JD Edwards: The Impact of Revenue from Contracts with Customers Frequently Asked Questions

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Executive Overview

The convergence of FASB and IASB standards for Revenue Recognition will require changes in Oracle accounting solutions. The new standard and future Oracle software updates will apply to most companies reporting under U.S. Generally Accepted Accounting Principles (GAAP) and International Financial Reporting Standards (IFRS).

The new accounting and disclosure standards for revenue recognition are Financial Accounting Standards Update (ASU) No. 2014-09, Revenue from Contracts with Customers, and International Financial Reporting Standards (IFRS) 15, Revenue from Contracts with Customers.

The new disclosure requirements are extensive and will require changes to financial systems and processes to collect the necessary data—even if application of the new accounting standard results in no significant change in the reported amounts of revenue.

To meet these new standards, changes are being made to JD Edwards EnterpriseOne and World software. Oracle's JD Edwards customers need to assess the impact to their business for the new standards. Decisions need to be made about when and how to transition to the new standard and when to upgrade their JD Edwards systems with the new features to support the new standard.

The effective date for public entities is expected to start with reporting periods beginning on or after December 15, 2017. The effective date for nonpublic entities will be deferred for one year to annual reporting periods beginning after December 15, 2018 and interims beginning after December 15, 2019. Early adoption is permitted one year earlier than these dates.

General

Q: What are the new accounting standards?

A: In May 2014, the Financial Accounting Standards Board (FASB) and the International Accounting Standards Board (IASB) issued a new joint standard on revenue recognition. This new standard, when implemented, will replace the accounting standards for revenue recognition that currently exist under U.S. GAAP and IFRS.

Q: Why are FASB and IASB issuing this Accounting Standards Update?

A: The prior revenue recognition guidance in U.S. GAAP comprised broad revenue recognition concepts together with numerous revenue requirements for particular industries or transactions, which sometimes resulted in different accounting for economically similar transactions. IFRS provided limited guidance and, consequently, the two main revenue recognition standards, IAS 18, Revenue and IAS 11, Construction Contracts, could be difficult to apply to complex transactions. Additionally, IAS 18 provides limited guidance on important revenue topics such as accounting for multiple-element arrangements.

The Financial Accounting Standards Board and the International Accounting Standards Board initiated a joint project to clarify the principles to recognize revenue and develop a common revenue standard for U.S. GAAP and IFRS that would:

1. Remove inconsistencies and weaknesses in revenue requirements.
2. Provide a more robust framework for addressing revenue issues.
3. Standardize revenue recognition practices across entities, industries, jurisdictions, and capital markets.
4. Provide more useful information to users of financial statements through improved disclosure requirements.
5. Simplify the preparation of financial statements by reducing the number of guidelines to which an entity must refer.

Q: At a high level, what is the new revenue recognition accounting standard?

A: The core principle as stated from IFRS is to “Recognize revenue to depict the transfer of goods or services to customers in an amount that reflects the consideration to which the entity expects to be entitled to exchange for those goods or services.”

Q: Are there some basic steps outlined related to this new standard?

A: Yes; the steps to apply the core principle are:

1. Identify the contract(s) with the customer.
2. Identify the separate performance obligations.
3. Determine the transaction price.
4. Allocate the transaction price.
5. Recognize revenue when a performance obligation is satisfied.

Q: What are the effective dates for reporting using the new accounting standards?

A: The expected effective dates are:

- For public entities, the effective date starts with reporting periods beginning on or after December 15, 2017.

  For nonpublic entities, the effective date will be deferred for one year to annual reporting periods beginning after December 15, 2018 and interims beginning after December 15, 2019. Early adoption is permitted one year prior to these dates.

Q: Is there an approach to transition to the new standard?

A: The standard states that the methods to transition to the new standards are as follows:

- Entities are permitted to apply the new revenue standard either retrospectively subject to some practical expedients (that is, to restate prior periods for a consistent basis of accounting and presentation) or through an alternative transition method.
- The alternative transition method requires an entity to apply the proposed guidance only to contracts not completed at the date of initial application. Then, recognize the cumulative effect of adoption as an adjustment to the opening balance of retained earnings in the year of initial application. Under this approach, the financial statements before and after implementation will not be comparable.
- Retrospective transition requires applying the new guidance to all prior periods (subject to certain practical expedients). From a timing standpoint, the critical issue is that an entity presenting three years of comprehensive income will likely need to run parallel systems for two years before the year of adoption.

Q: What types of revenue might be most significantly impacted?

A: With nearly all industry-specific revenue guidance superseded, many entities will face a clean slate—that is, they will be developing completely new ways to evaluate and process revenue transactions, without the benefit of longstanding industry practice. Some of the areas impacted include:

- Software – The new standard will eliminate the vendor-specific objective evidence (VSOE) requirement, which will result in accelerating revenue for many software licenses that is currently deferred because of a lack of VSOE for undelivered elements (for example, specified upgrades or promises for additional products).
- Real estate – Revenue recognition for leases is addressed in the new lease accounting standard and will follow the adoption timeline for the new lease accounting standard.
- Construction-type contracts – Under the new guidance, recognition of revenue and costs will be decoupled and an entity must determine the method that most appropriately measures progress toward complete satisfaction of a performance obligation.
- License arrangements – Under the new standard, an entity will determine whether a license is a promise to provide a right or a promise to provide access. Revenue for promises to provide access will be recognized over time. Entities that currently recognize license revenue upfront may conclude that revenue under the new standard will be recognized over time (for example, an upfront franchise fee may be recognized over time).
- Telecommunications – The new guidance will require entities to estimate a stand-alone selling price for free or discounted goods or services (for example, a wireless handset) whereas current guidance restricts revenue recognition to the amount of cash received.

- Manufacturing/Distribution – With the new standard, the performance obligation may not be complete until customer receives and accepts the goods based upon the contract with the customer.

Q: What types of revenue might be least impacted?

A: Retail (point of sale) and Manufacturing/Distribution (performance obligation complete at time of shipping arrangements).

Q: What other areas might be impacted?

A: Other examples include:

- Revenue-based employee bonus and compensation arrangements.
- Debt-covenants.
- Right of return (manufacturing and retail): The balance sheet will be grossed up with a return asset and that asset will be subject to impairment separate from the evaluation of inventory (today's GAAP).
- Warranties (both manufacturing and retail): Entities providing a warranty will need to distinguish between the assurance-type warranty and separate services if any. The estimated cost of the assurance-type warranty will be accrued, and a portion of the transaction price will be allocated to the service. Determining the stand-alone selling price of the service could be challenging if an entity does not separately sell the service. There could also be a change in the amount allocated to separately-priced warranties. Under existing GAAP, the contract amount is allocated to the separately-priced warranty. Under the new model, the separately-priced warranty will be another performance obligation and a portion of the transaction price will be allocated to that performance obligation (on a relative selling price basis).
- Timing: Any manufacturer that enters into long-term contracts to construct an asset for its customer will need to evaluate whether the performance obligation is satisfied over time or at a point in time, which may or may not result in a change in practice.
- Contract costs (likely manufacturing): Currently, entities make a policy election to capitalize costs. Under the new standard, entities will be required to capitalize certain contract acquisition costs if performance is expected to be one-year or longer.
- Variable consideration (both manufacturing and retail): Estimates will be required for incentives or vendor allowances when there is uncertainty about the outcome. These estimated amounts will be subject to a constraint in the standard.
- Synthetic FOB destination: The entity may determine that they have a performance obligation such as, in-transit risk of loss coverage, and would defer revenue related to that performance obligation. Whereas today, entities often wait until delivery to recognize revenue for the good.
- Manufacturer's coupons (retail): Retailers may experience a change in how they recognize a manufacturer coupon. Today, they recognize revenue gross, and under the new standard, they may recognize revenue net of the coupon with a reduction to cost of sales.
- Loyalty/Reward programs: Currently entities have a choice to recognize a cost deferral or a revenue deferral for such programs. The new standard requires an allocation of the transaction price (revenue deferral) to the loyalty/reward performance obligation. The amount deferred would take into account expected breakage.

- Sell-through: The change in focus from transfer of risks and rewards to transfer of control could result in earlier revenue recognition for some entities that recognize revenue on sell-through.

Q: What are the potential tax implications?

A: Tax implications may be:

- A change in financial reporting accounting methods may result in a need to change tax accounting methods. Key considerations include the following:
  - Is the new financial reporting method a permissible method for tax?
  - Will there be an increase or decrease to book-tax differences?
- A change in tax method of accounting, even to conform to a book method, requires the filing of a Form 3115 "Application for Change in Accounting Method."
- The new standard will need to be evaluated for potential tax method impacts. Certain contract acquisition and fulfillment costs will be capitalized under the new standard.
- Multinational entities should evaluate whether the new standard will have an impact on transfer pricing. For example, whether the transfer pricing is based on revenue or gross profit-based method.

Q: Will it affect accounting processes, IT systems, and internal control?

A: Likely as follows:

- Internal controls will require updating, if not a complete overhaul, to reflect changes in accounting policies and processes.
- Processes may need to be developed or updated to incorporate new management judgments.
- Systems may need updating to capture new data used for accounting and additional disclosures.
- Revenue recognition process and policy documentation will require updating.

Q: What businesses are affected by the changes in this accounting standard?

A: Affected entities are those that either (a) enter into contracts with customers to transfer goods or services or (b) enter into contracts for the transfer of nonfinancial assets, unless those contracts are within the scope of other standards (for example, insurance contracts or lease contracts).

In addition, the existing requirements for the recognition of a gain or loss on the transfer of nonfinancial assets that are not in a contract with a customer (for example, assets within the scope of Topic 360, Property, Plant, and Equipment, and intangible assets within the scope of Topic 350, Intangibles—Goodwill and Other) are amended to be consistent with the guidance on recognition and measurement (including the constraint on revenue) in this update.

Q: What is the impact to Oracle JD Edwards customers?

A: JD Edwards EnterpriseOne and World customers that are affected by the changes will require software updates to be compliant. This will affect all areas of the system that recognize revenue, such as Accounts Receivable, Sales Order Management, Advanced Contract Billing, Contract and Service Billing, and Project Costing.

Prior to the reporting changes, certain modules such as Contract and Service Billing might not have been necessary. With the change, some JD Edwards customers may require licensing and implementation of these additional products.

Q: Which JD Edwards releases will support these changes?

A: We are delivering changes to JD Edwards EnterpriseOne Releases 9.1 and 9.2. World updates will be available in Releases A93.1 and A94. .

Q: What are the recommended next steps for JD Edwards' customers?

A: JD Edwards' customers are in different stages of adoption with the pending changes. Some have no awareness, some have awareness with no action plan, and some are more strategic with awareness and a plan of action for handling the changes. Although the effective date is still in the future, how your business chooses to adopt the revenue recognition standard will affect several years of revenue recognition.

To be prepared for the changes, companies should take advantage of upcoming software updates from Oracle. We recommend that you upgrade your software before the effective date applicable to your organization in preparation for the transition to the new standard. All organizations should evaluate the potential impacts on financial statements, information systems, processes, and controls.

The direct effect of a change in accounting principles associated with Revenue from Contracts with Customers will be a restatement. If a public entity chooses full retrospective adoption, revenue and the direct effects of change in accounting principles to all contracts must be restated for 2016 and 2017 to show comparative financial statements with a cumulative adjustment as of January 1, 2016.

Use this roadmap to ensure that your company, as well as its management team and staff, do the following:

1. Understand the changes to current revenue recognition standards.
2. Establish a cross-functional implementation team including, but not limited to, accounting, tax, IT, legal, and sales personnel. Compensation and benefits personnel may also need to be included. This will be a significant change and entities should not underestimate the effort involved, including the need to engage external specialists.
3. Understand transition and retrospective adoption of the revenue recognition standard, and determine how your company will adopt the new guidance.
4. Find resources to help train your professional staff to ensure effective and efficient implementation of the revenue recognition standard.
5. Educate users about the changes they can expect in your company's financial statements.
6. Derive an enterprise applications "Net Change" plan that communicates the future changes to JD Edwards EnterpriseOne or World and other core solutions that integrate with Oracle's solutions.

Q: Where can I find more information?

A: Updates from Oracle's Office of Finance Solutions are available at the Financials Marketing Blog.

Updates from the Financial Accounting Standards Board are available at FASB.org.

Updates from the International Financial Reporting Standards are available at IFRS.org.

Public accounting firms provide a wealth of information and many have updates that address how the new standards impact various industries. The following Oracle partners provide updates on their websites:

- Deloitte
- Ernst & Young
- Grant Thornton
- KPMG
- PricewaterhouseCoopers

Be sure to contact your current external auditor for more information, if one of the firms above is not your auditor.

Find supporting JD Edwards Resources for Revenue Recognition here on LearnJDE.

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