Aldrich®

Construction

ARE YOU READY FOR THE NEW REVENUE RECOGNITION STANDARD?

The construction accounting standards as we've known them are about to undergo crucial change. After nine years in the making, the required implementation of Accounting Standards Codification ASC 606 – Revenue from Contracts with Customers – is right around the corner and becomes mandatory for annual reporting periods beginning after December 15, 2018. For most entities, this means a calendar year beginning January 1, 2019, and ending December 31, 2019.

Construction contractors are very familiar with contracts; however, the new revenue recognition standard will require management to make additional judgments regarding when to recognize revenue associated with contracts.

What are the Basic Provisions?

The standard creates a five-step model through which companies will analyze each contract.

Step 1: Identify the Contract

The definition of a contract with a customer is defined under five criteria, from which the contractor must first determine whether an actual contract exists.

For construction contractors, we find nothing new here that would significantly alter your basic understanding of a contract; however, facets such as termination clauses should be looked at more closely.

Step 2: Identify the Distinct Performance Obligations

A good or service is distinct if:

- The customer can benefit from the good or service on its own (or in conjunction with other readily available resources), and
- The good or service is separately identifiable from other obligations included in the contract.

The performance obligation may be specifically stated in the contract or implied based on the company's historical practices.

The determination of the various performance obligations in contracts with customers requires a great deal of analysis and judgment on the part of a contractor.

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Step 3: Determine the Transaction Price

A significant change included in the new revenue recognition standard is the treatment of variable consideration.

Examples of variable consideration within a contract are claims and pending change orders, unpriced change orders, incentive and penalty provisions within the contract, shared savings, price concessions, liquidating damages, etc.

Contractors need to consider the following steps in calculating the amount of variable consideration in the contract:

1. Identify all variable considerations associated with a given contract or performance obligation.
2. Determine which items, if any, can be grouped together due to similar characteristics for evaluation.
3. Document the amount of the variable consideration using information that the contractor typically uses during the bid and proposal process as well as information used in establishing prices for promised goods.

Step 4: Allocate the Transaction Price to the Performance Obligations in the Contract

The transaction price is allocated to separate performance obligations in proportion to the standalone selling price of the promised goods or services. Various methods can be employed when estimating the standalone selling price.

Step 5: Recognize Revenue when (or as) Each Performance Obligation is Satisfied

The amount of revenue recognized when transferring the promised good or service to the customer is equal to the amount allocated to the satisfied performance obligation, which may be satisfied at a point in time or over time. Control of the asset refers to the ability to direct the use of and obtain substantially all the remaining benefits from the asset.

For a complete copy of our Revenue Recognition Implementation Guide, go to bit.ly/rev-rec-guide.

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