



ASC 606 accounting: Sustainability through automation

In the past year, public companies with calendar-year reporting periods adopted ASC 606, the regulation that standardizes [new accounting rules for revenue recognition](#). This means the public has now seen the first wave of annual reports that reflect the revised rules.

For 2018 compliance, companies had to untangle the new standard's effects on revenue, pricing, contracts, and functional areas such as sales and legal. Many discovered ambiguities in their implementation, not to mention limitations in their financial systems' ability to process information required for compliance with the new standard. Companies often made do with spreadsheets and other manual workarounds.

That approach typically got the job done—but it doesn't necessarily lead to sustainability. For an effective and efficient process that stands up to scrutiny, companies should consider making ASC 606-compliant revenue recognition part of their normal operations. Here are five steps to help achieve that goal with revenue recognition automation.

1. Take stock

Since adoption began, [the Securities and Exchange Commission has issued a number of comments](#) that aim to clarify the basis for the accounting position companies have taken and/or need to take. Common themes have been the disclosure of significant judgments, comments about disclosures related to performance obligations, and the method for amortizing contracts.

But the SEC generally does not review filings for every company during a particular period. Some companies could go several years without a regulatory review on their filings which means companies may need to respond to adoption related questions and potentially change policies and procedures as a result of these questions long after the actual adoption date.

That's why now is the time for companies to take stock of where they are. What's working? What can be improved? How can revenue recognition automation play a bigger role? Perhaps some parts of the process for complying with the new revenue recognition standard are already automated and operating effectively. On the other hand, some areas might have multiple people reviewing contracts and making different judgments about how to record the revenue. Whatever the findings, self-evaluation is a critical starting point on the journey to a sustainable compliance process leveraging revenue recognition automation.

2. Establish policies and controls

An effective system of policies and controls starts with thoughtfully defined responsibilities. That involves assigning process owners, so company personnel can develop knowledge and experience in a given aspect of the revenue recognition process, then supporting owners with the tools and resources they need to fulfill their roles.

Next is identifying transactions that don't fit the company's existing norm. For instance, a software firm might land a contract for both software licenses and consulting services. Such a contract could require its own assessment if it's out of the ordinary for the company.

Revenue recognition automation often brings it all together. An appropriate level of automation can stand up to detailed audits, staff turnover, and ad hoc requests for information. It can also provide the peace of mind that comes with standardization, structure, and the reduction of human error. With automation carrying out repetitive processes, staff can limit their dependence on spreadsheets and other low-value, time-consuming work.

3. Create management oversight of significant judgments

Revenue recognition under the new standard can have gray areas that require judgment to resolve. For example, consider a company entering into a contract that includes a \$10 million fixed fee with the potential for an additional \$1 million if certain targets are met. Should the company consider the transaction price to be \$10 million or \$11 million as it recognizes revenue during the performance period?

Either tack might be reasonable. Which one to take may depend in part on how a particular transaction compares with current and past judgments—particularly when the circumstances are similar. The same principle of consistency comes into play with other judgment calls, including:

- **Over time or point in time.** A software company sells similar five-year software licenses to different customers along with a suite of related consulting and support-type services. The company may recognize the revenue over the life of the agreement or recognize a significant amount up front depending on the specific facts and circumstances of the transaction.

- **Combining performance obligations.** A company sells home security equipment and services. The services include installation of the equipment as well as remote monitoring over the course of a year. The company may be required to combine the equipment and the service into a single performance obligation or to recognize them separately—that is, recognize the equipment when it's delivered and the service as it's being performed.
- **Principal versus agent.** A medical equipment distributor sells equipment from a manufacturer to end-user customers. In some respects, the company appears to be a principal. In other respects, it seems more like an agent. The distinction matters because it makes a significant difference in how much revenue the distributor can recognize.

Management oversight is key to navigating the facts and circumstances of each case so that judgments reconcile from one transaction to another.

4. Set up a process for nonstandard transactions

Many companies have established revenue streams with recurring transactions that contain consistent contractual terms. However, companies often enter into transactions that don't conform with the standard revenue recognition process. Such a nonrecurring transaction may be a one-off event. Then again, it could turn out to be the first of a new series.

Either way, nonstandard transactions are likely to come up again and again in a dynamic business environment. Acquisitions, new product launches, entries into new markets, and first-time bundling of certain products and services are all situations that could give rise to new types of transactions.

As a result, once the policy and control system identifies a nonstandard transaction, a process must be put place to address it. Part of the process is to analyze new transactions against standard ones to determine where they differ. Another part is to conduct ongoing monitoring to see if the new transaction becomes a new stream of revenues requiring automation and controls.

5. Continue to benchmark

Many companies have been benchmarking their accounting, financial reporting, and disclosures against those of industry peers. Although in some respects the new standard offers more flexibility to account for various types of transactions, companies still must be able to justify their judgments in light of their specific facts and circumstances and the relevant accounting guidance. If the judgments appear similar to what other companies are doing, that can signal that the company is on the right track.

Even so, it's only a signal, as companies don't necessarily explain all the related details involved in their specific accounting methods and judgments in their financial reporting. They also might change their approach as they learn more about interpretations of the new standard from regulators and advisors. Furthermore, it may be that the company conducting the benchmarking is indeed justified in taking a different approach from its peers.

For all these reasons, recurring benchmarks are essential. As the world of business settles into a principles-based approach to revenue recognition, a watchful eye on regulatory interpretations and continued benchmarking against peers can spell the difference between a static state and continual improvement.

From disruption to new norm

In the context of revenue recognition, sustainability has much to do with keeping surprises to a minimum. Fire drills, duplication of effort, and stakeholder confusion are all problems companies would like to see less of in the conduct of their business. The careful integration of revenue recognition with ongoing operations—facilitated by revenue recognition automation—sets the stage for a time, someday soon, when the new ASC 606 is no longer new at all, just a normal part of an effective financial reporting process.



Let's Talk

For additional information regarding the above and other interpretative guidance related to the new revenue standard, contact:



Eric Knachel
Audit & Assurance Partner
Deloitte & Touche LLP
+1 203 761 3625

www.deloitte.com/us/audit



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