Grant Thornton

ADVISOR ALERT

ASPE and ASNPO: How changes to Section 3400 Revenue could affect your financial statements

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PART 1 Five-step revenue recognition assessment model

Introduction

Financial statement preparers that apply Accounting Standards for Private Enterprises (ASPE) or Accounting Standards for Not-for-Profit Organizations (ASNPO) will want to review their revenue recognition accounting policies to consider additional guidance. For many entities, accounting for revenue can be complex as every revenue stream, sales contract, and transaction can be unique. This additional guidance, now included in Section 3400 *Revenue* (in Part II of the CPA Canada Handbook – Accounting), eliminates room for interpretation in many areas; however, professional judgment will still be required. In this three-part series, we explain some of the additional guidance contained in Section 3400 and provide practical insights to help financial statement preparers and users evaluate the impact of these changes on an entity's financial statements.

In Part 1, we introduce a five-step revenue recognition assessment model and explain the considerations in each step.

The other publications in this series address the following topics:

PART 2	Determining the appropriate manner and timing of revenue recognition
PART 3	Applying the percentage of completion method

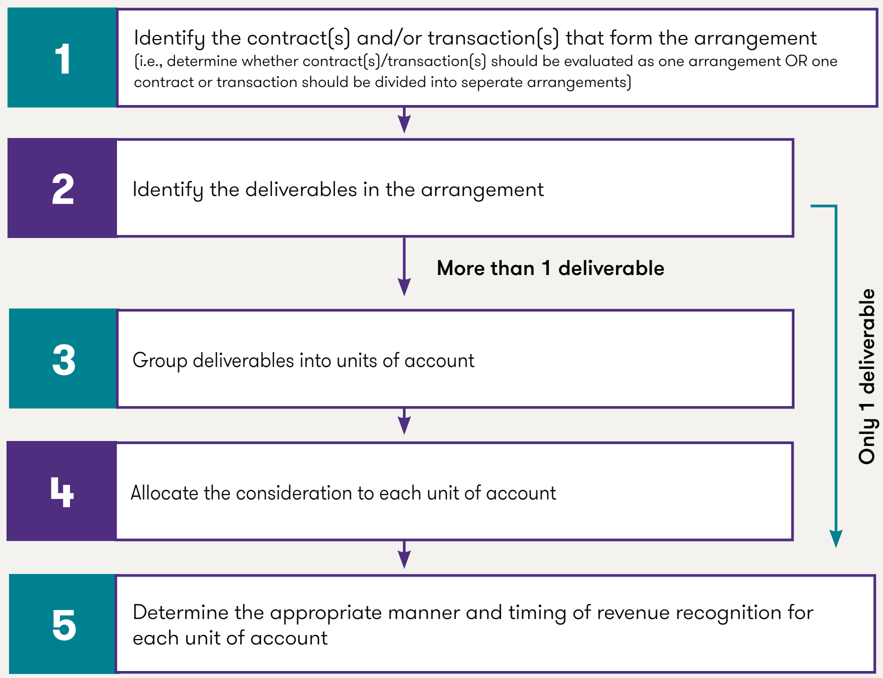
Practitioners are encouraged to read this series of publications in order and alongside Section 3400 to fully understand the requirements, as accounting for revenue contains many nuances. As entities prepare their financial statements under amended Section 3400, it's important to also take note of CPA Canada's publication, "ASPE briefing: Additional guidance added to Section 3400 Revenue", which provides:

- detailed guidance on each of the areas of revenue recognition impacted by the amendments;
- application guidance for not-for-profit organizations;
- additional resources; and
- comprehensive illustrative examples

For further background on the Accounting Standards Board's 2019 amendments to Section 3400, see Advisor Alert: How Section 3400 Revenue amendments could impact your enterprise's financial statements.

Revenue recognition assessment model

We've developed this five-step revenue recognition assessment model to help an entity determine how to appropriately account for revenue in accordance with ASPE. The five-step model is as follows:



STEP 1

Identify the contract(s)/transaction(s) that form the arrangement

(i.e., determine whether contract(s)/transaction(s) should be evaluated as one arrangement OR one contract transaction should be divided into separate arrangements)

→ It may be necessary to combine a group of transactions/contracts for purposes of assessing revenue recognition
→ Conversely, a single transaction/contract may include more than one arrangement, so it may be necessary to separate the transaction/contract into more than one arrangement for purposes of assessing revenue recognition

★ **Revenue is accounted for at the 'arrangement' level rather than the 'transaction' level** ★

→ Although not defined in ASPE, consider a transaction and arrangement, as follows:
- **Transaction:** an agreement with a customer to either sell a good, provide a service, or both (e.g., invoice, purchase order, or contract)
- **Arrangement:** the level at which revenue recognition is assessed, which may include one or more transactions/contracts

→ Combine separate contracts/transactions into a group and assess revenue recognition for the arrangement when the contracts/transactions:
- are negotiated as a package in the same economic environment with an overall profit margin objective;
- constitute, in essence, a single arrangement with a single customer;
- are so closely interrelated that they are, in effect, part of a single project with an overall profit margin; and
- and, are performed concurrently or in a continuous sequence

(Paragraphs 3400.A1-.A4)

STEP 2

Identify the deliverables in the arrangement

- → A single arrangement may involve multiple deliverables (i.e., the delivery or performance of multiple goods, services or rights to use assets)
  - Although not defined in ASPE, a 'deliverable' is essentially a 'promise made by an entity to a customer'
- → Identify all deliverables in an arrangement by examining the source documents that accompany the transaction (i.e., contract, agreement, invoice) and considering any oral or side arrangements

★ When an arrangement contains a single deliverable, proceed directly to Step 5 ★

(Paragraphs 3400.11, A3-A7)

STEP 3

Group deliverables into units of account

★ Step 3 applies only if the arrangement contains multiple deliverables ★

- → Identify units of account (which consist of one or more deliverables) so that consideration can be allocated and revenue can be recognized in Steps 4 and 5
- → A single deliverable constitutes its own unit of account if both the following criteria are met:
  - If the arrangement includes a general right or return relative to the deliverable(s), delivery or performance of the remaining deliverable(s) is considered probable and substantially in the control of the vendor; **and**
  - If the deliverable has value to the customer on a stand-alone basis (i.e., if it is sold separately by any vendor or if the customer could resell the deliverable on its own)
- → If a single deliverable does not constitute a unit of account on its own, it's combined with:
  - a related deliverable that meets the criteria noted above on its own; **or**
  - other applicable deliverables in order to meet the criteria noted above

(Paragraphs 3400. A5-A7)

STEP 4

Allocate consideration to each unit of account

★ If there is only one unit of account (i.e., goods/services/ rights to use assets), all consideration is allocated to that unit of account ★

- → Allocate consideration to each unit of account on a relative stand-alone selling price basis
- → **Stand-alone selling price:** the price at which an entity would sell a promised good or service separately to a customer
- → A contractually stated price or a list price for a good or service should not be presumed to be the stand-alone selling price, as the stated price may include price reductions/discounts not provided for other goods and services
- → If a stand-alone selling price cannot be directly observed, estimate the stand-alone selling price. Here are examples of two possible approaches:

Adjusted market assessment approach

- Evaluate the market in which the entity sells goods or services and estimate the price that a customer in that market would be willing to pay
- Refer to competitor's prices for similar goods or services and adjust for entity-specific costs and margins, if needed

Expected cost plus a margin approach

- Forecast expected costs of delivering a good or service for each unit of account and add an appropriate margin for that good or service

(Paragraphs 3400.11, A8-.A12)

STEP 5

Determine the appropriate manner and timing of revenue recognition for each unit of account

CAUTION: DO NOT SKIP STEPS 1-4 as it could cause a material misstatement in the amount and timing of revenue recognized

→ Recognize revenue for the **sale of goods or services** once performance is achieved and ultimate collection is reasonably assured

→ Performance is achieved for the **sale of goods** when all the following conditions are met:

1. The seller has transferred the significant risks and rewards of ownership to the buyer by:
   - completing all significant acts; and
   - retaining no continuing managerial involvement in, or effective control of, the goods transferred
2. Reasonable assurance exists regarding:
   - measurement of the consideration; and
   - the extent of returns
3. Persuasive evidence of an arrangement exists
4. Delivery has occurred or services have been rendered
5. The seller's price to the buyer is fixed or determinable

→ Performance is achieved for **services and long-term contracts:**

1. As the work is accomplished;
2. When reasonable assurance exists regarding measurement of the consideration;
3. Persuasive evidence of an arrangement exists;
4. Delivery has occurred or services have been rendered; and
5. The seller's price to the buyer is fixed or determinable

Revenue for a service or long-term contract is recognized as work is accomplished using either the percentage of completion method or the complete contract method
The method used is NOT A POLICY CHOICE!

(Paragraphs 3400.05-.07)

→ Recognize revenue from **interest, royalties, and dividends** when it's probable that the economic benefits will flow to the entity and the amount can be measured reliably, as follows:

- **Interest:** on a time proportion basis (i.e., as earned)
- **Royalties:** on an accrual basis in accordance with the substance of the relevant agreement
- **Dividends:** when the shareholder's right to receive payment is established

(Paragraph 3400.12)

For more details on how the amendments to Section 3400 could impact your financial statements, see the following articles included in this series on revenue recognition:

PART 2 Determining the appropriate manner and timing of revenue recognition

PART 3 Applying the percentage of completion method

We can help.

If you have any questions about the amended guidance or applying this revenue recognition assessment model, reach out to your Grant Thornton advisor today.

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