Haefele Flanagan
CERTIFIED PUBLIC ACCOUNTANTS & ADVISORS
P: 856-722-5300 | F: 856-722-5395 | www.hfco.com

REVENUE RECOGNITION

In May, 2014, the Financial Accounting Standards Board ("FASB") issued Accounting Standards Update ("ASU") NO. 2014-09 "Revenue from Contracts with Customers", which totally revised the principles used to recognize revenue.

The revenue recognition standard affects all entities-public, private and not-for-profit, that have contracts with customers. Exceptions to the standard include accounting for leases, insurance contracts, financial instruments and guarantees.

Why the change?

The FASB identified weakness and areas for improvement in the accounting for revenue. It also concluded that current disclosure requirements were inadequate.

Principle

The Revenue standard eliminates the transaction and industry specific revenue recognition guidance under current generally accepted accounting principles ("GAAP") and replaces it with a principle-based approach for determining revenue recognition.

The core principle of the revenue recognition standard 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 the entity expects to be entitled in exchange for those goods or services.

To apply the revenue recognition standard, an entity should take the following steps:

1. Identify the contract(s) 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.
5. Recognize revenue when (or as) the entity satisfies a performance obligation.

Revenue would be recognized when a company 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.

Disclosure Requirements

The new revenue recognition standard substantially increases the amount of disclosure required in the Notes to Financial Statements.

Effective Date

Nonpublic entities are required to apply the revenue recognition standard for annual reporting periods beginning on or after December 15, 2018 (i.e. Calendar years ending December 31, 2019)

LEASES

In February 2016, the FASB issued ASU NO. 2016-02, "Leases" which revised the accounting for and presentations of leases in financial statements. The new lease guidance makes substantial changes to the accounting for leases by lessees, but makes very few changes to the accounting for leases by lessors.

The guidance applies to all leases and subleases, with certain exceptions, that convey the right to control the use of identified property, plant or equipment for a period of time in exchange for consideration.

For a lessee to control the use of an asset for a period of time, he must have the right to (1) obtain substantially all of the asset's economic benefits from its use, and (2) direct how, and for what purpose, the asset is used.

Why the change?

The FASB identified inconsistencies in the accounting for leases due to the "bright line" requirements in the existing guidance. In addition, the FASB believes that the right-to-use asset should be included in the balance sheet as an asset and the related obligation should be included as a liability.

Principle

At the commencement date, a lessee should classify a lease as either a finance lease or an operating lease. A lease meeting any of the following criteria should be classified as a finance lease:

- The lease transfers ownership of the underlying asset to the lessee by the end of the lease term.
- The lease grants the lessee an option to purchase the underlying asset that the lessee is reasonably certain to exercise.
- The lease term if for the major part (e.g. 75% or more) of the remaining economic life of the underlying asset (i.e., the period over which the asset is expected to be economically usable or the number of production or similar units expected to be obtained from the asset).
- The present value of the sum of the lease payments and any residual value guaranteed by the lessee not already reflected in the lease payment equals or exceeds substantially all (e.g. 90%) of the fair value of the underlying asset.
- The underlying asset is of such a specialized nature that it is expected to have no alternative use to the lessor at the end of the lease term.

Initial Measurement for Finance and Operating Leases

At commencement date, all finance and operating leases should record a liability at the present value of lease payments not yet made discounted at the interest rate implicit in the lease (if readily determinable) or the lessee's incremental borrowing rate.

Also, at the commencement date, a corresponding right-of-use asset should be established.

Effective Date Nonpublic entities are required to apply the new lease guidance for annual reporting periods beginning on or after December 15, 2019 (i.e. Calendar years ending December 31, 2020).