

# 5 Key Principles in RMCS

## Session 2

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# New Revenue Recognition Standards

## Two key questions for recognizing revenue

The new model's core principle for revenue recognition is to “depict the transfer of promised goods or services to customers in an amount that reflects the consideration to which the entity expects to be entitled in exchange for those goods or services.” This principle was established by both the Financial Accounting Standards Board (FASB) and International Accounting Standards Board (IASB) and is the underpinning of the entire revenue framework. In particular, it identifies and answers the two most fundamental questions related to revenue.

**When to recognize revenue?** The entity may recognize revenue when it satisfies its obligations under a contract by transferring goods or services to its customer. (That is, when the entity performs, it should recognize revenue.)

**How much revenue to recognize?** The entity may recognize the amount to which it expects to be entitled under the contract. (Estimates may be required because this is an “expected” amount.)

# Five Key Concepts in RMCS

## Five Step Framework to recognise Revenue

Step 1-Identify the Contract with the Customer

Step 2- Identify the performance obligation in the contract

Step 3- Determine the Transaction Price

Step 4- Allocate the Transaction Price to the performance obligations

Step 5-Recognize revenue when performance obligation(s) is/are satisfied

# Customer Contracts Definition

A customer contract is an agreement between two or more parties that creates enforceable rights and obligations.

- Define an eligible contract very specifically.
- Require that in certain circumstances, you must combine contracts.
- Require that you review the transaction at inception and identify your promises to the customer as performance obligations, using the criteria of distinctness.
- Require you to determine at inception whether revenue can be recognized either over time (limited to three circumstances) or at a point in time

# Identify Customer Contracts in RMCS

## Concept of Common Identifier

Customer contracts are made up of a series of source lines. These sources lines represent different portions of the contract.

For example, Computer Hardware and Technical support as SO and Service Contract

The individual documents are extracted from these applications at different points of time and are interfaced with Revenue Management as source documents. In Revenue Management, these documents are identified as belonging to one customer contract. The Customer Contract document is created with lines of these documents.

To combine multiple source document lines into a single customer contract automatically, there must be a common link between these documents.

# Contract Identification Rules

## Rules to identify contracts from source application based on a common identifier

Grouping of lines to form an accounting contract can be based on Customer/Party, Time Frame, Customer Purchase Order, Salesperson

# Performance Obligations

A performance obligation is a distinct promise in the customer contract to transfer goods or services to the customer. A customer contract can have one or more performance obligations. The source document lines that are included in a contract are grouped into performance obligations.

## Explicit Performance Obligations

Explicit performance obligations are the goods or services that are explicitly stated in the contract.

## Implied Performance Obligations

Implied performance obligations include promises that are implied by an entity's customary business practices or published policies. These promises aren't explicitly stated in the contract.

Identify performance obligation in source document lines by Item, item classification and source document line

# Performance Obligation Satisfaction

Performance obligations can be satisfied at a point in time or over time. Satisfaction methods together with satisfaction measurement models drives how performance obligation is satisfied. The satisfaction measurement model specifies how satisfaction will be measured and recorded for a promised detail.

## **Measure Quantity Satisfied (when dealing in quantities)**

RMCS creates a performance obligation satisfaction event when a quantity of goods or services are delivered or satisfied. A performance obligation can have multiple satisfaction events if partial quantities are delivered.

## **Measure Percentage Satisfied ( for % of work completed scenario)**

RMCS creates satisfaction events based on satisfaction information received from the source applications. The performance obligation satisfaction record is created to specify the percentage of the work completed. Revenue will be recognized in the same proportion as the work completed.

## **Measure Period Satisfied**

RRMCS creates the satisfaction event to specify what time period is satisfied and the proportionate revenue for the time period. We should also provide the satisfaction plan that specifies the total number of periods and the proportionate revenue for each period

# Transaction Price and SSP

## Determine Transaction Price

Fixed and Variable Consideration ( Price Concession, incentives, refunds, bonuses, penalties, payment discounts)

Based on guidelines/rule for variable consideration

## Standalone Selling Price

Standalone Selling Price (SSP) is the price of a component of a contract if you purchase it separately. SSP is needed to allocate transaction price of a contract and that impacts the revenue recognition amounts

# Allocation using SSP

S.No.	Goods or Services	Transaction Price	Selling Price	Proportion	Allocated Transaction Price
1	Hardware	\$ 1000	\$ 900	45%	720
2	Software	\$ 500	\$ 600	30%	480
3	Service	\$ 100	\$ 500	25%	400
		\$ 1600	\$ 2000	100%	1600

# Recognize Revenue (Performance Obligation Satisfaction)

Performance obligations are satisfied either at a point in time or over time.

Two key attributes determine the timing and amount of revenue that's recognized for each performance obligation - **Satisfaction Method** and **Satisfaction Measurement Model**

RMCS provides two satisfaction methods

1. **Require Complete** - Revenue is recognized for the performance obligation when all promised details in the performance obligation have been completely satisfied.
2. **Allow Partial** - Revenue is recognized for the performance obligation incrementally as each portion of the obligation is satisfied.

RMCS provides three satisfaction measurement models

1. **Measure Quantity Satisfied** (satisfaction measurement events are created by source applications)
2. **Measure Percentage Satisfied** (satisfaction measurement events are created by source applications)
3. **Measure Period Satisfied** (RMCS creates the measurement events using the satisfaction plan and the plan start and end dates provided by the source application)

# Performance Obligation Satisfaction

The satisfaction measurement model specifies how satisfaction will be measured and recorded for a promised detail.

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# Application Navigation

# Questions

SSP is not mandatory for allocation of transaction price everytime and exception exists?

Can transaction price change during the course of the contract?

Can allocation be done for a contract with single performance obligation?

# Thanks!

Contact us:

[training@apps2fusion.com](mailto:training@apps2fusion.com)

+44 207 101 9262

+ 1 212 404 1735

[www.apps2fusion.com](http://www.apps2fusion.com)



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