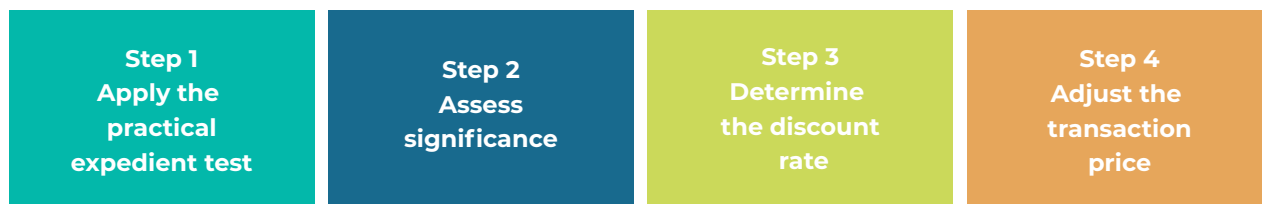


TREATMENT OF SIGNIFICANT FINANCING AS PART OF TRANSACTION PRICE

Determining the transaction price is an essential part of ASC 606. One aspect of the transaction price that must be considered is significant financing. In general, significant financing exists when (1) the contractor and the customer either explicitly or implicitly agree to a timing of payment arrangement that benefits one of the parties and (2) payments extend for more than one year of when the good or service is transferred to the customer.

Note that typical retainage terms do not constitute financing. In addition, because the transaction value assigned to the contract excludes the financing on the job schedule, separate lines should be created on the WIP schedule.

Four steps must be followed to determine whether there is significant financing:



HOW THIS RULE WORKS

- ▶ Apply the practical expedient test at the contract's inception.
 - A practical expedient exists if payment is expected within one year or less.
 - This test is applied to incremental costs as they are scheduled and the anticipated timing to receive payment from the customer for applying the costs.
 - No further testing need be done if it is determined that there is a practical expedient.
 - Use of the practical expedient must be disclosed in the financial statements.
- ▶ If there is no practical expedient, the next test is significance to the contract.
 - The longer the time between performance and payment, the likelier it is that significant financing exists.
 - But there are exceptions, for example:
 - Advance payments are not considered significant financing.
 - Variable payments dependent on the occurrence of a future event not in the control of either party generally is not considered significant financing.
 - Price differences arising for other reasons, such as nonperformance of part of a contractual obligation, may not be considered significant financing.

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TREATMENT OF SIGNIFICANT FINANCING AS PART OF TRANSACTION PRICE *continued from previous page.*

- ▶ Determining a discount rate.
 - The rate should reflect:
 - The rate that would be used in a separate financing transaction at the inception of the contract.
 - The credit risk assumed by the party obtaining the financing.
 - The rate should reflect the current market rate.
- ▶ Adjusting the transaction price.
 - Significant financing should be reflected separately in the statement of comprehensive income.
 - Interest income is recognized to the extent that a contract receivable is recognized.
 - Interest expense is recognized to the extent that a contract liability is recognized.

This determination requires the contractor to use a significant amount of judgment. To avoid making an error, be sure to review your determination with a professional with expertise in ASC 606.

HAVE QUESTIONS?

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