The New Revenue Recognition Model

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Amazon Says New Accounting Rule will Change when it Recognizes Sales of its Devices

Market Watch | August 15, 2017

Amazon.com Inc. says a new revenue-recognition accounting rule that goes into effect for public companies in 2018 will impact the timing of when it will recognize sales of its own electronic devices as well as the gross amount of sales it claims.

“These timing changes will include Amazon-branded electronic devices sold through retailers, which will be recognized upon sale to the retailer rather than to end customers, and the unredeemed portion of our gift cards, which we will begin to recognize over the expected customer redemption period, which is substantially within nine months, rather than waiting until gift cards expire or when the likelihood of redemption becomes remote, generally two years from the date of issuance. In addition, certain advertising services will be classified as revenue rather than a reduction in cost of sales.”

Revenue Recognition Standard Could Spell Trouble for Software Companies

Accounting Today | September 20, 2017

“This feels as big or bigger than Y2K or SOX. SOX was a big heavy cost, but it wasn’t like you were in danger of missing your earnings call, or you had to report earnings that differed from expectations, not because anything changed in your business but because of accounting standards” said Zuora CEO Tien Tzuo.

Christopher Hutten, Chief Accounting Officer at SAP says, “our revenue recognition guideline is 700 pages. So the topic of revenue alone covers more pages in our guide than all other topics in accounting together.”

ASU No. 2014-09 –
Revenue from Contracts with Customers

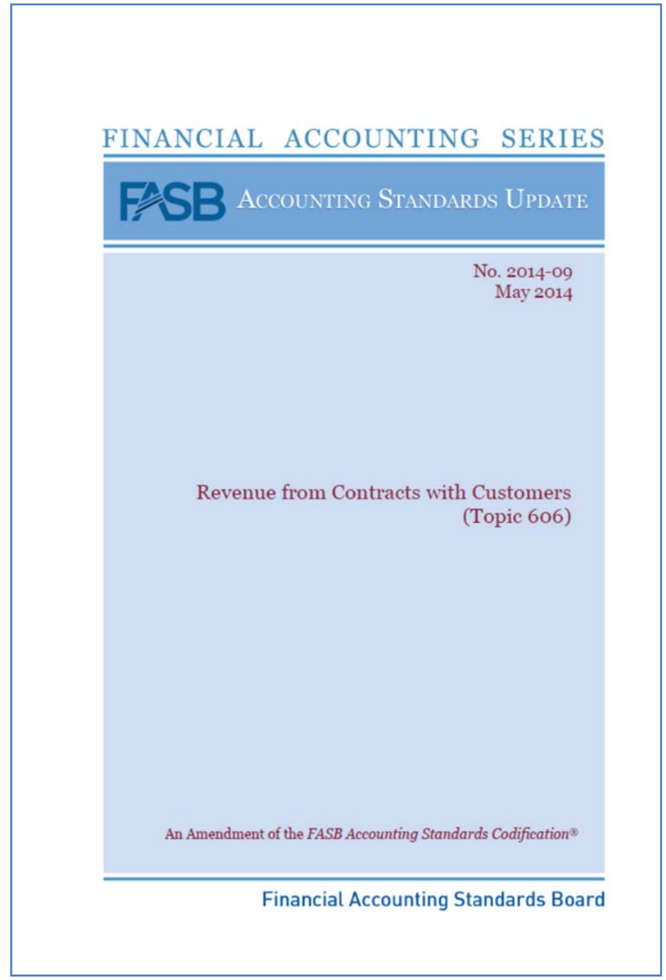
Overview

May 28, 2014 –

FASB and IASB issued converged guidance

Objective:

- To remove inconsistencies by providing a comprehensive framework for addressing revenue recognition issues
- To improve comparability across entities, industries, jurisdictions, and capital markets
- Simplify presentation by reducing complexity and volume of guidance
- Enhance disclosures about revenue-generating activities


FINANCIAL ACCOUNTING SERIES

FASB Accounting Standards Update

No. 2014-09
May 2014

Revenue from Contracts with Customers
(Topic 606)

An Amendment of the *FASB Accounting Standards Codification®*

Financial Accounting Standards Board

Effective Date of the New Revenue Standard

Public companies:

- Annual reporting periods beginning after December 15, 2017 (1/1/2018 for calendar year end entities), and interim periods therein

All other entities:

- Annual reporting periods beginning after December 15, 2018, and interim periods beginning after December 15, 2019

Early Adoption is permitted for annual reporting periods beginning after December 15, 2016 (the original effective date for public business entities)

Timeline – Implementation of New Standards

	2016	2017	2018	2019
Leasing Effective Retro		 X	 X	 X
Revenue Effective Retro	 X	 X	 X (Retro or cumulative as of 1/1/18)	

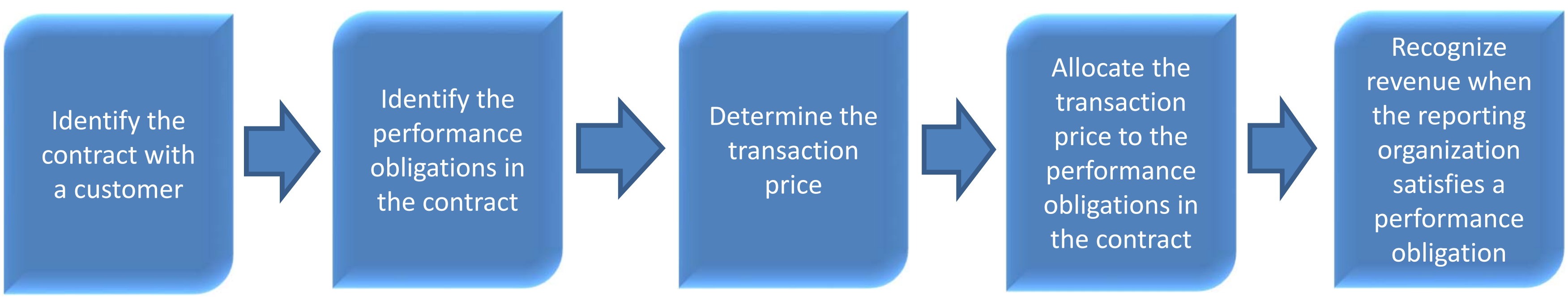
Adoption of the new leasing standard should take into consideration the Company's approach to how they are going to adopt the new revenue standard and the new cash flow guidance.

Slide source: Larry Schumann

Core Principle

Recognize revenue to depict the transfer of promised goods or services to customers in an amount that reflects the consideration the entity expects to be entitled to.

5 Step Model to Achieve Core Principle



Step 1-Identify the Contract with the Customer

Is it a contract with a customer within the scope of the new standard?

- Certain contracts with customers are outside of the scope (ex. Leases, Financial Instruments)

Must meet the following criteria:

- Approval and commitment of the parties
- Identification of rights of the parties
- Identification of payment terms
- Has commercial substance
- Probable that consideration will be collected in exchange for goods or services

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Step 2 - Identify the Performance Obligations in the Contract

- Contracts include promises to transfer goods/services
- When goods/services are distinct, the promises, or performance obligations, are accounted for separately
    - Distinct goods/services can have benefits on their own or together with other readily available resources
    - Seller's promise to transfer goods/services is separately identifiable from other promises

2

Step 3 - Determine Transaction Price

- The amount of consideration the entity expects to be entitled to for goods/services
- May be fixed or variable amount
    - If variable, an estimated amount of consideration should be made
    - Only to extent that it is probable that a significant reversal will not occur
- Should be adjusted for TVM if contract includes a significant financing component
- Noncash consideration

3

Step 4 - Allocation of the Transaction Price to Performance Obligations

- Typically allocate transaction price based on relative stand-alone selling price of each distinct good/service
  - *Use estimate if stand-alone selling price is not observable*
- Specific guidance applies when allocating a discount or variable consideration to one or more performance obligations

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Step 4 - Allocation of the Transaction Price to Performance Obligations

How to estimate stand alone non-observable selling price?

- Adjusted market assessment approach (what customer would pay)
- Expected cost plus a margin approach, or
- If price is highly variable or uncertain, a residual approach – total transaction price ($1,800 in the example) less sum of observable selling prices of the other goods or services

4

Step 5 - Recognize Revenue when the Reporting Organization Satisfies Performance Obligations

- Recognize revenue when customer obtains control of good/service
- Recognize amount allocated to distinct performance obligation
- Performance obligation may be satisfied at:
  - *Point in time (usually when transferring goods)*
  - *Over time (usually when transferring services)*
    - *Use appropriate method for measuring progress towards completion (output or input methods)*

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Transition Groups

- FASB and IASB's joint Transition Resource Group
  - Comprised of regulators, users, and other stakeholders Accounting processes and internal controls may need revisions
  - To evaluate issues that might emerge for companies trying to implement the new standard
  - Issues are then referred to FASB and the IASB for further standard-setting
- Extra guidance is needed because the converged standard is principles-based

Revenue Recognition Amendments

ASU 2015-14	ASU 2016-08	ASU 2016-10	ASU 2016-12	ASU 2016-20
One year deferral of the effective date	Principal vs. agent	Licenses	Sales tax presentation (gross v net)	Technical Corrections
		Sales-based and usage-based royalties	Measurement of non-cash consideration	
		Performance Obligations	Collectability	
		Accounting for shipping and handling services	Completed contracts at transition	
			Practical expedients upon transition	

Slide source: RGP

Implementation and Interpretation Issues

FASB Transition Resource Group ("TRG")

- One of the objectives of the group was to inform the standard-setting boards about implementation issues that might arise from the new standard.
- Amendments include those:

    Performance obligations

    - Differing outcomes now reached by each Board may strain the goal of ongoing convergence for the new standard.
    - The hope is that, the variations remain minor, so that the thrust of revenue recognition remains consistent between the IASB and FASB

FASB Makes Additional Revenue Recognition Clarifications

Issued in March: ASU No. 2016-8

- Addresses principal versus agent considerations

Issued in April: ASU No. 2016-10

- Addresses licensing and identifying performance obligations

Issued in May: ASU No. 2016-12, Revenue From Contracts With Customers (Topic 606): Narrow-Scope Improvements and Practical Expedients.

- Addresses issues of collectability, contract modifications, completed contracts at transition, and noncash considerations

Expanded Principles-Based Disclosures

Revenue from Contracts with Customers:

- Disaggregation of revenue (breakout of revenue into appropriate categories)
- Contract balances, including opening and closing balances of receivables, and contract assets/liabilities
- Description of Performance obligations – including nature, timing of satisfaction and significant payment terms
- Transaction price allocated to remaining performance obligations (and when amounts will be recognized)

Expanded Principles-Based Disclosures

Significant Judgements:

- Description of significant judgements and changes in judgements about:
  - —*When control is transferred*
  - —*Methods used to recognize revenue over time*
  - —*Methods, inputs and assumptions to determine and allocate the transaction price*

Transition Methods

Transition method		PY2 (2016)	PY1 (2017)		CY (2018)	CY Footnotes
Full Retrospective*	Cumulative catch-up	Contracts under new standard				
Modified Retrospective*		Contracts under legacy standard		Cumulative catch-up	Existing and new contracts under new standard	Existing and new contracts under legacy standard for CY (2018)

* Optional practical expedients available

Slide source: FASB/IASB webcast

What Disclosures are saying about the New Revenue Recognition Standard

FEI | September 17, 2017

- **Be Prepared**

  The Disclosure
  Form 10-Q, Note 2. New Accounting Pronouncements, page 8: Spirit AeroSystems Holdings, Inc. – SPR, Filed: August 04, 2017 (period: June 29, 2017):

  In 2016, the Company established a cross-functional team to assess and prepare for implementation of the new standard. While the Company continues to assess some elements of ASU 2014-09, the Company has reviewed substantially all of our contracts with customers and has determined the business process and technology requirements. This includes documenting process changes, determining data requirements, and identifying changes in system mapping and configuration. The Company has substantially completed designing our processes, including internal controls, and related systems solutions and is currently implementing the required changes.

What Disclosures are saying about the New Revenue Recognition Standard, Cont.

FEI | September 17, 2017

- **Rethink Internal Controls**

The Disclosure

Form 10-Q, Note M - NEW ACCOUNTING PRONOUNCEMENTS, page 32: BOSTON SCIENTIFIC CORP – BSX, Filed August 03, 2017 (period: June 30, 2017):

In 2017, we are implementing new internal controls as part of our efforts to adopt the new revenue recognition standard. These internal controls include providing global training to our finance team and holding regular meetings with management and the Audit Committee to review and approve key decisions. Upon adoption, we expect to implement new internal controls related to our accounting policies and procedures. We will require new internal controls to address risks associated with applying the five-step model, specifically related to judgments made in connection to variable consideration and applying the constraint. Additionally, we will establish monitoring controls to identify new sales arrangements and changes in our business environment that could impact our current accounting assessment. During the second half of 2017, we expect to finalize our impact assessment and redesign impacted processes, policies and controls.

What Disclosures are saying about the New Revenue Recognition Standard, Cont.

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- **Plan for Extensive Footnote Disclosures**

The Disclosure
Note 2. Revenue from Contracts with Customers, pages 9-17 of EnerNOC, Incorporated's (ENOC) Form 10-Q as filed with the SEC on August 09, 2017 for their quarter ended June 30, 2017.

What Disclosures are saying about the New Revenue Recognition Standard, Cont.

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- **Explain The Oversight of Adoption of New Revenue Recognition Standard**

  The Audit Committee is also very much focused on how the new standard will affect the Company's businesses, processes and financial reporting and how the Company's accounting processes and controls will be affected or will need to be changed. Company management is in the process of developing an updated accounting policy (which has been discussed with the Audit Committee). The Company is utilizing a bottoms-up approach by reviewing its current contracts with customers by various revenue streams, evaluating new disclosure requirements and identifying and implementing appropriate changes to business processes, systems and controls to support revenue recognition and disclosure under the new standard. The Company is still evaluating the impact of ASU No. 2014-09 on its financial statements. Based upon its evaluation to date, capitalization of costs associated with obtaining contracts will have an impact upon adoption of the new standard. The Company expects to finalize the evaluation in upcoming quarters and will provide updates on its progress in future filings.

Thank You

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