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New revenue standard issued

Potential challenges in the engineering and construction industry

The new revenue recognition standard will present different levels of complexity for companies in the engineering and construction industry, including challenges in determining the timing for recognizing revenue, disclosures, and taxes.

Background

The Financial Accounting Standards Board (FASB) issued Accounting Standards Update, *Revenue from Contracts with Customers* in May 2014. The standard provides companies with a single model for use in accounting for revenue arising from contracts with customers, and supersedes current revenue recognition guidance, including industry-specific revenue guidance. The core principle of the model is to recognize revenue when control of the goods or services transfers to the customer, as opposed to recognizing revenue when the risks and rewards transfer to the customer under the existing revenue guidance.

The effective date for public registrants has been deferred to 2018 for calendar year-end (annual reporting periods beginning after December 15, 2017). Early adoption as of the original effective date (2017 for calendar year-end) is permitted. The guidance permits companies to either apply the requirements retrospectively to all prior periods presented, or apply the requirements in the year of adoption, through a cumulative adjustment.

The delayed effective date and transition options are intended to allow companies a reasonable timeframe to comply. However, addressing some areas of the FASB Accounting Standards Codification may require longer lead-time, particularly related to revenue or billing systems where separation and/or allocation changes may be required, so companies should perform a preliminary analysis of the new requirements on a timely basis.

Considerations and challenges

The requirements in the standard may present complexity for companies in the engineering and construction (E&C) industry. Some of the challenges include:

Performance obligations — Under the standard, the performance obligations (i.e., the unit of account under current literature) may not be consistent with a company's current accounting policies or billing practices. Distinct performance obligations within contracts must be treated as separate units of accounting for revenue recognition purposes. Evaluating existing revenue contracts in order to identify such units could be challenging given the complexities of long-term construction arrangements. Additionally, the data to perform necessary calculations (e.g., standalone selling prices, contract terms and change orders, transaction prices) may be in multiple systems and may not currently meet applicable internal control requirements.

Revenue timing: "point in time" or "over time" — E&C companies have often used the percentage-of-completion method to recognize revenue from long-term construction contracts. Under the standard, companies would recognize revenue when control of a good or service is transferred to the customer, which could occur at a point in time or over time. Revenue recognition could be delayed and E&C companies may be required to recognize revenue at a point in time rather than over time, if specific continuous transfer-of-control criteria (as defined by the standard) are not met. Contracts currently accounted for under the percentage of completion method may need to be assessed to determine if they continue to qualify for recognition of revenue over time.

Fulfillment cost recognition — The standard requires capitalization of costs of fulfilling a contract when certain criteria are met. However, general deferral of costs, across different contracts and customers, may no longer be permitted. E&C companies may need to re-evaluate their existing long-term contracts and enhance processes, controls, and systems to confirm which costs would continue to qualify for capitalization.

Contract combination requirements — The standard may require a company that enters into multiple contracts at or near the same time with the same customer to be accounted for as a single contract when the pricing or economics for those contracts are interdependent. These contracts would need to be evaluated together, in terms of determining separate performance obligations and in terms of allocating the transaction price. These changes may cause a need for some companies to enhance their contract management systems and tools.

Disclosures — The disclosure requirements under the standard are significant and may require modifications to financial and management reporting processes and systems. This may particularly be the case for longer term contracts. Additional disclosures include, but are not limited to, disaggregation of revenue, certain information about changes in contract asset and liability balances and contract costs, and information related to the amount of the transaction price allocated to performance obligations not yet satisfied.

Tax — Certain tax implications may arise as taxpayers often follow the financial reporting revenue recognition methods in the determination of taxable income and transaction tax obligations. The changes may have cash tax implications, may require federal tax accounting method changes, or give rise to new tax temporary differences that may need to be captured, calculated, and tracked through tax provision processes and systems. Taxpayers who do not follow financial reporting methods for tax may also need to consider the impact of these changes on tax reporting and may need to change their computations and procedures, as well as consider potential tax method changes. Similar implications may arise in foreign jurisdictions that impose tax based upon statutory reporting maintained under either International Financial Reporting Standards (IFRS) or U.S. Generally Accepted Accounting Principles (U.S. GAAP), as this change may impact both standards.

Other implications

Organizations may need to consider other project needs, including:

- Implementation of updated or new processes, controls, and systems, where required
- Determination of new monthly closing process steps to accommodate the new requirements
- Steps to estimate the impact of the new standard, to facilitate understanding and planning by other key stakeholders
- Effective training and communication of new requirements
- Effective program and resource management related to this effort

Getting started

Some effective first steps to consider as you begin to evaluate the implications of the potential new standard may include:

- Evaluating significant revenue streams and key contracts to identify the specific revenue recognition changes required and the specific business units where these changes may have the greatest impact
- Addressing the longer lead-time areas where new calculation rules or revised allocation processes may be required
- Establishing a granular project plan and roadmap to manage the effort across multiple business units and countries

How Deloitte Advisory can help

We have an experienced team of professionals, both in the U.S. and globally across the member firms of Deloitte Touche Tohmatsu Limited, who can assist in developing an action plan to help you implement the new revenue recognition standard.

These capabilities includes the full breadth of services and competencies needed to help clients address these issues, and would include accounting assistance, help with process revisions, support in making system changes (including development of system business requirements), tax and other matters.

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