Episode 2: Deciphering the new revenue recognition standard

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Heidi: Hi, I'm Heidi Rataj and you're listening to Deloitte's UserFriendly, where we help your business decipher emerging tech, media and telecommunications trends.

Joe: There could very well be calculation rules or allocation processes that are going to be required to implement the new standard. And often times that requires some significant IT changes and what we're finding is that ends up being the long pole in the tent. I think it's really important to create a granular project plan; who are all the constituents involved in the implementation of the new standard because it will have an impact across many of the business units so getting it in writing and socializing it with the different business units and constituents I think is really, really important.

Heidi: The first world-wide principles-based revenue recognition accounting standard is about to hit US companies. The deadline to adopt the new guidance is quickly approaching. For companies impacted, time is of the essence and the challenge for companies is sizable. Who is ready and what are the possible impacts? Here with me today to discuss this timely topic are Bryan Anderson and Joe Talley. Brian and Joe, welcome to the show.

Joe: Glad to be here. **Bryan:** Thanks, Heidi

Heidi: Okay the new revenue recognition standard is just around the corner and companies need to prepare, what's the goal of the standard?

Joe: That was the sort overarching goal of the FASB and IASB was to improve comparability from one company to the next so that you wouldn't need to deal with the inconsistencies that result from the application and very specific rules that we currently have. It does make good sense to strive for comparability, in doing that it requires a fair amount of judgment on how to apply this new concept. Which is really focused on the transfer of control of goods or services.

Bryan: The new revenue standard was meant to finally align the revenue recognition policies for both US companies and international. Many people got very comfortable with rules-based accounting standards. You can have very strong and disparate views around how the standard should be applied to fairly similar fact patterns.

Heidi: So considering different views on the standard, what's the biggest challenge of implementation?

Bryan: The biggest ones I've seen is when you apply the standard and now something changes in the way you recognize revenue and essentially the contract information that you get from either contract system, the order entry system doesn't equal what you need to recognize. And when you have these issues, it doesn't necessarily mean you need to have five or six different accounting issues, it really only takes one to have a problem. And so one change can basically create, and if you have this in volumes of transactions, operationalizing these differences between I say data that comes in on the system and what you recognize can create very large system and operational process changes.

Heidi: So Bryan I'm guessing that the extent of these changes also depends on the type of company. For example, if there is a company that is simply selling widgets this impact may not be as great but a company bundling products and services, might be affected more by this?

Bryan: That's correct. I see a trend in revenue arrangements where companies believe that if they bundle more products and services together that they can increase the total value of not only the transaction but also the cash flow and earnings that they can receive from the business model. And changes all happening at one time, trying to get people to understand not only a new model but how the model would be applied to new revenue arrangements.

Heidi: Joe, with your background as both auditor and CFO do you anticipate significant changes for technology companies undergoing the new standard?

Joe: I've been at it for awhile now. I'm almost fully depreciated, some people will say, for about 38 years and for the last 20 or so I've been focused primarily on the technology sector. And there's all variety of different structures of revenue arrangements that have a number of different products and services. So you get a wide variety of different contract structures. You're also going to have in this transition from a rules-based to a judgment-based environment, you're probably going to see an acceleration of revenue for many technology companies which further increases the challenge of implementing the new standard.

Heidi: So there are implementation challenges, what about judgment versus rules-based accounting? Where do these challenges show up in technology companies?

Joe: Amongst the various challenges that tech companies has would be for example determining what your different performance obligations are in an arrangement, that requires a lot of judgment, and comparing one financial statement for one company to another for two companies that may be in the same sector, and may have competing products, you might have different judgments that are being applied as to what company A views as its performance obligations versus Company B. So the other aspect of that would with respect to the new standard is that it is now requiring much more footnote disclosure so that you can explain to the readers of the financial statements what those key judgments are because even if you think the new standard is not going to have an impact on your financial statements, it very well could have a significant impact on the breadth of the disclosures both quantitative and qualitative in your footnotes.

Heidi: The new revenue recognition brings us standardization, requires judgement and lots of footnotes, let's move to conversion. Bryan, how are companies doing with that?

Bryan: Really what I'm starting to see now is you know, I think there's a push for rationalization of hey this is really going to be the, not a big deal and here's why but the challenge I see with companies that acknowledge that maybe they have an issue is to really quickly digresses into what I'll say is the materiality discussion and trying to do the walk-thru on your policies and say okay we think this is an accounting difference, we don't think it's material, and kinda' being a former auditor and obviously knowing how our auditing practices

and everybody works, okay well , we can't go on we think it's not material you gotta go prove it and the level of effort to go and prove it it's not material can sometimes get you down a path where you pretty much have to go and calculate everything right.

Heidi: Okay so what are the best practices then to avoid the amount of time to prove something is a material fact?

Bryan: What I'd essentially do, if you haven't cleared the table, and said we don't have big issues, you really need to do that even if you can't do it in a systematic fashion, at some point even doing it in a manual effort that's not pretty, it's still going to take a lot of time to even make that happen so you really want to cross that off as soon as you can. And then the next step in the process is really to kind of get to those finer points and really conclude on here's exactly what we're going to do, here's our policy changes and then develop what's your plan of attack to address that. And also by the way when you're doing all of this making sure that you bring your auditors along for the entire ride is very critical, as they have to sign off and issue an opinion eventually on your position then you really can start getting into the meat of the implementation which is a combination of either a process, reengineering and/or really big projects will say I need to put in a new revenue allocation solution. Those are the really big meaty projects that you're implementing a new technology, you're putting together data flowing it thru a bunch of new systems and oh by the way, there's a variety of ways that revenue needs to be calculated once you get it into the system so now you got to test that all out as well. The time's running short on maybe getting an automated solution for your 1/1/18 but that doesn't mean you can't have the automated solution up and running before you have your first full year of financials.

Heidi: As a former auditor and now advisor, what do you see as the biggest learning curve?

Bryan: I've been with Deloitte for my entire career, I won't count the years because I like to pretend that I'm younger than I am but at the end of the day I still work very closely with Joe and our audit practice even though I do advisory work now and I'll say the biggest transition and learning curve that I've experienced from being an auditor and then moving over advisory are really two things: one and especially with revenue, it used to be you kind of knew the accounting rules and you didn't really need to understand the revenue transactions you just need the information. In order to really apply a principles-based model, the accountants and especially the revenue accountants really have to understand why the transactions are structured the way they are, why they're priced the way they are, why things you know are organized from a customer perspective because that means that you can really apply the standard in a way that you feel comfortable with because you know why things are priced the way they are, what the value drivers are and how things operate. The second part is great appreciation especially within revenue that it's more than just accounting white paper policy process. It's a big deal to do anything in the end-to-end revenue process from contracting, from billing, from fulfillment all the way into the GL and then to management reporting and external reporting, its uh, you touch one little area and but you pretty much touch the entire organization.

Heidi: Bryan I love your comment that it's more than accounting policy process and it does impact all areas of the company, that's really important to keep in mind. Joe, final thoughts for companies implementing the new standard?

Joe: Time is key here. Now of course before the standard becomes effective, certainly you really need to get started if you haven't already. Does that mean you don't have time to get ready? No. Does that mean that you really need to collaborate with those within your organization and actually outside of your organization, by that I mean those within your peer group, to share best practices, I'd say absolutely I think that this is an effort that requires a lot of interaction between a lot of parties. Your auditors, your peer group companies, others within your company and other departments including IT and outside consultants that you engage. We will all get there together it's very important to have that dialogue and that dynamic in place throughout your implementation phase of adopting this new standard.

Heidi: So it sounds like there's no need to panic but it is critical that companies are taking action to prepare themselves.

Bryan: Of the few early adopters that are out there, people are at various stages of implementation, what I'm seeing is there's always going to be more nuanced issues that come up at the end but you can't see those until you kind of start really getting into your implementation. And so, not only just getting the process started but having a reasonable expectation not to take your foot off the gas at any point until you're fully done because things will just naturally pop up and it happens everywhere. And hopefully people have that kind of open understanding that this is it gets more complicated before it gets easier.

Heidi: With the deadline quickly approaching, many companies have moved into high-gear to implement the new standard. They're working with their peer groups and including auditors early in the process. As we learned today, changes to revenue recognition can greatly impact how accounting systems and processes work with broad impacts to other parts of the organizations. I want to thank Bryan Anderson and Joe Talley for joining me today.

Bryan & Joe: Thanks. Take Care.

Heidi: I'm Heidi Rataj and from all of us at User Friendly, thank you. Next time UserFriendly

(Episode 3) : All the discussion around risk is about the risk of acting. You know, if I take this action what's the risk that it would fail but, what's never really addressed is what's the risk of not acting?

Heidi: We'll cover how to shape markets by taking risks and creating new value