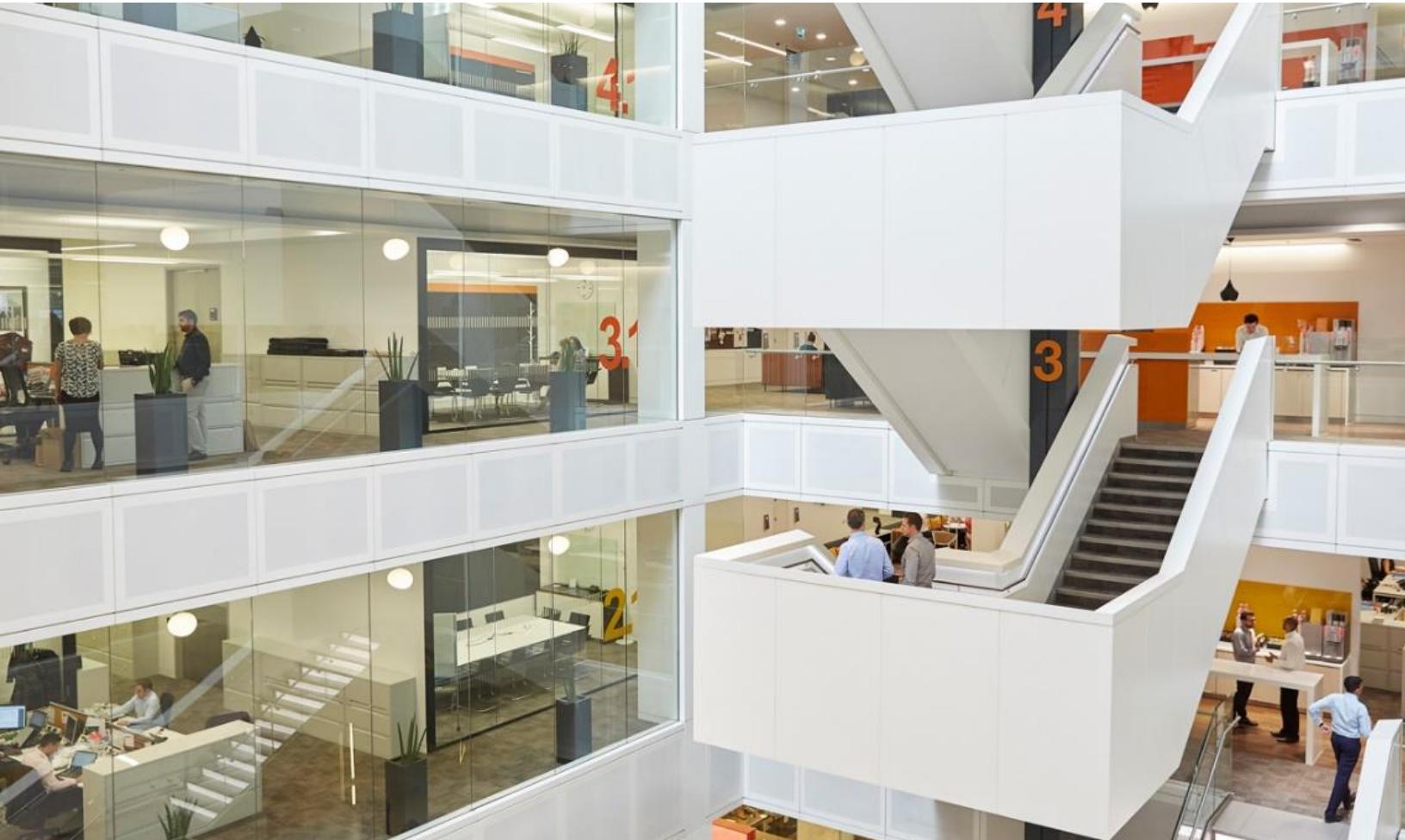


Private Company Services

Five ways the new accounting
standard for revenue recognition
can affect your business this year

March 2018

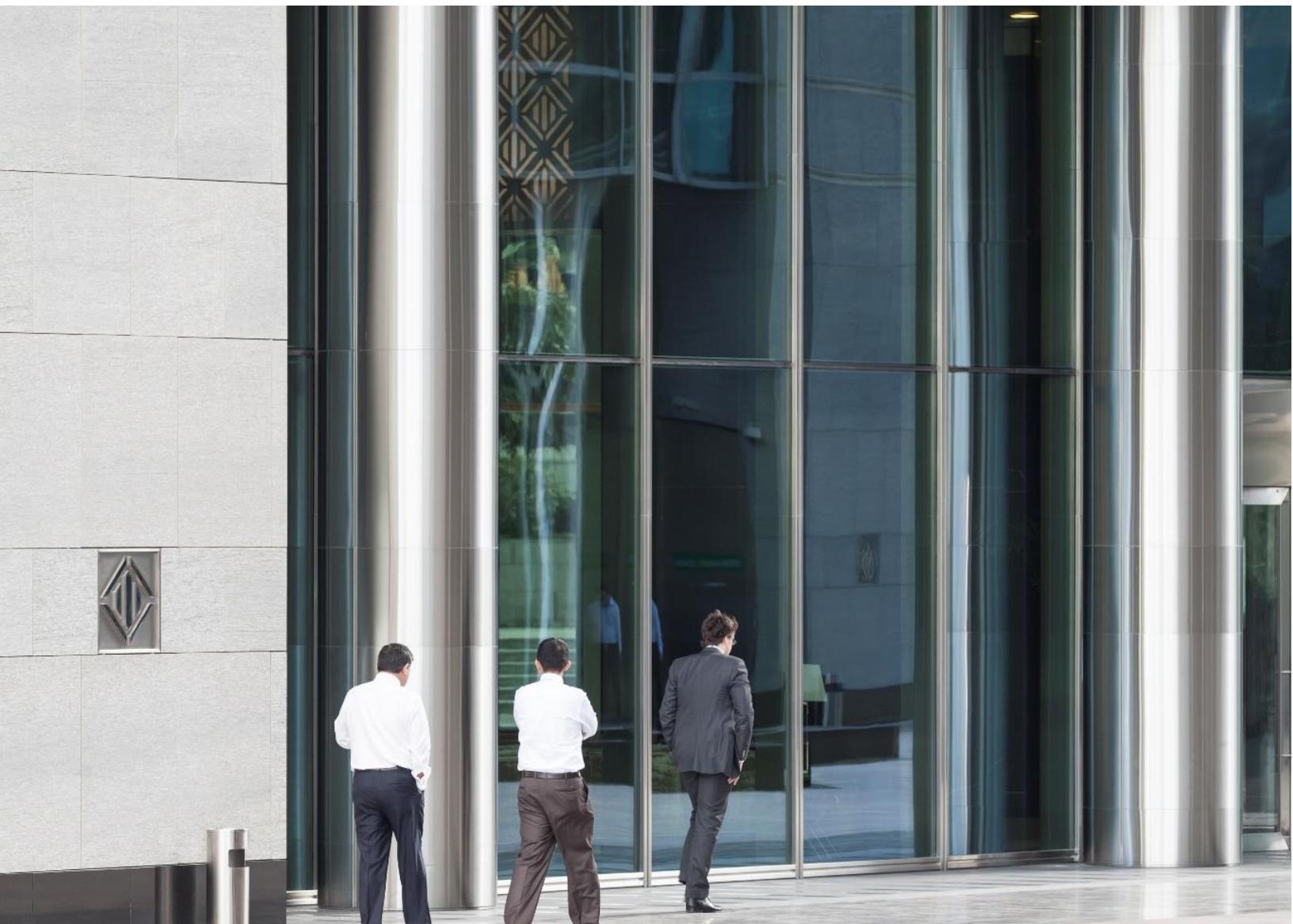


Unlike public companies, most privately-held companies have until January 2019 to meet the deadline to adopt the new accounting rules for how they recognize revenue.

Executives of privately-held companies should take this opportunity to learn from the experiences of their counterparts in public companies, who have spent the last year evaluating customer arrangements to come to a definitive, organization-wide view on how to recognize revenue from different types of contracts with customers and at what points in time to do so. It is not a simple task.

The FASB and IASB issued their converged revenue recognition standard (ASC 606 and IFRS 15, respectively) to improve transparency in financial statements based upon the nature, amount, timing, and uncertainty of revenue and cash flows that result from contracts with customers. The standard affects almost all companies yet the impact can vary widely depending on industry accounting practices.

Here are some considerations to help familiarize you with what is ahead as your company prepares to meet the new accounting and disclosure requirements. The points are adapted from lessons learned by public companies, who adopted the new standard effective January 1, 2018



1. *Implementation is likely to take more time than you think*

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My biggest lesson learned was that you shouldn't underestimate the number of hours you think it will take. It's harder than you think.

— Executive at a private software company and an early adopter

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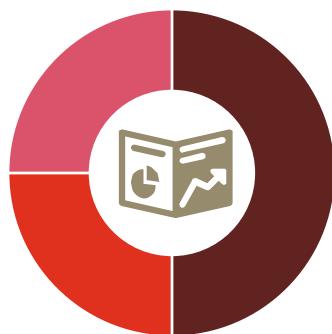
The effort to identify potential changes and transition to the new guidance will likely take more time than most private companies would typically expect—and certainly more than most accounting standards issued in recent memory.

The more companies get into the process of assessing the impact, the more changes to accounting, processes and controls they are identifying, including increased data needs.

Note that companies in some industries are impacted more than others because this rule supersedes industry-specific accounting standards for recognizing revenue.

2. *The effort will take time from accounting resources*

Process and/or systems changes created the biggest challenge during implementation, according to financial professionals in a mid-June 2017 PwC webcast poll.



- Process and/or system changes
- Disclosures
- Accounting policy changes

Because revenue transactions occur as a result of daily business activities, implementing the standard requires building the right processes at the source.

It is not unusual to find companies creating teams of people who are led by a project manager to analyze accounting transactions and the impact of the new revenue recognition rules. That is because this is not an accounting standard that can be implemented with a few top-side journal entries during the closing process for many companies. It will require knowledgeable, hands-on leadership to ensure a sustainable, successful implementation.

3. Company executives will be called upon to make decisions about contract strategies

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Given we only had 14 months to complete the entire adoption process and we didn't have enough internal resources, I was concerned about finding a third party to help. It was truly an all-hands-on-deck process that's still going on today.

– Executive at a private professional services company

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Contracts can be complex, involving product deliveries upfront as well as service deliveries over time, and with performance obligations or bonus incentive arrangements baked in. They may result in multiple questions for management to address and apply to the business models.

The new standard is principles-based, meaning the judgments management makes have a direct impact on the amount and timing of revenue recognized for financial reporting. With that in mind, it is important that the deep dive into contractual arrangements is performed by someone who is able to apply abstract concepts (the principles in the standard) to concrete facts (the terms of the contract). This is not something that can necessarily be done for one type of contract and then easily repeated by someone less experienced for other types of contracts.



Consider a company that has licensed its software for 5 years. The software provided to the customer is fully operational at the beginning of the license period. The licensee pays \$100,000 a year at the beginning of the year for each of the five years. Under existing guidance, the license revenue could be recognized straight-line over the term of the arrangement. However, the new guidance may indicate that the entire \$500,000 of revenue should be recognized at the beginning of the license period.

This could also create a change in how taxes are recognized, whether it's true cash tax or deferred taxes. On a go-forward basis, if a change in GAAP revenue leads to a change in revenue recognition for tax purposes, future cash taxes may be impacted. If a change in GAAP revenue does not have an identical impact on the timing of revenue recognition for tax, the new standard will likely result in new book-tax differences and the need for deferred taxes. Furthermore, changes in GAAP revenue may have knock-on effects to a variety of tax calculations, including certain credits and deductions. This could impact various components of the tax provision, such as the effective tax rate, financial statement disclosures, and year-over-year comparability.

4. *The effort will require coordination across the business*



As teams start to analyze and evaluate customer arrangements, and management determines how and when to record the revenue, the process will most likely draw in departments outside of financial accounting to consider the implications. Here are two examples to show how that might happen:

Human resources



Many employee commission and bonus compensation structures are based on a metric of revenue. A change in the timing of revenue recognition could impact these and other similar arrangements. Additionally, under the new standard, incremental costs of obtaining a contract with a customer, such as sales commissions and the related fringe benefits, are recognized as assets if recoverable and if the benefit of the contract exceeds one year. Human resources and management will need to consider these impacts to make any necessary adjustments to the accounting or even to the compensation plans.

Information technology



A change in how revenue is recognized will require reliable underlying data and may necessitate modifications or enhancements to existing information technology systems. Current systems and data capture may not be sufficient to provide the information needed to quantify the impact of the new standard as well as for the incremental disclosures required, as discussed more below.

5. *Your disclosures will be impacted*

Overall, the new standard is more prescriptive in the requirements for disclosure than current guidance. However, there is not a one-size-fits-all model for meeting the disclosure requirements, so management will need to exercise judgment when determining how to present some of the information. Similar to considerations around adoption method and timeline, companies may want to consider industry practices in designing their disclosures.

Given the importance and expected effort related to the new disclosures, companies should include these considerations in their plan for evaluating the new standard. This assessment should also contemplate the system changes necessary to collect the required information. The individual who is primarily responsible for drafting the footnotes should be experienced in accounting and financial reporting and should also play an active role in evaluating the new revenue recognition model.



Find more about the technical aspects of implementation and how to interpret the rules in PwC's extensive collection of accounting content. Here's a start:

[Five-step model to revenue recognition](#)

[February 2018 Webcast: Revenue recognition “next-stage” implementation insights](#)

[Revenue from contracts with customers, global edition](#)

Contact us for further information



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