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Revenue recognition standards may impact your real estate business

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The Financial Accounting Standards Board has issued the long awaited new standards on how revenue will be recognized for public, private, and nonprofit entities that have contracts with customers. These standards are for companies who report their financial results using generally accepted accounting principles (US GAAP).

The new revenue standard was issued in May of 2014 and superseded existing revenue guidance, with some notable exceptions. The new standards will go into effect for public companies starting with annual reporting periods after December 15, 2016. Nonpublic entities are required to start abiding by the new revenue recognition standards after December 15, 2017, but they can voluntarily choose to adopt these standards on the same date as public entities.

What does this mean for you and your organization?

The big question, of course, is how these new standards will impact your business.

The first thing to know is that these standards do not have any impact on leasing transactions. Although this may be a sigh of relief for many, there are other factors to consider. For example, there are certain types of reimbursements that could fall within the new standards, including maintenance, utility, and real estate tax reimbursements.

If your company's real estate business is other than rental, as an example a homebuilder, developer, or condominium seller, your accounting will be impacted. For companies that see a large amount of revenue from these kinds of contracts, serious changes to financial reporting could occur, which means your books might look quite different after the changes go into effect. Also, remember this is a financial reporting requirement only. This does not affect the tax reporting and therefore this may complicate the tracking of book and tax differences. Companies will also need to include more disclosures to the footnotes of the statements that they release.

Handling the New Revenue Recognition Standards

The new standard requires a five step model approach. On the face of it, each step appears rather basic but as you analyze each step, you may find it gets a bit more complex. The five step model is below:

1. Identify customer contracts;

2. Identify performance obligations within the contract;

3. Determine the transaction price;

4. Allocate the transaction price to performance obligations; and

5. Record revenue once performance obligation is satisfied.

These new revenue recognition standards are designed to focus on three primary principles of revenue: collectability, contract enforcement, and transfer of control. Companies should take time carefully defining their performance obligations, especially for complicated transactions that involve multiple deliverables.

The New Revenue Standards and Real Estate Deals

There are several ways that these new standards for revenue reporting could impact those in the real estate development field. Condo developers, for example, might find that their current contracts may result in the delay of recognizing revenue, since certain jurisdictions may not give them the right to enforce payment collection throughout the duration of the contract. This means that they may have to wait to recognize revenue until ownership of the unit being developed is passed on to the customer. Other types of real estate fees, such as property management fees and lease commissions, may also be affected.

Although compliance with the new standard is still a few years away, companies should establish a project management team to determine how the new standards will impact them. In many cases, these changes will have an impact on several departments within an organization. If you haven't already done so, discuss the changes with your CPA firm.

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