Revenue recognition

Going beyond accounting

CFO challenges and actions for adopting the new standard for U.S. public business entities
Revenue recognition: Going beyond accounting

With the new revenue recognition standard from the Financial Accounting Standards Board (FASB), companies face significant challenges, including new requirements for data collection, disclosures, and other financial processes. And the impacts will go far beyond accounting, ultimately cutting across business operations.

But even though the new standard is daunting, it is a great opportunity for chief financial officers (CFOs) to increase the value of finance. By taking a 360-degree view of the business, CFOs can understand the broad implications of the new standard, reevaluate processes and systems throughout the enterprise, and prepare the organization for change—all while identifying ways to make finance a better partner to the business.

How will the new standard change business planning, reporting, and forecasting? What new risks will arise, and how will the company address them? What kinds of new technology will be required? These kinds of decisions can have far-reaching impact, and CFOs will take the lead.
Overview of the new revenue recognition standard*

Why was the new standard developed?

— **Streamline and simplify**: To provide a single framework that replaces existing industry- and transaction-specific U.S. generally accepted accounting principles (GAAP)
— **Global and cross-industry consistency and comparability**: To enable financial statement users and preparers to compare companies in different industries, regardless of whether they apply U.S. GAAP or International Financial Reporting Standards (IFRS)
— **Transparency**: To provide financial statement users with more extensive disclosures

How could it impact your business?

— **Key financial measures and ratios** may change, affecting analyst expectations, earnouts, bonuses, budgeting, and compliance with contractual covenants.
— **Information technology (IT) systems** may need to be upgraded or modified for revised requirements to capture additional data necessary to support the accounting and disclosures.
— **Sales and contracting processes** may need to be reconsidered.
— **Accounting processes and internal controls** may need to be revised for the new standard, which requires significant judgment and use of estimates. There also may be a need to maintain parallel records during transition.

When is it effective?

— **Public business entities** and certain not-for-profit entities for fiscal years beginning after December 15, 2017, and interim periods within those years
— **All other entities** for fiscal years beginning after December 15, 2018, and interim periods thereafter
— **Early adoption permitted** for all entities for fiscal years beginning after December 15, 2016 (the standard’s original effective date)
— Companies can elect to transition to the new standard either retrospectively or as a cumulative-effect adjustment as of the adoption date.

*The FASB issued ASU No. 2014-09, *Revenue from Contracts with Customers*, in May 2014. The new revenue standard includes both the original ASU 2014-09 and subsequent amendments ASU 2016-08, ASU 2016-10, ASU 2016-12, and ASU 2016-20, as well as the deferral of the effective date in ASU 2015-14.*
U.S. public business entities have two options for transitioning
to the new standard:

**Cumulative effect method.** The standard is applied at the
beginning of a company’s fiscal year 2018, at which point the
company will elect application to either all current contracts or
only to those that are not complete. The applicable in-scope
contracts will need to be evaluated to determine the extent of the
overall opening retained earnings adjustment.

**Retrospective method, with optional practical expedients.**
The standard is applied at the beginning of a company’s fiscal year
2016, at which point the new standard is applied to all in-scope
customer contracts, and an opening retained earnings adjustment
is subsequently made. The financial statements presented for
2016 and 2017 are restated under the new standard. Optional
practical expedients can be elected to reduce the burden of
certain requirements.

All other entities should apply the new standard to annual
reporting periods beginning after December 15, 2018, as well
as interim reporting periods within annual reporting periods that
begin after December 15, 2019.

The graphic below outlines the timing of the new revenue
recognition standard based on a calendar fiscal year for U.S. public
business entities:
The choice of transition method is a critical decision that will impact the approach to financial reporting during the transition period. As adoption of the new standard will require substantial effort for adjusting to changes—along with side-by-side reporting and other implications depending on the chosen approach—CFOs should balance the level of required effort with the anticipated impact on the financial statements when selecting the approach.
Beyond selecting a transition method, CFOs will also face numerous other challenges associated with the new revenue recognition standard. For example, the standard has many complexities and interpretations, and the exact impacts can vary by industry, the specifics of a company’s business, or even its particular contracts. While many revenue accounting rules have been clarified, some accounting impacts remain unclear; organizations will need to define their positions based on their best judgment and obtain their auditors’ approval. Each company may have unique contractual provisions that need to be evaluated, and there could be instances in which specific guidance does not readily exist.

Additionally, as the challenges extend well beyond finance and accounting to other areas of the business, CFOs should evaluate the following early in the effort to adopt the standard:

– **Impact to functions and process areas.** To accommodate the new standard, companies may need to redesign processes not only in revenue accounting and financial planning and reporting, but also in areas throughout the order-to-cash cycle.

  This redesign should include documentation of current- and future-state processes; this will help CFOs define the impact of the new standard, increase functions’ awareness of forthcoming changes, and obtain buy-in from the business. Process redesign is usually underestimated in terms of the time, resources, training, and communications required.

  – **Capitalization of cost to obtain a contract.** The new standard requires companies to capitalize the incremental costs of obtaining a contract, including sales commissions. For existing and anticipated contracts (including renewals) covering a year or less, companies can elect to expense commissions immediately. These requirements present not only an accounting challenge for the finance team, but also a process and strategy challenge for the sales organization.

  – **Impact to compensation for sales executives.** A change in revenue recognition can also mean a change in compensation plans, which is an important consideration as companies aim to retain sales executives for the long term and maximize revenue growth.

  – **Identifying contracts, performance obligations, and estimating transaction price.** Some of the largest challenges within the new revenue recognition model relate to identifying customer contracts, identifying the performance obligations, and determining the transaction price within those contracts. The standard may be especially challenging for organizations with complex or customized customer contracts that include regular modifications of the contract scope, terms, or services, or include variable pricing such as tiered pricing, volume-based discounts, or other contingencies. The new standard eliminates the current accounting rules that generally prevent the recognition of revenue when the amount is contingent on a...
future event. This change results in increased estimation of variable consideration and will introduce greater risk and volatility in the income statement. It may also require that additional controls be implemented in functions within finance (e.g., Financial Planning & Analysis) or in other parts of the business where information necessary to make these estimates resides.

– Additional data requirements and the impact to IT systems. To comply with the new standard, many companies will need to capture new data, including customer accounts setup, new attributes on revenue inflows, and new dimensions on a transaction life cycle. Accordingly, organizations may need to change their business processes and systems, including those related to contract management, billing, revenue estimation, customer incentives, rebate and other revenue, and more.

In some cases, it may make more sense to implement new systems rather than upgrade legacy ones.

– Coherent message to investors and communications throughout the organization. Changes to the way revenue is recognized can affect financial statements, in turn impacting the way key stakeholders analyze a company. What kinds of internal reporting and key metrics will the business use to monitor performance? How will the company communicate these impacts to employees and investors to minimize disruption? There may be substantial changes, or entirely new tasks, in the day-to-day activities performed by staff.

Enterprises must answer these important questions as they prepare for the new standard. Moreover, they will need to ensure proper training, education, and communication throughout the organization.

Six operating model layers to consider

Organizations should consider the following six operating model layers when designing and implementing new processes or a solution to address the new revenue recognition standard requirements:

- **Service Delivery Model:** Describes how the organization provides the necessary data and information on a timely basis to enable the revenue recognition process

- **People:** Explains how employees are organized, including lines of reporting and spans of control; and outlines skills, roles, responsibilities, and support activities for each process area

- **Functional Process:** Breaks down functional silos; outlines how specific process steps link to functions or departments that perform each step; and describes accompanying policies/procedures to be followed when performing the revenue recognition process steps

- **Supporting Technology:** Describes the applications that are used to enable the processes, policy compliance, internal controls, and report generation

- **Data & Reporting:** Includes information requirements to drive key business insights and enhanced decision making, which enables key financial and management reporting needs and analytics

- **Governance & Controls:** Identifies the specific controls that are in place to mitigate risk of processing, financial and operational errors, as well as governance to manage data, processes, and reports
Taking action: Top 10 considerations for CFOs

So how can CFOs respond to these challenges to prepare their organizations for the new standard, while making finance a better partner to the business? Here are KPMG’s top 10 recommendations:

1. **Determine the best method of adoption.** CFOs should make their decision on which of the two adoption approaches is best for their business based on a balance of the level of effort needed and the anticipated impact on the financial statements. The full retrospective method (two years of comparable data under new guidance) is useful for companies that expect significant changes as a result of the new revenue standard. The cumulative approach is better suited to companies that anticipate minimal changes to their accounting process; however, these businesses may still find it preferable to adopt retrospective to make all the required changes at once.

   For example, if an organization expects to be significantly impacted by the revenue recognition standard (either change in the revenue trend or significant equity adjustment at adoption time), a company may adopt with a full retrospective approach disregarding the level of effort in order to ensure the investors have visibility on comparative data.

   Moreover, as comparable industries will likely face similar accounting challenges, CFOs should consider participating in industry share forums and peer working groups to benefit from industry best practices and benchmarking data related to adoption method and approach to changes under the standard.

2. **Understand the impact to disclosure requirements and financial statements.** Another impact to consider is the reporting on each revenue stream, as organizations will need to disclose more information—such as disaggregation of revenue or transaction price for remaining performance obligations. These disclosures aim to provide investors with greater information about current and future revenue. This may result in disclosure of revenue amounts that have not previously been disclosed to analysts or in segment reporting. It may also result in disclosure of forecasted revenue for certain contracts. In addition to assessing the impact on disclosures, CFOs should use financial modeling to determine the impact on financial statements. While CFOs may want to make some early high-level assumptions for this modeling, they should use a more robust modeling tool during implementation to ensure accuracy and auditability.

3. **Understand the impact beyond accounting.** To assess and manage the impacts throughout the business, CFOs should consider areas such as revenue management; business and finance operations; planning, forecasting, and reporting; technology; contract management; and investor guidance. CFOs will also need to develop strategies for capturing additional data, which may involve changes to processes and systems.

4. **Anticipate implementation cost.** The finance organization must properly anticipate the cost of implementing the new standard. While it is difficult to properly estimate the costs without doing an accounting assessment, companies often tend to underestimate the overall effort in numerous areas, such as:
   - The time necessary to properly interpret the new guidance and develop new accounting positions (white papers)
   - The number of impacted stakeholders across the organization and the time required to properly prepare nonaccounting/finance groups (e.g., Sales) for the change
   - The effort required to perform data analysis and design manual and automated solutions (e.g., estimation of variable consideration)
The effort required for system changes, solution evaluation, and system implementation costs.

CFOs will need to consider how they are going to prioritize their internal resources to properly identify the accounting gaps and interpret the new guidance.

Assess the changes to business planning, forecasting, and reporting. The new revenue recognition standard could have a critical impact on budgeting, cost allocation, periodic reporting, and variance management. In addition, significant changes in the amount or timing of revenue and earnings could cause changes to key performance indicators or other metrics used to communicate financial results. For example, traditional revenue seasonality may be flattened or shifted to other periods. Organizations will need to properly identify the expected changes, update their processes, and communicate those changes to management and investors.

Determine the tax impact. The new standard can change both the timing and method of revenue recognition for tax purposes, potentially resulting in changes to total income tax. Rather than simply viewing this as a bookkeeping exercise, CFOs should work with the company’s tax professionals to assess the impact on income tax and related reporting.

Provide market guidance on expected changes. One of the most critical considerations for CFOs of listed companies is how to communicate anticipated revenue changes to the street. The differences could influence a company’s market valuation if not properly understood by analysts and investors. CFOs should work closely with corporate communications and investor relations to develop a plan for seamless market guidance that aligns with the disclosures about the upcoming adoption that are required by the Securities and Exchange Commission (SEC).

Engage stakeholders and create a project team. Given the broad impact of the new revenue standard, implementation will be very complex, requiring commitment and cohesiveness throughout the organization and a strong focus on project management. Early in the planning, CFOs should engage key stakeholders from corporate accounting, finance, IT, tax, legal, sales, and other functions to discuss the impacts, prioritize the changes, and ensure buy-in. Moreover, CFOs should establish a project team to oversee the implementation. It will also be important to involve the company’s auditors in the implementation in order to ensure strong communication on the positions taken and the impacts to financial statements.

Evaluate new technology. To accurately report revenue under the new standard, CFOs will need to evaluate whether to upgrade or replace the company’s current systems. For companies that need a new solution, the market offers a range of products tailored specifically to revenue recognition. As part of the technology selection process, CFOs should consider the following:

- How does the solution address the new revenue recognition requirements for current sales transactions?
- How will it integrate with the company’s current IT landscape?
- How does it address dual reporting and disclosure requirements?
- How will it address potential changes to the business model resulting from an acquisition or other shift in direction?

Use internal controls to address new risks. Finally, the new revenue recognition standard may also bring new risks, such as those arising from IT systems changes, or the data inputs required to support new estimates and judgments. To manage these risks, CFOs will need to design new internal controls or modify existing ones.
Our Integrated Finance Transformation (IFT) framework, which is based on knowledge and experience gained through years of accounting change projects, is a tested methodology for transformation and the foundation of our revenue recognition implementations. Incorporating lessons learned from early adopters of revenue recognition, our methodology aims to help organizations by:

— Streamlining implementation efforts by defining requirements up front
— Driving a disciplined product evaluation process to check the chosen solution addresses all requirements
— Using thorough test planning, business scenario functional testing, and quality assurance to enable delivery of desired results.

The IFT framework is built upon six sections, as shown in the diagram below, to cover the main areas for a transformation process. It consists of the following key elements:

**Finance Vision and Strategy**
— Assessing the impact of the new revenue recognition standard (ASC 606) to the organization and defining new accounting position (white papers)
— Evaluating transition options (cumulative effect versus retrospective)

**High Level Design**
— Identifying missing data elements
— Defining business processes and systems changes to address new revenue policies
— Defining high-level design to address disclosures and dual reporting requirements

**Detail Design**
— Capturing the detailed requirements and defining the solution design to address the new revenue recognition standard (includes dual reporting and disclosures requirements)

**Build**
— Defining detailed use cases, developing prototypes, and testing the new solution to validate that it is aligned with detailed requirements and addresses new accounting policies

**Implement**
— Deploying the new solution and integrating it with the organization’s IT and processes landscape

**Improve**
— Checking that new GAAP revenue is properly calculated and can be properly reported under the current and new GAAP; enabling dual reporting and reconciliation between the current and new GAAP
KPMG’s approach to implementing the new revenue recognition standard considers the impact to the entire organization, not just accounting and financial reporting. This helps mitigate risks that could arise during the implementation, thereby helping to avoid delayed compliance, restatements, and related costs.

KPMG’s global network of financial management professionals helps clients align their finance organizations with the strategies and needs of their business to realize and sustain value over the long term. Our methodologies and tools are time-tested and have consistently demonstrated enhanced strategic value both to finance and the business.

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