COMPLIANCE WEEK
THE LEADING RESOURCE ON CORPORATE GOVERNANCE, RISK, AND COMPLIANCE

Technical side of revenue recognition still vexes companies

The more complex the transaction, the more difficult it gets to apply new revenue recognition rules. Eventually, something's got to give, writes **Tammy Whitehouse**.

In the continuing march to new accounting for how to recognize revenue in financial statements, some companies with complex transactions find they are still wrestling with how to apply the technical requirements.

The new five-step method for recognizing revenue that all public companies will apply beginning in 2018 requires companies to begin by identifying their contracts with customers. Then within each contract, companies must identify the individual performance obligations and allocate the purchase price to each of the distinct performance obligations. Revenue is recognized in financial statements as the company delivers on each of its distinct performance obligations.

The new model doesn't produce much change in the pattern of recognition for companies that have relatively straightforward transactions with their customers. But in sectors like technology or life sciences, where complex contracts with multiple performance obligations are the norm, some companies find they are still parsing through how to identify individual performance obligations and allocate pricing to each of them distinctly.

The life science sector, for example, includes companies in biotechnology, like pharmaceutical companies, clinical research organizations, and medical device manufacturers. Arrangements involving licensing technology are quite common in those kinds of organizations, says Jeff Ellis, life science industry practice director at Deloitte & Touche, and companies are getting tangled up in parsing out the accounting.

"You have significant intellectual property in this sector," says Ellis, and licensing is a common means of transferring that property among entities. "Licensing transactions are very common in this industry, and the new standard has some pretty significant changes."

The new standard requires companies to evaluate whether a particular good or service is separately identifiable in a contract, says Ellis. That led to questions early in the implementation process that inspired the Financial Accounting Standards Board to issue further guidance to clarify. In biotech companies, bundling of goods and services with licensing arrangements is typical. "A key question is whether the license of intellectual property represents a separate performance obligation from other goods or services in a contract," says Ellis. "That notion of whether it is distinct is a difficult judgment to make."

Another layer of complexity emerges as companies ponder how to account for arrangements that involve variable consideration, like royalties or sales-based milestones where the numbers are not distinct or predetermined at the outset of an arrangement. FASB's clarifying guidance has been somewhat helpful, says Dennis Howell, senior consultation partner at Deloitte, but companies are still left to exercise a great deal of judgment in deciding how to apply the requirements to their particular arrangements.

Even further complicating the accounting, biotech companies commonly enter into various kinds of collaboration arrangements with other entities, like joint ventures, which leads to even more questions about how to account for revenue, says Howell. In doing the analysis of how to recognize revenue under the new guidance, companies could feasibly come to a conclusion that they are neither the vendor nor the customer to a partner in such a collaborative arrangement, he says.

FASB recently added a project to its technical agenda to try to help sort out when transactions between parties to a collaborative arrangement are within the scope of the new revenue guidance. It's not clear when FASB might reach some conclusions that companies could apply in meeting the new revenue requirement in 2018, leading Howell to wonder if some companies might have to take their individual facts and circumstances to the Securities and Exchange Commission to ask for the staff's pre-clearance of their own accounting determinations.

A close cousin to life sciences, companies in the healthcare sector are wrestling with how to apply the new revenue recognition method to their contracts as well. The complexity of the payor system for hospitals working with various types of insurance programs, not to mention uninsured patients,