



How to Properly Recognize Revenue.



The Financial Accounting Standards Board (FASB) and the International Accounting Standards Board (IASB) have provided standards regarding revenue recognition. The standards bring uniformity to revenue recognition for public and nonpublic entities across many industries.

Under the standards, companies recognize revenue based on the value and timing of when control of the goods and services are transferred to the customer. The purpose of the standards is to provide investors with more transparency into a company's financials, and should make it easier to compare apples to apples when considering different investments.

5-Step Process for Revenue Recognition

FASB issued a five-step process to help companies recognize revenue under the standard: First, you should identify the contract(s) with a customer. A contract is any clear agreement made verbally or in writing that outlines specific terms and has value.

Second, you should identify the performance obligations in the contract(s). These may include goods or services or a mixture of both. Each performance obligation should be distinct, meaning that it provides value to the customer on its own.

Third, you should determine the transaction price. Many contracts have a clear transaction price. Others may include additional factors that should be considered, including variable considerations, noncash considerations and considerations made payable to the customer: Variable considerations are factors that may affect the final collectible price, such as discounts or rebates.

Noncash considerations include any goods or services used as payment, if the price won't be paid in full with cash. These items should be considered at fair market value. Considerations made payable to the customer are other items you will pay to the customer as a result of the contract. These should be included in the transaction price. Additionally, considerations paid to clients of the customer should be included.



Fourth, you should allocate the transaction price to the performance obligations in the contract. Use the individual price of each obligation, if it were sold separately, as the basis. If discounts or other considerations apply, include those with the respective obligation. If these considerations apply to the entire contract, allocate them across all obligations accordingly.

Finally, you should recognize the revenue when the entity satisfies a performance obligation. FASB states that you have satisfied the obligation when the control is transferred to the customer.

Extended Contracts

If the contract covers an extended period of time, FASB allows companies to recognize a portion of the revenue continuously over the specified period as long as one of the following three criteria are met:

1. The customer simultaneously receives and consumes the benefits provided by the company's performance as it occurs.
2. The company's performance creates or enhances an asset that the customer controls as the asset is created or enhanced
3. The company's performance doesn't create an asset with an alternative use to the entity, and the company has an enforceable right to payment for performance completed to date.

In most situations, one of these criteria will be included in the contract. However, if none of the criteria are met, the company should wait until the full obligation is met to recognize any of the revenue, at which point it should be recognized all at once.

Change Orders

FASB also provides additional information for change orders. If the change order adds distinct goods or services, then it should be treated as a separate contract. If the change order does not add distinct goods or services, it should be added to the original contract and treated as a variable consideration.



Final Thoughts

This document is intended to provide a brief overview of the process for recognizing revenue and is not a substitute for speaking with one of our expert advisors.

If you have additional questions or need assistance implementing these standards, please contact our office.

We'd be happy to discuss your specific situation.



About Heard, McElroy & Vestal

In 1946, S. Berton Heard, Charles McElroy and Charles Vestal founded Heard, McElroy & Vestal, LLC in Shreveport, Louisiana. Together, this trio of professionals established the firm as a pillar of trust, integrity and competence, with the mission to create solutions and provide opportunities for our clients, our people, and our communities. HMV is one of the largest public accounting and consulting firms in Northwest Louisiana, servicing our clients throughout the states of Louisiana, Arkansas, Texas, Mississippi, Oklahoma and Tennessee from offices in Shreveport and Monroe. Our firm is comprised of over one hundred (100) employees: Partners, Of Counsel Partners, Senior Managers, Managers, additional Professional Staff and Administrative Staff. Our Professional Staff includes more than fifty (50) certified public accountants who obtain additional certifications which are Accredited in Business Valuation (ABV), Certified Fraud Examiners (CFE), Not-for-Profit Certificate holders, Certified Valuation Analysts (CVA), Personal Financial Specialists (PFS), and Certified Mineral Managers (CMM). Our team of professionals brings together many years and diversification of experience, providing a network of knowledge and resources and allowing for industry and niche specialization. Not one CPA can offer the range and quality of services a firm of our size is able to provide, while remaining small enough to deliver personalized service and attention to our clients with consistency on engagements. HMV's strategic associations include Align Mineral Management, LLC, Business Valuation Consultants, LLC and HMV Wealth Advisors, LLC.



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