

UNANET WHITE PAPER

Revenue Recognition

OVERVIEW

Revenue Recognition has always been considered one of the most significant measurements in financial accounting. Today, due to the issuance of new revenue accounting standards that are about to take effect, it is a hot topic for firms having to prepare GAAP based audited financial statements. Regardless, all firms interested in providing reliable measurements of income should consider their approach to measuring revenue and understand available alternatives. Their options should not be constrained by their accounting software.

A basic accounting principle has been that revenue is earned as the goods and services are provided to a customer. This sounds simple enough. The consultant spends a day analyzing something and writing a report for the customer, and the customer pays them. Revenue is recognized. The reality is more complicated. In the case of extended service contracts, the measurement process can be quite involved. That is the situation for most architectural and engineering firms. Their work often involves multiple simultaneous contracts with multiple performance obligations, performed over months and years.

GENERAL APPROACH

For financial reporting by A&E firms, revenue recognition is typically based on what has been billed during a month. Many firms then adjust this amount based on an estimate of amounts earned, but not yet billed. The

estimated value of the earned but unbilled is typically referred to as work in progress or WIP. The process of estimating and booking WIP is referred to as accruing revenue.

In some cases, a firm may bill beyond what is earned, and this also should be considered. At a minimum, the accounting software should support the estimating of revenue at a project, phase and task (project structure) level using a variety of methods. It should also support approaches that allow for the sharing of the estimated revenue across profit centers. Firms may choose to keep it simple and not accrue revenue or sharing, but should not be constrained by their software in case they decide to accrue revenue at a future time.

TYPICAL REVENUE RECOGNITION APPROACHES IN USE BY FIRMS

Cash Basis:

Revenue is recognized upon receipt of payment from the customer. Many firms have elected to report their income on a cash basis for their income tax filings, but few use this method for their general financial reporting.

Billed Basis:

Monthly billings are tabulated and reported as the revenue for the month. Firms using this method may record their bills in the month prior to actual invoice preparation to match the revenue to the period during which the services were provided.

Simple WIP Estimate:

At the end of each month, the billable value of unbilled time and other costs are tabulated and recorded in the balance sheet as the WIP asset. A simultaneous reversal of the prior month's WIP in the current period results in a change that is recorded as unbilled revenue.

Advanced WIP Estimate:

At the end of each month, the system supports the estimating of WIP using a variety of project specific methods. The WIP asset is reduced at a

transaction level as customers are billed, allowing for contemporaneous WIP and revenue values for project reporting.

TYPICAL METHODS USED TO ESTIMATE WIP AT A PROJECT AND PROJECT STRUCTURE LEVEL

- Billed basis (no accrual)
- Percent complete, typically based on project managers' estimates.
- T&M
- T&M with caps applied to labor and/or consultants and/or other costs
- Alternate valuations such as burdened cost or pay rate
- Fixed dollar adjustments entered by management

However a firm is currently measuring revenue, circumstances may change in the future resulting in consideration of other approaches and methods. An ERP system should accommodate this.

Unanet serves more than 3,600 businesses with its ERP software solutions purpose-built for professional service organizations. Unanet's software helps project-driven organizations reliably plan, track and manage projects, people and financials. Unanet's customer-centric culture means we strive to deliver insights with personal service.



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