Transitioning to the new revenue recognition standard
An integrated approach to leveraging your SAP investment

This paper discusses the implications of the new accounting standard released jointly by the Financial Accounting Standards Board (FASB) and the International Accounting Standards Board (IASB). ASC 606, Revenue from Contracts with Customers, describes how companies can leverage their current SAP investments and use an integrated transition approach to reduce compliance risk and improve the revenue accounting process.
Introduction

On May 28, 2014 the FASB and IASB issued their long-awaited converged standard on revenue recognition. The objective of new standard (ASC 606 and IFRS 15) is to provide a single, comprehensive revenue recognition model for all customer contracts, improving comparability within and across industries, as well as across capital markets.

The new standard embodies a major shift in how revenue will be recognized in many organizations. Management will need to perform a thorough analysis of existing contracts, business models, company practices, and accounting policies. For industries that applied industry-specific guidance under the old standard—including software, construction, and entertainment, media, and communications—the transition to the principles-based single standard is expected to be a significant change.

The new standard introduces a five-step model (see Figure 1) that requires more judgments and estimates than the approach it replaces. There is a transition period during which companies must recognize revenue under both standards in order to allow investors to make accurate year-to-year comparisons.

The new guidance is effective in 2017 for public companies. Companies can either elect to apply the standard retrospectively (applying it to both current and prior years) or use a practical expedient—a prospective process with a cumulative catch-up. The new standard embodies a major shift in how revenue will be recognized in many organizations. Management will need to perform a thorough analysis of existing contracts, business models, company practices, and accounting policies.

Revenue recognition has routinely been viewed as one of the most difficult finance and accounting processes to get right. It represents one of the highest risks of material error on financial statements, and it is one of the leading causes of restatements. Companies move to the new standard, their compliance risk is likely to increase unless they have a well-planned, comprehensive approach to adoption. For example, according to a recent poll from a PwC-SAP webinar, less than 10% of respondents said that their current financial systems support revenue accounting processes in the context of the new standard, meaning a high proportion of companies are exposed to revenue compliance risk. There are a number of reasons why the transition could be especially challenging.

Accounting is just the tip of the iceberg

The implications of the new standard are far broader than simply changing accounting and reporting methods, although that change itself is highly complex. Because so many parts of a business are tied to revenue, the new guidance will have a pervasive organizational impact, affecting such areas as executive and sales compensation, debt covenants, taxes, and even product offerings and how products are sold. Systems and processes will need to change to accommodate the new standard, and an entire education and training program will be essential to retooling the organization to meet the standard’s requirements. Communications with outside stakeholders, including suppliers, customers, and to investors will be an important part of the transition. None of this can happen overnight. This transition is complicated and difficult, and organizational leadership will need to be involved.

The finance workload during transition will increase significantly

The new guidance sets a 2017 effective date that will call for most companies to go through approximately two years of transition. The question is, is that enough time? Polling conducted during a recent PwC-SAP webinar showed that only 38% of respondents believe enough time exists for their company to adequately prepare for the new standard's effective date. This suggests companies need to already be thinking about the transition.

During this time, companies will need to present their financials using both the current and new standard. This places a significant burden on finance staff—especially since much of the work done to reconcile the revenue accounting for bundled contracts is done manually via spreadsheets, a process that is both time-consuming and subject to human error. Simply throwing more bodies at the problem may not be practical in the long run. Companies will likely need technology solutions that can reduce the amount of manual calculation involved in accounting for revenue and related costs.

The challenges of transition

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The importance of an integrated approach

PwC delivers an integrated approach in three phases. Each phase includes steps for the five different workstreams—accounting oversight, program management, systems implementation, data, and organizational change management—that are involved in the transition:

- **Assess**: The Assess phase is critical to determining how the new standard will impact the organization and what types of training and communication will be required for a smooth transition. During this phase, the organization builds a solid foundation for the transition, establishing proper structures for governance, project management, and change management. PwC also recommends conducting a Revenue Automation Assessment to understand the current revenue accounting process, capability gaps, and data quality scoping.

- **Embed**: The accounting team drafts disclosures for both the transition and post-go live periods and begins communicating policy changes to stakeholders, including outside investors. IT builds, tests, and deploys the automation solution and performs mock and final data captures. By including each workstream throughout the three phases of the process, companies can address frequent interdependencies in a thoughtful and timely manner.

- **Convert**: During the Convert phase, the organization decides which adoption method (retrospective or prospective) it will use. This important decision will depend on whether the organization has the resources available to implement one method more effectively than the other given the taxonomies for each. The company also needs to consider what it needs to make to its business models, processes, and systems as well as what training and communications it will need to develop for internal and external stakeholders. The IT and finance teams conduct a data quality assessment to determine what needs to be done to improve data quality in preparation for automation.

SAP’s RAR solution will support the automation capabilities needed for transition to the new standard. Companies that currently use SAP financials can leverage this new solution to address their revenue automation needs.

**Revenue Allocation**: These capabilities reduce compliance risk by automating accounting policy rules and improving the efficiency of contract identification and assessment. The SAP RAR solution contains revenue allocation capabilities such as MEA (multiple-element arrangement) determination rules and MEA revenue allocation rules.

**Revenue Recognition**: These capabilities reduce compliance risk by providing an audit trail of revenue triggers and account postings to operational contracts. The SAP RAR solution supports revenue recognition capabilities such as MEA processing and approval, revenue recognition of distinct performance obligations, revenue

While the impact of the converged US GAAP/IFRS revenue recognition standard will vary depending on the company and the industry, it is likely to extend well beyond mere accounting policy. In preparing to adopt the new standard, companies will need to scrutinize many aspects of their operations, from business models to how they sell to customers. They will also need to address the standard’s complexity, looking for ways to lighten some of the burden on their finance staff via automation of revenue accounting processes. By combining automation with an integrated approach, companies can help facilitate a smooth transition while reducing their compliance risk.

**SIDEBAR: Transitioning to the new standards: Key considerations**

- Have you considered future business models and go-to-market approaches while assessing the accounting policy impact of the new standard?
- Did you define the MEA (multiple-element arrangement) use cases, revenue streams, and revenue accounting scenarios that are representative of sales transactions?
- Have you identified the revenue automation capabilities needed to support the future-state revenue accounting processes in the context of MEA use cases, revenue streams, and revenue accounting scenarios?

**Conclusion**

While the impact of the converged US GAAP/IFRS revenue recognition standard will vary depending on the company and the industry, it is likely to extend well beyond mere accounting policy. In preparing to adopt the new standard, companies will need to scrutinize many aspects of their operations, from business models to how they sell to customers. They will also need to address the standard’s complexity, looking for ways to lighten some of the burden on their finance staff via automation of revenue accounting processes. By combining automation with an integrated approach, companies can help facilitate a smooth transition while reducing their compliance risk.

**Additional Resources**

- PwC Guide to Revenue Recognition Website: http://www.pwcrevrec.com/
- “How companies can adopt the New Revenue Recognition Standard while leveraging their SAP Investment.”

**Mitigating transition risk through SAP automation**

- Is your future-state solution architecture defined and did you perform a fit/gap analysis of revenue automation solutions compared with future-state capabilities?
- Have you considered transition method and dual reporting needs as part of the data migration strategy?
- Have you established a program governance structure to enable quick decision-making across functions?
- Did you perform a stakeholder assessment to gain cross-functional support for the transition initiative?
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