



## Revenue recognition: Pain points beyond the accounting

The countdown has begun. In less than five months, public companies that operate on calendar year-ends will be required to implement the Financial Accounting Standards Board's (FASB) [new revenue recognition standard](#), ASU 2014-09, *Revenue from Contracts with Customers*. The experiences of some companies have already made it clear that this standard will affect more than just accounting.

The accounting ramifications are formidable enough: Given that the new standard is more principles-based than the existing one, finance professionals will need to apply more judgment to accounting decisions

going forward. In addition, much of the industry-specific guidance in the existing standard has been dropped in favor of guidance that applies across sectors.

But it's the broader ramifications—the impacts to information technology (IT) systems and human resources (HR) policies as well as the time and resources required to complete the necessary changes—that should have CFOs even more concerned.

In fact, those broader implications may find companies working on adjustments well into 2018. In this issue of *CFO Insights*, we will look at the multiple tentacles of the new

standard, and outline some of the things CFOs need to prepare for—and how they can reduce surprises.

### No accounting for time

Developed jointly by the FASB and the International Accounting Standards Board (IASB), the new standard, which was released in May 2014, provides a global framework to recognize revenue more consistently. Specifically, companies under contract to provide goods or services will now follow a five-step process to recognize revenue that requires more judgments and estimates than previously used. ➔

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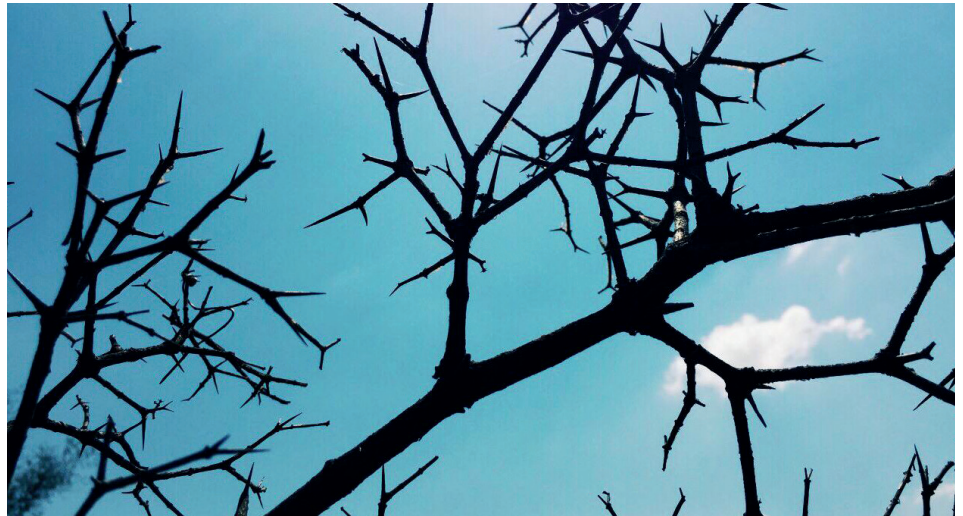
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Those judgments and estimates will typically require additional data-gathering and reporting, including extensive disclosures specifically on that data and those new judgments. In addition, companies will need to develop processes and controls related to the new standard itself. Little wonder that many companies are finding that revising accounting processes and controls to support the new standard is a more significant undertaking than originally thought.

Then there is the accounting itself, which is posing its own implementation challenges. Aside from the increase in judgments, the new standard requires many companies to work through new levels of materiality and greater depths of analysis. Consider, for example, the decisions around multiple element arrangements. If the contract pricing does not align with what the standard specifies, companies may find they need to perform allocations across multiple deliverables, multiple units of accounts, and multiple performance obligations—not an easy exercise across high volumes of transactions.

There are also confusing aspects to the standard. What happens, for example, if a company wants to identify contract costs that should be capitalized under the new standard, particularly with respect to costs to obtain, fulfill, or set up a contract, such as a sales commission? Cost guidance in the new standard seems to indicate that it applies only to transactions that are not already in the scope of another standard. However, if companies are already accounting for these transactions, they likely are already under the scope of another standard, making the guidance potentially confusing.

The time and complexity involved in implementing the new standard may be why many companies are leaning toward using the modified retrospective approach instead of the full retrospective. While the full retrospective approach—which recasts all of a company's financial information under the new rules—may be cleaner in terms of trend analysis (i.e., it calls for the current year and the two prior years to be converted to the new standard),



the modified retrospective approach may save time because it only requires converting the current year's financials. That snapshot approach, however, will likely require companies to provide additional information to help investors and analysts understand revenue trends. Additionally, CFOs may want to soon see some pro forma information as to what those financials will look like in order to craft investor relations messages going forward.

### Issues beyond the accounting

Part of the time and complexity creep associated with the new standard may also have to do with its implications for other functions. For example:

**IT implications.** The new standard has multiple implications for IT. Companies may want to determine whether their systems are configured to collect and analyze the information needed to produce acceptable disclosures, especially those related to customer contracts with variable considerations. Variable considerations include pricing concessions, such as rebates and discounts, which require new disclosures.

In addition, some IT systems may not be ready to extract the information needed to make revenue recognition decisions that require more judgment, such as those related to multiple-element software arrangements in which hardware and software are sold as bundles. Such information may be needed to determine whether control of certain elements of

bundled sales has been transferred to the customer, from an accounting perspective, thereby allowing revenue to be recognized rather than deferred.

Unlike the existing guidance, the new standard does not provide a “checklist” of obligations to meet in order to determine deliverability. Without such a checklist, more judgment likely will be needed, and more judgment about bundled sales could require additional information from the IT systems that support financial, sales, and marketing activities, data that typically was not collected under the existing standard.

**Legal ramifications.** Companies issue contracts, regardless of their business, and those contracts typically contain specific terms that may have been created either for business reasons or for prior accounting reasons. The new standard, however, introduces new ramifications for how contracts are worded. For example, the standard introduces parameters around whether a company is entitled to payment during the contract period or only at the end—and around whether that payment also includes profit margin. There are also termination provisions and penalty provisions. In the case of termination provisions, the new standard requires a company to assess what elements under the contract transfer to the customer and what payment is required upon termination—even if termination of contracts is rare or unlikely. ➤

**HR ramifications.** The aforementioned legal issues overlap with HR concerns. For example, many companies have bonus and compensation arrangements for executives and employees that are linked to revenue. Some may be tied to sales growth, for instance, or trends linked with EBITDA. A challenge is that these compensation metrics were designed based on the old rules, but under the new standard, companies may have to change the way they keep score. There are two potential ways to deal with this challenge. One is to keep the arrangement in place, which involves keeping two sets of information (i.e., one for the purpose of the bonus arrangement, the other to comply with the new standard). Another is to realign the arrangement to reflect how revenue is now recognized—but that triggers legal implications. Both methods can be problematic. Companies will likely have to coordinate the HR implications with legal requirements to determine what to do in their particular circumstances.

Another HR implication involves the resources required to comply with the new standard. Does the company have enough people? Is training required? Are third-party resources required—and available? Given the finite nature of the run-up to the deadline, having enough resources and having the relevant ones will likely be essential to compliance.

#### What CFOs can do now

There are a few ways that CFOs can help lessen the pain of implementing the new revenue recognition standard, including:

**1. Appoint a PMO.** Given the implications spelled out above, companies should consider establishing a revenue recognition project management office (PMO) comprising representatives from accounting, finance, IT, legal, HR, and sales and marketing. Such a team can offer periodic updates on system requirements as well as the legal and HR impacts. In addition, the cross-functional nature of the team can help expose interdependencies that may not have been originally anticipated. In the final few months leading up to the deadline, the PMO can also red flag problems that could lead to delays—and reallocate resources accordingly.

**2. Seek outside help.** The new revenue recognition standard is complex, and some answers may not be found internally. There is external help available, however. For example, companies can submit questions to the FASB, and even seek pre-clearance from the Securities and Exchange Commission (SEC) on tricky interpretive questions. There are also industry working groups actively addressing the issues involved. A company's external auditors are an additional resource. After all, they will need to understand the company's technical accounting positions and the processes used to properly apply the new standard as well as evaluate the related internal controls. It behooves companies to involve them early, and possibly often.

**3. Educate the Street.** Changing how revenue is accounted for is likely going to change revenue totals. It's that simple. So it is important that CFOs proactively educate their analysts and investor relations professionals to help them understand the new figures and the relevant trends. While some industries may be more affected than others, CFOs across industries will need to communicate what drives revenue increases or decreases. Are they directly tied to changes in how revenue is recorded? Do increases represent true growth? Or, in the case of decreases,

what are the drivers? Moreover, how should comparisons with prior years be interpreted now that the method of keeping score has changed? This is particularly important for companies that choose to use a modified retrospective approach, since the trends may not be as apparent as those found under the full retrospective. But either way, CFOs need to prepare analysts for the shift in how revenue is recognized so that they are not blindsided when the numbers come in.

**4. Brace for the costs involved.** Complying with the new standard will likely come at a cost. Some of the price tag may be related to reconfiguring IT systems or hiring third-party resources, but the main cost will likely be the time involved. The vast majority of the effort will probably be associated with the accounting analysis and fully understanding what changes need to be made. Part of the issue is that, for some companies, there may be large amounts of manual process rework involved, which could take weeks or months. At the extreme end, companies that have to do a major overhaul may have to introduce a revenue automation engine, which is a system implementation layered on their current IT infrastructure that may involve major investments and many months of work. ➤



## Ready or not

Almost four years since it was unveiled, the new revenue recognition standard is going to happen—whether companies are ready or not—and it will likely affect many aspects of business that relate to revenue, from financial results to executive compensation.

Indications are that there will be plenty of scrambling between now and January 1, 2018, and some companies may be making adjustments well into 2018. But there really is no alternative: not embracing the new standard basically means you may not be complying with GAAP. ◀

### Revenue recognition: 10 critical questions

In preparation for the new standard, CFOs should ask critical questions of the PMO and additional internal stakeholders, including the CIO, corporate legal counsel, and HR director. Such questions include:

1. Do we have enough internal and external resources dedicated to implementing the new revenue recognition standard?
2. Are we able to prepare the disclosures necessary in an automated or efficient manner?
3. Do we need to make any additional investments from a systems perspective to prepare the new disclosures?
4. Are we satisfied that we have conducted a complete analysis of the standard and identified areas of revenue recognition that need to be changed?
5. Have we established a framework to ensure a consistent approach for making judgments and estimates required by the new standard?
6. From a legal perspective, are there any contractual terms or language that need to be addressed?
7. Do we have multiyear bonus or compensation agreements that will be affected by the new standard?
8. If we have opted for the modified retrospective approach, what steps are we taking to ensure trend analysis is possible?
9. Are our current revenue recognition disclosures robust enough for our regulators, and will they have to be reconsidered under the new standard?
10. How will we explain differences in revenue due to the new standard to shareholders and the Street?

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