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Rev rec's apples and oranges

Prepare for an implementation hangover of data comparison challenges

August 4, 2010

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New Financial Accounting Standards Board (FASB) guidelines will change the way many companies recognize revenue. The final challenge in the process is providing financial data that executives, investors, and analysts can compare across the adoption divide. This guide walks you through the options and their pros and cons.

You *can* compare apples and oranges—you'll have to

While many companies will experience a revenue boost upon adopting the new Financial Accounting Standards Board (FASB) rev rec rules for multiple-element arrangements (EITF 08-1 [ASU 2009-13] and EITF 09-3 [ASU 2009-14]), that pleasurable sensation comes with a lingering hangover of financial data reporting hassles. You'll have to determine how to compare revenue recognized under the new rules with revenue recognized under the old rules in a way that satisfies regulators, investors, analysts, board members, and executives.

Headache and nausea may ensue—but you can ward them off by making sure you have a stable footing. We'll walk you through your options at each step toward providing comparative financial information across pre- and post-adoption periods.

Is it better to look forward or back?

Step 1: Determine how you will adopt. Companies can adopt the new rev rec rules on a prospective or retrospective basis. Most companies are adopting on a prospective basis—they're using the new rules only for revenue arrangements entered into or materially modified after adoption.

Retrospective adoption requires recasting prior-year revenues for up to two years, which delivers better comparative data but takes a lot more work. Prospective adoption saves time and resources, but comes with its own challenges. If you adopt prospectively, prior years will not be comparable to the adoption year. In year one—and possibly longer—you'll almost certainly need to recognize revenue under two methods: the old rules for deferred revenue remaining at the adoption date and the new rules for new contracts. Then it will take several years to get revenue numbers that are comparable year over year.

If, like Apple, you adopt the new rules on a retrospective basis, you'll be reporting comparative financial results from the start. Proceed with caution, though: while the Emerging Issues Task Force (EITF) ultimately allowed retrospective adoption, the proposal-stage guidance prohibited it. One concern was that companies wouldn't be able to estimate the selling price of individual deliverables in multiple-element arrangements dating back two years. Before you take this path, evaluate the third-party evidence and internal documentation available to support estimated selling prices for historical periods.

Also consider the time and money you'll spend on converting historical data. Apple did it because it had such a significant impact on the company's results. If that's also the case for your company, it may be worth the cost; if it provides only a hiccup in your results, it's probably not. For pre-IPO companies, retrospective adoption might make sense because it produces better trend information—and when you're trying to raise money, you don't want to have to explain data discontinuities.

Which numbers paint the clearest picture?

Step 2: Choose your quantitative disclosures. Prospective adopters must provide both qualitative *and* quantitative disclosures in the year of adoption so that anyone reading your financial statements can "understand the effect of the change in accounting principle," per the EITF. There are no prescribed quantitative disclosures. You determine the information to provide based on your company's individual facts and circumstances. However, the EITF did list a few potential quantitative disclosures:

1. Revenue that would have been recognized in the year of adoption under the old rules
2. Revenue that would have been recognized in the year before adoption if the new rules had been in force
3. How much revenue was recognized under the old rules in the year of adoption and how much (if any) deferred revenue remains, along with how much revenue was recognized under the new rules for contracts entered into or materially modified in the year of adoption

Number 3 would be easiest to provide—you'll need to have the information on hand anyway to manage rev rec in the year of adoption. Numbers 1 and 2 would make it easier for readers of your financial statements to assess trends, but these disclosures require additional work. We recommend consulting with your auditors before making a final decision.

How do I satisfy the trend watchers?

Step 3: Consider non-GAAP trended financial statements. Prospective adoption, alas, may not entirely free you from providing retrospective information. Management, analysts, and investors probably will want to see financial trends. Satisfy their need to know by preparing a high-level approximation of retrospective adoption for internal uses and non-GAAP reporting. Although the historical revenue and results will be pure estimates, they can help executives, directors, or financial planning groups evaluate historical performance and forecast future performance. In addition, many companies provide non-GAAP financial results (in accordance with SEC Regulation G) as part of their quarterly earnings releases. You can give analysts and investors a sense of trends by adjusting historical results in these releases on a non-GAAP basis, which will approximate the effect of applying the new rules to prior periods.

Too many choices?

Get help! RoseRyan can help you evaluate your adoption, disclosure, and reporting alternatives and help you ensure compliance with both FASB rules and SEC regulations. We can also assess your revenue impact, scope your implementation needs, reinvent your revenue accounting processes, and more. Contact Maureen Ryan at mryan@roseryan.com to find out how we can relieve rev rec headaches.

If you missed any of our previous rev rec guides—the *OMG! Rev rec is coming!* overview; *Priced to sell,* on determining the selling price of deliverables in multiple-element arrangements; and *Does rev rec compute?,* on getting your accounting system to handle the relative selling price method—get them here.

About Kelley Wall: Kelley Wall, a CPA with more than 15 years' experience in finance and accounting, regularly advises clients on the interpretation and implementation of new accounting pronouncements. She joined RoseRyan in 2005 and helps lead the firm's growing technical accounting group.