Understanding the new Revenue Recognition Standard

The old model

Recognizes revenue when a company “earns” it.

THE ISSUE

This model has lead to similar companies arriving at different revenue recognition for similar services or goods, making it difficult to compare companies or compare certain goods and services.

The new model

Recognizes revenue as companies fulfill their promises to provide goods or service to their customers.

THE BENEFITS

Provides owners and operators with a clearer picture of the business – with better insight into which parts of a contract are most profitable.

Consistency across industries and companies, making it easier to compares goods and services.

For investors, interested parties can be sure the revenue is based on the same standards as all other companies – making comparison and consideration simpler.

5-step process to recognize and record revenue

1. **Identify customer contracts**

   A contract is defined as an agreement between two or more parties that creates enforceable rights and obligations. Every sale in which goods or services are exchanged is a contract.

2. **Identify performance obligations**

   A contractual agreement with a customer to transfer distinct goods or services is identified as a performance obligation. Some contracts may only have one obligation, and others may have more than one bundled or sold together.

3. **Determine the transaction price**

   The transaction price is the amount a company is entitled to receive from the customer for performance of the contract.

4. **Allocate the transaction price**

   The transaction price should be allocated based on the relative standalone selling price of each performance obligation.

5. **Recognize revenue when the performance obligation is met**

   The obligation is considered met when the customer obtains control. For some transactions, this means recognizing revenue for different obligations at different times.

Software contract example

MARK BUYS A

1-Year Software Subscription

FOR

$100 per month

THAT INCLUDES

Initial setup, ongoing software licensing, and as-needed service

Let's break it down

1 Identify customer contracts

The signed customer agreement where the company agrees to provide the software subscription package in exchange for a set fee per month, meets the criteria of a customer contract.

2 Identify performance obligations

In our example, the software company has three distinct obligations – the setup, the ongoing software, and as-needed service.

3 Determine the transaction price

Our company determined the transaction price for the subscription is $100 per month, or $1,200 per year.

4 Allocate the transaction price

We have identified the specific performance obligations in step two and total transaction price in step three. Now, we need to determine the value of each individual obligation based on standalone market value.

Setup	$200
Software ($50 per month)	$600
Service	$400
Total Annual Price	$1,200

5 Recognize revenue when the performance obligation is met

For our software company, the revenue allocated to our setup fees would need to be recognized once the software is operational, the software license would be recognized each month, and the service would be recognized as it is used or based on a standard use model.

Next steps

For most companies and many contracts, this may be a quick adjustment to the way you calculate and record revenue. However, for some, this may be an opportunity to review, update and standardize the contract process and structure.

We are here to help!

By the end of 2019, we will provide guidance and support as you update your contracts and accounting processes to ensure you are prepared and compliant!

Grow with us

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