

***Beyond Accounting:***  
Process, data, system  
and control implications  
of the new revenue  
recognition standard

October 2015

# Prepare for the pervasive business and technology impacts of the new standard

## Introduction

The new revenue recognition standard, *Revenue from contracts with customers*, was issued by the Financial Accounting Standards Board (FASB) and the International Accounting Standards Board (IASB) in May 2014 (ASC 606 and IFRS 15, respectively). This principles-based standard will replace industry-specific guidance, improving comparability across industries, within industries and throughout global capital markets. The extent of the impact will vary, but all companies will see some level of change, including additional estimates and judgments, new business processes and controls, and expanded disclosures.

The impacts of the new standard extend far beyond technical accounting. Change to the way revenue is recognized will have broader impacts on other areas of the business, including go-to-market strategies, income taxes, compensation arrangements and debt covenants, among others. Companies must assess their business processes, data, systems and internal controls to determine whether they can capture and report the information needed to comply with the new standard.

Application of the new standard requires companies to apply a single revenue recognition model to all contracts with customers, using the five-steps illustrated in Figure 1. The principles-based standard involves more judgments and estimates to better reflect the economics of the arrangement, prompting some companies to re-evaluate their current business models. Ultimately, new estimates and increased judgments made by management, along with new disclosures, will call for new processes, policies and controls.

On July 9, 2015 the FASB approved the delay in effective date by one year (which was also subsequently approved by the IASB). The deferral requires adoption of the new standard for calendar year-end, U.S. GAAP public companies on January 1, 2018 (see Figure 2 on page 2). The effective date for non-public companies is a year later (calendar year 2019). Companies are permitted to adopt the new standard as of the original January 1, 2017 effective date.

**Figure 1:**  
A five-step model for revenue recognition



In the year of adoption, companies can select from two methods:

**Full Retrospective Method:** Assuming a calendar year, U.S. GAAP public company adopts on January 1, 2018, the new standard is applied retrospectively to each prior reporting period presented with the cumulative effect of the change recorded in retained earnings as of January 1, 2016. (Figure 2)

**Modified Retrospective Method:** The new standard is applied to all existing contracts as of the effective date and to all future contracts; the cumulative effect of initially applying the new standard is recognized in opening retained earnings as of the effective date. Under this transition method, companies only need to consider the effects of applying the new standard to contracts that are not completed as of the effective date.

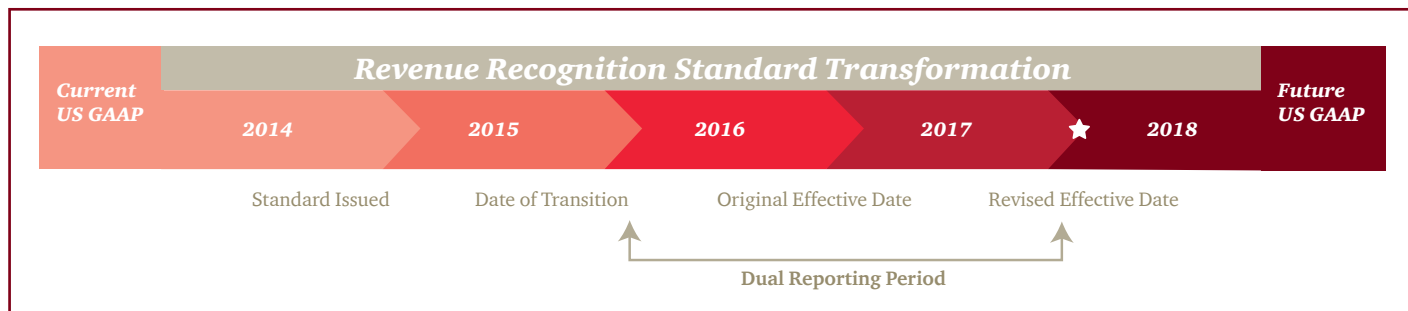
While this allows companies to avoid restating prior periods, the qualitative and quantitative impact of applying the new standard on all affected financial statement line items must be disclosed in the year of adoption.

Regardless of the adoption method selected, some level of dual GAAP reporting will be required. Consequently, companies will have to maintain two sets of accounting records and supporting processes for a period of time (two years for full retrospective and one year for modified retrospective).

The 2018 effective date may seem distant, but a smooth transition will require planning and a significant investment in time and resources. The earlier you identify the implications of the new guidance, the better positioned you will be to optimize its implementation. The clock is ticking.

**Figure 2:**

Adoption timeline: Assumes a calendar year, public company electing the full retrospective method without early adoption.



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## **Implementation considerations and challenges across the business**

The new standard constitutes a major shift in how revenue will be recognized for many industries, and it will necessitate changes to processes, data, systems and controls across the organization. Preparing for the business and technology impacts of the new standard will be challenging for many companies.

Below are some key implementation considerations:

### **1. Program management is essential to drive the change across the organization**

Integrated program governance and management of interdependencies by an experienced program management office (PMO) will be critical to the success of this initiative. Because so many aspects of a business are tied to revenue, implementation of the new standard will demand participation of stakeholders across many functions and lines of business. This effort will not be achieved without proactive collaboration and a unified and structured approach. Additionally, executive sponsorship, adequate resource allocation and a well-defined change-management program are critical. The PMO should lead the transition to ensure that all business units' requirements are included, timely progress is made and the initiative is completed on schedule.

### **2. Business processes and controls will require updates**

There will be pervasive impacts to business processes and controls as a result of accounting policy changes, new decision points and increased disclosure requirements, among other aspects of the new standard. Companies need to assess the implications across their customer to cash and close to report processes and determine whether new policies, processes and controls are necessary to address requirements that do not exist today.

The entire revenue process from contract initiation to cash collection will need to be aligned with the new standard. Policies and procedures for areas such as contract reviews, contract modifications, incremental costs of obtaining contracts and calculation of stand-alone selling prices are among a few areas that will need to be assessed. For example, determination of stand-alone selling prices for separate performance obligations within a contract may require new processes to accumulate additional data, ensure its completeness and accuracy, and estimate transaction values.

Other business processes such as sales commissions, tax, compensation arrangements and legal will also be impacted. For example, sales commissions may now have to be capitalized and amortized as an incremental cost of obtaining a contract. New accounting procedures will be required to capture these costs and recognize the expense in a manner consistent with the recognition of contract revenue. Other compensation and bonus arrangements may need to be modified if based on earned revenue.

Management will be required to address how process changes impact their current control environment and the related policies, procedures and controls will need to be updated accordingly. Companies will also need to consider whether two sets of controls are required to meet the dual-reporting requirements during the transition period.

### **3. Dependencies on data will be increased**

Data requirements for ongoing reporting will change significantly. The new standard will require companies to capture and report new information. For example, additional contract attributes such as future committed payments and tiered discounts may be required to determine performance obligations and variable consideration.

Key data elements will need to be identified requiring a comprehensive understanding of the new standard, related use cases, technology and existing data stores and their integration. IT and relevant stakeholders should assess the quality of the data including availability, completeness and accuracy. Critical data gaps identified will need to be prioritized and remediated.

Key data elements should be integrated and standardized so that they are interoperable with disparate systems and can be used to potentially reduce manual processes. In addition, historical data attributes will need to be maintained with relevant controls to meet dual-reporting requirements during the transition period.

#### **4. Revenue automation solutions will require upgrades and enhancements**

Business process changes, additional data needs and new reporting requirements are driving companies to prioritize and implement revenue automation solutions. Maximizing business process effectiveness and efficiency and reducing manual processing are just a few of the benefits of automating certain aspects of the revenue process. For example, revenue automation solutions can provide analysis of historical sales data to determine Stand-alone Selling Price (SSP), link related transactions into a single contract and allocate consideration to individual performance obligations. Each company will need to identify business and system requirements for revenue recognition scenarios and define future-state architectures before implementing a revenue automation solution. In addition, the selected revenue automation solution must be compatible with the company's existing enterprise architecture and align with IT strategic plans. Implementing a revenue automation solution should be treated like any other enterprise-wide transformational change.

The initiative to update technologies and automation capabilities is complicated by the fact that enterprise resource planning (ERP) and specialized software vendors continue to enhance and develop functionality to address the evolving revenue standard. Consequently, it is challenging for companies to fully assess vendor offerings to determine if they address their business needs and requirements. The evolving state of software solutions, however, should not prevent organizations from initiating the assessment of systems and data requirements and exploring revenue automation solutions in order to allow adequate time for implementation.

#### **5. IT involvement is crucial throughout the implementation lifecycle**

Given the pervasive impacts on the company's business systems, IT stakeholders will need to collaborate with finance, accounting and other relevant business units to determine technology-enabled future-state processes and capabilities necessary to implement the new standard. In addition, changes must be evaluated along with short-term and long-term IT strategic plans to achieve efficiencies across IT projects by aligning requirements. Early awareness, thoughtful planning and regular interaction among IT and key stakeholders are critical.

## How we can assist you with implementing this change

PwC's team of professionals can help you evaluate and address the impact of the new standard to your company's processes, data, systems and controls. We utilize a comprehensive, end-to-end strategy, structured procedures and project-enabling tools and accelerators to assist companies in implementing this change.

We recommend a phased approach to implementation, including:

Phase 1 - Assess: Determine impacts to the business;

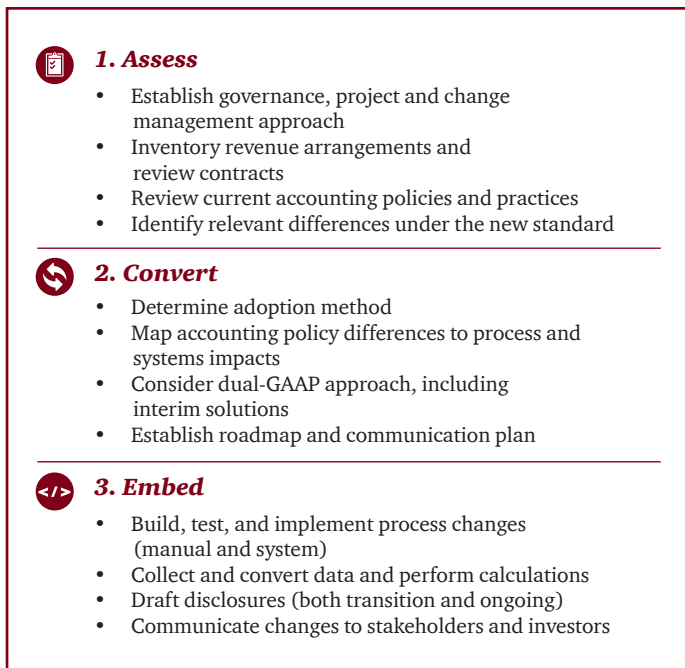
Phase 2 - Convert: Identify and prepare for changes to be made; and

Phase 3 - Embed: Implement the changes into the business.

Because the impact will vary by company, we can work with your organization to develop the "right size" solution to address your business needs. An example of what each typical phase might entail is included in Figure 3.

**Figure 3:**

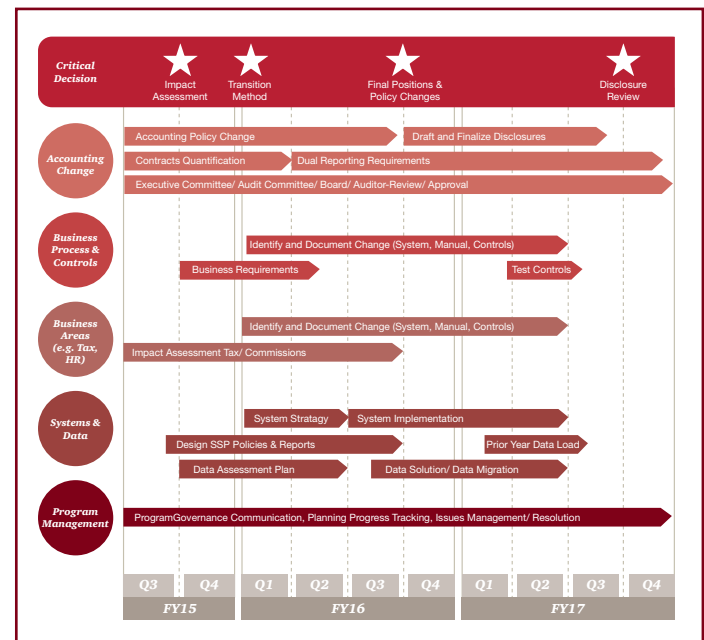
Phased approach to implementation



Timely adoption of the new standard will be a significant undertaking for many companies. Figure 4 provides an example of what a timeline and roadmap might look like to enable your company to meet the defined deadline. As represented, many of these tasks are sequential in nature and require dependent tasks to be completed before proceeding (e.g., the business requirements must be substantially complete before the system strategy can be started). Accordingly, appropriate planning and consideration must be taken in creating the implementation plan to ensure adequate time exists for key tasks to be accomplished noting these linear relationships—and the significant change.

**Figure 4:**

Example Timeline and Roadmap



There is no one-size fits all solution to address the new standard. For many, the most challenging aspect of the transition will be identifying and deploying the right combination of technologies and processes to address the new requirements. Your company needs to prepare and adequately plan for the potential changes to processes, systems, data and controls across the business. It's time to get started, if you have not already.

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## ***Continuing the conversation***

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