Revenue Recognition: Point in Time vs. Over Time

Presented by:

Brad Muniz, CPA, CGMA
Adam Berger, Audit Supervisor

November 14, 2019

ALLIOTT GROUP

SOBELCO

Member of Allinial GLOBAL
An association of legally independent firms

Disclaimer

The views or statements expressed herein are our own and do not necessarily reflect the views of Sobel & Co., LLC.

Agenda

- Review of ASC Topic 606
- Concept of Control
- Over Time vs. Point in Time
- Examples
- Disclosures

The Core Principle of ASC Topic 606

- Recognize revenue when:
  - Promised goods or services are transferred to customers
  - In an amount that reflects the consideration a company expects to be entitled to in exchange for those goods and services

- Recognized when you transfer control

5 Steps for Revenue Recognition

1. Identify the contract with a customer
2. Identify the separate performance obligations in the contract
3. Determine the transaction price
4. Allocate the transaction price to the separate performance obligations in the contract
5. Recognize revenue when (or as) entity satisfies a performance obligation

Transactions Scoped out of ASC 606

- Lease contracts under Topic 840/842
- Insurance contracts under Topic 944
- Financial instruments and other contractual rights under:
  - Topic 310 Receivables
  - Topic 320, 323, 325 Investment Topics
  - Topic 450 Liabilities
  - Topic 815 Derivatives and Hedging
  - Topic 825 Financial Instruments
  - Topic 860 Transfers and Servicing
  - Topic 958 Not-for-Profit Entities
- Guarantees Topic 460
- Nonmonetary exchanges between entities in the same line of business to facilitate customers or potential customers

Effective Date

Effective Date:

- Fiscal years, beginning after December 15, 2017 - Public business entities

- Fiscal years, beginning after December 15, 2018 - All other entities

The Concept of Control

- The customer has obtained control of a good/service when the following factors have been met:

  a) The customer is obligated to pay for the good or service (and the provider has a right to be paid for the good or service)

  b) The customer has legal title to the good or service

  c) The customer has the significant risks and rewards of owning the good or service

  d) The customer has accepted the good or service

  e) The customer has obtained physical possession of the good or service

- Note: This list is not all inclusive as there could be other factors that indicate controls have been transferred

Over Time vs. Point in Time?

- Revenues must be recognized **over time** if any of the following are true:

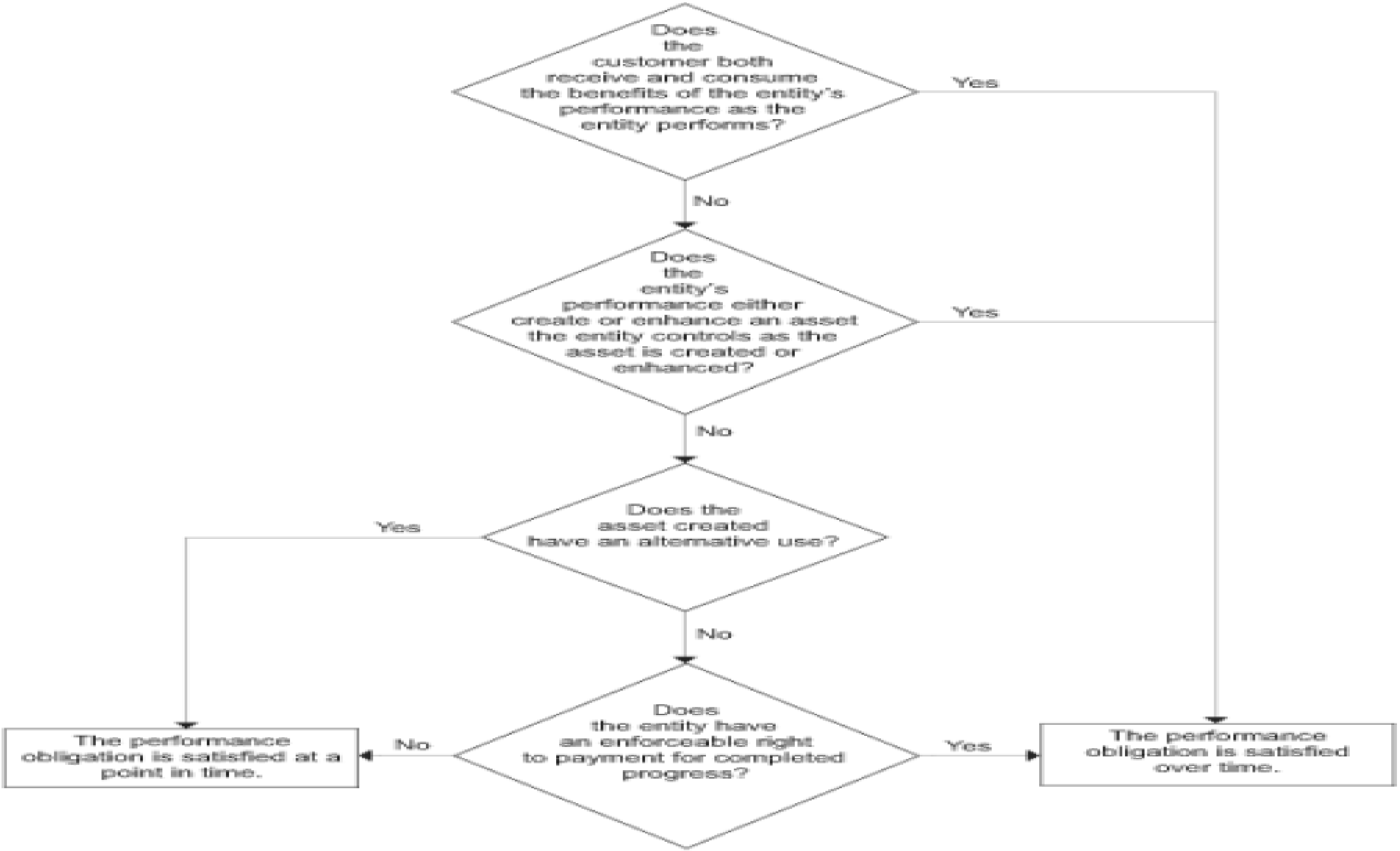
  a) The customer simultaneously receives and consumes the benefits
  b) The entity's performance creates or enhances an asset that the customer controls
  c) The entity's performance does not create an asset with an alternative use to the entity and the entity has an enforceable right to payment for performance completed to date

- If none of the above are true, then revenue must be recognized at a **point in time**
- The entity must evaluate all performance obligations in a contract on an individual basis

Over Time Clarifications

- The entity’s performance does not create an asset with an alternative use to the entity and the entity has an enforceable right to payment for performance completed to date
  a) Asset is unique to the customer
  b) Significant costs would be incurred to rework the asset for another customer
  c) The asset would be sold to another customer at a significant loss

Over Time vs. Point in Time?



Revenue Recognition Over Time

- Revenues measured over time are recognized as the entity makes progress towards fulfilling the performance obligation
  a) Input method
  b) Output method
- The entity should select the method that is most appropriate based on the nature of the performance obligation

Input Method of Recognizing Revenue

- Inputs used to satisfy a performance obligations may be used to measure the amount of revenue recognized

$$\text{Percentage of performance obligation satisfied} = \frac{\text{Inputs used to date}}{\text{Total expected inputs to satisfy the performance obligation}}$$

Output Method of Recognizing Revenue

- Outputs may also be used to satisfy a performance obligation that may be used to measure the amount of revenue recognized
  a) Surveys of performance completed to date
  b) Appraisals of results achieved
  c) Milestones
  d) Time passed since the contract began
  e) Units produced/delivered
  f) Billable amounts

Example 1 – Manufacturer/Retail

- XYZ Company produces and distributes widgets for various customers. The terms for nearly all contracts are FOB shipping point. XYZ Company has a product guarantee that the product will not have any defects 18 months after purchase. (Note for this example we are assuming 1 performance obligation)
  - Should the revenue for the performance obligation be recognized over time or point in time?
  - If over time, should the input method or output method be used?

Example 2 – Contracting/Construction

- ABC Construction Company constructs various homes and apartments. The Company has a contract to construct one apartment building and provide monthly maintenance five years after the construction is complete. (Note for this example we are assuming 2 performance obligations)
  - Should the revenue for the performance obligations be recognized over time or point in time?
  - If over time, should the input method or output method be used?

Example 2 – Contracting/Construction

- Construction – over time – input method
- Maintenance – over time – output method

Example 3 - Technology

- Large Technology Company provides software as a service. In the contract, the Company will provide an annual subscription for the software, installation of software, provide training for the customer, and provide updates during the year. (Note for this example we are assuming 4 performance obligations)
  - Should the revenue for the performance obligations be recognized over time or point in time?
  - If over time, should the input method or output method be used?

Example 3 - Technology

- Annual subscription – over time – output method
- Installation – point in time – n/a
- Training – point in time – n/a
- Updates – over time – output method

Example 4 - Nonprofit

- Prestigious Boarding School provides education to middle and high school students. In addition to the excellent education, the School requires all students to live on campus which is included in the tuition cost. Lastly, there is a club fee which is charged to the students on an annual basis. (Note for this example we are assuming 3 performance obligations)
  - Should the revenue for the performance obligations be recognized over time or point in time?
  - If over time, should the input method or output method be used?

Example 4 - Nonprofit

- Tuition – over time – output method
- Room and Board – over time – output method
- Club fee – over time – output method

Disclosures

ASC 606 requires significant enhancement to disclosures, quantitative and qualitative, including:

- Disaggregation of revenue (over time -v- point in time)
- Contract balances and significant changes
- Information about performance obligations
- Remaining performance obligations
- Significant judgements, including input/output considerations
- Contract assets/liabilities
- Practical expedients

Disclosures

Over time vs. Point in Time disclosure should include:

1. When the company typically satisfies its performance obligations (e.g., at shipment, at delivery, as services rendered, etc.)

2. Revenue must be presented disaggregated on how control of goods and services transfers (i.e. over time vs. point in time)

3. For performance obligations satisfied over time:
   a) The method used to measure progress
   b) How the method is applied


ANY
QUESTIONS
?