accountingTODAY

March 20, 2018 accountingtoday.com

Mixed results seen in early revenue recognition standards implementation

BY MICHAEL COHN

Businesses that were early adopters of the revenue recognition standard that's taking effect for public companies this year have been running into some issues with regulators and investors, according to some observers.

The Financial Accounting Standards Board, with the support of the Securities and Exchange Commission, set an effective date of last December for public companies to begin implementing the standard. The results won't be widely seen until corporations begin filing their quarterly financial statements this year, but some companies chose to adopt the standard early and have already been receiving comment letters from the SEC.

"Companies are now navigating these new rules as they engage in reporting to the SEC, and early indications suggest an uneven rollout," said Rob Peters, a senior director at the SEC risk and compliance analytics firm Intelligize.

He has followed the SEC's efforts to promote revenue transparency this reporting season. "The early takeaways from two high-profile case studies (Alphabet and GE) will not cheer information-hungry investors," he said. "In fact, one could make an argument that the less information companies provide under the new revenue recognition standards, the better they fare."

Alphabet, Google's parent company, initially indicated that it would be an early adopter of the new revenue recognition standard, but in practice, the company has avoided separately disclosing the revenue for some of its separate lines of business, such as YouTube. After months of back and forth, Peters noted the SEC essentially threw up its hands and appears to have given up the fight.

"They [Alphabet] were one of the early adopters, and then in the review process that the SEC does over disclosures in their financial statements, either their 10-K or 10-Q, they were asking pointed questions based on the revenue recognition [standard], ASC 606, as to why they didn't disaggregate certain revenues, particularly YouTube," said Peters. "The argument was that they consider that all part of the Google business. They basically say they have their Google business, and what they call other 'bets,' other lines of business that they have. The SEC came back and said aren't you supposed to be disclosing it like you would be disclosing it to your chief operating decision makers. The person they named was [Google co-founder] Larry Page, and they said that the information that Mr. Page sees is basically the total revenues for the different operating segments, for instance Google as a whole, instead of breaking it down into specific businesses, like the YouTube business, or this business or that business under Google. The SEC's argument was how would they know about the different businesses. Alphabet's argument was that the different business decisions aren't made at the CEO of each business level. For instance they would receive information on how their own firm is doing and sort of aggregate that all the way to the top, so they get just the top-line revenue for all of Google. That was the argument that went back and forth. Then finally the SEC just accepted that argument after about two or three times going back and forth on it."

As for General Electric, GE recently filed an annual report that was full of disclosures about the new revenue recognition rules and the new tax law that had an impressive level of detail and overall transparency, according to Peters. However, it was swiftly punished by investors, losing 3.5 percent of its share price before the next opening of trading. GE's efforts at transparency seemed to confuse both the media and its own investors and had the opposite of the intended effect of the rev rec standard.

"GE obviously has been the center of a lot of attention recently with the changing of the CEO and some of the businesses," said Peters. "One of the things that was maybe misinterpreted was that they were restating their financials on their 10-K. Most companies that have taken the full retrospective method on the transition for [ASC] 606 are going to have to restate in some way their financials based on going through that method and how the accounting process is going to change. Restatements in general seem to have a negative connotation. It wasn't that GE made some kind of omission or misstatement. All it was is that with their compliance with the new regulations, they would have to restate them based on their transition method. We'll see other companies have to do it as well this year, for those that elect to do the full retrospective [method]."

A little less than 200 companies have declared that they will use the full retrospective method so far in their 10-K's this year, according to Peters, while approximately 1,500 have declared they would use the modified retrospective method.

The SEC has only commented so far on a handful of early adopter companies besides GE and Alphabet. Others include Ford Motor Company, Microsoft, Radius Health, First Solar, CBOE Global Markets and Workday. "The Alphabet one was probably the longest back and forth that they went through with the SEC," said Peters.

Alex Wodka, a partner at Crowe Horwath, noted that many companies have put a tremendous amount of resources into preparation for the new rev rec standard, and some of those efforts have been ongoing since the time that the converged standard was released in May 2014 by FASB and the International Accounting

Standards Board. But many companies are still having difficulties adjusting.

"Some of the challenges that companies have today is that, depending on where they were in the context of trying to integrate and implement the standard, it may provide them with some challenges today as they're ultimately applying the standard," said Wodka. "Some of the more prepared companies have really thought through the infrastructure issues and made the appropriate modifications, whether it be to their systems, their contracts or the like. There's also been a number of companies that have actually been addressing this on a fairly accelerated basis. What they're finding today is it's up and running and they think they finally understand it, but there's probably some unintended or unconsidered consequences."

Many companies outsourced some of the work to third parties and now have to pull the work back in-house. "There is a transition from the third party to the entity itself that could create some challenges," said Wodka.

He believes it's still too early to assess what the overall challenges or disruptions of the new standard are at this point in the year. "I think we'll probably know very shortly," he said. "Given the fact that they don't report at least to the public domain until the first quarter, you're probably going to see an accumulation of those challenges when they file their 10-Q."

He believes the standard will provide greater comparability in financial reporting. "It does create a common methodology, that being the five-step process," said Wodka. "But it will also create and it has created some challenges because some minor differences in contractual terms can impact how a particular contract is recognized. From a disclosure perspective there likely will be a more robust and consistent disclosure within the various industries."

Most of his clients have elected to use the modified retrospective as opposed to the full retrospective method. "That's a simpler way of doing it," he added.

Certain industries are feeling more of an impact than others from the new standard. "I think the industries that are probably most impacted are technology, telecommunications and aerospace," said Wodka. "Health care has also had some impact, particularly in terms of the groupings of some of the portfolios. On the other hand I have had reasonably minor amounts of impacts. The issues are that the contracts are very complex and may have multiple performance obligations. Trying to assess those performance obligations could be a daunting task. Part of the issue is that under this standard it requires in many cases a lot of judgment. If you look at the system technology that is out there, you're not necessarily equipped to address judgment issues, so you've got some of that coming into play as well."