ASC 606 – The Aftermath

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Most public companies have now adopted ASC 606 Revenue from Contracts with Customers. If you speak to any of these public companies that have already adopted, for many, especially in the Silicon Valley, was one of the most difficult new accounting standards to adopt and implement. While some fiscal year end public companies are still in the process of adopting, here are some of our observations from the public companies that have already adopted:

- Approximately 85% of the companies that adopted the Standard in Q118 did so on a modified retrospective basis. This is in stark contrast to a study made in early 2017 where only less than 25% of the companies were planning on adopting using the modified retrospective basis, and the rest (i.e. 75%) were planning on using the full retrospective basis. Presumably, the initial 25% of companies were planning on using the modified retrospective basis was because they preliminarily assessed that the impact would not be material. So one can only imagine why 85% of companies have used the modified retrospective basis. From what we observed, the adoption efforts were too great to go back the multiple years and adopt using the full retrospective bases.
- In fact, because the modified retrospective basis requires companies to report both under old GAAP versus new GAAP, it has proven to be costly and draining on company personnel to calculate both methods for the first year of adoption.
- For those public companies that have adopted already, a majority of these companies disclosed significantly more information than they historically did under legacy GAAP, with revenue being most commonly disaggregated by products/services, geographies and customer types.
- There is significant diversity in how companies have interpreted disclosure requirements, and the type and amount of information being disclosed – such diversity in practice would be expected to decrease over time as more companies adopt the Standard and registrants further evaluate their peers' disclosures and receive additional guidance and clarification from regulators. In fact, some surveys are predicting a swarm of restatements as a result of regulators following up with registrants on either the adoption, or changes in estimates that cause the question of but should registrants have known.
- Most companies elected to apply the practical expedients provided by the Standard, with the most common relating to the disclosure of the aggregate amount of the transaction price allocated to remaining performance obligations and quantitative or qualitative explanation of when revenue will be recognized.
- Approximately a third of the 27% of companies that provided disclosures about significant financing components elected not to account for financing effects as the difference between the dates on which control of the goods/services transfers to the customer and payment is received was a year or less.
- Certain areas are proving to be challenging in practice, such as variable consideration (the estimation process is often intrinsically complex and the Standard requires that variable consideration be constrained, as defined, and reassessed for each reporting period) and contract modifications (determining if the remaining goods/services are distinct and if the pricing of remaining items is reflective of standalone selling prices is often challenging, especially when adequate resources are not in place and processes and controls have not been implemented/updated to capture all potential modifications for evaluation).

So what can learn and apply if you are a private company or a public company for which the Standard isn't already effective?

- Start your assessment/adoption early and don't underestimate the efforts required – in our experience, identifying potential changes and transiting to the new guidance is often more time-consuming than most companies would typically expect, the deeper you dig, the more likely you are to identify more changes to accounting, processes and controls, and increased data needs.
- If you are a December year end private company, it would be good to start the Assessment process now, so that you can start transacting using new GAAP from 1/1/18, rather than reporting initially using old GAAP, and then having to re-transact using new GAAP.

- The Standard is principles-based – management judgments and estimates will directly impact the amount and timing of revenue recognized and any changes in how revenue will be recognized under the Standard will require reliable underlying data and may necessitate modifications or enhancements to existing information technology systems.
- Expertise matters - the individuals who will perform a deep dive into contractual arrangements selected for review as part of the assessment must be able to apply abstract concepts (the principles in the Standard) to concrete facts (the contract terms). Attempts to transfer the knowledge developed to someone less experienced don't always yield the expected results.
- Complying with disclosure requirements could prove challenging – while these are clearly spelled out by the Standard, there is no one-size-fits-all model. Significant judgment may be required in determining what to disclose and how to present some of the required information, and management may want to consider industry practices when designing the disclosures.
- Factor disclosure requirements in your plans when evaluating the Standard – your assessment should contemplate the system changes necessary to collect the required information and the individuals responsible for drafting disclosures should play an active role in the assessment efforts.
- Anticipate on external auditors' needs – you must be prepared to support your transition disclosures and adjustments and have adequate controls and processes in place during the implementation and post adoption. Controls must be designed and implemented to address the risks associated with the transition disclosures and the finalization of the transition adjustments in the year of adoption - you will need controls and processes to group contracts for analysis, ensure these contracts are timely reviewed and develop new policies to address the risk that contractual terms that have accounting implications are not timely and correctly identified.
- Running behind on your adoption efforts? – you are possibly facing a higher risk of deficiencies in controls over both implementation and reporting after adoption due to the abbreviated time period to design and implement them and you should ensure that controls are in place to address this new risk.
- Be sure that everyone in the organization understands the importance of appropriately implementing the Standard, with an emphasis on controls, policies and processes - controls over the implementation approach should provide sufficient evidence that the complete population of contractual terms that are relevant to the development of new accounting policies have been identified, especially if the entity has a significant number of non-standard contracts.
- Certain areas are that have proven to be challenging in practice, such as variable consideration (the estimation process is often intrinsically complex and the Standard requires that variable consideration be constrained, as defined, and reassessed for each reporting period) and contract modifications (determining if the remaining goods/services are distinct and if the pricing of remaining items is reflective of standalone selling prices is often challenging, especially when adequate resources are not in place and processes and controls have not been implemented/updated to capture all potential modifications for evaluation), will need to be dealt with for private companies. These changes will require companies to track discounts, not make concessions, bring new rigorous discipline to business practices, and everyone including outside of accounting and finance will need to be educated.

It will be interesting to see what happens after the regulators' inspection season concludes. And next new accounting guidance that must be adopted is ASC 842, Accounting for Leases, effective 1/1/19 for December year end public companies, and 1/1/20 for December year-end private companies.