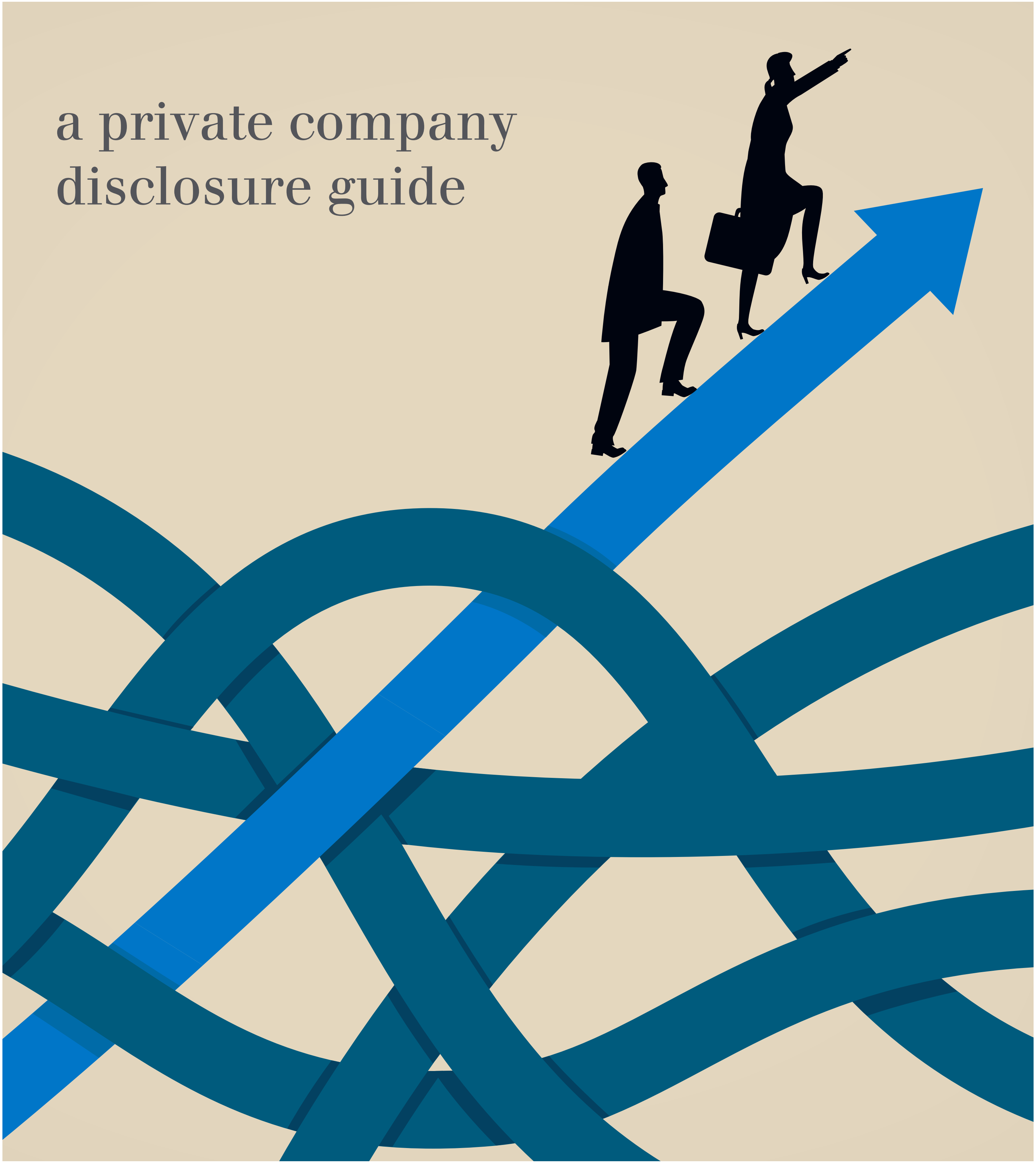
DHG | assurance

ASC 606 – REVENUE FROM CONTRACTS WITH CUSTOMERS



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a. introduction & background

The Financial Accounting Standards Board issued Accounting Standards Codification (ASC) 606 - *Revenue from Contracts with Customers* in May 2014. The new standard becomes effective for private companies[1] for fiscal years beginning after December 15, 2018 (i.e. calendar year 2019 for companies with a December 31st year end) and interim periods within fiscal years beginning after December 15, 2019 (i.e. first quarter 2020 for private companies with quarterly interim reporting requirements and a December 31st year end). The primary objective of the new standard is to enable users to better understand and consistently analyze revenue across industries, transactions, and geographies. **One of the primary ways that this is achieved is through improved disclosure requirements.**

Under previous U.S. GAAP (ASC 605), the revenue disclosure requirements were limited and dispersed among various industry-specific guidance. The new standard introduces a comprehensive disclosure package designed to better enable users to understand the nature, amount, timing, and uncertainty of revenue recognized.

In accordance with the overall intention of the new revenue standard, the most noticeable difference between the disclosure requirements for ASC 605 and 606 is the transition away from industry-specific guidance in favor of broader, principles-based guidance. The shift to principles-based guidance necessitates a greater degree of judgment by those preparing the financial statements. The standard also offers non-public business entities the option to omit some of the disclosures that are required for public business entities in order to reduce the reporting burden on these companies. This guide provides interpretive guidance to assist private companies in determining the appropriate disclosures under the new standard.

A-1 HOW TO USE THIS GUIDE

This guide is designed to assist readers in navigating the disclosure requirements of the new standard, in addition to providing interpretive guidance, examples, and practical application considerations. The material is organized in the order that a preparer would be expected to apply the information; starting with the detailed guidance, transitioning to practical application considerations, and ending with illustrative examples. Those who are unfamiliar with the new disclosure requirements may consider starting at the beginning; however, all of the information in this guide has been written so that it may also be used as reference material. **The information presented within this publication is not authoritative, and may not be applicable to all facts and circumstances. This publication does not constitute professional advice and no actions should be taken based on the information herein without consulting a qualified professional.**

A-1.1 DISCLOSURE REQUIREMENTS (SECTION B)

The first section of this guide contains detailed information about the disclosure requirements themselves, as well as interpretive guidance that aims to aid the reader in determining the applicability of the requirements to their situation.

A-1.2 PRACTICAL APPLICATION (SECTION C)

Section C provides considerations for private companies regarding the business system and data collection processes that may need to change in order to collect the data necessary in order to comply with the new disclosure requirements, as well as guidance related to the application of judgment that is required for the disclosures of this principles-based standard.

A-1.3 DISCLOSURE EXAMPLES (SECTION D)

The final section of this guide provides comprehensive examples of disclosures that can be used as a reference for private companies.

[1] *Note private companies are non-public business entities and may be referred to in this publication as "companies."*

b. disclosure requirements

The new standard identifies two types of required disclosures: transition disclosures, which are required only in the year of adoption, and recurring, annual disclosures.

B-1 TRANSITION DISCLOSURES

Private companies who have not elected to early adopt the standard are required to adopt the new standard effective for fiscal years beginning after December 15, 2018. For calendar year-end companies this results in a required effective date of January 1, 2019. In addition to the changes to the recurring revenue disclosures, there are additional, transition-specific disclosures required in the year of adoption. The transition must be accounted for retrospectively using one of two acceptable transition methods: retrospective or modified retrospective. Both methods are described in the following section.

B-1.1 FULL RETROSPECTIVE ADOPTION

Application of the retrospective method (referred to herein as the full retrospective method), results in presentation of all periods as if the new standard had always been applied. This method results in consistent application across all periods presented, which aides comparability. However, it also requires companies to begin applying the new standard at an earlier date than the modified retrospective method, and requires some additional analysis, as described in further detail below.

Companies that elect the full retrospective method will follow the existing guidance on accounting changes, ASC 250 – *Accounting Changes and Error Corrections*. ASC 250-10-45-5 through 45-10 dictate the mechanics of presentation. In accordance with ASC 250-10-45-5, the cumulative effect of the change must be reflected in the opening balances of assets, liabilities, and retained earnings for the earliest period presented (for two year comparative financial statements, this would be January 1, 2018 for calendar year-end private companies that do not early adopt). Additionally, the financial statements must reflect the period-specific effects of the change for each individual prior period presented.

The disclosures required under the full retrospective method are dictated by ASC 250-10-50-1 through 50-2. This includes disclosure of the following:

- The nature of and reason for the change in accounting principle, including an explanation of why the newly adopted accounting principle is preferable.
- The method of applying the change, including:
  + A description of prior-period information that has been retrospectively adjusted
  + The effect of the changes on any prior periods that have been retrospectively adjusted
  + The cumulative effect of the change on retained earnings or other components of equity or net assets in the statement of financial position as of the beginning of the earliest period presented

The new standard exempts companies applying the full retrospective method from disclosing the effect of the accounting change on the current period, which is ordinarily required by ASC 250-10-50-1(b)(2).

If there are indirect effects resulting from the change, however, disclosure of those effects on the current period is required. Indirect effects might include changes in the calculation of nondiscretionary profit sharing, or royalty payments. The following disclosures regarding indirect effects of the accounting change are required by 250-10-50-1(c)):

- A description of the indirect effects, including amounts recognized in the current period
- The total amount of indirect effects attributable to each prior period presented

b. disclosure requirements *continued*

B-1 TRANSITION DISCLOSURES *continued*

Under the full retrospective method, companies must disclose the effect of the change for period(s) that are retrospectively restated. The full retrospective method also requires that companies evaluate contracts that were completed prior to the adoption of the standard in order to determine if there would have been an effect on revenue in one of the periods presented. However, several practical expedients are available to companies who elect the full retrospective method, as follows:

- Companies are not required to restate revenue from a contract for which substantially all revenue was recorded within the same annual reporting period (that is, a contract which begins and ends in the same fiscal year) (606-10-65-1(f)(1)).
- Companies may use hindsight when determining the transaction price for a contract that includes variable consideration, rather than estimating variable consideration amounts in the comparative reporting period (606-10-65-1(f)(2)).
- Companies are not required to disclose the amount of transaction price allocated to unsatisfied performance obligations, or when those amounts are expected to be recognized, for the reporting periods presented before the date the standard was adopted.
- Companies may choose not to restate contracts for modifications that occurred prior to the beginning of the earliest reporting period presented. Instead, companies shall reflect the aggregate effect of such modifications when (606-10-65-1(f)(4)):
  - + Identifying performance obligations
  - + Determining the transaction price
  - + Allocating the transaction price to performance obligations

Companies that elect any practical expedients are required to disclose the following (606-10-65-1(g)):

- The expedients that have been elected
- To the extent reasonably possible, a qualitative assessment of the estimated effect of applying each of those expedients (for example, whether or not the effect of the expedients is estimated to be material to the financial statements.)

See Example 1 in Section D

B-1.2 MODIFIED RETROSPECTIVE ADOPTION

Under the modified retrospective method (also known as the cumulative effect method) the cumulative effect of the application of the new standard is shown as an adjustment to beginning retained earnings as of the date of application (January 1, 2019 for calendar year-end private companies that do not early adopt). Companies who elect the modified retrospective method must disclose the nature of and reason for the change in accounting principle. However, the other disclosures within ASC 250 regarding the effects of the change on prior periods are not applicable to the modified retrospective method. (606-10-65-1(i))

Additionally, if a company's revenue recognition changes in the period of adoption as a result of the new standard, they must disclose the following:

- The amount by which each financial statement line item is affected
- A qualitative explanation of the reasons for significant changes

Companies must choose between applying the modified retrospective method to all contracts within the transition period or applying it only to contracts not completed at the date of initial application, and they must disclose how they have chosen to apply it. (606-10-65-1(h))

b. disclosure requirements *continued*

B-1 TRANSITION DISCLOSURES *continued*

PRACTICAL CONSIDERATION

Companies might want to consider applying the modified retrospective approach to all contracts, rather than just contracts that were not complete at the beginning of the period of adoption, in order to avoid applying different accounting treatments to similar contracts during the period of adoption or beyond.

> Example: A company sells electric scooters. Included in the sales contract is a warranty provision under which the company will repair or replace damaged handlebars or wheels free of charge for the first three years following the sale. Under legacy GAAP, this warranty would be accounted for as a liability (rather than as a revenue element). Under the new guidance, this warranty would constitute a service warranty and a portion of the transaction price would be allocated to it and recorded as deferred revenue.

The new standard includes guidance related to warranties whereby certain service-type warranties are identified as performance obligations and have revenue allocated to them (606-10-55-30 through 55-34).

If a contract of this type was executed on December 31, 2018, it would be considered complete as of the date of adoption. Therefore if the company chose to apply the modified retrospective method only to contracts not completed as of the beginning of the period of adoption, the revenue on this contract would not be restated and the warranty obligation resulting from this contract would continue to be accounted for as a liability in accordance with legacy GAAP after adoption of the new standard. However, similar contracts executed on or after January 1, 2019 would result in the warranty being identified as a performance obligation and deferred revenue being recorded. The result is that elements of these similar contracts would be accounted for differently.

However, if the company chose to apply the modified retrospective method to all contracts, they would restate the revenue on the contract executed on December 31, 2018 to reflect the new guidance, resulting in consistent treatment for the warranty obligations on these similar contracts.

Companies that elect the modified retrospective method are also permitted to employ the practical expedient for contract modifications available under the full retrospective method.

Companies that elect the practical expedient for the modified retrospective method are required to disclose the following: (606-10-65-1(g))

- The expedient that has been elected
- To the extent reasonably possible, a qualitative assessment of the estimated effect of applying the expedient (for example, whether or not the effect of the expedient is estimated to be material to the financial statements)

See Example 2 in Section D

B-1.3 DETERMINING WHICH TRANSITION METHOD TO USE

Companies will need to carefully consider the requirements of the two methods along with the needs of the financial statement users in order to determine the most suitable adoption method.

The needs of the financial statements users will likely play a significant role in which method is selected for transition. The full retrospective method results in numbers that are comparative year-over-year, which enables users to identify trends more easily than the modified retrospective method. This is something that may be important if the users of the financial statements are primarily concerned with year-over-year changes, such as demonstration of growth or evidence of deteriorating financial

b. disclosure requirements *continued*

B-1 TRANSITION DISCLOSURES *continued*

health. The modified retrospective method, however, provides greater insight into the effect of the change on the year of adoption than the full retrospective method does. This is something that may be of concern to the financial users if, for example, there are revenue-based debt covenants.

Under the modified retrospective method, companies must disclose the effect of applying the new standard on specific financial statement line items in the period of adoption, which will require presenting revenue under both the old and new standard in that period. Under the full retrospective method, companies must disclose the effect of the change for period(s) that are retrospectively restated, but need not disclose the effect of the change on the period of adoption. Therefore under the full retrospective method, companies would be required to calculate revenue under both the old and the new standard for the comparative period(s), but would only need to maintain records in accordance with the new standard during the year of adoption.

If significant changes to the amount and timing of revenue recognition are expected, companies may want to utilize the full retrospective method in order to present financial statements that are comparable year-over-year. Whereas companies that are not anticipating significant changes may find the modified retrospective method to be more efficient.

As discussed in Section C-1, companies will need to ensure that their systems are set up to capture the data necessary to apply the new standard. While this is true regardless of the transition method selected, companies that plan to utilize the full retrospective method must ensure that this data is being captured for the year that is being restated in addition to the year of adoption.

Although a best practice for being able to meet the transition disclosure requirements for the new standard in the period of adoption would be to maintain two sets of books (one under ASC 605 and one under ASC 606), it is unlikely this will be a practical approach for all private companies. At a minimum, preparers should have a clear understanding of the information that will need to be captured based on their company's individual contracts in order to meet the requirements of the new standard. This could be accomplished through performing a detailed analysis of the company's contracts prior to implementation to identify information or data necessary for the new standard and related disclosures that may not be captured by the company's current systems or processes.

Reasons why companies might choose the full retrospective method include:

- Financial statement users primarily concerned with ease of year-over-year comparability
- Changes to the amount and timing of revenue recognition are expected to be significant

Reasons why companies might choose the modified retrospective method include:

- Financial statement users primarily concerned with identifying the effect of the change on the current year
- Changes to the amount and timing of revenue recognition are expected to be minimal
- Circumstances exist in the comparative year that would make restatement more challenging (such as discontinued operations)

b. disclosure requirements *continued*

B-2 ANNUAL DISCLOSURES

B-2.1 OVERVIEW

The new standard calls for significant new and expanded disclosures. The objective of the disclosure requirements under the new standard is for companies to disclose sufficient information to enable users of the financial statements to understand the nature, amount, timing, and uncertainty of revenue and cash flows arising from contracts with customers (ASC 606-10-50-1).

Companies will still need to comply with the existing requirement to disclose significant accounting policies in accordance with ASC 235-10-50. Any disclosures required by the new standard that are already included in an entity's significant accounting policies should not be duplicated.

Private companies are offered the option to reduce or omit some of the disclosures that are required for public companies. This section describes the minimum disclosures that are required for private companies if all private company alternatives are elected. See Section B-3 for discussion of potential additional disclosures, and when private companies may want to consider including them. As discussed in Section B-3, companies should consider the specific needs of the users of their financial statements in determining which, if any, of the additional disclosures to include in their financial statements.

The disclosure requirements for private companies are summarized in the table below. Additional discussion about each requirement follows.

REQUIRED ANNUAL DISCLOSURES FOR PRIVATE COMPANIES

Disaggregated Revenue	
• Quantitative revenue information disaggregated based on whether performance obligations are satisfied over time or at a point in time. • Qualitative information about how economic factors affect the nature, timing, and uncertainty of revenue and cash flows.	ASC 606-10-50-5 through 50-7
Contract Balances	
• Opening and closing balance of receivables, contract assets, and contract liabilities	606-10-50-8(a) 606-10-50-11
Performance Obligations	
• When performance obligations are typically satisfied (e.g. upon shipment, or as services are rendered) • Significant payment terms (including variable consideration and significant financing components) • The nature of the goods or services the company has promised to transfer • Obligations for returns, refunds, and other similar obligations • Types of warranties and related obligations	606-10-50-11 606-10-50-12 606-10-50-16
Significant Judgments	
• The method used to recognize revenue for performance obligations satisfied over time (input or output method) and how that method was applied. • Methods, inputs, and assumptions used to evaluate whether an estimate of variable consideration is constrained.	606-10-50-17 606-10-50-18(a) 606-10-50-20(b) 606-10-50-21

b. disclosure requirements *continued*

B-2 ANNUAL DISCLOSURES *continued*

B-2.3 DISAGGREGATED REVENUE INFORMATION

For private companies, the standard dictates the categories for revenue disaggregation. That is, private companies are required to disclose, at a minimum, the amount of revenue earned from performance obligations that are satisfied over time and those that are satisfied at a point in time.

Examples of qualitative information that a company might disclose include customer type, geographical location of customers, and type of contract. These examples are not all-inclusive – the qualitative information that must be disclosed in order to meet the objective of the standard is a matter of judgment. Companies with unusual characteristics, such as those in the startup phase or those with production cycles in excess of one year, may need to disclose additional information to meet the requirements of the standard.

The disaggregated revenue information may be presented in tabular format or in narrative format.

See Example 3 in Section D

B-2.4 CONTRACT BALANCES

Many companies likely already disclose contract asset or liability balances under different names. If these balances are separately presented or disclosed elsewhere within the financial statements, that information need not be duplicated. Contract assets that are often separately identified under legacy GAAP include unbilled receivables and costs in excess of billings. Contract liabilities often separately identified include billings in excess of costs and deferred revenue. For companies that already calculate and disclose these balances, the most significant change will be in the disclosure of the opening balances.

Other assets related to contracts with customers, such as capitalized incremental costs to obtain a contract, must be presented separately from true contract assets if material.

See Example 4 in Section D

B-2.5 NATURE OF PERFORMANCE OBLIGATIONS

Companies are required to disclose information about the nature of the company's performance obligations. The disclosures related to performance obligations should expand upon the information included in the disclosure of significant accounting policies.

The required information is as follows:

When the company typically satisfies its performance obligations	For example, performance obligations could be satisfied upon shipment, upon delivery, as services are rendered, or upon completion of service. Additionally, companies should disclose when performance obligations are satisfied in a bill-and-hold arrangement.
Significant payment terms	Disclosure of significant payment terms should include when payment is typically due, whether the contract has a significant financing component, whether the consideration amount is variable, and whether the estimate of variable consideration is constrained.
The nature of the goods or services promised	Disclosure of the nature of goods and services need only be detailed enough to allow a typical financial statement user to understand the nature of the goods or services being described. In addition, companies must be sure to highlight any arrangements under which they are acting as an agent.

b. disclosure requirements *continued*

B-2 ANNUAL DISCLOSURES *continued*

Obligations for returns, refunds, and other similar obligations	If returns are material to a company's business, the balance of the related provision, as well as the company's policy for accepting returns, should be disclosed (if not already disclosed in the summary of significant accounting policies).
Types of warranties and related obligations	The new standard modifies the guidance related to warranties. The standard introduces the concept of assurance-type warranties and service-type warranties. Companies that offer warranties should disclose if those warranties are assurance-type, service-type, or both. Companies also must disclose the balance of any related warranty obligations or deferred revenue resulting from warranties. If the balance of deferred revenue related to service-type warranties that are considered performance obligations is already disclosed elsewhere as part of the disclosure of contract balances, that information need not be duplicated.

See Example 3 in Section D

B-2.6 SIGNIFICANT JUDGMENTS

The new standard requires companies to disclose the significant judgments and changes in judgments made in applying the standard.

For performance obligations satisfied over time, companies will need to disclose the following:

- The methods used to recognize revenue
- Whether they used the input method or the output method, and how that method was applied

Companies must also disclose the methods, inputs, and assumptions used to evaluate whether an estimate of variable consideration is constrained. This information would include all of the factors that the company considered when determining the amount of variable consideration that was deemed probable of not being reversed in the future. Examples of such factors could include, but are not limited to:

- Company experience with similar contracts
- Susceptibility to factors outside the company's control
- Company practices of granting price concessions or changing payment terms
- Range of possible consideration amounts

See Example 3 in Section D

b. disclosure requirements *continued*

B-3 ADDITIONAL DISCLOSURES

The disclosures described above are the minimum disclosures that are required for private companies under the new standard when all private company alternatives have been elected. However, companies are ultimately responsible for ensuring that their disclosures provide sufficient, appropriate information to meet the stated objectives of the disclosure requirements. This means that some companies may be required to disclose information over and above the minimum requirements in order to comply with the standard.

For guidance on the type of information that they may need to disclose, private companies can refer to the additional disclosures that are required for public companies. The table below identifies the disclosure requirements for public business entities (PBEs) that are different from or in addition to the requirements for private companies.

Additional Disclosures Related to Disaggregated Revenue Information	
• Revenue disaggregated into categories that depict how the nature, amount, timing, and uncertainty of revenue and cash flows are affected by economic factors	606-10-50-5
Additional Disclosures Related to Contract Balances	
• Revenue recognized in the reporting period that was included in the contract liability balance at the beginning of the period • The effect that the timing of satisfaction of performance obligations and timing of payment has on the balances of contract assets and liabilities • Explanation of significant changes in the contract asset and liability balances during the year	606-10-50-8(b) through 50-10
Additional Disclosures Related to the Nature of Performance Obligations	
• Revenue recognized in the current year related to performance obligations satisfied in a prior year. • Total transaction price amount allocated to performance obligations that are unsatisfied (or partially unsatisfied) at year-end and when that amount is expected to be recognized as revenue	606-10-50-12A through 13
Additional Disclosures Related to Significant Judgments	
• For performance obligations satisfied over time, why the methods used provide a faithful depiction of the transfer of goods or services • For performance obligations satisfied at a point in time, the factors used in evaluating when a customer obtains control of promised goods or services • Information about the methods, inputs, and assumptions used for: + Determining transaction price + Allocating transaction price + Measuring return, refund, or other obligations	606-10-50-18(b) through 50-20
Additional Disclosures Related to Contract Costs	
• Significant judgments made in determining the amount of contract costs to capitalize • The method used to determine amortization of capitalized contract costs • The closing balance of capitalized costs, by category (e.g. costs to obtain, costs to fulfill) • The amount of amortization and any impairment losses recognized	340-40-50-2 & 3

Sections B-3.1 through B-3.5 provide interpretive guidance for determining how and when to apply the additional disclosures listed above.

b. disclosure requirements *continued*

B-3 ADDITIONAL DISCLOSURES *continued*

B-3.1 ADDITIONAL DISCLOSURES RELATED TO DISAGGREGATED REVENUE INFORMATION

If a company finds that disclosing revenue disaggregated according to the timing and transfer of goods does not adequately depict how the nature, amount, timing, and uncertainty of revenue is affected by economic factors, they may choose to disaggregate revenue in another manner in order to achieve this.

For example, if a company has determined that all of their revenue is recognized at a point in time, but that revenue is derived from two different product lines that are subject to substantially different economic risk factors, that company might consider disclosing quantitative revenue data disaggregated between the two product lines instead of, or in addition to, the disaggregation based on timing and transfer of goods.

ASC 606-10-55-91 lists the following examples of categories that might be appropriate:

- Type of good or service (for example, major product lines)
- Geographical region (for example, country or region)
- Market or type of customer (for example, government and nongovernment customers)
- Type of contract (for example, fixed-price and time-and-materials contracts)
- Contract duration (for example, short-term and long-term contracts)
- Timing of transfer of goods or services (for example, revenue from goods or services transferred to customers at a point in time and revenue from goods or services transferred over time)
- Sales channels (for example, goods sold directly to consumers and goods sold through intermediaries)

This list is not all-inclusive. Companies must utilize judgment to determine if different categories of disaggregation would be most appropriate for them in order to satisfy the disclosure objectives of the standard.

When selecting the category or categories to use to disaggregate revenue, companies should also consider how revenue information is provided to financial statement users or other decision makers for the purpose of evaluating the company's financial performance or making resource allocation decisions (606-10-55-89 through 55-91). The way that revenue information is presented for these purposes may be an indication as to how it should be disaggregated within the financial statements.

b. disclosure requirements *continued*

B-3 ADDITIONAL DISCLOSURES *continued*

B-3.2 ADDITIONAL DISCLOSURES RELATED TO CONTRACT BALANCES

Revenue recognized in the reporting period that was included in the contract liability balance at the beginning of the period	Companies that have significant deferred revenue or billings in excess of costs may want to consider disclosing the amount of revenue recognized in the current year that was included in the contract liability balance at the beginning of the period. Particularly for companies that typically have significant balances of this nature on a recurring basis, it can be difficult for financial statement users to determine if a similar balance year over year is the result of current year deferred revenue, or if it represents old deferred revenue that hasn't yet been recognized.
The effect that the timing of satisfaction of performance obligations and timing of payment has on the balances of contract assets and liabilities.	Private companies are required to disclose timing of satisfaction of performance obligations as well as timing of payment (Section B-2.5). If the relationship between the timing of these factors results in significant balances of contract assets or liabilities, companies may want to consider disclosing the reason behind this. For example, if a company experiences large changes in the balances of contract assets or liabilities year over year due to unusual payment terms, it may be beneficial to the users of the financial statements to understand the reason for the variability.
Explanation of significant changes in the contract asset and liability balances during the year	The guidance lists the following examples of reasons for changes in the balances of contract assets or liabilities that companies may want to disclose: a. Changes due to business combinations b. Cumulative catch-up adjustments to revenue that affect the corresponding contract asset or contract liability, including adjustments arising from a change in the measure of progress, a change in an estimate of the transaction price (including any changes in the assessment of whether an estimate of variable consideration is constrained), or a contract modification c. Impairment of a contract asset d. A change in the time frame for a right to consideration to become unconditional (that is, for a contract asset to be reclassified to a receivable) e. A change in the time frame for a performance obligation to be satisfied (that is, for the recognition of revenue arising from a contract liability). This list is not all-inclusive. Companies must use judgment when determining if an event has occurred that necessitates additional disclosure related to changes in the balance of contract assets or liabilities.

b. disclosure requirements *continued*

B-3 ADDITIONAL DISCLOSURES *continued*

B-3.3 ADDITIONAL DISCLOSURES RELATED TO THE NATURE OF PERFORMANCE OBLIGATIONS

Revenue recognized in the current year related to performance obligations satisfied in a prior year	Companies may want to disclose the amount of current-year revenue that stems from performance obligations satisfied (partially or fully satisfied) in a prior year if it represents a significant amount, or if it is the result of unusual circumstances. One example of why this might occur is if there is a change in transaction price.
Total transaction price amount allocated to performance obligations that are unsatisfied (or partially unsatisfied) at year-end and when that amount is expected to be recognized as revenue	Companies may want to disclose additional information about unsatisfied performance obligations if the company's contract backlog is of particular concern to the users of the financial statements. Additionally, this may be beneficial information to disclose if a company's current year revenue appears low, but there are significant unsatisfied performance obligations that will result in future revenue.

B-3.4 ADDITIONAL DISCLOSURES RELATED TO SIGNIFICANT JUDGMENTS

For performance obligations satisfied over time, why the methods used provide a faithful depiction of the transfer of goods or services	A company may want to consider including such an explanation if they experienced a significant change in their pattern of revenue recognition from legacy GAAP, or if they have an unusual business model. Additionally, such explanations may be beneficial if a company identifies that two or more streams of revenue that were previously accounted for the same way result in differing treatment under the new standard.
For performance obligations satisfied at a point in time, an entity may disclose the significant judgments made in evaluating when a customer obtains control of promised goods or services.	If a company has an unusual policy for determining when a customer obtains control of goods or services, they may want to consider disclosing the significant judgments that went into the policy. Additionally, if a company experienced a change in the determination of when the customer obtains control of goods or services from legacy GAAP, they may want to consider disclosing the judgments behind the new determination.
Information about the methods, inputs, and assumptions used for determining transaction price	Information that might be disclosed regarding determining transaction price includes estimating variable consideration, adjusting consideration for the effects of the time value of money, and measuring noncash consideration, among other information.
Information about the methods, inputs, and assumptions used for allocating transaction price	Information that might be disclosed regarding allocating transaction price includes estimating standalone selling prices, and allocating discounts and/or variable consideration to a specific part of a contract, among other information.
Information about the methods, inputs, and assumptions used for measuring return, refund, or other similar obligations	If a company experienced a significant change in the balance of refund or similar obligation from what was recorded under legacy GAAP, they may want to disclose that fact.

b. disclosure requirements *continued*

B-3 ADDITIONAL DISCLOSURES *continued*

B-3.5 ADDITIONAL DISCLOSURES RELATED TO CONTRACT COSTS

Companies that will capitalize costs to obtain or fulfill contracts with customers may want to consider disclosing some or all of the following information:

- Significant judgments made in determining the amount of contract costs to capitalize
- The method used to determine amortization of capitalized contract costs
- The closing balance of capitalized costs, by category (e.g. costs to obtain, costs to fulfill)
- The amount of amortization and any impairment losses recognized

Companies who have financial covenants that are based on net income or asset ratios may want to disclose this information, as this is information may be relevant to the bank (or other lender) enforcing the covenants.

c. practical application

C-1 DISCLOSURE DATA AND OTHER REPORTING CONSIDERATIONS

C-1.1 SYSTEM AND DATA REQUIREMENTS

Some of the requirements of the new standard will require new information to be captured from the revenue processes. Even companies that do not experience significant changes in amount or timing of revenue will experience changes in their disclosures.

For this reason, companies must be proactive in their adoption efforts in order to ensure that they have identified how their disclosures will change under the new standard.

The first step in the process of composing disclosures that are compliant with the new standard is gaining an understanding of the standard itself. Specifically, companies will need to complete an evaluation of their contracts and revenue streams in the context of the new standard.

Once this evaluation is complete, companies will be able to determine which of the new disclosure requirements are applicable to them. As companies identify those requirements, they should keep in mind whether or not the data necessary to fulfill the requirements is being captured through existing processes. For example, companies that have transactions that may result in variable consideration will need to have processes in place to identify such transactions when they occur, and ensure that the necessary information is captured to support disclosure of the methods, inputs, and assumptions used to evaluate whether that consideration is constrained.

Companies that do not currently capture all of the necessary data will likely need to look beyond the accounting department for solutions:

- Information may be needed from human resources about commissions paid to employees for capitalization as contract acquisition costs
- Members of sales and contracts departments will likely need to receive training on the new standard in order to ensure that they fully understand any new information that they will need to capture in the execution of new contracts
- Coordination with IT may be necessary in order to make changes to the data collection processes of the company

C-1.2 OTHER REPORTING CONSIDERATIONS

It is important to consider whether there are nuances to the company's revenue streams that may not have been relevant under the old standards but that are relevant under the new standard. Differences in payment terms or contract language between contracts could trigger differences in treatment under the new standard.

Companies must consider if their accounting systems are configured such that it will allow easy identification of the total revenue derived from performance obligations satisfied over time versus a point in time. Companies may want to consider breaking out or combining general ledger codes in order to reflect the company's revenue streams.

It is important for Companies to consider that some of the data that is not currently being collected may be unavailable or more difficult to access after a significant amount of time has passed. This issue can be mitigated by completing the necessary analysis early.

Changes in GAAP revenue may have an impact on revenue recognition for tax purposes.

c. practical application *continued*

C-2 APPLYING JUDGMENT

After collecting all of the necessary information, the next challenge that companies will face is composing the disclosures themselves. The new standard, including the determination of appropriate disclosures, requires a significant amount of judgment in its application.

In order to meet the disclosure objective, the information disclosed must be sufficient for users of the financial statements to understand the nature, amount, timing, and uncertainty of revenue. However, the determination of what information is necessary to achieve this objective is a matter of judgment. The standard provides the following guidance for companies in their application of judgment:

"An entity shall consider the level of detail necessary to satisfy the disclosure objective and how much emphasis to place on each of the various requirements. An entity shall aggregate or disaggregate disclosures so that useful information is not obscured by either the inclusion of a large amount of insignificant detail or the aggregation of items that have substantially different characteristics" (ASC 606-10-50-2).

There are two important factors to consider when determining what may or may not be necessary to disclose – materiality and the needs of the financial statement users.

C-2.1 MATERIALITY

Companies should keep in mind that the concept of materiality applies to the footnotes just as it applies to the face of the financial statements. A piece of information is considered material if it would have an impact on the decision making of financial statement users. Information can be assessed as based on its quantitative significance, or based on qualitative factors. The determination of materiality in the context of disclosures will require judgment. Companies should consider the objective of the disclosures, which is to enable financial statement users to understand the nature, amount, timing, and uncertainty of revenue, when making decisions about materiality of disclosures.

For example, when determining the qualitative information to disclose regarding disaggregated revenue, if substantially all of the company's customers are located in the United States and an insignificant portion of customers are located in Canada, the company may simply disclose that substantially all customers are located in the United States. However, if that small population of Canadian customers is responsible for an outsize portion of the company's sales, that may be information that is material to the disclosures.

C-2.2 FINANCIAL STATEMENT USERS

The needs of the financial statement users are paramount in determining what needs to be included in the financial statement disclosures. If the primary user of the financial statements is a lending institution that provides the company with a line of credit, their concerns are likely centered around information that might impact the company's borrowing base or compliance with debt covenants. Whereas the concerns of a sole shareholder of the company may be more focused on operations or profitability. In some cases, information that is quantitatively immaterial to the financial statements may be qualitatively material to the financial statement users, in which case it must be disclosed.

d. disclosure examples

The following examples are designed to illustrate the concepts discussed in the previous sections.

EXAMPLE 1: TRANSITION DISCLOSURE – FULL RETROSPECTIVE METHOD

ADOPTION OF NEW ACCOUNTING STANDARD

In May 2014, the Financial Accounting Standards Board ("FASB") issued Accounting Standards Update ("ASU") No. 2014-09, Revenue from Contracts with Customers (Topic 606). The ASU and all subsequently issued clarifying ASUs replaced most existing revenue recognition guidance in U.S. GAAP. The ASU also required expanded disclosures relating to the nature, amount, timing, and uncertainty of revenue and cash flows arising from contracts with customers. The Company adopted the new standard effective January 1, 2019, the first day of the Company's fiscal year, using the full retrospective method.

As part of the adoption of the ASU, the Company elected to use the following transition practical expedients: (i) completed contracts that begin and end in the same annual reporting period have not been restated; (ii) the company used the known transaction price for completed contracts; (iii) to exclude disclosures of transaction prices allocated to remaining performance obligations when the Company expects to recognize such revenue for all periods prior to the date of initial application of the ASU; and (iv) the company has reflected the aggregate of all contract modifications that occurred prior to the date of initial application when identifying the satisfied and unsatisfied performance obligations, determining the transaction price, and allocating the transaction price.

The majority of the Company's revenue is recognized at a point in time based on the transfer of control. Revenue recognized over time primarily consists of performance obligations that are satisfied within one year or less. In addition, the majority of the Company's contracts do not contain variable consideration and contract modifications are generally minimal. For these reasons, there is not a significant impact as a result of electing these transition practical expedients.

The adoption of this ASU did not have a significant impact on the Company's financial statements. The majority of the Company's revenue arrangements generally consist of a single performance obligation to transfer promised goods or services. Based on the Company's evaluation process and review of its contracts with customers, the timing and amount of revenue recognized previously is consistent with how revenue is recognized under the new standard. No changes were required to previously reported revenues as a result of the adoption. However, the adoption resulted in the recognition of an asset related to certain product returns by increasing the returns liability for December 31, 2018 and recognizing a corresponding asset for the estimated value of the returns from customers. This gross up had no corresponding impact on the Statement of Income. The Balance Sheet as of December 31, 2018 has been adjusted to reflect retrospective application of the new accounting standard as follows:

	As Previously Reported	Adjustments	As Adjusted
Other current assets	140,000	50,000	190,000
Accrued expenses	210,000	50,000	260,000

d. disclosure examples *continued*

EXAMPLE 2: TRANSITION DISCLOSURE – MODIFIED RETROSPECTIVE METHOD

ADOPTION OF NEW ACCOUNTING STANDARD

In May 2014, the Financial Accounting Standards Board ("FASB") issued Accounting Standards Update ("ASU") No. 2014-09, "Revenue from Contracts with Customers (Topic 606)". The ASU and all subsequently issued clarifying ASUs replaced most existing revenue recognition guidance in U.S. GAAP. The ASU also required expanded disclosures relating to the nature, amount, timing, and uncertainty of revenue and cash flows arising from contracts with customers. The Company adopted the new standard effective January 1, 2019, the first day of the Company's fiscal year using the modified retrospective approach.

As part of the adoption of the ASU, the Company elected the following transition practical expedients: (i) to reflect the aggregate of all contract modifications that occurred prior to the date of initial application when identifying satisfied and unsatisfied performance obligations, determining the transaction price, and allocating the transaction price; and (ii) to apply the standard only to contracts that are not completed at the initial date of application. Because contract modifications are minimal, there is not a significant impact as a result of electing these practical expedients.

The adoption resulted in an increase to beginning retained earnings of approximately $750,000 as of January 1, 2019. The adjustment primarily relates to our sales of custom-designed wallpaper, which are now recognized over the period of product manufacturing rather than upon final delivery. The impact of applying this ASU for the year ended December 31, 2019 primarily resulted in a decrease in product sales and an increase in service sales driven by a reclassification of custom-designed wallpaper sales of approximately $900,000, which are now accounted for as a single performance obligation and recognized over the life of the project.

EXAMPLE 3: REVENUE DISCLOSURES

REVENUE RECOGNITION POLICY

The Company derives its revenues primarily from the sale of wallpaper products and installation services. Revenues are recognized when control of these products or services is transferred to its customers, in an amount that reflects the consideration the Company expects to be entitled to in exchange for those products and services. Sales and other taxes the Company collects concurrent with revenue-producing activities are excluded from revenue. Shipping and handling fees charged to customers are reported within revenue. Incidental items that are immaterial in the context of the contract are recognized as expense. The Company does not have any significant financing components as payment is received at or shortly after the point of sale. Costs incurred to obtain a contract will be expenses as incurred when the amortization period is less than a year.

DISAGGREGATION OF REVENUE FROM CONTRACTS WITH CUSTOMERS

The following table disaggregates the Company's revenue based on the timing of satisfaction of performance obligations for the years ended December 31:

	2019	2018
Performance obligations satisfied at a point in time	$3,000,000	$4,000,000
Performance obligations satisfied over time	$922,000	$726,000
TOTAL NET SALES	**$3,922,000**	**$4,726,000**

d. disclosure examples *continued*

EXAMPLE 3: REVENUE DISCLOSURES *continued*

Revenue from performance obligations satisfied at a point in time consists of sales of wallpaper products. These goods are sold to homeowners and commercial designers and builders.

Revenue from performance obligations satisfied over time consists of the sale of wallpaper installation services. These services are sold to homeowners and commercial designers and builders.

PERFORMANCE OBLIGATIONS

For performance obligations related to the sale of wallpaper products, control transfers to the customer at a point in time. The Company's principal terms of sale are FOB Shipping Point and FOB Destination and the Company transfers control and records revenue for product sales either upon shipment or delivery to the customer, respectively.

For performance obligations related to wallpaper installation services, control transfers to the customer over time. These services are sold under time-and-materials contracts. Revenue under time-and-materials contracts is recognized on the basis of actual time incurred multiplied by the billable hourly rate stated in the contract, plus materials expense incurred.

VARIABLE CONSIDERATION

The nature of the Company's business gives rise to variable consideration, including rebates, allowances, and returns that generally decrease the transaction price which reduces revenue. These variable amounts are generally credited to the customer, based on achieving certain levels of sales activity, product returns or price concessions.

Variable consideration is estimated at the most likely amount that is expected to be earned. Estimated amounts are included in the transaction price to the extent it is probable that a significant reversal of cumulative revenue recognized will not occur when the uncertainty associated with the variable consideration is resolved. Estimates of variable consideration are estimated based upon historical experience and known trends.

EXAMPLE 4: CONTRACT BALANCES

CONTRACT ASSETS AND LIABILITIES

Contract assets include unbilled amounts typically resulting from sales under contracts when the percentage-of-completion cost-to-cost method of revenue recognition is utilized and revenue recognized exceeds the amount billed to the customer. Contract liabilities include billings in excess of revenue recognized. Contract assets and contract liabilities were as follows for the years ended December 31:

	2019	2018	2017
Contract assets	5,000	6,000	7,000
Contract liabilities	6,000	7,000	8,000

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Taylor serves as a member of the Professional Standards Group, which is responsible for oversight of quality control and the technical aspects of the assurance services practice. These responsibilities include developing and implementing policies and procedures for the conduct and monitoring of the assurance services practice, assessing the impact of developments in the profession, and implementing programs and processes responsive to changes in the assurance services environment.

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