MOSSADAMS

Compliance Changes for Government Contractors

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Presenters

Mary Beth Jackson
Director
Redstone Government Consulting, Inc.

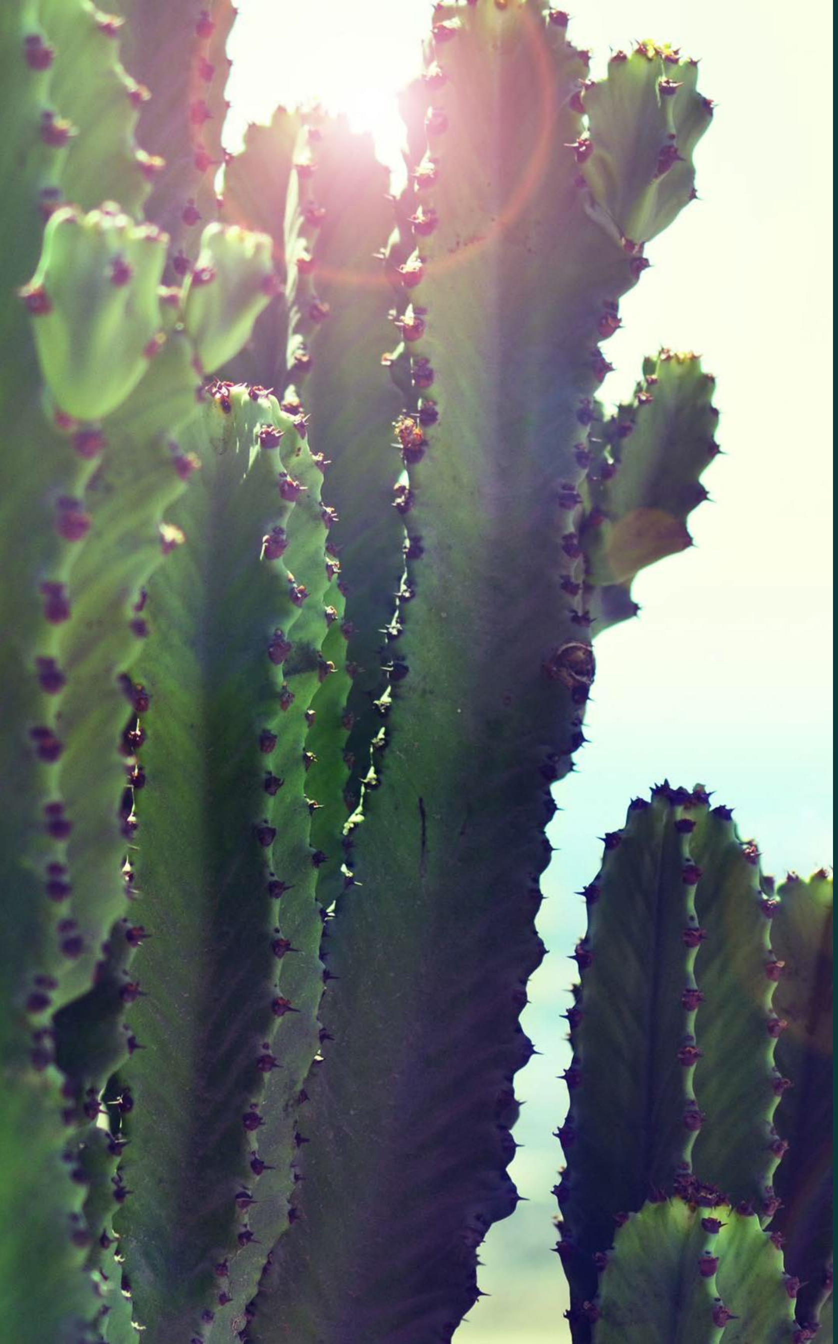
mjackson@redstonegci.com
256.704.9872

Nick Bergamo
Partner
Moss Adams

nick.bergamo@mossadams.com
949.221.4022

Nick Fusca
Partner
Moss Adams

nick.fusca@mossadams.com
256.704.9872



Agenda

Accounting Standards Codification (ASC) 842 Leases

Polling Question #1

HAS YOUR COMPANY ADOPTED THE NEW LEASING STANDARD (ASC 842 – LEASES)?

Yes

No

We are working on it now

I don’t know

Overview: ASC Topic 842

Lessees will record assets and liabilities for almost every lease on the balance sheet as either:

- Finance (formerly capital)
- Operating

An exception is made for short-term leases (12 months or less) with certain caveats.

Scope & key terms

Classification

Recognition & measurement

Disclosures & transition

Does the Contract Contain a Lease?

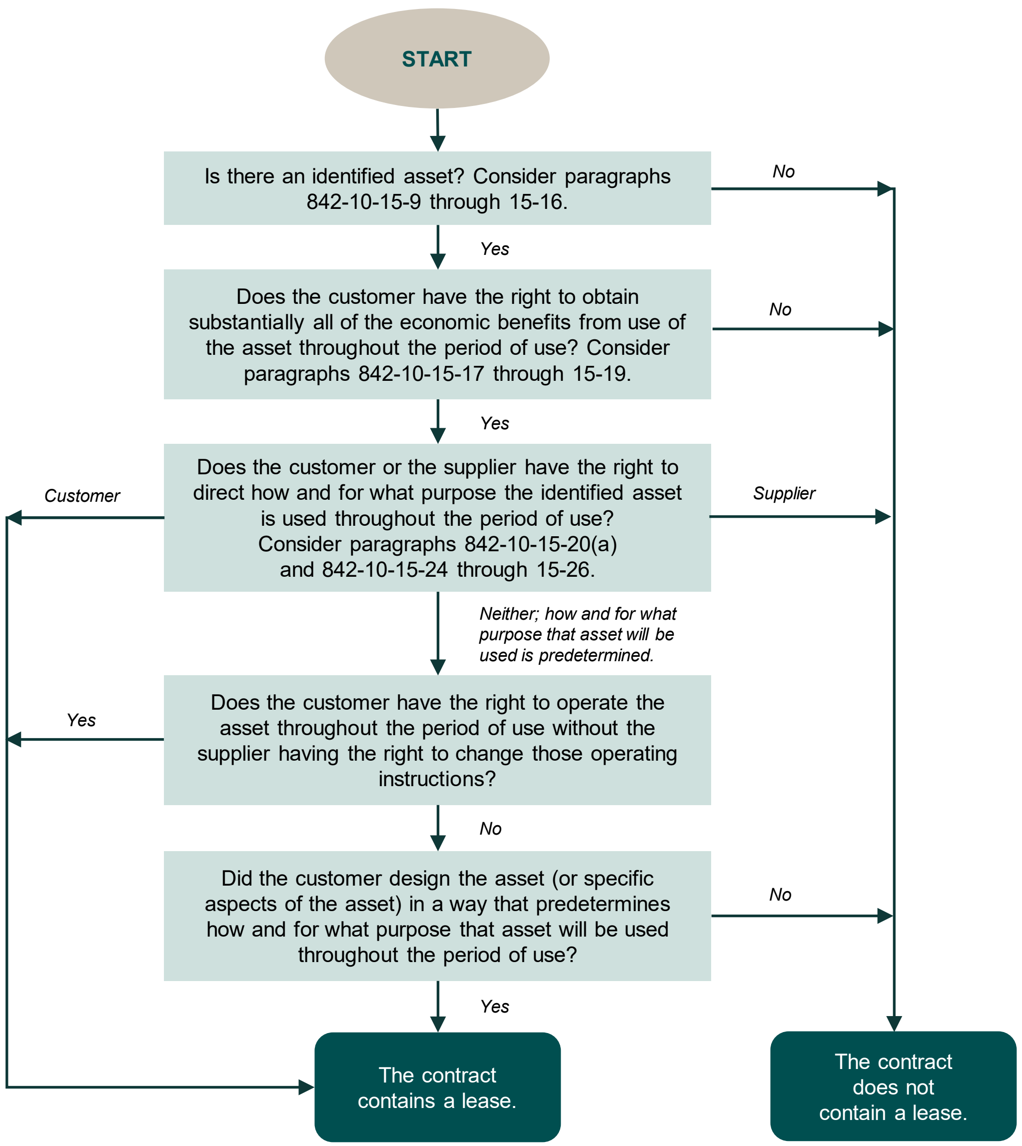
EXAMPLES:

- Server space
- Vehicles

IDENTIFIED ASSETS	• Explicitly or implicitly • Supplier has no practicable ability to substitute and wouldn’t benefit from substitute
RIGHT TO CONTROL	• Direct the use of the identified asset • Ability to obtain substantially all the economic benefit from the use of the asset

Does the Contract Contain a Lease?

This flowchart was provided by the Financial Accounting Standards Board (FASB) to depict the decision process to follow in identifying whether a contract is or contains a lease.



What Information is Needed?

SCOPE AND KEY TERMS

Under the ASC 840, classification was one of the more important aspects of lease accounting since the results impacted whether a lease was on a balance sheet.

Since most leases are now on a balance sheet, classification could become less of a factor, making these key terms more relevant going forward when reporting leasing activities as they impact the amounts reported.

Step 1

- Scope & key terms
- Classification
- Recognition & measurement
- Disclosures & transition

Identification of the Lease Term

Initial Measurement

Consider all relevant factors that create an economic incentive to renew the lease

Include if reasonably certain to exercise

Subsequent Measurement

Reassess only upon occurrence of a significant change in circumstances that's within control of lessee

Non-Lease Components

ALLOCATE CONSIDERATION

Identifying non-lease components, such as service elements, is a critical factor for lessee accounting and will require judgment when market information is not readily available from lessors.

Examples of non-lease components:

- Maintenance or repairs
- Insurance
- Janitorial services

Observable stand-alone prices

Estimate if not readily available

Residual method

Accounting policy election to treat as single component

Lease Payments: Present Value Over Lease Term

Lessee includes purchase options or termination penalties if they're reasonably certain to be exercised.

EXAMPLE:

Charlie's Bakery enters a building lease with a noncancelable term of four years and has a four-year renewal option at market pricing.

Charlie's Bakery also makes leasehold improvements that are expected to have significant value at the end of the initial lease term but can only be realized through continued occupancy. What is the lease term?

- Fixed payments
- Purchase options
- Termination penalties
- Residual value guarantees

Variable Lease Payments

TWO COMMON EXAMPLES OF VARIABLE PAYMENTS:

- Rents that change annual based on an index—for example, consumer price index
- Payments contingent on achieving sales, gross receipts, or net income figures—for example, 4% of sales in excess of $500,000

GENERALLY ACCOUNTED FOR AS PERIOD EXPENSES

- Increase not included in lease liability or right-of-use (ROU) asset
  - Use the index at the lease commencement date
- If the lease liability is remeasured for any other reason, it would update the variable lease payments to the current rate/index at the remeasurement date

Discount Rate: Lease-by-Lease Basis

Implicit rate is the rate that causes the present value of the lease payments to equal the sum of the fair value of the underlying asset and initial direct costs of the lessor.

Initial direct costs include only incremental costs associated with originating the lease.

- Rate implicit in lease
- Incremental borrowing rate
- Risk-free rate
- Reassessment

FASB's Dual Model

	BALANCE SHEET	INCOME STATEMENT	CASH FLOWS
Finance	ROU asset lease liability	Amortization expense interest expense	Financing section for principal payments Operating section for all other payments
Operating	ROU asset lease liability	Single lease expense on straight line basis	Operating section for all lease payments

ROU Assets = noncurrent classification as this is a non-financial asset similar to intangible assets

Lease Liability = breakout between current and noncurrent as these are financial liabilities, but not debt or debt-like

Lessee Accounting

FINANCE OR OPERATING LEASE

Classification Criteria:

- Five items to consider for finance lease classification
- Four are similar to the existing lease guidance
- Fifth criterion: Highly specialized asset that cannot be used without major modification (no alternative future use)
- If lease does not meet the criteria for finance, then it's considered an operating lease

Transfer of ownership by end of lease term

Purchase option that is "**reasonably certain**" to be exercised

Lease term is for "**major part**" of remaining economic life

Present value (PV) of lease payments plus any Residual Value Guarantee (RVG) equals or exceeds "**substantially all**" the asset's fair value

Asset is of such specialized nature that only lessee can use it without major modifications

Bringing Leases on a Balance Sheet

RECOGNITION & MEASUREMENT

ROU asset equals sum of lease liability, prepaid rent, and initial direct costs, less lease incentives received.

Lease liability equals present value of lease payments not yet paid.

Finance leases will result in a front-loaded expense vs. straight line for operating leases.

- Commencement date
- ROU asset
- Lease liability
- Expense patterns

Sample Finance Lease

ABC Foods Equipment Lease Annual Payments Classification: Finance					
	BEGINNING OF YEAR 1	END OF YEAR 1	END OF YEAR 2	END OF YEAR 3	TOTAL
INCOME STATEMENT					
Interest expense		$1,483	$1,006	$511	**$3,000**
Amortization expense		$15,000	$15,000	$15,000	**$45,000**
Total period expense		$16,483	$16,006	$15,511	**$48,000**
BALANCE SHEET					
Right-of-use asset (noncurrent)	$45,000	$30,000	$15,000	-	
Finance lease liability: current portion	$14,517	$14,994	$15,489	-	
Finance lease liability: noncurrent portion	$30,483	$15,489	-	-	
Total period expense	$45,000	$30,483	$15,489	-	
STATEMENT OF CASH FLOWS					
Financing Cash Flows: Finance lease principal payments		$14,517	$14,994	$15,489	**$45,000**
Operating Cash Flows: Interest remains in cash flows from operating activities and disclosed as cash paid for interest		$1,483	$1,006	$511	**$3,000**
Total cash outflows		$16,000	$16,000	$16,000	**$48,000**

Assumes: Three-year equipment lease with annual payment amount of $16,000 due at end of each year, approximate interest rate of 3.25%, equals present value of $45,000. Lease commencement is day one of year one.

Sample Operating Lease

ABC Foods Office Lease Annual Payments Classification: Operating					
	BEGINNING OF YEAR 1	END OF YEAR 1	END OF YEAR 2	END OF YEAR 3	TOTAL
INCOME STATEMENT					
Lease Expense		$16,000	$16,000	$16,000	**$48,000**
Total period expense		$16,000	$16,000	$16,000	**$48,000**
BALANCE SHEET					
Right-of-use asset (noncurrent)	$45,000	$30,483	$15,489	-	
Finance lease liability: current portion	$14,517	$14,994	$15,489	-	
Finance lease liability: noncurrent portion	$30,483	$15,489	-	-	
Total period expense	$45,000	$30,483	$15,489	-	
STATEMENT OF CASH FLOWS					
Operating Cash Flows: Lease Payments remain in cash flows from operating activities		$16,000	$16,000	$16,000	**$48,000**
Total cash outflows		$16,000	$16,000	$16,000	**$48,000**

Assumes: Three-year retail office lease with annual payment amount of $16,000 due at end of each year, approximate interest rate of 3.25%, equals present value of $45,000. Lease commencement is day one of year one.

Potential Impacts (Lessee)

INCREASED LIABILITIES (CURRENT AND NONCURRENT)

- Technically, operating lease liabilities are not “debt,” unclear if creditors will share this view
- Impact to working capital ratios (like current ratio) and debt ratios

INCREASED ASSETS

- Lower return on assets

CASH FLOW AND PROFITABILITY

- Finance lease: reduced earnings up-front, but larger earnings before interest, taxes, depreciation, and amortization (EBITDA) add-back
- Operating lease: no impact

Polling Question #2

DO YOU ANTICIPATE SIGNIFICANT IMPACTS TO YOUR COMPANY'S FINANCIAL STATEMENTS FROM THE ADOPTION OF ASC 842 – LEASES?

Yes – there will be significant impacts to our financial statements

Yes – but "significant" is debatable

No – this is just an accounting exercise

I'm not sure yet

Potential Impacts

How do these changes provide incentives or penalties?

- Will financing leases be more attractive, given all leases are on the balance sheet?
- Will entities be put-off by upfront earnings hit from financing leases, or will the EBITDA add-back balance this out?
- How will creditors and equity investors view balance sheet metrics and other ratios?
- Will negotiating covenants be more difficult, or will there be a soft transition?

Tax Considerations

Recognition of lease-related assets and liabilities that aren't on the balance sheet today would impact many aspects of accounting for income taxes, such as:

- Recognition and measurement of deferred tax assets and liabilities
- Assessment of the recoverability of deferred tax assets—in other words, the need for and measurement of a valuation allowance

Presentation in Financial Statements

Cash flows from finance lease are included in finance and operating activities, operating lease payments are included in operating activities.

BALANCE SHEET	INCOME STATEMENT
Present separately on face of balance sheet or in footnotes	Present as period lease expense or interest and amortization
Operating lease liability is not debt or debt-like	Accelerated vs. straight line
Related parties	Impairment expense (ASC 360)

Disclosures in Footnotes

QUANTITATIVE	QUALITATIVE
Periodic lease expense, ROU asset amortization, interest costs	Terms and conditions, purchase options, termination penalties
Short-term, variable leases, sublease income, cash and non-cash flows	Accounting policy elections, areas of significant judgment, assumptions
Weighted average discount rate for both finance and operating	Residual value guarantees
Weighted average remaining lease term for both finance and operating	Significant judgments and assumptions

Effective Dates

TRANSITION	PUBLIC*	NONPUBLIC**
Present comparative periods using modified retrospective method	Fiscal years (including first interim period) beginning after December 15	Fiscal years beginning after December 15
	2018	2021

** Includes public business entity; not-for-profits (NFPs) that has issued, or is a conduit bond obligor for, securities that are traded, listed, or quoted on an exchange or an over-the-counter (OTC) market; and employee benefit plans (EBPs) that file financial statements with the SEC.*

*** Interim periods beginning in fiscal years beginning after December 15, 2020.*

Transition Guidance: Modified Retrospective

FASB provided a variety of “practical expedients” an entity may elect to reduces the cost of transition.

Adoption methods permitted:

- Modified retrospective: as of the earliest comparative period presented at the date of initial application
- Cumulative-effect adjustment to the opening balance of retained earnings in the period of adoption.

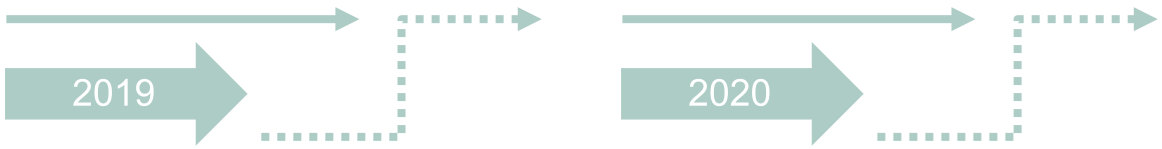
Existing leases at transition

New leases during transition

Changes in classification

Specified reliefs

Comparative Periods



ASC 842 Cost Accounting Standards (CAS) Impact

Advance Notice of Proposed Rulemaking (ANPRM) published November 5, 2020, in the Federal Register

- Generally accepted accounting principles (GAAP) changes to report most operating leases as assets and liabilities on the balance sheet are not recognized for the purpose of computing facilities capital cost of money in accordance with CAS 414 and 417
- Right of use assets should be excluded from treatment as tangible capital assets and intangible capital assets for CAS purposes
- CAS board proposing to revise definitions:
  - Intangible capital asset for CAS 414 and 417
  - Tangible capital asset for CAS 403, 404, 409, 414, and 417
  - Clarify language in instructions for Form CASB-CMF

Polling Question #3

DO YOU ANTICIPATE UTILIZING A CONSULTANT TO ASSIST WITH THE ADOPTION OF THE NEW LEASING STANDARD?

Yes, definitely

No, we have constraints that won’t allow for an additional resources to be utilized

I will try to do it in house

ASC 842 Implementation Overview

PHASE 1
Assessment of Impact

- Develop cross-functional team responsible for design phase
- Establish governance, project, and change management approach
- Review and inventory leasing arrangements and contracts
- Review current accounting policies and practices
- Identify relevant differences under the new standard
- Map accounting policy differences to process and systems impact
- Consider running dual GAAP approach during initial year
- Draft disclosures both for transition and ongoing
- Establish roadmap and communication plan

PHASE 2
Redesign of New Processes and Controls

- Walk through entire process from contract initiation to cash disbursement
- Analyze close process through to financial reporting
- Identify systems, processes, and controls that need to be changed or developed
- Consider dual reporting requirements during transition process and effect on controls
- Design processes and controls so they are aligned with the new leasing model
- Determine adoption method
- Validate with management and external auditors that processes and controls are properly designed before moving to the implementation phase

PHASE 3
Implementation of Systems, Processes, and Controls

- Perform system and process implementation
- Integrate and establish new controls into framework
- Test and validate new controls or controls that were changed
- As necessary, perform data migration, user acceptance testing, and data validation
- Conduct post-implementation reviews
- Sustain and support ongoing solution
- Conduct education and training workshops

Scoping

It's important to agree upon a detailed scope of analysis. Specific locations and contracts should be considered and selected. Consider bucketing the existing contracts into homogenous populations:

QUANTITATIVELY SIGNIFICANT:

- Building or equipment leases

QUALITATIVELY SIGNIFICANT:

- Operating vs. finance
- Short-term leases
- Unique transactions
  - For example, sale-leasebacks or sub-leases

EMBEDDED LEASES:

- Beverage dispensing machines and beer taps
- Contracts that utilize all capacity of provider or specified assets with no other use during contract
- For example, tower cranes
- Review other assets and expenses
- Perform inquiries of management
- Site observations

➤ QUESTIONS

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ASC 606
Revenue from Contracts with Customers

Polling Question #4

HAS YOUR COMPANY ADOPTED THE NEW LEASING STANDARD (ASC 606 – REVENUE FROM CONTRACTS WITH CUSTOMERS)?

Yes

No

We are working on it now

I don’t know

Agenda

Old Method (ASC 605)

FOUR CRITERIA TO RECOGNIZE REVENUE:

- Collectability is reasonably assured
- Delivery has occurred or services have been rendered
- Persuasive evidence of an arrangement exists
- The seller’s price to the buyer is fixed or determinable

New Five-Step Process (ASC 606)

Step 1	Step 2	Step 3	Step 4	Step 5
Identify the contract with a customer.	Identify the separate performance obligations in the contract.	Determine the transaction price.	Allocate the transaction price to the separate performance obligations in the contract.	Recognize revenue when (or as) the entity satisfies a performance obligation.

Scope of ASC 606

APPLIES TO:

- Nearly every industry and entity
- Contracts with customers: a party that's contracted with an entity to obtain goods or services that are an output of the entity's ordinary activities in exchange for consideration

EXCLUSIONS:

- Leases
- Financial instruments
- Insurance contracts
- Nonmonetary exchanges

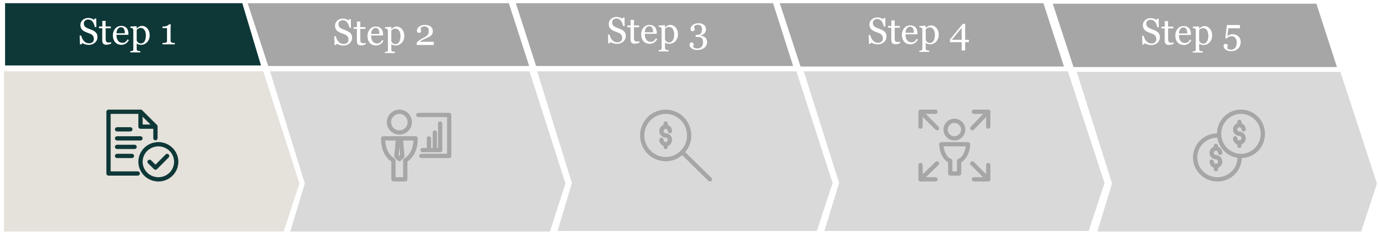
ASC 606

Step 1: Identify the Contract

Contract: an agreement that creates enforceable rights and obligations

CRITERIA:

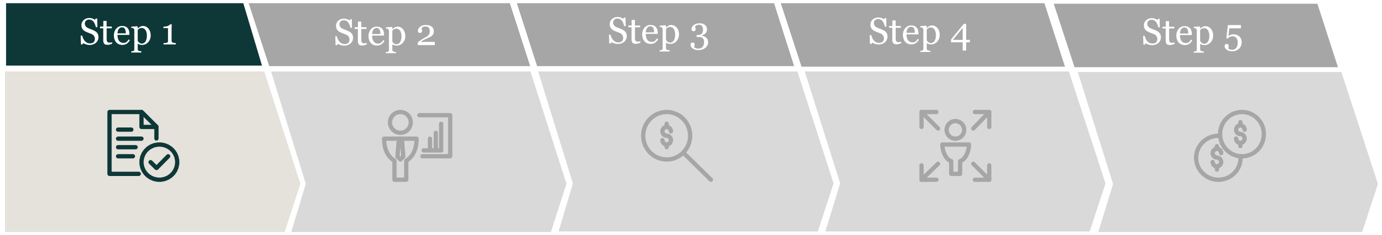
- Approval and commitment of the parties (written, oral, customary business practices)
- Identification of rights and payments terms
- Commercial substance
- Collectability is **probable** at inception



Step 1: Identify the Contract

Grouping contracts: practical expedient

- Can apply guidance to a portfolio or group of contracts with similar characteristics if the entity reasonably expects the effects on the financials wouldn't be significant from applying the guidance to each individual contract
- Could benefit industries that have many similar contracts



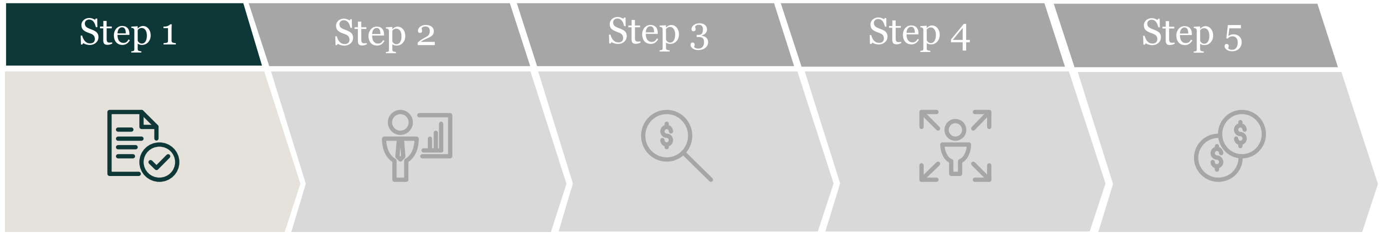
ASC 606

Contract Modification

Modifications common in the Aerospace & Defense Industry

TREAT AS SEPARATE CONTRACT IF:

Adds a distinct performance obligation and changes the consideration of the stand-alone selling price

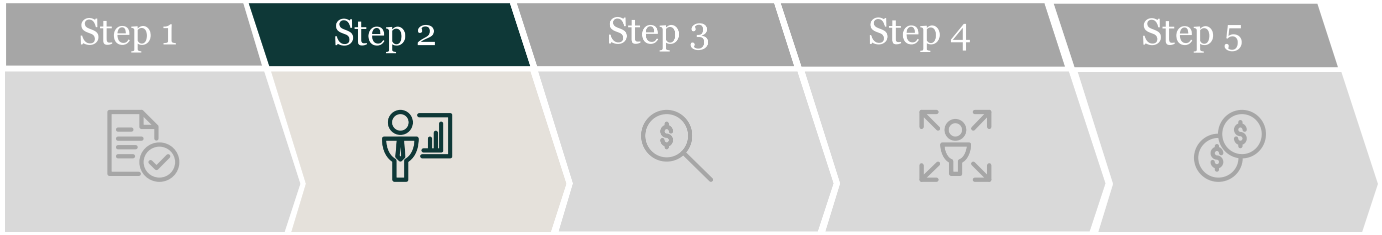


Step 2: Identify Performance Obligations

Performance obligation: a promise in a contract to transfer a good or service

CRITERIA:

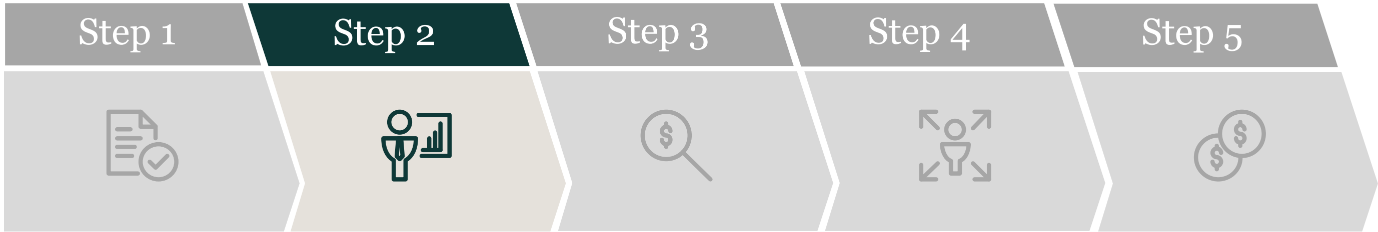
- **Distinct** good or service
- Series of substantially similar **distinct** goods or services that have the same pattern of transfer



Step 2: Identify Performance Obligations

A good or service is **distinct** if both criteria are met:

1. Benefits the customer on its own (capable of being distinct)
2. Separately identifiable from other promises (distinct within context of the contract)
   - Isn’t used as an input to produce a combined output (integration)
   - Doesn’t significantly modify or customize another good or service in the contract
   - Isn’t highly dependent or interrelated with other goods or services in the contract



Step 2: Identify Performance Obligations (cont.)

An entity should consider the following factors that indicate that multiple units of a product in a production-only arrangement are not separately identifiable and therefor not distinct. (ASC 606-10-25-19(b))

- The product specifications are complex and customized to the customer's needs
- A manufacturing process specific to this contract is established in order to produce the contracted units
- The company is responsible for the overall management of the contract, including performance and integration of various activities including procurement of materials, identifying and managing subcontractors and performing manufacturing, assembly, and testing

An entity should consider the following factors that indicate that the promised goods and services in a design, development and production contract are not separately identifiable and therefor not distinct. (ASC 606-10-25-19(b))

- During the bidding process, the customer did not seek separate bids on the design and production phases
- The contract involves design and production services for a new or experimental product
- The specifications for the product include unproven functionality
- The contract involves production of prototypes
- The design of the product will likely require revision or rework during production based on the testing of initial units produced

ASC 606

Step 3: Determine Transaction Price

Transaction price: amount of consideration which an entity expects to be entitled in exchange for transferring goods or services

COMPLEX AREAS:

- Variable consideration and related constraints
- Right of return
- Noncash consideration

Step 3: Determine Transaction Price

Variable consideration: The transaction price might include an element of consideration that's variable or contingent on the outcome of future events, including but not limited to:

- Discounts, rebates, coupons, price concessions, refunds, returns, credits, incentives, performance bonuses, and royalties

TWO METHODS FOR ESTIMATION:

- Most likely amount
- Expected value

Step 3: Determine Transaction Price

Variable consideration is included in the transaction price to the extent it’s probable or highly probable that there won’t be a significant reversal in the amount of cumulative revenue recognized

- Consider likelihood and magnitude in determining constraints

Estimated transaction price is reassessed at the end of each reporting period through end of contract to determine whether variable consideration is constrained

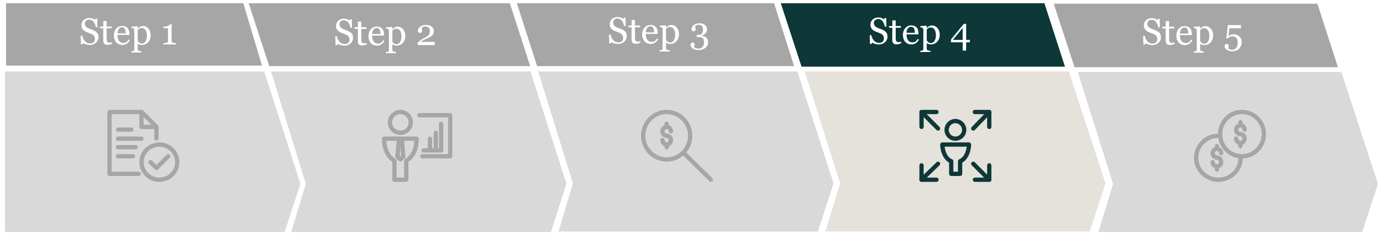
Step 3: Determine Transaction Price

SIGNIFICANT FINANCING COMPONENTS

- Transaction price should be adjusted for the effects of the time value of money if the timing of the payments agreed to by the parties to the contract provide the customer or the entity with a significant benefit of financing the transfer of goods or services
- Can be explicit or implicit

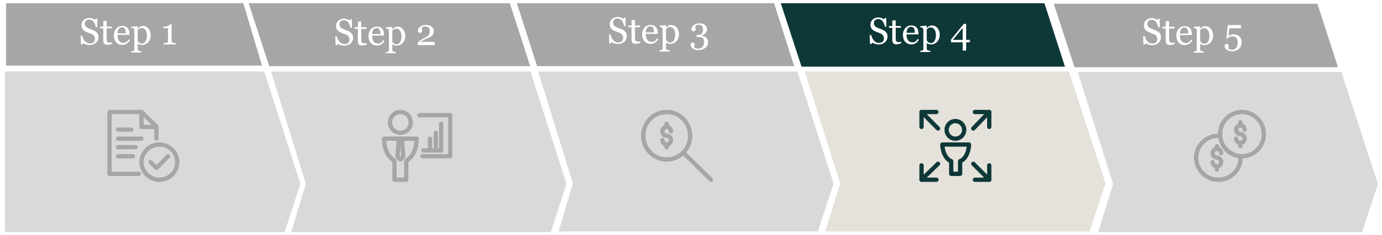
Step 4: Allocate the Transaction Price

- Allocate the transaction price to each performance obligation based on a relative **standalone selling price** basis
- One performance obligation: simple
- Multiple performance obligations: more complex



Step 4: Allocate the Transaction Price

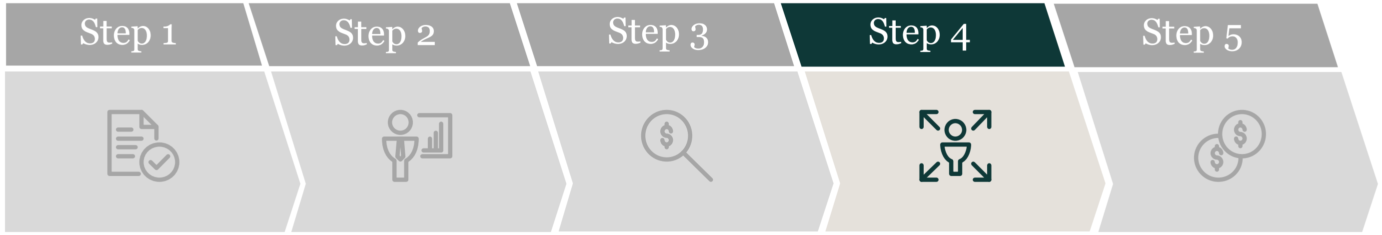
- **Standalone selling price** is the price at which the entity would sell a good or service to a customer
- Doesn't require the good or service to be sold
- Best evidence of **standalone selling price** is the observable price of a good or service sold separately, if available



Step 4: Allocate the Transaction Price

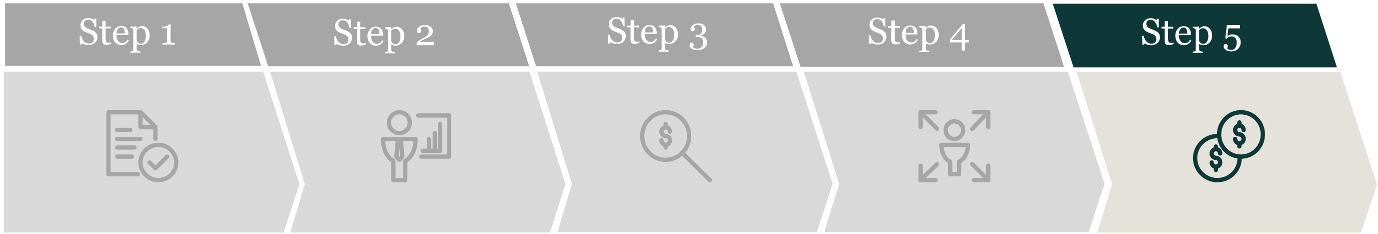
If no observable sales, estimate standalone selling price based on the following methods:

- Top-down approach
  - Adjusted market assessment
- Bottom-up approach
  - Expected cost plus a margin
- Residual approach
  - Only if standalone pricing is highly variable or no established price, and has not been sold standalone



Step 5: Recognize the Revenue

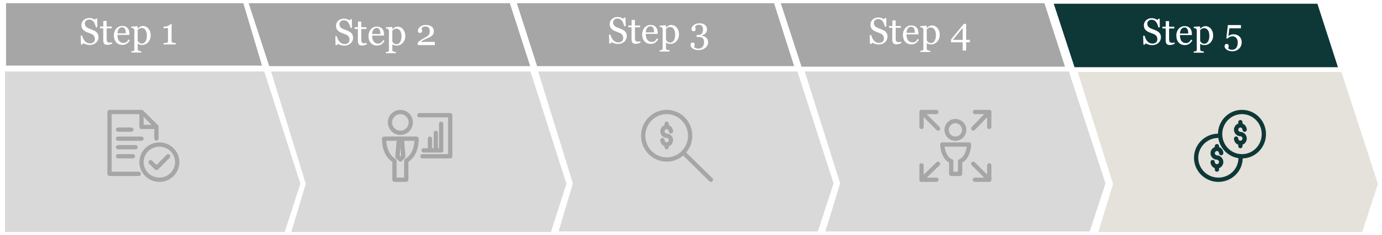
- An entity recognizes revenue when or as the entity satisfies a performance obligation by transferring the goods or services to a customer
- An asset (good or service) is considered transferred when (or as) the customer obtains control of the asset



Step 5: Recognize the Revenue

INDICATORS OF TRANSFER OF CONTROL INCLUDE:

- The entity has a present right to payment for the asset
- The customer has legal title to the asset
- The entity has transferred physical possession of the asset
- The customer has the significant risks and rewards of ownership of the asset
- Customer has accepted the asset

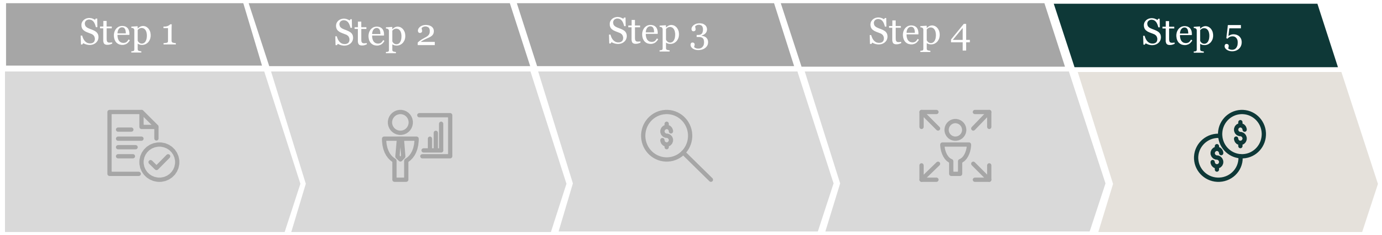


Step 5: Recognize the Revenue

Recognize revenue when or as a performance obligation is satisfied

TWO METHODS:

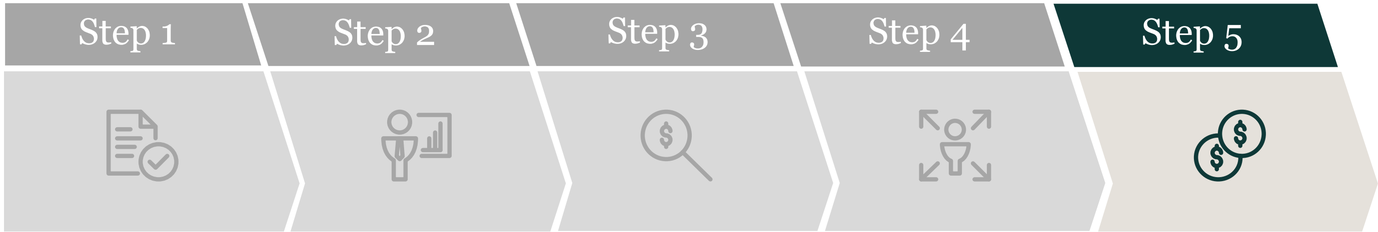
- At a point in time
- Over time



Step 5: Recognize the Revenue

REVENUE IS RECOGNIZED OVER TIME IF:

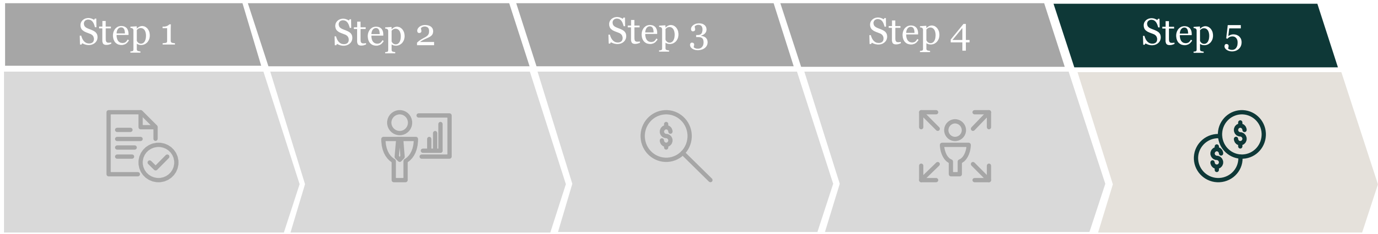
- The customer simultaneously receives and consumes the benefits as the entity performs; or
- The entity’s performance creates or enhances an asset that the customer controls; or
- The entity’s performance doesn’t create an asset with an alternative use to the entity and enforceable right to payment exists



Step 5: Recognize the Revenue

MEASUREMENT OF PROGRESS OVER TIME:

- Output Methods
  - Units produced, appraisals of results, surveys of performance, milestones reached
- Input Methods
  - Resources consumed, labor hours expended, costs incurred, time elapsed
  - Inputs must be proportionate to the entity’s progress



Polling Question #5

DO YOU ANTICIPATE SIGNIFICANT IMPACTS TO YOUR COMPANY'S FINANCIAL STATEMENTS FROM THE ADOPTION OF ASC 606 REVENUE FROM CONTRACTS WITH CUSTOMERS?

Yes – this will be a significant impact on our company's financial statements

Yes – but "significant" is debatable

No – this is just an accounting exercise

I'm not sure yet

Five-Step Process: Summary

Step 1	Step 2	Step 3	Step 4	Step 5
Identify the contract with a customer.	Identify the separate performance obligations in the contract.	Determine the transaction price.	Allocate the transaction price to the separate performance obligations in the contract.	Recognize revenue when (or as) the entity satisfies a performance obligation.

Other: Capitalized Contract Costs

Costs of obtaining a contract (in other words, sales commissions)

- Under ASC 340-40, the incremental costs of obtaining a contract—costs that wouldn't have been incurred if the contract hadn't been obtained—will be recognized as an asset if the entity expects to recover them.
- Practical expedient: an entity may recognize the incremental costs of obtaining a contract as an expense when incurred if the amortization period of the asset that the entity otherwise would've recognized is one year or less.

Costs of fulfilling a contract (direct labor and material, certain factory setup costs)

- Under this guidance, entities will capitalize the costs to fulfill a contract if the costs relate directly to the contract, generate or enhance the resources used to satisfy performance obligations, and are expected to be recovered.

Deferred costs are amortized over the life of the contract (including anticipated renewals) in same pattern as revenue is recognized.

Disclosures

Qualitative and quantitative information is required to be disclosed

- Contracts with customers
- Significant judgments and changes in judgments
- Assets recognized from the costs to obtain or fulfill a contract

The following is to be disclosed unless presented separately in the income statement

- Revenue recognized from contracts with customers (disclosed separately from other sources of revenue)
- Impairment losses recognized on receivables or contract assets

Disclosures (cont.)

Disclosure of disaggregated revenue

- Disaggregate revenue recognized from contracts with customers into categories that depict how the nature, amount, timing, and uncertainty of revenue and cash flows are affected by economic factors
- Disclose information related to the relationship between disaggregated contract revenue and revenue disclosed for each reportable segment

Disclosure of contract balances

- The opening and closing balances of receivables, contract assets, and contract liabilities from contracts
- Revenue recognized in the reporting period that was included in the contract liability balance at the beginning of the period
- Revenue recognized in the reporting period from performance obligations satisfied or partially satisfied in previous periods

Disclosures (cont.)

Disclosure of contract balances

- Explain the relationship between the timing of satisfaction of performance obligations, payments, and the balances of contract assets and liabilities
- Provide explanations for significant changes in contract assets and liabilities

Disclosure of performance obligations

- When the entity typically satisfies performance obligations
- Significant payment terms
- Nature of goods or services that the entity has promised to transfer
- Obligations for returns, refunds, etc.
- Types of warranties and relate obligations

Disclosures (cont.)

Disclosure of remaining performance obligations

- Aggregate amount of the transaction price allocated to unsatisfied performance obligations
- Explanation of when the entity expects to recognize this revenue
- Two practical expedients
  - If either is met, then the entity is not required to disclose remaining performance obligations
  - Need to disclose the application of the practical expedient

Disclosure: Significant Judgments

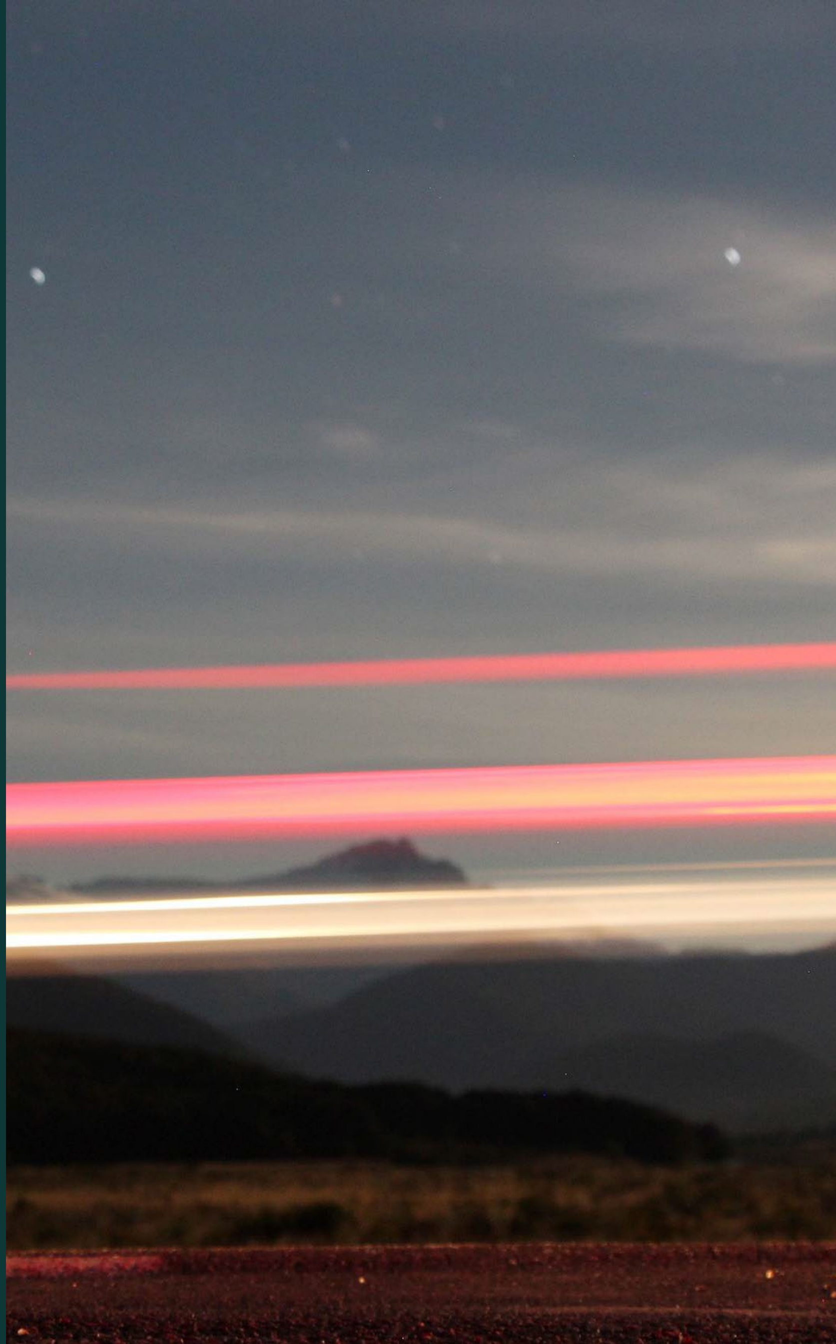
Disclose of judgments and changes in judgments that significantly affect the amount and timing of revenue from contracts

Performance obligations satisfied over time

- Disclose methods used and why

Performance obligations satisfied at a point in time

- Disclose significant judgments made in evaluating when a customer obtains control of promised goods or services



Disclosure: Significant Judgments

Disclose methods, inputs, and assumptions used for the following:

- Transaction price, includes estimating variable consideration
- Assessment of whether estimated variable consideration is constrained, in other words, it’s probable that significant reversal of revenue won’t occur
- Allocation of the transaction price

Effective Dates

Public Entities

- Already effective

Nonpublic Entities

- Effective date: periods beginning after 12/15/20

Transition Method: Full Retrospective

Retrospective to each prior period reported with practical expedients:

- Completed contracts that begin and end in the same annual reporting period do not need to be restated
- Completed contracts with variable consideration, can use the transaction price at the completed contract date
- For reporting periods prior to initial adoption don’t need to disclose the portion of the transaction price allocated to the remaining performance obligation

Disclose prior-period information that’s been adjusted

Transition Method: Modified Retrospective

Retrospectively with the cumulative effect recognized at the date of initial application. Any necessary adjustments would be recorded to opening retained earnings on the date of adoption—prior periods wouldn’t be restated.

This would involve comparing how those contracts would‘ve been recorded under ASC Topic 606 with how they were actually recorded under legacy GAAP.

Must provide additional disclosure in the reporting period of initial application

- Disclose effects of adoption on each FS line item
- Explanation for the reasons for any significant changes in financial reporting based on the new standard

Choosing a Transition Method

Recommend that a transition method be decided as soon as possible to help:

- Identify the extent of data gathering required for the adoption of the new standard
- Identify nature and timing of system and process changes

Overview

PHASE 1
Assessment of Impact

- Develop cross-functional team responsible for design phase
- Establish governance, project, and change management approach
- Review revenue arrangements and contracts
- Review current accounting policies and practices
- Identify relevant differences under the new standard
- Map accounting policy differences to process and systems impact
- Consider running dual GAAP approach during initial year
- Draft disclosures both for transition and ongoing
- Establish roadmap and communication plan

Takes about two months

PHASE 2
Redesign of New Processes and Controls

- Walk through entire process from contract initiation to cash collection
- Analyze close process through to financial reporting
- Identify systems, processes, and controls that need to be changed or developed
- Consider dual reporting requirements during transition process and effect on controls
- Design processes and controls so they are aligned with the five-step revenue model
- Determine adoption method
- Validate with management and external auditors that processes and controls are properly designed before moving to the implementation phase

Takes about one month

PHASE 3
Implementation of Systems, Processes, and Controls

- Perform system and process implementation
- Integrate and establish new controls into framework
- Test and validate new controls or controls that were changed
- As necessary, perform data migration, user acceptance testing, and data validation
- Conduct post-implementation reviews
- Sustain and support ongoing solution
- Conduct education and training workshops

Timing varies, depending on it systems

Polling Question #6

DO YOU ANTICIPATE UTILIZING A CONSULTANT TO ASSIST WITH THE ADOPTION OF THE NEW REVENUE STANDARD?

Yes, definitely

No, we have constraints that won’t allow for an additional resources to be utilized

We are working on it now

I don’t know

Revenue Recognition by Contract Type

Contract Type	Statement of Work	Revenue Recognition Method	Satisfaction of Performance Obligation	Method of Measuring Progress toward Satisfaction of Performance Obligation
CPFF	All	RTB	Over-Time	Output: a) Hours of service provided; b) Time elapsed
CPAF/CPIF/FPIF	All	PoC CTC	Over-Time	Input: Cost incurred
FFP	System Integration/Engineering Services	PoC CTC	Over-Time	Input: Cost incurred
FFP	Services and Maintenance	RTB	Over-Time	Output: a) Hours of service provided; b) Time elapsed
FFP	Hardware Products	RTB	Point-in-time	Units delivered
T&M/FPLOE	All	RTB	Over-Time	Output: a) Hours of service provided; b) Time elapsed

ACS 606 CAS Impact

Advance Notice of Proposed Rulemaking (ANPRM) published November 5, 2020, in the Federal Register

Definition of operating revenue between GAAP and CAS

- Board believes the definition in GAAP is essentially equivalent to that in CAS
- Exception for government-owned facilities, the CAS definition of operating revenue includes only the fee earned for managing the contracts

ASC 606 may have impacted cost accounting practices to the extent that:

- Changes were made to the measurement or allocation of related costs
- Changes were made to the composition of the allocation base for residual expenses causing a change to the assignment of residual expenses to cost accounting periods

➤ QUESTIONS

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THANK YOU