COVID-19's Impact on Revenue Recognition — What Accountants Need to Know

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Lynn Fountain

Lynn Fountain has over 38 years of experience spanning public accounting, corporate accounting and consulting. 20 years of her experience has been working in the areas of internal and external auditing and risk management. She is a subject matter expert in multiple fields including internal audit, ethics, fraud evaluations, Sarbanes-Oxley, enterprise risk management, governance, financial management and compliance.

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Introduction

- The pandemic has and will continue to impact major economic/financial markets, and virtually all industries/governments are facing challenges.
- As the spread of the pandemic continues, entities are experiencing conditions associated with a general economic downturn.
- Last month in our Lunch & Learn we spoke about some of the impacts on Financial Statement Disclosures.
- This month we will focus specifically on Revenue Recognition.

Agenda

- Understand how COVID-19 has impacted each of the five steps of the revenue recognition model:
  - Understand financial statement disclosures for revenue recognition due to COVID-19
  - Disclosures that should be made as a result of COVID-19 and the current economic crisis

- Additional Resources in CCH® Accounting Research Manager® —
  Beth Patrick, Sales & Business Development Manager
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Impacted Topics

There continue to be many accounting and FR issues that should be on the radar of accounting professionals. These include (but are not limited to):

Forward looking CF estimates	Impairment testing and recoverability of impairment of assets	Indefinite lived intangible assets other than goodwill and LLA	Accounting for financial assets: • Inventory, • Equity method investments, • **Revenue recognition**
Leases	Goodwill	Subsequent Events	Going Concern
Disclosures	ICFR	Exist or Disposal Costs	Loss Contingencies
Future Operating Losses	Insurance Recoveries	Government Grants	

POLLING QUESTION

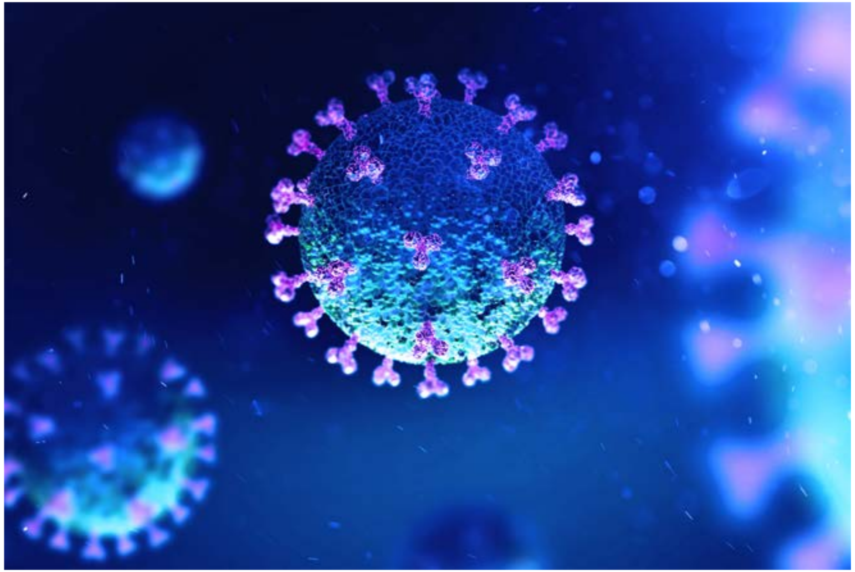
Which topic would you like to be covered during next month's (June 30th) Lunch and Learn webinar?

A. Internal Controls (ICFR)
B. Leases
C. Estimate and Assumptions
D. Going Concern and Subsequent Events

Revenue Recognition

COVID-19

- COVID-19 and its related impact on the economic environment have raised numerous questions that affect almost each step of the updated standard.
- As we review each step of the process, we will identify some of the many considerations that have arisen from COVID-19 that could impact the revenue recognition process.



Implications

Key areas to consider related to the 5-step revenue recognition process.

- **Step 1: Identify contract with a customer**
- **Step 2: Identify performance obligations**
- **Step 3: Determine the transaction price**
- **Step 4: Allocate the transaction price**
- **Step 5: Recognize Revenue**

- This is not meant to be an all-inclusive list.
- Due to limited time, we will review a few of the selected implications in each step.

Step One — Contract Existence

- Parties to the contract must have **approved** the contract and be **committed** to perform.
- Consider all relevant factors when determining if the other party is willing to perform.

Step One — Contract Existence *(cont'd)*

- **The entity must be able to identify each party's rights regarding the goods or services to be transferred.**
- **Must be able to identify the payment terms for goods/services.**
  - Payment terms must be identified to be able to calculate the TP
  - Agreements with VC may have varying implications on how revenue is recognized in relationship to the VC

Contract Existence and Collectability

The contract has commercial substance.

- Commercial substance exists if an entity expects the likelihood, timing, or quantity of cash received to change because of the contract.

It is probable the entity will collect consideration which it will be entitled.

- Probable is defined as “likely to occur.“

POLLING QUESTION

Which step of the revenue recognition process have you found most challenging?

A. Step 1: Identify contract with a customer
B. Step 2: Identify performance obligations
C. Step 3: Determine the transaction price
D. Step 4: Allocate the transaction price
E. Step 5: Recognize Revenue

Other Step One Considerations

Per Topic 606, is defined as a party that enters into a contract with an entity to acquire goods and services that are outputs of its ***ordinary activities*** in exchange for consideration.

- Have your “ordinary” activities changed?
- If so, do you have new types of contracts that are within the scope of Topic 606?

Step Two — Performance Obligations

- **Contract Modifications** – With fluctuating market conditions, the scope/price of contracts may be altered to meet customer needs.
  - Follow 3 steps outlined in the standard’s contract modifications section to determine how changes should be accounted for.
- Requirements for contract combinations.
- Seriously evaluate and document the potential for contract combinations.

Step Two — Contract Modifications

- Changes to existing revenue contracts may need to be considered.
- Considerations for when evaluating LT contracts with commitments overtime or service overtime.
- Look at facts in contract modification guidance including:
  - Are contracts negotiated as a package or single commercial objective
  - Are goods/services promised part of a single performance obligation

Step Three

- *Step 3: VC* — Significant uncertainty of pandemic's effects on an entity/customers, it may be challenging for the entity to make appropriate estimates of VC.
- Step 3: *Material Right (MR)* — To mitigate decline in sales, an entity may offer sales incentives.

Step Three *(cont'd)*

- *Step 3: SFC* — Entity may provide extended payment terms to assist customers experiencing liquidity issues.
- *Step 3: Implied performance obligation* — Free goods/ services provided solely as a result of COVID is not a contract modification.
- Step 5: RR — Revenue cannot be recognized until control of the goods/ services transfers to the customer.

Disclosures

- The objective of the disclosure requirements related to ASC 606 is to “disclose sufficient information to enable users of financial statements to understand the nature, amount, timing, and uncertainty of revenue and cash flows arising from contracts with customers”.
- With this goal in mind, entities will need to disclose significant judgments used to apply ASC 606.
  - Examples include:
    - Estimating probability of collection of receivables
    - Assumptions in the estimation and related constraints applied to VC
    - Estimating price concessions, discounts, returns, refunds and other similar items affecting TP
    - Measuring progress towards completion of a performance obligation recognized over time

POLLING QUESTION

Would you like additional resources to help with Revenue Recognition changes by receiving a free trial to CCH ARM?

A. Yes, sign me up!
B. No, I already have a CCH ARM subscription
C. No, I'm not interested

Beth Patrick

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Beth Patrick is a Sales & Business Development Manager at Wolters Kluwer and has over 20 years' experience serving Accounting Professionals. She works with both CPA firms and Corporations sharing best practices to ensure they are utilizing CCH Accounting Research Manager to its fullest.

Additional Answers in CCH® Accounting Research Manager®

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POLLING QUESTION

Would you like a more in-depth demo of the tools and content available on CCH Accounting Research Manager?

A. Yes

B. No

Thank you for attending

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