Government Contractors: Are You Prepared for the New Revenue Standard?

Presented by CohnReznick’s Government Contracting Industry Practice
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Agenda

• Background
• Exceptions
• Significant Changes
• 5 Step Model for Recognizing Revenue
• Presentation and Disclosure
• Transition Methods
• Implementation
• Questions and Comments
**Background**

On May 28, 2014, the Financial Accounting Standards Board (FASB) issued Accounting Standards Update (ASU) 2014-09 Revenue from Contracts with Customers (Topic ASC 606)

- The standard outlines a single comprehensive model for entities to use in accounting for revenue arising from contracts with customers.

- It supersedes most current revenue recognition guidance, including industry-specific guidance.

- Affects all entities: public, private, and not-for profit that enter into contracts with customers to transfer goods or services.
Background

Effective Dates

- Public Companies – annual reporting periods beginning after December 15, 2017, and interim periods that fall within that reporting period.

- Nonpublic Companies – annual reporting periods beginning after December 15, 2018, and any interim periods after that date.
Objective

➢ To establish the principles that an entity shall apply to report useful information to users of financial statements about the

➢ Nature

➢ Timing

➢ Uncertainty of revenue and cash flows arising from a contract with a customer.

➢ To meet the objective, an entity shall recognize revenue to depict the

➢ Transfer of promised goods or services to customers

➢ In the amount that reflects the consideration to which the entity expects to be entitled

➢ In exchange for those goods or services.
Scope Exceptions

The following contracts with customers are excluded:

- Lease contracts covered by ASC 840, Leases
- Insurance contracts covered by ASC 944, Financial Services – Insurance
- Contractual rights and obligations covered by any of the following topics:
  - ASC 310, Receivables
  - ASC 320, Investments – Debt and Equity Securities
  - ASC 323, Investments – Equity Method and Joint Ventures
  - ASC 325, Investments – Other
  - ASC 405, Liabilities
  - ASC 815, Derivatives and Hedging
  - ASC 825, Financial Instruments
  - ASC 860, Transfers and Servicing
- Guarantees (except for product or service warranties) covered by ASC 460, Guarantees
- Nonmonetary exchanges that entities in the same line of business enter into for the purpose of facilitating sales to customers
Significant Changes

Current U.S. GAAP

- Numerous requirements for recognizing revenue.
- Other than disclosures in accounting policies and segment reporting, most entities provided limited information about revenue recognition for contracts.
- Many goods or services promised in contracts with customers are not considered to be distinct revenue transactions when in fact they may represent separate distinct obligations to the customers.

New Guidance

- A consistent set of principles for recognizing revenue.
- Includes a cohesive set of disclosure requirements that will provide users of the financial statements with useful information about the entity’s contracts with customers.
- Reporting entities will identify each of the goods or services promised to the customer, determine if those goods or services represent a performance obligation, and recognize revenue when (or as) each performance obligation is satisfied.
**Significant Changes**

**Current U.S. GAAP**

- In a multiple element contract arrangement, the amount of consideration allocated to a delivered element is limited to the amount that is not contingent on delivering future goods or services.

- Accounting for variable consideration differs greatly across industries.

**New Guidance**

- Companies will allocate the transaction price to each of the performance obligations on the basis of the relative standalone selling price of the underlying goods or services, except when a discount or variable amount of consideration relates entirely to one or more of the performance obligations in the contract.

- A single model to consider for variable consideration, which includes rebates, discounts, bonuses, or a right of return. Variable consideration will be included in the transaction price to the extent it is probable that a significant reversal in the cumulative amount of revenue recognized will not occur.
Terminology and Definitions

• Performance Obligation – what did you agree to provide or do?

• Standalone Selling Price – price at which a contractor would sell a promised good or service (your GSA schedule)

• Variable Consideration – items such as discounts, credits, price concessions, or performance bonuses/penalties

• Transaction Price – contract amount that you expect to be entitled to for a good or service
5 Step Model for Recognizing Revenue

Step 1: Identify the contract with the customer

Step 2: Identify the performance obligations in the contract

Step 3: Determine the transaction price

Step 4: Allocate the transaction price to the performance obligations in the contract

Step 5: Recognize revenue when (or as) each performance obligation is satisfied
Step 1: Identify the Contract with the Customer

**Contract:** An agreement between two or more parties that creates enforceable rights and obligations.
May be written, verbal, or implied by customary business practices.

**Does a contract exist under the standard?**

- Is the contract (or part of the contract) explicitly scoped out of the revenue standard?
- Is the contract with a customer?

**What is a customer?**

A party that has contracted with a company to obtain goods or services that are an output of the company’s ordinary activities in exchange for consideration.
Contract with a Customer: Requirements

A Contract with a customer must meet all of the following requirements:

• Approval has been obtained and parties are committed to their obligations
• The rights of the parties are identified
• Identification of the payment terms
• The contract has commercial substance
• Collection is probable

Reassessing Requirements
Combining Contracts

Accounting for Multiple Contracts as a Single Contract

Required: Contracts entered into at or near the same time with the same customer.

One or more of the following criteria must be met:

• Contracts are negotiated as a package with a single commercial objective

• Amount of consideration to be paid in one contract depends on the price or performance of the other contract

• Goods or services promised in the contract are a single performance obligation

Election: A portfolio of similar contracts can be accounted for collectively if the results would not be materially different than if applied to the individual contracts.
Accounting for Contract Modifications

**Contract Modification** – a change in scope, price or both to an existing contract.

**Separate Contract or Part of Existing Contract?**

**Separate Contract**
Must meet **both** of the following criteria:

- The additional goods and services included in the contract modification must be **distinct** from the goods and services in the original contract.

- The amount of consideration expected for the added goods and services reflects the **standalone selling price** of those goods or services.
Definitions

Distinct

- The customer can benefit from the good or service either on its own or together with other readily available resources and
- The contractor’s promise to transfer the good or service is separately identifiable from other promises in the contract.

Separately Identifiable

- The good or service is not an input used to create the end product.
- The good or service does not substantially modify or customize another good or service.
- The good or service is neither highly dependent on nor highly interrelated with another good or service promised in the contract.
Accounting for Contract Modifications

If a contractor determines that a modification is not a separate contract, the contractor would, depending on the facts and circumstances, apply one of the following methods to recognize revenue for the contract modification:

New Contract Combined with the Remaining Performance Obligations

The contract modification must meet both of the following criteria:

- Goods or services are distinct, but the transaction price does not reflect the standalone selling price of the additional goods or services.

- The remaining goods or services of the “old” contract are distinct from the goods or services transferred on or before the date of the contract modification.

Remaining portion of the original contract and the modification are accounted for together on a prospective basis by allocating the remaining consideration to the remaining performance obligations.
Accounting for Contract Modifications

Combined with Original Contract

If the remaining goods and services are not distinct from those goods and services already provided and, therefore, are part of a single performance obligation that is partially satisfied at the date of modification, the contractor should account for the modification as if it were part of the original contract.

For these modifications, the contractor will adjust revenue previously recognized on a cumulative basis to reflect the effect of the modification on the transaction price and the measure of progress (catch-up basis).
Accounting for Revenue for Contract Modifications

Separate Contract

Example: Seller promises to sell 120 computers to Buyer for $120,000 ($1,000 each). The computers are transferred to Buyer over a 6 month period. After Seller has transferred 60 computers, the contract is modified to require delivery of 30 additional computers (total of 150).

When the contract is modified the price of the additional computers is $28,500 ($950 each). The pricing of the additional computers reflects the standalone selling price at the time of the contract modification and the additional computers are distinct.

The contract mod is accounted for as a separate contract. Seller recognizes $1,000 each in the original contract and $950 each for the “new” contract.
Accounting for Revenue for Contract Modifications

New Contract Combined with the Remaining Performance Obligations

Example: During negotiation for the additional 30 computers, the parties agree on a price of $800 per computer. The Seller has determined that the $800 per computer does not meet the standalone selling price.

The contract mod is accounted for as a “termination” of the original contract and the creation of a new contract.

The amount of revenue for the remaining computers is a blended price of $933.33 (($1,000 X 60) + ($800 X 30)) / 90 remaining computers.
Accounting for Revenue for Contract Modifications

Combined with Original Contract

Example: Construction Company enters into a contract to construct a building for $2,000,000 with expected costs of $1,400,000. At the end of year 1, the Company has satisfied 60% of the performance obligation and recognized $1,200,000 of revenue.

In the beginning of year 2, the parties modified the contract by changing the floor plan and agreed to an increase in price of $500,000 with costs of $250,000.

Since this was a single performance obligation, at the time of the modification, 50.9% of the performance obligation was satisfied and the Company recognized $1,272,727 of revenue (50.9% X $2,500,000).
Step 2: Identify the Performance Obligations

Performance Obligation - a promise to transfer distinct goods or services
It is the unit of account for purposes of applying the revenue standard and therefore determines when and how revenue is recognized.

Not limited to goods or services that are explicitly stated in a contract.

Does not include activities to fulfill a contract unless those activities transfer a good or service to the customer.

1) Identify all Performance Obligations
2) Separate Performance Obligation
Step 2: Identify the Performance Obligations

A performance obligation is allocated a portion of the transaction price if either of the following is true:

- The good or service (or bundle of goods or services) is distinct;

  or

- The good or service is part of a series of distinct goods or services that are substantially the same and have the same pattern of transfer to the customer.

Goods or services that are not distinct should be combined with other goods and services until a bundle of goods or services are distinct and create a single performance obligation.
Identifying a Performance Obligation

Is it a Performance Obligation?

• Goods or services that are immaterial in the context of the contract
• Administrative tasks to fulfill a contract
• Pre-production activities
• Implicit promises in a contract
• Free handsets from a telecommunication company
• Product liability
• Patent infringement protection
• Shipment of goods to a customer
Step 3: Determine the Transaction Price

**Transaction Price** - the amount of consideration the contractor expects to be entitled to, in exchange for transferring goods or services to a customer.

Must consider the following in determining the transaction price:

- Terms of the contract and customary business practices
- **Variable consideration**
- Significant financing components
- Noncash consideration
- Consideration payable to the customer
Variable Consideration

Examples of Variable Consideration

- Discounts
- Rebates & Credits
- Performance bonuses
- Refunds
- IFF
- Penalties
- Price concessions
- Incentives
- Right of Return

The revenue standard requires the transaction price to be adjusted by an estimated amount of the variable consideration to which it will be entitled.

Objective – to predict the amount the contractor will actually receive.

If the amount is not fixed there are two methods for estimating variable consideration:

1. Expected Value
2. Most Likely Amount
Variable Consideration

Constraining Variable Consideration

- Variable consideration involves a degree of uncertainty
- Could result in a contractor recording less revenue than expected
- A contractor can recognize variable consideration as revenue only to the extent that the contractor thinks it is probable that a significant reversal of the revenue will not be recorded in the future
- Example:
  - Management estimates that the most likely outcome is that an award fee will be achieved, so the variable consideration is $100,000
  - However, management determines that it is not yet probable that a significant reversal will not occur, thus the entire amount is constrained until it becomes probable
**Step 4: Allocate the Transaction Price to the Performance Obligations**

**ASC 606-10-32-28 and IFRS 15.73**

The objective when allocating the transaction price is for an entity to allocate the transaction price to each performance obligation (or distinct good or service) in an amount that depicts the amount of consideration to which the entity expects to be entitled in exchange for transferring the promised goods or services to the customer.

**One Performance Obligation** - the transaction price is allocated entirely to that performance obligation.

**Multiple Performance Obligations** - the contractor determines an appropriate allocation of the transaction price using the relative standalone selling price.

The best estimate of standalone selling price is based on observable inputs (similar sales, market conditions and relationship-specific factors).
Standalone Selling Price

The standalone selling price of an item that is not directly observable must be estimated.

Estimation Methods

Adjusted Market Assessment Approach - Evaluating the market and estimating the price customers would be willing to pay.

Expected Cost Plus a Margin Approach - Forecasting expected costs plus an appropriate margin.

Residual Approach - Subtracting the sum of observable standalone selling prices of other goods and services in the contract from the total transaction price (used in limited circumstances and only if specific criteria is met).
Example

<table>
<thead>
<tr>
<th>Product</th>
<th>$</th>
<th>Percentage</th>
</tr>
</thead>
<tbody>
<tr>
<td>A</td>
<td>50</td>
<td>33% Directly Observable</td>
</tr>
<tr>
<td>B</td>
<td>25</td>
<td>17% Adjusted Market Approach</td>
</tr>
<tr>
<td>C</td>
<td>75</td>
<td>50% Expected Cost Plus a Margin Approach</td>
</tr>
</tbody>
</table>

Total $150 100%

Total Transaction Price = $100
Allocated to Products as Follows:

<table>
<thead>
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<th>Product</th>
<th>$</th>
</tr>
</thead>
<tbody>
<tr>
<td>A</td>
<td>33</td>
</tr>
<tr>
<td>B</td>
<td>17</td>
</tr>
<tr>
<td>C</td>
<td>50</td>
</tr>
</tbody>
</table>

Total $100
Step 5: Recognize Revenue when each Performance Obligation is Satisfied

- Revenue is recognized as performance obligations are satisfied by transferring a promised good or service to a customer.

- A good or service is considered transferred when a customer obtains **control** of the good or service.

- At contract inception, a contractor must determine whether transfer of control will occur over time or at a point in time.

- If a performance obligation doesn’t meet the criteria to be recognized over time, then it must be recognized at a point in time when control of the good or service is transferred.

- Once management determines that a performance obligation is satisfied over time, it must measure its progress toward completion to determine the timing of revenue recognition.
Performance Obligations Satisfied Over Time

Transfer of control occurs over time and satisfies a performance obligation over time if one of the following is met.

1. The customer simultaneously receives and consumes the benefits provided by the contractor’s performance as the contractor performs.

2. The contractor’s performance creates an asset that the customer controls as the asset is created.

3. The contractor’s performance does not create an asset with an alternative use to the contractor, and the contractor has an enforceable right to the payment for performance completed to date.
Presentation and Disclosure

The standard requires disclosure of both quantitative and qualitative information to enable users of the financial statements to understand the nature, timing, and uncertainty of revenue and cash flows arising from contracts with customers:

- Disaggregation of revenue
- Reconciliation of contract balances
- Performance obligations
- Remaining performance obligations
- Costs to obtain or fulfill contracts
- Other
  - Significant judgments and changes in judgments that affect the amount and timing of revenue
  - Information about the inputs, methods, and assumptions used to determine transaction price
- Practical expedients
Contracts with customers

An entity shall disclose all of the following amounts for the reporting period unless those amounts are presented separately in the statement of comprehensive income (statement of activities) in accordance with other disclosure requirements: (606-10-50-4)

- Revenue recognized from contracts with customers, which the entity shall disclose separately from its other sources of revenue
- Any impairment losses recognized (in accordance with ASC 310 on receivables) on any receivables or contract assets arising from an entity’s contracts with customers, which the entity shall disclose separately from impairment losses on other contracts
Presentation and Disclosure
Nonpublic Companies

Disaggregation of revenue

An entity shall disclose, at a minimum, the following related to disaggregated revenue: (660-10-50-7)

- Revenue disaggregated according to the timing of transfer of goods or services (e.g., revenue from goods or services transferred to customers at a point in time and revenue from goods or services transferred to customers over time)
- Qualitative information about how economic factors (e.g., type of customer, geographical information of customers, types of contract) affect the nature, amount, timing and uncertainty of revenue and cash flows
**Presentation and Disclosure**

**Nonpublic Companies**

**Contract balances**

An entity shall disclose, at a minimum, the opening and closing balances of receivables, contract assets and contract liabilities from contracts with customers, if not otherwise separately presented or disclosed. (606-10-50-11)
Performance obligations

An entity shall disclose information about its performance obligations in contracts with customers, including a description of all of the following: (606-10-50-12)

- When the entity typically satisfies its performance obligations (e.g., upon shipment, upon delivery, as a bill and hold arrangement, as services are rendered, upon completion of service)
- The significant payment terms (e.g., when payment typically is due, whether the contract has a significant financing component, whether the consideration amount is variable, whether such estimate is constrained in accordance with paragraph 606-10-32-11 through 32-13)
- The nature of the goods or services that the entity has promised to transfer, highlighting any performance obligations to arrange for another party to transfer goods or services (i.e., if the entity is acting as an agent)
- Obligations for returns, refunds and other similar obligations
- Types of warranties and related obligations
Presentation and Disclosure
Nonpublic Companies

**Significant judgments in the application of the guidance in ASC 606**

An entity shall disclose the judgments, and changes in the judgments, made in applying the guidance in ASC 606 that significantly affect the determination of the amount and timing of revenue from contracts with customers. In particular, a nonpublic entity shall, at a minimum, disclose the following: (606-10-50-17)

- For performance obligations that an entity satisfies over time, the methods used to recognize revenue (e.g., a description of the output methods or input methods used and how these methods are applied) (606-10-50-18a)
- Information about the methods, inputs and assumptions used for assessing whether an estimate of variable consideration is constrained (606-10-50-20(b))
Presentation and Disclosure
Nonpublic Companies

Accounting policies

An entity may make an accounting policy election to exclude from the measurement of the transaction price all taxes assessed by a governmental authority that are both imposed on and concurrent with a specific revenue-producing transaction and collected by the entity from a customer (for example, sales, use, value added and some excise taxes). An entity that makes this election shall comply with the disclosure requirements in paragraphs 235-10-50-1 through 50-6. (606-10-32-2A)

If shipping and handling activities are performed after a customer obtains control of the good, then the entity may elect to account for shipping and handling as activities to fulfill the promise to transfer the good. An entity that makes this election shall comply with the disclosure requirements in paragraphs 235-10-50-1 through 50-6. (606-10-25-18B)
Presentation and Disclosure
Nonpublic Companies

Effective date and transition disclosures

An entity that applies the standard retrospectively to each prior reporting period (i.e., using the full retrospective approach), is required to make the disclosures required by paragraphs 250-10-50-1 through 50-2 in the fiscal period in which the standard is adopted: (Note: An entity need not disclose the effect of the changes on the current period, which otherwise would be required by paragraph 250-10-50-1(b)(2)). (606 10-65-1(e))

- The nature of and reason for the change in accounting principle, including an explanation of why the newly adopted accounting principle is preferable
Presentation and Disclosure
Nonpublic Companies

Effective date and transition disclosures

- The method of applying the change, and:
  - A description of the prior-period information that has been retrospectively adjusted, if any
  - The effect of the change on income from continuing operations, net income (or other appropriate captions of changes in the applicable net assets or performance indicator), any other affected financial statement line item, and any affected per-share amounts for the current period and any prior periods retrospectively adjusted. Presentation of the effect on financial statement subtotals and totals other than income from continuing operations and net income (or other appropriate captions of changes in the applicable net assets or performance indicator) is not required. (Note: An entity need not disclose the effect of the changes on the current period, which otherwise would be required by this paragraph.)
  - The cumulative effect of the change on retained earnings or other components of equity or net assets in the statement of financial position as of the beginning of the earliest period presented
  - If retrospective application to all prior periods is impracticable, disclose the reasons and a description of the alternative method used to report the change (see paragraphs 250-10-45-5 through 45-7).
Presentation and Disclosure
Nonpublic Companies

Effective date and transition disclosures

• If indirect effects of a change in accounting principle are recognized:
  – A description of the indirect effects of a change in accounting principle, including the
    amounts that have been recognized in the current period, and the related per-share
    amounts, if applicable
  – Unless impracticable, the amount of the total recognized indirect effects of the accounting
    change and the related per-share amounts, if applicable, that are attributable to each
    prior period presented

• If a change in accounting principle has no material effect in the period of
  change but is reasonably certain to have a material effect in later periods, the
  disclosures specified in item 8.a. above shall be provided whenever the financial
  statements of the period of change are presented. (250-10-50-1)

• The SEC staff has stated that while labeling financial statement columns “as
  adjusted” for a change in accounting principle is not explicitly required, it is
  considered a best practice to facilitate as much transparency as possible. (SP —
  AICPA/SEC Regulations Committee, Current Practice Issues, dated 9/26/06,
  Discussion Document D)
Effective date and transition disclosures

- The transition practical expedients that have been used: (606-10-65-1(g)(1))
  - Disclose that the entity has not restated completed contracts that begin and end in the same annual reporting period. (606-10-65-1(f)(1))
  - Disclose the entity’s use of the transaction price at the date the contract was completed rather than estimating variable consideration amounts in the comparative reporting periods. (606-10-65-1(f)(2))
  - Disclose that the entity has not disclosed the amount of the transaction price allocated to the remaining performance obligations and an explanation of when the entity expects to recognize that amount as revenue for the reporting periods presented prior to the initial date of application. (606-10-65-1(f)(3))
  - For contracts that were modified before the beginning of the earliest reporting period presented in accordance with the standard, disclose that the entity has not retrospectively restated the contract for those modifications in accordance with the contract modification guidance in paragraphs 606-10-25-12 and 25-13. Disclose that the entity instead reflected the aggregate effect of all modifications when identifying the satisfied and unsatisfied performance obligations, determining the transaction price, and allocating the transaction price. (606-10-65-1(f)(4))
Presentation and Disclosure
Nonpublic Companies

Effective date and transition disclosures

- To the extent reasonably possible, a qualitative assessment of the estimated effect of applying each of the transition practical expedients listed in item 8.f. (606-10-65-1(g)(2))

An entity that applies the standard retrospectively with the cumulative effect recognized at the date of initial application (i.e., using a modified retrospective approach), is required to disclose the following in the fiscal period in which the standard is adopted: (606-10-65-1(h))

- Whether the entity has applied the standard to all contracts or only to contracts that are not completed at the date of initial application.
- The transition practical expedients that have been used:
  - For contracts that were modified before the beginning of the earliest reporting period presented in accordance with the standard disclose that the entity has not retrospectively restated the contract for those modifications in accordance with the contract modification guidance in paragraphs 606-10-25-12 and 25-13. Disclose that the entity instead reflected the aggregate effect of all modifications when identifying the satisfied and unsatisfied performance obligations, determining the transaction price, and allocating the transaction price (606-10-65-1(h), 606-10-65-1(f)(4))
Presentation and Disclosure
Nonpublic Companies

Effective date and transition disclosures

• To the extent reasonably possible, a qualitative assessment of the estimated effect of applying the expedients listed in item 9.b. (606-10-65-1(h), 606-10-65-1(g)(2))
• The amount by which each financial statement line item is affected in the current reporting period by the standard as compared with the guidance that was in effect before the change (606-10-65-1(i)(1))
• An explanation of the reasons for significant changes identified in item 9.d. (606-10-65-1(i)(2))
## Contract Assets/Liabilities

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<th>20X2</th>
<th>20X1</th>
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<td>$</td>
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<tr>
<td>Amounts recognized in the Statement of Income:</td>
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<td></td>
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<tr>
<td>Revenue recognized for performance obligations satisfied during the year</td>
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<td>-</td>
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<td>Revenue recognized in the period from performance obligations satisfied in previous periods</td>
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<td>-</td>
</tr>
<tr>
<td>Customer consideration received in advance</td>
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<td>-</td>
</tr>
<tr>
<td>Transfers to accounts receivable</td>
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<td>-</td>
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<tr>
<td>Non-cash consideration received in advance</td>
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<td>-</td>
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<tr>
<td>Acquisitions (disposals) of contract assets</td>
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<tr>
<td><strong>Closing asset (liability) balance</strong></td>
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<td>$</td>
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## Presentation and Disclosure

**Contract Acquisition Costs**

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<td>Opening balance</td>
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<td>$</td>
</tr>
<tr>
<td>Additions</td>
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<td>-</td>
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<tr>
<td>Amortization</td>
<td>-</td>
<td>-</td>
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<tr>
<td>Impairment losses</td>
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<td>-</td>
</tr>
<tr>
<td>Closing balance</td>
<td>$</td>
<td>$</td>
</tr>
</tbody>
</table>

February 1, 2017
Performance Obligations Outstanding

Performance obligations expected to be satisfied:

- in one year or less $ -
- in more than one year but less than two years -
- in more than two years but less than three years -
- in more than three years -

Total performance obligations outstanding $ -
Where do we start?

Now is the time to evaluate the Transition Methods and determine which will work best for your company.

**Transition Methods**

- Full Retrospective Approach
- Modified Retrospective Approach
Transition Method
Full Retrospective Approach

Apply the new guidance as if it had been in effect since the inception of all contracts with customers presented in the financial statements subject to the expedients created to provide relief.

Practical Expedients for Full Retrospective Approach Only

- **Contracts completed before the initial application date** – contractors need not restate contracts that begin and end in the same annual reporting period.

- **Completed contracts with variable consideration** – contractors can use the transaction price at the date of completion rather than estimating the amount of variable consideration.

- **For periods presented before the initial application date** – a contractor is not required to disclose the amount of the transaction price allocated to the remaining performance obligations or an explanation of when that revenue will be recognized.
Transition Method
Modified Retrospective Approach

Apply the new guidance retrospectively only to the most current period presented in the financial statements.

• The contractor will have to recognize the cumulative effect of initially applying the new standard as an adjustment to the opening balance of retained earnings at the date of initial application.

• The new standard will apply to contracts in progress at the date of initial application and will have to be evaluated as if the contractor had applied the new standard at the inception of the contract.

Practical Expedient for Either Transition Method
Contracts modified before the initial application date – a contractor can reflect the aggregate effect of all modifications that occur before the beginning of the earliest period presented under the new standard with regard to the transaction price and allocating the transaction price to the satisfied and unsatisfied performance obligations.
What are you doing?

- Training and education
- Information gathering and awareness
- Sample contract reviews
- Identify and compile differences
- Develop roadmap for implementation
Questions? Please Contact Us.

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Presentation and Disclosure
Public Companies

Contracts with customers

- An entity shall disclose all of the following amounts for the reporting period unless those amounts are presented separately in the statement of comprehensive income (statement of activities) in accordance with other disclosure requirements: (606-10-50-4)
  - Revenue recognized from contracts with customers, which the entity shall disclose separately from its other sources of revenue
  - Any impairment losses recognized (in accordance with ASC 310 on receivables) on any receivables or contract assets arising from an entity’s contracts with customers, which the entity shall disclose separately from impairment losses on other contracts
Presentation and Disclosure
Public Companies

Disaggregation of revenue

- An entity shall disclose disaggregated revenue from contracts with customers into categories that depict how the nature, amount, timing, and uncertainty of revenue and cash flows are affected by economic factors. An entity shall apply the guidance in paragraphs 606-10-55-89 through 55-91 when selecting the categories to use to disaggregate revenue. (606-10-50-5)

- When selecting the type of category (or categories) to use to disaggregate revenue, an entity should consider how information about the entity’s revenue has been presented for other purposes, including all of the following: (606-10-55-90)
  - Disclosures presented outside the financial statements (for example, in earnings releases, annual reports or investor presentations)
  - Information regularly reviewed by the chief operating decision maker for evaluating the financial performance of operating segments
  - Other information that is similar to the types of information identified in (i) and (ii) and that is used by the entity or users of the entity’s financial statements to evaluate the entity’s financial performance or make resource allocation decisions

- An entity shall disclose sufficient information to enable users of financial statements to understand the relationship between the disclosure of disaggregated revenue (in accordance with paragraph 606-10-50-5) and revenue information that is disclosed for each reportable segment, if the entity applies ASC 280 on segment reporting. (606-10-50-6)
Presentation and Disclosure
Public Companies

Contract balances

An entity shall disclose all of the following: (606-10-50-8)

- The opening and closing balances of receivables, contract assets and contract liabilities from contracts with customers, if not otherwise separately presented or disclosed
- Revenue recognized in the reporting period that was included in the contract liability balance at the beginning of the period
- Revenue recognized in the reporting period from performance obligations satisfied (or partially satisfied) in previous reporting periods (for example, changes in transaction price)

An entity shall explain how the timing of satisfaction of its performance obligations (see paragraph 606-10-50-12(a)) relates to the typical timing of payment (see paragraph 606-10-50-12(b)) and the effect that those factors have on the contract asset and contract liability balances. The explanation provided may use qualitative information. (606-10-50-9)
Presentation and Disclosure
Public Companies

Contract Balances

An entity shall provide an explanation of the significant changes in the contract asset and contract liability balances during the reporting period. The explanation should include qualitative and quantitative information. Examples of significant changes include any of the following: (606-10-50-10)

- Changes due to business combinations
- Cumulative catch-up adjustments to revenue that affect the corresponding contract asset or contract liability, including adjustments arising from a change in the measure of progress, the estimate of the transaction price (including any constrained amounts) or a contract modification
- Impairment of a contract asset
- A change in the timeframe for a right to consideration to become unconditional (i.e., a contract asset reclassified to a receivable)
- A change in the timeframe for a performance obligation to be satisfied (i.e., the recognition of revenue arising from a contract liability)
Presentation and Disclosure
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Performance Obligations

An entity shall disclose information about its performance obligations in contracts with customers, including a description of all of the following:

(606-10-15-12)

- When the entity typically satisfies its performance obligations (e.g., upon shipment, upon delivery, as a bill and hold arrangement, as services are rendered, upon completion of service)
- The significant payment terms (e.g., when payment typically is due, whether the contract has a significant financing component, whether the consideration amount is variable, whether such estimate is constrained in accordance with paragraphs 606-10-32-11 through 32-13)
- The nature of the goods or services that the entity has promised to transfer, highlighting any performance obligations to arrange for another party to transfer goods or services (i.e., if the entity is acting as an agent)
- Obligations for returns, refunds and other similar obligations
- Types of warranties and related obligations
Performance Obligations

An entity shall disclose the aggregate amount of the transaction price allocated to remaining performance obligations as of the end of the current reporting period. (606-10-50-13(a))

An entity shall explain when the entity expects to recognize the amount disclosed in accordance with paragraph 606-10-50-13(a) either on a quantitative basis using the time bands that would be most appropriate for the duration of the remaining performance obligations or by using qualitative information. (606-10-50-13(b))

As a practical expedient, an entity need not disclose the information in paragraphs 606-10-50-13(a) and 50-13(b) for a performance obligation if either of the following conditions are met: (606-10-50-14)

- The performance obligation is part of a contract that has an original expected duration of less than one year
- The entity recognizes revenue from the satisfaction of the performance obligation in accordance with paragraph 606-10-55-18
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Performance Obligations

An entity shall explain qualitatively whether it is applying the practical expedient in paragraph 606-10-50-14 and whether any consideration from contracts with customers is not included in the transaction price and, therefore, not included in the information disclosed in accordance with paragraph 606-10-50-13. For example, an estimate of the transaction price would not include any estimated amounts of variable consideration that are constrained (see paragraphs 606-10-32-11 through 32-13). (606-10-50-15)
Presentation and Disclosure
Public Companies

Significant judgments in the application of the guidance in ASC 606

An entity shall disclose the judgments, and changes in the judgments, made in applying the guidance in ASC 606 that significantly affect the determination of the amount and timing of revenue from contracts with customers. In particular, an entity shall explain the judgments, and changes in the judgments, used in determining both of the following:

(606-10-50-17)

- The timing of satisfaction of performance obligations (see paragraphs 606-10-50-18 through 50-19)
- The transaction price and the amounts allocated to performance obligations (see paragraph 606-10-50-20)
Presentation and Disclosure
Public Companies

Significant judgments in the application of the guidance in ASC 606

For performance obligations that an entity satisfies over time, an entity shall disclose both of the following: (606-10-50-18)
- The methods used to recognize revenue (e.g., a description of the output methods or input methods used and how these methods are applied)
- An explanation of why the methods used are a faithful depiction of the transfer of goods or services

For performance obligations satisfied at a point in time, an entity shall disclose the significant judgments made in evaluating when the customer obtains control of promised goods or services. (606-10-50-19)
Presentation and Disclosure
Public Companies

Significant judgments in the application of the guidance in ASC 606

An entity shall disclose information about the methods, inputs and assumptions used for all of the following: (606-10-50-20)

- Determining the transaction price, which includes, but is not limited to, estimating variable consideration, adjusting the consideration for the effects of the time value of money and measuring noncash consideration
- Assessing whether an estimate of variable consideration is constrained
- Allocating the transaction price, including estimating standalone selling prices of promised goods or services and allocating discounts and variable consideration to a specific part of the contract (if applicable)
- Measuring obligations for returns, refunds and other similar obligations
Presentation and Disclosure
Public Companies

Costs to obtain or fulfill a contract

An entity shall describe both of the following: (340-40-50-2)

- The judgments made in determining the amount of the costs incurred to obtain or fulfill a contract with a customer (in accordance with paragraph 340-40-25-1 or 340-40-25-5)
- The method it uses to determine the amortization for each reporting period

An entity shall disclose all of the following: (340-40-50-3)

- The closing balances of assets recognized from the costs incurred to obtain or fulfill a contract with a customer (in accordance with paragraph 340-40-25-1 or 340-40-25-5) by main category of asset (for example, costs to obtain contracts with customers, pre-contract costs, setup costs)
- The amount of amortization and any impairment losses recognized in the reporting period
Presentation and Disclosure
Public Companies

Practical expedients

If an entity uses either the practical expedient in paragraph 606-10-32-18 (about the existence of a significant financing component) or paragraph 340-40-25-4 (about the incremental costs of obtaining a contract), the entity shall disclose that fact. (606-10-50-22 and 340-40-50-5)
Presentation and Disclosure
Public Companies

Accounting policies

An entity may make an accounting policy election to exclude from the measurement of the transaction price all taxes assessed by a governmental authority that are both imposed on and concurrent with a specific revenue-producing transaction and collected by the entity from a customer (e.g., sales, use, value added, some excise taxes). An entity that makes this election shall comply with the disclosure requirements in paragraphs 235-10-50-1 through 50-6. (606-10-32-2A)

If shipping and handling activities are performed after a customer obtains control of the good, then the entity may elect to account for shipping and handling as activities to fulfill the promise to transfer the good. An entity that makes this election shall comply with the disclosure requirements in paragraphs 235-10-50-1 through 50-6. (606-10-25-18B)
Effective date and transition disclosures

An entity that applies the standard retrospectively to each prior reporting period (i.e., using the full retrospective approach) is required to make the disclosures required by paragraphs 250-10-50-1 through 50-2 in the fiscal period in which the standard is adopted: (Note: An entity need not disclose the effect of the changes on the current period, which otherwise would be required by paragraph 250-10-50-1(b)(2)). (606-10-65-1(e))

- The nature of and reason for the change in accounting principle, including an explanation of why the newly adopted accounting principle is preferable
Presentation and Disclosure
Public Companies

Effective date and transition disclosures

- The method of applying the change, and:
  - A description of the prior-period information that has been retrospectively adjusted, if any
  - The effect of the change on income from continuing operations, net income (or other appropriate captions of changes in the applicable net assets or performance indicator), any other affected financial statement line item, and any affected per-share amounts for the current period and any prior periods retrospectively adjusted. Presentation of the effect on financial statement subtotals and totals other than income from continuing operations and net income (or other appropriate captions of changes in the applicable net assets or performance indicator) is not required. (Note: An entity need not disclose the effect of the changes on the current period, which otherwise would be required by this paragraph in ASC 250).
  - The cumulative effect of the change on retained earnings or other components of equity or net assets in the statement of financial position as of the beginning of the earliest period presented
  - If retrospective application to all prior periods is impracticable, disclose the reasons and a description of the alternative method used to report the change (see paragraphs 250-10-45-5 through 45-7)
Presentation and Disclosure
Public Companies

Effective date and transition disclosures

• If indirect effects of a change in accounting principle are recognized:
  – A description of the indirect effects of a change in accounting principle, including the amounts that have been recognized in the current period, and the related per-share amounts, if applicable
  – Unless impracticable, the amount of the total recognized indirect effects of the accounting change and the related per-share amounts, if applicable, that are attributable to each prior period presented

• If a change in accounting principle has no material effect in the period of change but is reasonably certain to have a material effect in later periods, the disclosures specified in item 20.a. above shall be provided whenever the financial statements of the period of change are presented. (250-10-50-1)

• The SEC staff has stated that while labeling financial statement columns “as adjusted” for a change in accounting principle is not explicitly required, it is considered a best practice to facilitate as much transparency as possible. (SP — AICPA/SEC Regulations Committee, Current Practice Issues, dated 9/26/06, Discussion Document D)
Presentation and Disclosure
Public Companies

Effective date and transition disclosures

- The transition practical expedients that have been used: (606-10-65-1(g)(1))
  - Disclose that the entity has not restated completed contracts that begin and end in the same annual reporting period. (606-10-65-1(f)(1))
  - Disclose the entity’s use of the transaction price at the date the contract was completed rather than estimating variable consideration amounts in the comparative reporting periods. (606-10-65-1(f)(2))
  - Disclose that the entity has not disclosed the amount of the transaction price allocated to the remaining performance obligations and an explanation of when the entity expects to recognize that amount as revenue for the reporting periods presented prior to the initial date of application. (606-10-65-1(f)(3))
  - For contracts that were modified before the beginning of the earliest reporting period presented in accordance with the standard, disclose that the entity has not retrospectively restated the contract for those modifications in accordance with the contract modification guidance in paragraphs 606-10-25-12 and 25-13. Disclose that the entity instead reflected the aggregate effect of all modifications when identifying the satisfied and unsatisfied performance obligations, determining the transaction price and allocating the transaction price. (606-10-65-1(f)(4))
- To the extent reasonably possible, a qualitative assessment of the estimated effect of applying each of the expedients listed in item 20.f. (606-10-65-1(g)(2))
Effective date and transition disclosures

An entity that applies the standard retrospectively with the cumulative effect recognized at the date of initial application (i.e., using a modified retrospective approach) is required to disclose the following in the fiscal period in which the standard is adopted: (606-10-65-1(h))

- Whether the entity has applied the standard to all contracts or only to contracts that are not completed at the date of initial application.
- The transition practical expedients that have been used: (606-10-65-1(g)(1))
  - For contracts that were modified before the beginning of the earliest reporting period presented in accordance with the standard disclose that the entity has not retrospectively restated the contract for those modifications in accordance with the contract modification guidance in paragraphs 606-10-25-12 and 25-13. Disclose that the entity instead reflected the aggregate effect of all modifications when identifying the satisfied and unsatisfied performance obligations, determining the transaction price and allocating the transaction price. (606-10-65-1(h), 606-10-65-1(f)(4))
Presentation and Disclosure
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Effective date and transition disclosures

- The amount by which each financial statement line item is affected in the current reporting period by the standard as compared with the guidance that was in effect before the change (606-10-65-1(i)(1))
- An explanation of the reasons for significant changes identified in item 21.d. (606-10-65-1(i)(2))