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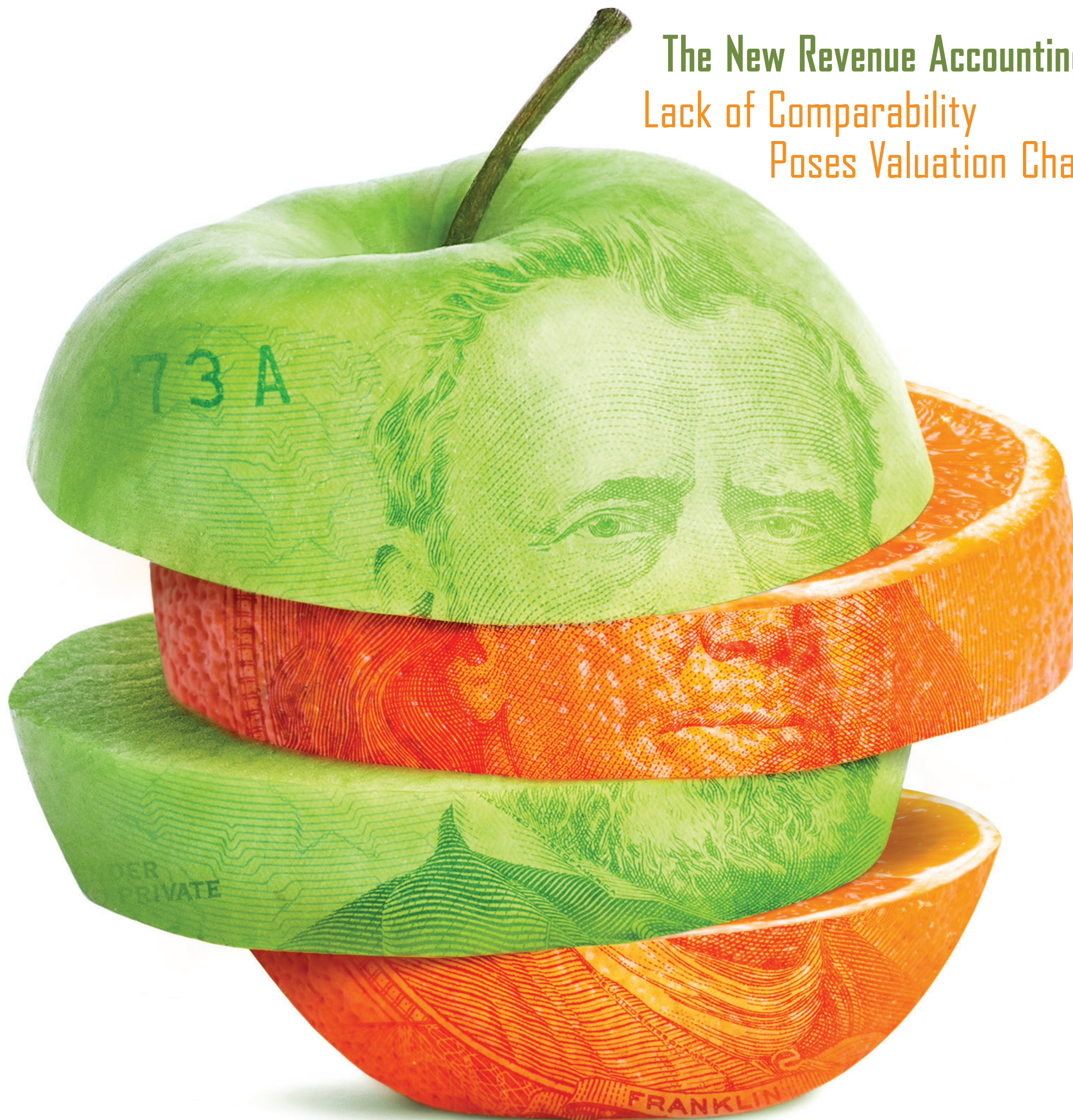
The New Revenue Accounting Standard:

Lack of Comparability Poses Valuation Challenges



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VALUATION

The New Revenue Accounting Standard: Major Impacts on Business Valuation

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The purpose of this article is to introduce the reader to the new Revenue Recognition Accounting Standard (the Standard) issued jointly by the U.S. Financial Accounting Standards Board (FASB) and the UK-based International Accounting Standards Board (IASB) and to consider the Standard's impact on financial analyses prepared by practitioners performing business valuation engagements. A future article will explore the Standard's impact on economic damages engagements.

The Standard is now part of U.S. and international financial reporting standards (U.S. GAAP and IFRS, respectively, and GAAP collectively). All reporting companies—both public and private—are now required to have implemented the Standard pursuant to the staggered implementation dates (see below).

Business valuations are performed formally or informally in several settings for a variety of purposes. These include financial reporting under GAAP, and in connection with lending activities, buy-sell agreements, estate planning, mergers and acquisitions, litigation matters—such as shareholder disputes and matrimonial dissolution proceedings—and turnaround and reorganization work.

Because most of the essential business valuation analyses begin with revenues,[1] obtaining a complete and detailed understanding of the revenues of a business enterprise or comparable company is essential to performing and properly completing a business valuation.

This article:

- Summarizes the Standard,
- Analyzes the Standard's impact on financial analyses customarily performed in connection with business valuation engagements, and
- Discusses the factors to be considered by practitioners when completing their engagements due to the potential impact of the noncomparability of revenue-related data.

The Amended Standard

On May 28, 2014, the FASB and IASB each issued an amended accounting standard entitled *Revenue from Contracts with Customers.*[2] This joint Standard represents the most transformational change to U.S. and international GAAP since each of the two frameworks were originally established.

In its entirety, ASU 2014-09, as originally issued, is a staggering 706 pages in length. The amendments contained in the Standard affect virtually every aspect of how a seller measures the amount of revenue it will recognize, the period or periods during which the revenue will be recognized, the disclosures the seller is required to include in its interim and annual financial statements and even the unit of accounting to be used to account for revenue.

The Standard applies to all publicly traded and privately held businesses and not-for-profit organizations. The only entities that are exempt from the new provisions are state and local governmental entities that use, as their accounting framework, the accounting standards issued by the Governmental Accounting Standards Board (GASB) or, in the U.S., the accounting standards issued by the Federal Accounting Standards Advisory Board (FASAB) that apply to federal entities.[3]

1 In most but not all instances, this article uses "revenues" throughout, including where the reader may expect to see "sales," unless in quoted text. Similarly, for "cost of revenues" vs. "cost of sales."

2 FASB Accounting Standards Update (ASU) 2014-09, which added a new Topic 606 (ASC 606) to the FASB Accounting Standards Codification® (ASC) and International Financial Reporting Standard (IFRS) No. 15.

3 ASC 606-10-15-1 provides that the new guidance applies to all entities. However, ASC 105-10-15-1 specifies that the ASC "applies to financial statements of nongovernmental entities that are presented in conformity with generally accepted accounting principles (GAAP)."

One aspect of the Standard that likely will be unfamiliar to users of U.S. GAAP is the fact that it is industry agnostic. Unlike legacy GAAP, which contains prescriptive rules that apply to transactions in various specialized industries, amended GAAP is based on the premise, common in IFRS, that the industry in which an entity operates should not influence the portrayal of its revenues in its financial statements. Thus, the new revenue recognition model is intended to be universally applied in all industries regardless of whether there were formerly specialized carve-outs or industry-specific rules.[4]

Immediately following the issuance of the Standard, FASB and IASB (the Boards) formed a joint Transition Resource Group (TRG) to perform outreach during the implementation period and to identify operational difficulties or areas where the Standard may be ambiguous or confusing. While the TRG meeting minutes are published and available to stakeholders, the results of TRG deliberations are not intended to be viewed as authoritative standards.[5]

Per ASC 606-10-65, as amended to incorporate the one-year deferral provided by ASU 2015-14, the effective dates on which the new Standard was required to be implemented are as follows:

<table>
<tr><th rowspan="3">Effective Date</th><th colspan="3">U.S. GAAP Reporting Entities</th><th rowspan="3">IFRS Reporting Entities[6]</th></tr>
<tr><th colspan="2">Public Business Entities (PBEs) and Certain Other Entities[7]</th><th rowspan="2">All Other Entities</th></tr>
<tr><th>Emerging Growth Companies [8, 9]</th><th>Other</th></tr>
<tr><td>Annual periods—fiscal years beginning on or after</td><td>12/16/2018 (Calendar 2019)</td><td>12/16/2017 (Calendar 2018)</td><td>12/16/2018 (Calendar 2019)</td><td rowspan="2">1/1/2018 (Calendar 2018)</td></tr>
<tr><td>Interim periods—included in fiscal years beginning on or after</td><td>12/16/2019 (Interim 2020)</td><td>12/16/2017 (Q1-2018)</td><td>12/16/2019 (Interim 2020)</td></tr>
<tr><td>Early adoption allowed—in fiscal years beginning on or after</td><td colspan="3">12/16/2016 (Calendar 2017)</td><td>The 1st annual period beginning on or after June 1, 2014 (Calendar 2015)</td></tr>
</table>

4 ASC 606-10-15-1.

5 In spite of the admonitions of FASB that TRG minutes do not establish GAAP, in a speech delivered by James V. Schnurr, the SEC Chief Accountant, on March 22, 2016, Schnurr strongly encouraged SEC registrants to consult with his office if they intend to select and implement an accounting policy for revenue that is inconsistent with TRG discussions. As a result of Schnurr's remarks, the TRG minutes have, in effect, become de facto GAAP for companies subject to the SEC's jurisdiction. As of the last published minutes of the TRG from its November 7, 2016, meeting, there had been 108 issues submitted by stakeholders to the TRG for its consideration.

6 IFRS 15, Appendix C, paragraph C1.

7 (1) Public business entities, (2) not-for-profit organizations that have issued, or are conduit bond obligors for, securities that are traded, listed, or quoted on an exchange or an over-the-counter market; and (3) employee benefit plans that file financial statements with the Securities and Exchange Commission (SEC).

8 A new category of public business entity created under the Jumpstart Our Business Startups (JOBS) Act of 2012, an emerging growth company (EGC) is a company with annual gross revenues of less than $1,070,000,000 (initially $1 billion but adjusted for inflation in April 2017) during its most recent fiscal year.

9 The SEC issued final rules effective April 12, 2017, that, among its other provisions, permits EGCs to elect to defer compliance with any new or revised financial accounting standards until the date that companies that are not "issuers" as defined in Section 2(a) of the Sarbanes-Oxley Act are required to comply. (See https://www.sec.gov/rules/final/2017/33-10332.pdf.)

ASC 606 starts by establishing a core principle and supplements that principle with a five-step process for implementing it. The core principle holds that revenue is to be recognized as the price that a seller expects to receive from its customer in exchange for the transfer of control of promised products or services.

The five-step process for implementing the core principle is:[10]

1. Identify the contract (or contracts) with the customer. For an arrangement to qualify as a contract, it must meet six criteria, including a determination of whether collectability is probable.

2. Identify the distinct performance obligations (promises by the seller to transfer control of distinct products or services to the customer) in the contract.

3. Determine the transaction price, that includes, if applicable, both fixed consideration and variable consideration (consideration that is based on the outcome of a contingency for which the outcome will become known during the period of the contract).

4. Allocate the transaction price determined in step 3 above to the performance obligations identified in step 2 above using relative standalone selling price.

5. If a performance obligation is satisfied over a period of time, recognize revenue as the seller satisfies the performance obligation using an appropriate measure of inputs or outputs to estimate progress to date. (If the performance obligation is satisfied at a point in time, recognize revenue when the seller transfers control of the product or service to the customer.)

In addition to establishing the new universal model for measuring and recognizing revenue, the Standard also affects the amounts and timing of recognizing two types of contract-related costs that will, henceforth, be required to be recognized as contract assets during the period of time from when they are incurred until such time as the contract is complete. The two categories of costs that are to be capitalized are (1) the incremental costs to acquire a contract, such as sales commissions; and (2) the costs to fulfill contracts, such as direct labor, direct materials, subcontract costs, and other contract-related costs.

These capitalized costs are referred to in the Standard as "contract assets." Correspondingly, the balance sheets of reporting companies may also present contract liabilities representing amounts paid by customers in advance of performance by the seller. After initially recognizing the contract assets, they are to be subsequently amortized on a systematic basis consistent with the transfer to the customer of the products or services to which the assets relate.

In addition, during periods subsequent to initially recognizing these assets, the unamortized balances of the assets are to be evaluated for impairment and a loss recognized if impairment has occurred. Should a particular contract give rise to both contract assets and contract liabilities, only the net contract asset or liability is to be presented on the balance sheet. This new universal model departs from current practice in several significant ways:

1. **Elimination of specialized industry carve-outs.** To facilitate adoption of a universal rule for revenue recognition, FASB rescinded virtually all its prior specialized industry guidance affecting industries, such as: construction contractors; franchisors; media and entertainment; real estate sales; and the sale, lease, or licensure of software.

2. **Emphasis on transfer of control**. The trigger for revenue recognition is changed from an emphasis on delivery and transfer of the risk of loss and rewards of ownership to an emphasis on transfer of control from the seller to its customer that enables the customer to direct the use of the asset and obtain benefits from the asset.

3. **Unit of accounting.** Under prior GAAP, most sellers (with some notable industry-specific exceptions) recorded revenue as being earned concurrently with the issuance of an invoice to the customer. Thus, for a given selling arrangement, for most businesses, the invoice represented the unit of accounting under GAAP. Under ASC 606, the sellers' accounting systems will require, in most cases: a major overhaul to enable the system to hierarchically track customers; contracts with those customers; modifications (change orders) to existing contracts;

10 ASC 606-10-05-4.

performance obligations (fulfilled, partially fulfilled, or unfulfilled); costs to obtain and fulfill contracts; and the related amortization and, if applicable, impairment of those costs.

4. **Transaction price.** Transaction price under the previous standard was required to be both fixed and determinable. Under ASC 606, transaction price is a broader concept that encompasses additional elements, including, but not limited to:
   - Fixed cash consideration
   - Noncash consideration
   - An adjustment for consideration payable by the seller to its customer (e.g., credits, coupons, vouchers, slotting fees, rebates, etc.)
   - Imputed interest income or interest expense (discussed below under the caption "significant financing component")
   - Nonrefundable up-front fees (such as initiation fees for a health club membership)
   - Variable consideration (discussed below)
5. **Variable consideration.** The new standard requires the inclusion of estimated variable consideration as a part of the transaction price at contract inception. This requires management to estimate, presumably based on its historical experience, whether unknown amounts of contingent consideration will be earned and the amount that is ultimately expected to be realized.

   To further complicate these revenue recognition determinations, variable consideration is subject to a constraint that limits the amount included in the transaction price to the portion of the variable consideration for which it is probable (approximately 70–100 percent likely under U.S. GAAP) that a future reversal of cumulative revenue recognized *will not occur.*

   The estimation of this "constraint on estimates of variable consideration" is highly subjective, but is meant to serve as an anti-abuse provision aimed at preventing management from being too optimistic when making its estimates about its chances of actually earning the variable consideration.

   There are many types of variable consideration, including but not limited to:
   - Discounts (including volume discounts)
   - Rebates
   - Refunds
   - Rights of return
   - Price concessions
   - Coupons
   - Options to purchase additional products or services at a discount
   - Customer loyalty point programs
   - Store credits
   - Incentives and awards
   - Performance bonuses
   - Penalties
6. **Significant financing component.** Subject to certain exceptions and practical expedients, contracts that contain provisions for extended payment terms or customer prepayments are generally required to reflect a portion of the transaction price as interest income (extended payment terms) or interest expense (customer prepayments) by adjusting the transaction price to discounted present value using the interest rate that would be used in a separate financing transaction between the parties.
7. **Principal versus agent (gross reporting of revenue versus net reporting of revenue).** Determination may be required to be made regarding whether a party is the principal to the sales transaction or, alternatively, is acting in the capacity of an agent on behalf of another party that is the principal based on determination of the party that possesses control of the products or services contracted for. Control is defined as the ability to direct the use of, and obtain substantially all the benefits from, the product or service as indicated by:
   - Assumption of inventory risk
   - Ability to establish prices
   - Possessing the primary responsibility to provide the product or service to the end customer

This determination can have a significant effect on the amount of revenue reported by the reporting entity. An agent reports its revenue as the commission it earns on the sale it negotiated on behalf of the principal, whereas a principal reports its revenue as the gross amount of the selling price and accrues or pays a commission to the agent that is reflected as a selling expense.

8. **Income tax effects.** Many, if not most of the changes described above may not be permissible for income tax reporting purposes. Consequently, there are expected to be contract assets and contract liabilities recorded under GAAP that will have an income tax basis of zero. These differences between GAAP and income tax reporting represent future deductible temporary differences that will give rise to the recognition of deferred income tax assets, or future taxable temporary differences that will give rise to the recognition of deferred income tax liabilities that were not previously recognized by reporting entities.[11]

9. **Licenses of intellectual property.** ASC 606, as amended, sets forth a separate model to apply to transactions between sellers or licensors of intellectual property (IP) and their customers or licensees. Included in the scope of this model are:
   - Software
   - Franchise rights to use a brand name
   - Copyrights, patents, and trademarks
   - Films, music recordings, and video games
   - Scientific compounds

   The model is used to differentiate between:
   - Intellectual property included or integrated with a product or service
   - An outright sale of intellectual property
   - A license of intellectual property, including perpetual licenses

   The new revenue recognition model for intellectual property is complex and differs substantially from the current accounting for intellectual property transactions. It is generally expected that, under the new revenue recognition model, technology and life sciences companies will recognize revenue earlier than they currently recognize it.

10. **Estimation and re-estimation of prior estimates.** ASC 606 requires a substantial number of management estimates to be made at contract inception and further requires management to revise these estimates prospectively each time it prepares interim or annual financial statements. Among the many estimates required to be made and regularly updated are:
    - Determining whether an arrangement between two parties qualifies as a sales contract and that the counterparty to the contract is a customer
    - Determining whether collectability of the transaction price is considered probable
    - Determining whether products or services included in the contract are distinct performance obligations or, alternatively, are required to be combined with other products or services in a bundled performance obligation that is distinct
    - Determining whether two or more contracts are to be combined and accounted for as a single contract
    - Estimating variable consideration
    - Determining whether any or all of the variable consideration is to be excluded from the transaction price due to the application of the constraint on estimates of variable consideration
    - Determining whether a contract contains a significant financing component and, if so, estimating the interest rate to use to discount the cash flows to adjust the transaction price for imputed interest income or expense
    - Determining whether revenue is to be recognized over a period of time (the default) or, alternatively, at a point in time
    - Using either measures of input or output, and estimating the extent of progress to date on contracts for which revenue is recognized over a period of time
    - Determining the timing of when control transfers from seller to buyer

11 LLCs and other "pass-through" entities do not always use GAAP accounting.

11. **Extensive newly required disclosures.** Arguably, the prior revenue standard provided minimal, woefully inadequate disclosures regarding revenue, even though revenue is likely the largest and among the most important metrics provided by a reporting entity in its financial statements. The Standard remedies this by providing an overarching objective and five categories of required disclosures that are designed to meet the objective. The objective is to inform the reader of the financial statements about the nature, amount, timing, and uncertainty associated with revenue and cash flows. The objective is to be met by providing extensive disclosures, categorized as follows:

    - Disaggregation of revenue[12]
    - Performance obligations
    - Contract acquisition and fulfillment costs
    - Contract assets and liabilities
    - Significant judgments made by management

    In the interest of balancing the costs of providing disclosures with the benefits received by users (referred to as decision-usefulness), privately held entities are exempt from a substantial portion of the disclosures that are required to be made by public business entities.

    In addition to the foregoing disclosures, certain transition disclosures will be required on a nonrecurring basis in the period in which the reporting entity initially implements the new standard.

Impact on Financial Analyses Performed in Connection with Business Valuation Engagements

Our discussion of the Standard's impact on business valuation focuses on issues of comparability concerning the financial statements of subject and peer companies that either elected early adoption or elected adoption on the required effective date. Among the Standard's impacts are the disaggregation disclosures of various attributes of revenue streams; the extensive use of management estimates; and other issues impacting the comparability of financial information from period to period and from company to company.

Further complicating the issue of noncomparability is the fact that many private companies, with the consent of their creditors, choose not to incur the expenses associated with preparation of GAAP financial statements and report using an alternative "special purpose framework," such as the income tax basis or modified cash basis of accounting. Use of these special-purpose frameworks circumvents the need to apply the recognition and measurement provisions of the amended standard but, importantly, such financial statements are required to have the same or similar disclosures that are included in their GAAP counterparts.

Further complicating the issue of noncomparability is the fact that many private companies, with the consent of their creditors, choose not to incur the expenses associated with preparation of GAAP financial statements and report using an alternative "special purpose framework."

Clearly, the Standard will have an impact on business valuation engagements. Valuators will need to carefully consider the comparability of revenue data between subject and peer companies; between periods in which the Standard was effective and periods in which the legacy standard was effective; between revenues and costs of revenues; between aggregated and disaggregated data; between tax-exempt and non-exempt companies; and between privately held and publicly held companies in terms of the differing transition dates and differing volume of required disclosures.

Moreover, practitioners may need to consider identifying contracts, invoice dates, transaction pricing, discounts, rebates, refunds, rights of return, and other forms of variable

12 Examples of categories to be considered for disaggregation include, but are not limited to: (1) timing of transfer of products or services; (2) by geography; (3) by type of contract; (4) by duration of contracts; (5) by market or type of customer; (6) by distribution channel.

consideration. A determination may also need to be made regarding gross versus net reporting of revenues and separate accounting for significant financing components. Certain of these issues are discussed in additional detail below.

Depending on business valuation engagement needs, facts, and circumstances, the practitioner may need to obtain a sufficient understanding of contracts with an enterprise's customers and the underlying performance obligations and transaction prices allocated to those performance obligations. If the engagement involves comparing subject and comparable companies, current and prior periods, tax-exempt and non-exempt companies, or actual and budgeted data, the practitioners may need to obtain the aforementioned understanding in order to make accurate comparisons.

One area that may prove to be a boon to practitioners is the extensive, expanded revenue disclosures required by the Standard.

In addition, depending on the needs, facts, or circumstances of the engagement, a practitioner may need to obtain an understanding of contract-related costs—again, between companies, periods, or budgets.

The Standard introduces an additional wrinkle into business valuation because of the new requirement that contract assets must be amortized on a systematic basis consistent with the pattern of transfer of products or services to customers. The practitioner will encounter analytical difficulties if the subject or comparable company adopted the Standard during the period of analyses, especially in the situation when the adoption dates differ between the comparable entities and when the companies' managements elected different allowable methods of transition in the period of adoption.

The practitioner may also need to obtain an understanding of the Standard's impact on publicly available metrics—such as the comparative industry benchmark data included in the Risk Management Association's (RMA's) Annual Statement Studies, or industry studies published by IBISWORLD Inc. or similar business intelligence companies—and how that impact affects reported trends in industry growth and profitability data.

As the Standard rescinds virtually all prior specialized industry guidance, practitioners may be required to take additional care when analyzing companies in the specialized industries that, under legacy U.S. GAAP, applied specialized accounting rules to the determination of their revenue. Examples include construction contractors, franchisors, or software developers.

The financial analysis underpinning business valuation engagements may need to identify which comparable companies, periods, or budgets involved gross reporting of revenues versus net reporting of revenues, which, in turn, may depend on assessing whether a party is the principal to the revenue generating transaction or an agent acting on behalf of another party. An agent reports revenue as the commission earned while a principal reports gross revenue and accounts for the agent's commissions as a selling expense.

Because many, if not most, of the Standard's principles may not be permissible for income tax reporting purposes, practitioners may need to deal with deferred income tax assets (net of any required valuation allowance) or deferred income tax liabilities. An additional financial analysis difficulty may be encountered when the subject company data is provided solely in the company's income tax returns whereas the benchmark data is provided in the form of GAAP-compliant financial statements.

The Standard will have yet another separate impact relating to the recognition or treatment of management estimates. It requires management to make (1) a substantial number of estimates at the inception of the seller/customer contract and (2) to revise those estimates prospectively each time interim or annual financial statements are prepared for distribution to external users. This will add to the practitioner's burden in evaluating revenue trends (1) between periods, (2) between budgets and actual results, and (3) between subject and target companies.

One area that may prove to be a boon to practitioners is the extensive, expanded revenue disclosures required by the Standard. Practitioners may find a host of valuable new disclosures in financial statements of adopting companies, informing readers of the nature, amount, timing, and risks associated with revenues and cash flows. Practitioners may find a treasure trove of new and useful data disaggregating

revenues by geography, type of contract, market, distribution channel, and timing of transfers, providing valuable insights that may assist in further development of the business valuation modeling.

The availability of such valuable analytical information will, however, be limited with respect to privately held companies that are exempt from a substantial portion of these disclosures. Practitioners finding only these less voluminous disclosures will be missing information with which to benchmark to comparable public companies and may now be called upon to obtain and analyze information from other sources to fully justify whether the non-disclosing private company is truly comparable to its public company counterpart.

While practitioners may encounter many challenges in their work occasioned by the new Standard, the authors submit that primary among these challenges will be understanding the impacts on analyses of comparable information or companies for engagements dependent on such comparisons. Enterprise valuations derived in whole or in part from revenues of comparable companies may need to examine whether the subject or comparable companies adopted the new Standard, when and how they adopted it, and the impact on reported revenues. This may be equally true of enterprise values derived in whole or in part from comparable transactions.

When practitioners use EBITDA in calculations, they must be mindful of the effects the revenue accounting changes will have on current EBITDA or how historic EBITDA multiples might change as a result of the amended Standard.

The new Standard may have less impact if the practitioner uses discounted cash flow (DCF) modeling to determine business value. Clearly, the practitioner will need to make a reasonable and appropriate determination of cash flows from revenues. This determination may or may not need to consider the impacts, if any, of the Standard, given that the DCF would be based on cash flows as opposed to GAAP accounting for revenues. This problem can be avoided if, instead of using revenues as the starting point, the practitioner uses data provided in the subject or comparable companies' statements of cash flows and makes any necessary adjustments thereto.

In a business valuation based, in whole or in part, on DCF modeling, the practitioner will need to determine an appropriate discount rate—typically, the cost of capital—to apply to the DCF free cash flows. Generally, the cost of capital is the market rate of return on the financial asset mixture the entity uses to finance capital investment, with adjustments made to the discount rate to reflect risks associated with uncertain cash flows or other significant issues.

The authors submit that the determination of the cost of capital should largely be unaffected by the new Standard and, accordingly, the Standard will not impact either DCF free cash flows or the discount rate.[13]

Factors to Consider

When completing business valuation engagements, there are many factors practitioners should consider that may be affected by the noncomparability of revenue-related data. The authors do not intend to list all such factors, but some of the more important ones are described below.

- Consider the purpose of the business valuation and whether such purpose is impacted by the new Standard. Consider the nature, timing, and extent of available underlying accounting books and records and the information or documentation available, especially regarding revenues.
- Obtain a sufficient understanding of the accounting for, measurement of, quality of, and comparability of the subject company's and benchmark companies' revenue streams sufficient to plan, perform, and complete the engagement; and determine whether the past, present or future earnings of a business enterprise involve determining its past, present, or future revenues and whether the reporting for such revenues was, is or will be impacted by the new Standard.
- Understand whether the entity being analyzed is exempt from the Standard and, if not, determine the effective date for implementation of the Standard by that entity. Consider the five-step process for implementing the Standard's core principle, the ways in which the new universal model departs from prior practice, and the many types of variable consideration that could impact the financial analysis.
- Understand how the extensive, newly required disclosures can provide a deeper understanding of the financial statements, especially about the nature, amount, timing, and uncertainty associated with revenue and cash flows. Consider the comparability of revenue data between subject and peer companies;

13 It is not inconceivable, however, that the new Standard may hypothetically impact industry risk premia or company-specific risk premia—and practitioners should remain vigilant to such possibility.

To avoid significant valuation errors, practitioners will need to be aware of whether the Standard affects the various modeling techniques used in business valuation engagements.

between periods in which the new Standard was effective and periods in which the legacy standard was effective; between revenues and costs of revenues; between aggregated and disaggregated data; and between tax-exempt and non-exempt companies.

- Give special consideration to the Standard's impact on publicly available metrics or comparative industry benchmark data. Take additional care when analyzing companies in specialized industries that, under legacy U.S. GAAP, applied specialized accounting rules in determining their revenue.
- Because the Standard emphasizes transfer of control from sellers to customers rather than transfer of risk, consider cutoff issues (e.g., before and after distribution agreement terminations) and focus in a more granular manner on the terms of customer contract arrangements versus the more traditional invoice/delivery cutoff analyses under the legacy standard.
- Evaluate whether comparable companies, periods, and budgets involved gross or net reporting of revenues. Because many, if not most, of the Standard's principles may not be permissible for income tax reporting purposes, it may be necessary to deal with deferred income tax assets or liabilities. Consider instances when subject company data is provided solely in the form of income tax returns, while benchmark data is provided in GAAP-compliant financial statements.
- Consider impacts on management estimates, especially those made at the inception of the seller/customer contract and periodic revisions thereto. Pay special attention to evaluating revenue trends between periods, between budgets and actual results, and between subject and target companies.

To avoid significant valuation errors, practitioners will need to be aware of whether the Standard affects the various modeling techniques used in business valuation engagements. Accordingly, they should conduct a thoughtful review and analysis to fully understand the impacts on the financial analyses of comparable information or companies for engagements dependent on such comparisons. Enterprise values derived in whole or in part from revenues of comparable companies should be based on a proper and detailed understanding of whether the subject or comparable companies adopted the new Standard, when and how they adopted it, and the impact thereof on reported revenues. This may be equally true of enterprise values derived in whole or in part from comparable transactions.

It will take a few years for the impact of the Standard to be fully understood and properly implemented. FASB and IASB may issue further implementation guidance as issues arise. Practitioners may need to adjust their budgets for valuation engagements when working with companies with complex revenue recognition issues. VE

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