Written by Nick Sanders Monday, 09 June 2014 11:03

We suspect that many readers will find the headline of this blog article more than a little difficult to decipher. The title discusses changes to Generally Accepted Accounting Principles (GAAP) in the area of revenue recognition. Revenue recognition doesn't often factor into government contract accounting, since the primary focus tends to be on contract cost accounting

rather than the measurement of revenue (and project margin) during contract performance. Nevertheless, government contractors and their accountants (both internal and external) spend a lot of time thinking about revenue recognition on government contracts.

For example, if you have a firm, fixed-price contract to deliver 20 widgets over a 36-month period of performance, do you recognize revenue as each widget—is delivered (say, at 1/20<sup>th</sup> of the contract price for each delivery) or do you recognize revenue based on the percentage of completion of the—entire contract? What about if you believe you planned profit won't materialize because of unplanned cost growth? How does that knowledge factor in to the picture? What's the impact on revenue recognition when you file a Request for Equitable Adjustment (REA) that you believe will lead to a contract—modification that will cover the cost growth? What happens if you file the REA but the government customer rejects it?

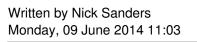
These are just some of the questions involved in government contractor revenue recognition. And we didn't even touch on issues such as providing services—at fixed hourly rates, accounting for repairs and warranty expense, and contracts that involve multiple CLINS, each with a different contract type. Suffice—to say, for those accountants who deal with the matter, proper measurement of revenue at a government contractor is far from easy.

And things just got more complicated. It's called " convergence ".

Convergence is the elimination of differences between U.S. GAAP and International Financial Reporting Standards (IFRS). It has been in process since 2000 and is nearing a significant milestone: the merging of revenue recognition standards. In May 2013, the Financial Accounting Standard Board (FASB) issued Topic 606, entitled, "Revenue from Contracts with Customers." At the same time, the International Accounting Standards Board (IASB) is issuing IFRS 15 with the same title.

According to the FASB, Topic 606 establishes the following broad process steps:

## Goodbye SOP 81-1 and SAB 104 and Topic 605: Hello Topic 606



Step 1: Identify the contract(s) with a customer.

Step 2: Identify the performance obligations in the contract.

Step 3: Determine the transaction price.

Step 4: Allocate the transaction price to the performance obligations in the contract.

Step 5: Recognize revenue when (or as) the entity satisfies a performance obligation.

The FASB believes that the new revrec principles will make it easier on companies, because they are more broad-based than previous GAAP and some industry-specific topics (e.g., SOP 81-1) are being discontinued.

There's more - far more - to the new Topic than we've glossed-over here. For instance, our initial reading seems to confirm that percentage of completion, cost to cost, revrec will still be permissible under Cost-Type contracts. But you will need to read the Topic closely if you are one of the affected companies.

You are one of the affected companies if you are a public entity, in which case you have until December 2016 to implement any required revrec changes. If you are a nonpublic entity, you have an extra year. But make no mistake, Topic 606 is the new Standard for revenue recognition and you had better prepare for it.