The Bottom Line

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UNDERSTAND, SERVICE, INNOVATE

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Famous Quotes

"Lots of people want to ride with you in the limo, but what you want is someone who will take the bus with you when the limo breaks down."

-Oprah Winfrey

"Wise men learn by other men's mistakes, fools by their own."

-Anonymous

"Before you criticize a person, walk a mile in his shoes. Then when you do criticize that person, you'll be a mile away and have his shoes!"

-Anonymous

"Dollars do better if they are accompanied by sense."

-Earl Riney

The New Revenue Recognition Standards Have Finally Arrived. Now What?

Well it's finally here. After many years, many changes and much speculation, on May 28, 2014, the Financial Accounting Standards Board and the International Accounting Standards Board issued their converged standards on revenue recognition. While the new standards are not going to drastically change the way contractors recognize revenue, as many originally thought might happen, there will be changes in how contracts need to be analyzed. In addition, there will be changes in what needs to be disclosed in financial statements and possibly even changes in process and controls.

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While the new standards are not effective until 2017 for public companies and 2018 for non-public companies, there may be changes that could impact income taxes, compensation plans and even debt arrangements, so steps should be taken now to address the changes.

The new standard is principle-based, which is a big change from the industry - specific guidance currently used.

The following is a brief overview of the new revenue recognition standards and how they may impact contractors' financial statements.

The new revenue recognition model uses a five-step approach:.

- Identify contract with the customer.
- Identify separate performance obligations in the contract.
- Determine the transaction price.
- Allocate the transaction price to performance obligations.
- Recognize revenue when (or as) performance obligations are satisfied.

While on the surface it may appear the changes won't severely alter the way a contractor recognizes revenue on its contracts with customers, each step entails certain specifics that, at a minimum, will require more analysis and judgment than in the past.

Identify contract with the customer - The first step is to evaluate the criteria for the existence of a contract. Contract modifications (change orders) need to be analyzed to determine if the change order should be treated as a new contract or a continuation of the original contract.

Identify separate performance obligations in the contract- Contracts must be reviewed to determine if they contain specific performance obligations. Each specific performance obligation must be accounted for separately.

Determining the transaction price- You will need to understand and evaluate any potential variable considerations included in the contract, such as awards,

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Common Bond Terms

A surety bond is a written instrument typically signed by two parties. One of these – the surety – becomes obligated to a third party – the obligee – for the payment of money, the sum not to exceed the bond amount, if the obligation set forth therein is not fulfilled by the principal – the other party signing the bond.

The **Principal**, who is primarily responsible for the fulfillment of the obligation set forth in the bond. He must perform some act under certain conditions or, in lieu thereof, respond in damages.

The **Obligee**, who is in beneficiary under the terms of the bond, Either the obligation set forth is fulfilled or the amount of the bond is available so that, in any case, the obligee is adequately protected.

The **Surety**, the party who joins with the principal for the purpose of guaranteeing the obligee the fulfillment of the principal's obligation.

The New Revenue Recognition Standards Have Finally Arrived. Now What?

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incentives, liquidated damages, claims and unpriced change orders. If any variable considerations exist as part of the contract, the expected value (probability-weighted) or the most likely amount will need to be estimated.

Additionally, if there is a significant financing component to the contract, then contract revenue should reflect the time value of money of the financing component.

Allocate transaction price to performance obligations- If the contract has more than one performance obligation, the transaction price will be allocated to each obligation. In order to do this, the transaction price will need to be allocated at the beginning of the contract for each separate service determined on a standalone basis.

Recognize revenue when (or as) performance obligations are satisfied- You can recognize revenue over time when you create or enhance an asset that the customer controls. Determining when control transfers will require a significant amount of judgment. Similar to the percentage of completion currently used, progress towards completion is measured either by the input method or the output method. If the input method is used, you must exclude inputs that do not depict performance (owner-provided material, waste and uninstalled material).

In addition to understanding and applying this new terminology, additional financial statement disclosures will also be required, such as disaggregation of revenue by category, remaining performance obligations and reconciliation of contract balances and cost will be required.

As you can see, the new revenue recognition rules have some similarities to the existing rules but in other ways are very different and require subjective decisions to be made in the correct way in order to account for certain items.

Although the requirement of the new revenue recognition standards is still a few years away, now is the time to start evaluating and planning for the potential impact these new standards could have on your company.

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