



New Developments Summary

A shift in the top line

The new global revenue standard is here!

Summary

After dedicating many years to its development, the FASB and the IASB have issued their converged standard on revenue recognition. Accounting Standards Update (ASU) 2014-09, *Revenue from Contracts with Customers*, and IFRS 15 with the same title create a new, principle-based revenue recognition framework that will affect nearly every revenue-generating entity.

ASU 2014-09 creates a new topic in the *FASB Accounting Standards Codification*[®] (ASC or Codification), Topic 606. In addition to superseding and replacing nearly all existing U.S. GAAP revenue recognition guidance, including industry-specific guidance, ASC 606

- Establishes a new control-based revenue recognition model
- Changes the basis for deciding when revenue is recognized over time or at a point in time
- Provides new and more detailed guidance on specific topics
- Expands and improves disclosures about revenue

In addition, ASU 2014-09 adds a new Subtopic to the Codification, ASC 340-40, *Other Assets and Deferred Costs: Contracts with Customers*, to provide guidance on costs related to obtaining a contract with a customer and costs incurred in fulfilling a contract with a customer that are not in the scope of another ASC Topic.

The guidance in ASU 2014-09 is effective for public entities for annual reporting periods beginning after December 15, 2016, including interim periods therein. Nonpublic entities are required to apply the guidance for annual periods beginning after December 15, 2017 and for interim and annual reporting periods thereafter. Early application is not permitted for public entities. A nonpublic entity may apply the guidance as early as annual reporting periods, and interim periods within those years, beginning after December 15, 2016.

This bulletin explains the key features of ASC 606 and provides practical insights into its application and impact.

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A. Overview

After more than 10 years of work on the project, the FASB and IASB have published their new, converged standard on revenue recognition. The FASB issued ASU 2014-09, *Revenue from Contracts with Customers*, and the IASB issued IFRS 15 with the same title. ASU 2014-09 supersedes and replaces virtually all existing U.S. GAAP revenue recognition guidance, including industry-specific guidance, and affects almost every revenue-generating entity that applies U.S. GAAP.

ASU 2014-09 creates a single, principle-based revenue recognition framework and is codified in a new Topic 606 in the Codification. The shift from primarily rules-based U.S. GAAP requires entities to apply significantly more judgment, and with that increase in management judgment, ASC 606 also requires expanded disclosures surrounding revenue recognition.

Although the new guidance is not effective for more than two years, all entities will need to apply ASC 606 once effective, even though not every entity will experience a significant change in the top line revenue amount. Accordingly, all entities should begin their impact assessment now to enable them to determine what changes to systems, processes, and policies are needed to implement ASC 606 and how to communicate the impact of the new guidance to stakeholders.

In addition, SEC Staff Accounting Bulletin (SAB) 74 (Topic 11M), *Disclosure of the Impact that Recently Issued Accounting Standards Will Have on the Financial Statements of the Registrant When Adopted in a Future Period*, requires public entities to provide disclosures of new authoritative guidance that has been issued, but will not be adopted until some future date. Public entities should consider the following disclosures before their adoption of ASU 2014-09:

- A description of the new requirements and the date when adoption is required

- A discussion of the alternative transition methods that are allowed, and the method the entity plans to use, if known
- A discussion of the anticipated impact of the new requirements on the entity's financial statements; if unknown, a statement to that effect
- Disclosure of any other significant consequences of adopting the new requirements (such as debt covenants violations, changes in business practices, or others)

A public entity should consider SAB 74 disclosures for financial statement periods that include the May 28, 2014 issuance of ASU 2014-09, for example, in an interim filing on Form 10-Q for the quarter ended June 30, 2014.

B. A single, principle-based model for revenue recognition

Unlike the voluminous and often industry-specific revenue recognition rules it is replacing, ASC 606 is a single, principle-based model. The core principle requires an entity to recognize revenue in a manner that depicts the transfer of goods or services to customers at an amount that reflects the consideration to which the entity expects to be entitled in exchange for those goods or services.

Practical insight: Principle-based model

The shift in the U.S. GAAP revenue landscape from guidance that tends to be prescriptive to guidance that is based on a single core principle will require entities to use more judgment. Some entities will be required to make more estimates, for example, for transactions with variable consideration. In addition, the increase in estimates and judgments is accompanied by an increase in disclosures to describe the estimation methods, inputs, and assumptions.

We expect that all entities will need to update their accounting policies, processes, and internal controls to conform to the new revenue recognition model.

C. Scope

ASC 606 applies to contracts with customers to provide goods or services. It does not apply to certain contracts within the scope of other ASC Topics, such as lease contracts, insurance contracts, financing arrangements, financial instruments, guarantees other than product or service warranties, and nonmonetary exchanges between entities in the same line of business to facilitate sales to customers.

A contract with a customer may be partially within the scope of ASC 606 and partially within the scope of other ASC Topics. If the other Topics specify how to separate and/or measure a portion of the contract, then that guidance should be applied first. The amounts measured under other Topics should be excluded from the transaction price that is allocated to performance obligations under ASC 606. If the other Topics do not stipulate how to separate and/or measure a portion of the contract, then ASC 606 would be used to separate and/or measure that portion of the contract.

A "customer" is defined as "a party that has contracted with an entity to obtain goods or services that are an output of the entity's ordinary activities in exchange for consideration." A counterparty to the contract might not be a customer if, rather than the counterparty obtaining an output of the entity's ordinary activities, the contract calls for an entity to participate with the counterparty in an activity or process, such

as developing an asset, and the parties share in the risks and benefits resulting from that activity or process. Therefore, an entity that enters into such arrangements as those for collaborative research and development activities will need to evaluate the particular facts and circumstances of each contract, including its purpose, to determine if the counterparty is a customer.

Practical insight: Identifying the customer

Entities might find it challenging to determine which party is the customer in an arrangement involving multiple parties. Furthermore, some transactions among partners in collaboration arrangements are excluded from the scope of ASC 606 because the counterparty to the arrangement is not obtaining an output of the entity's ordinary activities.

Sales of nonfinancial assets

ASU 2014-09 amends ASC 360, *Property, Plant, and Equipment*, and ASC 350, *Intangibles: Goodwill and Other*, to require entities to apply the guidance in ASC 606 on contract existence, control, and measurement to transfers of nonfinancial assets that are not an output of the entity's ordinary activities.

Example: Sales of nonfinancial assets

Quality Paper (QP) is a manufacturer of paper goods that operates in seven locations across the United States. QP builds a new facility in Omaha and sells its existing facility in Lincoln to a third party. The sale of manufacturing facilities is not an output of QP's ordinary activities; however, it should still apply the contract existence, control, and measurement provisions in ASC 606 to the sale of its Lincoln facility. Applying those provisions, however, will not affect QP's income statement presentation of any resulting gain or loss from the facility sale.

D. The five steps of the revenue recognition model

Applying the core principle involves the following five steps:

1. Identify the contract with a customer.
2. Identify the performance obligations in the contract.
3. Determine the transaction price.
4. Allocate the transaction price to the performance obligations.
5. Recognize revenue.



Step 1: Identify the contract with a customer

Because the guidance in ASC 606 applies only to contracts with customers, the first step in the model is to identify those contracts. A “contract” is defined as “an agreement between two or more parties that creates enforceable rights and obligations.” A contract can be written, oral, or implied by an entity’s customary business practices.

In addition, the guidance in ASC 606 applies only to arrangements that meet all of the following criteria:

- The parties have approved the contract, which creates enforceable rights and obligations.
- The entity can identify each party’s rights.
- The entity can identify the payment terms for the goods or services.
- The contract has commercial substance.
- It is probable that the entity will collect the consideration to which it will be entitled.

When evaluating the probability of collectibility, an entity should assess only the customer’s ability and intention to pay the amount of consideration when it is due. In addition, in determining the consideration to which it will be entitled, an entity needs to evaluate at contract inception whether it expects to provide a price concession that will result in it receiving less than the full contract price from the customer.

Practical insight: Existence of a contract

Step 1 serves as a “gate” through which an entity must pass before proceeding to the later steps of the model. In other words, if at the inception of an arrangement, an entity concludes that the criteria above are not met, it should not apply Steps 2 through 5 of the model until it determines that the criteria above are subsequently met. Significant judgment may be required to conclude whether a contract meets the criteria above.

If an entity determines at the arrangement’s inception that one or more of the specified criteria above have not been met, it should reassess whether the criteria are subsequently met. An entity may receive consideration from a customer before meeting all of the above criteria. In that circumstance, the entity cannot recognize revenue until the criteria above are subsequently met or either of the following conditions occurs:

- The entity has completed the performance under the contract, and all, or substantially all, amounts have been received from the customer and are nonrefundable.
- The arrangement is cancelled, and amounts received from the customer are nonrefundable.

In some circumstances, the guidance on accounting for contracts when the criteria are not met may result in a delay in recognizing revenue compared to the guidance under existing U.S. GAAP. For example, under ASC 606, if a contract does not meet the criteria above, an entity is required to recognize a liability for nonrefundable amounts received in an arrangement when performance is not complete, whereas under existing GAAP, an entity may be permitted to recognize revenue in the amount of cash received.

Practical insight: Collectibility

This new guidance regarding collectibility is somewhat similar to current U.S. GAAP. However, an entity currently evaluates collectibility when revenue is recognized, while under ASC 606, an entity evaluates collectibility in Step 1 when it determines whether a contract exists.

Under ASC 606, an entity needs to assess whether collectibility is probable before it applies Steps 2 through 5 and before it recognizes any revenue. An entity must conclude that collectibility is probable before proceeding to Step 2. This threshold is similar to the threshold in the software guidance in ASC 985-605, *Software: Revenue Recognition*, and is slightly higher than the “reasonably assured” guidance in SEC Staff Accounting Bulletin Topic 13, *Revenue Recognition*.

Another difference from existing U.S. GAAP is that ASC 606 explicitly requires an entity to consider whether the transaction price is variable because the entity may offer the customer a price concession before determining that collectibility is probable.

Combining contracts

An entity should combine two or more contracts and account for them as a single contract if they are entered into with a single customer (or related parties) at or near the same time and if they meet at least one of the following criteria:

- The contracts are negotiated as a package with one commercial objective.
- The amount paid under one contract depends on the price or performance under another contract.
- The goods or services to be transferred under the contracts constitute a single performance obligation.

Practical insight: Combining contracts

The guidance in ASC 606 on combining contracts is similar to current U.S. GAAP, except for one important distinction. Current guidance includes indicators for an entity to consider in evaluating whether two or more contracts should be combined. In contrast, ASC 606 requires that an entity combine contracts that were entered into at or near the same time if they meet any of the stated criteria. As a result, an entity needs to determine what constitutes “at or near the same time” as well as develop processes on how to evaluate whether the criteria are met.

In many situations, the criteria related to whether the performance obligations or payments in multiple contracts are interdependent will be a more straightforward evaluation; however, because ASC 606 is principle-based, many entities might find that significant judgment is required in certain circumstances in determining whether multiple contracts are negotiated with a single commercial objective in mind or whether the goods and/or services under those contracts constitute a single performance obligation.

For example, if one contract with a party is for the construction of a building and another contract is for the installation of the elevators, careful analysis of both contracts may lead to the conclusion that there is a single performance obligation and the contracts therefore should be combined. On the other hand, a contract with that party to construct a building and a second

contract to install elevators at an adjacent property owned by the customer may require greater effort to determine whether the contracts should be combined.

Contract modifications

A contract modification results when the parties to a contract approve a change in the scope and/or the price of a contract (in other words, there exist new enforceable rights and obligations or changes to those previously existing). Several possibilities exist for changes in price or scope. For example, the parties may agree on scope, but not price changes, or they may have a dispute regarding the price or scope. When the parties have approved a change in scope but the corresponding price has not yet been determined, the entity should evaluate whether the relevant facts and circumstances in estimating the change in the transaction price arising from the modification using the guidance on variable consideration (variable consideration is discussed at Step 3 below).

Similar to approval of the original contract, approval of a modification could be made orally or in writing or could be implied by customary business practice.

An entity accounts for a modification as a separate contract, which affects only future revenues, if the modification results in both of the following conditions:

- The scope increases to reflect additional promised goods or services that are “distinct,” as defined (see “Step 2: Identify the performance obligations”).
- The additional consideration to the seller reflects the added goods’ or services’ stand-alone selling prices and any appropriate adjustments based on the circumstances.

If a contract modification is not considered a separate contract, there are three potential outcomes. An entity would evaluate the remaining goods and services to be delivered under the modified contract to determine how to account for the modification, as follows:

- If the remaining goods or services are distinct from those delivered before the contract was modified, the entity treats the modification as a termination of the original contract and the creation of a new contract. As such, the amount of consideration allocated to the remaining separate performance obligations equals the sum of the estimated transaction price (including amounts already received from the customer) not yet recognized as revenue, plus the amount of consideration arising from the modification.
- If the remaining goods or services are not distinct and are part of a single performance obligation that is partially satisfied as of the modification date, the entity treats the modification as part of the original contract by adjusting the transaction price and remeasuring its progress toward completion of the performance obligation. The revenue recognized to date should be increased or decreased for the effects of the contract modification on a cumulative catch-up basis.
- If the modification represents a combination of the two preceding scenarios, the entity should use a combination of the two methods above.

Practical insight: Contract modifications

An entity may also be required to apply significant judgment in evaluating a claim, which is defined in ASC 605-35 as an amount in excess of the agreed contract price that an entity seeks to collect from customers for unanticipated additional costs in fulfilling a contract. By their nature, claims are unapproved and unpriced change orders. An entity should first determine that it has enforceable rights and obligations related to the claim and then estimate the change in transaction price, if any, resulting from such a contract modification using the variable consideration guidance discussed in Step 3 below.

Step 2: Identify the performance obligations

Having identified a contract, the entity next identifies the performance obligations within that contract. A “performance obligation” is defined as a promise in a contract with a customer to transfer either (1) a good or service, or a bundle of goods or services, that is “distinct” (see below), or (2) a series of distinct goods or services that are substantially the same and that have the same pattern of transfer to the customer.

Performance obligations are normally specified in a contract but also may include promises implied by an entity’s customary business practices, published policies, or specific statements that create a valid customer expectation at contract inception.

Performance obligations exclude activities that do not result in the transfer of a good or service to the customer (for example, some set-up activities).

Under ASC 606, a promised good or service is considered “distinct” if both of the following criteria are met:

- *The customer can benefit from the good or service either on its own or with other resources readily available to the customer.* A readily available resource is a good or service that is sold separately (by the entity or by another entity) or that the customer has already obtained (from the entity or from other events or transactions).
- *The promise to transfer a good or service is separable from other promises in the contract.* The following factors indicate that a good or service is separable from other goods or services in the contract:
 - The entity does not provide significant integration services. Stated differently, the entity is not using the good or service as an input to produce the specific output called for in the contract.
 - The good or service does not significantly modify or customize other promised goods or services in the contract.
 - The good or service is not highly dependent on, or interrelated with, other promised goods or services in the contract. For example, a good or service might not be highly interrelated if a customer can decide not to purchase a particular good or service and that decision does not significantly affect other promised goods or services under the contract.

Practical insight: Performance obligations

Entities need to analyze all but the simplest customer contracts to identify whether they include more than one performance obligation based on the “distinct” principle described above. That said, we expect that many long-term construction and service contracts will be identified as single performance obligations because they often include a significant integration service. Likewise, a contractor who agrees to paint the exterior of a customer’s house and purchases and delivers all paint at the outset of the contract will likely determine that the paint is an input to produce the painted house and that the painting service is a significant integration service; therefore, the paint and the services are a single performance obligation. By contrast, some practices—for example, treating a “free” cell phone that is provided in a bundled contract including airtime as a marketing expense in the telecom sector—will no longer be acceptable.

Under ASC 606, an entity might identify and separately account for more performance obligations in a single contract than under current U.S. GAAP. For example, under the new model, an entity might conclude that the following goods and services are separate performance obligations:

- Service-type warranties
- When-and-if available software upgrades
- Free products or services, including loyalty points
- Discounts on future sales

Step 3: Determine the transaction price

Under ASC 606, “transaction price” is defined as the amount of consideration to which an entity expects to be entitled in exchange for the goods or services promised under a contract, excluding any amounts collected on behalf of third parties (for example, sales taxes). The transaction price may include fixed amounts, variable amounts, or both.

An entity should consider the effects of all the following factors in determining the transaction price:

- Variable consideration
- Significant financing components
- Noncash consideration
- Consideration payable to the customer

Variable consideration

The amount of consideration received under a contract might vary due to discounts, rebates, refunds, credits, price concessions, performance bonuses, penalties, and similar items. The variable consideration guidance in ASC 606 also applies if the entity expects to offer a price concession or if goods are sold with a right of return.

If a contract includes a variable amount, an entity is required to estimate the transaction price. To estimate the variable consideration in a contract, an entity determines either the expected value or the most likely amount of consideration to be received, depending on which method better predicts the

amount to which the entity will be entitled. The *expected value method* might be appropriate in situations where the variable outcome is a range of outcomes and an entity has experience with a large number of similar contracts that provide a reasonable basis to predict future outcomes. The *most likely amount method* might be appropriate in situations where a contract has only two possible outcomes rather than a range of possible outcomes (for example, a bonus for early delivery that would be either fully received or not received at all).

ASC 606 requires an entity to use the same method to estimate the variable consideration throughout the life of a contract.

Constraint on variable consideration

If the amount of consideration from a customer contract is variable, an entity must evaluate whether the variable consideration should be constrained. The objective of the constraint is for an entity to recognize revenue only to the extent it is probable that a significant reversal in cumulative revenue recognized on the contract will not occur when the uncertainty is resolved.

To meet the objective, an entity should make an assessment to determine if it is probable that changes in the entity's estimate of variable consideration will not result in a significant downward adjustment of the cumulative amount of revenue recognized on the contract. In making this assessment, an entity should consider all of the facts and circumstances associated with both the likelihood and the magnitude of the reversal if that uncertain event were to occur or fail to occur.

The following indicators might signify that including an estimate of variable consideration in the transaction price could result in a significant revenue reversal:

- The amount of consideration is highly susceptible to factors outside the entity's influence such as market volatility, third-party actions, weather, and obsolescence risk.
- The uncertainty is not expected to be resolved for a long time.
- The entity's experience with similar contracts is limited or its experience has limited predictive value.
- The entity has a practice of offering a broad range of price concessions or changing the payment terms in similar circumstances.
- There are a large number and wide range of possible consideration amounts in the contract.

An entity should update its estimate of variable consideration, including the application of the constraint, at the end of each reporting period to reflect changes in facts and circumstances.

Practical insight: Constraint

If an entity previously determined that the transaction price should include \$100 of variable consideration but now believes the variable amount is \$200, this revision to the overall transaction price is subject to the constraint discussed above. The entity's assertion in reaching a conclusion to increase the transaction price to \$200 would be that it is probable that a subsequent change in the estimate of variable consideration will not result in a significant revenue reversal.

Sales- and usage-based royalties on licenses of intellectual property

Contracts for licenses of intellectual property often include sales- and usage-based royalties that represent variable consideration. ASC 606 includes a specific requirement related to variable consideration in the form of sales- or usage-based royalties on licenses of intellectual property. That requirement stipulates that an entity that licenses its intellectual property under a contract that includes a sales- or usage-based royalty should include consideration from the sales- or usage-based royalty in the transaction price only when the later of the following events occurs:

- The subsequent sale or usage occurs (that is, when the uncertainty is resolved).
- The performance obligation to which the sales- or usage-based royalty is allocated has been satisfied.

Significant financing components

In determining the transaction price, an entity must reflect the time value of money in its estimate of the transaction price if the agreed-upon timing of payments in the contract includes a significant financing component, whether explicit or implicit. The objective in adjusting the transaction price for the time value of money is to reflect an amount for the selling price as though the customer had paid cash for the goods or services when they were transferred. Either party may receive credit—that is, the customer may pay before the entity performs its obligation (in essence, a customer loan to the entity) or it may pay after the entity performs its obligation (in essence, a loan by the entity to the customer).

To determine whether a financing component is “significant,” an entity considers all relevant facts and circumstances, including, but not limited to, the following:

- The difference, if any, between the promised consideration and the cash price that would be paid if the customer had paid as the goods or services are delivered
- The combined effect of both
 - The expected length of time between delivery of the goods or services and receipt of payment
 - The prevailing market interest rates

A contract may not have a significant financing component if any one of the following scenarios exists:

- Advance payments have been made but the timing of the transfer of the good or service is at the customer’s discretion.
- The consideration is variable based on factors outside the vendor’s or customer’s control (for example, a sales-based royalty).
- A difference between the promised consideration and the cash price relates to something other than financing and the difference is proportional to the reason for the difference, such as protecting one of the parties from the other party’s nonperformance (for example, a customary retainage of a certain percentage of all payments made until completion of a project).

As a practical expedient, an entity can ignore the impact of the time value of money on a contract if it expects, at contract inception, that the period between the delivery of goods or services and the customer payment will be one year or less.

To adjust the amount of consideration for a significant financing component, an entity should use the discount rate that would be reflected in a separate financing transaction between the entity and the customer at contract inception. That rate should reflect the credit risk of whichever party is receiving credit

(for example, the customer's rate if payment is deferred and the vendor's rate if payment is made in advance).

An entity presents the effects of financing separately from revenue as interest expense or interest income in the statement of comprehensive income.

Noncash consideration

Under ASC 606, if a customer promises consideration in a form other than cash, an entity should measure the noncash consideration at fair value in determining the transaction price. This includes arrangements in which the customer transfers control of the goods or services to the vendor to facilitate the vendor's fulfillment of a contract. For example, a customer might contribute materials to a vendor for use in the vendor's construction of a building under a contract with that customer. In that case, the vendor should recognize revenue for those contributed materials if it obtains control of those materials.

If an entity is unable to reasonably measure the fair value of noncash consideration, it should indirectly measure the consideration by referring to the stand-alone selling price of the goods or services promised under the contract.

Consideration payable to a customer

Consideration payable to a customer includes amounts that an entity pays or expects to pay to a customer in the form of cash or noncash items, including credit or other items that the customer can apply against amounts owed to the entity. An entity should reduce the transaction price by the amount it owes to the customer, unless the consideration owed is in exchange for distinct goods or services transferred from the customer to the entity.

An entity's acquisition of goods or services from a customer may affect the transaction price of the entity's revenue contract with the customer. If the customer transfers distinct goods or services to an entity in exchange for payment, the entity should account for the purchase of these goods or services similarly to purchases from suppliers. If the amount of consideration owed by the entity to the customer exceeds the fair value of those goods or services, the entity should reduce the transaction price by the amount of the excess. If the entity cannot estimate the fair value of the goods or services it receives from the customer, it should reduce the transaction price by the total consideration owed to the customer. For example, in certain co-operative advertising programs, a vendor makes payments to its customers in exchange for advertising services.

ASC 606 requires an entity to recognize a reduction in revenue associated with adjusting the transaction price for consideration payable to a customer at the later of the following events:

- The entity recognizes revenue for the transfer of goods or services to the customer.
- The entity pays or promises to pay the consideration to the customer; a promise might be implied by the entity's customary business practices.

Practical insight: Determining the transaction price

Under existing revenue recognition guidance, uncertainty in the transaction price is a recognition issue. In other words, if the revenue amount is not fixed and determinable, then no revenue can be recognized.

ASC 606 has more specific and detailed guidance and changes existing practice in some areas. However, in highly uncertain situations (for example, some success fee-type arrangements

when the outcome of the relevant contingency is unpredictable), the practical effect of the new guidance is likely to be the same—that is, revenue is recognized only when the uncertainty is resolved. If the entity has had relevant, predictive experience involving multiple similar transactions, we believe that ASC 606 could lead to earlier revenue recognition in some cases.

Step 4: Allocate the transaction price to the performance obligations

Under ASC 606, an entity allocates a contract’s transaction price to each separate performance obligation in that contract based on a relative stand-alone selling price at contract inception. ASC 606 defines a “stand-alone selling price” as “the price at which an entity would sell a promised good or service separately to a customer.” The best evidence of the stand-alone selling price, if available, is the observable price charged by the entity to similar customers in similar circumstances. If the stand-alone selling price is not observable because, for example, the entity does not sell the good or service separately, an entity should estimate the stand-alone selling price using all reasonably available information (including market conditions, entity-specific factors, and information about the customer or class of customer) and maximizing the use of observable inputs.

ASC 606 suggests, but does not require, three suitable methods to estimate the stand-alone selling price, shown in the following table.

Method	Description
Adjusted market assessment approach	An entity evaluates the market in which it sells goods or services and estimates the price that customers in that market would pay for those goods or services. An entity might also consider price information from its competitors and adjust that information for its particular costs and margins.
Expected cost plus margin approach	An entity forecasts its expected costs to provide the good or service and adds an appropriate margin.
Residual approach	<p>An entity subtracts the sum of observable stand-alone selling prices for other goods and services promised under the contract from the total transaction price to arrive at an estimated selling price for the remaining performance obligation(s). This method is permitted only if the entity meets either of the following criteria:</p> <ul style="list-style-type: none"> • Sells the same good/service to different customers, at or near the same time, for a broad range of amounts so that a representative stand-alone price is not discernible. In these situations, the selling price is considered highly variable. • Has not yet established a price for the good/service and the good/service has not previously been sold on a stand-alone

Method	Description
	basis and, thus, the selling price is uncertain.

The residual approach may be used for two or more goods or services with highly variable or uncertain stand-alone selling prices if one or more other goods or services in the contract do not have highly variable or uncertain stand-alone selling prices. In addition, a combination of techniques could be used when estimating stand-alone selling prices of two or more goods or services with highly variable or uncertain stand-alone selling prices, as follows:

- First, an entity may apply the residual approach to estimate the aggregate stand-alone selling prices of all goods and services with highly variable or uncertain selling prices.
- Then, it may utilize another technique to allocate that aggregate stand-alone selling price to those individual goods and services.

Entities should not reallocate the transaction price to reflect changes in the stand-alone selling price of goods or services that occur after contract inception.

Practical insight: Allocating transaction price

Entities applying the existing multiple-element guidance in ASC 605-25, *Revenue Recognition: Multiple-Element Arrangements*, will find similarities in the allocation guidance in the new model; however, ASC 606 does not require the use of a hierarchy to determine the stand-alone selling price.

Entities that have historically applied the software guidance in ASC 985-605, *Software: Revenue Recognition*, are not required to demonstrate vendor-specific-objective evidence (VSOE) of fair value to separate elements under ASC 606. As a result, we expect that software companies might identify more performance obligations under the new guidance than they do under the existing guidance, which requires combining elements into a single unit of accounting when there is a lack of VSOE.

Allocating discounts and variable consideration

If the sum of the stand-alone selling price for the promised goods or services exceeds the contract's total consideration, an entity should treat the excess as a discount that is allocated to the separate performance obligations based on relative stand-alone selling prices. However, an entity should allocate a discount entirely to one or more, but not all, of the performance obligations only if all of the following criteria are met:

- The entity regularly sells each distinct good or service in the contract on a stand-alone basis.
- The entity regularly sells a bundle (or bundles) of some of the distinct goods or services in the contract on a stand-alone basis at a discount to the stand-alone selling prices of the bundled goods or services.

- The entity has evidence based on stand-alone selling prices that the discount in the contract is attributed to that bundle of goods or services.

Under ASC 606, if an entity meets the above criteria for allocating the discount entirely to one or more performance obligations, it should allocate the discount before using a residual approach to estimate a stand-alone selling price for a good or service.

Variable consideration may be attributable to the entire contract or only to a specific part of the contract. ASC 606 requires entities to allocate variable consideration entirely to a single performance obligation (or to a distinct good or service that forms part of a single performance obligation) only if both of the following conditions apply:

- The terms of the variable payment relate specifically to the entity's efforts toward satisfying that performance obligation (or distinct good or service).
- The allocation to the performance obligation (or distinct good or service) is consistent with the general allocation principle, which states that the transaction price is allocated to each performance obligation in the amount that the entity expects to be entitled to in exchange for satisfying each performance obligation.

Practical insight: Allocating variable consideration

Under the guidance in ASC 606, an entity allocates total transaction consideration to the identified performance obligations based on their relative stand-alone selling prices. If a contract includes variable payments and the entity concludes that it is probable there will be no significant downward adjustment to the cumulative amount of revenue recognized on the performance obligation, even though the final amount remains uncertain, the entity would include the reasonably assured amount in the total consideration. In other words, the entity is not limited to allocating the amount that is not contingent on the future satisfaction of performance obligations, as it is under existing U.S. GAAP.

Changes in transaction price

If the transaction price changes, an entity should allocate the change to separate performance obligations on the same basis used at contract inception (subject to the specific guidance on contract modifications). Amounts allocated to a satisfied performance obligation should be recognized either as revenue or as a reduction in revenue in the period the change occurs.

Changes in the transaction price should be allocated entirely to one or more, but not all, distinct goods or services promised in a series that forms part of a single performance obligation using the same criteria applied to allocating variable consideration.

Step 5: Recognize revenue

Under ASC 606, an entity recognizes revenue when or as it transfers promised goods or services to a customer. A "transfer" occurs when the customer obtains control of the good or service.

A customer obtains control of an asset when it can direct the use of, and obtain substantially all the remaining benefits from, an asset. Control includes the ability to prevent other entities from directing the use of and obtaining the benefits from an asset. The benefits of an asset are the potential cash flows that can be obtained either directly or indirectly from the asset.

A key part of the model is the concept that for some performance obligations, control is transferred over time, while for others, control transfers at a point in time. ASC 606 specifies a sequence that requires entities first to determine whether control transfers over time for each performance obligation. If transfer is not over time, then the entity would conclude that transfer is made at a point in time.

Control transferred over time

An entity determines at contract inception whether each separate performance obligation will be satisfied (that is, control will be transferred) over time or at a specific point in time.

Control is considered transferred over time if one of the following conditions exists:

- The customer controls the asset as it is created or enhanced by the entity's performance under the contract.
- The customer receives and consumes the benefits of the entity's performance as the entity performs its obligation (for instance, if another entity would not have to substantially reperform the work completed to date if it stepped in to complete the remaining obligation under the contract).
- The entity's performance creates or enhances an asset that has no alternative use to the entity, and the entity has the right to receive payment for work performed to date and expects to fulfill the contract as promised. An entity evaluates whether a promised asset has an alternative use to the entity at contract inception by considering whether it can readily redirect the partially completed asset to another customer throughout the production process. In addition, the right to payment should be enforceable, and a vendor should consider the contractual terms, as well as any legislation or legal precedent that could override those terms, in assessing the enforceability of that right.

Practical insight: No alternative use

The "no alternative use" assessment is made at contract inception and is updated only if the contract parties approve a contract modification that substantively changes the performance obligation. In making the assessment, an entity should consider the characteristics of the asset ultimately transferred rather than at a point in time during the production process. If an entity can readily direct the asset to another customer, then the customer has not obtained control of that asset. The determination of whether an alternative use exists is a matter for significant judgment based on the particular facts and circumstances of each situation.

If a substantive contract provision precludes an entity from directing an asset for another use during the creation or enhancement of the asset, the entity does not have an alternative use for that asset because it is legally obliged to transfer the asset to the customer.

However, a contractual restriction that provides a protective right to the customer is not sufficient to conclude that the restriction is substantive. For example, a provision is not substantive if the entity can substitute a different asset to transfer to the customer and remain in compliance with the contract. Such a contract provision may serve to protect the customer in the event that the entity breaches the contract by not transferring the asset to the customer.

An entity recognizes revenue associated with a performance obligation that is satisfied over time by measuring its progress toward completion of that performance obligation. The objective of this measurement is to depict the pattern by which the entity transfers control of the goods or services to the

customer. The entity should update this measurement over time as circumstances change and account for these changes as a change in accounting estimate under the guidance in ASC 250, *Accounting Changes and Error Corrections*.

ASC 606 discusses two methods that are appropriate for measuring an entity's progress toward completion of a performance obligation: output methods and input methods.

Output methods

Under an output method, an entity recognizes revenue by directly measuring the value of the goods and services transferred to date to the customer (for example, milestones reached, time elapsed, or units produced). When applying an output method, it is appropriate for an entity to recognize revenue in the amount it is entitled to invoice the customer, provided that the amount corresponds directly with the value of the goods or services transferred to date. Although output methods might be the most faithful depiction of an entity's performance, there are challenges in applying output methods. For instance, outputs often are not readily observable, and the information required to use them may not be available to an entity without undue cost.

The units produced method of measuring progress toward satisfying a performance obligation could provide a reasonable proxy for the entity's performance if the value of any work-in-progress at the end of the reporting period is immaterial. In addition, a units delivered method could provide a reasonable proxy for the entity's performance in satisfying a performance obligation if both of the following conditions exist:

- The value of any work-in-progress at the end of the reporting period is immaterial.
- The value of any units produced but not yet delivered to the customer at the end of the reporting period is immaterial.

As a practical expedient, an entity that has a contractual right to an amount of consideration that corresponds to the value received by its customer for the entity's performance to date is permitted to recognize revenue equal to the amount that the entity has a right to invoice. An example of such a situation is a service contract in which an entity contractually bills a fixed amount for each hour of service.

Input methods

With an input method, an entity recognizes revenue based on the extent of its efforts or inputs toward satisfying a performance obligation compared to the expected total efforts or inputs needed to satisfy the performance obligation. Examples of input measures include labor hours expended, machine hours used, and costs incurred. It might be appropriate for an entity to recognize revenue on a straight-line basis if its efforts or inputs are expended evenly throughout the performance period. If an entity selects an input method such as costs incurred to measure its progress, it is required to make adjustments to that measure of progress if including some of those costs (for example, wasted materials) distorts the entity's performance under the contract.

If a performance obligation consists of goods and related services and the customer obtains control of the goods (uninstalled materials) significantly before receiving the related services, an entity might best depict its performance by recognizing revenue associated with the goods in an amount equal to their cost when the goods are transferred to the customer. To recognize revenue in this manner, both of the following conditions must exist at contract inception:

- The cost of the goods is significant compared to the total expected costs associated with the performance obligation.

- The entity obtains the goods from another entity and is not significantly involved in their design or manufacture.

Practical insights: Measuring progress

ASC 606 permits an entity to use either input methods or output methods to measure progress toward satisfying a performance obligation. However, when determining the method to apply to a specific contract or performance obligation, management should select the method that best depicts the transfer of control of the goods or services. If an input method is selected, an entity excludes from the measurement those amounts related to activities that do not depict the transfer of control (for example, abnormal amounts of wasted materials or labor).

Additionally, an entity should apply the method that it chooses consistently to similar performance obligations in similar circumstances.

Ability to reasonably measure progress

An entity recognizes revenue for a performance obligation satisfied over time only if it can reasonably measure its progress. An entity cannot reasonably measure its progress toward completion if it lacks reliable information that is required to apply an appropriate method of measurement.

In some cases, such as during the early stages of a contract, an entity might not be able to reasonably measure its progress toward completion, but still expects to recover costs incurred in satisfying the performance obligation. An entity is then permitted to recognize revenue to the extent of costs incurred until it can reasonably measure its progress.

Control transferred at a point in time

Revenue for performance obligations that do not meet the criteria for control transferred over time is recognized at a point in time. Accordingly, an entity recognizes revenue by evaluating when the customer obtains control of the asset (goods or services).

In performing the evaluation, an entity should consider indicators of control, including, but not limited to, the following:

- The entity has a present right to receive payment for the asset.
- The customer has legal title to the asset.
- The customer has physical possession of the asset.
- The customer has assumed the significant risks and rewards of owning the asset.
- The customer has accepted the asset.

Practical insight: Over time and point in time

We believe that many entities currently using proportional performance, percentage-of-completion, or another means of recognizing revenue over time will find the concepts in ASC 606 to be somewhat familiar.

However, some entities that currently recognize revenue at a point in time may meet the requirements in ASC 606 for over-time recognition. For instance, some contract manufacturers that currently recognize revenues when products are delivered may meet one of the criteria in ASC 606 for recognition over time.

Similarly, it is possible that some contracts that currently fall under the percentage-of-completion guidance in ASC 605-35 may not meet the over-time criteria in ASC 606 and that revenue on those contracts will be recognized at a point in time.

E. Other topics

Contract costs

Costs to fulfill a contract

If costs incurred in fulfilling a contract with a customer are covered under another Codification Topic (such as ASC 330, *Inventory*, or ASC 360, *Property, Plant, and Equipment*), an entity should account for those costs in accordance with those Topics. Otherwise, costs should be accounted for using the guidance in ASC 340-40, *Other Assets and Deferred Costs: Contracts with Customers*, which was added to the Codification in ASU 2014-09. Under ASC 340-40, an entity should recognize an asset for contract fulfillment costs, provided all of the following criteria are met:

- The costs relate directly to a contract. Examples of costs that relate directly to a contract include the following:
 - Direct labor
 - Direct materials
 - Allocated costs that relate directly to the contract or contract activities (for example, contract management and supervision costs and depreciation of tools and equipment used in fulfilling the contract)
 - Costs that are chargeable to the customer
 - Other costs that the entity incurs only because it entered into the contract
- The costs generate or enhance resources that the entity will use to satisfy performance obligations in the future.
- The entity expects to recover the costs.

An entity would expense the following costs as incurred:

- General and administrative costs that are not explicitly chargeable to the customer

- Costs of wasted materials, labor, or other resources that are not reflected in the contract price
- Costs that relate to past performance that results in satisfied or partially satisfied performance obligations
- Costs related to remaining performance obligations that cannot be distinguished from costs related to satisfied or partially satisfied performance obligations

Incremental costs of obtaining a contract

Under ASC 340-40, an entity capitalizes the incremental costs of obtaining a contract if it expects to recover those costs. “Incremental costs” of obtaining a contract are defined as costs that an entity would not have incurred if it had not obtained the contract (for example, some sales commissions). Costs that an entity incurs regardless of whether it obtains a contract should be expensed as incurred, unless the costs are explicitly chargeable to the customer regardless of whether the entity obtains the contract.

As a practical expedient, ASC 340-40 allows an entity to expense the incremental costs of obtaining a contract as incurred if the amortization period of the asset that the entity would otherwise have recognized is one year or less.

Amortization and impairment

Under ASC 340-40, an entity amortizes capitalized contract costs on a systematic basis consistent with the pattern of transferring the goods or services related to those costs. If an entity identifies a significant change to the expected pattern of transfer, it should update its amortization to reflect that estimated change in accordance with ASC 250.

An entity should recognize an impairment loss in earnings if the carrying amount of an asset exceeds its recoverable amount. Under ASC 340-40, the recoverable amount equals the remaining amount of consideration the entity expects to be entitled to in exchange for the goods or services associated with the capitalized contract costs, minus the costs directly related to those goods or services.

Before recognizing an impairment loss, an entity should recognize impairment losses associated with assets related to the contract that are accounted for under other Codification guidance, such as ASC 330. An entity is not permitted to reverse a previously recognized impairment loss.

Practical insight: Contract costs

The guidance on contract fulfilment costs in ASC 340-40 is similar to the guidance in ASC 605-35 for production- and construction-type contracts. However, ASC 340-40 applies to all customer contracts, not only to construction contracts, so that most entities in a wide variety of industries will need to consider accounting for contract costs.

The guidance on the costs of obtaining or securing a contract in ASC 340-40 appears similar to the guidance in ASC 605-35, but, again, applies to a broader range of contracts. ASC 340-40 requires immediate expensing of costs incurred regardless of whether a contract is won or lost (for example, most bid costs), unless those costs are explicitly chargeable to the customer regardless of whether the contract is obtained. In contrast, under ASC 605-35, precontract costs are deferred and later included in contract costs if they relate directly to a specific anticipated contract and if it is probable that the costs will be recovered from that contract.

Warranties

ASC 606 retains many aspects but changes certain other aspects of accounting for warranties under the existing revenue recognition guidance. If a customer has the option to separately purchase a warranty, then an entity accounts for that warranty as a separate performance obligation. If a customer does not have the option to separately purchase a warranty, then the entity accounts for the warranty using the cost accrual guidance in ASC 450, *Contingencies*, unless all or part of the warranty provides the customer with an “additional service” beyond the assurance that the product complies with agreed-upon specifications.

ASC 606 lists the following factors that an entity should consider in determining whether a warranty provides a customer with an “additional service”:

- *Whether the warranty is required by law* – A legal requirement to provide a warranty indicates that the warranty is intended to protect the customer from purchasing a defective product. Therefore, such a warranty would not likely represent a performance obligation.
- *The term of the warranty coverage period* – The longer the coverage period, the more likely a warranty is a performance obligation.
- *The nature of the tasks the entity promises to perform under the warranty* – If an entity must perform certain tasks to provide assurance to the customer that the product complies with agreed-upon specifications, those services would not likely constitute a separate performance obligation.

If an entity determines that a warranty provides a service that is separate from the assurance of the product’s compliance with agreed-upon specifications, the service is considered a separate performance obligation. The entity should allocate a portion of the transaction price to that service unless it cannot reasonably account for the assurance and service portions of the warranty separately. If an entity determines that it cannot reasonably separate the assurance and service components of a warranty, it should account for both together as a single performance obligation.

The following do not give rise to performance obligations:

- A law requiring an entity to compensate victims if its products cause harm or damage
- An entity’s indemnification of its customers for liabilities from claims of patent, copyright, trademark, or other infringement by the entity’s products

Practical insight: Warranties

Under existing U.S. GAAP, entities generally account for standard warranty obligations under the guidance in ASC 460, *Guarantees*, which refers to the guidance in ASC 450. That is, an entity accrues a liability for its expected costs associated with performing under a warranty when the obligation is probable and the entity can reasonably estimate the costs. For separately priced extended warranties, entities currently look to the guidance in ASC 605-20, *Revenue Recognition: Services*.

Under ASC 606, an entity is required to distinguish between warranty obligations that represent assurance of a product’s performance and those that represent a separate performance obligation. Therefore, an entity offering a standard warranty that is not separately priced might determine that all or a portion of its warranty obligation constitutes a separate performance obligation.

Licensing intellectual property

Under ASC 606, an entity must determine whether revenue from licensing rights to its intellectual property (for example, software, technology, motion pictures, music, franchises, patents, trademarks, and copyrights) should be recognized over time or at a point in time. To do so, the entity must consider the separability (or nonseparability) of any other promises in the contract, as well as the nature of the entity's (licensor's) performance under the license.

If the contract includes other promises that are nonseparable from the license rights, the license is not distinct, and the entity should then account for the bundle of promises as a single performance obligation. The entity should apply the control guidance to determine if a transfer takes place (and revenue is recognized) over time or at a point in time. For example, a life sciences entity licenses its intellectual property for an early-stage drug candidate and also agrees to provide research and development (R&D) services to assist the customer in obtaining federal approval for the drug. Under ASC 606, the entity might conclude that the license is not distinct and therefore is nonseparable from the R&D services because the customer cannot use the license without the R&D services.

If a license is distinct, the nature of what is promised under the licensing agreement determines whether it results in a performance obligation that is satisfied at a point in time or over time. If the license is a promise to provide access to the entity's intellectual property as it exists throughout the license period, the performance obligation is satisfied over time. Under ASC 606, a license is a promise to provide access to the entity's intellectual property if all of the following conditions exist:

- There is a requirement or implicit understanding that the entity will undertake activities that will change the underlying intellectual property.
- The customer is exposed to positive or negative effects as those activities take place.
- Those activities do not result in a transfer of goods or services as they take place.

ASC 606 also specifies that contractual restrictions on time, geography or use, and guarantees that the entity has a valid patent over the intellectual property, are not considered in making this determination.

If these conditions are not present, the license is considered a promise to provide a right to use the intellectual property as it exists when the license is granted, and the performance obligation is satisfied at a point in time (similar to a sale of a good).

Practical insight: Licenses

Existing U.S. GAAP provides limited guidance on accounting for revenue associated with licensing arrangements outside of certain industries, such as software, motion pictures, and music. The guidance in ASC 606 standardizes the process used for evaluating how to recognize revenue associated with licenses and rights to use. Under ASC 606, an entity that currently recognizes license revenue over time could be required to recognize such revenue "up front" if it determines that the licensing arrangement is a promise to provide a right and is a separate performance obligation.

Rights of return and repurchase obligations

In general, an entity that sells goods might also grant the customer a right to return the asset or might promise the customer, or obtain from the customer an option, to repurchase the asset (a repurchase agreement).

Sale with a right of return

In some contracts, an entity transfers control of a product to a customer and also grants the customer the right to return the product for various reasons (such as dissatisfaction with the product) and to receive any combination of the following:

- A full or partial refund of any consideration paid
- A credit that can be applied against amounts that the customer owes, or will owe, to the entity
- Another product in exchange

Broadly, the entity recognizes revenue for these arrangements, net of estimated returns, by recognizing the following:

- Revenue for the sold products, reduced for estimated returns (the guidance on variable consideration applies)
- A refund liability measured at the amount of consideration received that the entity expects to refund
- An asset initially measured at the carrying amount of the inventory, less costs of recovery, and corresponding adjustment to cost of sales

An entity's promise to accept a returned product is not considered a performance obligation.

The refund liability and asset are updated at the end of each reporting period for changes in expectations, with corresponding adjustments to revenue.

Exchanges of a product for another product of the same type, quality, condition, and price (such as the exchange of a sweater for the same sweater in a different color) are not considered a return. Contracts that permit the exchange of a defective product for a functioning product should be evaluated using the warranty guidance discussed earlier.

Practical insight: Sale with right of return

Under ASC 606, accounting for return rights is similar to the guidance under existing U.S. GAAP, except that the balance sheet will be grossed up to include the refund obligation and the asset for the right to the returned goods. What's more, the asset for the right to returned goods should be evaluated for impairment under the guidance in ASC 606 rather than under the inventory impairment guidance that is used today.

In addition, current U.S. GAAP requires an entity to defer revenue if it does not meet the restrictive criteria under ASC 605 for estimating returns. The guidance in ASC 606 could result in earlier revenue recognition if a right of return exists because management estimates returns as the more predictive of either the expected value (sum of the probability-weighted amounts) or most likely amounts and recognizes revenue net of those estimated returns.

Repurchase agreements

Sometimes an entity that enters into a contract to sell an asset also promises, or has the option, to repurchase the same asset, an asset that is substantially the same, or another asset in which the original asset sold is a component. Under ASC 606, an entity should evaluate the form of the promise to repurchase the asset (for example, a forward, call, or put option) in determining the appropriate accounting.

If a contract includes a forward (entity's obligation to repurchase) or a call option (entity's right to repurchase), an entity should account for the contract in one of two ways:

- As a lease if it can or must repurchase the asset for an amount that is less than the original selling price
- As a financing arrangement if it can or must repurchase the asset for an amount that is equal to or more than the original selling price

If a customer is granted the right to require an entity to repurchase the asset (a put option) at a price that is less than the original selling price, the entity should assess whether the customer has a significant economic incentive to exercise its right. This assessment should take into consideration various factors including the relationship between the repurchase price and the expected market value of the asset at the date of repurchase. If the repurchase price is expected to significantly exceed market value, then a significant economic incentive exists. The agreement should then be accounted for as a lease (because the customer is effectively paying the entity for the right to use the asset for a period of time), unless the contract is a part of a sale-leaseback arrangement (see "Sale-leaseback transactions" below).

If the customer does not have a significant economic incentive, the entity should account for the agreement as a sale with a right of return (see "Sale with a right of return" above).

If a contract grants the customer a put option and the repurchase price of the asset is equal to or greater than its original selling price and is more than the asset's expected market value, the contract is considered a financing arrangement. In such circumstances, the entity continues to recognize the asset as well as a liability initially measured at the asset's original selling price.

If either a call or put option expires unexercised, any liability recorded should be derecognized and revenue recognized.

Sale-leaseback transactions

A sale-leaseback transaction with a forward or call option that has an repurchase price less than the asset's original sales price should be accounted for as a financing transaction rather than as a sale-leaseback.

Repurchase arrangements			
Type of repurchase arrangement	Relationship between repurchase price (RP) and original selling price (OSP)	Relationship between repurchase price and expected market value (EMV) at repurchase date	Accounting treatment
Forward or call option*	$RP \geq OSP$	Not applicable	Financing arrangement
	$RP < OSP$	Not applicable	Lease
Put option	$RP \geq OSP$	$RP > EMV$	Financing arrangement
	$RP \geq OSP$	$RP \leq EMV$	Sale with right of return
	$RP < OSP$	$RP > EMV^{**}$	Lease
	$RP < OSP$	$RP < EMV$	Sale with right of return
* Excluding sale-leaseback transactions.			
** If significant; otherwise, account for as a sale with a right of return.			

Customer options for additional goods or services

An entity that sells goods or services may also provide customers with options to acquire additional goods or services for free or at a discount, for example, sales incentives, award credits or points, and renewal options. Under ASC 606, such options are a performance obligation only if they represent a “material right.” The following options would not be material rights:

- A discount or other right that the customer could receive without entering into the contract
- A discount that is no more than the range of discounts typically given for those goods or services to that class of customers in that geographical area or market
- An option to acquire an additional good or service at a price that reflects the stand-alone selling price for that good or service

If a customer option is a material right, then the entity allocates part of the transaction price to that performance obligation on a relative stand-alone selling price basis. If the stand-alone selling price is not directly observable, as is often the case, it must be estimated. The estimate should reflect the discount the customer will obtain when exercising the option, adjusted for

- Any discount that the customer could receive without exercising the option
- The likelihood that the option will be exercised

Revenue allocated to customer options is recognized when the options either are exercised or expire.

ASC 606 also provides a practical expedient that applies to some customer rights to renew a contract on pre-agreed terms. In such cases the entity is permitted to allocate the transaction price to the optional goods or services by reference to the goods or services expected to be provided and the corresponding expected consideration.

F. Presentation and disclosure

Presentation

Under ASC 606, an entity presents a contract in its statement of financial position as a contract liability, a contract asset, or a receivable, depending on the relationship between the entity's performance and the customer's performance at the reporting date.

An entity should present a contract as a contract liability if the customer has paid consideration, or if payment is due as of the reporting date but the entity has not yet satisfied a performance obligation by transferring a good or service. Conversely, if the entity has transferred goods or services as of the reporting date but the customer has not yet paid, the entity should recognize either a contract asset or a receivable. An entity should recognize a contract asset if its right to consideration is conditioned on something other than the passage of time; otherwise, an entity should recognize a receivable.

Disclosure

ASC 606 requires many new disclosures about contracts with customers and presents an overall disclosure objective. The disclosure objective requires an entity to present sufficient information for users of the financial statements to understand the nature, amount, timing and uncertainty of revenue and the related cash flows. The following table provides a summary of the disclosures required for public entities for each period a statement of comprehensive income and statement of financial position are presented.

Disclosure area	Summary of requirements
Disaggregation of revenue	<ul style="list-style-type: none"> • Revenue from contracts with customers disclosed separately from other sources of revenue (if not separately presented) • Categories that depict how the nature, amount, timing, and uncertainty of revenue and cash flows* • Sufficient information to enable users of financial statements to understand the relationship with revenue information disclosed for reportable segments under ASC 280, <i>Segment Reporting</i>*

Disclosure area	Summary of requirements
Contract balances	<ul style="list-style-type: none"> • Opening and closing balances of contract assets, contract liabilities, and receivables (if not separately presented)* • Revenue recognized in the period that was included in opening contract liabilities and from performance obligations either wholly or partially satisfied in prior periods* • Explanation of relationship between timing of satisfying performance obligations and payment, and the effect on contract assets and contract liabilities* • Significant changes in the balances of contract assets and contract liabilities* • Impairment losses presented separately from those losses on other contracts
Performance obligations	<ul style="list-style-type: none"> • When the entity typically satisfies performance obligations • Significant payment terms • Nature of goods and services • Obligations for returns, refunds, and similar terms • Types of warranties and related obligations • Aggregate amount of transaction price allocated to remaining performance obligations at end of period, including partially satisfied performance obligations and when amounts are expected to be recognized as revenue*
Significant judgments and changes in judgments	<p>Significant judgments used to determine both of the following:</p> <ul style="list-style-type: none"> • Expected timing of satisfying performance obligations • The transaction price and amounts allocated to performance obligations, including methods, inputs, and assumptions
Assets recognized from the costs to obtain or fulfill a contract	<ul style="list-style-type: none"> • Judgments made in determining costs capitalized* • Amortization method used* • Closing balances by main category and amortization expense*

Disclosure area	Summary of requirements
* Disclosure is optional for private entities.	

G. Effective date and transition

ASC 606 is effective for public entities, as defined, for annual reporting periods beginning on or after December 15, 2016. Early adoption is not permitted for public entities. The effective date for all other entities is deferred for one year to annual reporting periods beginning after December 15, 2017 and to interim periods in annual reporting periods beginning after December 15, 2018. Nonpublic entities may elect to early adopt the guidance as follows:

- Fiscal years, and interim periods within those years, beginning after December 15, 2016
- Fiscal years beginning after December 15, 2016 and interim periods in fiscal years beginning after December 15, 2017
- Fiscal years, and interim periods within those years, beginning after December 15, 2017

IFRS 15 allows early adoption for all entities.

Entities are permitted to apply the guidance in ASC 606 using one of the following two methods:

- Retrospectively to each prior period presented in accordance with ASC 250, subject to certain practical expedients
- Retrospectively with a cumulative effect adjustment to opening retained earnings in the period of initial adoption. If applying this transition method, an entity should apply the new revenue recognition guidance only to contracts not completed under existing U.S. GAAP at the date of adoption.

An entity that chooses to apply the cumulative effect transition method should not restate comparative years; however, it is required to provide the following additional disclosures in the initial year of adoption:

- By financial statement line item, the current-year impact of applying the new revenue standard
- An explanation of the significant changes between the reported results under legacy U.S. GAAP and the new revenue standard

H. Comparison with IFRS

The new guidance aligns substantially with the guidance in IFRS 15. The principal differences between U.S. GAAP and IFRS are

- In determining if it is probable that an entity will collect the consideration it is entitled to in exchange for the goods or services that will be transferred to the customer, the term *probable* means “likely to occur” under U.S. GAAP and “more likely than not” under IFRS.
- IAS 34, *Interim Financial Reporting*, is amended to require disclosure of disaggregated information of revenue from contracts with customers in interim financial statements. U.S. GAAP requires similar disclosure on an interim basis for public entities, along with requirements to disclose information about both contract balances and remaining performance obligations.

- Early adoption is available under IFRS.
 - The reversal of an impairment loss on an asset that is recognized as costs to obtain or fulfill a contract is not permitted under U.S. GAAP but required under IFRS under IAS 36, *Impairment of Assets*.
 - U.S. GAAP includes specific relief for nonpublic entities related to disclosure, transition, and effective date, while IFRS does not include such guidance.
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