HASKELL & WHITE LLP
CERTIFIED PUBLIC ACCOUNTANTS AND BUSINESS ADVISORS

The Value of Experience

HASKELL & WHITE LLP

Roundtable Series

THE FUTURE OF REVENUE RECOGNITION

Orange County - December 14, 2011

San Diego – January 25, 2012

Agenda

I. Welcome, introductions and expectations

II. The Future of Revenue Recognition

- An executive summary of the new Exposure Draft
- An action plan to help you implement the new guidance
- A few examples

III. Closing and Questions

HASKELL & WHITE LLP
CERTIFIED PUBLIC ACCOUNTANTS AND BUSINESS ADVISORS

Introduction to Haskell & White LLP

- ✓ We are a middle-market focused firm powered by 60 client-centered professionals and 9 entrepreneurial partners
- ✓ We practice with the technical competencies and experience of larger accounting firms and the attentiveness and responsiveness of smaller accounting firms
- ✓ Our primary focus areas include SEC, Real Estate and M&A
- ✓ Our SEC clients include both accelerated and non-accelerated filers; we serve pre-revenue companies, as well as businesses with revenues in the hundreds of millions
- ✓ In January 2011, we received our second consecutive "clean" PCAOB inspection report

HASKELL & WHITE LLP

CERTIFIED PUBLIC ACCOUNTANTS AND BUSINESS ADVISORS

A Few Expectations

7. The standard is only 30 days old – there are no real experts yet!
6. Common view: easy to understand – difficult to apply
5. The new model is contract-based and requires a five-step approach
4. Can one size really fit everyone?
3. I really like “rules” – the “principles-based approach” will require even more judgments and estimates
2. Great, just what we need – more disclosures
1. In your spare time, you will have to think about strategic changes to contract terms and business strategies

The Future of Revenue Recognition

How did we get here?

- ✓ December 2008 – FASB and IASB published Discussion Papers
- ✓ June 2010 – FASB and IASB issued Exposure Drafts, *Revenue From Contracts with Customers*
- ✓ November 2011 – The Boards re-exposed the proposals because of the significant number of comment letters and because of the importance to all entities of reporting revenues
- ✓ March 2012 – Comments on the re-exposed Exposure Draft are due
- ✓ December 2012 (?) – Final standard expected
- ✓ January 2015 – Expected required implementation date

HASKELL & WHITE LLP
CERTIFIED PUBLIC ACCOUNTANTS AND BUSINESS ADVISORS

The Future of Revenue Recognition

The core principle of the proposed guidance:

An entity should recognize revenue to depict the transfer of promised goods or services to customers in an amount that reflects the consideration to which the entity expects to be entitled in exchange for those goods or services.

The Future of Revenue Recognition

To achieve the core principle, an entity would apply all of the following steps:

Step 1: Identify the contract with a customer

Step 2: Identify the separate performance obligations in the contract

Step 3: Determine the transaction price

Step 4: Allocate the transaction price to the separate performance obligations

Step 5: Recognize revenue when (or as) each performance obligation is satisfied

HASKELL & WHITE LLP

CERTIFIED PUBLIC ACCOUNTANTS AND BUSINESS ADVISORS

The Future of Revenue Recognition

Step 1: Identify the contract with a customer:

- ✓ Can be written, oral or implied by an entity's customary business practices
- ✓ Two or more contracts with the same customer may need to be combined if they are negotiated with a single commercial objective
- ✓ Modifications are separate contracts if there is a new separate performance obligation and it is priced at a stand-alone amount

HASKELL & WHITE LLP

CERTIFIED PUBLIC ACCOUNTANTS AND BUSINESS ADVISORS

The Future of Revenue Recognition

Step 2: Identify the separate performance obligations in the contract:

- ✓ **Performance obligation** – a promise to transfer a good or service
- ✓ May be explicit, implicit or implied
- ✓ In bundled arrangements, each promised good or service is a separate performance obligation only if it is **distinct** –
  1. The entity regularly sells the good/service separately, or
  2. The customer can benefit from the good/service either on its own or with other resources that are readily available

HASKELL & WHITE LLP
CERTIFIED PUBLIC ACCOUNTANTS AND BUSINESS ADVISORS

The Future of Revenue Recognition

Step 2: Identify the separate performance obligations in the contract:

- ✓ Notwithstanding this, a good or service in a bundle of promised goods or services is **not distinct** if –
  1. The goods/services are highly interrelated and requires the entity to also provide a significant integration service, **and**
  2. The bundle is significantly modified or customized

HASKELL & WHITE LLP
CERTIFIED PUBLIC ACCOUNTANTS AND BUSINESS ADVISORS

The Future of Revenue Recognition

Step 3: Determine the transaction price:

- ✓ Defined as the amount of consideration to which an entity **expects to be entitled** (at the "reasonably assured" level)
- ✓ An entity must consider:
  - Variable consideration (discounts, royalties, rebates, incentives, etc.)
  - Time value of money (more than one year)
  - Noncash consideration (at fair value)
  - Amounts payable to the customer (rebates, slotting fees)
- ✓ Allowance for impairment loss is presented against gross revenues

HASKELL & WHITE LLP
CERTIFIED PUBLIC ACCOUNTANTS AND BUSINESS ADVISORS

The Future of Revenue Recognition

Step 4: Allocate the transaction price to the separate performance obligations:

- ✓ Determine the stand-alone selling price of the good or service underlying each separate performance obligation and allocate the transaction price on a **relative stand-alone selling price basis**
- ✓ If a stand-alone selling price is not observable - estimate it

HASKELL & WHITE LLP
CERTIFIED PUBLIC ACCOUNTANTS AND BUSINESS ADVISORS

The Future of Revenue Recognition

Step 5: Recognize revenue when (or as) the performance obligation is satisfied:

- ✓ Recognition when (or as) an entity satisfies a performance obligation by transferring a promised good or service to a customer
- ✓ Goods or services are transferred when (or as) the customer obtains **control** (the ability to direct its use)
- ✓ Performance obligations are satisfied **over time** or at a **point in time**
- ✓ Those that are satisfied over time, requires measuring the progress towards completing the performance obligation
  - Output methods (surveys, units produced)
  - Input methods (costs or hours incurred)
- ✓ New concepts of "reasonably assured" and "predictive experience"

HASKELL & WHITE LLP
CERTIFIED PUBLIC ACCOUNTANTS AND BUSINESS ADVISORS

The Future of Revenue Recognition

The new proposed standard also addresses these oldies, but goodies:

- ✓ Principal versus Agent – gross versus net
- ✓ Options (loyalty rewards)
- ✓ IP licenses
- ✓ Rights of return
- ✓ Warranties
- ✓ Nonrefundable upfront fees
- ✓ Bill-and-hold, consignment, and sale/repurchase arrangements
- ✓ Contract costs (may capitalize)
- ✓ Onerous contracts

HASKELL & WHITE LLP
CERTIFIED PUBLIC ACCOUNTANTS AND BUSINESS ADVISORS

The Future of Revenue Recognition

Just what we need – more disclosures:

- ✓ Disaggregation of revenues into primary categories
- ✓ Reconciliation of changes in contract balances
- ✓ Tabular reconciliation of movements of the assets recognized from the costs to obtain or fulfill contracts and onerous performance obligation liabilities
- ✓ Analysis of remaining performance obligations
- ✓ Significant judgments that impact revenue
- ✓ Interim disclosures will be similar to annual disclosures
- ✓ "Opt out" election for nonpublic companies is available

HASKELL & WHITE LLP
CERTIFIED PUBLIC ACCOUNTANTS AND BUSINESS ADVISORS

The Future of Revenue Recognition

Transition:

- ✓ Good news – Effective date will be no sooner than 1/1/2015
- ✓ Bad news – Retroactive application is required (with some practical expedients)

HASKELL & WHITE LLP
CERTIFIED PUBLIC ACCOUNTANTS AND BUSINESS ADVISORS

Implementation Action Plan

Prepare:

- ✓ Educate yourself and key stakeholders
- ✓ Develop a timeline and plan
- ✓ Know your current contracts
- ✓ Update your data
- ✓ Assess potential changes in timing of revenue and disclosures

Implementation Action Plan

Educate:

- ✓ Read the Exposure Draft
- ✓ Attend seminars
- ✓ Read! – articles; CFO.com, Journal of Accountancy, daily email updates (AICPA, Cal Society, etc.)
- ✓ Don’t have time ? – delegate project to staff
- ✓ Inform executive management and audit committee

HASKELL & WHITE LLP
CERTIFIED PUBLIC ACCOUNTANTS AND BUSINESS ADVISORS

Implementation Action Plan

Create a timeline and a plan:

- ✓ Establish key dates and prepare calendar
- ✓ Identify team (sales, finance, legal, tax, auditors, etc.)
- ✓ Effective date expected to be in 2015 with **retroactive** application; this will impact your 2013 and 2014 financial statements
- ✓ If you need to implement changes, 2012 will be the time to do it!

HASKELL & WHITE LLP

CERTIFIED PUBLIC ACCOUNTANTS AND BUSINESS ADVISORS

Implementation Action Plan

Know your customer contracts:

- ✓ Update sales personnel to upcoming changes
- ✓ Inventory revenue streams and current contracts
- ✓ Are all entity contracts similar in terms? How are changes being made? Will this impact the timing and extent of revenue recognized?
- ✓ Future contracts – who is writing them and who is negotiating sales terms?

HASKELL & WHITE LLP
CERTIFIED PUBLIC ACCOUNTANTS AND BUSINESS ADVISORS

Implementation Action Plan

Update and capture data:

- ✓ Amounts requiring estimates based on experience; is your data current? Are you capturing accurate data?
- ✓ Are there new revenue streams that will not have sufficient data? Alternatives?
- ✓ Internal/external financial projections – be cognizant of what you promise if you have not evaluated potential changes
- ✓ Potential for capitalizing costs directly related to contracts – are these identified? Are they being captured?
- ✓ New disclosure requirements – are you/your systems ready?

HASKELL & WHITE LLP
CERTIFIED PUBLIC ACCOUNTANTS AND BUSINESS ADVISORS

Implementation Action Plan

Assess potential changes in timing of revenue and disclosure:

- ✓ After you are familiar with the new guidance, model the impact of significant contracts; how does it impact your company? Are the changes acceptable? If not, what changes can be made?
- ✓ Transparent disclosures – do you want this information disclosed?
- ✓ ERP systems need to capture and report additional data – is this contemplated in your CAPEX/IT plan?
- ✓ Evaluate impact on contractual commitments (earn-outs, covenants)
- ✓ Communicate to stakeholders well in advance – no surprises

HASKELL & WHITE LLP

CERTIFIED PUBLIC ACCOUNTANTS AND BUSINESS ADVISORS

The Future of Revenue Recognition

Example – Bundled Contracts

Your company enters into a contract to build special manufacturing equipment and is responsible for procurement, design and installation.

Are the bundled goods/services a single performance obligation?

- Highly interrelated; significant integration service to customize

HASKELL & WHITE LLP
CERTIFIED PUBLIC ACCOUNTANTS AND BUSINESS ADVISORS

The Future of Revenue Recognition

Example – Variable Consideration

Your company enters into a contract to build special equipment for $100,000 with a performance bonus of $50,000 based on timing of completion. The bonus decreases by 10% per week for every week beyond the due date.

What is the "transaction price"?

- Probability-weighted method versus most likely outcome approach

HASKELL & WHITE LLP
CERTIFIED PUBLIC ACCOUNTANTS AND BUSINESS ADVISORS

The Future of Revenue Recognition

Example – Predictive Experience

Your company sells maintenance contracts on behalf of manufacturers for upfront commissions of $1,000 and $250 per year based on how long the customer renews the contract. Past experience shows that renewals are typically for 2 years.

What is the transaction price?

HASKELL & WHITE LLP
CERTIFIED PUBLIC ACCOUNTANTS AND BUSINESS ADVISORS

Haskell & White Roundtable Series

For more information on the Roundtable Series or to find out about future Roundtables, please contact Meagan Hayes at 949-450-6249 or mhayes@hwcpa.com.

HASKELL & WHITE LLP

CERTIFIED PUBLIC ACCOUNTANTS AND BUSINESS ADVISORS

Opportunities to connect

- Check out our website at **www.hwcpa.com**
- Try our MindShop Growth & Profit Diagnostic Tool – free of charge!
- Follow us on:
  - Facebook
  - LinkedIn
  - Twitter

HASKELL & WHITE LLP
CERTIFIED PUBLIC ACCOUNTANTS AND BUSINESS ADVISORS

HASKELL & WHITE LLP

CERTIFIED PUBLIC ACCOUNTANTS AND BUSINESS ADVISORS

8001 Irvine Center Drive

Suite 300

Irvine, CA 92618

T (949) 450-6200

12707 High Bluff Drive

Suite 200

San Diego, CA 92130

T (858) 350-4215