

Revenue From Contracts with Customers



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Accounting Standards Codification 606 (ASC 606)

In May 2014, the Financial Accounting Standards Board (FASB) and international Accounting Standards Board (IASB) issued a converged standard on revenue recognition from contracts with customers. The FASB's Accounting Standards Update (ASU) NO. 2014-09, *Revenue from Contracts with Customers (Topic 606)* is a revenue recognition standard that affects all entities -public, private, and not-for-profit - that have contracts with customers, except for certain items which include leases, insurance contracts, most financial instruments, guarantees (other than product or service warranties) and nonmonetary exchanges between entities in the same line of business to facilitate sales to customers or potential customers.

Revenue recognition practices are currently diverged across industries due to a lack of a comprehensive standard. The revenue recognition standard aims to improve comparability and transparency as to how entities recognize revenue. The new revenue recognition standard (ASC 606) eliminates the transaction and industry specific revenue recognition guidance under current GAAP and replaces it with a principle-based approach in determining revenue recognition.

Effective Date

Public entities are required to implement ASC 606 for annual reporting periods (including interim periods therein) beginning after December 15, 2017. Early adoption a year earlier (annual periods beginning after December 15, 2016) is permitted.

Nonpublic entities are required to implement ASC 606 for annual periods beginning after December 15, 2018. Early adoption is permitted, however, adoption can be no earlier than annual reporting periods beginning after December 15, 2016.

Public entities should apply the new revenue standard to interim reporting periods within annual reporting periods beginning after December 15, 2017 (that is, a public entity is required to apply the new revenue standard beginning in the first interim period within the year of adoption). Nonpublic entities should apply the new revenue standard to interim reporting periods within annual reporting periods beginning after December 15, 2019 (that is, a nonpublic entity is not required to apply the new revenue standard in interim periods within the year of adoption).

What Does It Do?

- Removes inconsistencies and weaknesses in revenue requirements
- Provides a more robust framework for addressing revenue issues
- Improve comparability of revenue recognition practices across entities, industries, jurisdictions and capital markets
- Provides more useful information to users of financial statements through improved revenue disclosure requirements
- Simplify the preparation of financial statements by reducing the number of requirements to which an entity must refer

Five Step Model

Identify the contract(s) with the customer

01

Identify the performance obligations in the contract

02

Determine the transaction price

03

Allocate the transaction price to the performance obligations

04

Recognise revenue when (or as) each performance obligation is satisfied

05



REVENUE RECOGNITION - A FIVE STEP PROCESS

The core principle of ASC 606 is that an entity should recognize revenue to depict the transfer of goods or services to customers in an amount that reflects the consideration to which an entity expects to be entitled in exchange for those goods or services. ASC 606 explains that to achieve this core principle, an entity should take the following actions which is explained in a five step process.

- 1) **Step 1: Identify the contract(s) with a customer** - A contract is an agreement between two or more parties what creates enforceable rights and obligations.
- 2) **Step 2: Identify the performance obligations in the contract** - A contract includes promises to transfer goods or services to a customer. If those goods or services are distinct, the promises and are performance obligations and are accounted for separately.
- 3) **Step 3: Determine the transaction price** - The transaction price is the amount of consideration in a contract to which an entity expects to be entitled in exchange for transferring promised goods or services to a customer. Consideration may include fixed, variable amounts, or both.
- 4) **Step 4: Allocate the transaction price to the performance obligations in the contract** - An entity typically allocates the transaction price to each performance obligation on the basis of the relative standalone selling prices of each distinct good or service promised in the contract.
- 5) **Step 5: Recognize revenue when (or as) the entity satisfies a performance obligation** - An entity recognizes revenue when (or as) it satisfies a performance obligation by transferring a promised good or service to a customer (which is when the customer obtains control of that good or service).



SOME INSIGHT

While the policies used by almost all entities to account for revenue and certain related costs will be affected by ASC 606, the degree of change to a specific entity's revenue recognition policies and the effects the changes have on an entity's financial statements will vary depending on the nature and terms of the entity's revenue generating transactions.

While ASC 606 primarily affects the accounting and disclosures relating to revenue, complying with ASC 606 may also require entities to change operational processes, related internal controls and perhaps even business systems.



PREPARING YOUR ORGANIZATION

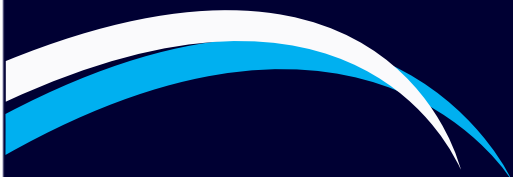
First and foremost, you will need to determine to what extent the new revenue recognition standard (ASC 606) will impact your organization. This begins with a good understanding of ASC 606 and also, a determination of the impact on how your customer contracts are currently handled. Again, ASC 606 will impact some entity's more than others, especially those under industry specific guidance.

It is important to start preparing now. Here are some suggestions to help you get stated.

- Assign individuals or create a task force to take the lead on understanding and implementing ASC 606.
- Evaluate the changes ASC 606 will have from current GAAP and evaluate the impact on current revenue streams and the financial statements. Also evaluate how ASC 606 will impact current accounting policies, internal controls and tax matters.
- Determine how to retrospectively adopt ASC 606 and how to track the accounting differences for periods that require restatement.
- Determine whether any changes to IT applications or software are necessary to capture the information needed for ASC 606
- Develop an evolving project plan for implementation of ASC 606.
- Educate key stakeholders (audit/finance committees, board of directors, etc.) on ASC 606 and what changes to expect on your organizations financial statements.

How can we help?

N&K's professionals can assist your organization with understanding the upcoming changes and meeting with your financial personnel to discuss in more detail, the impact of ASC 606 will have to your organization. Our professional staff can provide training sessions for your accounting personnel and your organization's management and other personnel to better understand the upcoming changes.





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N&K is a local firm that values its autonomy and its local traditions. We are very committed to the Hawaii market, as evidenced by our 45 years of serving the people of this state. The firm was founded in 1973 with a staff of nine people. Today, the firm is one of the largest CPA firms in the State of Hawaii with 64 personnel, which now includes eight principals. On the latest list of national and local CPA firms on Oahu from February 2017, compiled by Pacific Business News, N&K is ranked number 5. Of our total personnel, we have 54 locally-based professionals, 32 of whom are CPAs.

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N&K CPAs, Inc. is an independently owned and operated firm of CPAmerica International, one of the largest associations of CPA firms in the United States. Through our affiliation, we have instant access to the expertise and resources of more than 3,900 professionals across America. N&K offers clients unique access to national and international markets through our membership in CPAmerica, an association of independent accounting firms that maintain the highest practice standards. CPAmerica is a member of Crowe Horwath International, providing our firm access to more than 200 independent accounting and advisory services firms in more than 130 countries worldwide. As a client of our firm, you truly receive the best of both worlds: the personal attention and sincere concern of a local firm and the knowledge and resources of an international association.



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