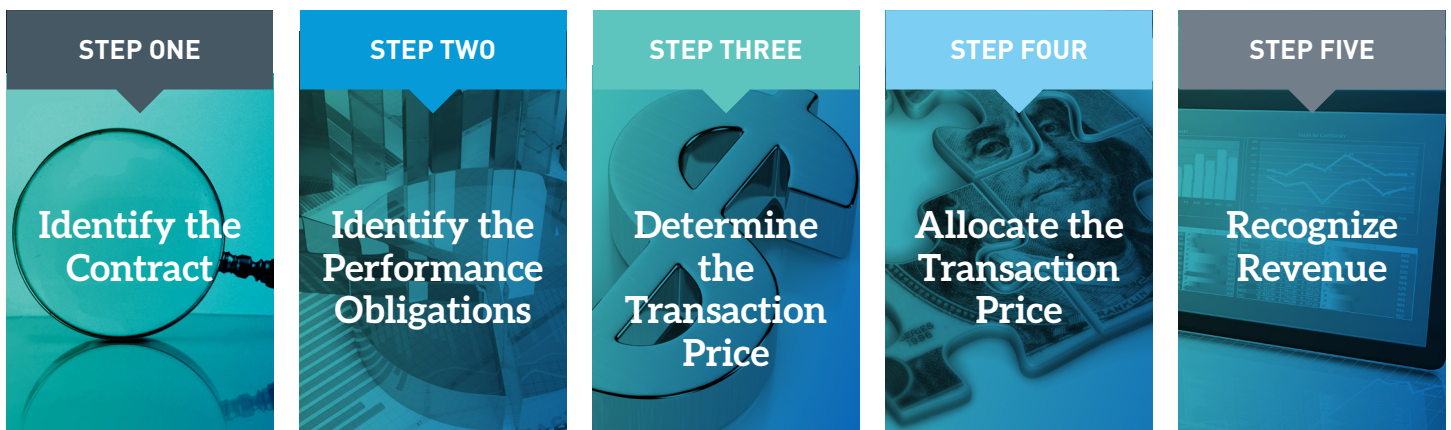
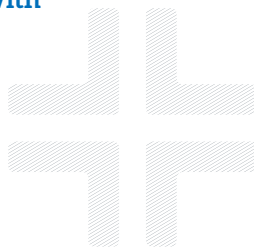




## THE NEW REVENUE RECOGNITION ACCOUNTING: WHAT WILL THE IMPACT BE FOR CONSTRUCTION?

ASC 606 (Revenue from Contracts with Customers) affects virtually all entities who enter into contracts with customers, whether public, private or not-for-profits. ASC 606 will completely replace all revenue guidance under US GAAP, including the guidance for construction-type contracts under SOP 81-1. This far-reaching revenue recognition framework will impact a construction company's accounting systems and processes, financial reporting and documentation functions, operating software systems, internal controls and financial ratios. Construction companies will need to exercise subjective yet consistent judgement when reviewing and accounting for revenue from contracts with customers.



**Implementing the new revenue recognition accounting (ASC 606) is imminent.** All private entities must adopt it for fiscal years beginning after December 15, 2018 (ie. January 1, 2019 for calendar year-ends).

Use this high-level assessment tool to assess whether your ASC 606 impact will be minimal, moderate or significant, and identify areas with more complexity. User guide: consider distinct revenue streams; pay closer attention to large, customized arrangements; and bunch generic transactions and evaluate as a group.

We've **bolded** the most sensitive and complex accounting judgements for you.

## STEP ONE

### 1 Identify the Contract

- ☐ A customer agreement must have all necessary approvals to be an **ASC 606 contract**. It must identify any and all legally enforceable rights, obligations, and payment terms.
- ☐ Not all **master contracts** are ASC 606 “contracts.”
  - ☐ Example: blanket purchase orders issued for materials or service are usually not deemed to be an ASC 606 contract, however specific purchase orders may be considered an ASC 606 contract.
- ☐ Agreements with **unilateral termination clauses** are not ASC 606 revenue contracts.
- ☐ **Subsequent contract modifications**, i.e. change orders, claims and progressive scope arrangements, must be individually assessed to determine if they are a separate ASC 606 contract.
- ☐ **ASC 606 requires combining contracts** if they are entered into at or near the same time with the same customer (or related parties) and any one of the following criteria is met: (a) contracts were negotiated as a single commercial package; (b) consideration in one contract depends on another contract; or (c) goods or services (or some of the goods or services) in the contracts form a single performance obligation.
- ☐ Do not move to Step 2 unless an ASC 606 “contract” exists.

## STEP TWO

### 2 Identify the performance obligations

- ☐ Begin by understanding and identifying all promised goods or services that you are to provide to your customers within your contracts.
- ☐ Then, determine which promised goods or services are ASC 606 performance obligations:
  - ☐ A promised good or service is a separate performance obligation if it is “**distinct**”. “Distinct” is very similar to the current concept of a deliverable with standalone value to the customer. **Highly interdependent or integrated deliverables** are usually not “distinct” for ASC 606. We expect that a construction contract will be deemed to be a single performance obligation in many cases.
  - ☐ **Example: a contract that includes project management services, build of a commercial building, related landscaping, and parking will be one performance obligation due to the interdependent nature of the services to be performed.**
  - ☐ **A series of distinct goods or services** are those which are substantially the same, meet over-time attributes and have the same pattern of transfer.
  - ☐ Disregard any promised goods or services that are immaterial at the contract level.
  - ☐ Example: Design, build, operate and maintain projects could have two performance obligations, with design and build being one performance obligation and operate and maintain being the second performance obligation.
- ☐ This step is the **most critical part** of your assessment.
- ☐ Do not move to Step 3 until you have identified your performance obligations and how many there are.

## STEP THREE

### 3 Determine the transaction price

- ☐ Approach this step at the contract level.
- ☐ Start with the fixed price stated in the contract.
- ☐ Include **good-quality estimates of probable variable consideration** (both positive and negative), including performance awards or penalties, change orders or variations, claims or extras, liquidated damages or back charges, unit pricing, and refunds, rebates or discounts.
- ☐ For those **modifications** that are approved for scope but not pricing, estimate the change to contract value as variable consideration.
- ☐ ASC 606 specifies **2 methods for estimating variable consideration**. The method chosen must be suited to the facts and circumstances. The 'expected value' approach incorporates probability weighted outcomes; the 'most likely amount' approach selects the most likely outcome within a range of possible amounts.
- ☐ Do not move to Step 4 until you quantify the total transaction price.

## STEP FOUR

### 4 Allocate the transaction price to the performance obligations

- ☐ Skip to Step 5 if there is only one performance obligation.
- ☐ Allocate Step 3's total transaction price amongst the performance obligations (from Step 2) based on **relative standalone selling prices**.
  - ☐ You may use **reasonable estimates** in the allocation process if quoted prices are not available.
- ☐ **Variable consideration may be allocated entirely to one performance obligation if it relates specifically to it.** (consult specific guidance).

## STEP FIVE

### 5 Recognize revenue for each performance obligation

- ☐ Recognize revenue when (at **a point in time**) or as (**over time**) the customer obtains control of the good or service.
- ☐ A significant change for construction entities is that costs related to **wasted efforts, uninstalled materials** and **mobilization** must be accounted for **separate** from measures of progress.
- ☐ **Pre-contract costs and certain costs to fulfill a contract**, such as mobilization and sales commissions, are capitalized and amortized over the length of the contract.
- ☐ Methods for measure of progress allowed by ASC 606 include **output and input methods** (the latter for construction companies is typically costs incurred).
  - ☐ Output methods include surveys of performance completed to date, appraisals of results achieved, milestones reached and units produced or units delivered.
- ☐ Recognize allocated revenue (from step 4) separately as each performance obligation is satisfied.





## AREAS WITH SPECIAL CONSIDERATIONS:

- Impact on Internal Controls, General Ledger and IT Systems
- Contract Modifications
- Variable Consideration
- Upfront Costs to Fulfill a Contract
- Impact on Sales Commission Plans
- Impact on Bank Covenant and Bonding Capacity Requirements
- Income Taxes
- Financial Statement Reporting Considerations
- Expanded Disclosure Requirements

**If your ASC 606 impact will be moderate to significant, we recommend a deeper dive, sooner rather than later. Please contact a Withum professional to guide you through these changing rules.**

*The information presented in this publication is not necessarily all inclusive, does not constitute accounting, legal, tax or any other advice and should not be relied upon without first consulting with appropriate qualified professionals for your individual business facts and circumstances.*



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