Making the Move to ASC 606: What to Know

By Nazish Khan
The ASC 606 adoption date—the biggest accounting guidance change in recent history—is past due for public companies. However, according to a 2017 survey conducted by EY, 34% of US public company CFOs said they are behind schedule. In fact, a whopping 71% said their revenue recognition programs are not complete. Meanwhile, private companies are finding themselves in the same position that public companies were in a year earlier: figuring out where and how to start the ASC 606 adoption process. While their public counterparts learned through a series of trial-and-errors on picking the right adoption approach, private companies now have the luxury of learning from these many lessons. The key to doing so is action.

When it comes to adopting ASC 606, starting as early as possible is critical. Learning and applying the new guidance to the business is the tip of the iceberg; corporate buy-in, assembling project teams, automating revenue recognition, data refining, and performing accounting assessment are just a few examples of the many tasks that must be completed in order to meet the requirements of the new standard.

Private companies must take a hardline approach to their adoption of ASC 606 or IFRS 15 (for international). After understanding what ASC 606 and IFRS 15 are and what they hope to accomplish, companies need to develop a plan of action to meet their effective date deadline. Some of the biggest lessons that public companies have learned in their adoption process come from the following three areas:

- **ACCOUNTING ASSESSMENT**
- **DATA AND SYSTEM ASSESSMENT**
- **OPERATIONAL ASSESSMENT**
What is ASC 606?

ASC 606, in contrast to its predecessor, is a principle-based approach to revenue recognition as opposed to a rules-based framework. The goal of the new guidance is twofold: one, to eliminate industry-specific guidance to allow for more transparent and balanced reporting across companies, and two, to allow companies more judgement in applying accounting guidance to meet the ever-changing needs of their businesses.

The new five-step criteria allow for increased flexibility in the determination of how revenue can be recognized. An example of this is collectability assessments. Under ASC 605, if a customer was deemed uncollectable, an entity would have to defer all revenue until receipt of payment. Under ASC 606, companies can now estimate if a percentage of the revenue from customers with bad credit can be recognized by analyzing collections made from customers in similar regions and verticals. ASC 606 also smooths out the varying guidance for commissions under old GAAP and IFRS standards by requiring capitalization of acquisition and fulfillment costs; however, the period over which these costs are amortized will require judgement.
Getting a jump start on the accounting assessment will be the groundwork for adopting ASC 606. The more complete and accurate the assessment, the more confidence a company should have about compliance. Perhaps even more important is the pivotal role that the accounting assessment can play for companies deciding between adopting ASC 606 via either the modified retrospective or full retrospective transition approaches. This decision will shape the path of the adoption and must be finalized as soon as possible. Many public companies found themselves struggling to decide between methods. Performing an accounting assessment helps provide C-Suite executives, auditors, and investors a snapshot of the key areas affected by the new guidance and how material the impact will be.

Some private companies are currently finding themselves at the early stages of their accounting assessment where they are determining how material ASC 606 will be to their businesses. In doing so, the impact of the new five-step approach must be assessed for all revenue streams within a company. Additionally, companies should start thinking about aspects of the new guidance that are newly introduced, such as contract modifications and variable consideration, among others.

For commissions, companies that currently do not amortize these costs need to estimate what the expected life of either the transaction or customer will be across the period they choose to amortize over. This may require external assistance from specialists. The main areas of finance under consideration are revenue and commissions, but what about the other areas of the business?
Companies will also have to consider the impact that ASC 606 will have for SOX 404 controls. Many companies may consider adding or strengthening management review controls over areas of estimation, such as variable consideration or amortization calculations. Entity-level controls may also play a role to establish policy and procedure controls around ASC 606. The additional disclosures, such as backlog and disaggregation of revenue, may require scoping exercises to determine financial statement presentation. Other areas of impact potentially include tax and principal versus agent transactions.

Taking full advantage of the increased flexibility allowed under ASC 606 will come from the accounting assessment, and the sooner the impact is quantified, the closer companies will get to kicking off the adoption of the new guidance.
Perhaps the most important area, and most heavily scrutinized, is the data that will be used to support the foundation that ASC 606 is built on. A company’s financials, disclosures, and accounting assessments are only as good as the underlying data used to support them. Given the sheer number of additional estimations and calculations that companies must perform to fully determine the impact of the new guidance, the completeness and accuracy of underlying data has never been as crucial. Up until now, many companies have maintained manual spreadsheets to track areas such as commissions or backlog, and will need to significantly improve this data to an auditable format.

For companies that will implement new revenue recognition systems under ASC 606, the cleaner the data is, the smoother the implementation will be. Both the data assessment and system implementation go hand in hand, particularly when it comes to data migration. Having data that is scrubbed and set for migration will make or break implementation milestones, especially for those companies implementing on shorter timelines. For many, sifting through and refining historical data that will flow into the financials will require an increased amount of attention, especially if it has not been audited in the past.

In addition to having system-ready data, companies will also have to place serious consideration over the design of the new system. Examples of the design decisions that need to be made include adding new fields, exploring forecasting capabilities, and defining new reporting requirements. Companies should also look into automating processes on the front end. Take the example of assessing for contract modifications. Companies may want to develop indicators to automate how contract modifications are determined within the system to avoid a manual and tedious path going forward. Identifying similar shortcuts will allow for more efficiency in the future.

The data assessment must be prioritized and will be fundamental to the success of the overall adoption.
Most, if not all, public companies can agree that the transition requires a significant amount of time and resources. Consider the incremental time required to prepare the accounting analysis, gather data required for new disclosures, implement a new revenue recognition system, provide education, and more. For companies choosing the full retrospective method, a complete reworking of historical data will be required for reporting, while the modified retrospective approach will require two sets of books to be maintained in the year of adoption. Companies should take a steadfast approach in quantifying not only the accounting impact but also the additional manpower that is required to take this new project from beginning to end.

Outside of finance, companies must look to the other groups that are impacted from the deal negotiation stage to the point of sale, such as sales teams spanning across all regions, deal desk, sales compensation, and IT, among others. Take for example the assessment of whether a contract is legally binding under step one of five. Companies will need to change practices to align all sales teams as to what the point of sale should be and what documents constitute a sale. Additionally, as mentioned under data assessment, companies may require new reporting fields which would lead to process changes to capture data in those fields.

Assessing the impact for all groups is critical to streamlining the adoption process by changing the way a company does business as a whole.
Final Words

Many companies are attempting to manage the additional calculations and reporting on spreadsheets. The public entities that chose this route in 2017 will no doubt discover the manual process to be fraught with errors. Spreadsheets also pose challenges for version control, security, and audit functionality. There is too much at stake to continue with manual processes. Automating revenue recognition saves finance teams from spending hours double-checking spreadsheets. Consider saving time, money, and closing faster.

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