Feature

It's finally here:

FASB issues new revenue recognition standard

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THE MODEL FOR revenue recognition in construction is changing with the Financial Accounting Standards Board (FASB) May 28, 2014 release of Accounting Standards Update (ASU) 2014-09, *Revenue from Contracts with Customers* (Topic 606). Since 2008, FASB and the International Accounting Standards Board (IASB) have been working jointly on developing a single principles-based model for recognizing revenue, with a goal of improving consistency of requirements, comparability of revenue recognition practices, and usefulness of disclosures.

Throughout the FASB process, NASBP, the Construction Financial Management Association (CFMA) and other interested organizations have been very involved in providing input on the impact of the new standard. The ASU eliminates all existing revenue recognition guidance under both U.S. Generally Accepted Accounting Principles (GAAP) and International Financial Reporting Standards (IFRS), including industry-specific guidance, and significantly expands revenue recognition disclosures.

The required disclosure changes will include both quantitative and qualitative information about the amount, timing, and uncertainty of revenue from contracts with customers and the significant judgments used. There is limited relief offered to nonpublic companies on some of the qualitative disclosures.

There are some myths that have been rolling around the construction industry related to the changes in revenue recognition. Hopefully, many of these myths can be put to rest with the issuance of the final standard. The table in this article provides some of the highlights.

Assumption	True/False
Percentage completion accounting has been eliminated.	**False** – While the thought process and terminology will be different, revenue recognized under the new standard may be similar to the percentage of completion method used today.
Revenue can be recognized on uninstalled materials.	**True** – FASB included specific language whereby, in certain circumstances, contractors may be allowed to recognize revenue equal to the cost of the uninstalled materials if the customer obtains control of the goods.
All contracts will have multiple performance obligations.	**False** – Many (not all) construction contracts may have one performance obligation. Contractors will still need to evaluate each contract for separate performance obligations and document their conclusions.
Contractors will have to recalculate all completed contracts under the new standard when implemented.	**False** – During the transition period, FASB has allowed for two options: restate prior periods presented, or account for contracts in progress and all new contracts going forward.
Cost to cost (costs incurred) can still be used to determine percentage complete on contracts in progress.	**True** – The new standard allows for the use of input or output methods to determine percentage complete.
Contractors will add significantly more footnotes to the financial statements.	**Depends** – New disclosures will be required, with some relief for nonpublic entities.

EFFECTIVE DATES

Many contractors enter into agreements that can span multiple years; therefore, it is important to understand the effective dates in the new standard. For public companies, the standard will be effective for annual reporting periods beginning on or after December 15, 2016, including interim reporting periods therein. Early application is not permitted for public companies. For nonpublic companies, the standard will be effective for annual reporting periods beginning on or after December 15, 2017, and interim and annual reporting periods thereafter. Nonpublic companies may elect early application, but no earlier than the effective date for public companies.

ASSESS ALL ARRANGEMENTS

The ASU applies to all contracts with customers, other than those within the scope of other standards, such as leases, insurance, financing arrangements, financial instruments, and guarantees (other than product or service warranties). The ASU does not apply to other parties to a contract who are not customers. Management will need to review partnership and collaborative arrangements to assess if such arrangements will be subject to the ASU.

THE NEW REVENUE RECOGNITION MODEL

The core principle of the new model is that an entity would recognize revenue as it transfers goods or services to customers in an amount reflecting the consideration it expects to receive. To achieve that core principle, an entity would apply a five-step model.

Collectability will be an explicit threshold that must be assessed *before* applying the revenue recognition model to a contract. An entity must evaluate customer credit risk and conclude it is "probable" it will collect the amount of consideration due in exchange for the goods or services. The assessment is based on the customer's ability and intent to pay as amounts become due. This is a significant shift from the previous exposure drafts.

STEP 1: IDENTIFY THE CONTRACT WITH A CUSTOMER

The first step in applying the model is to identify the contract with a customer. A contract is defined as "an agreement between two or more parties that creates enforceable rights and obligations." The ASU includes criteria for combining contracts into a single contract for accounting purposes. Accounting for a contract modification will depend on the type of modification and would be treated as either a separate contract or as an adjustment to the original contract, depending on circumstances.

STEP 2: IDENTIFY THE PERFORMANCE OBLIGATIONS IN THE CONTRACT

Once an entity has identified a contract, it would identify performance obligations within that contract that require separate accounting. A performance obligation is defined as "a promise in a contract with a customer to transfer a good or service to a customer." Management will need to use significant judgment to distinguish each performance obligation within a contract; identifying performance obligations and how they are satisfied will directly affect when revenue is recognized.

STEP 3: DETERMINE THE TRANSACTION PRICE

The transaction price is the amount of consideration to which an entity expects to be entitled in exchange for transferring goods or services. To determine the transaction price, an entity would consider the terms of

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construction CPA firms, and the members of the Construction Industry CPAs/Consultants Association.

"The links section is impressive," said Spencer. "There are so many different government agencies involved in construction that one can get frustrated searching for the appropriate site."

Newton said, "The directories are invaluable in that they assist the contractor in finding the true surety professionals who can provide the best surety assistance."

Spencer predicted, "The next generation of construction owners are used to immediate information being available on the Web; sites like this are what they want and will use."

Despite the wealth of information available at SuretyLearn.org, the neat, simple layout makes it easy to navigate through and find what one wants.

"I like the elegant simplicity of it—very straightforward and easy to navigate," said Newton.

"The website is well laid out and is user friendly," Guignard added.

Resource for Surety Professionals, Too

Newton said the website will benefit surety bond producers by providing a resource to help educate clients and prospects about the surety process. Sometimes changes in a construction client's operations and management are necessary, he said, and the information on the website reinforces the process a surety professional will discuss and implement with the contractor.

Spencer said, "We are using the website to help train our newer producers and also to reeducate some of our long-term accounts. The information on indemnity agreements is very useful, as this is one of the more misunderstood documents in our business." ●

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the contract, its customary business practices and the effects of the time value of money, variable and noncash consideration as well as consideration payable to the customer. Variable consideration will be included in the transaction price to the extent it is probable that a significant revenue reversal will not occur. Consideration can vary because of discounts, rebates, refunds, credits, price concessions, incentives, performance bonuses, penalties, or other similar items.

STEP 4: ALLOCATE THE TRANSACTION PRICE TO THE PERFORMANCE OBLIGATIONS IN THE CONTRACT

The transaction price would be allocated to all performance obligations that require separate accounting based on their relative standalone selling price. The best evidence of standalone selling price would be the observable price for which the entity sells the good or service separately. In the absence of separate observable sales, the standalone selling price would be estimated.

STEP 5: RECOGNIZE REVENUE WHEN (OR AS) THE ENTITY SATISFIES A PERFORMANCE OBLIGATION

Revenue is recognized when (or as) control of a good or service is transferred to a customer. Satisfaction would occur when the customer has the ability to direct the use of, and receive the benefits from, the transferred good or service. Revenue can be recognized over time (typically, for transferred services) or at a point in time (typically, for transferred goods).

ALTERNATIVE TRANSITION METHOD

Contractors can retrospectively apply the new revenue standard or use an alternative transition method that provides for certain practical expedients. The alternative transition method requires an entity to apply the new guidance only to contracts not completed under legacy GAAP at the date of initial application and recognize the cumulative effect of adoption as an adjustment to the opening balance of retained earnings in the year of initial application. An entity choosing to apply the alternative transition method would not restate comparative years, but it would be required to provide additional disclosures in the initial year of adoption.

STAY INFORMED

The issuance of the final standard is not the end; rather it is just the beginning. CFMA, American Institute of Certified Public Accountants, FASB, and many other organizations will be developing information related to the impact on the construction industry. The hard work that was done over the past few years has resulted in a new standard that retains much of the revenue recognition accounting for construction contracts that we are all familiar with; but terminology has changed, and there are some new twists that will have to be evaluated and accounted for.

NASBP maintains a strong relationship with CFMA, and as a result the NASBP membership benefits from many initiatives and programs jointly undertaken by the two associations.

For news and information on this standard, visit CFMA's Revenue Recognition Hub at www.cfma.org/revenuerecognition. ●

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