New Revenue Recognition Guidelines: What Are the Guidelines and Examples?

Part two of a 6-part series on new revenue recognition guidelines.

The core principle of the new guidelines is to *recognize revenue to depict the transfer of promised goods or service to customers in an amount that reflects the consideration to which the entity expects to be entitled for those goods or services*[2]. That is, the aim is to recognize revenue consistently as the customer assumes ownership of the various components of a contract, and values the revenue at that obligation's appropriate share of the expected revenue.

Steps to achieve this core principle:

• Establish the **contract** with the customer
• Identify the **performance obligations** (promises / deliverables) in the contract
• Determine the (overall) **transaction price**
• **Assign** the transaction price to the contract's performance obligations
• **Recognize revenue** as the reporting organization satisfies a performance obligation

A Simple Example
Your organization sells a computer system and printer to a customer for $1,000. The computer and software are delivered to the customer in June but, due to manufacturing delays, the printer is delivered in July. Under the new Performance Obligation guidelines, when is the revenue for the various components of the contract to be recognized?

1. A contract is established for a computer system

2. Consisting of three performance obligations:

a. Laptop computer
b. Software
c. Printer

3. The overall transaction price is $1,000

4. The company's standalone selling prices are:

a. Laptop: $800
b. Printer: $200
c. Software: $200
(Total: $1,200)

Under the contract, based on the total contracted price, the performance obligations are assigned transaction prices of:

a. Laptop: $1,000 / 1200 * 800 = $666.67
b. Printer: $1,000 / 1200 * 200 = $166.67
c. Software: $1,000 / 1200 * 200 = $166.67
(Total: $1,000)

Once either party has acted on the contract (i.e., at the earlier of the customer accepting an invoice or the vendor commencing shipping), the vendor accrues the liability to the customer for each performance obligation at the assigned revenue valuations.

5. Upon delivery of the laptop and software, the vendor recognizes revenue $833.33 in June. At the end of June, the balance sheet records an accrued liability to the customer of $166.67 for the printer. In July, when the client takes ownership of the printer, the vendor recognizes revenue of $166.67.

Do the new revenue recognition guidelines affect you? Would you like to learn more about how to leverage your existing Oracle/Hyperion investment to meet the guidelines? **Contact GBI for a free Consultation.**

[2]Retrieved from FASB web page

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Sherri Schaffroth
National Sales Director, GBI
(919)324-5351