Public Relations /Advertising/ Marketing Communications Topic 606 – Common Issues

Tuesday, December 17, 2019

Presented by:
Michael Belfer, CPA – Practice Leader

Agenda

1. Contract
2. Performance obligations
3. Methods for measuring progress towards complete satisfaction of a performance obligation
4. Principal versus Agent considerations
5. Implementation (documentation)

1. Contract

- An contract exists if it meets the following five criteria:

1) The parties have approved the contract (in writing, orally, or in accordance with other customary business practices) and are committed to perform their contractual obligations.
2) The entity can identify each party's rights
3) The entity can identify the payment terms
4) The contract has commercial substance
5) It is probable that the entity will collect substantially all of the consideration to which it expects to be entitled.

1. Contract (continued)

- When a contract with a client does not meet the criteria and an entity receives consideration from the client, the entity shall recognize the consideration received as revenue only when one or more of the following events occurred:

1) The entity has no remaining obligations to transfer services to the client, and all, or substantially all, of the consideration promised by the client has been received by the entity and is not able to deferred.
2) The contract has been terminated, and the consideration received from the client is nonrefundable.
3) The entity has performed services to which the consideration that has been received relates, the entity has ceased performing services to the client and has no obligation under the contract to perform services, and the consideration received from the client is nonrefundable.

Example

- Company A's practice is to obtain written and customer-signed MSA/SOW. Company A performs the service without a signed MSA/SOW based on a request by the customer to perform PR service.

- Can an enforceable contract exist if Company A has not obtained a signed MSA/SOW consistent with its customary business practice?

- *It depends. The entity needs to determine if a legally enforceable contract exists without a signed agreement. The fact that is normally obtains written agreements does not necessarily mean an oral agreement is not a contract; however, the entity must determine whether the oral arrangement meets all of the criteria to be a contract.*

2. Performance Obligation Satisfied Over Time

- An entity performs control of a goods or service over time and, therefore satisfies a performance obligation and recognizes revenue over time if **<u>ONE</u>** of the following criteria is met:

1) The client simultaneously receives and consumes the benefits provided by the entity.

2) The entity's performance creates or enhances an asset (for example, work in process that the client controls as the asset is created or enhanced)

3) The entity's performance does not create an asset with an alternative use to the entity and the entity has an enforceable right to payment for performance completed to date

3. Measure Of Progress

Once management determines that a performance obligations is satisfied over time, it MUST measure its progress toward completion to determine the timing of revenue recognition.

The method selected for measuring progress toward completion should be consistently applied to arrangements with similar performance obligations and similar circumstances. Methods for measuring progress include:

3. Measure Of Progress (Continued)

1) Input methods, that recognize revenue based on the entity's efforts to satisfy the performance obligation.
   Example: Cost incurred, labor hours expended
2) Output method, that recognize revenue based on direct measurements of the value transferred to the customer.
   Example: Surveys of work performed and contract milestones
3) Time-based methods might be appropriate in situations when a performance obligation is satisfied evenly over a period of time or the entity has a stand-ready obligation to perform over a period of time. Judgment will be needed to determine the appropriate method to measure progress toward satisfaction of a stand-by obligation. It is not appropriate to default to straight-line attribution

3. Measure Of Progress (Continued)

- Management should select the method that best depicts the providing services.
- However, that **<u>DOES NOT</u>** mean that an entity has a free choice.

Generally Accepted Accounting Principals states that an entity should select a method of measuring progress that is consistent with the clearly stated objective of depicting the entity’s performance that is , the satisfaction of an entity’s performance obligation in providing service to the client.

Example

- An entity enters into a PO with a client to provide PR service for a total fee of $4,000,000. The PO contains a single performance obligation that is satisfied over time.
- Total estimated costs are $3,600,000, excluding cost related to excess labor and material. Cost incurred in year one are $740,000 and including $20,000 of excess labor.
- The entity concludes that the performance obligation is satisfied over time as the client will obtain controls of all work in process if PO terminates. The entity also concludes that an input method using cost incurred to total cost expected to be incurred as an appropriate measure of progress toward satisfying the performance obligation.
- How much revenue and cost should the entity recognize as of the end of year one?

Example (continued)

- The entity should recognize revenue of $800k based on a calculation of costs incurred relative to the total expected cost. The entity would recognize revenue as follows:

Total transaction price	$4,000,000
Progress toward completion ($720,000/$3,600,000)	20%
Revenue recognized	$800,000

4. Principal Versus Agent Considerations

- When more than one party is involved in providing goods or services to a customer, an entity must determine whether it is a principal or an agent in these transactions by evaluating the nature of its promise to the client.
- An entity is a principal and therefore records revenue on a gross basis, if it controls a promised good or service before transferring that good or service to the customer.
- An entity is an agent and therefore records revenue at the net amount it retains for its agency services if its role is to arrange for another entity to provide the goods or services. Because it is not always clear whether an entity controls a specified good or service in some contracts (e.g., those involving services), the standard also provides indicators of when an entity may control the specified service as follows:

4. Principal Versus Agent Considerations (Continued)

1) The entity is primarily responsible for fulfilling the promise to provide the service.
2) The entity has discretion in establishing the price for the specified service.

- Management needs to apply judgment when assessing the indicators.

Example

- Company A enters into a contract with Company B to design, plan and execute certain public relations events or activities for Company B. Company A takes on the responsibility of entering into agreements with certain vendors to provide incidental expenses such as photocopying, postage, travel, meals as well as production and media costs. These costs are incurred by Company A and Company A subsequently bills their client for these costs. Company A is free to negotiate the best possible rates with its vendor.

- Is Company A the principal or agent?

- *Company A is the principal and should recognize revenue for the gross fee charged to clients. Company A obtains control of the inputs, including getting third party vendors and entering into agreements with vendors.*

ANCHIN
Your Expert Partner

5. Implementation

- Document implementation
- Memo
- Checklist

Resources For ASC 606

https://www.aicpa.org/interestareas/frc/accountingfinancialreporting/revenuerecognition.html

https://www.aicpa.org/interestareas/centerforplainenglishaccounting.html

https://www.ey.com/ul/en/accountinglink/current-topics-revenue-recognition

https://www.pwc.com/us/en/cfodirect/publications/accounting-guides.html

https://www2.deloitte.com/us/en/pages/audit/articles/a-roadmap-to-applying-the-new-revenue-recognition-standard.html

https://frv.kpmg.us/reference-library/2017/handbook-revenue-recognition.html

Questions?

Michael Belfer
Partner and Leader
Public Relations/Advertising/Digital Media Group
Michael.Belfer@anchin.com

Thank you!