CRI'S INVESTIGATIVE REPORT:

How the New Revenue Recognition Standard Will Affect Construction Contractors

WHEN

For nonpublic entities, fiscal years that start after December 15, 2018. Because the standard requires retrospective application, it also must be applied to the year before adoption. So, for entities with calendar year-ends, the standard must be applied to both 2018 and 2019.

WHAT

Accounting Standards Update ("ASU") 2014-09, *Revenue from Contracts with Customers*, will replace current industry-specific guidance and will require all entities to use the following five-step process:

1. Identify the contract
2. Identify the separate performance obligations in the contract
3. Determine the transaction price
4. Allocate the transaction price to the separate performance obligations in the contract
5. Recognize revenue when (or as) the entity satisfies a performance obligation

WHY REV REC MATTERS

- One of the most pervasive accounting standard changes in a generation
- Will impact timing, presentation, and potentially the amount of revenues to be recognized
- Implementation will require substantial investment of time and resources

WHAT TO ASK

Unlike organizations in some other industries, most construction contractors will not have to completely overhaul how they account for contract revenue. They will, however, need to ask some important questions as they recognize revenue:

Does the contract need to be broken up into separate performance obligations?

→ Although most construction contracts comprise one performance obligation, the contract might need to be broken up if each deliverable is distinct from the others. An example might be a school contract that calls for classrooms completed by August 1, a gymnasium building by October 1, and a cafeteria by January 1.

Do multiple contracts need to be combined into one?

→ Entering into two or more contracts with the same customer at or near the same time, with a single commercial objective, might trigger a requirement to combine these contracts.

Is the buyer committed to perform his or her obligations under the contract? Is it probable the organization will collect all of the consideration to which it is entitled?

→ If the answer to *either* question is 'no,' then a contract does not exist, and revenue cannot be recognized.

Should revenue be recognized at a point in time (as in the old completed contract method) or over a period of time (as in the percentage of completion method)?

→ Most contractor performance obligations are satisfied over time, with progress measured using either input (e.g., costs) or output methods (e.g., miles of railroad track completed).

Has the contract changed?

→ If so, then the contract modification *might* need to be accounted for as a separate contract. The new guidance says that the contract modification should be accounted for as a new contract if:

1. The goods or services to be provided under the modified contract are distinct from the goods or services transferred on or before the date of the contract modification, and
2. The new price reflects the value of those goods or services.

Does the contract include "variable consideration?"

→ An unpriced change order will require significant judgment and analysis to determine the amount of variable consideration to include in the transaction price. It will require estimating the expected value (or most likely amount) and then taking into account the likelihood and magnitude of a potential reversal of revenue. For example, a project that is subject to factors outside the contractor's control could entail a high likelihood of a reversal of revenue.

WHO CAN HELP?

CRI is a leader in construction accounting. We can help you dot the i's and cross the t's of this and all other accounting standards.

If your organization has yet to fully consider the impacts of this new standard, the time for action is now! **Contact us at construction@CRIcpa.com to discuss how CRI can help you prepare for and adopt the new revenue recognition standard.**

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