



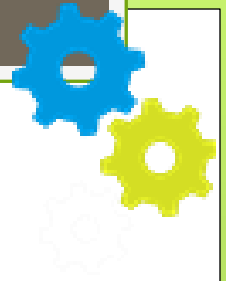
Revenue Recognition Ready?

Construction



Agenda

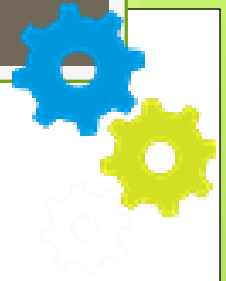
- **General Information – Revenue Recognition**
- **Special Challenges for Contractors**
- **Transition and Disclosure**
- **Implementation in Your Organization**
- **Q&A**



History

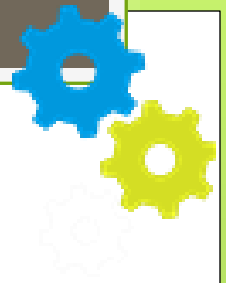


- **Multiple methods for timing, amount;**
- **Varying by industry**



Revenue defined

*“income from **customers** arising from an entity’s **central operations** in an **exchange transaction**”*



Rules-based to Principles-based

5 Basic Steps

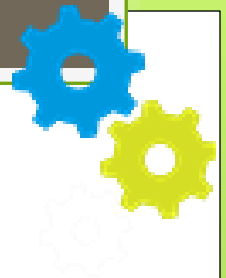
Step 1: Identify the contract

Step 2: Identify the performance obligation

Step 3: Determine the transaction price

Step 4: Allocate the transaction price

Step 5: Recognize revenue

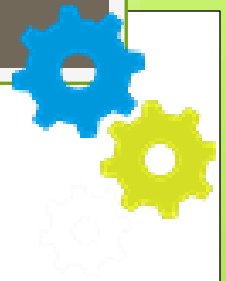


5 Revenue Recognition

Basic Steps

Step 1: Identify the contract

- Written
- Oral
- Implied by customary business practice



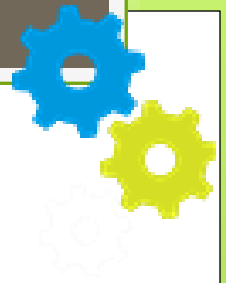
5 Revenue Recognition

Basic Steps

Step 1: Identify the contract

Side agreements considered with primary agreement

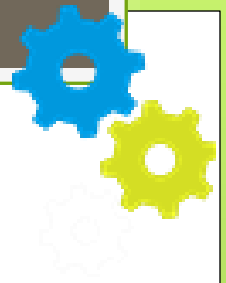
- Cancellation
- Termination
- Options
- Discounts



5 Revenue Recognition Basic Steps

Step 2: Identify the performance obligation

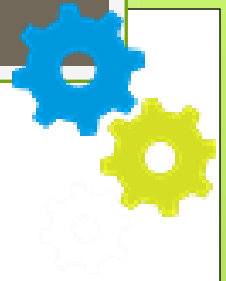
- Performance obligation – “promise” that creates an expectation that an entity will provide a good or service
- Contracts are broken down or bundled to get to the level of “distinct” goods or services



5 Revenue Recognition Basic Steps

“Distinct” goods or services

- Customer could benefit from the good or service on its own or in combination with other readily available resources
- Not distinct if one or more goods or services significantly modifies another, or the goods or services are highly interdependent

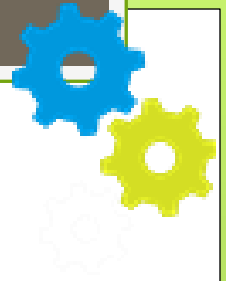


5 Revenue Recognition

Basic Steps

Step 3: Determine the transaction price

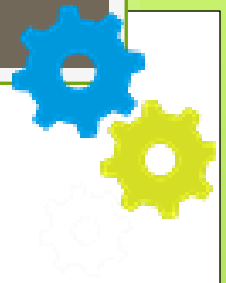
Variable consideration – estimate and record to the extent that it is unlikely to be reversed



5 Revenue Recognition Basic Steps

Variable consideration

- Price concessions
- Refunds
- Coupons
- Credits
- Volume discounts
- Performance bonuses/penalties
- Incentives
- Royalties
- Rebates

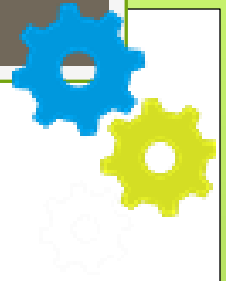


5 Revenue Recognition

Basic Steps

Step 4: Allocate the transaction price

- Allocated to performance obligations
- Based on standalone selling prices
 - Estimated using most directly observable information
- At contract inception
- Discounts generally allocated ratably
 - Unless specifically identified to one performance obligation

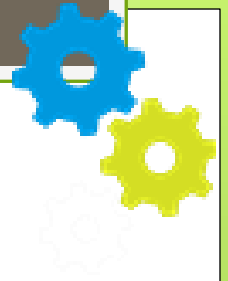


5 Revenue Recognition

Basic Steps

Step 5: Recognize Revenue

When the customer obtains control

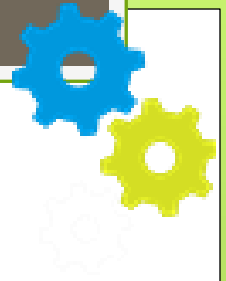


5 Revenue Recognition

Basic Steps

Customer obtains control:

When it has the ability to **use**,
consume, **deploy**, allow
another to **deploy**, restrict
another from **deploying**,
pledge, or **sell** an asset



5 Revenue Recognition

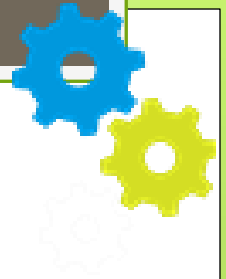
Basic Steps

Step 5: Recognize revenue

Customer obtains control and revenue is recognized either

“over time” or

“at a point in time”



5 Revenue Recognition

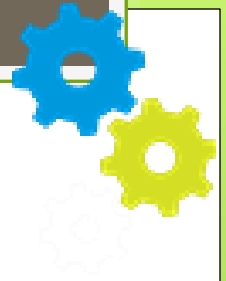
Basic Steps

Revenue recognized over time

If any one of the following criteria are met:

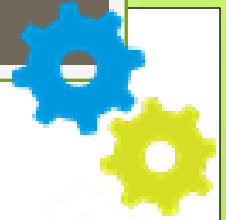
- Customer simultaneously receives and consumes the benefits as the entity performs (service)
- Entity's performance creates or enhances an asset that the customer controls
- Entity's performance does not create an asset with alternative uses to the entity and the entity has an enforceable right to payment for performance completed to date (including a profit component)

Otherwise recognized at a point in time when customer obtains control



Special Challenges for **CONTRACTORS**

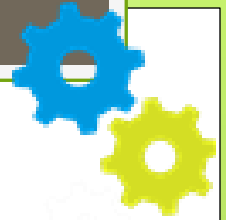




Special Challenges for **CONTRACTORS**



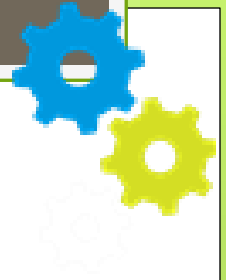
- Combining contracts
- Change orders
- Variable consideration – claims, performance incentives, penalties, liquidated damages
- Significant financing component
- Loss accrual
- Measure of progress toward performance obligations
- Uninstalled materials
- Pre-contract costs
- Warranties



Combining Contracts

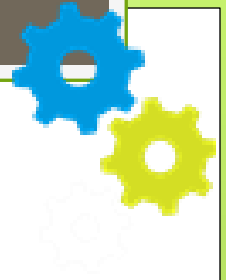
If entered into at or near the same time with the same customer or related parties and at least one of the following:

- Contracts are negotiated as a package with a single commercial objective
- Consideration to be paid on one contract depends on the price or performance of another
- Goods or services comprise a single performance obligation



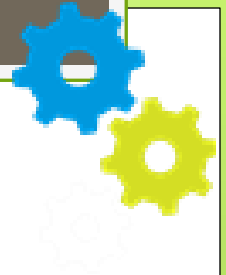
Change Orders

- Allows verbal acceptance
- Unpriced change orders should be estimated, subject to constraint
- Consider contract modification guidance regarding separate contract accounting or continuation of existing contract



“Distinct” Goods or Services

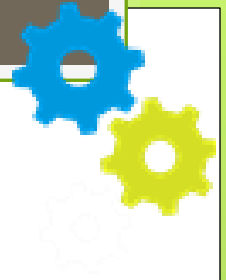
- Customer could benefit from the good or service on its own or in combination with other readily available resources
- Not distinct if one or more goods or services significantly modifies another, or the goods or services are highly interdependent



Variable Consideration –

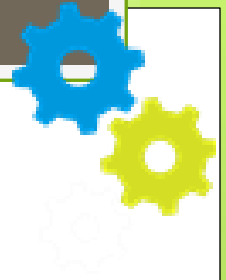
Claims, Performance Incentives,
Penalties, Liquidated Damages

- Estimated and included in transaction price at contract inception
 - Probability
 - Most likely
- Subject to constraint
- Evaluated each accounting period



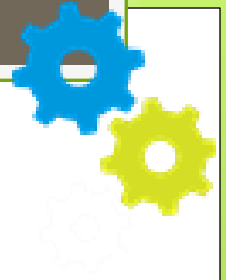
Significant Financing Component

- Explicit or implicit based on payment terms
- Could benefit entity (advance payment) or customer (deferred payment)
- Record interest income/expense at market rate
- May be disregarded if period between fulfillment of performance obligation and payment is less than 1 year



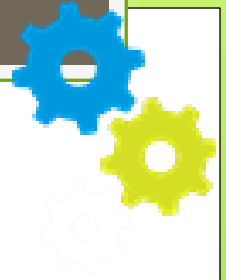
Loss Accrual

- May be determined at either performance obligation level or contract level (vs. contract level currently)
- Policy election – consistent application



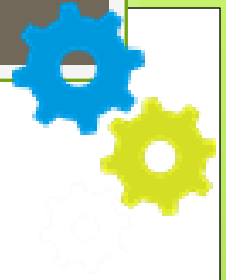
Measure of Progress Toward Performance Obligations

- Most appropriate measure
- Input – entity's efforts to satisfy performance obligation
 - Examples: Cost; labor hours; machine hours; time lapsed; quantities of materials used
- Output – direct measure of value transferred to the customer
 - Examples: Survey of work performed; units produced; units delivered; contract milestones



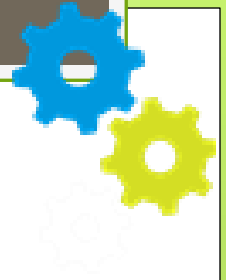
Uninstalled Materials

- Most recent proposed guidance August 2017; may be further discussion
- Excluded from the measure of progress until control is transferred to the customer
- When customer has control, revenue recognized only to the extent of cost until materials are installed
- If customer does not obtain control and materials have alternative uses, they are inventoriable (same as current)



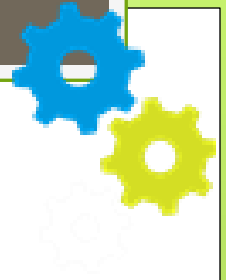
Uninstalled Materials – Key Concepts

- Customer Control
- Alternative uses



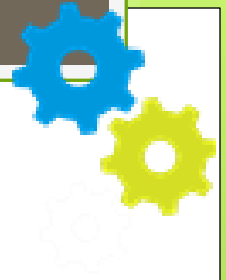
Customer Obtains Control

- When it has the ability to use, consume, deploy, allow another to deploy, restrict another from deploying, pledge or sell an item
- When it can direct the use of, or obtain substantially all of, the remaining benefits from an item



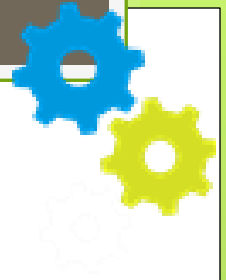
Alternative Uses

Standard inventoriable materials that can be readily used by the contractor in other construction projects without incurring significant costs.



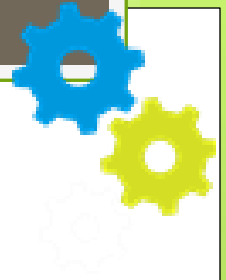
Pre-Contract Costs

- Sales commissions, design phase costs, bonds, insurance premiums, set-up costs, mobilization
- Amortized over the period of fulfillment of performance obligations



Warranties

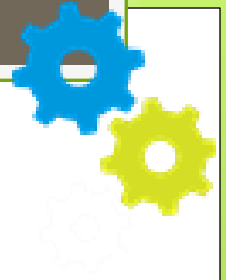
- Assurance – product will function as expected – expense accrued – no change
- Service plus assurance – protection against wear and tear – separate performance obligation – allocate transaction price



Penalty Example

Facts:

Total Contract	\$50,000
Total Expected Costs	\$40,000
Possible Penalty	\$ 5,000



Penalty Example

Existing Guidance

Year 1:

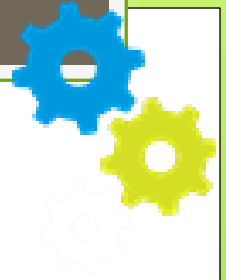
Cost incurred \$30,000

Estimated likelihood of penalty 50%

Calculation of income:

$$\$30,000 / \$40,000 \times \$50,000 = \$37,500$$

Penalty not included until fairly certain



Penalty Example

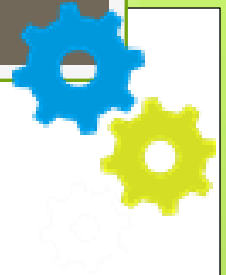
New Guidance

Year 1:

Cost incurred	\$30,000
Estimated likelihood of penalty	50%

Adjusted estimate of total cost:

Expected contract cost	\$40,000
Estimate of penalty (\$5,000 x 50%)	<u>\$2,500</u>
	\$42,500



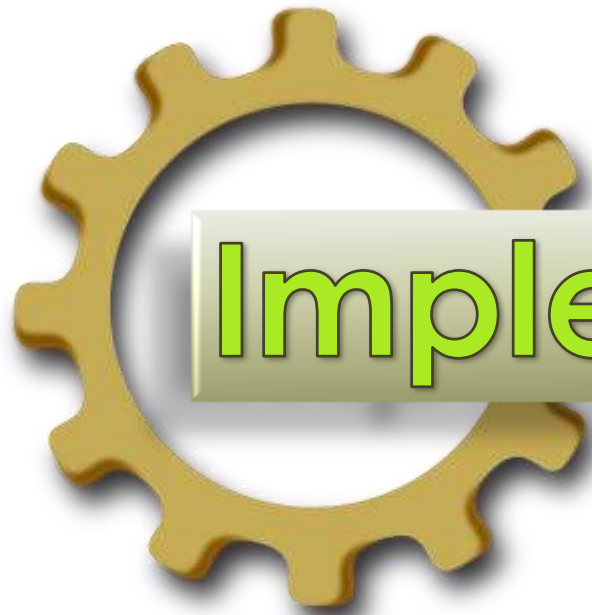
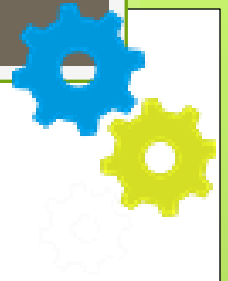
Penalty Example

Calculation of Income:

$$\$30,000/\$42,500 \times \$50,000 = \$35,294$$

Incorporation of penalty “constrains” recognition of revenue by \$2,206 in this example.

- *How would the calculation change if the likelihood of penalty was estimated at 30-50%?*



Implementation

Effective – Annual periods beginning
after **December 15, 2018**



Implementation

Two methods of application:

1. Retrospective restatement
2. Modified retrospective restatement

Expanded disclosures



Retrospective restatement

- Restate any prior years presented
- Adjust beginning retained earnings for earliest year presented
- Disclose change in each prior year financial statement line



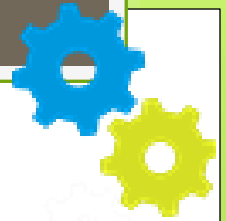
Modified Retrospective Restatement

- Don't adjust prior period
- Adjust beginning retained earnings for year of change
- Additional disclosure – amount by which each financial statement line item is affected by adoption



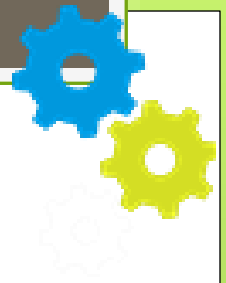
Presentation

- Contract assets – segregated by those that are unconditional other than for the passage of time and those that are conditional
- Contract liabilities
- Totaled at the contract level
- Revenue from contracts with customers must be segregated from all other types of revenue (i.e., lease, interest, gains, etc.)



Note Disclosures

Underlying objective – disclose qualitative and quantitative information about an entity’s contracts with customers, significant judgments, changes in judgments, and assets recognized



Note disclosures – Non-public companies

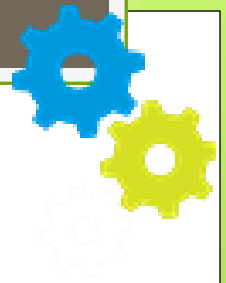


Disaggregated revenue

- ✓ Recognized over time vs.
at a point in time



Qualitative information about how economic factors affect the nature, amount, timing and uncertainty of revenue and cash flows

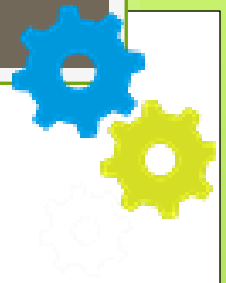


Note disclosures – Non-public companies



Performance obligations - descriptive information, including:

- ✓ When an entity typically satisfies its performance obligation
- ✓ Significant payment terms
- ✓ Nature of goods or services
- ✓ Obligations for returns, refunds, etc.
- ✓ Warranties, etc.

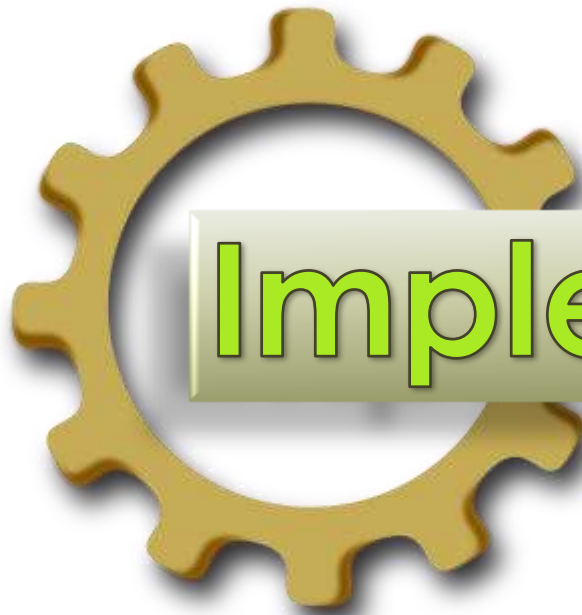
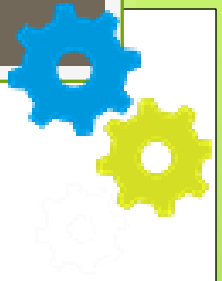


Note disclosures – Non-public companies



Significant judgments

- ✓ Method used to recognize revenue for performance obligations satisfied over time
- ✓ Methods, inputs, assumptions to assess variable consideration constraint









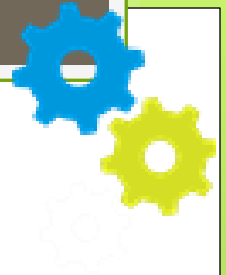
Implementation

AT YOUR ORGANIZATION



Implementation at Your Organization

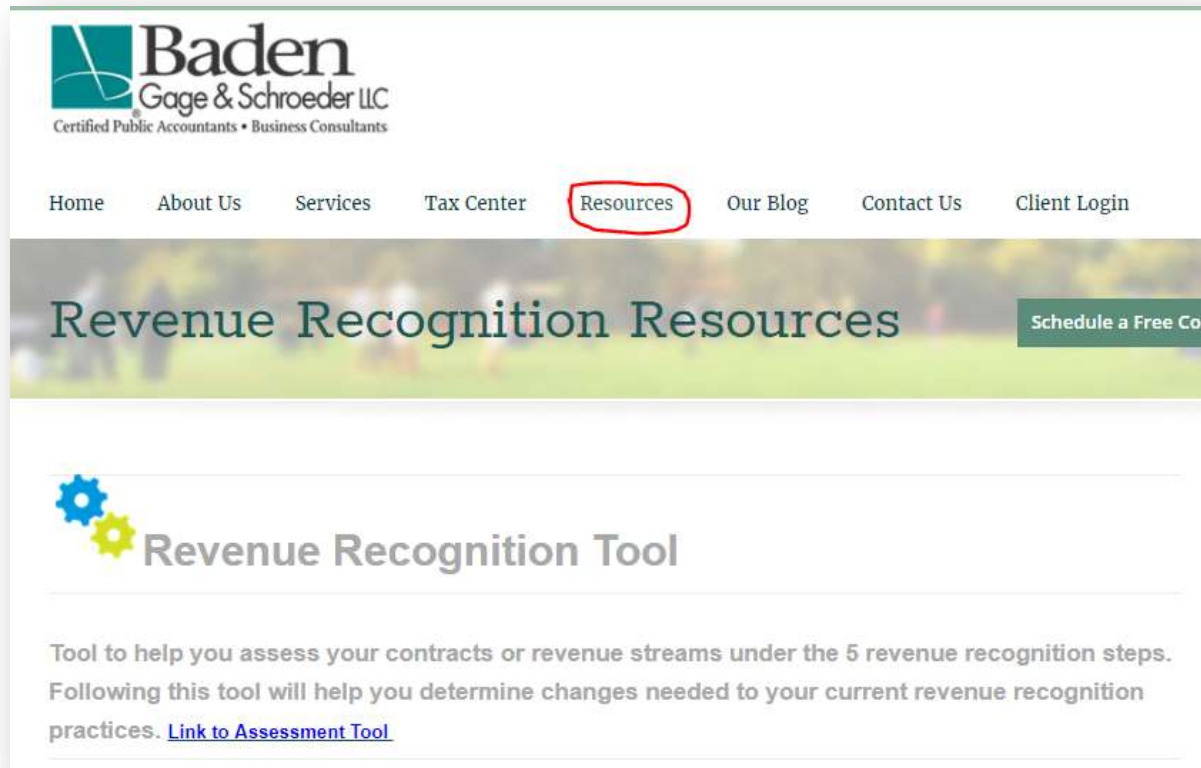
-  Assess your revenue streams/cycles/contracts
-  Determine accounting changes needed
-  Educate management and staff
-  Discuss with your Baden team
-  Make necessary procedure and software changes
-  Prepare disclosure information




Assessment Tool



www.badencpa.com/RevRecg.php




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Revenue Recognition Resources

[Schedule a Free Con](#)

Revenue Recognition Tool

Tool to help you assess your contracts or revenue streams under the 5 revenue recognition steps. Following this tool will help you determine changes needed to your current revenue recognition practices. [Link to Assessment Tool](#)