



Services to Businesses
Services to Individuals

About Our Firm

Our Assurance and
Advisory Practice



Tim Perotti
415.439.1147
tperotti@frankrimerman.com



Frank F. Pasacreta
650.845.8101
fpasacreta@frankrimerman.com

Palo Alto San Francisco San Jose St. Helena

ASC 606 and the Software Industry

The FASB has made its final amendments and clarifications to the new revenue recognition standard, *Revenue from Contracts with Customers* (Topic 606 of the Accounting Standards Codification). The standard's implementation date for public entities is for fiscal years beginning after December 15, 2017. The implementation date for nonpublic entities is a year later, for fiscal years beginning after December 15, 2018.

Nonpublic entities have the option to early adopt Topic 606 as of the public entity implementation date. Although it may be late to consider such an option, stakeholders of a nonpublic entity positioning itself as an acquisition target should strongly consider assessing the impact of Topic 606 on operations now. Understanding how Topic 606 will impact future revenues is essential in helping target company stakeholders to determine the true value of their company and better negotiate a fair acquisition price. For an acquirer, especially a public entity, it will be important to understand how ready a target company is for the transition to Topic 606.

Topic 606 is a principle-based standard that replaces industry-specific revenue recognition guidance. This is especially significant for the software industry where Topic 606 will eliminate the:

- three-tiered relative selling price methodology under Topic 605-25, *Multiple Element Arrangements*, and
- residual method of accounting under Topic 985, *Software Revenue Recognition*

Topic 606's impact will vary among companies, but most entities will see some level of change beyond the technical accounting for revenue recognition. Topic 606 can significantly impact an entity's:

- standard contract terms
- customer communications
- go-to-market strategies
- compensation arrangements
- investor relations
- debt covenants
- income taxes

Implementing Topic 606 will definitely impact accounting and finance personnel; however, it will be felt throughout the organization, as companies must reassess their overall:

- business processes
- accounting systems
- departmental lines of communications
- internal controls over financial reporting
- capital and personnel budgets
- data retention capabilities to capture and process the accounting information

The new standard will apply to all existing contracts at the implementation date and all future contracts. Topic 606 allows two methods to account for Topic 606's implementation: 1) retroactive application (restate all periods being presented), or 2) cumulative effect (recognize impact at the date of implementation).

Regardless of the method selected, management will have to account for all revenue transactions twice for at least one year, to capture revenue under Topic 606 and under the company's current accounting policies, in order to present the significant disclosures required in the 2019 financial statements. This dual revenue reporting will far exceed the capabilities of Excel-based accounting systems currently utilized by many software companies.

January 1, 2019 may seem far away; however, a smooth transition to Topic 606 will require a detailed implementation plan and a significant investment of personnel and financial resources. Planning should begin now!

How can we help?

We can leverage our detailed knowledge of your business operations, products and services, contracts, accounting policies and procedures, personnel resources, and accounting system capabilities to:

- train company management and personnel on Topic 606
- analyze existing revenue streams and contract terms to identify areas requiring management's immediate attention
- discuss potential improvements to contract terms, revenue policies and company processes
- help form an internal implementation team consisting of key stakeholders
- assist in developing an implementation process, including timeline, budget and lines of communication
- provide ongoing support to the implementation team and management, as needed
- assess system capabilities and provide input as to potential system solutions