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Balance sheet

Revenue Recognition

By Jeffrey C. Quinlan, CPA

In a move to unify accounting standards, the Financial Accounting Standards Board (FASB) along with the International Accounting Standards Board (IASB) issued *Revenue from Contracts with Customers*. The adoption was delayed and now is effective for calendar year 2019 for nonpublic companies. The new standard affects almost all revenue recognition for public, nonpublic and not-for-profit companies. The purpose of the new standard is to have a uniform, industry neutral way of recognizing revenue.

Before the new revenue standard, revenue was recognized when earned and realizable. Revenue is earned and realizable when there is an arrangement between two parties, delivery of goods and services is provided, the price is fixed or determinable, and collectability is reasonably assured. In addition, these criteria were subject to industry guidance such as percentage of completion for the construction industry. The principle of the new standard is to recognize revenue for the transfer of promised goods or services to customers at the amount the entity expects to be entitled in exchange for those goods or services. An entity recognizes revenue under the new standard by applying the following steps:

Identify the contract(s) with a customer – a contract is an agreement with enforceable rights and obligations between two or more parties. In some instances, an entity must combine multiple contracts to account for them as one contract. There is further guidance required on modifications of a contract.

Identify the performance obligations – performance obligations are distinct goods or services in a contract. A good or service is distinct if a customer can benefit from the good or service on its own or together with readily available resources and the good or service is separately identifiable from other promises in a contract.

Determine the transaction price – the transaction price is the amount of consideration in a contract that the entity expects to be entitled in exchange for transferring goods or services to the customer. Consideration can be a fixed price or involve variable consideration and non-cash consideration. Variable consideration requires an estimate of the amount that will be received to the extent that a significant reversal of revenue will not be probable.

Allocate the transaction price to the performance obligation – the price should be allocated to each performance obligation on a relative standalone selling price basis. If a standalone price is not available, then an estimate of each performance obligation is required.

Recognize revenue when (or as) performance obligations are satisfied – an entity satisfies performance obligations when they transfer a good or service to a customer with the customer having control of the good or service. This can happen at a point in time such as a delivery of goods or can happen over time such as providing a service for multiple years. Performance obligations satisfied over time need an appropriate measurement of the progress toward satisfaction of the performance obligation.

Although the new standard takes effect in 2019 for nonpublic companies, entities that report GAAP financial statements need to consider how the standard changes their revenue recognition and procedures for implementing the new standard. Please contact our office if you have questions.

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