FASB PROPOSED REVENUE RECOGNITION AND THE IMPACT UPON UNITED STATES CORPORATE FINANCIAL STATEMENTS

by

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ABSTRACT

The objective of this paper is to better understand how proposed revenue recognition principles by the International Accounting Standards Board (IASB) and the Financial Accounting Standards Board (FASB) will impact financial reporting in the United States. This thesis focuses on current revenue recognition principles, both in the United States and internationally. Furthermore, the convergence effort between the United States Generally Accepted Accounting Principles (U.S. GAAP) and International Financial Reporting Standards (IFRS) will be a significant influence upon the final revenue recognition rules. Additionally, an examination of the new revenue recognition rules will allow the reader to compare and contrast current and proposed rules. Finally, the implementation of new revenue recognition standards will have meaningful implications for both historical and future reporting. This research should be of interest to business men and women familiar with financial reporting in the United States. At the end of this paper, the reader will have a better understanding of the new revenue recognition principles and the effect it will have upon financial reporting in the United States.
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Introduction

The Financial Accounting Standards Board (FASB) and the International Accounting Standards Board (IASB) have delivered on a promise made over a decade ago to work together and converge certain aspects of the differing accounting standards. The two most influential accounting boards have issued a joint statement converging revenue recognition standards for contracts with customers named IFRS 15 and ASU 2014-09 on May 28th, 2014. This cooperation, in combination with an actual product indicates to the financial and accounting professional that the two institutions can work together. While the new standard is a positive indication of future efforts, the success of the joint project remains to be seen. Overall, the joint statement represents a significant move toward convergence between IFRS and U.S. GAAP that cannot be overlooked by interested parties.

The focus of this thesis and the associated research is to determine the impact that the new revenue recognition rules will have upon corporate financial statements and the financial reporting process in the United States. In the short-term, corporations will have to incur significant costs in order to effectively implement the new revenue recognition standards. While the practical implications are costly for public financial statement filers, a debate exists around the best manner to present financial statements for decision making. Issues such as contract structuring and the transparency of the financial statements will continue to be discussed by both the academic community and practicing professionals.
While the FASB and the IASB have multiple outstanding joint projects, including business combinations and financial statement presentation, revenue recognition has been in the works for many years. “Since 2008, the FASB and the IASB have collaborated on a converged revenue recognition standard” (Bloom and Kamm 49). This collaboration on revenue recognition also targets a vital aspect of the financial statements. Russell Golden, Chairman of the FASB was quoted saying, “The revenue recognition standard represents a milestone in our efforts to improve and converge one of the most important areas of financial reporting” (IASB and FASB issue converged standard on revenue recognition).

Those familiar with accounting understand the importance of revenue in the overall communication of financial information. The differences that existed between the two standards would result in material divergences throughout the remaining statements. The new standard is limited in scope and will focus on customer contracts. Specifically, how performance obligations are assigned to portions of the contract and when those separate obligations of the contract can be recorded as revenue.

The reminder of the thesis will analyze the new standards and discuss the implications for all stakeholders. First, the accounting institutions that created the new standard and the related organizations that have an interest in its success will be discussed. Additionally, the convergence effort that has taken place up until now will be explored for a greater understanding of the path that has led to the joint statement. A look at the underlying differences in accounting approaches, rules vs principles, will provide context for the structure of the new standards. Finally, the actual revenue recognition standard will be interpreted for greater clarity and the implementation of the standard will be explored. The joint statement regarding revenue recognition will be at the forefront of many
business discussions in the near-term and a great deal of understanding will be necessary for success of this project making this research relevant to all interested parties.

Accounting Institutions and Standard Setting

The joint statement by the FASB and the IASB regarding revenue recognition for customer contracts represents a significant step forward in a decade long effort to create a worldwide accounting standard. Originally, the United States had given authority to the Securities and Exchange Commission (SEC) to create and implement accounting practices for businesses that operated under its jurisdiction (publicly traded companies conducting business within the borders of the United States). The creation of the SEC in the United States was a result of the federal government needing more regulation on the financial markets and the reporting of financial information to the general public after the Great Depression. With the many responsibilities delegated to the SEC, accounting standards and specifically revenue recognition were among the most important. Without a singular accounting standard in place, there would effectively be no way for investors to compare companies or have confidence in the numbers that were being conveyed to them in reports. In 1973 the FASB was created to be the private sector liaison to the SEC in U.S. GAAP creation and Glenn Alan Cheney (2013) takes a close look at its 40 year history. The author notes that the Financial Accounting Standards Board was established after a long history of accounting standard setters such as the Committee on Accounting Procedure and the Accounting Principles Board of the American Institute of Certified Public Accountants. The previous accounting boards were required to be efficient in responding to accounting issues and create a philosophical framework from which future guidelines could permeate. After the previous boards were ultimately unsuccessful at
achieving the stated goals, a committee found that these organizations needed to consist of private industry experts and function independent of political pressures. Cheney goes on to describe the difficult issues that the FASB has faced over the years and particularly the important role that it has played in world events such as the Enron Corp. scandal. Furthermore, the FASB was integral in the transition from historical cost to fair market value accounting. This look at how the FASB came to prominence and the underlying factors that shape its decision making provide great insight into how it has addressed revenue recognition convergence with the IASB and IFRS.

After multiple groups were established and ultimately replaced under the SEC, specifically to prescribe accounting rules, the FASB was created and has remained the primary facilitator of accounting legislation. The international equivalent of the FASB was established many years later with a similar structure but ultimately different purpose. As the world became more globalized throughout the late 1980’s and 1990’s, the need for a uniform accounting standard was recognized by many nations around the world. When organizations such as the International Accounting Standards Committee (IASC) were unsuccessful at creating an enforceable standard, a new board with a similar organization to the FASB was established. The effort to establish an enforceable global accounting code began in 2001 when the IASB was created. The IASB remains the standard setting entity for IFRS with board members from around the world. The IASB will continue to work on creating an effective international standard and cooperate with U.S. entities throughout the process.

The new revenue recognition principles took many years of collaboration between various entities all around the world. While organizations such as the FASB and the
IASB were involved in creating the new language, many others provided support and input that shaped the eventual product. Furthermore, many regulatory bodies and private organizations will be involved in the implementation and education of the new principles throughout the United States. An overview of the involved stakeholders will provide a view into how the new principles were shaped and will be implemented.

The American Institute of Certified Public Accountants (AICPA) is a private organization that maintains ethical standards for all professional accountants in addition to establishing auditing standards for private companies. The AICPA will be involved in updating industry specific guidance to assist in the transition to the new guidance. Webinars, websites, short films, and briefs have been prepared to assist companies as well as public accounting firms understand the new standard and ease transition efforts. Another entity is the Public Company Accounting Oversight Board (PCAOB) which was established in the 2002 legislation, Sarbanes-Oxley. The goal of the PCAOB is to monitor and certify public accounting firms that audit public corporations in the United States. The PCAOB will have a significant part in the implementation of the new revenue recognition standard. This group will work closely with the audit professionals to ensure that the new revenue recognition standards are understood and followed moving forward.

To ease the transition process a group has been established by the FASB to serve as an intermediary between the auditors, board of directors, investors, and the regulatory bodies. The group will be named the Joint Transition Resource Group for Revenue Recognition (TRG). The TRG will report to the IASB and the FASB regarding issues that arise specifically out of implementation and will provide all stakeholders with the perspective and challenges that are being faced by implementers of the new standard.
This effort is intended to be proactive in seeking out issues that will surely arise from the impending transition. It remains to be seen how effective the group will communicate between parties and offer solutions. The TRG will be comprised of various stakeholders in order to accommodate and gain from multiple perspectives and interests including auditors, investors, and regulators. It is important to note that the TRG will not issue any new guidance or change any of the existing language. Members will instead focus on uncovering difficulties in the transition process and report them to the FASB and the IASB.

The effort to converge accounting standards on a single issue such as revenue recognition has been extremely difficult. With many different interests it is easy to see how difficult it can be to satisfy all groups involved with a single product. However, the FASB and the IASB have issued guidance related to revenue recognition of customer contracts. The various entities presented above will work in tandem with each other moving forward in both implementation of the new standards and any development of future standards. To further understand the difficulties involved in the process of issuing standards that are acceptable to all groups, the overall convergence picture should be understood.

Convergence

Convergence of accounting standards involves the merging of multiple standards into a single, enforceable set among various groups. Many different factors affect how the FASB and the IASB conduct themselves to achieve this goal. To begin, the Norwalk Agreement in 2002 set out the intent of the two boards to work collaboratively. This action was followed by guidance to incorporate international principles into U.S.
financial reporting practices by the SEC. However, the United States refuses to adopt IFRS partially as a result of its economic importance in the global economy. Overall, convergence efforts will continue despite any challenges between U.S. GAAP and IFRS.

The Norwalk Agreement is a joint memorandum of understanding between the FASB and the IASB issued in 2002. The two boards agreed that they would, “use their best efforts to make their existing financial reporting standards fully compatible as soon as is practicable and to coordinate their future work programs” (The Norwalk Agreement 1). This statement marked the first time that either organization made a significant statement to work with the other on various convergence topics. Additionally, the groups committed the necessary resources that would be required to complete the daunting project. The Norwalk Agreement has served as the basis for cooperation efforts since 2002 and encouraged other stakeholders to take action in converging U.S. GAAP and IFRS.

The term convergence has only recently become the most prominent term used in discussions, whereas harmonization dominated conversation after the Second World War until the new millennium. The primary difference between the two terms being, convergence is focused on the creation of one set of standards that every country is comfortable using while the earlier harmonization efforts centered on reducing differences among national accounting standards. This convergence mindset is summarized by Sydney K. Garmong (2012) in her article “The State of Major Convergence Projects”. The SEC, as a major stakeholder in the accounting process, understands the benefit to the United States that will result from better comparability of
financial statements across international capital markets. “The Commission continues to believe that a single set of high-quality globally accepted accounting standards will benefit U.S. investors and that this goal is consistent with our mission of protecting investors, maintaining fair, orderly, and efficient markets, and facilitating capital formation” (Commission 1). In 2003 a statement was issued by the SEC encouraging the FASB to incorporate international principles when creating guidance so convergence could be achieved in the near future. Garmong introduces multiple elements of accounting that have been successfully converged between the two standards including, business combinations, fair value measurements, and comprehensive income. All of these examples point to the efforts and importance placed upon the eventual convergence of the two dominant standards. However, the author emphasizes the fact that there are many political and bureaucratic challenges that will most likely keep IFRS from replacing U.S. GAAP. It appears while convergence is the ultimate goal for many parties involved; harmonization will have to suffice in the medium-term as vast differences will persist between the boards well into the future.

While U.S. GAAP has been in place for many years in the United States, almost every other industrialized country is using IFRS as of 2014. The United States has opposed implementing international standards or converging U.S. GAAP and IFRS for a variety of reasons. The primary reasons that the United States has not adopted international standards are explored in the research of Ramanna and Sletten (2009). Ramanna and Sletten inspect national characteristics that are likely to affect the adoption of International Financial Reporting Standards by any given country. The research focused primarily on non-European Union countries and examined characteristics such as global
influence of the nation’s economy and network of trading partners who support IFRS usage. The initial conclusion found that countries with more economic prowess are extremely less likely to adopt IFRS as an accounting standard primarily because of the power they would have to cede to outside interests. The decision to give up power to other bodies of standard setters, especially to other countries around the world, is unsatisfactory given their relative importance in the capital markets. The prime example of their research is the United States which has been insulated from outside pressures in the past because of overwhelming recognition of its economic authority. This research provides additional evidence why IFRS adoption has failed to be implemented in the United States thus far. Furthermore, it sets the stage for the recent efforts of collaboration between the FASB and the IASB toward convergence on a single unified accounting standard.

Convergence is a complex issue that has been the focus of international organizations for over a decade. The Norwalk Agreement between the FASB and the IASB formalized the convergence effort by stating the goals of each organization with respect to the collaboration effort. Later, the United States recognized the importance of implementing portions of international standards as a method of slowly transitioning to a more closely aligned standard. Alternatively, the United States has economic clout that has prevented it from adopting IFRS altogether and will prevent such action in the near future. To further converge IFRS and U.S. GAAP, standard setters must agree that a converged accounting standard is superior to the current method.

The revenue recognition standard for customer contracts issued by both the IASB and the FASB represent a large move by the two boards to converge accounting standards. The
idea of a converged accounting standard is appealing for many different reasons that need to be understood. Additionally, there are drawbacks to a converged accounting standard that will prevent international organizations from achieving this lofty goal. A better understanding of the benefits and drawbacks to a converged accounting standard can provide an insight into the challenges faced when creating international accounting standards.

The new revenue recognition rules will serve as an example of what can be accomplished by the two boards and drive efforts in the future toward overall convergence. The fundamental difference in the two standards originates from the theoretical approach to accounting and the presentation of the financial statements. U.S. GAAP has traditionally been focused on rules and specific guidance to be followed across multiple industries and circumstances. On the other hand, the IASB and subsequently the IFRS standards have always held a more principles based approach that allows more room for judgment and relevant information. The new standards proposed by the FASB are an attempt to produce U.S. GAAP policies that are more principles based and more generally in-line with IFRS thinking. It remains to be seen how the new proposal will be received by United States corporations and what this new alteration means in terms of future standard development.

As convergence efforts continue, it is important to understand why a converged set of accounting standards would be beneficial to stakeholders involved. The argument in favor of a single accounting standard is the access that will be available to more companies and capital markets. Using one standard will allow all capital markets to operate on the same basis and open up investment opportunities in companies that were previously closed. The increased amount of capital available to corporate entities will
lower the overall cost of capital for business and encourage investment in projects to expand operations. The result of the unified standard would be increases in international capital flows, business transactions, and trade. Furthermore, global comparability will provide investors a better means to evaluate business and make the correct investment decisions. Finally, a single standard would have a meaningful reduction in the cost of preparing financial statements. Presently, companies that are cross-listed on multiple exchanges must provide multiple forms of their financial statements. By reducing the required number of statements to produce and subsequently have audited, fewer expenses will be incurred. The various benefits of a converged accounting standard would impact many nations and businesses around the world.

A single unified accounting code has many hypothesized benefits that involve access to capital markets and global comparability. Many opponents also exist that proclaim the benefits of the IFRS standard are outweighed by the drawbacks. Investor protection is a primary goal of U.S. GAAP because public equity is the primary form of capital funding and IFRS is believed to be inadequate for this purpose. The goal of stakeholders is to produce high-quality accounting standards that will translate into high-quality financial statements. IFRS fails to set strict guidance for important areas including revenue recognition. The United States has pushed back against IFRS adoption for this reason. Additionally, opponents of a single standard believe that cultural differences across nations such as auditor and regulatory authority demand different accounting standards to be effective. Although the revenue recognition standard is now agreed upon by both the FASB and the IASB, many factors remain at the fore-front of the discussion including the underlying accounting philosophy and the international community.
Rules vs Principles

The theory behind accounting standards usually falls into one of two schools of thought; rules or principles. The two ideas differ in many respects when applied to practical issues such as balance sheet presentation or revenue recognition. To gain a perspective on the differences, it is important to understand how current accounting standards in the United States operate, namely a rules-based approach. In contrast, the international community has adopted an approach based primarily upon principles which has its own benefits and drawbacks. Finally, given the history of the United States regarding regulation, the hesitation to move to a principles-based approach is more clearly recognized. The United States has been using rules based legislation since accounting standards were first implemented and it will be difficult to change the prevailing mindset.

Approaching accounting code from a theoretical framework can often times be difficult without the proper background. The United States code for financial reporting, U.S. GAAP, has been written, from the beginning, to use rules as a means of explaining the desired outcome of financial information. The rules-based approach provides tremendous depth and description for any given accounting topic to be conveyed to the general public and investors. The details of the standards are much more extensive compared to the equivalent interpretations of IFRS. This has the negative effect of hindering that auditor’s ability to correctly relay a transparent financial statement in some cases. Currently, the view of a rules-based approach is that it is, “undesirable or inappropriate…fostering an alleged current check-box or compliance mentality that is, in the view of some, an open invitation to financial structuring and other activities that subvert high-quality financial reporting” (Schipper 62). For example, the rules for determining a capital lease versus an
operating lease has always been very clear with any one of four criteria triggering a
capital lease classification. One such criterion is if the life of a lease is greater than or
equal to 75% of the leased asset’s economic life, capital lease accounting is required.
This situation has led to managers structuring the contracts so that the lease is 74% of the
economic life to avoid capitalizing the asset. Rather than requiring management to report
the economic reality of the transaction, the auditors would simply mark that the criteria
were not triggered. While the downsides of rules are the lack of flexibility, the upside is a
procedural description that ensures adequate levels of investor protection. The forced
compliance keeps every aspect of financial reporting consistent and is biased toward the
conservative side so that there is little room for manipulation to take place. The rules
based approach has been utilized by the United States for many years and it shall remain
that way until a principles based approach is fully adopted.

The United States adopting a rules based approach from the very beginning has greatly
influenced subsequent standard setting. In contrast, the international community has
moved to adopt a principles based approach to accounting. The principles based approach
can most accurately be described as having a goal in mind with regards to a singular
accounting issue, and providing accommodation for the process to achieve that goal.
IFRS proclaims many benefits are captured by allowing for open interpretation and more
decision making being placed in the hands of professionals. “…A principles-based
system is desirable, because such as system allows (or requires) the appropriate exercise
of professional judgment” (Schipper 61). The basis of this argument is found in the fact
that the professionals who put together these financial statements and work with the
company everyday have a better understanding of the correct information. Furthermore, a
principles-based standard will have less trouble with law enforcement since there are multiple ways to present the information within the legal scope. As a result, enforcement agencies such as the Securities and Exchange Commission will have less prosecution to undertake specific to accounting misrepresentation. In contrast, the ability for managers to structure the financial statements could lead to less protection for investors. Opponents of the principles-based approach anticipate management will structure deals and present financial statements in a way that presents them in the best light rather than providing the most transparent and relevant information for making decisions. The two different approaches will ultimately result in the same amount of revenue being recognized according to the contract. The primary issue is the period when those revenues will be recognized and ultimately if the financial statements have been manipulated by management at the detriment of stakeholders. Despite the large differences between the two approaches, the overall convergence effort is focused on the principles method moving forward.

As the United States moves toward convergence, many practical issues will have to be resolved that have very little to do with theory. First, the financial statements that have been prepared in the past will not be consistent with more recent releases and create comparability issues. As a transition occurs, many costs will be incurred by both auditors and companies in providing revised financial statements so that comparability between periods can still exist in the short term. Second, recent legislation that centers on corporate governance such as Sarbanes-Oxley may come into conflict because of the specificity placed upon certain aspects of financial reporting. Third, the education of professionals has been focused on the current rules approach to accounting and a period
of retraining will be required in order to have financial statements prepared according to the new standards. In conclusion, there are many considerations that must take place before the transition to a truly principles-based approach can be implemented in the United States.

The United States remains the only large industrialized nation that has not adopted IFRS. Countries around the world have adopted this method of financial reporting while the United States retains US GAAP. The fact that every other country has adopted IFRS points to a desire for a singular, unified code. Furthermore, the international community and the IASB have demonstrated their desire to see the United States adopt IFRS in the near future. Finally, despite hesitation to adopt, the United States maintains a significant presence on the IASB and influences how IFRS is crafted. The international nature of this situation is extremely complicated; however, all signs point toward the international community pushing for the United States to adopt their standards.

Countries other than the United States that participate in financial information reporting have unanimously proclaimed that IFRS is the standard of choice. First observations would make it appear as though a singular worldwide code would be unobtainable considering the differences in option and culture that exist around the world. However, given the principles-based approach and the flexibility of information presentation, the global community has decided to adopt IFRS standards. As a case study, the Australian government reported that adoption of IFRS would bring numerous benefits to their capital markets when convergence took place from the mid-1990s through the 2000s. “…a single set of high-quality accounting standards, which are accepted in major international capital markets, will greatly facilitate cross-border comparisons by
investors, reduce the cost of capital, and assist Australian companies wishing to raise capital or list overseas” (Australia 2005). All of these benefits derive from the singular fact that international cooperation has resulted in an ongoing and ever-changing code with input from a diverse global community. Although there are many critics of a unified code that argue its true worth, countries still would like to see the United States use the international standard.

The worldwide group of territories that adopted the IFRS standards have benefited in many ways from the convergence of accounting standards. This group would like to have the United States adopt similar rules as a means of gaining the same benefits that it already enjoys with other countries. Once the United States has fully adopted IFRS, the other countries of the world will have a better platform on which to communicate financial information, in conjunction with the other benefits discussed above. Additionally, the members overseeing IFRS view the United States as an important piece in the overall acceptance of its worldwide standard. “The Trustees of the IFRS Foundation acknowledge that much of the worldwide success of IFRS is a result of the willingness of the U.S. to engage in convergence, to accept IFRS as issued by the IASB for foreign U.S. cross-listed companies, and to consider adoption for U.S. domestic companies” (Kaya 277). The fact that the United States currently adheres to its own rules creates tremendous difficulties for cross-country information sharing. Currently, the SEC does allow foreign corporations to report using IFRS, but requires certain alterations to be made before publication. Overall, the international community and the United States would both benefit on many levels from convergence of accounting standards. Finally,
the United States is not isolated from international accounting code as it actively participates in crafting the rules and regulations for IFRS.

Since the United States creates and adheres to its own accounting rules while the rest of the industrialized world follows slight variations of one code, it would appear that the U.S. is insulated from international standard making. However, since the inception of the International Accounting Standards Board in 2001, there have always been positions for a North American board member. This position was given to North America as a way of achieving geographical balance among the different regions of the world. “To ensure a broad international diversity, from July 2012 there will normally be four members from the Asia/Oceania region; four from Europe; four from North America; one each from Africa and South America; and two appointed from any area, subject to maintaining overall geographical balance” (IASB). The fact that Americans are involved in the standards making process, yet do not adhere to its laws is a point of contention among many other countries that see this as the United States overreaching its jurisdiction. In the near future, the United States will continue to be pressured toward adopting the legislation that it has participated in creating or relinquish its position on the board. As discussed earlier, both options are not appealing to the United States as either requires the relinquishment of the power it currently holds. The fact that the United States maintains a seat on the board that creates accounting code, which does not apply to the United States, further presses the point that international organizations are asking for the United States to make a significant effort to converge accounting standards.

The international community and the IASB have pushed the United States to converge accounting standards for many years. The participating countries benefit greatly from the
combined effort and ease with which information can be shared across capital markets. The inclusion of the United States in a singular accounting standard would further extend these benefits to both parties involved. Also, considering the active role that the United States already has in the creation of the international standard; many countries argue that convergence is a natural action. In conclusion, there is a heavy amount of pressure being applied to the United States from the international community for convergence.

Revenue recognition is seen as the starting point in what can become a continued effort to converge remaining standards discrepancies. Revenue recognition is a vital part of financial accounting and impacts many decisions made by managers and investors. The joint statement issued by the FASB and the IASB on May 28th, 2014 will have a large impact upon all financial reporting stakeholders in the coming years.

FASB and IASB Joint Statement

The FASB and the IASB issuing joint standards regarding revenue recognition for customer contracts was a significant step forward in the convergence of U.S. GAAP and IFRS. However, the new standard requires examination to understand how it will be used moving forward. The new standards follow a more principles-based approach indicated by the short length and minimal guidance. Furthermore, this new standard is quite different from the now outdated version of U.S. GAAP. Finally, the new standards will remove long-standing rules for revenue recognition that were applicable under U.S. GAAP. The new standard will affect many companies throughout the United States as it differs in material aspects from the standard that is being replaced.
The new standard is shorter than its predecessor and can be broken down into individual pieces for application. This standard focuses only on revenue recognition for contracts with customers and is separated into five distinct steps to be followed for any revenue recognition. First, a contract with a customer must exist with the necessary elements of offer, acceptance, and consideration being present. This can be either a formal written document, a verbal contract or implied based upon ordinary practices of the two contracting entities. Second, the seller must identify separate performance obligations in the contract. Third, determination of the overall transaction price for the contract and goods or services rendered is required. Fourth, the transaction price must be allocated to the separate performance obligations according to what the firm earns from fulfilling that aspect of the contract. Fifth, revenue may be recognized as the entity meets the performance obligations. The new standard comments that the performance obligation is met when a promised good or service is transferred to the customer. Bundled products will have to be broken up into separate performance obligations if they are distinct from each other or if each part provides a benefit to the customer on its own. “Promised goods and services represent separate performance obligations if the goods or services are distinct. A good or service is distinct if the customer can benefit from the good or service on its own or together with other readily available resources (i.e., the good or service is capable of being distinct) and the good or service is separately identifiable from other promises in the contract” (The New Revenue Recognition Standard 10). The new rules are noticeably different from U.S. GAAP rules and material differences in reporting exist as well.
As rules are eschewed for the principles approach, greater understanding of the methods used will be required. As a result, more extensive disclosure of the accounting used will change how companies report their earnings. “Extensive disclosures will be required, including disaggregation of total revenue; information about performance obligations; changes in contract asset and liability account balances between periods and key judgments and estimates” (IASB 1). The obligation for reports to contain disclosures will provide greater transparency regarding the interpretation of new revenue recognition principles. However, a greater effort will be needed to understand the recognized revenue for users of financial statements. Furthermore, the new principles will require a higher level of professional judgment and commitment to reporting the appropriate information. All of this will require more effort on the part of financial statement users than previously. In addition to the required disclosures, old revenue recognition standards will no longer be applicable to U.S. companies.

Previous revenue recognition standards under U.S. GAAP had been industry specific and detailed regarding the appropriate method to use. The new standard will replace standards such as percentage completion and how licenses are recognized. “Current GAAP approaches including percentage of completion on long-term contracts, completed contracts, installment sales, and cost recovery will be changed. They will no longer be used” (Bloom and Kamm 50). The rule change will primarily affect businesses that operate with contracts that span many years including those in the construction, technology, and telecommunication industry. Businesses with a short term cycle such as retail will only have specific aspects affected by the new accounting standard. Contracts can now be separated into many more performance obligations than under U.S. GAAP.
For example, the construction of a school by a private company for the state government may span three to five years. Under previous methods such as percentage completion, if 20% of the construction is completed in the first year, 20% of the total revenue from the project would be recognized in the first year. Under the new revenue recognition standards, the builder might complete 20% of the work but recognize 45% of the revenue since they are able to allocate a greater portion of the revenue to the tasks completed at the beginning of the project. Another aspect that will be changing is the collectability requirement under U.S. GAAP. “Reasonable assurance of collectability is one of the four fundamental revenue recognition criteria” however, “under the new guidance, assurance of collectability will not be a recognition criterion and, for contracts without a significant financing component, transaction price will be equal to the amount of consideration to which the reporting entity is entitled – not the amount that the reporting entity expects to receive” (Starczewski 6). It is important to note that collectability will “still be an important concept in determining whether a contract exists” (Starczewski 6), even if it is not a criteria for recognizing the revenue. This readjustment will have significant impact upon contracts that are currently in place and future negotiations between parties.

Revenue recognition is an important aspect of many corporate operations and has now changed moving forward. The new guidance is more general in its approach and follows a five step process. Additionally, the new standard will require greater amounts of disclosure to ensure that the users of financial statements have a complete picture of the revenue recognition methods implemented. Furthermore, old methods of revenue recognition such as percentage of completion or cost plus project accounting for contracts will no longer be in use. Finally, the new standards can be separated into a greater
amount of performance obligations and collectability has been removed from the requirements for recognizing revenue. The new standard is vastly different from the rules that U.S. companies are accustomed to using and will impact how revenue is reported.

Implementation

The new accounting principles for revenue recognition regarding customer contracts will require detailed understanding by all involved parties before implementation occurs. Before the official date of implementation arrives, companies and managers specifically, will need thorough preparation. The effective date for public and private companies differs by one year and will be applicable at different times. Therefore, it is important for companies to understand the cut-off date that is applicable to their situation. However, the AICPA has released best practices guidance for companies to use in the interim. Furthermore, initial practical difficulties should be recognized by implementing parties to avoid pitfalls. Implementation of the new revenue recognition standard will be difficult even after the effective date has passed.

Companies that will be implementing the new revenue recognition rules will need to be fully prepared once the effective date has passed. For public companies that are filing with the SEC, December 15th, 2016 represents the official date. Prior to that date, public companies will not be allowed to utilize the new standard if they are filing using U.S. GAAP. “Early adoption is permitted under IFRS, but not for public entities reporting under US GAAP” (IASB 2). For private companies, the effective date is one year later on December 15th, 2017. Early adoption is permitted, however most companies will use the extended time frame to adequately prepare. The effective dates for transition will
approach very quickly and the AICPA has issued a framework to assist companies in their preparation before these dates.

The AICPA released guidance related to the implementation of the new revenue recognition standards. This is an ongoing effort to assist in the implementation process for corporate entities. The first step suggests that management, “assign individual company staff or a small task force to become experts and take the lead on understanding and implementing the new revenue recognition standard” (New Revenue Recognition Accounting Standard 3). This will need to be personnel that are familiar with accounting and have time to dedicate to this project. Next, “evaluate the changes from current GAAP to the new revenue recognition standard and evaluate the impact on how your company accounts for existing revenue streams and the results to the company’s financial statements” (4). This step also requires that the task force look at other areas that may be affected by the change such as performance metrics and compensation plans. Third, “determine how you will retrospectively adopt the new revenue recognition standard and how to track the accounting differences” (5). Again, an understanding of the appropriate methods for restating will be required. Fourth, “determine whether any changes will need to be made to IT systems or software applications to capture information needed for the new revenue recognition standard” (6). Existing methods of data collection or accounting software will need to be reviewed to avoid any material misstatements related to the new recognition principles. Fifth, “determine what interim disclosures will need to be made before the revenue recognition standard is effective” (6). Interim disclosures will be needed to aide in the transition period for users of the financial statements. Sixth, “develop an evolving project plan for implementation of the revenue recognition standard
considering all of the steps above and facilitate training for your staff” (7). Once the small group of personnel understands how the new revenue recognition principles will affect the financial statements and systems of the firm, a specific plan is needed to achieve the changes previously identified. Finally, “educate key stakeholders (audit committee, board of directors, and investors), on the new revenue recognition standard and what changes to expect in your company’s financial statements” (7). The remaining members of the firm will need to be informed of the discoveries that have taken place and how their roles will be impacted by the changes. While this outline will serve as a helpful starting point for many corporate managers, certain practical difficulties will still exist in the transition period.

While stakeholders including the AICPA and the SEC are taking proactive steps to ensure that the transition period is accomplished as best as possible, certain practical difficulties still exist and will need to be addressed. One of the AICPA steps involves assessing the existing corporate infrastructure and software for compliance with the new standard. These complex systems will need to be adjusted to collect the appropriate data which can involve hundreds of man hours and incur additional costs. These systems will require some adjustment but the extent of the changes are yet to be fully understood and will vary from firm to firm. “It’s a bit too early to predict, though, whether companies will need widespread systems changes or overhauls just to accommodate the new revenue recognition standard” (Tysiac). Furthermore, the task force that will be assigned the duty of understanding the changes will be pulled away from existing duties. Firms will be required to either hire additional personnel or consultants to accomplish this task in a timely manner. The need for the task force to undertake such a large and pervasive
project will add to the cost and complexity of the human resources department, IT services, and management. Finally, the need to educate large groups of workers at these firms will prove difficult depending largely upon the size of the organization. Smaller firms may have a more streamlined process for education; however larger organizations will have to implement learning on a bigger scale. This will again add to the costs of the project, require significant man hours to be used in place of work, and the effectiveness of the training will vary from firm to firm creating some inconsistencies. The practical difficulties associated with the implementation of the new revenue recognition principle will prove to be costly to all firms affected.

New revenue recognition principles will require a significant implementation effort for all stakeholders involved in the process. The effective dates for transition have been disseminated and will be different for public and private corporations. To aide in the transition, the AICPA has established a guideline for companies to utilize the remaining time before the new standard is required. Despite all of the efforts to simplify or hasten the transition, practical difficulties will remain that hamper business’ ability to conform to the new principles. The stakeholders will continue to address issues as they arise and assist companies in their implementation efforts.

The move to a converged customer contract revenue recognition standard is seen by many professionals and academics as a positive move. However, opposition to the new revenue recognition joint statement exists as well and has many stakeholders uncertain of what the future will hold. Transparent financial information is key to the use of financial statements and many will argue that under the principles based approach, transparency will be lost as more professional judgment is used. Furthermore, the alteration of
historical reports presents a unique and costly challenge for many companies. The necessary understanding of the process and changes to previous interpretations could impact perceptions of the company’s operations. Next, the need to review current contracts and alter how future contracts are structured will require experts on the issue and significant effort for certain personnel. Finally, the changes in revenue recognition have many investors and creditors worried about the potential outcomes of the new standard on the review process. Thus, an increased level of scrutiny can be expected from users of the financial statements until they become more comfortable with its application. The opposition to the new revenue recognition rules will shape how implementation is achieved and the measure of its success.

The new revenue recognition standards for both U.S. GAAP and IFRS will take time to become trusted by the users of financial statements. The transparency of the financial information being conveyed is a primary concern of all financial reporting stakeholders. The new standards provide less structure and specific rules that require a greater amount of professional judgment by the company’s management and its auditors. “But the new standard is critical to meeting U.S. Generally Accepted Accounting Principles, making it vital for company credit access and bonding capacity. Lenders and sureties are "scared to death" because the standard creates situations where "judgment rather than a set of rules determine when things will come into play." Banks and bonding firms may boost client analysis, although this may ease once the standard is better understood” (Illia 1). The openness of the standard allows managers to manipulate the structure of contracts to meet their own goals. Furthermore, the various contract structures can be justified as long as they meet the five requirements laid out by the FASB and the IASB. While extensive
disclosures are required under the new standard to aide in the presentation of transparent information, managers will be able to manipulate the true economic reality of the situation. This can be accomplished by shifting a large portion of the total contract value to the beginning of the work in order to recognize revenue in an earlier period. Additionally, the wide range of acceptable methods across multiple industries and management teams will harm the comparability of financial statements. One management team may be committed to recognizing revenue evenly over the course of multiple years while another will front-load the contract. This will result in reported figures that are not consistent and users of financial statements will have a more difficult time deciphering the economic picture. While transparency remains an issue, corporate entities will have to revisit historical financial statements as part of the transition process.

The need for comparability of financial statements across multiple periods is important for all users of financial statements, especially investors and creditors. The change in revenue recognition will create discrepancies between historical revenue figures and future numbers. As a requirement of implementation, a restatement of historical financial reports will be needed by all affected companies. “Under the full retrospective method, public entities would be required to restate two comparative years prior to the implementation date” (Tysiac 40). Two methods for restatement will be allowed, the full retrospective method or an alternative method that will apply the new standard to new contracts only. The full retrospective method will provide the greatest amount of comparability; however it will also require the greatest amount of effort and expedited action. “Using the full retrospective approach could be difficult because it may require systems to be ready to capture data to perform dual reporting as early as the beginning of
2015. This could mean a substantial overhaul in business processes, accounting systems, and employee trainings” (Tysiac 41). The need for immediate changes in the accounting procedures stems from the requirement that two years of previous financial statements be reported when the standard takes effect in 2017. The vast amount of changes that would be required to begin capturing the appropriate data would be expensive to companies and require expertise. In contrast, the legacy method will be easier but provide less comparability to users of the financial statements. “Under an alternative method, the new standard would be applied only to contracts that are not completed under legacy IFRS or U.S. GAAP at the date of initial application. Entities would recognize the cumulative effect of initially applying the new standard as an adjustment to the opening balance of retained earnings in the year of initial application. Comparative years would not be restated, but some detailed additional disclosures would be required” (Tysiac 41). This could have a negative impact upon companies in the short-term as creditors and investors adjust to the new revenue figures. Companies implementing the new revenue standard will incur additional costs to adjust their financial reporting, serving as another point of contention related to the new revenue standards.

Many professionals in the United States have used U.S. GAAP revenue recognition rules since they received their education. These professionals will need to retrain in order to understand the new rules and apply them in a satisfactory manner in the future. The total costs associated with the new standard are not fully understood by firms or the regulators and will vary from company to company. This education process will be expensive both in terms of cost and lost productivity for all affected companies. The internal effort that will be required by each firm to educate not only the staff accountants but also the
internal audit committees, management, and perhaps the board of directors will be significant. “Education should go upward, too. Board members should be kept up to date on the changes and their implications” (Tysiac). This process will need to be developed quickly by the firms or contracted to outside experts in a timely manner to meet the transition deadline. Previous systems and the related experience will also be adjusted resulting in lost efficiencies and lower productivity in the short-term. Opponents of the new rule see the education and retraining requirements as one of the largest and most pervasive issues that will affect companies during this process.

Contracts that are in progress at many companies will require review once the new standard is fully implemented. Depending upon the method of implementation, changes will be required to either existing contracts or the structure of future deals with customers. Under the full retrospective method, revenue will need to be analyzed and perhaps restated if the assignment of revenue to performance obligation changes the correct amount to be recognized. Revenue may have been recognized for certain aspects of the contract in previous periods that will apply to work that is scheduled to be completed in the future. Conversely, additional revenue may need to be recognized in prior periods that were expected in the future. It is important to note that contracts that are made and completed within one reporting period will not need to be restated or require explanatory disclosures. This correction could impact the future cash flows of companies with multiple affected contracts. The effort to review most outstanding contracts as well as restate previous revenues will require significant effort and firm resources to complete.
The opposition to the new revenue recognition standard for customer contracts has many points that will need to be addressed by regulatory bodies. Transparency of financial information may be compromised under the new system and users of financial statements are not pleased. Furthermore, historical financial reports will require one form or another of restatement to ensure comparability, resulting in complications for the firm and significant effort. Additionally, the education of all personnel involved in the financial operations and reporting of the company will be expensive in both costs incurred and lost productivity. Finally, the review of current contracts and revenue streams will prove time-consuming for the accounting departments for all firms involved. The opposition to the new revenue principle will be incorporated in discussions to ease the transition and will result in a more effective standard.

The joint statement made by the FASB and the IASB effectively represents the convergence of revenue recognition for contracts with customers. However, the FASB issued ASU 2014-09 for US. GAAP and the IASB issued an update to IFRS 15 for international standards. The two standards represent the same method of accounting, but differ in very minor respects. First, collectability must be “probable” which has different thresholds for the two standards at present. “the Boards used the term “probable” to describe the level of confidence needed when assessing collectability to identify contracts with customers, which will result in a lower threshold under IFRS than US GAAP” (A Closer Look at the New Revenue Recognition Standard 2). Second, the FASB demands more disclosure related to revenue recognition as a means of providing the appropriate level of detail during the transition period. Third, “the FASB provides relief for nonpublic entities relating to specific disclosure requirements, the effective date and
transition” (A Closer Look at the New Revenue Recognition Standard 2). The difference in adoption dates for public companies and non-public companies differ from IFRS which will allow early adoption of the standard by all corporate entities. The minor differences will not have a material effect on comparability between the two standards as the remainder of the guidance is identical.

The FASB and the IASB have made tremendous strides towards convergence with the joint statement regarding revenue recognition. Between now and the implementation dates, the FASB specifically will be working on creating a smooth transition for all stakeholders. Corporate entities will have significant costs arise as a result of changing accounting systems and more importantly retraining current staff. Additionally, the FASB will have to work on a systematic approach to ensuring that managers do not deliberately alter contracts to create the best situation rather than the proper economic reality. As a result, the financial reports will be subject to a greater amount of scrutiny in the near-term until the full impact of the new standard is understood by the users of the financial statements. Once implementation is complete, growing pains will still persist and require the attention of the two boards and the FASB in particular.

Conclusion

The joint statement issued by the IASB and the FASB relating to revenue recognition was a significant step forward in the overall work of the two boards. The various stakeholders both in the United States and internationally will continue to influence the standard and work toward successful implementation. The convergence effort is one step closer to realization as the result of this work between the two boards and will determine the
success of future projects. The potential benefits of a converged standard including increased capital flows between the international community and the United States could greatly benefit businesses. Even though the new standards will implement a principles based approach, the debate involving the academic and professional communities regarding the best method for reporting financial information will continue for a long time.

The new standard will be implemented by corporate entities in the next few years, replacing existing methods of U.S. GAAP revenue recognition. This implementation effort will provide many practical difficulties that will require significant effort and resources to overcome. The new standard will have an immediate impact upon U.S. companies that will need to review internal systems, educate essential personnel, and learn how to recognize revenue in this new environment. The users of financial statements will be affected by this change in the accounting standards as well and will require a similar level of reeducation in order to properly conduct analysis. The aggregate impact upon individual business entities and the financial reporting process have yet to be determined but will absolutely affect all stakeholders in the near future.

The research for this paper sought to understand how the new revenue recognition principle with regards to customer contracts would affect companies in the near-term. Research was conducted using existing academic literature related to the history of accounting standard setting, the convergence effort related to IFRS and U.S. GAAP, and the changes that will be implemented for revenue recognition in the United States. Additionally, professional journals and commentaries provided a useful perspective regarding how corporate entities plan to address the issues that will arise. The new
standards were examined to provide an overview of the new requirements and how the new standards will vary from previous accounting standards. Further research should explore the development and discussion that took place over the course of a decade and eventually led to the joint statement issued by the two boards. Additionally, the impact that this collaborative effort will have upon future converged accounting standards should be researched. The reception, difficulties, and successes will have a significant impact upon future efforts and the speed at which such efforts will be accomplished.
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