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INDUSTRY OF IMPACT:

MANUFACTURING

Manufacturers will find the new standard may change the timing of revenue recognition. Transfer of control will drive revenue recognition rather than legal title or risks and rewards. This may result in some manufacturers recognizing revenue earlier or later than they had in the past.

This along with the following points warrant further consideration:

Timing of Revenue Recognition

Current Generally Accepted Accounting Principles (GAAP) treat manufacturing arrangements as product sales, recognized when goods are shipped or delivered to a customer (point in time). The new standard requires goods manufactured to unique customer specifications with no reasonable alternative use, which provide the manufacturer with an enforceable right to payment for work performed, be recognized over time. Alternatively, the new criteria for manufactured goods not meeting the over time criteria will use the point in time criteria but will rely on the transfer of control of the goods rather than the transfer of risk and rewards criteria under current GAAP.

Volume Discounts

Volume discounts can be applied towards future purchases or retrospectively. Manufacturers will need to review their sales agreements and any volume based discounts to determine whether a material right exists. Material rights are options provided to a customer only upon entering the contract and represent separate performance obligations under the contract.

Shipping and handling

Manufacturers will need to determine whether shipping and handling activities occur before or after control has passed to the customer. If before, these activities are considered a fulfillment activity. If after, the manufacturer may elect to treat them as a fulfillment activity or a performance obligation. When treating them as a fulfillment activity after control has passed, it will be necessary to accrue the costs associated with shipping and handling since all revenue will be recognized at the time control transfers to the customer.

Rights of Return

Much of the new standard's requirements for rights of return are similar to current practices. One difference though involves entities now having to present a right of return asset (representing an estimated value of products they expect to receive back) and a refund liability. This will be a change in practice from current GAAP for many manufacturers.

Reseller/Distributor Arrangements

Under current GAAP, manufacturers typically delay recognition of revenue until the reseller has sold the product and the price is fixed and determinable. The new standard will require manufacturers to apply the variable consideration guidelines and recognize revenue when the product is transferred to the reseller (ie, when control has passed).

Additional Resources

This is by no means a complete list of the new standard's effect on manufacturing. Please consult your financial partners at Ellin & Tucker or one of our Manufacturing Services team members to review the impact of the new standard on your company. Visit us at ellinandtucker.com or call 410.727.5735.

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SUMMARY OF CHANGES TO REVENUE RECOGNITION

FASB Accounting Standards Update No. 2014-09

The Financial Accounting Standards Board (FASB) issued Accounting Standards Update No. 2014-09, developed as part of the convergence initiatives of the FASB and International Accounting Standards Board (IASB) to align accounting standards, reduce industry specific complexities, and shift the thought process of recording revenue from a rules based process to a principles based approach. **This standard replaces nearly all existing revenue recognition guidance**.

The new standard will go into effect in calendar year 2018 for public business entities and calendar year 2019 for private companies. Implementation may also affect earlier periods.

MAIN PROVISIONS

The standard creates the following five steps for recognizing revenue:

1 IDENTIFY THE CONTRACT

A contract is an agreement between a customer and vendor for goods or services. It requires commercial substance, identification of the rights and obligations of each party, and has a high probability of fulfillment.

2 IDENTIFY THE CONTRACT'S SEPARATE PERFORMANCE OBLIGATIONS

These are the distinct goods or services to be delivered. A good or service is considered distinct if it is a separate line item in the contract and the customer can utilize it on a stand-alone basis. The goods or services should not depend on or significantly modify another deliverable.

3 DETERMINE THE TRANSACTION PRICE

The transaction price is the amount the vendor expects to be paid when the goods or services are delivered to the customer. The transaction price takes into account any discounts, financing components, variable and noncash consideration, as well as amounts payable to the customer.

4 ALLOCATE THE TRANSACTION PRICE OVER THE PERFORMANCE OBLIGATIONS

The total transaction price must be allocated to the distinct performance obligations. This is accomplished by accumulating the stand-alone prices of the deliverables and allocating the transaction price on a pro-rata basis. The normal selling price for the goods or services is used to determine stand-alone prices. If such price does not exist, a best estimate can be used.

5 RECOGNIZE REVENUE AS THE ENTITY SATISFIES PERFORMANCE OBLIGATIONS

Revenue is recognized as control of the deliverable passes from the vendor to the customer. This happens either at a point in time (buying groceries) or over time (construction project). Control is considered to have passed when the customer has the ability to use the goods or received benefit of the services. How this transfer takes place determines whether recognition occurs at a point in time or over time.

DISCLOSURES

Specifically, the new standard includes disclosure requirements for:

- Disaggregation of revenue
- Contract balance, including changes during the period
- Performance obligations
- Significant judgements
- Assets recognized to obtain or fulfill a contract, including changes during the period