In 2014, the Federal Accounting Standards Board (FASB) and the International Accounting Standards Board (IASB) issued ASC 606. The new standards focus on proper recognition of revenue from contracts with customers. ASC 606 guidelines was instituted in 2018 for public companies and 2019 for private firms. These standards are significant and have both technical and operational implications, both of which impact your business.

**TECHNICAL**
First, on the technical front, we clear up the ambiguity in our Five Step Process outlined in the standards and the technical components of each step. It’s important to understand these five steps, so we’ve taken the technical language and put it into a simple “what does it mean?” format.

If you are already familiar with the technical aspects of ASC 606 and don’t need a refresher, click here to go directly to the Implementation Challenges of ASC 606.

**IMPLEMENTATION**
Secondly, we address the implementation challenges imposed on accounting departments. Implementation goes beyond a technical understanding of the standards and focuses on the day-to-day tasks of collecting, allocating, tracking and recognizing revenue recognition under ASC 606.

In this white paper, we offer a practical resource of what you should expect and identify the challenges that companies face in complying with the new standards.

**AUTOMATION IS THE KEY**
Finally, we outline the power of automation in the revenue recognition and make our pitch for RevLock our revenue recognition automation software.

Check out our website at [www.rev-lock.com](http://www.rev-lock.com) or call us at 724-312-9417.
The standards outline a five-step process:

1. Identify the Contract(s) with a Customer
2. Identify the Performance Obligations in the Contract
3. Determine the Transaction Price
4. Allocate the Transaction Price to the Performance Obligations in the Contract
5. Recognize Revenue When (or as) the Performance Obligation is Satisfied

Most companies are able to identify the elements of a contract (step one) and normally able to determine the transaction price (step three). The challenge typically comes with steps two and four due to technical considerations:

- **Step Two:** Requires determining the performance obligations and identifying which products and services are distinct and separable obligations.

- **Step Four:** Requires establishing the stand-alone selling price for each product and service offered. The stand-alone selling price (SSP) is determined based on historical data and is crucial to complying with ASC 606.

It’s important that you consult with your outside auditors as you determine your company’s policies on ASC 606. This will mitigate the risk of year-end surprises.

Steps one through five culminate in the goal of the entire exercise: the proper recognition of revenue under ASC 606. By this point, the technical aspects of the standards should be well understood (e.g., determining performance obligations, the stand-alone selling price and the proper revenue recognition methodology). But don’t be lulled to sleep—once the technical aspects are hammered out, step five presents real operational challenges, such as tracking and recognizing revenue in the period it’s earned.

This has proved to be the biggest on-going challenge of implementing ASC 606 due to the number of customers, the number of contracts, multiple products and services for each contract and accounting for these over multiple periods.

Now on to the five steps of ASC 606.
WHAT IT SAYS:

1. Parties must approve and be committed to contract terms.
2. Party’s rights to goods and services are identified.
3. Payment terms are identified.
4. The contract has commercial substance.
5. Evaluation of the probability that the entity will collect the consideration it is entitled to.

WHAT IT MEANS:

Most companies’ policies and processes will comply with the requirements of step 1. Most of it is common sense. Note that the probability of collection must be considered. This was not a requirement under the previous guidance.

WHAT IT SAYS:

1. The revenue recognition standard defines a performance obligation as a promise in a contract with a customer to transfer a good or service to the customer.
2. At contract inception, an entity should assess the goods or services promised in a contract with a customer and should identify as a performance obligation (could be multiple performance obligations) each promise to transfer to the customer as:
   A. Distinct – The customer can benefit from the goods or services
   B. Separable – The promise to transfer goods or services is separately identifiable from other promises in the contract.

WHAT IT MEANS:

This is a critical concept of ASC 606 and is at the heart of the implementation of the standards for two reasons:
1. The bundling of multiple products and services within a single contract (e.g. sales order).
2. The negotiated pricing of the multiple products and services included in the contract.
It’s common for a single contract to include multiple products and services. If the individual offering are distinct and separable, it’s likely that they will each have different performance obligations that will be satisfied at various times.

Understanding and tracking each performance obligation is important since revenue cannot be properly recognized until the performance obligation is met.

The second item that significantly impacts the implementation of ASC 606 is pricing of multiple products and services. During the course of negotiations, the contract price for the products and services are determined. It’s common to discount one or more of the multiple products and services being offered. This becomes important when determining the amount of revenue to be recognized for each performance obligation in the contract. This determination is discussed in Step 4 below.

WHAT IT SAYS:

3. Determine the transaction price

1. The transaction price is the amount of consideration (e.g., payment) which the company expects to receive in exchange for transferring promised goods or services to a customer, excluding amounts collected on behalf of third parties (e.g., sales taxes).

2. To determine transaction price, an entity should consider the effects of:
   
   A. Variable consideration
   B. Constraining estimates of variable consideration
   C. Existence of significant financing component
   D. Non-cash considerations
   E. Consideration payable to the customer

WHAT IT MEANS:

This is a fancy way of saying you should do what you are probably already doing. In other words, include everything you expect to receive from the customer. For some companies, award fees and milestone and success fees may be recorded to revenue earlier than under historical GAAP.
1. If a contract has more than one performance obligation, an entity should allocate the transaction price to each separate performance obligation in an amount that depicts the amount of consideration to which the entity expects to be entitled in exchange for satisfying each separate performance obligation.

2. To allocate an appropriate amount of consideration to each performance obligation, an entity should determine the stand-alone selling price at contract inception of the distinct goods or services underlying each performance obligation.

3. Amounts allocated to a satisfied performance obligation should be recognized as revenue, or as a reduction of revenue, in the period in which the transaction price changes.

Let’s look back at Step 2, where we determine the distinct and separate performance obligations.

Once the distinct and separable performance obligations are identified, the amount of revenue to be recognized (when the obligation is met) must be determined for each distinct and separable performance obligation.

This is not as simple as identifying the multiple performance obligations included in the contract and recognizing income based on the contract price.

This is due to the fact that multiple performance obligations are often included in a single contract. During the negotiations, these performance obligations are “bundled” and offered at a combined price in a single contract.

It’s routine during the negotiations to offer discounts for multiple years, services or simply to land the deal. If bundled items are discounted, the standards require the seller to allocate the discount to each product and service offered. The standards do not rely on the price for each item as outlined in the contract.

The whole idea is to apply a consistent methodology to allocate the discount to the multiple items included in the contract. This is important since the revenue associated with each product and service will be recognized over various accounting periods.
In other words, the allocation of the total contract to the individual performance obligations impacts when and how much revenue is recognized.

The allocation process begins with the concept of “Stand-Alone Selling Price.” The stand-alone selling price is the price that each product and service would be sold for if it were sold on its own (in other words, sold on a stand-alone basis).

This price is determined through the analysis of historical data. It’s normally developed by management but ultimately it’s critical that outside auditors are in agreement with the Stand-Alone Selling Price for each product and service and agree with the methodology to determine this price.

Once this is determined, the total contract price is allocated to the individual products and services based on the Stand-Alone Selling Price. This is done on a pro-rata basis. For example:

<table>
<thead>
<tr>
<th>Contract Price</th>
<th></th>
</tr>
</thead>
<tbody>
<tr>
<td>Product A</td>
<td>$10,000</td>
</tr>
<tr>
<td>Product B</td>
<td>$5,000</td>
</tr>
<tr>
<td>Service 1</td>
<td>$8,000</td>
</tr>
<tr>
<td>Service 2</td>
<td>$7,000</td>
</tr>
<tr>
<td>Total Contract</td>
<td>$30,000</td>
</tr>
</tbody>
</table>

Each of these represent a distinct and separate performance obligation. As mentioned, it’s improper under ASC 606 to simply recognize the income for each product and service as the obligation is met based on the contract price. Instead, it must be compared to the Stand-Alone Selling Price for each distinct and separate performance obligation.

Using the items included in the Contract Example above, assume that the stand-alone selling price (SSP) for each of these items are as follows:

<table>
<thead>
<tr>
<th>SSP</th>
<th></th>
</tr>
</thead>
<tbody>
<tr>
<td>Product A</td>
<td>$14,000</td>
</tr>
<tr>
<td>Product B</td>
<td>$7,000</td>
</tr>
<tr>
<td>Service 1</td>
<td>$9,000</td>
</tr>
<tr>
<td>Service 2</td>
<td>$7,000</td>
</tr>
<tr>
<td>Total Contract</td>
<td>$37,000</td>
</tr>
</tbody>
</table>
In this example, the total price of the items sold on a stand-alone basis is $37,000 while the contract price is $30,000.

Under ASC 606, the total contract price must be allocated to each of the products and services offered based on its pro-rata relationship of the SSP for each of these products. As a result, the income to be recognized for each item is as follows:

<table>
<thead>
<tr>
<th></th>
<th>Revenue To Be Recognized</th>
</tr>
</thead>
<tbody>
<tr>
<td>Product A</td>
<td>$11,351</td>
</tr>
<tr>
<td>Product B</td>
<td>$5,676</td>
</tr>
<tr>
<td>Service 1</td>
<td>$7,296</td>
</tr>
<tr>
<td>Service 2</td>
<td>$5,677</td>
</tr>
<tr>
<td><strong>Total Contract</strong></td>
<td><strong>$30,000</strong></td>
</tr>
</tbody>
</table>

Notice that the allocated revenue to be recognized equals the total contract price. This should always be the case.

Now let’s look at the contract price compared to the allocated revenue to be recognized under ASC 606.

<table>
<thead>
<tr>
<th></th>
<th>Contract Price</th>
<th>Revenue To Be Recognized</th>
</tr>
</thead>
<tbody>
<tr>
<td>Product A</td>
<td>$10,000</td>
<td>$11,351</td>
</tr>
<tr>
<td>Product B</td>
<td>$5,000</td>
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<td>$7,000</td>
<td>$5,677</td>
</tr>
<tr>
<td><strong>Total Contract</strong></td>
<td><strong>$30,000</strong></td>
<td><strong>$30,000</strong></td>
</tr>
</tbody>
</table>

As you can see, the revenue to be allocated for each line item is different than the price included in the contract.

The allocation of the contract price as determined in step 4 is the revenue that will be recognized in accordance with the requirements in step five. And as we will see in step 5, depending on how and when the revenue is recognized, revenues in any particular period can be significantly impacted.
1. Revenue is recognized as/when an entity satisfies each performance obligation.

2. **Satisfaction** occurs when control of goods/services transfers to the customer.

3. **Control** is the ability to direct use of and obtain all remaining benefits from an asset (or prevent others from doing so).

4. An obligation is satisfied over time if it meets one of the following criteria:
   a. The customer receives and consumes the benefits as the entity performs (as described in FASB ASC 606-10-55-5 through 55-6).
   b. The performance creates or enhances an asset (e.g., work in process) that the customer controls as the asset is created or enhanced.
   c. The performance does not create an asset with an alternative use to the entity and the entity has an enforceable right to payment for performance completed to date.

5. If the obligation does not meet any of the criteria to satisfy a performance over time, the obligation is satisfied at a point in time.

**WHAT IT MEANS:**

In step 4, the amount of revenue to be recognized is allocated to your identified performance obligations. Step five outlines when (during the term of the contract) the revenue will be recognized.

Revenue is either recognized over time (e.g., over the term of a SaaS arrangement) or recognized at a point in time (e.g., delivery of software or equipment).

The standards get fairly detailed in describing performance obligations over time. This is due to the fact that anything that does not meet this definition is by default recognized at a point in time.

The best way to think of this is to ask yourself “How are you satisfying your performance obligation?”

If you are providing a service over a contract term or constructing an asset over a period of time, chances are you will be recognizing revenue over time vs. a point in time.
Alternatively, if you are delivering an asset and have no further performance requirement after the transfer of that asset to the customer, you will be recognizing revenue at a point in time.

It’s routine during the negotiations to offer discounts for multiple years, services or simply to land the deal. If bundled items are discounted, the standards require the seller to allocate the discount to each product and service offered. The standards do not rely on the price for each item as outlined in the contract.

The whole idea is to apply a consistent methodology to allocate the discount to the multiple items included in the contract. This is important since the revenue associated with each product and service will be recognized over various accounting periods.

In summary, ASC 606 follows a clear path of identifying a contract, identifying the performance obligations of the contract, determining the contract price, allocation of the performance obligations based on stand-alone selling price and finally, recognizing the income as the obligation is satisfied.

Sounds simple when boiled down into the individual components, but there are technical challenges as well as operational challenges. Once the technical issues are resolved, companies must deal with the excruciating details of implementation.

And this brings us to the next section: implementing ASC 606.
PART 2: IMPLEMENTATION

As companies move from understanding ASC 606 and determining the technical components of revenue recognition, the next step is implementing the requirements into the day-to-day processes of the accounting department. This is not an easy task. Consider the detailed steps of implementation and you can see the strain that ASC 606 imposes on your accounting team.

DETAILED STEPS

• Gather relevant information for each sales order.

• Identify each performance obligation for all sales orders and categorize into the proper revenue recognition methodology.

• Match product and services listed by line item for each sales order to the stand-alone selling price.

• Allocate the revenue to be recognized over the life of the contract based on the stand-alone selling price.

• Determine the commission expense that will be recognized.

• Track the delivery of products and services each period to determine the revenue to be recognized in the period.

• Monitor bookings activities for new bookings.

• Monitor bookings activities for modifications of existing contracts.

• Monitor cancellations and renewals.

• Measure the efficacy of the established stand-alone selling price.

These are the activities that need to be considered each accounting period for proper recognition. Individually and collectively, these steps take time and are often difficult to manage.

Let’s look at each individual step and the challenges they present.

GATHER RELEVANT INFORMATION
The information needed for revenue recognition resides in various departments and within multiple systems. This information must be gathered and includes items such as:

• New bookings (contracts) entered into in the current period.

• Products delivered on existing contracts for the current period.

• Services performed (often tracked by labor hours) for the current period.

• Modifications and/or cancellations of existing contracts.

• Commissions earned on new bookings.

IDENTIFY EACH PERFORMANCE OBLIGATION
Contracts often contain multiple line items. Each line item must be categorized into the proper revenue recognition methodology (over time or point in time).

MATCH PRODUCTS AND SERVICES TO STAND-ALONE SELLING PRICE
Each line item on the contract must be cross-referenced to the product or service’s stand-alone selling price.
ALLOCATE THE CONTRACT PRICE TO DETERMINE THE REVENUE TO BE RECOGNIZED

Based on the stand-alone selling price, the revenue to be recognized over the term of the contract must be calculated based on the stand-alone selling price. This must be done for each line item in the contract.

DETERMINE THE COMMISSION EXPENSE THAT WILL BE RECOGNIZED

ASC 606 requires that the commission expense be allocated to each line item and the expense recorded as the revenue is recognized.

TRACK THE SATISFACTION OF PERFORMANCE OBLIGATIONS FOR REVENUE RECOGNITION

As products are delivered and services are performed, the performance obligation is satisfied, and revenue can be recognized. This information must be collected and tracked. This information comes from a variety of sources (such as labor hours) and must be matched to the respective customer, contract and performance obligation. This process normally results in a journal entry to recognize income and reduce deferred revenue. It’s important to effectively and efficiently track the deferred revenue liability.

MONITOR BOOKING ACTIVITY, MODIFICATIONS, CANCELLATIONS AND RENEWALS

Each of these items directly impact the monthly journal entry for revenue recognized and deferred revenue. The actual impact is based on the terms of the contract and your company’s policies, but each of these items must be monitored and the impact evaluated.

MEASURE THE EFFICACY OF THE ESTABLISHED STAND-ALONE SELLING PRICE

Stand-alone selling price is an estimate. It’s based on historical sales data. Of course, as markets for certain products mature, the estimated stand-alone selling price can also change. Companies must monitor actual sales to the estimated SSP and make adjustments when appropriate.

Companies that attempt this through spreadsheets and memorandum are in for a big surprise. We always tell people, “Spreadsheets never start out complicated. They just end up that way.” In this case, this spreadsheet starts out complex and inherently become more complex with each sales order.

In addition, spreadsheets present a number of other issues that cannot be overlooked, such as:

- They are normally created and managed by one person, causing chaos if this person leaves or changes positions.
- They are subject to human error and/or manipulations.
- Formulas can change or be wrong, making it difficult to check and for auditors to audit.
- Spreadsheets have limited reporting capabilities. All of this information is in the spreadsheet, but it is hard to pull meaningful, dynamic reports.
We have developed an infographic that captures the challenges of spreadsheets:

**ANATOMY of a REVENUE RECOGNITION SPREADSHEET**

1. Companies have lots of customers
2. Customers generate lots of sales orders
3. Sales orders have lots of line items
4. Line items must be matched to lot of products and service
5. Revenue must be tracked and recognized over lots of periods
6. Complex spreadsheets grow more complex with every order and every month

Eliminate Spreadsheets...RevLock Automates!

www.Rev-Lock.com
If this does not make you head spin, it will make your team’s head spin. After all, they are tasked with making this happen. Unfortunately, it’s the division’s leader that is held accountable if it does not happen correctly.

Think of these steps—including maintaining a massive spreadsheet—as “moving parts”. In our house, we do not buy gifts with lots of moving parts because moving parts break. The more moving parts, the more likely something will fail.

So, the goal of efficiently complying with ASC 606 is to focus on eliminating moving parts.

This is where automation comes in. By automating the revenue recognition process, companies save time and money, in addition to significantly reducing the risk of errors.

AUTOMATION

There are several steps that can be automated. In fact, all of the detailed steps listed above can be automated. But beware—not all “automated solutions” are automated. Many solutions focus only on the allocation of the contract price to the revenue to be recognized under ASC 606.

These solutions still require you to:

• Gather the information needed for new bookings and modifications.
• Identify the distinct and separable performance obligations.
• Cross reference these items to the stand-alone selling price.
• Update the activity to determine which obligations were satisfied.

All of this information must be manually entered for new orders and existing orders must be manually updated for current period activity, modifications and cancellations.

Not much automation going on here.

REAL AUTOMATION

Real automation is a solution that provides the following:

• Automatically updates when a new order is received or when an order is modified or cancelled.
• Identifies the products and services offered in each contract and automatically populates the stand-alone selling price and revenue recognition.
• Automatically calculates the revenue to be recognized based on this information.
• Allocates commissions to each item on the sales order.
• Automatically pulls the services performed during the period and recognizes the revenue in that period.
• Creates a journal entry that recognizes revenue and the changes in the deferred revenue account.
• Tracks active sales orders and generates revenue forecasts.
• Easily handles modifications and cancellations.
• Tracks and alerts the users of contracts up for renewals.
• Efficiently utilizes all of the information that it has to generate customizable reports for management.
Does such a system exist? It does! RevLock provides true automation, saving you time, money and mitigating the risk of errors.

**HOW REVLOCK SOLVES YOUR ASC 606 PAIN POINTS**

To help you better understand how RevLock provides these benefits, allow me to share with you some background and features of RevLock:

- RevLock was developed by accountants based on the real-life challenges that our clients were experiencing. We have consulted and led the implementation and audited ASC 606. We know what the issues are.
- RevLock is committed to full automations. Our goal is to eliminate spreadsheets and manual input, and as a result reduce the risk of human error.
- RevLock is built on an open API platform that allows our software to pull the information from wherever it resides. This can be done through integration or through the export of the data to an excel spreadsheet, which is then uploaded to RevLock. (Sometimes, IT people get nervous when outside vendors tie directly into their systems. We understand!)
- RevLock’s Stand-Alone Selling Price Library™ is populated with all of your products and services, the stand-alone selling price for each of these products and services and the proper revenue recognition methodology.
- When a new order is identified, RevLock automatically matches the product or service to information in the Stand-Alone Selling Price Library™, eliminating the need for cross-referencing.
- RevLock calculates the revenue to be recognized for every line item on every contract.
- RevLock is able to pull information from your project management system to recognize revenue based on the performance during the period.
- Our algorithms identify changes in the price, contract dates, items included in a contract and other modifications and updates the revenue recognition calculation.
- RevLock is built on a powerful MicroStrategy reporting package providing standard and customizable reports. All the information is there—we want to be able to use it effectively.
- RevLock knows that implementation must be simple and have developed the fastest implementation process in the industry. You really need to see how simple and quick it is.

**SCHEDULE A REVLOCK DEMO TODAY!**

We hope that this document provides the information that you need to understand and implement ASC 606 and we hope you do not mind the sales pitch at the end. We are on a mission to automatically simplify, recognize and analyze revenue recognition.

*Schedule a free 30-minute consultation and demo today.*