February 2018

ASUpdates in Focus: Part 2

An article by Greg Brown, CPA, and Dwayne Dillard, CPA

This article focuses on the new revenue recognition standard, *Accounting Standards Update* (ASU) No. 2014-09, deferred by ASU 2015-14, and amended by several clarifying ASUs.

The core principle states an entity will recognize revenue at an amount that reflects the consideration to which the entity expects to be entitled in exchange for transferring goods or services to a customer. The standard outlines a five-step model for recognizing revenue:

- Identify the contract(s) with the customer.
- Identify separate performance obligations in the contract(s).
- Determine the transaction price.
- Allocate the transaction price to the performance obligations in the contract(s).
- Recognize revenue when (or as) the entity satisfies the performance obligation.

Changes in the New Revenue Recognition Standard

Uninstalled materials. Uninstalled materials are materials acquired by a contractor that will be used to satisfy its performance obligations within a contract for which the cost incurred does not depict the entity's overall performance in completing construction services.

- **New guidance –** Contractors should consider if the reflection of materials cost represents an accurate estimate of progress towards completion to date. This estimate includes considering if the materials are distinct, the customer obtains control significantly before they are installed, the cost relative to the project, and third-party involvement in the procurement process. The cost of uninstalled materials should be excluded from measuring the progress toward completion if the entity is only providing a procurement service. The entity might determine it is appropriate to recognize revenue to the extent of the cost incurred (for example, no margin recognized) if the goods are on-site and control has transferred to the customer. If control has not transferred to the customer, the cost incurred related to these items might be more appropriately reflected as prepaid expense or inventory. Contractors should take into account if another Accounting Standard Codification (ASC) topic applies when reporting uninstalled materials cost. Costs that are within another ASC topic would include inventory and prepaid assets, for example, and should be accounted for in accordance with that guidance. If no other ASC topic applies, contractors should consider if the cost is a fulfillment cost (capitalized and amortized over the duration of the contract). Based on these considerations, these costs may be included in the total job cost to date as incurred, capitalized, and amortized over the duration of the contract, or they may be expensed depending on the specific GAAP that applies.

Incremental costs to obtain contracts. Incremental costs are costs incurred to obtain a contract that would not have been incurred if the contract had not been obtained.

- **New guidance –** Incremental costs to obtain contracts are capitalized as an asset; however, materiality may determine the general approach. Sales commissions, for example, would be recognized as assets if the entity expects to recover these costs. The assets would be amortized and the correlating amortization expense recorded to selling, general, and administrative expenses over the respective amortization period. However, as a practical expedient, an accounting policy election can be made to expense incremental costs as they are incurred if the amortization period would be one year or less.

Variable consideration. Variable consideration includes scope changes that affect the contract price as well as unpriced change orders, claims, and incentive or penalty payments.

- **New guidance –** The contract price should include an estimate for variable consideration, including change orders, claims, incentives, and penalties, to the extent it is probable that a significant reversal in the amount of cumulative revenue recognized will not occur in a future period.

Surety Industry Considerations

- Potential segmenting of contracts previously reflected as one job on the WIP
- Potential changes to revenue recognition from variable consideration and claims and the related one-time charge to retained earnings for those entities electing the modified retrospective method of application
- Contract assets for uninstalled materials, and pursuit costs. Will the surety industry give full credit for those assets?

Effective Dates and Adoption

The new revenue recognition standard has an effective date for public business entities for fiscal years beginning after Dec. 15, 2017, and interim periods within those fiscal years, and nonpublic business entities for fiscal years beginning after Dec. 15, 2018, and interim periods beginning after Dec. 15, 2019. The Financial Accounting Standards Board (FASB) has decided to allow either a “full retrospective” adoption in which the standard is applied to all of the periods presented or a “modified retrospective” adoption. For more information, please feel free to reach out to us, visit the FASB website, or visit the CFMA for webinars and self-study sessions available.

Learn More

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