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Balance sheet

IN ACCORDANCE WITH GAAP… REVENUE RECOGNITION IS CHANGING

By Douglas E. Schleucher, CPA

The revenue recognition standards are changing for anyone who prepares financial statements in accordance with Generally Accepted Accounting Principles (GAAP). Revenue recognition standards determine both how much and when revenue is recognized on the income statement. Revenue is one of the most important measures used in assessing an entity's performance. The new standards were developed jointly by the Financial Accounting Standards Board (FASB) and the International Accounting Standards Board (IASB) in June of 2014. Private companies and organizations using GAAP are required to apply the new rules for annual reporting periods beginning after December 15, 2018.

The old standards were very rules-based with many industry-specific rules. As a result, determining applicable rules could be difficult and different industries recognized revenue differently for similar transactions. The new standards have a principle-based focus and will apply to all industries. This should provide a more standard and consistent recognition of revenue. Also, since the standards were jointly developed by the FASB and the IASB, the United States standards for revenue recognition are now consistent with the international standards.

The core principle established by the new guidance is to recognize revenue upon the transfer of goods or services to customers in amounts that reflect the consideration expected to be received in exchange for those goods or services. A company or organization will apply a five-step process to achieve the core principle.

The five steps are:

1. Identify the agreement with the customer
2. Identify the performance obligations (promises) under the agreement
3. Determine the transaction price
4. Allocate the price to each separate performance obligation
5. Recognize revenue when (or as) a performance obligation is satisfied

Revenue recognition in some instances can be simple. Consider the sale of a non-warranty, non-returnable product to a customer for cash at the time of transfer. On the other hand, revenue recognition for goods and/or services that are provided under a contract over a long period of time but not uniformly will be much more difficult to determine.

Every business and organization that prepares GAAP financial statements needs to evaluate the impact of these new standards on their recognition of revenue. We are here to help and will be happy to assist with the evaluation of these new standards.