist with analysis and documentation. If you would like assistance complying with the new revenue recognition standard, contact your trusted BKD advisor. BKD has prepared a library of **BKD Thoughtware®** on revenue recognition issues. Visit our website to learn more.

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Appendix

Fourth Quarter 2018

Project Governance

1. Read the standard and related Thoughtware
2. Schedule BKD to host an education session
3. Identify a champion or task force to study ASC 606, lead adoption efforts and work directly with auditors. Some questions entities should consider in assessing the size and scope of implementation plans include:
    - How many different types of revenue transactions exist?
    - Where are sales contracts stored?
    - What level of detail is maintained on sales terms?
    - What systems are used to manage revenues and costs?
4. Develop and document project timeline, roles and responsibilities. Consider team bandwidth and competencies, and conclude on the level of outside assistance needed
5. Begin to educate audit committees, boards, banks and other stakeholders about the project plan and expected significant effects
6. Formally kick off adoption project and reiterate project timeline. Consider sharing this with your auditor to ensure resources are scheduled accordingly

First Quarter 2019

Revenue Scoping

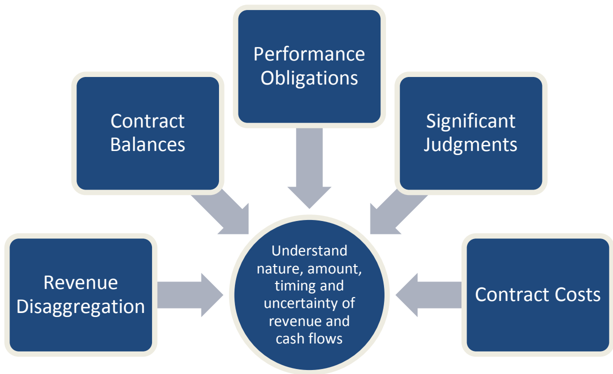
1. Identify all revenue by starting with the trial balance and tying out total revenue to final financial statements (completeness)
2. For each revenue general ledger account, document whether in scope or not in scope. Not-in-scope items could include rental or investment income or insurance or derivative revenue, which are specifically excluded from ASC 606
3. Materiality considerations. ASC 606 does not apply a materiality concept so care should be given to ensure insignificant items are not significant in the aggregate
4. Review scope conclusions with your auditor

Disclosure Scoping

Companies in all industries that have adopted ASC 606 have found this area to be more challenging than initially anticipated. The new revenue standard provides significant relief for nonpublic entities with less focus on quantitative disclosures. Even still, additional data will need to be collected and additional monitoring and record-keeping will be required. Developing a disclosure requirement working plan upfront can avoid duplication of efforts and make data gathering more efficient. Questions entities should consider:

- What controls are in place to test the completeness and accuracy of the information disclosed?
- Is the current accounting information system capable of providing the required information?
- How do current-year acquisitions or divestitures affect the revenue disclosures?

- What payment terms, *e.g.*, payments in arrears, milestones, contingent payments and postpaid customers, give rise to contract assets?
- How does the satisfaction of performance obligations correlate with customer payment?



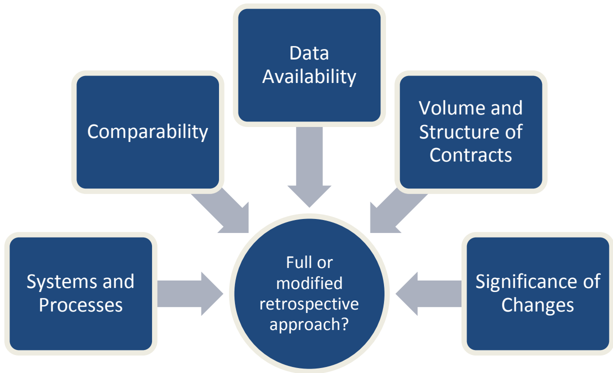
Second Quarter 2019

Analysis of In-Scope Revenue

1. Evaluation and documentation of contract terms are critical. Consider the level of analysis and documentation needed:
   - **High**: Large and complex revenue streams
   - **Low**: Revenue that is noncomplex
   - **Medium**: Judgment will be needed
2. Analysis of portfolios and related rationalizations involves judgment and verification. The Financial Accounting Standards Board recognized the challenges of applying the new revenue rules on a contract-by-contract basis and provided a practical expedient for entities with a large volume of similar contracts or with similar customer classes

Transition

Determine an adoption method. Entities must retrospectively apply the new revenue standard using either a full or modified retrospective approach, with multiple practical expedients permitted. Each approach has relative benefits, costs and complexities. There is no one-size-fits-all solution—it will depend on each entity's specific facts and circumstances and which factors are most relevant. Some entities may consider comparability to peers or between reporting periods to be most relevant while others may prioritize the cost of implementation. In other cases, an entity may consider comparability most important but determine the retrospective method is not feasible because it cannot make the necessary system changes in the required time frame at a reasonable cost.



Third Quarter 2019

Document Final Analysis & Conclusions

1. Schedule time with auditor to sign off on all key adoption concepts

Fourth Quarter 2019

Develop Disclosures & Financial Statement Presentation

1. Have disclosures drafted by the end of 2019—do not wait until audit fieldwork starts in 2020. A second set of eyes can help check that the following requirements are sufficiently addressed and disclosed:
   - Are all significant judgments and estimates related to variable consideration, noncash consideration and determining the transaction price disclosed? Has the entity adequately disclosed information about the methods, inputs and assumptions used in the annual financial statements?
   - What estimates help determine the level of completion?
   - What information does management consider to determine when performance obligations are satisfied?
2. Have your auditor sign off on the financial statement presentation format by the end of calendar year 2019. Certain industry presentation practices for taxes or shipping costs may require an accounting policy election to continue current practice under the new guidance. In addition, changes to the principal versus agent criteria may require changing revenue from net to gross presentation