

Financial Reporting Brief: Roadmap to Understanding the New Revenue Recognition Standards



In May 2014, FASB issued Accounting Standards Update (ASU) 2014-09, *Revenue from Contracts with Customers* (Topic 606), and the International Accounting Standards Board (IASB) issued International Financial Reporting Standards (IFRS) 15, *Revenue from Contracts with Customers*. FASB and the IASB have basically achieved convergence with these standards, with only some minor differences that will be discussed later in this brief. FASB ASU No. 2014-09 will amend FASB Accounting Standards Codification® (ASC) by creating Topic 606, *Revenue from Contracts with Customers* and Subtopic 340-40, *Other Assets and Deferred Costs—Contracts with Customers*.

The FASB also issued the following amendments to ASU No. 2014-09 to provide clarification on the guidance:

- ASU No. 2015-14, *Revenue from Contracts with Customers (Topic 606) – Deferral of the Effective Date*
- ASU No. 2016-08, *Revenue from Contracts with Customers (Topic 606) – Principal versus Agent Considerations (Reporting Revenue Gross Versus Net)*
- ASU No. 2016-10, *Revenue from Contracts with Customers (Topic 606) – Identifying Performance Obligations and Licensing*
- ASU No. 2016-12, *Revenue from Contracts with Customers (Topic 606) – Narrow-Scope Improvements and Practical Expedients*

Public entities¹ are required to adopt the revenue recognition standards for reporting periods beginning after December 15, 2017, and interim and annual reporting periods thereafter (which equates to January 1, 2018 for public entities with a December 31 year-end). Earlier application would be permitted only as of annual reporting periods beginning after December 15, 2016, including interim reporting periods within that reporting period.

All other entities are required to apply the revenue recognition standard for annual reporting periods beginning on or after December 15, 2018, and interim reporting periods within annual reporting periods beginning after December 15, 2019. Application would be permitted earlier only as of an annual reporting period beginning after December 15, 2016, including interim reporting periods within that reporting period, or an annual reporting period beginning after December 15, 2016, and interim reporting

¹ A public entity is an entity that is any one of the following:

1. A public business entity
2. A not-for-profit entity that has issued, or is a conduit bond obligor for, securities that are traded, listed, or quoted on an exchange or an over-the-counter market
3. An employee benefit plan that files or furnishes financial statements to the SEC

periods within annual reporting periods beginning one year after the annual reporting period in which an entity first applies the guidance in ASU No. 2014-09.

This document reorganizes the guidance contained in Topic 606, to follow the five-step revenue recognition model along with other guidance impacted by this standard. Additionally, it provides references to applicable examples in the implementation guidance.

Scope—Who Should Apply the Guidance

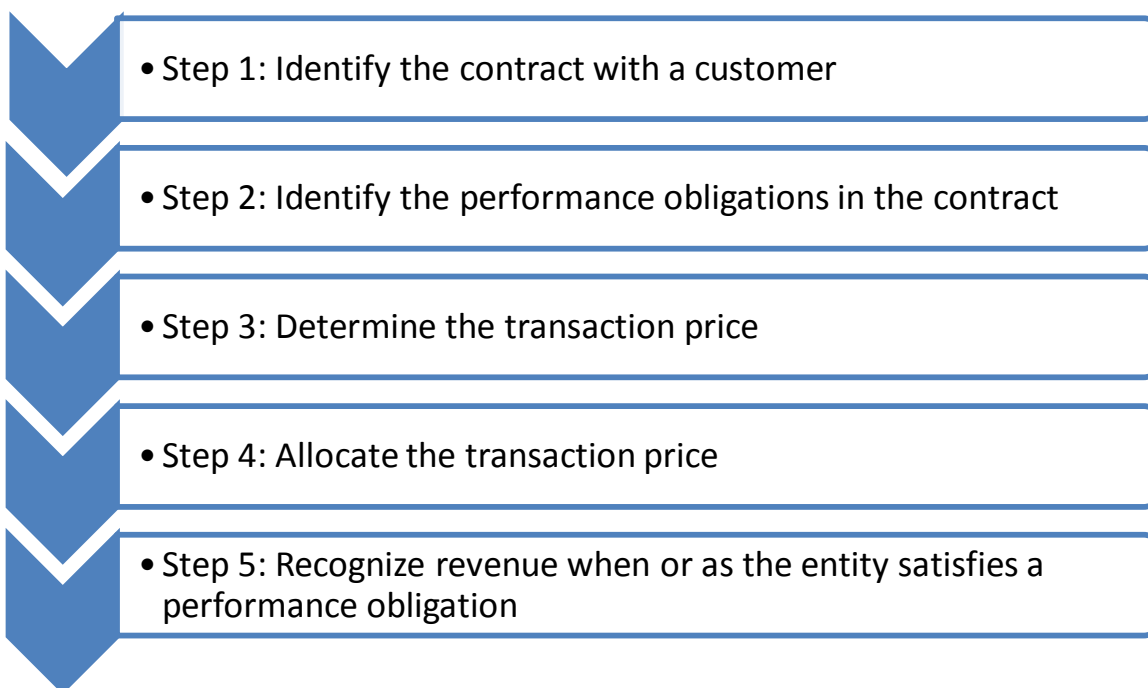
FASB ASC 606-10-15-2 through 15-4

The revenue recognition standard affects all entities—public, private, and not-for-profit—that either enters into contracts with customers to transfer goods or services or enters into contracts for the transfer of nonfinancial assets unless those contracts are within the scope of other standards (for example: leases and insurance contracts). 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 or potential customers are also scoped out.

The core principle of Topic 606 is that an entity should recognize revenue to depict the transfer of goods or services to customers in an amount that reflects the consideration to which the entity expects to be entitled in exchange for those goods or services.

FASB ASC 606-10-05-3 through 05-4 and 606-10-10-2 through 10-4

The revenue recognition standard explains that To achieve the core principle of Topic 606, an entity should take the following actions:



Revenue is recognized when a company satisfies a performance obligation by transferring a promised good or service to a customer (which is when the customer obtains control of that good or service).

An entity should consider the terms of the contract and all relevant facts and circumstances when applying the revenue recognition standard. An entity should apply the revenue recognition standard, including the use of any practical expedients, consistently to contracts with similar characteristics and in similar circumstances.

Practical Expedient: The revenue recognition standard prescribes accounting for an individual contract with a customer, but allows for application of the guidance to a portfolio of contracts (or performance obligations) with similar characteristics if the entity reasonably expects that the effects on the financial statements of applying this guidance to the portfolio would not differ materially from applying this guidance to the individual contracts (or performance obligations) within that portfolio.

Step 1: Identify the contract(s) with a customer (FASB ASC 606-10-25-1 through 25-8)

The revenue recognition standard prescribes that an entity should account for a contract with a customer that is within its scope only when all of the following criteria are met:

- a. The parties to the contract have approved the contract (in writing, orally, or in accordance with other customary business practices) and are committed to perform their respective obligations.
- b. The entity can identify each party's rights regarding the goods or services to be transferred.
- c. The entity can identify the payment terms for the goods or services to be transferred.
- d. The contract has commercial substance (that is, the risk, timing, or amount of the entity's future cash flows is expected to change as a result of the contract).
- e. It is probable that the entity will collect substantially all of the consideration to which it will be entitled in exchange for the goods or services that will be transferred to the customer (collectability threshold). In evaluating whether collectability of an amount of consideration is probable, an entity should consider only the customer's ability and intention to pay that amount of consideration when it is due. The amount of consideration to which the entity will be entitled may be less than the price stated in the contract if the consideration is variable because the entity may offer the customer a price concession.

The Contract

FASB ASC 606-10-25-2 through 25-8

A contract is an agreement between two or more parties that creates enforceable rights and obligations. Enforceability of the rights and obligations in the contract is a matter of law. Contracts can be written, oral, or implied by an entity's customary business practices. The practices and processes for establishing contracts with customers vary across legal jurisdictions, industries, and entities. In addition, they may vary within an entity (for example, they may depend on the class of customer or the nature of the promised goods or services). Those practices and processes should be considered in determining whether and when an agreement with a customer creates enforceable rights and obligations of the entity.

A contract does not exist if each party to the contract has the unilateral enforceable right to terminate a wholly unperformed contract without compensating the other party (parties). A contract is wholly unperformed if both of the following criteria are met:

- a. The entity has not yet transferred any promised goods or services to the customer.
- b. The entity has not yet received, and is not yet entitled to receive, any consideration in exchange for promised goods or services.

If a contract with a customer meets the criteria to be considered a contract under the revenue recognition standard at contract inception, those criteria should not be reassessed unless there is an indication of a significant change in facts and circumstances. If a contract with a customer does not meet the criteria to be considered a contract under the revenue recognition standard, the contract should continue to be assessed to determine whether the criteria are subsequently met.

When a contract with a customer does not meet the criteria to be considered a contract under the revenue recognition standard and consideration is received from the customer, the entity should recognize the consideration received as revenue only when one or more of the following events have occurred:

- a. The entity has no remaining obligations to transfer goods or services to the customer, and all, or substantially all, of the consideration promised by the customer has been received by the entity and is nonrefundable.
- b. The contract has been terminated, and the consideration received from the customer is nonrefundable.

- c. The entity has transferred control of the goods or services to which the consideration that has been received relates, the entity has stopped transferring goods or services to the customer (if applicable) and has no obligation under the contract to transfer additional goods or services, and the consideration received from the customer is nonrefundable.

Consideration received from the customer should be recognized as a liability until one of the events above occurs or until the contract meets the criteria to be considered a contract with a customer under the revenue recognition standard are subsequently met. Depending on the facts and circumstances relating to the contract, the liability recognized represents the entity's obligation to either transfer goods or services in the future or refund the consideration received. In either case, the liability should be measured at the amount of consideration received from the customer.

Collectability Threshold

FASB ASC 606-10-25-1(e) and 606-10-55-3(a) through 55-3(c)

One of the required criteria in FASB ASC 606-10-25-1 is that it be probable that the entity will collect substantially all of the consideration to which it will be entitled in exchange for the goods or services that will be transferred to the customer to be considered a contract with a customer.

FASB ASC 606-10-25-3 explains that in evaluating the criterion in FASB ASC 606-10-25-1(e), an entity should assess the collectability of the consideration promised in a contract for the goods or services that will be transferred to the customer rather than assessing the collectability of the consideration promised in a contract for all of the promised goods or services (see 606-10-55-3(a) through 55-3(c)).

Difference with IFRS: Collectability Threshold

The collectability threshold is probable under both GAAP and IFRS 15 because that is similar to current guidance under each of the frameworks. It should be noted that in GAAP, probable is defined as "likely to occur" while it is defined in some IFRSs as "more likely than not." This is one of the differences between the standards.

Probable, as defined under GAAP, is a slightly higher threshold as compared to IFRS; this may mean there will be differences between what is considered a contract with a customer under the two revenue recognition standards.

For additional information, see example 1: Collectability of the Consideration in FASB ASC 606-10-55-95 through 55-98.

Combination of Contracts

FASB ASC 606-10-25-9

Two or more contracts entered into at or near the same time with the same customer (or related parties of the customer) should be combined and accounted for as a single contract if one or more of the following criteria are met:

- The contracts are negotiated as a package with a single commercial objective.
- The amount of consideration to be paid in one contract depends on the other price or performance of the other contract.
- The goods and services promised in the contracts (or some goods or services promised in the contracts) are a single performance obligation, in accordance with the standard.

Contract Modifications

FASB ASC 606-10-25-10 through 25-13

A contract modification is a change in the scope or price of a contract (or both) that is approved by the parties to the contract (sometimes called a change order, a variation, or an amendment). A contract modification exists when the parties to a contract approve a modification that either creates new or changes existing enforceable rights and obligations of the parties to the contract. A contract modification could be approved in writing, orally, or implied by customary business practice. If the parties to a contract have not approved a contract modification, an entity should continue to apply the guidance in the Standard to the existing contract until the contract modification is approved.

A contract modification may exist even though the parties to the contract have a dispute about the scope or price (or both) of the modifications or the parties have approved a change in the scope of the contract but have not yet determined the corresponding change in price. In determining whether the rights or obligations that are created or changed by a modification are enforceable, an entity should consider all relevant facts and circumstances including the terms of the contract and other evidence.

If the parties to a contract have approved a change in the scope of the contract but have not yet determined the corresponding changes in price, an entity should estimate the change to the transaction price arising from the modification in accordance with the guidance on estimating variable consideration and constraining estimates of variable consideration.

An entity should account for a contract modification as a separate contract if both of the following conditions are present:

- a. The scope of the contract increases because the addition of promised goods or services that are distinct.
- b. The price of the contracts increases by an amount of consideration that reflects the entity's standalone selling prices of the additional promised goods or services and any appropriate adjustments to that price to reflect the circumstances of the particular contract. For example, an entity may adjust the standalone selling price of an additional good or service for a discount that the customer receives, because it is not necessary for the entity to incur the selling-related costs that it would incur when selling a similar good or service to a new customer.

If a contract modification is not accounted for as a separate contract (if both of the conditions above are not met), an entity should account for the promised goods or services not yet transferred at the date of the contract modification (that is, the remaining promised goods or services) in whichever of the following ways is applicable:

- a. Account for the contract modification as if it were a termination of the existing contract, and the creation of a new contract, if the remaining goods and services are distinct from the goods or services transferred on or before the date of the contract modification. The amount of consideration to be allocated to the remaining performance obligations (or to the remaining distinct goods or services in a single performance obligation) is the sum of:
 1. The consideration promised by the customer (including amounts already received from the customer) that was included in the estimate of the transaction price and that had not been recognized as revenue and
 2. The consideration promised as part of the contract modification.
- b. Account for the contract modification as if it were a part of the existing contract if the remaining goods or services are not distinct and, therefore, form part of a single performance obligation that is partially satisfied at the date of the contract modification. The effect that the contract modification has on the transaction price, and on the entity's measure of progress toward complete satisfaction of the performance obligation, is recognized as an adjustment to revenue (either as an increase in or a reduction of revenue) at the date of the contract modification (that is, the adjustment to revenue is made on a cumulative catch-up basis).
- c. If the remaining goods or services are a combination of items (a) and (b), account for the effects of the modification on the unsatisfied (including partially unsatisfied) performance obligations in the modified contract in a manner that is consistent with the objectives of this paragraph.

FASB ASC 606-10-65-1(f)4 provides a practical expedient for contract modifications at transition that permits an entity to reflect the aggregate effect of all modifications that occur before the beginning of the earliest period presented in accordance with Topic 606 when identifying the satisfied and unsatisfied performance obligations, determining the transaction price, and allocating the transaction price to the satisfied and unsatisfied performance obligations.

For additional information see the following examples:

- Example 5 - Modification of a Contract for Goods in FASB ASC 606-10-55-111 through 55-116,
- Example 6 – Change in the Transaction Price after a Contract Modification in FASB ASC 606-10-55-117 through 55-124,
- Example 7 – Modification of a Services Contract in FASB ASC 606-10-55-125 through 55-128,
- Example 8 – Modification Resulting in a Cumulative Catch-Up Adjustment to Revenue in FASB ASC 606-10-55-129 through 55-133, and
- Example 9 – Unapproved Change in Scope and Price in FASB ASC 606-10-55-134 through 55-135.

The revenue recognition standard defines a *performance obligation* as a promise in a contract with a customer to transfer a good or service to the customer.

At contract inception, an entity should assess the goods or services promised in a contract with a customer and should identify as a performance obligation (could be multiple performance obligations) each promise to transfer to the customer either:

- a. A good or service (or bundle of goods or services) that is distinct
- b. A series of distinct goods or services that are substantially the same and that have the same pattern of transfer to the customer.

A good or service that is not distinct should be combined with other promised goods or services until the entity identifies a bundle of goods or services that is distinct. In some cases, that would result in the entity accounting for all the goods or services promised in a contract as a single performance obligation.

Distinct Goods or Services

FASB ASC 606-10-25-19 through 25-22

A good or service is distinct if both of the following criteria are met:

- a. Capable of being distinct—The customer can benefit from the good or service either on its own or together with other resources that are readily available to the customer.
- b. Distinct within the context of the contract—The entity's promise to transfer the good or service is separately identifiable from other promises in the contract.

Capable of being distinct. A customer can benefit from a good or service if the good or service could be used, consumed, sold for an amount that is greater than scrap value, or otherwise held in a way that generates economic benefits. For some goods or services, a customer may be able to benefit from a good or service on its own. For other goods or services, a customer may be able to benefit from the good or service only in conjunction with other readily available resources. A readily available resource is a good or service that is sold separately (by the entity or another entity) or a resource that the customer has already obtained from the entity (including goods or services that the entity will have already transferred to the customer under the contract) or from other transactions or events. Various factors may provide evidence that the customer can benefit from a good or service either on its own or in conjunction with other readily available resources. For example, the fact that the entity regularly sells a good or service separately would indicate that a customer can benefit from the good or service on its own or with other readily available resources.

Distinct within the context of the contract. Factors that indicate that two or more promises to transfer a good or service to a customer are not separately identifiable include, but are not limited to, the following:

The entity provides a significant service of integrating the good or service with other goods or services promised in the contract into a bundle of goods or services that represent the combined output for which the customer has contracted. In other words, the entity is using the goods or services as inputs to produce or deliver the combined output or outputs specified by the customer. A combined output or outputs might include more than one phase, element, or unit. One or more of the goods or services significantly modifies or customizes or are significantly modified or customized by one or more of the other goods or services promised in the contract.

- a. The goods or services are highly interdependent or highly interrelated. In other words, each of the goods or services is significantly affected by one or more of the other goods or services in the contract. For example, in some cases, two or more goods or services are significantly affected by each other because the entity would not be able to fulfill its promise by transferring each of the goods or services independently.

Series of Distinct Goods or Services

FASB ASC 606-10-25-15

A series of distinct goods or services has the same pattern of transfer to the customer if both of the following criteria are met:

- a. Each distinct good or service in the series that the entity promises to transfer to the customer would meet the criteria to be a performance obligation over time.
- b. The same method would be used to measure the entity's progress toward complete satisfaction of the performance obligation to transfer each distinct good or service in the series to the customer.

Promises in Contracts with Customers

FASB ASC 606-10-25-16 through 25-18

A contract with a customer generally explicitly states the goods or services that an entity promises to transfer to a customer. However, the promised goods or services identified in a contract with a customer may not be limited to the goods or services explicitly stated in that contract. This is because a contract with a customer may also include promises implied by an entity's customary business practices, published policies, or specific statements if those promises create a reasonable expectation of the customer that the entity will transfer a good or service to the customer. Performance obligations do not include activities that an entity must undertake to fulfill a contract unless the entity will transfer a good or service to the customer. For example, a services provider may need to perform various administrative tasks to set up a contract. The performance of those tasks does not transfer a service to the customer as the tasks are performed. Therefore, those setup activities are not a performance obligation.

FASB ASC 606-10-25-16(A) states that entities are not required to assess whether promised goods or services are performance obligations, if they are immaterial in the context of the contract with the customer. If the revenue related to a performance obligation that includes goods or services that are immaterial in the context of the contract is recognized before those immaterial goods or services are transferred to the customer, then the related costs to transfer those goods or services should be accrued. This does not apply to a customer option to acquire additional goods or services that provides the customer with a material right.

Depending on the contract, promised goods or services may include, but are not limited to, the following:

- a. Sale of goods produced by an entity (for example, inventory of a manufacturer)
- b. Resale of goods purchased by an entity (for example, merchandise of a retailer)
- c. Resale of rights to goods or services purchased by an entity (for example, a ticket resold by an entity acting as a principal, as described in FASB ASC 606-10-55-36 through 55-40)
- d. Performing a contractually agreed-upon task (or tasks) for a customer
- e. Providing a service of standing ready to provide goods or services (for example, unspecified updates to software that are provided on a when-and-if-available basis) or of making goods or services available for a customer to use as and when the customer decides
- f. Providing a service of arranging for another party to transfer goods or services to a customer (for example, acting as an agent of another party, as described in FASB ASC 606-10-55-36 through 55-40)
- g. Granting rights to goods or services to be provided in the future that a customer can resell or provide to its customer (for example, an entity selling a product to a retailer promises to transfer an additional good or service to an individual who purchases the product from the retailer)
- h. Constructing, manufacturing, or developing an asset on behalf of a customer
- i. Granting licenses (see FASB ASC 606-10-55-54 through 55-65)
- j. Granting options to purchase additional goods or services (when those options provide a customer with a material right, as described in FASB ASC 606-10-55-41 through 55-45)

An entity that promises a good to a customer also might perform shipping and handling activities related to that good. If the shipping and handling activities are performed before the customer obtains control of the good, then the shipping activities are not a promised service to the customer. Rather, shipping and handling are activities to fulfill the entity's promise to transfer the good.

If the shipping and handling activities are performed after a customer obtains control of the good, then the entity may elect to account for shipping and handling as activities to fulfill the promise to transfer the good. The entity should apply this accounting policy election consistently to similar types of transactions. An entity that makes this election would not evaluate whether shipping and handling activities are promised services to its customers. If revenue is recognized for the related good before the shipping and handling activities occur, the related costs of those shipping and handling activities should be accrued. An entity should disclose this accounting policy election.

For additional information see the following examples:

- Example 10 – Goods and Services Are Not Distinct in FASB ASC 606-10-55-136 through 55-140
- Example 11 – Determining Whether Goods or Services Are Distinct in FASB ASC 606-10-55-141 through 55-150

- Example 12 – Explicit and Implicit Promises in a Contract in FASB ASC 606-10-55-151 through 55-157

Step 3: Determine the Transaction Price (FASB ASC 606-10-32-2 through 32-27)

The revenue recognition standard states that the transaction price is the amount of consideration (for example, payment) to which an entity expects to be entitled in exchange for transferring promised goods or services to a customer, excluding amounts collected on behalf of third parties (for example, some sales taxes). To determine the transaction price, an entity should consider the effects of

- variable consideration,
- constraining estimates of variable consideration,
- the existence of a significant financing component,
- noncash considerations, and
- consideration payable to the customer.

An entity should consider the terms of the contract and its customary business practices to determine the transaction price.

FASB ASC 606-10-32-2(A), allows an entity to make an accounting policy election to exclude from the measurement of the transaction price all taxes assessed by a governmental authority that are both imposed on and concurrent with a specific revenue producing transaction and collected by the entity from a customer (for example, sales, use, value added, and some excise taxes). Taxes assessed on an entity's total gross receipts or imposed during the inventory procurement process should be excluded from the scope of the election. An entity that makes this election should exclude from the transaction price all taxes in the scope of the election and should comply with the applicable accounting policy guidance, including the disclosure requirements in FASB ASC 235-10-50-1 through 50-6.

For purposes of determining the transaction price, an entity should assume that the goods or services will be transferred to the customer as promised in accordance with the existing contract and that the contract will not be cancelled, renewed, or modified.

Variable Consideration

FASB ASC 606-10-32-5 through 32-9

If the consideration promised in a contract includes a variable amount, an entity should estimate the amount of consideration to which the entity will be entitled in exchange for transferring the promised goods or services to a customer.

Consideration can vary because of discounts, rebates, refunds, credits, price concessions, incentives, performance bonuses, penalties, or other similar items. The promised consideration also can vary if an entity's entitlement to the consideration is contingent on the occurrence or nonoccurrence of a future event. For example, an amount of consideration would be variable if either a product was sold with a right of return or a fixed amount is promised as a performance bonus on achievement of a specified milestone.

The variability relating to the consideration promised by a customer may be explicitly stated in the contract. In addition to the terms of the contract, the promised consideration is variable if either of the following circumstances exists:

- The customer has a valid expectation arising from an entity's customary business practices, published policies, or specific statements that the entity will accept an amount of consideration that is less than the price stated in the contract. That is, it is expected that the entity will offer a price concession. Depending on the jurisdiction, industry, or customer this offer may be referred to as a discount, rebate, refund, or credit.
- Other facts and circumstances indicate that the entity's intention, when entering into the contract with the customer, is to offer a price concession to the customer.

The amount of variable consideration should be estimated by using either of the following methods, depending on which method the entity expects to better predict the amount of consideration to which it will be entitled:

- a. The expected value—the sum of probability-weighted amounts in a range of possible consideration amounts. An expected value may be an appropriate estimate of the amount of variable consideration if an entity has a large number of contracts with similar characteristics.
- b. The most likely amount—the single most likely amount in a range of possible consideration amounts (that is, the single most likely outcome of the contract). The most likely amount may be an appropriate estimate of the amount of variable consideration if the contract has only two possible outcomes (for example, an entity either achieves a performance bonus or does not).

An entity should apply one method consistently throughout the contract when estimating the effect of an uncertainty on an amount of variable consideration to which the entity will be entitled. Also an entity should consider all the information (historical, current, and forecast) that is reasonably available to the entity and identify a reasonable number of possible consideration amounts. The information that an entity uses to estimate the amount of variable consideration typically would be similar to the information that the entity's management uses during the bid-and-proposal process and in establishing prices for promised goods or services.

For additional information see the following examples:

- Example 2 – Consideration Is Not the Stated Price in FASB ASC 606-10-55-99 through 55-101
- Example 3 – Implicit Price Concession in FASB ASC 606-10-55-102 through 55-105
- Example 20 – Penalty Gives Rise to Variable Consideration in FASB ASC 606-10-55-194 through 55-196
- Example 21 – Estimating Variable Consideration in FASB ASC 606-10-55-197 through 55-200

Constraining Estimates of Variable Consideration

FASB ASC 606-10-32-11 through 32-13

An entity should include in the transaction price some or all of an amount of variable consideration only to the extent that it is probable that a significant reversal in the amount of cumulative revenue recognized will not occur when the uncertainty associated with the variable consideration is subsequently resolved.

In assessing such probability, an entity should consider both the likelihood and the magnitude of the revenue reversal. Factors that could increase the likelihood or the magnitude of a revenue reversal include, but are not limited to, any of the following:

- a. The amount of consideration is highly susceptible to factors outside the entity's influence. Those factors may include volatility in a market, the judgment or actions of third parties, weather conditions, and a high risk of obsolescence of the promised good or service.
- b. The uncertainty about the amount of consideration is not expected to be resolved for a long period of time.
- c. The entity's experience (or other evidence) with similar types of contracts is limited, or that experience (or other evidence) has limited predictive value.
- d. The entity has a practice of either offering a broad range of price concessions or changing the payment terms and conditions of similar contracts in similar circumstances.
- e. The contract has a large number and broad range of possible consideration amounts.

At the end of each reporting period, the estimated transaction price (including updating its assessment of whether an estimate of variable consideration is constrained) should be updated to represent faithfully the circumstances present at the end of the reporting period and the changes in circumstances during the reporting period. The entity should account for changes in the transaction price in accordance with FASB ASC 606-10-32-42 through 32-45.

For additional information see the following examples:

- Example 22 – Right of Return in FASB ASC 606-10-55-202 through 207
- Example 23 – Price Concessions in FASB ASC 606-10-55-208 through 55-215
- Example 24 – Volume Discount Incentive in FASB ASC 606-10-55-216 through 55-220
- Example 25 – Management Fees Subject to the Constraint in FASB ASC 606-10-55-221 through 55-225
- Example 26 – Significant Financing Component and Right of Return in FASB ASC 606-10-55-227 through 55-232

Sales-Based or Usage-Based Royalty Exception

FASB ASC 606-10-55-65

Consideration in the form of a sales-based or usage-based royalty that is promised in exchange for a license of intellectual property is an exception to the guidance for constraints on variable consideration. An entity should recognize revenue for a sales-based or usage-based royalty promised in exchange for a license of intellectual property *only* when (or as) the later of the following events occurs:

- a. The subsequent sale or usage occurs.
- b. The performance obligation to which some or all of the sales-based or usage-based royalty has been allocated has been satisfied (or partially satisfied).

FASB ASC 606-10-55-65(A) explains that the guidance for a sales-based or usage-based royalty applies when the royalty relates only to a license of intellectual property or when a license of intellectual property is the predominant item to which the royalty relates. For example, the license of intellectual property may be the predominant item to which the royalty relates when the entity has a reasonable expectation that the customer would ascribe significantly more value to the license than to the other goods or services to which the royalty relates.

When the guidance in FASB ASC 606-10-55-65(a) is met, revenue from a sales-based or usage-based royalty should be recognized in full in accordance with the guidance in FASB ASC 606-10-55-65. When this guidance is not met, the guidance in FASB ASC 606-10-32-5 through 32-14 applies to the sales-based or usage-based royalty.

For additional information, see example 4 – Reassessing the Criteria for Identifying a Contract in FASB ASC 606-10-55-106 through 55-109.

Refund Liability

FASB ASC 606-10-32-10 and 55-22 through 55-29

A refund liability should be recognized if the entity receives consideration from a customer and expects to refund some or all of that consideration to the customer. A refund liability is measured at the amount of consideration received (or receivable) for which the entity does not expect to be entitled (that is, amounts not included in the transaction price). The refund liability (and corresponding change in the transaction price and, therefore, the contract liability) should be updated at the end of each reporting period for changes in circumstances.

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 receive any combination of the following:

- a. A full or partial refund of any consideration paid
- b. A credit that can be applied against amounts owed, or that will be owed, to the entity
- c. Another product in exchange.

To account for the transfer of products with a right of return (and for some services that are provided subject to a refund), an entity should recognize all of the following:

- a. Revenue for the transferred products in the amount of consideration to which the entity expects to be entitled (therefore, revenue would not be recognized for the products expected to be returned)
- b. A refund liability
- c. An asset (and corresponding adjustment to cost of sales) for its right to recover products from customers on settling the refund liability

An entity's promise to stand ready to accept a returned product during the return period should not be accounted for as a performance obligation in addition to the obligation to provide a refund.

Contracts in which a customer may return a defective product in exchange for a functioning product should be evaluated in accordance with the guidance on warranties in FASB ASC 606-10-55-30 through 55-35.

FASB ASC 606-10-55-22 through 55-29 contains additional informational on how to account for a refund liability relating to a sale with a right of return in.

For additional information, see example 22 – Right of Return in FASB ASC 606-10-55-202 through 55-207.

Significant Financing Component

FASB ASC 606-10-32-15 through 32-20

In determining the transaction price, an entity should adjust the promised amount of consideration for the effects of the time value of money if the timing of payments agreed to by the parties to the contract (either explicitly or implicitly) provides the customer or the entity with a significant benefit of financing the transfer of goods or services to the customer. In those circumstances, the contract contains a significant financing component. A significant financing component may exist regardless of whether the promise of financing is explicitly stated in the contract or implied by the payment terms agreed to by the parties to the contract.

The objective when adjusting the promised amount of consideration for a significant financing component is to recognize revenue at an amount that reflects the price that a customer would have paid for the promised goods or services if the customer had paid cash for those goods or services when (or as) they transfer to the customer (that is, the cash selling price).

All relevant facts and circumstances should be considered in assessing whether a contract contains a financing component and whether that financing component is significant to the contract, including both of the following:

- a. The difference, if any, between the amount of promised consideration and the cash selling price of the promised goods or services
- b. The combined effect of both of the following:
 1. The expected length of time between when the entity transfers the promised goods or services to the customer and when the customer pays for those goods or services
 2. The prevailing interest rates in the relevant market

A contract with a customer would not have a significant financing component if any of the following factors exist:

- a. The customer paid for the goods or services in advance, and the timing of the transfer of those goods or services is at the discretion of the customer.
- b. A substantial amount of the consideration promised by the customer is variable, and the amount or timing of that consideration varies on the basis of the occurrence or nonoccurrence of a future event that is not substantially within the control of the customer or the entity (for example, if the consideration is a sales-based royalty).
- c. The difference between the promised consideration and the cash selling price of the good or service (as described in FASB ASC 606-10-32-16) arises for reasons other than the provision of finance to either the customer or the entity, and the difference between those amounts is proportional to the reason for the difference. For example, the payment terms might provide the entity or the customer with protection from the other party failing to adequately complete some or all of its obligations under the contract.

When adjusting the promised 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 its customer at contract inception. That rate would reflect the credit characteristics of the party receiving financing in the contract, as well as any collateral or security provided by the customer or the entity, including assets transferred in the contract. The entity may be able to determine that rate by identifying the rate that discounts the nominal amount of the promised consideration to the price that the customer would pay in cash for the goods or services when (or as) they transfer to the customer. After contract inception, the discount rate should not be updated for changes in interest rates or other circumstances (such as a change in the assessment of the customer's credit risk).

Practical Expedient: The promised amount of consideration does not need to be adjusted for the effects of a significant financing component if the entity expects, at contract inception, that the period between when the entity transfers a promised good or service to a customer and when the customer pays for that good or service will be one year or less.

The effects of financing (interest income or interest expense) should be presented separately from revenue from contracts with customers in the statement of comprehensive income (statement of activities). Interest income or interest expense is recognized only to the extent that a contract asset (or receivable) or a contract liability is recognized in accounting for a contract with a customer. In accounting for the effects of the time value of money, the following guidance should be considered:

- Subsequent measurement guidance in FASB ASC 835-30, specifically the guidance in FASB ASC 835-30-45-1A through 45-3 on presentation of the discount and premium in the financial statements
- Application of the interest method in FASB ASC 835-30-55-2 through 55-3

For additional information see the following examples:

- Example 26 – Significant Financing Component and Right of Return in FASB ASC 606-10-55-227 through 55-232
- Example 27 – Withheld Payments on a Long-Term Contract in FASB ASC 606-10-55-233 through 55-234

- Example 28 – Determining the Discount Rate in FASB ASC 606-10-55-236 through 55-239
- Example 29 – Advance Payment and Assessment of Discount Rate in FASB ASC 606-10-55-240 through 55-243
- Example 30 – Advance Payment in FASB ASC 606-10-55-244 through 55-246

Noncash Consideration

FASB ASC 606-10-32-21 through 32-24

To determine the transaction price for contracts in which a customer promises consideration in a form other than cash, an entity should measure the noncash consideration (or promise of noncash consideration) at fair value.

If the fair value of the noncash consideration cannot be reasonably estimated, the entity should measure the estimated fair value of noncash consideration at contract inception.

The fair value of a noncash consideration may vary after contract inception because of the form of consideration (for example, a change in the price of a share to which an entity is entitled to receive from a customer). Changes in the fair value of noncash consideration after contract inception that are due to the form of the consideration are not included in the transaction price. If the fair value of the noncash consideration promised by a customer varies for reasons other than the form of the consideration (for example, the exercise price of a share option changes because of the entity's performance), an entity should apply the guidance on variable consideration. If the fair value of the noncash consideration varies because of the form of the consideration and for reasons other than the form of the consideration, an entity should apply the guidance on variable consideration only to the variability resulting from reasons other than the form of the consideration.

If a customer contributes goods or services (for example, materials, equipment, or labor) to facilitate an entity's fulfillment of the contract, the entity should assess whether it obtains control of those contributed goods or services. If so, it should account for the contributed goods or services as noncash consideration received from the customer.

For additional information, see example 31 – Entitlement to Noncash Consideration in FASB ASC 606-10-55-248 through 55-250.

Consideration Payable to a Customer

FASB ASC 606-10-32-25 through 32-27

The consideration payable to a customer should be accounted for as a reduction of the transaction price and, therefore, of revenue unless the payment to the customer is in exchange for a distinct good or service (as described in FASB ASC 606-10-25-18 through 25-22) that the customer transfers to the entity. If the consideration payable to a customer includes a variable amount, an entity should estimate the transaction price (including assessing whether the estimate of variable consideration is constrained) in accordance with guidance on variable consideration.

Consideration payable to a customer includes cash amounts that an entity pays, or expects to pay, to the customer (or to other parties that purchase the entity's goods or services from the customer). Consideration payable to a customer also includes credit or other items (for example, a coupon or voucher) that can be applied against amounts owed to the entity (or to other parties that purchase the entity's goods or services from the customer).

If consideration payable to a customer is a payment for a distinct good or service from the customer, then an entity should account for the purchase of the good or service in the same way that it accounts for other purchases from suppliers. If the amount of consideration payable to the customer exceeds the fair value of the distinct good or service that the entity receives from the customer, then the entity should account for such an excess as a reduction of the transaction price. If the entity cannot reasonably estimate the fair value of the good or service received from the customer, it should account for all of the consideration payable to the customer as a reduction of the transaction price.

Accordingly, if consideration payable to a customer is accounted for as a reduction of the transaction price, an entity should recognize the reduction of revenue when (or as) the later of either of the following events occurs:

- a. The entity recognizes revenue for the transfer of the related goods or services to the customer.
- b. The entity pays or promises to pay the consideration (even if the payment is conditional on a future event). That promise might be implied by the entity's customary business practices.

Step 4: Allocate the Transaction Price to the Performance Obligations (FASB ASC 606-10-32-28 through 32-41)

Allocating the Transaction Price to Separate Performance Obligations

FASB ASC 606-10-32-28 through 32-30

The revenue recognition standard states that if a contract has more than one performance obligation, an entity should allocate the transaction price to each separate performance obligation in an amount that depicts the amount of consideration to which the entity expects to be entitled in exchange for satisfying each separate performance obligation.

To allocate an appropriate amount of consideration to each performance obligation, an entity should determine the stand-alone selling price at contract inception of the distinct goods or services underlying each performance obligation. Sometimes, the transaction price includes a discount or variable consideration that relates entirely to one of the performance obligations in a contract. The requirements specify when an entity should allocate the discount or variable consideration to one (or some) performance obligation(s) rather than to all performance obligations in the contract.

An entity should allocate to the performance obligations in the contract any subsequent changes in the transaction price on the same basis as at contract inception. Amounts allocated to a satisfied performance obligation should be recognized as revenue, or as a reduction of revenue, in the period in which the transaction price changes.

Standalone Selling Price

FASB ASC 606-10-32-31 through 32-35

To allocate the transaction price to each performance obligation on a relative standalone selling price basis, an entity should determine the standalone selling price at contract inception of the distinct good or service underlying each performance obligation in the contract and allocate the transaction price in proportion to those standalone selling prices.

The standalone selling price is the price at which an entity would sell a promised good or service separately to a customer. The best evidence of a standalone selling price is the observable price of a good or service when the entity sells that good or service separately in similar circumstances and to similar customers. A contractually stated price or a list price for a good or service may be (but should not be presumed to be) the standalone selling price of that good or service.

If a standalone selling price is not directly observable, an entity should estimate it. When estimating a standalone selling price, an entity should consider all information (including market conditions, entity-specific factors, and information about the customer or class of customer) that is reasonably available to the entity and maximize the use of observable inputs and apply estimation methods consistently in similar circumstances.

The standard includes a list of suitable methods for estimating the standalone selling price of a good or service include, but are not limited to, the following:

- a. Adjusted market assessment approach—An entity could evaluate the market in which it sells goods or services and estimate the price that a customer in that market would be willing to pay for those goods or services. That approach also might include referring to prices from the entity's competitors for similar goods or services and adjusting those prices as necessary to reflect the entity's costs and margins.
- b. Expected cost plus a margin approach—An entity could forecast its expected costs of satisfying a performance obligation and then add an appropriate margin for that good or service.
- c. Residual approach—An entity may estimate the standalone selling price by reference to the total transaction price less the sum of the observable standalone selling prices of other goods or services promised in the contract. However, an entity may use a residual approach to estimate the standalone selling price of a good or service only if one of the following criteria is met:
 1. The entity sells the same good or service to different customers (at or near the same time) for a broad range of amounts (that is, the selling price is highly variable because a representative standalone selling price is not discernible from past transactions or other observable evidence).

2. The entity has not yet established a price for that good or service, and the good or service has not previously been sold on a standalone basis (that is, the selling price is uncertain).

A combination of methods may need to be used to estimate the standalone selling prices of the goods or services promised in the contract if two or more of those goods or services have highly variable or uncertain standalone selling prices. For example, an entity may use a residual approach to estimate the aggregate standalone selling price for those promised goods or services with highly variable or uncertain standalone selling prices and then use another method to estimate the standalone selling prices of the individual goods or services relative to that estimated aggregate standalone selling price determined by the residual approach. When an entity uses a combination of methods it should evaluate whether allocating the transaction price at those estimated standalone selling prices would be consistent with the allocation objective and the guidance on estimating standalone selling prices in the Standard.

For additional information see example 33 – Allocation Methodology in FASB ASC 606-10-55-256 through 55-260.

Allocation of a Discount

FASB ASC 606-10-32-36 through 32-38

A customer receives a discount for purchasing a bundle of goods or services if the sum of the standalone selling prices of those promised goods or services in the contract exceeds the promised consideration in a contract. Except when an entity has observable evidence (as discussed in the paragraph below) that the entire discount relates to only one or more, but not all, performance obligations in a contract, the entity should allocate a discount proportionately to all performance obligations in the contract. The proportionate allocation of the discount in those circumstances is a consequence of the entity allocating the transaction price to each performance obligation on the basis of the relative standalone selling prices of the underlying distinct goods or services.

A discount should be allocated entirely to one or more, but not all, performance obligations in the contract if all of the following criteria are met:

- a. The entity regularly sells each distinct good or service (or each bundle of distinct goods or services) in the contract on a standalone basis.
- b. The entity also regularly sells on a standalone basis a bundle (or bundles) of some of those distinct goods or services at a discount to the standalone selling prices of the goods or services in each bundle.
- c. The discount attributable to each bundle of goods or services described in (b) is substantially the same as the discount in the contract, and an analysis of the goods or services in each bundle provides observable evidence of the performance obligation (or performance obligations) to which the entire discount in the contract belongs.

If a discount is allocated entirely to one or more performance obligations in the contract, an entity should allocate the discount before using the residual approach to estimate the standalone selling price of a good or service.

For additional information, see example 34 – Allocating a Discount in FASB ASC 606-10-55-259 through 55-269.

Allocation of Variable Consideration

FASB ASC 606-10-32-39 through 32-41

Variable consideration that is promised in a contract may be attributable to the entire contract or to a specific part of the contract, such as either of the following:

- a. One or more, but not all, performance obligations in the contract (for example, a bonus may be contingent on an entity transferring a promised good or service within a specified period of time)
- b. One or more, but not all, distinct goods or services promised in a series of distinct goods or services that forms part of a single performance obligation (in accordance with FASB ASC 606-10-25-14(b)) (for example, the consideration promised for the second year of a two-year cleaning service contract will increase on the basis of movements in a specified inflation index)

A variable amount (and subsequent changes to that amount) should be allocated entirely to a performance obligation or to a distinct good or service that forms part of a single performance obligation in accordance with FASB ASC 606-10-25-14(b) if both of the following criteria are met:

- a. The terms of a variable payment relate specifically to the entity's efforts to satisfy the performance obligation or transfer the distinct good or service (or to a specific outcome from satisfying the performance obligation or transferring the distinct good or service).
- b. Allocating the variable amount of consideration entirely to the performance obligation or the distinct good or service is consistent with the overall objective for allocating the transaction price to performance obligations, when considering all of the performance obligations and payment terms in the contract.

If the variable consideration is not allocated entirely to a performance obligation or to a distinct good or service that forms part of a single performance obligation, the remaining amount of the transaction price should be allocated based on the allocation requirements related to allocation based on standalone selling price and allocation of a discount.

For additional information, see the following examples:

- Example 25 – Management Fees Subject to the Constraint in FASB ASC 606-10-55-221 through 55-225
- Example 35 – Allocation of Variable Consideration in FASB ASC 606-10-55-270 through 55-279

Change in the Transaction Price

FASB ASC 606-10-32-42 through 32-45

After contract inception, the transaction price can change for various reasons, including the resolution of uncertain events or other changes in circumstances that change the amount of consideration to which an entity expects to be entitled in exchange for the promised goods or services.

An entity should allocate to the performance obligations in the contract any subsequent changes in the transaction price on the same basis as at contract inception. Consequently, the transaction price should not be reallocated to reflect changes in standalone selling prices after contract inception. Amounts allocated to a satisfied performance obligation should be recognized as revenue, or as a reduction of revenue, in the period in which the transaction price changes.

A change in the transaction price should be allocated entirely to one or more, but not all, performance obligations or distinct goods or services promised in a series that forms part of a single performance obligation in accordance with paragraph 606-10-25-14(b) only if both of the following criteria are met:

- a. The terms of the change in transaction price relate specifically to the entity's efforts to satisfy the performance obligation or transfer the distinct good or service (or to a specific outcome from satisfying the performance obligation or transferring the distinct good or service).
- b. Allocating the change in transaction price entirely to the performance obligation or the distinct good or service is consistent with the overall objective for allocating the transaction price to performance obligations, when considering all of the performance obligations and payment terms in the contract.

A change in the transaction price that arises as a result of a contract modification should be accounted for in accordance with the guidance on contract modifications. However, for a change in the transaction price that occurs after a contract modification, an entity should apply the guidance on changes in the transaction price to allocate the change in the transaction price in whichever of the following ways is applicable:

- a. Allocate the change in the transaction price to the performance obligations identified in the contract before the modification if, and to the extent that, the change in the transaction price is attributable to an amount of variable consideration promised before the modification and the modification is accounted for as if it were a termination of the existing contract and the creation of a new contract (in accordance with FASB ASC 606-10-25-13(a)).
- b. In all other cases in which the modification was not accounted for as a separate contract (in accordance with FASB ASC 606-10-25-12), allocate the change in the transaction price to the performance obligations in the modified contract (that is, the performance obligations that were unsatisfied or partially unsatisfied immediately after the modification).

Step 5: Recognize Revenue When (or as) the Entity Satisfies a Performance Obligation

(FASB ASC 606-10-25-23 through 25-37)

Transfer of Control

FASB ASC 606-10-25-23 through 25-26

The revenue recognition standard states that an entity should recognize revenue when (or as) the entity satisfies a performance obligation by transferring a promised good or service to a customer. An asset is transferred when (or as) the customer obtains control of that asset.

Control of an asset refers to the ability to direct the use of, and obtain substantially all of the remaining benefits from, the asset. Control includes the ability to prevent other entities from directing the use of, and obtaining the benefits from, an asset.

Goods and services are assets, even if only momentarily, when they are received and used (as in the case of many services). The benefits of an asset are the potential cash flows (inflows or savings in outflows) that can be obtained directly or indirectly in many ways, such as by

- a. using the asset to produce goods or provide services (including public services),
- b. using the asset to enhance the value of other assets,
- c. using the asset to settle liabilities or reduce expenses,
- d. selling or exchanging the asset,
- e. pledging the asset to secure a loan, and
- f. holding the asset.

For each performance obligation, an entity would determine whether the entity satisfies the performance obligation over time by transferring control of a promised good or service over time. If the entity does not satisfy a performance obligation over time, the performance obligation is satisfied at a point in time.

When evaluating whether a customer obtains control of an asset, any agreement to repurchase the asset should be considered (see FASB ASC 606-10-55-66 through 55-78).

Performance Obligations Satisfied Over Time

FASB ASC 606-10-25-27 through 25-29, 25-36 through 25-37, 55-5 through 55-10

An entity transfers control of a good or service over time and satisfies a performance obligation and recognizes revenue over time if one of the following criteria is met:

- a. The customer receives and consumes the benefits provided by the entity's performance as the entity performs (as described in FASB ASC 606-10-55-5 through 55-6).
- b. The entity's performance creates or enhances an asset (for example, work in process) that the customer controls as the asset is created or enhanced (as described in FASB ASC 606-10-55-7).
- c. The entity's performance does not create an asset with an alternative use to the entity (see FASB ASC 606-10-25-28), and the entity has an enforceable right to payment for performance completed to date (as described in FASB ASC 606-10-25-29).

Simultaneous Receipt and Consumption of the Benefits of the Entity's Performance: For some types of performance obligations, the assessment of whether a customer receives the benefits of an entity's performance as the entity performs and simultaneously consumes those benefits as they are received will be straightforward. Examples include routine or recurring services (such as a cleaning service) in which the receipt and simultaneous consumption by the customer of the benefits of the entity's performance can be readily identified.

For other types of performance obligations, the entity may not be able to readily identify whether a customer simultaneously receives and consumes the benefits from the entity's performance as the entity performs. In those circumstances, a performance obligation is satisfied over time if an entity determines that another entity would not need to substantially reperform the work that the entity has completed to date if that other entity were to fulfill the remaining performance obligation to the customer. In determining whether another entity would not need to substantially reperform the work the entity has completed to date, an entity should make both of the following assumptions:

- a. Disregard potential contractual restrictions or practical limitations that otherwise would prevent the entity from transferring the remaining performance obligation to another entity.

- b. Presume that another entity fulfilling the remainder of the performance obligation would not have the benefit of any asset that is presently controlled by the entity and that would remain controlled by the entity if the performance obligation were to transfer to another entity.

Customer Controls the Asset as It Is Created or Enhanced: In determining whether a customer controls an asset as it is created or enhanced, an entity should apply the guidance on control in FASB ASC 606-10-25-23 through 25-26 and 606-10-25-30. The asset that is being created or enhanced (for example, a work in process asset) could be either tangible or intangible.

Entity's Performance Does Not Have an Alternative Use: An asset created by an entity's performance does not have an alternative use to an entity if the entity is either restricted contractually from readily directing the asset for another use during the creation or enhancement of that asset or limited practically from readily directing the asset in its completed state for another use. The assessment of whether an asset has an alternative use to the entity is made at contract inception. After contract inception, an entity should not update the assessment of the alternative use of an asset unless the parties to the contract approve a contract modification that substantively changes the performance obligation. (FASB ASC 606-10-55-8 through 55-10 provide guidance for assessing whether an asset has an alternative use to an entity.)

Enforceable Right to Payment: The terms of the contract, as well as any laws that apply to the contract, should be considered when evaluating whether it has an enforceable right to payment for performance completed to date. The right to payment for performance completed to date does not need to be for a fixed amount. However, at all times throughout the duration of the contract, the entity must be entitled to an amount that at least compensates the entity for performance completed to date if the contract is terminated by the customer or another party for reasons other than the entity's failure to perform as promised. (FASB ASC 606-10-55-11 through 55-15 provide guidance for assessing the existence and enforceability of a right to payment and whether an entity's right to payment would entitle the entity to be paid for its performance completed to date.)

Reasonable Measure of Progress: An entity should recognize revenue for a performance obligation satisfied over time only if the entity can reasonably measure its progress toward complete satisfaction of the performance obligation. An entity would not be able to reasonably measure its progress toward complete satisfaction of a performance obligation if it lacks reliable information that would be required to apply an appropriate method of measuring progress. In some circumstances (for example, in the early stages of a contract), an entity may not be able to reasonably measure the outcome of a performance obligation, but the entity expects to recover the costs incurred in satisfying the performance obligation. In those circumstances, the entity should recognize revenue only to the extent of the costs incurred until such time that it can reasonably measure the outcome of the performance obligation.

For additional information, see the following examples:

- Example 13 – Customer Simultaneously Receives and Consumes the Benefits in FASB ASC 606-10-55-159 through 55-160,
- Example 14 – Assessing Alternative Use and Right to Payment in FASB ASC 606-10-55-161 through 55-164,
- Example 15 – Asset Has No Alternative Use to the Entity in FASB ASC 606-10-55-165 through 55-168, and
- Example 16 – Enforceable Right to Payment for Performance Completed to Date in FASB ASC 606-10-55-169 through 55-172.

Performance Obligations Satisfied at a Point in Time

FASB ASC 606-10-25-30

If a performance obligation is not satisfied over time, the performance obligation is satisfied at a point in time. To determine the point in time at which a customer obtains control of a promised asset and the entity satisfies a performance obligation, the entity should consider the guidance on control in FASB ASC 606-10-25-23 through 25-26. In addition, it should consider indicators of the transfer of control, which include, but are not limited to, the following:

- a. The entity has a present right to payment for the asset—If a customer presently is obliged to pay for an asset, then that may indicate that the customer has obtained the ability to direct the use of, and obtain substantially all of the remaining benefits from, the asset in exchange.
- b. The customer has legal title to the asset—Legal title may indicate which party to a contract has the ability to direct the use of, and obtain substantially all of the remaining benefits from, an asset or to restrict the access of other entities to those benefits. Therefore, the transfer of legal title of an asset may indicate that the customer has obtained control of the asset. If an entity retains legal title solely as protection against the customer's failure to pay, those rights of the entity would not preclude the customer from obtaining control of an asset.

- c. The entity has transferred physical possession of the asset—The customer’s physical possession of an asset may indicate that the customer has the ability to direct the use of, and obtain substantially all of the remaining benefits from, the asset or to restrict the access of other entities to those benefits. However, physical possession may not coincide with control of an asset. For example, in some repurchase agreements and in some consignment arrangements, a customer or consignee may have physical possession of an asset that the entity controls. Conversely, in some bill-and-hold arrangements, the entity may have physical possession of an asset that the customer controls. FASB ASC 606-10-55-66 through 55-78, 606-10-55-79 through 55-80, and 606-10-55-81 through 55-84 provide guidance on accounting for repurchase agreements, consignment arrangements, and bill-and-hold arrangements, respectively.
- d. The customer has the significant risks and rewards of ownership of the asset—The transfer of the significant risks and rewards of ownership of an asset to the customer may indicate that the customer has obtained the ability to direct the use of, and obtain substantially all of the remaining benefits from, the asset. However, when evaluating the risks and rewards of ownership of a promised asset, an entity should exclude any risks that give rise to a separate performance obligation in addition to the performance obligation to transfer the asset. For example, an entity may have transferred control of an asset to a customer but not yet satisfied an additional performance obligation to provide maintenance services related to the transferred asset.
- e. The customer has accepted the asset—The customer’s acceptance of an asset may indicate that it has obtained the ability to direct the use of, and obtain substantially all of the remaining benefits from, the asset. To evaluate the effect of a contractual customer acceptance clause on when control of an asset is transferred, an entity should consider the guidance in FASB ASC 606-10-55-85 through 55-88.

Measuring Progress Toward Complete Satisfaction of a Performance Obligation

FASB ASC 606-10-25-31 and 25-32

For each performance obligation satisfied over time, an entity should recognize revenue over time by measuring the progress toward complete satisfaction of that performance obligation. The objective when measuring progress is to depict an entity’s performance in transferring control of goods or services promised to the customer (that is, the satisfaction of an entity’s performance obligation).

A single method of measuring progress should be applied for each performance obligation satisfied over time, and should apply that method consistently to similar performance obligations and in similar circumstances. At the end of each reporting period, an entity should remeasure its progress toward complete satisfaction of a performance obligation satisfied over time.

Methods for Measuring Progress

FASB ASC 606-10-25-33 through 25-35 and 606-10-55-16 through 55-21

Appropriate methods of measuring progress include output methods and input methods.

Output Methods: Output methods recognize revenue on the basis of direct measurements of the value to the customer of the goods or services transferred to date relative to the remaining goods or services promised under the contract. Output methods include methods such as surveys of performance completed to date, appraisals of results achieved, milestones reached, time elapsed, and units produced or units delivered. When an entity evaluates whether to apply an output method to measure its progress, the entity should consider whether the output selected would faithfully depict the entity’s performance toward complete satisfaction of the performance obligation. An output method would not provide a faithful depiction of the entity’s performance if the output selected would fail to measure some of the goods or services for which control has transferred to the customer. For example, output methods based on units produced or units delivered would not faithfully depict an entity’s performance in satisfying a performance obligation if, at the end of the reporting period, the entity’s performance has produced work in process or finished goods controlled by the customer that are not included in the measurement of the output.

The disadvantages of output methods are that the outputs used to measure progress may not be directly observable and the information required to apply them may not be available to an entity without undue cost. Therefore, an input method may be necessary.

Practical Expedient: If an entity has a right to consideration from a customer in an amount that corresponds directly with the value to the customer of the entity’s performance completed to date (for example, a service contract in which an entity bills a fixed amount for each hour of service provided), the entity may recognize revenue in the amount to which the entity has a right to invoice.

Input Methods: Input methods recognize revenue on the basis of the entity's efforts or inputs to the satisfaction of a performance obligation (for example, resources consumed, labor hours expended, costs incurred, time elapsed, or machine hours used) relative to the total expected inputs to the satisfaction of that performance obligation. If the entity's efforts or inputs are expended evenly throughout the performance period, it may be appropriate for the entity to recognize revenue on a straight-line basis.

A shortcoming of input methods is that there may not be a direct relationship between an entity's inputs and the transfer of control of goods or services to a customer. An entity should exclude from an input method the effects of any inputs that, in accordance with the objective of measuring progress in FASB ASC 606-10-25-31, do not depict the entity's performance in transferring control of goods or services to the customer. For instance, when using a cost-based input method, an adjustment to the measure of progress may be required in the following circumstances:

- a. When a cost incurred does not contribute to an entity's progress in satisfying the performance obligation. For example, an entity would not recognize revenue on the basis of costs incurred that are attributable to significant inefficiencies in the entity's performance that were not reflected in the price of the contract (for example, the costs of unexpected amounts of wasted materials, labor, or other resources that were incurred to satisfy the performance obligation).
- b. When a cost incurred is not proportionate to the entity's progress in satisfying the performance obligation. In those circumstances, the best depiction of the entity's performance may be to adjust the input method to recognize revenue only to the extent of that cost incurred. For example, a faithful depiction of an entity's performance might be to recognize revenue at an amount equal to the cost of a good used to satisfy a performance obligation if the entity expects at contract inception that all of the following conditions would be met:
 1. The good is not distinct.
 2. The customer is expected to obtain control of the good significantly before receiving services related to the good.
 3. The cost of the transferred good is significant relative to the total expected costs to completely satisfy the performance obligation.
 4. The entity procures the good from a third party and is not significantly involved in designing and manufacturing the good (but the entity is acting as a principal in accordance with FASB ASC 606-10-55-36 through 55-40).

As circumstances change over time, the measure of progress should be updated to reflect any changes in the outcome of the performance obligation. Such changes to a measure of progress should be accounted for as a change in accounting estimate in accordance with FASB ASC 250-10 on accounting changes and error corrections.

For additional information, see the following examples:

- Example 17 – Assessing Whether a Performance Obligation is Satisfied at a Point in Time or Over Time in FASB ASC 606-10-55-173 through 55-182
- Example 18 – Measuring Progress When Making Goods or Services Available in FASB ASC 606-10-55-185 through 55-186
- Example 19 – Uninstalled Materials in FASB ASC 606-10-55-187 through 55-192

Other Areas of Interest

Presentation

FASB ASC 606-10-45-1 through 45-5

The revenue recognition standard requires that when either party to a contract has performed, an entity should present the contract in the statement of financial position as a contract asset or a contract liability, depending on the relationship between the entity's performance and the customer's payment. An entity should present any unconditional rights to consideration separately as a receivable.

Contract Liability: If a customer pays consideration, or an entity has a right to an amount of consideration that is unconditional (that is, a receivable), before the entity transfers a good or service to the customer, the entity should present the contract as a contract liability when the payment is made or the payment is due (whichever is earlier). A contract liability is an entity's obligation to transfer

goods or services to a customer for which the entity has received consideration (or an amount of consideration is due) from the customer.

Contract Asset: If an entity performs by transferring goods or services to a customer before the customer pays consideration, the entity should present the contract as either a contract asset or as a receivable, depending on the nature of the entity's right to consideration for its performance.

- A contract asset is an entity's right to consideration in exchange for goods or services that the entity has transferred to a customer, when the right is conditioned on something other than the passage of time.
- A receivable is an entity's right to consideration that is unconditional. A right to consideration is unconditional if only the passage of time is required before payment of that consideration is due. An entity should account for a receivable in accordance with FASB ASC 310. Upon initial recognition of a receivable from a contract with a customer, any difference between the measurement of the receivable in accordance with Topic 310 and the corresponding amount of revenue recognized should be presented as an expense (for example, as an impairment loss).

An entity is not prohibited from using alternative descriptions in the statement of financial position (instead of contract asset and contract liability). If an alternative description is used for a contract asset, an entity should provide sufficient information for a user of the financial statements to distinguish between unconditional rights to consideration (that is, receivables) and conditional rights to consideration (that is, contract assets).

For additional information, see the following examples:

- Example 38 – Contract Liability and Receivable in FASB ASC 606-10-55-284 through 55-286
- Example 39 – Contract Asset Recognized for the Entity's Performance in FASB ASC 606-10-55-287 through 55-290
- Example 40 – Receivable Recognized for the Entity's Performance in FASB ASC 606-10-55-291 through 55-294

Incremental Costs of Obtaining a Contract

FASB ASC 340-40-25-1 through 25-4

The revenue recognition standard states that an entity should recognize as an asset the incremental costs of obtaining a contract with a customer if the entity expects to recover those costs.

The incremental costs of obtaining a contract are those costs that an entity incurs to obtain a contract with a customer that it would not have incurred if the contract had not been obtained (for example, a sales commission). Costs to obtain a contract that would have been incurred regardless of whether the contract was obtained should be recognized as an expense when incurred, unless those costs are explicitly chargeable to the customer regardless of whether the contract is obtained.

Practical Expedient: The incremental costs of obtaining a contract may be recognized as an expense when incurred if the amortization period of the asset that the entity otherwise would have recognized is one year or less.

For additional information, see the following examples:

- Example 1 – Incremental Costs of Obtaining a Contract in FASB ASC 340-40-55-2 through 55-4
- Example 2 – Costs that Give Rise to an Asset in FASB ASC 340-55-6

Costs of Fulfilling a Contract

FASB ASC 340-40-25-5 through 25-8

The revenue recognition standard states an entity should recognize an asset from the costs incurred to fulfill a contract only if those costs meet all of the following criteria:

- a. The costs relate directly to a contract or to an anticipated contract that the entity can specifically identify (for example, costs relating to services to be provided under renewal of an existing contract or costs of designing an asset to be transferred under a specific contract that has not yet been approved).
- b. The costs generate or enhance resources of the entity that will be used in satisfying (or in continuing to satisfy) performance obligations in the future.
- c. The costs are expected to be recovered.

For costs incurred in fulfilling a contract with a customer that are within the scope of another topic (for example, FASB ASC 330 on inventory; FASB ASC 340-10-25-1 through 25-4 on preproduction costs related to long-term supply arrangements; FASB ASC 350-40 on internal-use software; FASB ASC 360 on property, plant, and equipment; or FASB ASC 985-20 on costs of software to be sold, leased, or otherwise marketed), should account for those costs in accordance with that other guidance.

Costs that relate directly to a contract (or a specific anticipated contract) include any of the following:

- a. Direct labor (for example, salaries and wages of employees who provide the promised services directly to the customer)
- b. Direct materials (for example, supplies used in providing the promised services to a customer)
- c. Allocations of costs that relate directly to the contract or to contract activities (for example, costs of contract management and supervision, insurance, and depreciation of tools and equipment used in fulfilling the contract)
- d. Costs that are explicitly chargeable to the customer under the contract
- e. Other costs that are incurred only because an entity entered into the contract (for example, payments to subcontractors).

The following costs should be expensed when incurred:

- a. General and administrative costs (unless those costs are explicitly chargeable to the customer under the contract, in which case an entity should evaluate those costs in accordance with FASB ASC 340-40-25-7)
- b. Costs of wasted materials, labor, or other resources to fulfill the contract that were not reflected in the price of the contract
- c. Costs that relate to satisfied performance obligations (or partially satisfied performance obligations) in the contract (that is, costs that relate to past performance)
- d. Costs for which an entity cannot distinguish whether the costs relate to unsatisfied performance obligations or to satisfied performance obligations (or partially satisfied performance obligations).

For additional information, see example 2 – Costs that Give Rise to an Asset in FASB ASC 340-55-6 through 55-9.

Amortization and Impairment

FASB ASC 340-40-35-1 through 35-6

An asset recognized either for incremental costs of obtaining a contract with a customer (in accordance with FASB ASC 340-40-25-1) or for costs incurred to fulfill a contract (in accordance with FASB ASC 340-40-25-5) should be amortized on a systematic basis that is consistent with the transfer to the customer of the goods or services to which the asset relates.

Amortization should be updated to reflect a significant change in the entity's expected timing of transfer to the customer of the goods or services to which the asset relates. Such a change should be accounted for as a change in accounting estimate in accordance with FASB ASC 250-10 on accounting changes and error corrections.

An entity should recognize an impairment loss in profit or loss to the extent that the carrying amount of an asset recognized for incremental costs of obtaining a contract with a customer or for costs incurred to fulfill a contract exceeds

- a. the remaining amount of consideration that the entity expects to receive in exchange for the goods or services to which the asset relates, less
- b. the costs that relate directly to providing those goods or services and that have not been recognized as expenses (see FASB ASC 340-40-25-7).

For the purposes of determining the amount of consideration that an entity expects to receive, an entity should use the principles for determining the transaction price (except for the guidance in FASB ASC 606-10-32-11 through 32-13 on constraining estimates of variable consideration) and adjust that amount to reflect the effects of the customer's credit risk.

Before an entity recognizes an impairment loss for an asset recognized for incremental costs of obtaining a contract with a customer or for costs incurred to fulfill a contract, it should recognize any impairment loss for assets related to the contract that are recognized in accordance with other guidance (for example, FASB ASC 330 on inventory; FASB ASC 985-20 on costs of software to be sold, leased, or otherwise marketed; FASB ASC 360 on property, plant, and equipment; and FASB ASC 350 on goodwill and other intangibles).

After applying the impairment test in FASB ASC 340-40-35-3, an entity should include the resulting carrying amount of the asset recognized in accordance with FASB ASC 340-40-25-1 or 340-40-25-5 in the carrying amount of the asset group or reporting unit to which it belongs for the purpose of applying the guidance in FASB ASC 360 and 350 to that asset group or reporting unit.

An entity should not recognize a reversal of an impairment loss previously recognized.

Difference with IFRS: Impairment loss reversal

IFRS 15 requires an entity to reverse impairment losses, consistent with the requirements of the impairment of assets within the scope of IFRS 36, *Impairment of Assets*.

Principal vs. Agent Considerations

FASB ASC 606-10-55-36 through 55-40

When another party is involved in providing goods or services to a customer, the entity should determine whether the nature of its promise is a performance obligation to provide the specified goods or services itself (that is, the entity is a principal) or to arrange for those goods or services to be provided by the other party (that is, the entity is an agent). An entity determines whether it is a principal or an agent for each specified good or service promised to the customer. A specified good or services is a distinct good or service (or a distinct bundle of goods or services) to be provided to the customer. If a contract with a customer includes more than one specified good or service, an entity could be a principal for some specified goods or services, and an agent for others.

To determine the nature of its promise, the entity should:

- a) identify the specified goods or services to be provided to the customer (which, for example, could be a right to a good or service to be provided by another party)
- b) Assess whether it controls each specified good or service before that good or service is transferred to the customer.

An entity is a principal if it controls the specified good or service before that good or service is transferred to the customer. However, an entity does not necessarily control a specified good if the entity obtains legal title to that good only momentarily before legal title is transferred to a customer. An entity that is a principal may satisfy its performance obligation to provide the specified good or service itself or it may engage another party (for example, a subcontractor) to satisfy some or all of the performance obligation on its behalf.

When another party is involved in providing goods or services to a customer, an entity that is a principal obtains control of any one of the following:

- a) A good or another asset from the other party that it then transfers to the customer.
- b) A right to a service to be performed by the other party, which gives the entity the ability to direct that party to provide the service to the customer on the entity's behalf.
- c) A good or service from the other party that it then combines with other goods or services in providing the specified good or service to the customer. For example, if an entity provides a significant service of integrating goods or services provided by another party into the specified good or service for which the customer has contracted, the entity controls the specified good or service before that good or service is transferred to the customer. This is because the entity first obtains control of the inputs to the specified good or service (which include goods or services from other parties) and directs their use to create the combined output that is the specified good or service.

When (or as) an entity that is a principal satisfies a performance obligation, the entity recognizes revenue in the gross amount of consideration to which it expects to be entitled in exchange for the specified good or service transferred.

An entity is an agent if the entity's performance obligation is to arrange for the provision of the specified good or service by another party. An entity that is an agent does not control the specified good or service provided by another party before that good or service is transferred to the customer. When (or as) an entity that is an agent satisfies a performance obligation, the entity recognizes revenue in the amount of any fee or commission to which it expects to be entitled in exchange for arranging the specified goods or services to be provided by the other party. An entity's fee or commission might be the net amount of consideration that the entity retains after paying the other party the consideration received in exchange for the goods or services to be provided by that party.

Indicators that an entity controls the specified good or service before it is transferred to the customer (and is therefore a principal) include, but are not limited to, the following:

- a) The entity is primarily responsible for fulfilling the promise to provide the specified good or service. This typically includes responsibility for the acceptability of the specified good or service (for example, primary responsibility for the good or service meeting customer specifications). If the entity is primarily responsible for fulfilling the promise to provide the specified good or service, this may indicate that the other party involved in providing the specified good or service is acting on the entity's behalf.
- b) The entity has inventory risk before the specified good or service has been transferred to a customer, or after transfer of control to the customer (for example, if the customer has a right of return). For example, if the entity obtains, or commits to obtain, the specified good or service before obtaining a contract with a customer, that may indicate that the entity has the ability to direct the use of, and obtain substantially all of the remaining benefits from, the good or service before it is transferred to the customer.
- c) The entity has discretion in establishing the price for the specified good or service. Establishing the price that the customer pays for the specified good or service may indicate that the entity has the ability to direct the use of that good or service and obtain substantially all of the remaining benefits. However, an agent can have discretion in establishing prices in some cases. For example, an agent may have some flexibility in setting prices in order to generate additional revenue from its service of arranging for goods or services to be provided by other parties to customers.

The indicators above may be more or less relevant to the assessment of control depending on the nature of the specified good or service and the terms and conditions of the contract. In addition, different indicators may provide more persuasive evidence in different contracts.

If another entity assumes the entity's performance obligations and contractual rights in the contract so that the entity is no longer obliged to satisfy the performance obligation to transfer the specified good or service to the customer (that is, the entity is no longer acting as the principal), the entity should not recognize revenue for that performance obligation. Instead, the entity should evaluate whether to recognize revenue for satisfying a performance obligation to obtain a contract for the other party (that is, whether the entity is acting as an agent).

Warranties

FASB ASC 606-10-55-30 through 55-35

The revenue recognition standard explains that it is common for an entity to provide (in accordance with the contract, the law, or the entity's customary business practices) a warranty in connection with the sale of a product (whether a good or service). The nature of a warranty can vary significantly across industries and contracts. Some warranties provide a customer with assurance that the related product will function as the parties intended because it complies with agreed-upon specifications. Other warranties provide the customer with a service in addition to the assurance that the product complies with agreed-upon specifications.

If a customer has the option to purchase a warranty separately (for example, because the warranty is priced or negotiated separately), the warranty is a distinct service because the entity promises to provide the service to the customer in addition to the

product that has the functionality described in the contract. In those circumstances, an entity should account for the promised warranty as a performance obligation in accordance with FASB ASC 606-10-25-14 through 25-22 and allocate a portion of the transaction price to that performance obligation in accordance with FASB ASC 606-10-32-28 through 32-41.

If a customer does not have the option to purchase a warranty separately, should account for the warranty in accordance with the guidance on product warranties in FASB ASC 460-10 on guarantees, unless the promised warranty, or a part of the promised warranty, provides the customer with a service in addition to the assurance that the product complies with agreed-upon specifications.

In assessing whether a warranty provides a customer with a service in addition to the assurance that the product complies with agreed-upon specifications, an entity should consider factors such as the following:

- a. Whether the warranty is required by law—If required by law to provide a warranty, the existence of that law indicates that the promised warranty is not a performance obligation because such requirements typically exist to protect customers from the risk of purchasing defective products.
- b. The length of the warranty coverage period—The longer the coverage period, the more likely it is that the promised warranty is a performance obligation because it is more likely to provide a service in addition to the assurance that the product complies with agreed-upon specifications.
- c. The nature of the tasks that the entity promises to perform—If it is necessary for an entity to perform specified tasks to provide the assurance that a product complies with agreed-upon specifications (for example, a return shipping service for a defective product), then those tasks likely do not give rise to a performance obligation.

If a warranty, or a part of a warranty, provides a customer with a service in addition to the assurance that the product complies with agreed-upon specifications, the promised service is a performance obligation. Therefore, should allocate the transaction price to the product and the service. If both an assurance-type warranty and a service-type warranty are promised but cannot reasonably account for them separately, the entity should account for both of the warranties together as a single performance obligation.

A law that requires an entity to pay compensation if its products cause harm or damage does not give rise to a performance obligation. For example, a manufacturer might sell products in a jurisdiction in which the law holds the manufacturer liable for any damages (for example, to personal property) that might be caused by a consumer using a product for its intended purpose. Similarly, an entity's promise to indemnify the customer for liabilities and damages arising from claims of patent, copyright, trademark, or other infringement by the entity's products does not give rise to a performance obligation. Such obligations should be accounted for in accordance with the guidance on loss contingencies in FASB ASC 450-20 on contingencies.

For additional information, see example 44 – Warranties in FASB ASC 606-10-55-309 through 55-315.

Licensing

FASB ASC 606-10-55-54 through 55-65

The revenue recognition standard explains that a license establishes a customer's rights to the intellectual property of an entity. Licenses of intellectual property may include, but are not limited to, any of the following:

- a. Software (other than software subject to a hosting arrangement that does not meet the criteria in FASB ASC 985-20-15-5) and technology
- b. Motion pictures, music, and other forms of media and entertainment
- c. Franchises
- d. Patents, trademarks, and copyrights

In addition to a promise to grant a license to a customer, an entity may also promise to transfer other goods or services to the customer. Those promises may be explicitly stated in the contract or implied by an entity's customary business practices, published policies, or specific statements (see FASB ASC 606-10-25-16). As with other types of contracts, when a contract with a customer includes a promise to grant a license in addition to other promised goods or services, an entity applies FASB ASC 606-10-25-14 through 25-22 to identify each of the performance obligations in the contract. If the promise to grant a license is not distinct from other promised goods or services in the contract in accordance with FASB ASC 606-10-25-18 through 25-22, should account for the promise to grant a license and those other promised goods or services together as a single performance obligation. Examples of licenses that are not distinct from other goods or services promised in the contract include the following:

- a. A license that forms a component of a tangible good and that is integral to the functionality of the good
- b. A license that the customer can benefit from only in conjunction with a related service (such as an online service provided by the entity that enables, by granting a license, the customer to access content)

When a single performance obligation includes a license (or licenses) of intellectual property and one or more other goods or services, the entity considers the nature of the combined good or service for which the customer has contracted (including whether the license that is part of the single performance obligation provides the customer with a right to use or a right to access intellectual property in accordance with FASB ASC 606-10-55-59 through 55-60 and 606-10-55-62 through 55-64A) in determining whether the combined good or service is satisfied over time or at a point in time in accordance with FASB ASC 606-10-25-23 through 25-30 and, if over time, in selecting an appropriate method for measuring progress in accordance with FASB ASC 606-10-25-31 through 25-37.

In evaluating whether a license transfers to a customer at a point in time or over time, an entity should consider whether the nature of the entity's promise in granting the license to a customer is to provide the customer with either:

- a. A right to access the entity's intellectual property throughout the license period (or its remaining economic life, if shorter)
- b. A right to use the entity's intellectual property as it exists at the point in time at which the license is granted

An entity should account for a promise to provide a customer with a right to access the entity's intellectual property as a performance obligation satisfied over time because the customer will simultaneously receive and consume the benefit from the entity's performance of providing access to its intellectual property as the performance occurs. An entity should apply FASB ASC 606-10-25-31 through 25-37 to select an appropriate method to measure its progress toward complete satisfaction of that performance obligation to provide access to its intellectual property.

An entity's promise to provide a customer with the right to use its intellectual property is satisfied at a point in time. The entity should apply FASB ASC 606-10-25-30 to determine the point in time at which the license transfers to the customer.

Revenue cannot be recognized from a license of intellectual property before:

- a. An entity provides (or otherwise makes available) a copy of the intellectual property to the customer, and
- b. The beginning of the period during which the customer is able to use and benefit from its right to access or its right to use the intellectual property. That is, an entity would not recognize revenue before the beginning of the license period even if the entity provides (or otherwise makes available) a copy of the intellectual property before the start of the license period or the customer has a copy of the intellectual property from another transaction. For example, an entity would recognize revenue from a license renewal no earlier than the beginning of the renewal period.

To determine whether the entity's promise to provide a right to access its intellectual property or a right to use its intellectual property, the entity should consider the nature of the intellectual property to which the customer will have rights. Intellectual property is either:

- a. Functional intellectual property. Intellectual property that has significant standalone functionality (for example, the ability to process a transaction, perform a function or task, or to be played or aired). Functional intellectual property derives a substantial portion of its utility (that is, its ability to provide benefit or value) from its significant standalone functionality.
- b. Symbolic intellectual property. Intellectual property that is not functional intellectual property (that is, intellectual property that does not have significant standalone functionality). Because symbolic intellectual property does not have significant standalone functionality, substantially all of the utility of symbolic intellectual property is derived from its association with the entity's past or ongoing activities, including its ordinary business activities.

A customer's ability to derive benefit from a license to symbolic intellectual property depends on the entity continuing to support or maintain the intellectual property. Therefore, a license to symbolic intellectual property grants the customer a right to access the entity's intellectual property, which is satisfied over time (see FASB ASC 606-10-55-58A and 606-10-55-58C) as the entity fulfills its promise to:

- a. Grant the customer rights to use and benefit from the entity's intellectual property, and
- b. Support or maintain the intellectual property. An entity generally supports or maintains symbolic intellectual property by continuing to undertake those activities from which the utility of the intellectual property is derived and/or refraining from activities or other actions that would significantly degrade the utility of the intellectual property.

A license to functional intellectual property grants a right to use the entity's intellectual property as it exists at the point in time at which the license is granted unless both of the following criteria are met:

a. The functionality of the intellectual property to which the customer has rights is expected to substantively change during the license period as a result of activities of the entity that do not transfer a promised good or service to the customer (see FASB ASC 606-10-25-16 through 25-18). Additional promised goods or services (for example, intellectual property upgrade rights or rights to use or access additional intellectual property) are not considered in assessing this criterion.

b. The customer is contractually or practically required to use the updated intellectual property resulting from the activities in criterion (a).

Because functional intellectual property has significant standalone functionality, an entity's activities that do not substantively change that functionality do not significantly affect the utility of the intellectual property to which the customer has rights. Therefore, the entity's promise to a customer in granting a license to functional intellectual property does not include supporting or maintaining the intellectual property. Consequently, if a license to functional intellectual property is a separate performance obligation and does not meet the criteria in FASB ASC 606-10-55-62, it is satisfied at a point in time.

Sales-Based or Usage-Based Royalties

FASB ASC 606-10-55-65

As discussed in the section on Constraining Estimates of Variable Consideration, an entity should recognize revenue for a sales-based or usage-based royalty promised in exchange for a license of intellectual property only when (or as) the later of the following events occurs:

- a. The subsequent sale or usage occurs.
- b. The performance obligation to which some or all of the sales-based or usage-based royalty has been allocated has been satisfied (or partially satisfied).

For additional information, see the following examples:

- Example 54 – Rights to Use Intellectual Property in FASB ASC 606-10-55-362 through 55-363
- Example 55 – Licenses of Intellectual Property in FASB ASC 606-10-55-364 through 55-366
- Example 56 – Identifying a Distinct License in FASB ASC 606-10-55-367 through 55-374
- Example 57 – Franchise Rights in FASB ASC 606-10-55-375 through 55-382
- Example 58 – Access to Intellectual Property in FASB ASC 606-10-55-383 through 55-388
- Example 59 – Rights to Use Intellectual Property in FASB ASC 606-10-55-389 through 392
- Example 60 – Access to Intellectual Property in FASB ASC 606-10-55-393 through 55-394
- Example 61 – Access to Intellectual Property in FASB ASC 606-10-55-395 through 55-399

Disclosures

FASB ASC 606-10-50-1 through 50-23 and 340-40-50-1 through 340-40-50-6

The revenue recognition standard states that the objective of the disclosure requirements are to enable users of financial statements to understand the nature, amount, timing, and uncertainty of revenue and cash flows arising from contracts with customers, and assets recognized from the costs to obtain or fulfill a contract with a customer. Qualitative and quantitative information is required about

- a. contracts with customers—including revenue and impairments recognized, disaggregation of revenue, and information about contract balances and performance obligations (including the transaction price allocated to the remaining performance obligations) ;
- b. significant judgments and changes in judgments—determining the timing of satisfaction of performance obligations (over time or at a point in time), and determining the transaction price and amounts allocated to performance obligations; and
- c. assets recognized from the costs to obtain or fulfill a contract.

The revenue recognition standard allows nonpublic entities elections to not to provide specific disclosures related to the following:

1. Quantitative disaggregation disclosures (FASB ASC 606-10-50-7)
2. Contract balances (FASB ASC 606-10-50-11)
3. Transaction price allocated to remaining performance obligations (FASB ASC 606-10-50-15)
4. Certain information related to significant judgements (FASB ASC 606-10-50-21)
5. Use of practical expedients (FASB ASC 606-10-50-23 and 340-40-50-6)
6. Certain information related to costs incurred to obtain or fulfill a contract with a customer (FASB ASC 340-40-50-4)

Difference with IFRS: Interim Disclosure Requirements

The revenue recognition standard requires additional interim disclosures for public entities (contract balances and remaining performance obligations) as compared to IFRS 15.

For additional information, see the following examples:

- Example 41 – Disaggregation of Revenue – Quantitative Disclosure in FASB ASC 606-10-55-296 through 55-297
- Example 42 – Disclosure of the Transaction Price Allocated to the Remaining Performance Obligations in FASB ASC 606-10-55-298 through 55-305
- Example 43 – Disclosure of the Transaction Price Allocated to the Remaining Performance Obligations – Qualitative Disclosure in FASB ASC 606-10-55-306 through 55-307

Effective Date

FASB ASC 606-10-65-1

The guidance in FASB ASU No. 2014-09 was originally effective for annual reporting periods of public entities beginning on or after December 15, 2016, including interim periods within that reporting period. Early application was not permitted for public entities. For all other entities, the guidance in the new standard was originally effective for annual reporting periods beginning after December 15, 2017, and interim periods within annual periods beginning after December 15, 2018.

To allow entities additional time to implement systems, gather data, and resolve implementation questions, FASB issued ASU No. 2015-14, *Revenue From Contracts with Customers – Deferral of the Effective Date*, in August 2015, to defer the effective date of ASU No. 2014-09 for one year.

Public entities are required to adopt the revenue recognition standards for reporting periods beginning after December 15, 2017, and interim and annual reporting periods thereafter (which equates to January 1, 2018 for public entities with a December 31 year-end). Earlier application would be permitted only as of annual reporting periods beginning after December 15, 2016, including interim reporting periods within that reporting period. Early adoption of ASU No. 2014-09 is not permitted for public entities.

All other nonpublic entities are required to apply the revenue recognition standard for annual reporting periods beginning on or after December 15, 2018, and interim reporting periods within annual reporting periods beginning after December 15, 2019. Alternately, nonpublic entities can elect several variations of early adoption not earlier than public entities. Application would be permitted earlier only as of an annual reporting period beginning after December 15, 2016, including interim reporting periods within that reporting period, or an annual reporting period beginning after December 15, 2016, and interim reporting periods within annual reporting periods beginning one year after the annual reporting period in which an entity first applies the guidance in ASU No. 2014-09.

Difference with IFRS: Effective Date and Nonpublic Entity Requirements

IFRS 15 does not apply to nonpublic entities, IFRS for Small and Medium-sized entities is available for entities that do not have public accountability.

Transition

FASB ASC 606-10-65-1

The revenue recognition standard should be applied using one of the following two methods:

1. Retrospectively to each prior reporting period presented (by applying the requirements on accounting changes in FASB ASC 250-10-45-5 through 45-10) and the entity may elect any of the following practical expedients:
 - a. For completed contracts, an entity need not restate contracts that begin and end within the same annual reporting period.
 - b. For completed contracts that have variable consideration, an entity may use the transaction price at the date the contract was completed rather than estimating variable consideration amounts in the comparative reporting periods.
 - c. For all reporting periods presented before the date of initial application, an entity need not disclose the amount of the transaction price allocated to remaining performance obligations and an explanation of when the entity expects to recognize that amount as revenue.
2. Retrospectively with the cumulative effect of initially applying the revenue recognition standard recognized at the date of initial application. If an entity elects this transition method it also should provide the additional disclosures in reporting periods that include the date of initial application of:
 - a. The amount by which each financial statement line item is affected in the current reporting period by the application of the revenue recognition standard as compared to the guidance that was in effect before the change.
 - b. An explanation of the reasons for significant changes.

How an entity chooses to either apply full retrospective adoption of the revenue recognition standard, or a combination of the allowable practical expedients, dictates the years that contracts will need to be restated and the date of the cumulative effect adjustment. The following is a summary of transition options for public entities with a calendar fiscal year:

- Full retrospective adoption
 - January 1, 2018 apply the revenue recognition standard to all contracts
 - 2016 and 2017 restate all contracts
 - Date of Cumulative Adjustment: January 1, 2016
- Retrospective adoption using one or more practical expedient
 - January 1, 2018 apply the revenue recognition standard to all contracts
 - 2016 and 2017 restate for all contracts under the revenue recognition standard except for contracts under the practical expedients elected (as discussed in FASB ASC 606-10-65-1)
 - Date of Cumulative Adjustment: January 1, 2016
- Cumulative effect at the date of adoption
 - January 1, 2018 apply the revenue recognition standard to all contracts and disclose the effect of applying the new revenue recognition standard (each financial statement line item impact)
 - 2016 and 2017 no contracts restated, continue to report on legacy accounting
 - Date of Cumulative Adjustment: January 1, 2018

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