Instructions

This practice aid is intended to help auditors perform auditing procedures while considering the requirements of FASB’s Topic ASC 606, *Revenue from Contracts with Customers*, and meeting the requirements of AU-C 540, *Auditing Accounting Estimates, Including Fair Value Accounting Estimates*. This publication is an “other auditing publication” as defined in AU-C 200B, *Overall Objectives of the Independent Auditor and the Conduct of an Audit in Accordance With Generally Accepted Auditing Standards* (AICPA, Professional Standards). Other auditing publications have no authoritative status; however, they may help you, as an auditor, understand and apply certain auditing standards.

In applying the auditing guidance included in an “other auditing publication,” the auditor should, exercising professional judgment, assess the relevance and appropriateness of such guidance to the circumstances of the audit. The AICPA® Audit and Attest Standards staff reviewed auditing guidance in this document, the AICPA published it and it’s presumed to be appropriate. This document has not been approved, disapproved or otherwise acted on by any AICPA senior technical committee.

There are five steps to FASB’s Topic ASC 606. This document lays out the five-step model. For each step, the document lists potential risks of material misstatement (RMM), processes where the client should have established controls and examples of audit procedures to address the RMM. This aid should be used as a guide when obtaining an understanding of the client’s procedures around developing accounting estimates related to revenue from contracts with customers.
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<tr>
<th>Model step:</th>
<th>Potential RMM</th>
<th>Controls over:</th>
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<tbody>
<tr>
<td>1. Identify the contract with a customer.</td>
<td>• Revenue is/is not recognized when a contract (as defined by ASC 606) does/not exist. • Side agreements exist that are not known to accounting personnel.</td>
<td>• Identifying contracts (whether written or unwritten) that meet the criteria defined by the standard • Reassessing arrangements not initially meeting the criteria of a contract in accordance with ASC 606 as significant changes may occur in the underlying facts and circumstances • Assessing management’s and the customer’s commitment and ability to perform under the contract • Ensuring payment terms are properly considered • Assessing the collectability criterion • Evaluating whether combined or individual contracts meet the various criteria specified in ASC 606 • Evaluating contract modifications</td>
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<td>2. Identify the performance obligations.</td>
<td>• Performance obligations are not properly identified.</td>
<td>• Identifying performance obligations, including those explicitly stated in the contract and those that may be implied based on customary business practices • Evaluating whether a promised good or service is distinct, particularly within the context of the contract • Evaluating whether a series of goods or services should be treated as a single performance obligation</td>
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Example audit procedures:

- Perform procedures to identify how management enters into contracts and, when needed, modifies contractual terms.
- Evaluate management’s collectability estimation.

- Determine if the promises are capable of being distinct and distinct within the context of the contract based on accounting literature.
- Identify explicit or implicit promised goods or services in the contract.
### Model step: 3. Determine the transaction price.

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| • Management’s estimates are inaccurate as a result of an inappropriate method or inappropriate significant assumptions. | • Estimating the amount to which the entity expects to be entitled (that is, the transaction price), including any variable consideration. When valuation consultants are hired, it is normally expected that controls are in place to ensure their competence and objectivity.  
  • Evaluating whether any portion of variable consideration should be constrained  
  • Determining the fair value of noncash consideration  
  • Identifying and measuring whether there is a significant financing component in the contract  
  • Determining the accounting for consideration payable to a customer |

**Example audit procedures:**
- Develop estimate for transaction price using information and assumptions available and compare with management’s estimates.
- Determine whether events occurring up to the date of the auditor’s report provide evidence for the accounting estimate.
- Test how management made the accounting estimate and the data on which it is based.
- Test the operating effectiveness of the controls over how management made the accounting estimate, together with substantive procedures.

### Model step: 4. Allocate the transaction price.

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| • Management’s estimates are inaccurate as a result of an inappropriate method or inappropriate significant assumptions. | • Estimating the standalone selling price, including maximizing the use of observable inputs in that process  
  • Determining the appropriate transaction price allocation, including variable consideration and discounts |

**Example audit procedures:**
- Develop estimate for transaction price using information and assumptions available and compare with management’s estimates.
- Determine whether events occurring up to the date of the auditor’s report provide evidence regarding the accounting estimate.
- Test how management made the accounting estimate and the data on which it is based.
- Test the operating effectiveness of the controls over how management made the accounting estimate, together with substantive procedures.
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<td>5. Recognize revenue when (or as) performance obligations are satisfied.</td>
<td>• Revenue is recognized before the performance obligation is satisfied.</td>
<td>• Determining whether performance obligations are satisfied at a point in time or over time</td>
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<td>• Measuring progress toward complete satisfaction of a performance obligation that is satisfied over time (that is, the input and output methods)</td>
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<td>• Recognizing revenue only when (or as) control is transferred to the customer</td>
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Example audit procedures:
- Evaluate management’s method used to measure the progress.
- Evaluate the reliability of the data used to develop the accounting estimate(s).