Revenue Recognition Criteria Increases Profitability

“Life is change. Growth is optional. Choose wisely.” - Karen Kaiser Clark, Author and Motivational Speaker

Revenue recognition criteria effective this year will provide new income potential for savvy firms. The five step reporting process allows for accelerating or postponing income depending on the tax strategy that is most advantageous to your business.

Five Step Reporting Process

The new five-step process for revenue recognition is as follows:

1) Identify the contract with the customer.

2) Identify the performance obligations (promises) in the contract.

3) Determine the transaction price.

4) Allocate the transaction price to the performance obligations in the contract.

5) Recognize revenue as the reporting organization satisfies each performance obligation.

Application Illustration

A very simplified example of an application of the revenue recognition process for a service business would be in the case where a Business Consulting firm had a three-year contract with a medical firm. This example is provided for illustration purposes and is not to be considered accounting or legal advice.

Assume the Business Consulting firm contract specified that in the first year the Business Consultant would provide recommendations for increasing the medical firm’s revenue by ten percent for a fee of $48,000 payable in twelve monthly payments of $4,000. Each month the firm would recognize $4,000 in revenue as it completed its contract.

Information Required

Organizations must record information from all sales contracts related to revenue with a customer. Revenue recognition is always fluid. This is particularly true when agreement terms are updated or new performance requirements are added to an existing contract.

There is a technical accounting assessment that must be completed in advance of implementing

any part of a revenue recognition system. It is imperative the intricate standards be fully understood before any accounting software system changes are attempted. Potential parallel reporting requirements and impacts should be analyzed fully before proceeding with any implementation methodology.

It can take six to twelve months for a professional trained in the application of the revenue recognition process to get a business to the point where it has a working knowledge of the system. Businesses should start preparing a strategy to maximize their profitability potential now. Early adoption of the revenue recognition criteria will accelerate its benefits.

Collaboration Is Key

The best way to prepare for the new standard should be iterative and dynamic as opposed to sudden and static. Excellent teamwork and collaboration will be needed throughout departments such as Strategic Planning, Accounting, Finance and Human Resources (HR). Teams should be co-located as much a possible with regular and consistent communication channels in place to organize and share all the required data.

How We Can Help You

Pacific Crest Group (PCG) provides professional services that keep your business focused on your critical objectives. We provide strategic Accounting and Human Resource (HR) services created specifically to help you meet your goals. Through exemplary customer service, clearly defined policies and procedures as well as a forward-looking perspective, we provide the outsourced solutions your business needs to grow. A PCG professional is happy to meet with you to discuss solutions for your unique requirements designed to maximize all of your business opportunities.