



Revenue Recognition Challenges under ASC 606





Introduction

ASC 606, the new revenue recognition standard, brings about a few challenges for businesses. One major shift is the emphasis on recognizing revenue when goods or services are transferred to customers, which may not align with previous practices. Companies now need to identify performance obligations, or distinct promises to customers, and allocate the transaction price accordingly. This process requires a careful evaluation of contracts to determine the standalone selling prices of each obligation. Additionally, estimating variable considerations, such as discounts or bonuses, adds complexity. Businesses must regularly assess these estimates and make adjustments as needed, impacting how revenue is recognized over time.

Another challenge lies in the disclosure requirements. ASC 606 mandates detailed disclosures about revenue recognition in financial statements, aiming for transparency. Companies need to provide information on the nature, timing, and uncertainty of revenue and cash flows, making it crucial to maintain accurate records and communicate effectively with stakeholders. The transition to ASC 606 demands a thorough understanding of the new guidelines, robust systems to capture relevant data, and effective communication strategies to ensure stakeholders, including investors and regulators, comprehend the changes in revenue recognition practices.

What is Revenue Recognition?

Revenue, a pivotal indicator for business growth, is crucial for investors and decision-makers. This guide is designed for business leaders navigating global accounting principles. The revenue recognition principle, central to accrual accounting, stresses recognizing revenue when earned, not just when received. Accuracy is vital, leading to the introduction of ASC 606 by the Financial Accounting Standards Board (FASB), providing a structured framework. The International Accounting Standards Board (IASB) collaborated, issuing IFRS 15 for global consistency.

What is ASC 606?

ASC 606, the new global standard for revenue recognition, impacts all businesses engaging in customer contracts. Applicable to public, private, and non-profit entities, compliance became mandatory by the 2017 and 2018 deadlines. This framework, released by the Financial Accounting Standards Board (FASB) and International Accounting Standards Board (IASB) in 2014, offers a simplified, universal approach to revenue recognition. Replacing industry-specific standards, ASC 606 fosters transparency, and accountability, and facilitates seamless financial statement comparison across diverse industries.

ASC 606 and Revenue Recognition:

ASC 606, the revenue recognition standard established by the Financial Accounting Standards Board (FASB) and the International Accounting Standards Board (IASB), sets the rules for how companies, both public and private, record revenue in their financial statements. It became effective for public companies in fiscal years after mid-December 2017 and a year later for non-public companies. The core principle of ASC 606 is to recognize revenue when the goods or services are transferred to the customer, emphasizing transparency and consistency in financial reporting.

Guiding Revenue Recognition:

ASC 606, or the Accounting Standards Codification, plays a pivotal role in guiding companies through best practices in revenue recognition, offering a clear framework for reporting. Specifically designed to bring transparency, ASC 606 is particularly relevant for companies engaged in long-term contracts. This standard introduces crucial guidelines related to performance obligations and licensing agreements, which are fundamental in navigating the complex landscape of contemporary business.

By providing a step-by-step approach, ASC 606 aids companies in making critical distinctions between "earned" and "unearned" revenue. This is especially valuable in ensuring that financial reporting practices are standardized and transparent. The framework empowers businesses with a comprehensive methodology, addressing the intricacies of revenue

recognition for long-term projects. As a result, companies can enhance their financial reporting accuracy and align their practices with industry standards.

In essence, ASC 606 serves as a valuable tool for companies, offering a structured and systematic approach to revenue recognition. Its guidelines contribute to the overall consistency and reliability of financial reporting, providing stakeholders with a clearer understanding of a company's performance in the realm of long-term contracts.



Challenges in Revenue Recognition under ASC 606

ASC 606, the Accounting Standards Codification, set forth by the Financial Accounting Standards Board (FASB), outlines a structured approach for companies to recognize and report revenues. Despite its apparent clarity, companies often encounter challenges in adhering to this standard. Here are some prominent challenges faced during revenue recognition:

1. Complex Implementation Process:

Implementing ASC 606 involves a five-step approach, from identifying contracts to recognizing revenue. The complexity arises in determining the suitable time for revenue recognition and accurately measuring the transaction price.

2.Impact on SaaS Business Model:

The Software as a Service (SaaS) business model, while advantageous, introduces complexities in revenue recognition. This accounting principle, crucial for businesses of all sizes, becomes intricate within the evolving landscape of SaaS.

3.Challenges in Construction Contracts:

The transition to a control-based revenue model posed challenges, especially in the construction industry accustomed to the percentage of completion accounting. Sureties, major users of construction entities' financial statements, expressed dissatisfaction with this shift.

4.Custom Manufacturing Issues:

Entities engaged in custom manufacturing face challenges as the concept of a performance obligation satisfied over time affects a broader range of goods and services. This impacts suppliers manufacturing goods based on customer specifications.

5.Introduction of Material Rights:

ASC 606 introduces the concept of material rights, potentially allocating revenue between current and future transactions. Contracts offering customers options for additional goods or services may create separate performance obligations.

6.Interplay with Leasing under ASC 842:

Challenges arise in the accounting for performance obligations within a single contract when some fall under ASC 606, and others under ASC 842 for Leases. The dichotomy between lease and nonlease elements within a contract requires careful consideration.

7.Global Impact:

ASC 606 brings about universal standards, impacting businesses globally. This shift replaces industry-specific standards with a more consistent and transparent approach.

8.Need for Awareness:

The dynamic nature of accounting standards adds a layer of challenge, making revenue recognition intricate for businesses of all sizes. Heightened awareness of these challenges becomes imperative to ensure businesses produce precise and timely financial reports.

9.Ensuring Compliance:

The need for compliance with ASC 606 is crucial. Navigating the complexities requires strategic planning and adherence to the standard's structured guidelines, ensuring accurate revenue recognition across diverse business models.

Guide to Overcome Revenue Recognition Challenges

Here's a practical guide to overcome them and streamline your processes:

1. Segregate Data:

One common hurdle is disorganized data. Make sure to segregate and organize your data systematically. Utilize automated billing and accounting systems to aggregate data from various sources, ensuring a hassle-free and clear revenue recognition process. This practice not only resolves challenges but also facilitates easy analysis of metrics.

2. Recalculate Revenue as Per the Contract:

Stay updated with the latest contract models. The challenge often lies in tracking changes or modifications throughout the customer lifecycle, especially for subscription-based businesses. According to the new revenue recognition standard, such changes don't constitute a new contract. Automation becomes crucial for accurate analysis and allocation in these scenarios.

3. Focus on Event-Based Revenue:

Timing matters in revenue recognition, triggered by events like acceptance, consumption, or delivery. Automation becomes indispensable for keeping track of these events efficiently. Implementing automated tools ensures precision and eliminates the challenges associated with manual tracking.

4. Calculate and Allocate Standalone Selling Price (SSP):

SSP is the key to understanding the price at which a company would sell a promised good or service to an individual customer. Manual calculation of SSPs, especially with the new contract standards, can be time-consuming. Opt for automated tools integrated into your billing system, providing smart record-keeping and detailed insights on key metrics, simplifying your work.

5. Don't Forget Cost of Contract:

Often, companies overlook calculating the cost of contracts, leading to ambiguities in revenue recognition. Consider all revenue-related costs such as sales commissions, COGS, and others at the right time. To avoid challenges, ensure timely consideration of cost, adopt automated processes from billing to revenue calculation, and stay vigilant during each step before finalizing.

In summary, tackling revenue recognition challenges involves a strategic approach encompassing data organization, contract recalculations, event-based revenue focus, SSP calculations, and diligent consideration of contract costs. Automation emerges as the guiding solution, reducing errors, enhancing efficiency, and aligning with evolving accounting standards. Remember, a well-organized and automated system is your key to navigating the complexities of revenue recognition seamlessly.

Meru Accounting: Your Trusted Partner for ASC 606 Compliance

Navigating the complexities of ASC 606 compliance demands a strategic and expert approach. Meru Accounting stands as your reliable ally, offering comprehensive assistance to ensure a seamless transition and ongoing adherence to ASC 606 standards.

1.Expert Guidance: Meru Accounting provides expert guidance tailored to your organization's unique needs. Our seasoned professionals bring extensive experience in ASC 606 compliance, ensuring that you are well-informed and equipped to meet the standards effectively.

2.End-to-End Support: From initial assessment to the full implementation of ASC 606, Meru Accounting offers end-to-end support. We understand that compliance is an ongoing process, and our dedicated team is committed to assisting you at every stage, and alleviating the burden on your internal resources.

3.Efficient Transition Management: The impending deadline for financial statement filing requires a swift and efficient transition to ASC 606. Meru Accounting specializes in managing transitions seamlessly. Whether you need a comprehensive overhaul or assistance with specific tasks like contract review, our team ensures a smooth and timely compliance process.

4.Software Industry Expertise: With profound experience in working with software companies, Meru Accounting brings a nuanced understanding of the technical, operational, and financial intricacies involved. We tailor our approach to the software industry, ensuring that your ASC 606 compliance aligns seamlessly with your business model.

5.Customized Solutions: Meru Accounting recognizes that every organization is unique. Our approach is not one-size-fits-all; instead, we provide customized solutions. Whether you require complete transition management or specific services like system analysis or configuration assessments, our solutions are designed to meet your precise needs.

Focus on Your Business: By engaging Meru Accounting, you free up your internal resources to focus on core business operations. ASC 606 compliance can be intricate, but with us as your partner, you can confidently delegate the work, knowing that experts are handling it efficiently.

Conclusion

Revenue Recognition Challenges under ASC 606 are challenging and demand strategic solutions. ASC 606, introduced by the Financial Accounting Standards Board (FASB), serves as a comprehensive guide for proper revenue recognition. Despite its structured five-step approach, challenges persist, especially in the evolving landscape of the Software as a Service (SaaS) business model.

From complexities in contract modifications to challenges in construction contracts and custom manufacturing, businesses of all sizes face hurdles. The cooperation with leasing under ASC 842 adds further intricacy. These challenges highlight the need for vigilance and precision in implementing ASC 606.

Meru Accounting emerges as a key ally, offering expert guidance, end-to-end support, and customized solutions tailored to diverse business needs. Engaging **Meru Accounting** allows businesses not only to tackle challenges efficiently but also to ensure a seamless transition, freeing up internal resources for core business operations. In the evolving realm of revenue recognition, **Meru Accounting** stands as a steadfast partner, committed to steering businesses toward compliance success.

