Revenue Recognition
The Effects of ASC Topic 606 on Your Contracts with Customers
What do these four seemingly diverse companies all have in common? On the surface it doesn’t seem like much. However, each will be affected in some way by Accounting Standards Update (ASU) 2014-09, Revenue from Contracts with Customers, issued by the Financial Accounting Standards Board (FASB).

The ASU, which introduces a new Accounting Standards Codification (ASC) Topic 606, Revenue from Contracts with Customers, fundamentally changes how companies across nearly every industry will recognize revenue. The only types of revenue-producing activities not affected by the new revenue guidelines are:

• Leases
• Loans, investments, and guarantees
• Insurance contracts
• Certain nonmonetary exchanges

Long-standing industry-specific guidelines will be eliminated—including some that have been a part of US generally accepted accounting principles (GAAP) for decades, such as contract accounting (ASC 605-35), software revenue recognition (ASC 985-605), and real estate sales (ASC 360-20).

What could this mean for your business? Let’s use the four company types to illustrate how the new guidelines will bring change with implementation of the new ASC Topic 606.

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Subsequent to the issuance of ASU 2014-09, the FASB issued the following amendments based on operational issues raised by its Transition Resource Group and other practitioners: ASUs 2015-14 (deferring the effective date of the new revenue rules by one year), 2016-08 (principal versus agent considerations (gross versus net revenue presentation)), 2016-10 (identifying performance obligations and accounting for intellectual property licenses), and 2016-12 (narrow scope improvements and practical expedients).

All references in this publication to “ASC Topic 606” and “Topic 606” are intended to encompass ASU 2014-09, as amended by each of the four updates mentioned here.
Apparel offers a loyalty program in which customers earn a point for every dollar spent. Once a customer reaches 500 points, they receive a $50 voucher that can be used for future purchases of goods from Apparel.

Under legacy GAAP, Apparel has elected an accounting policy to accrue the estimated program costs as award credits are being earned. Under ASC Topic 606, Apparel would evaluate whether the loyalty program represents a material right—that is, it provides a discount beyond what Apparel offers to customers who aren’t participating in the loyalty program. If so, then Apparel would have to change its accounting policy to account for the loyalty program as a distinct performance obligation, deferring a portion of the transaction price from current sales revenue until the voucher right is exercised or expires.

Biotech performs research on a new drug compound on behalf of a customer. Biotech previously received a nonrefundable up-front payment and is entitled to a $25 million nonrefundable milestone payment upon the successful enrollment of 100 patients into a Phase III clinical trial. Although the activities necessary to complete Phase III enrollment are substantive, Biotech believes it’s 75% likely to achieve the milestone.

Under legacy GAAP, Biotech would likely recognize the up-front nonrefundable payment over the period it performs services, using a proportional performance methodology. Biotech could elect an accounting policy to recognize the milestone payment in its entirety when the milestone is achieved.

Under Topic 606, given the high probability of achieving the milestone, Biotech would include the milestone payment as part of the transaction price. Accordingly, as Biotech performs services, it would recognize revenue for both the up-front and milestone portions of the transaction price—even prior to actually achieving the milestone.
These are just a few examples across a handful of industries. Undoubtedly, ASC Topic 606 will have a broad impact on most companies. This is especially true for entities that sell bundled product and service offerings, provide return or refund rights, or periodically amend contract terms.

In this guide we’ll examine the basic principle behind ASC Topic 606, discuss the transition process, and delve into the major changes, including examples along the way to help shape your understanding.
The Basic Principle

ASC Topic 606 contains an overarching principle:

A company should recognize revenue when it transfers goods or services to a customer. The amount of revenue recognized should represent the consideration "to which the entity (or the seller) expects to be entitled."

Five-step process

Step One:
Identify the contract with the customer.

Step Two:
Identify the separate performance obligations in the contract.

Step Three:
Determine the transaction price.

Step Four:
Allocate the transaction price to the separate performance obligations in the contract.

Step Five:
Recognize revenue when—or as—the entity satisfies a performance obligation.
Companies won’t always perform these steps sequentially.

**EXAMPLE**

For example, let’s say Contractor enters into a series of contracts with a customer to construct a building and parking garage. The parties separately agree for Contractor to install surveillance equipment and provide monitoring services on an annual basis, once the facilities are constructed.

Before identifying all the separate performance obligations (Step 2) in the various arrangements, Contractor may first want to simultaneously perform Steps 1 and 3 to identify whether the various contracts should be combined and, if so, determine the transaction price of the total accounting unit.

Overall, applying the new guidance in ASC Topic 606 requires a change in mind-set.

Much of legacy GAAP is built around a risks-and-rewards notion: Revenue is recognized when substantially all the risk of loss from the sale of goods or services has passed to the customer. The trigger for revenue recognition under Topic 606 is based on the transfer of control over a good or service to the customer. As a result, the new model could lead to very different revenue recognition patterns and amounts.

In some circumstances the new five-step process may result in the same or substantially similar accounting outcome as legacy GAAP, but the logic and reasoning for reaching those conclusions may change. Regardless of the accounting outcome, it’s nearly certain the disclosures required by ASC Topic 606 will be more detailed and require considerably more time to prepare as compared to what most companies provided under legacy GAAP.

**EXAMPLE**

For example, a manufacturer produces and sells fishing rods to a distributor. The manufacturer offers the distributor generous return rights and price protection guarantees. In turn, the distributor sells the fishing rods to a retail store.

Under legacy GAAP, the manufacturer may recognize revenue on a sell-through basis. This means it would wait to report revenue until its customer, the distributor, sells the fishing rods through to the retail store.

The manufacturer may have selected this accounting policy because it retained a number of risks following delivery of the products to the distributor. Specifically, the arrangement fee may not be fixed or determinable—a necessary condition for recognizing revenue under legacy accounting guidance—because of the generous return rights and price protection guarantees included in the contract.

Under Topic 606, the manufacturer will likely recognize revenue upon delivery of the fishing rods to the distributor. This is because control over those products transfers to the distributor at that time. The manufacturer would consider the risks of price concessions and future returns when determining the transaction price in Step 3 of the process—that is, in calculating how much revenue to recognize at the time of transfer.
In response to the feedback from stakeholders, in August 2015 the FASB deferred the effective date of ASC Topic 606 by issuing ASU 2015-14, Revenue from Contracts with Customers (Topic 606)—Deferral of the Effective Date. This ASU deferred the effective date by one year for all entities while still allowing those that wish to implement Topic 606 as of the original effective date the opportunity to do so.

**REVISED EFFECTIVE DATES**

| Public Entities | For annual reporting periods beginning on or after December 15, 2017, and related interim periods. |
| Nonpublic Entities | For annual reporting periods beginning on or after December 15, 2018, and related interim periods beginning after December 15, 2019. |

The ASU defines a public entity as any one of the following:
- A public business entity, as described in ASU 2013-12, *Definition of a Public Business Entity*
- A not-for-profit entity that’s issued, or is a conduit bond obligor for, securities that are traded, listed, or quoted on an exchange or an over-the-counter market
- An employee benefit plan that files or furnishes financial statements to the SEC

For a public, calendar-year-end company, for example, Topic 606 will first be required to be applied in its Form 10-Q for the quarter ending March 31, 2018. There’s no relief for smaller reporting companies or nonaccelerated filers.

Any company can voluntarily elect to adopt ASC Topic 606 early, but no earlier than annual reporting periods beginning after December 15, 2016, including related interim periods.
METHODS OF TRANSITION

Companies can choose one of two methods to transition to the new standard: full retrospective with optional practical expedients or a modified retrospective.

FULL RETROSPECTIVE WITH OPTIONAL PRACTICAL EXPEDIENTS

Under this transition approach, all prior periods presented in the financial statements would be presented as though the new guidelines had always been in effect, with the optional use of one or more of the following practical expedients:

• Entities wouldn’t need to restate completed contracts that began and ended within the same annual reporting period.

• For completed contracts that have variable consideration, entities may restate prior periods using the final transaction price rather than estimating the transaction price that would have been used throughout comparative reporting periods.

• An entity may reflect the aggregate effect of all modifications that occurred before the beginning of the earliest period presented, rather than determining the individual impacts of older modifications on the opening adjustments. This practical expedient could help companies that have a significant number of contract modifications or contract modifications that occur over an extended period of time.

• Entities wouldn’t need to disclose the amount of transaction price allocated to remaining performance obligations and an explanation of when the entity expects to recognize that amount as revenue for periods presented before the date of initial application.

MODIFIED RETROSPECTIVE

Under the modified retrospective method, entities must elect to apply the new revenue recognition model in Topic 606 to either all contracts or only those that aren’t completed as of the date of adoption—January 1, 2018, for public, calendar-year-end companies, for example.

This would involve comparing how those contracts would have been recorded under Topic 606 with how they were actually recorded under legacy GAAP. Any necessary adjustments would be recorded to opening retained earnings on the date of adoption—prior periods wouldn’t be restated.

If companies elect this method of transition, they’ll need to disclose the effect of adopting the new standard on each affected financial statement line item. In other words, in the initial period of adoption, the actual financial statements would reflect the application of Topic 606. However, the footnotes would show pro forma balances had legacy GAAP continued to be applied. Significant variances would require explanation. These disclosures would require entities to effectively maintain two sets of books during the initial year of applying the new revenue recognition guidance.
The selection of a transition method is very important because it can affect reported trends, perhaps in surprising ways.

**EXAMPLE**

Let’s say on December 31, 2017, Coder sells a license to software that allows for four-dimensional mapping. Coder makes no commitments, express or implied, to update the software following delivery of the license.

However, Coder does agree to provide telephone or email support for the next three years. The support is intended to help the customer maximize the utility of the software—for instance, by providing tips on how to take advantage of some of its embedded functionality.

Coder sells the bundled software and support solution for $20 million. There’s no VSOE for the support. Therefore, the entire $20 million fee would be spread over the three-year support period under legacy GAAP.

Under the new revenue recognition guidance, the support services would be separated from the software license. Assume $14 million of the arrangement fee would be allocated to the license and the remaining $6 million to the support services based on relative stand-alone selling prices of both performance obligations.

ASC Topic 606 requires the $14 million allocated to the license be recognized as revenue upon transferring the license to the customer, which occurred on December 31, 2017. The $6 million attributable to the support services would be recognized over time as those services are delivered throughout the three-year support period.

Coder has a calendar year-end and adopts ASC Topic 606 on January 1, 2018. If Coder uses a modified retrospective transition approach, $14 million of revenue would in essence disappear. Here’s how:

- Upon adoption of Topic 606 on January 1, 2018, Coder would eliminate $14 million of deferred revenue reported under legacy GAAP from the balance sheet and would adjust opening retained earnings by the same amount. This adjustment reflects that the license portion of the arrangement fee would have been booked as revenue in 2017 had the new guidance been applied in that period.
- When a modified retrospective transition method is used, prior-period results aren’t restated. Accordingly, the $14 million in revenue wouldn’t appear in either the 2017 or 2018 issued income statements. It just disappears from all income statements.

Companies should select a transition method as soon as possible. This will help identify the extent of data gathering required to properly adopt ASC Topic 606 and impact the nature and timing of systems and process changes.
Upon adopting any new accounting standard, SEC registrants typically would have to recast all five years of financial information presented in the Selected Financial Data table.

However, in the case of the new revenue guidance in ASC Topic 606, the SEC staff has provided some relief. It has stated it won’t object if a registrant reflects its adoption of the new revenue standard in the five-year table on a basis that’s consistent with the adoption in its financial statements. Specifically, a registrant could present one of these options in the five-year table:

• The most recent three years, if the registrant uses the full retrospective method to adopt the new revenue standard
• The most recent fiscal year, if it uses the modified retrospective transition method

Registrants should disclose the method used to reflect the selected data for all periods presented and, as applicable, a statement that the periods aren’t comparable.
The new revenue recognition guidelines will affect every entity differently. However, in a number of situations, the new standard is expected to:

- Result in more performance obligations—or separate accounting units—for bundled sales agreements
- Allow for earlier revenue recognition versus legacy GAAP
- Permit more costs to be deferred and amortized in the same periods that revenue is being recognized

Again, these are generalizations, and the exact effects of the new standard on your business may differ and should be carefully evaluated.

In this section, we’ll highlight some of the more significant changes that will result from ASC Topic 606. Where possible, we’ve included examples—often based on the companies we introduced at the beginning of this publication—to demonstrate how to apply the new revenue guidelines.
STEP ONE: IDENTIFY THE CONTRACT WITH THE CUSTOMER

In many cases it will be straightforward to apply the first step of the revenue recognition process introduced earlier. A contract is in the scope of Topic 606 if all of the following conditions are met:

**CONTRACT CRITERIA**

- The parties have approved the contract (in writing, orally, or in accordance with other customary business practices) and are committed to performing their respective obligations.
- Each party’s rights regarding the goods or services to be transferred can be identified.
- The payment terms are identifiable, and it’s probable the seller will collect the consideration to which it’s entitled.
- The arrangement has commercial substance.
- All conditions met = contract

If a contract fails to meet all of these criteria, ASC Topic 606 prescribes a very draconian accounting outcome—no revenue is recognized until any of the following occur:

**RECONCILIATORY MEASURES**

- The four conditions noted previously are subsequently met.
- The seller’s performance is complete and substantially all of the consideration in the arrangement has been collected and is nonrefundable.
- The contract is terminated and the consideration received from the customer is nonrefundable.
- The seller has transferred control of the goods or services to which the consideration that has been received relates, the seller 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.

COLLECTABILITY: REASONABLY ASSURED VERSUS PROBABLE

One way that a contract with a customer may not exist is if there are doubts around collectibility. Specifically, a company can’t have a contract with a customer unless it’s probable it will collect the amounts to which it will be entitled under the contract. This is the same threshold that applies under ASC 985-605-25-3(d) for companies that license software. However, under legacy GAAP, businesses that aren’t software companies typically can’t recognize revenue unless collectibility of amounts due under a contract is reasonably assured. Although some practitioners interpret reasonably assured as a higher level of confidence than probable, the FASB didn’t. ASU 2014-09’s basis for conclusions indicates “the FASB understood that in practice, probable and reasonably assured had similar meanings.” As a result, the FASB doesn’t expect entities to change existing practices or arrive at different conclusions when evaluating collectibility using the probable threshold in Topic 606 versus legacy GAAP.
Topic 606 applies only to contracts between a seller and a customer.

A customer represents a party that will obtain goods or services in exchange for consideration. In certain types of arrangements, it may take some analysis to determine whether an entity has entered into a contract with a customer.

**EXAMPLE**

**BIOTECH**

Assume Biotech enters into a collaboration agreement with another pharmaceutical company. In accounting for this arrangement, Biotech would first evaluate whether the other pharmaceutical company is a customer. This would be the case if the arrangement calls for both:

- Biotech to provide goods or services to the counterparty, which could include licenses to certain intellectual property rights or R&D services
- The counterparty to pay consideration in exchange for those goods and services, which may include potential variable or contingent amounts, such as milestone payments and royalties

However, sometimes a collaboration agreement may be more akin to a partnership rather than a contract with a customer.

**EXAMPLE**

**BIOTECH**

Let’s say Biotech and another party agree to copromote a developed product and share any profit. As part of the arrangement, the other party agrees to make payments to cover Biotech’s marketing expenses. Despite these payments, the collaboration partner isn’t a customer—the counterparty isn’t receiving goods or services in exchange for the payments. Hence this type of arrangement is outside the scope of the new revenue guidance.

In other cases, certain transactions that weren’t revenue arrangements under legacy GAAP might now be under Topic 606.

**EXAMPLE**

**CODER**

Let’s say Coder enters into a funded software-development arrangement with a customer. Assuming technological feasibility was established prior to entering into the arrangement—and prior to ASU 2014-09—paragraphs 86-87 of ASC 985-605-25 required that any payments received under this type of arrangement first be netted against capitalized development costs rather than reported as revenue.

Under Topic 606, this arrangement would be considered a contract with a customer. Therefore, Coder would record revenue for any goods and services transferred to the customer rather than reducing capitalized development costs as required by legacy GAAP.
STEP TWO: IDENTIFY THE SEPARATE PERFORMANCE OBLIGATIONS

Companies commonly sell multiple products and services in a single transaction. From an accounting perspective, a key issue is whether individual goods and services in the bundled arrangement can be accounted for separately, with a portion of the total arrangement fee recognized as revenue each time a product or service is delivered, or whether all of the revenue in the arrangement must be deferred and recognized only once the final good or service in the contract is delivered.

Legacy GAAP describes when certain individual elements in an arrangement can be unbundled, allowing for revenue recognition upon delivery of each product or service. The rules differ by industry, though.

**SOFTWARE**
Software companies can unbundle an arrangement when there is VSOE of the fair value of the undelivered elements. This means that the licensor has strong evidence of the price at which it sells any remaining products or services, such as postcontract support (PCS) on a stand-alone basis—that is, unencumbered by the initial software license or any other deliverables.

**LIFE SCIENCES & RETAIL**
Other companies, such as those in the life sciences or retail industries, can unbundle a multiple-element arrangement if the conditions in ASC 605-25-25 are met—the most important of which is that any delivered items have stand-alone value to the customer.

**CONSTRUCTION**
Contractors may be able to segment a customer contract into smaller profit centers if certain conditions are met. For example, a contractor may submit a bundled proposal to deliver a manufacturing plant, an office building, and a parking garage in three phases, all on a single parcel of land. Depending on facts and circumstances, the contractor may be able to account for the plant, building, and garage portions of the contract separately, with different margins assigned to each segment of the contract.

ASC Topic 606 replaces all of these various guidelines with a single principle. It states that a seller should identify any performance obligations within a contract, then allocate a portion of the total contract price to each distinct performance obligation. Once the company satisfies a particular performance obligation, the value assigned to it should be recognized as revenue.
PERFORMANCE OBLIGATIONS

A performance obligation represents a distinct product or service within a broader contract that the seller has promised to deliver to the customer.

Topic 606 indicates a product or service is distinct if both of the following criteria are met:

DISTINCT PRODUCT OR SERVICE CRITERIA

- The promised good or service is capable of being distinct because the customer can benefit from it either on its own or together with other resources that are readily available to the customer. ✓
- The promise to transfer a good or service is distinct within the context of the contract. ✓

Both conditions met = distinct ✓

The purpose of the second criterion is to identify whether the nature of the seller’s promise in the contract is to transfer either:

- Individual goods or services to the customer, which could result in distinct performance obligations
- A combined item for which the individual goods or services are inputs

Factors that indicate two or more promises to transfer goods and services aren’t distinct within the context of the contract include, but aren’t limited to:
- The seller provides a significant integration service that results in a combined output.
- One or more of the goods or services significantly modifies or customizes another good or service in the contract.
- The goods or services are highly interdependent or highly interrelated.

EXAMPLE CONTRACTOR

Assume Contractor agrees to rebuild a dilapidated warehouse for a customer. The construction process will involve a number of steps, including demolishing the existing structure, pouring the foundation, framing, installing plumbing lines and electrical fixtures, insulating the walls, installing drywall, and performing finish work.

Each of these activities is "capable of being distinct." For instance, the customer can benefit from the demolition even if Contractor performs nothing else. (Presumably the customer could find someone else to complete the rest of the work if it desired.) Similarly, the customer would obtain value from Contractor’s framing services or its drywall installation. Even if the remainder of construction hypothetically was turned over to another contractor to complete, no rework would be required for the framing services or drywall installation delivered by Contractor.

However, the various goods and services aren’t distinct within the context of the entire contract. Each one represents an input to produce a combined output specified by the customer—a rebuilt warehouse.

Because the various aspects of the contract are interrelated, Contractor wouldn’t have distinct performance obligations for each step of construction process. That is, the second criterion mentioned isn’t met for each of these activities, since they’re not distinct within the context of the contract with the customer. Therefore, Contractor would conclude there’s only one performance obligation in the arrangement—delivery of a rebuilt warehouse.

However, as we’ll see in Step 5, the fact that the arrangement contains just one distinct performance obligation doesn’t mean all revenue will be deferred until the new warehouse is completed.
Let’s say Biotech enters into a collaboration agreement with a customer. Under the terms of the agreement, Biotech delivers a license that will allow the customer exclusive marketing and distribution rights to a drug candidate currently under development. Biotech also agrees to perform R&D services with the goal of achieving approval of the drug candidate.

In exchange, the customer agrees to pay Biotech an up-front, nonrefundable license fee. The customer also agrees to make a large milestone payment if the drug candidate is approved by regulators as well as pay royalties on future sales of the commercialized product.

Depending on facts and circumstances, Biotech may have two performance obligations in this arrangement—providing a license to its intellectual property and performing R&D services. Alternatively, Biotech may just have a single performance obligation.

How so? Biotech would consider the nature of the promise it made to its customer. For example, Biotech may have agreed to deliver a license to the customer, and separately agreed to perform R&D services that others—such as contract research organizations—could have just as easily provided. These facts suggest the contract has two distinct performance obligations.

Alternatively, Biotech may have instead promised to transfer a combined item to the customer—namely, a fully developed drug compound. In this circumstance, the license and research services represent inputs to the deliverable that are the subject of the customer contract, which means the contract would contain a single performance obligation.

Assume Coder licenses software to a customer and agrees to provide PCS for one year. However, upon closer examination of the customer contract, Coder determines the PCS includes 24/7 telephone support and delivery of software updates for bug fixes and functionality improvements, when and if these are made available.

Under legacy GAAP, all types of PCS are typically viewed as a single accounting unit. However, Coder may reach a different conclusion under Topic 606—that the telephone support and the unspecified upgrade rights represent distinct performance obligations.

The unspecified product upgrades may be based on the software Contractor’s internal product road map or discussions with customers about feature enhancements.

In contrast, the telephone support is geared primarily toward helping address user issues related to the current software. Therefore, the two services are each capable of being distinct. In addition, they’re not interrelated to, or interdependent on, one another in the context of the contract.

In summary, the arrangement may contain up to three distinct performance obligations: delivery of a software license, telephone support, and unspecified updates. Note, however, that specified upgrades—in which a seller agrees to make certain software updates—will also typically qualify as distinct performance obligations under Topic 606. Unlike legacy GAAP, though, specified upgrade rights won’t preclude revenue recognition for other distinct performance obligations in a customer contract, even if there’s no VSOE for the fair value of those specified upgrades.

On a final note, Topic 606 expressly states a company need not assess whether promised goods or services are performance obligations if they’re immaterial in the context of the contract with the customer. However, if multiple goods or services in a contract are individually immaterial in the context of the contract, but are material in the aggregate, then a company can’t ignore those goods or services when identifying performance obligations.
STEP THREE:  
CALCULATE THE TOTAL TRANSACTION PRICE

This step can be challenging to apply, even for fixed-price arrangements. This is because Topic 606 requires companies to consider potential discounts, concessions, rights of return, liquidated damages, performance bonuses, and other forms of variable consideration when calculating the transaction price.

VARIABLE CONSIDERATION
INDUSTRY-SPECIFIC EXAMPLES

CONSTRUCTION

• If project completion is delayed beyond 180 days, the contractor will pay liquidated damages of $1,000 for every day delayed.
• If a project is completed prior to year-end, the contractor will receive a performance bonus of $1 million.

LIFE SCIENCES

• Upon enrollment of the first patient in a Phase II clinical trial, an entity will receive a $50 million milestone payment.
• The owner of intellectual property (IP) will receive royalties of 5% on all sales of product containing that IP.

SOFTWARE

• A Contractor will grant concessions to the customer if the software doesn’t perform as expected.
• A cloud provider agrees to provide 10 terabytes of storage for a fixed fee with additional storage charged at a monthly rate in 50 gigabyte increments.

RETAIL

• If customers purchase $1,000 or more of goods, they’ll receive a 10% discount.
• If customers aren’t completely satisfied with their purchase, they can return it for a full refund within 30 days.
When estimating the amount of variable consideration to include in the transaction price, companies shouldn’t look just to the stated terms of the customer contract. Consideration should also be given to any past business practices of providing refunds or concessions or the intentions of the seller in potentially providing rebates or other credits to specific customers.

Variable consideration should be calculated using either a best estimate or expected value approach, whichever method is expected to better predict the amount of consideration to which an entity will be entitled.

No matter which method a company uses to measure variable consideration, the transaction price should be reevaluated and updated as necessary during each reporting period over the course of the contract, as better estimates become available.

Another thing to keep in mind is that variable consideration shouldn’t consider any losses that may result from credit risk—in other words, the customer’s inability to pay for goods or services. If it’s probable the seller will collect the consideration to which it’s entitled (as evaluated in Step 1 of the process), the transaction price shouldn’t reflect any downward adjustments for credit risk. Instead, consistent with legacy GAAP, any credit risk will be accounted for as an impairment of corresponding receivables or other contract asset.
When developing the new revenue recognition guidelines, the FASB acknowledged there can be significant uncertainty involved in estimating variable consideration. In fact, it might even be misleading to reflect certain types of variable consideration in the transaction price.

For this reason, the FASB introduced the concept of constraint. Specifically, variable consideration should ultimately be included in the transaction price only to the extent that it’s probable a significant revenue reversal won’t occur. The codification doesn’t define the term significant revenue reversal.

To be clear, Topic 606 effectively requires a company to first estimate the total amount of variable consideration from a contract. Then, as a second independent step, a company will evaluate how much of the total estimated variable consideration should ultimately be included in the transaction price, considering the aforementioned constraint.

ASC Topic 606 provides specific guidance for sales- or use-based royalties on IP licenses. Specifically, in no circumstances should the transaction price include estimates of royalties on licenses of IP until any uncertainty around such royalties has been resolved. In other words, royalties from licensing IP represent a type of variable consideration that must always be constrained.

**Example**

Assume Biotech grants a license to a customer to commercialize a developmental drug candidate. Biotech will also perform R&D services for the customer, with the goal of gaining regulatory approval.

Biotech receives an up-front, nonrefundable license fee of $10 million. Biotech will also receive a milestone payment of $20 million upon regulatory approval and will be paid a 3% royalty on net sales of any commercialized products sold by the customer.

In this contract the milestone payment and sales royalties represent variable consideration. The milestone payment may or may not be included in the transaction price. Biotech would have to assess whether it’s probable a significant revenue reversal won’t occur to determine if the milestone payment should be included in the transaction price.

This determination will involve judgment and consideration of specific facts and circumstances. For example, if the contract were signed before the drug candidate even started Phase II clinical trials, this variable consideration likely would be constrained. On the other hand, if the contract were signed after completion of Phase III(b) trials, it’s less likely the variable consideration would be constrained.

The sales royalties wouldn’t be included in the transaction price based on specific guidance around sales- or use-based royalties on licenses of IP in Topic 606. Instead, any sales royalties would be reported as revenue only as and when sales of the approved and commercialized product occur.
SIGNIFICANT FINANCING COMPONENT

The transaction price should be adjusted if the arrangement contains an implicit element of financing.

EXAMPLE

To demonstrate, assume a manufacturing company typically sells a machine for $1 million with 10-day payment terms. In one instance, though, the company enters into a contract to sell an identical machine for $1.18 million. Payment is due from the customer in 18 months.

In this circumstance, it appears there’s an implicit financing component to the arrangement. The cash price—the cost of the equipment with normal 10-day payment terms—is $1 million. The fee in this arrangement is $1.18 million, or 11% higher than normal. This is because the manufacturing company in substance has provided the customer with an 18-month loan in addition to providing equipment.

When a customer contract contains a significant financing component, a company is required to adjust the transaction price to give consideration to the time value of money.

Using the previous example, the transaction price for the equipment would be $1 million, assuming that an 11% interest rate is the prevailing market rate considering the customer’s credit standing.

The manufacturing company would recognize $1 million of revenue when the equipment is transferred to the customer. Over the 18-month loan period, the manufacturing company would accrue interest on the receivable. Note that Topic 606 doesn’t allow the interest income to be reported as revenue. Instead it would typically be presented in the financing section of the income statement.

As a practical expedient, a company can presume there’s no significant financing component in a customer contract if the time period between payment and performance of services, or delivery of products, is one year or less.

ASC Topic 606 emphasizes that not all differences in the timing between satisfying a performance obligation and receiving payment give rise to a significant financing component.

EXAMPLE

BIOTECH

Assume Biotech agrees to perform R&D services for a customer—namely, conducting clinical trials on a new drug candidate. Biotech owns the IP for this drug candidate but has exclusively licensed its marketing rights to the customer.

As consideration, Biotech will receive a $10 million milestone payment, but only if the drug is approved by regulators. Regulatory approval won’t occur until at least three years from contract signing at the earliest.

The delay between payment of the arrangement consideration and the performance of R&D services doesn’t give rise to a significant financing element. Designed to protect a customer from taking undue risk, milestone payments are customary in the life sciences industry. In this example, there’s significant uncertainty as to whether Biotech will be able to develop a safe and effective medicine that will gain regulatory approval. The customer is delaying payment because of that uncertainty and not because Biotech is providing implicit
Let’s say Contractor agrees to refurbish a 500,000-square-foot facility for a customer. The project is expected to take 18–24 months to complete. As is customary for similar types of contracts, Contractor receives a 25% down payment, which will be used to acquire materials for the facility that are in limited supply. The materials likely won’t be installed, however, until toward the end of the contract.

The advance payment doesn’t give rise to a significant financing component. The payment is necessary to secure materials that are in scarce supply and likely have a long lead time to procure. This conclusion is appropriate even if the materials won’t be installed or delivered to the job site until the latter stages of the contract.

Let’s also assume that three additional payments are due following specific milestones: upon passing the electrical inspection, completion of drywall installation, and receipt of the certificate of occupancy. At each payment date the customer will withhold 5% of the amount due as retention. The retained amounts will be remitted to Contractor only once the customer has signed off on all open punch-list items.

Again, the retention isn’t designed to be a significant financing element. Instead it provides the customer with assurance that Contractor will complete its obligations. Accordingly, the retention provisions of the contract aren’t deemed to be a significant financing component.
STEP FOUR: ALLOCATE THE TRANSACTION PRICE TO THE PERFORMANCE OBLIGATIONS

The process for allocating the transaction price to the distinct performance obligations is similar to what’s done today in many industries and is based on a relative stand-alone selling-price approach.

Assume Coder enters into a fixed-price bundled contract to deliver software licenses, implementation services, and one year of telephone support. Coder believes it can directly determine the stand-alone selling price of the telephone support based on substantive renewal rates. Furthermore, although there’s no observable stand-alone selling price for the software license, Coder believes it can estimate this price using top-down and bottom-up approaches.

The implementation services don’t constitute significant customization or modification of the software. Instead they involve Coder helping the customer troubleshoot any installation and interfacing issues that arise. There haven’t been many clients who have contracted for these services, and the prices in those instances have deviated substantially. Therefore, Coder’s pricing for the implementation services is highly variable.

Under Topic 606, Coder would be permitted to use a residual approach to allocate a portion of the transaction price to the implementation services, provided that the outputs of this approach reflect the consideration that Coder would expect to be entitled in exchange for such services.

However, before using a residual approach, Coder would evaluate whether there’s a discount embedded in the arrangement and whether that discount relates to one or both of the distinct performance obligations whose stand-alone selling price can be determined—in this example, the telephone support or software license. If so, the discount would first have to be allocated to the license, the telephone support, or both before the residual amount would be allocated to the implementation services. Otherwise the discount would be allocated on a pro rata basis, after applying the residual approach, to all three performance obligations.
To perform the allocation, the business should first try to determine the stand-alone selling price of each distinct performance obligation.

This can be straightforward if the business routinely sells the product or service on a stand-alone basis to similar customers. If an entity doesn’t sell a particular performance obligation on a stand-alone basis, it will have to estimate the stand-alone selling price. Techniques to make such estimates include:

**Top-down Approach**
A company can work with its sales team to develop a price it believes the market would be willing to pay for its goods or services. In doing so, the company should consider its standing in the marketplace—for example, is it the market leader, meaning it could command a premium price? Or is it a new entrant, in which case it may have to discount its prices?

**Bottom-up Approach**
A company can also estimate the stand-alone selling price for a good or service based on a “cost plus” methodology, estimating its costs to provide a good or service and adding a reasonable margin for its production and selling efforts.

**Residual Approach**
If the stand-alone selling prices of one or more performance obligations are highly variable or uncertain, a business can use a residual approach so long as doing so is consistent with the objective of Topic 606. That is, the amount allocated as a result of applying the residual approach would reflect the consideration to which a company expects to be entitled in exchange for a good or service.
Under ASC Topic 606, a company will recognize revenue as it satisfies a performance obligation.

In other words, revenue is recognized each time a company transfers a good or service to the customer and the customer obtains control over the delivered item.

These principles seem straightforward, but they may result in very different patterns of revenue recognition compared with legacy GAAP.

EXAMPLE

Many original equipment manufacturers used the sell-through method under legacy GAAP when recognizing revenue from sales to distributors. Under this method, revenue isn’t recognized until the product is sold through the sales channel to the end customer. This accounting policy is appropriate when distributors are afforded generous return rights, price protection privileges, or other entitlements that call into question whether the arrangement fee is fixed or determinable—a necessary condition for revenue recognition under legacy GAAP.

Under the new guidelines, revenue is recognized upon transferring control of a good or service to the distributor regardless of whether the arrangement fee is fixed or determinable. However, the amount of revenue reported may be constrained somewhat to reflect the variable transaction price risk. This means the new revenue recognition guidance eliminates the sell-through method of revenue recognition and instead requires more judgment in determining the amount of revenue to recognize upon transferring control of products to a distributor.
REFUND RIGHTS

Often a company will sell items with an express or implied refund right. For example, the company will permit the customer to return a good for a full refund or credit against a future purchase if the customer isn’t satisfied with a purchase for any reason. When a good or service is sold together with a refund right, a company should record:

- Revenue for the transferred goods or services in the amount of consideration to which the company expects to be entitled—therefore, no revenue would be recognized for products expected to be returned or services expected to be refunded.
- A refund liability for any consideration received (or in some cases receivable) that’s expected to be refunded.
- As applicable, an asset—and corresponding adjustment to cost of goods sold (COGS)—for a company’s right to recover products from customers upon settling the refund liability.

Note that the principles in ASC Topic 606 are intended to be applied on a contract-by-contract basis. However, the guidance permits, as a practical expedient, application to a portfolio of similar contracts if doing so wouldn’t result in material differences. In accounting for contracts with refund and return rights, companies may want to take advantage of this accommodation.

Exchanges by customers of one product for another of the same type, quality, condition, and price—one color or size for another, for example—aren’t considered returns under Topic 606. In fact, these types of exchange have no accounting implications under the new revenue recognition guidance.

Contracts in which a customer may return a defective product in exchange for a functioning product should be evaluated as a warranty. Typically, Topic 606 requires the same accounting for assurance-type warranties as legacy GAAP—record a liability and COGS for any probable warranty claims, in accordance with ASC 450-20.

### EXAMPLE

To demonstrate, assume Apparel offers its customers the right to return any products purchased up to 30 days after sale, for any reason. Last Tuesday, Apparel sold 100 red sweaters to different customers. Based on historical experience, Apparel expects 15 of those sweaters to be returned for a full refund. Each sweater sells for $80 and costs Apparel $35 to produce.

Apparel would record the following journal entries for the sale of the sweaters and the expected refund liability and corresponding asset.

<table>
<thead>
<tr>
<th>Account</th>
<th>Amount</th>
</tr>
</thead>
<tbody>
<tr>
<td>Cash</td>
<td>$8,000</td>
</tr>
<tr>
<td>Revenue</td>
<td>$6,800</td>
</tr>
<tr>
<td>Refund liability</td>
<td>$1,200</td>
</tr>
<tr>
<td>COGS</td>
<td>$2,975</td>
</tr>
<tr>
<td>Recovery asset</td>
<td>$625</td>
</tr>
<tr>
<td>Inventory</td>
<td>$3,500</td>
</tr>
</tbody>
</table>
CONTROL TRANSFERS OVER TIME

In some situations, control over a good or service isn’t transferred at a point in time but rather over time. This would occur when one or more of the following conditions is met.

**CRITERIA FOR TRANSFERRING CONTROL OVER TIME**

<table>
<thead>
<tr>
<th>CONDITION</th>
<th>EXAMPLE</th>
</tr>
</thead>
<tbody>
<tr>
<td>The customer simultaneously receives and consumes the benefits provided by a company as it performs them.</td>
<td>A company provides daily cleaning services. The customer benefits from these services as the company performs the work.</td>
</tr>
</tbody>
</table>

**OR**

The company’s performance creates or enhances an asset—work in process, for example—that the customer controls as the asset is created or enhanced.

**CONTRACTOR**

Contractor performs refurbishments on a manufacturing plant owned by a customer. As Contractor performs the work, the customer’s asset is enhanced.

**OR**

The company’s performance doesn’t create an asset with an alternative use to the company, and the company has an enforceable right to payment for performance completed to date.

**CODER**

Coder is asked to develop custom software for a customer. The software can’t be transferred to another customer. If the contract is terminated prematurely, Coder has an enforceable right to collect compensation from the customer equal to Coder’s development costs incurred plus a normal profit margin on those services.

Recall our earlier example, in which Contractor agrees to rebuild a dilapidated warehouse for a customer. Previously, Contractor concluded the individual performance obligations—demolition, pouring the foundation, framing, installing plumbing lines and electrical fixtures, insulating the walls, installing drywall, and performing finish work—aren’t distinct within the context of the contract because they’re interrelated. In other words, each activity represents an input to produce a combined output specified by the customer.

Nonetheless, Contractor may still be able to recognize revenue over time as the renovation work is performed—in lieu of waiting until the entire job is complete. This accounting outcome would occur if either:

- Contractor’s performance creates or enhances an asset the customer controls as the asset is created or enhanced. This may very well be the case if Contractor is performing the refurbishment work on customer-owned property.
- Contractor’s performance doesn’t create an asset with an alternative use—Contractor can’t sell the refurbishments to another customer, for example—and Contractor has a right to payment for performance completed to date.
When revenue is recognized over time, Topic 606 allows a company to measure performance using either input measures, such as those based on costs or labor hours incurred, or output measures, such as milestones or units produced. However, an entity doesn’t have free choice to select a measure of progress. Instead the performance measure should be determined based on the method that best reflects the pattern in which a reporting entity satisfies its performance obligations, considering the nature of the goods and services being provided to the customer.

Note that under the new guidance, a units-of-delivery or production method may only be appropriate if, at the end of the reporting period, the value of any work in progress or units produced, but not yet delivered to the customer, is immaterial. This is because if customers are gaining control of an asset over time, revenue should be recognized on a corresponding basis. Waiting to recognize revenue until a unit is produced or delivered may fail to properly match the timing of revenue recognition with when control over the goods or services are transferred to the customer. This outcome could be a significant change in practice for many contractors that currently use the units-of-production or units-of-delivery method to recognize revenue from production contracts.

On the other hand, there are expected to be few differences in employing a cost-to-cost or similar input measure of progress under Topic 606 versus how this type of method is applied under legacy GAAP.
LICENSES

Software and life sciences companies typically grant customers licenses to IP. ASC Topic 606 specifies whether revenue from granting a license should be recognized at a point in time or over time.

As a first step, a company must determine whether the license is distinct from other goods and services in the contract, as mentioned earlier. Assuming that granting a license represents a distinct performance obligation, revenue would be recognized as follows:

- If the underlying IP to which the license relates is functional, then revenue is recognized at a point in time—namely, when control of the license is transferred to the customer at the beginning of the license period.
- If the underlying IP is symbolic—that is, the IP doesn’t have significant standalone functional value but instead provides utility in the form of access to the entity’s past or ongoing activities—then revenue from the performance obligation will be recognized over time.

EXAMPLE

Coder licenses software under a three-year time-based license. Coder also offers “when and if available” upgrades.

ANALYSIS

- The license is distinct from the unspecified upgrades because the customer can benefit from the license even if the unspecified upgrades aren’t provided.
- Revenue allocated to the license performance obligation would be recognized upon transfer of the license to the customer. The IP to which the license relates is functional. For purposes of the analysis, Coder should ignore the fact that unspecified upgrades will enhance or change the IP because those updates represent a separate performance obligation.
- The arrangement doesn’t meet any of the three conditions mentioned previously to recognize revenue over time.
As a first step, a company must determine whether the license is distinct from other goods and services in the contract.

Coder offers a cloud-based storage solution, which it hosts on its own servers. Coder grants a license to the customer that allows it to access Coder’s cloud solution for 12 months.

**ANALYSIS**
- The arrangement contains multiple performance obligations, including a license to use Coder’s software, hosting, and storage services.
- The license isn’t distinct, because it’s highly interrelated with other promised goods or services in the contract. As a result, the arrangement represents a single performance obligation.
- The customer simultaneously receives and consumes the benefits provided by Coder’s services. Hence Coder would recognize revenue from satisfaction of the performance obligation over time.

Biotech licenses to a customer the commercialization rights to a drug compound under development. Biotech also agrees to provide R&D services to ready the drug for regulatory approval. The R&D services could be performed by other vendors, such as contract research organizations.

**ANALYSIS**
- The license is a distinct performance obligation. This is because the R&D services and license aren’t interdependent upon one another.
- Revenue allocated to the license would be recognized at a point in time, upon transfer of the license to the customer. The IP subject to the license is functional. As with the previous example, Biotech should ignore the fact that its R&D services will enhance the IP because those services are a distinct performance obligation.

Apparel licenses to a customer the rights to use Apparel’s trade name on branded coffee mugs for a period of five years.

**ANALYSIS**
- The IP underlying the license is symbolic—it doesn’t have standalone functional value.
- Accordingly, Apparel would recognize revenue from this license over time, evenly throughout the five-year license term.
OTHER ISSUES

In this section:
- Contract Costs
- Contract Modifications
- Disclosures
**Obtaining a Contract**

- Incremental costs of obtaining a contract are those incurred only as a result of a contract being obtained.
- Incremental costs to obtain a contract are deferred, so long as the seller expects to recover those costs.
- Any deferred costs are amortized over the life of the contract (including, as applicable, anticipated contract renewals) in the same pattern as revenue is recognized.
- A company may elect to immediately expense these costs if the amortization period would be one year or less.

<table>
<thead>
<tr>
<th>QUALIFYING COSTS</th>
<th>NONQUALIFYING COSTS</th>
</tr>
</thead>
<tbody>
<tr>
<td>Sales commissions</td>
<td>- Customer credit evaluations</td>
</tr>
</tbody>
</table>

**Fulfilling a Contract**

- If the costs of fulfilling a contract should be accounted for under other GAAP standards—ASC 330 or ASC 985-20, for example—then apply those other standards.
- If no other GAAP applies, then fulfillment costs should be capitalized if all of the following are true:
  - They relate directly to a contract or to an anticipated contract that the entity can specifically identify.
  - They generate or enhance resources of the entity that will be used in satisfying performance obligations in the future.
  - They’re expected to be recovered under the contract.
- Any deferred costs are amortized over the life of the contract (including, as applicable, anticipated contract renewal) in the same pattern as revenue is recognized. Such costs aren’t allowed to be immediately expensed even if the contract will be completed in one year or less.

**QUALIFYING COSTS**

- Equipment recalibration costs (if required to fulfill a contract)
- Certain design costs (if required to fulfill a contract)

**NONQUALIFYING COSTS**

- Costs of wasted materials, labor, or other resources
- Costs related to already satisfied performance obligations

ASC Topic 606 clarifies the accounting for certain costs associated with customer contracts.
A contract modification is a change in the scope or price (or both) of a contract that’s approved by the parties to the contract.

In the construction industry, a contract modification may be described as a change order or a variation. In other industries a contract modification is sometimes called an amendment. ASC Topic 606 contains complex guidelines around the accounting for contract modifications. In some cases, the modification will be treated as a separate contract and won’t affect revenue recognized on the original contract in any way. In other situations, a company will be required to treat a contract modification as a termination of the existing contract and the creation of a new replacement contract. In still other cases a company will account for a contract modification by recording a catch-up journal entry to adjust the cumulative revenue recognized to date on the contract. The ultimate accounting treatment will depend on the nature of the modification.

Assume Contractor agrees to refurbish a facility for a customer. The 12-month project is expected to cost Contractor $1 million to complete, and Contractor will charge a fixed $2 million fee for the services. Assume also that the contract contains a single performance obligation—the construction services. Revenue will be recognized over time using a cost-to-cost progress measure because the customer controls the facility during the refurbishment period.

Six months into the contract, Contractor is about 40% complete with the assignment, having incurred $400,000 in cost (and recognizing $800,000 in cumulative revenue to date). At that time the customer requests that Contractor make a significant change to the facility’s layout, which will result in an additional $200,000 of costs. The customer and Contractor agree on a price of $500,000 related to the change order.

Following the contract modification, the new estimated transaction price and costs are as follows:

<table>
<thead>
<tr>
<th></th>
<th>Transaction Price</th>
<th>Contract Cost</th>
</tr>
</thead>
<tbody>
<tr>
<td>Original estimate</td>
<td>$2,000,000</td>
<td>$1,000,000</td>
</tr>
<tr>
<td>Change order</td>
<td>$600,000</td>
<td>$200,000</td>
</tr>
<tr>
<td><strong>New estimate</strong></td>
<td><strong>$2,500,000</strong></td>
<td><strong>$1,200,000</strong></td>
</tr>
</tbody>
</table>

The change order isn’t considered a separate performance obligation, since the contract amendment doesn’t create a new good or service distinct from the construction services set out in the original contract. Accordingly, Contractor will account for the modification as though it were part of the original contract, using a cumulative catch-up approach.

Contractor will update its measure of progress, determining that it has satisfied 33% of its revised performance obligation to date ($400,000 ÷ $1,200,000). This would mean that Contractor should recognize cumulative revenue of $825,000 (33% × $2,500,000), resulting in Contractor recording—at the time of the change order—additional revenue of $25,000 ($825,000 – $800,000) as a catch-up adjustment.
Let’s say that Contractor enters into a second contract with a different customer to perform refurbishment work on customer-owned property for a fixed fee. Unfortunately, the contract doesn’t go well. Inspectors find toxic materials in the walls, causing Contractor to incur $1 million of unanticipated removal and disposal costs. The customer has refused to reimburse Contractor for these additional costs, claiming Contractor should have known that similar vintage buildings would contain these harmful materials. The customer further believes Contractor should have considered the potential additional remediation costs in its original bid.

Even though Contractor doesn’t have an agreement with the customer as to the scope and price of the additional work, it’s possible under Topic 606 that a contract modification exists. As a first step, Contractor would evaluate whether its claim for recovery of the additional costs is enforceable. Contractor would have to evaluate all the facts and consider the laws and regulations of the jurisdiction in which legal action would take place. Significant judgment is involved in this evaluation.

If the Contractor does believe the claim is enforceable, it would then determine whether de facto contract modification creates new goods or services that are distinct from the original performance obligation in the contract. In this example no new goods or services would be created—the additional work relates to the same refurbishment services promised under the terms of the original contract. The claim would be treated as an amendment of the original contract and affect the estimated costs and revenue associated with that arrangement.

As a final step, Contractor would adjust the transaction price of the original contract to consider the variable consideration associated with the claim. Of course, Contractor would also consider the “constraint” on variable consideration, and may conclude that no additional revenue should be recognized because of the uncertainties around the claim.
One of the FASB’s main goals in issuing the new guidance was to improve the disclosures around revenue recognition, believing that under legacy GAAP the required disclosures about revenue “were limited and lacked cohesion.” As a result, Topic 606 contains extensive new disclosures related to a company’s contracts with customers. Many of these disclosures are quantitative in nature and hence entity-specific.

All entities—public and nonpublic—will also have to include qualitative disclosure of the methods used to recognize revenue for performance obligations satisfied over time, such as a description of the output methods or input methods used to measure progress towards satisfaction of the performance obligation and how those methods are applied.

All entities must also disclose significant judgments made in applying the guidance in Topic 606, including judgments around the timing of satisfying performance obligations, determining the transaction price, and allocating amounts to performance obligations. In addition, all entities will need to disclose information about their contracts with customers, including the following:

- The nature of the goods or services the entity has promised to transfer, highlighting any performance obligations where the entity is acting as an agent
- When the entity typically satisfies its performance obligations, such as upon shipment, upon delivery, as services are rendered, or upon completion of service
- Significant payment terms, including when payment typically is due
- Whether any contracts have a significant financing component
- Whether any consideration amount is variable, and whether the estimate of variable consideration is typically constrained
- Obligations for returns, refunds, and other similar obligations
- Types of warranties offered

Public entities have additional qualitative disclosure requirements around accounting policies selected and critical inputs and assumptions for determining the transaction price and estimated standalone selling prices of performance obligations2.

2 See paragraphs 18-20 of ASC 606-10-50 for additional details.
### MINIMUM REQUIRED QUANTITATIVE DISCLOSURES

<table>
<thead>
<tr>
<th></th>
<th>Public Entities</th>
<th>Nonpublic Entities</th>
</tr>
</thead>
<tbody>
<tr>
<td><strong>Revenue</strong></td>
<td>Revenue from contracts with customers, separate from other sources of revenue</td>
<td>May elect to not present the disclosure at left. When such election is made, the nonpublic entity shall disclose, at a minimum:</td>
</tr>
<tr>
<td></td>
<td>Impairment losses recognized on accounts receivable or contract assets, separate from impairment losses on other contracts</td>
<td>• Revenue disaggregated according to the timing of transfer of goods or services—revenue from goods or services transferred to customers at a point in time and revenue from goods or services transferred to customers over time, for example.</td>
</tr>
<tr>
<td><strong>Disaggregated</strong></td>
<td>Revenue must be disaggregated into categories that depict how the nature, amount, timing, and uncertainty of revenue and cash flows are affected by economic factors. Examples of how revenue can be disaggregated include the following:</td>
<td>May elect to not present the disclosure at left. When such election is made, the nonpublic entity shall disclose, at a minimum:</td>
</tr>
<tr>
<td><strong>information about</strong></td>
<td>• By geographic region</td>
<td>• Qualitative information about how economic factors, such as type of customer, geographical location of customers, and type of contract affect the nature, amount, timing, and uncertainty of revenue and cash flows.</td>
</tr>
<tr>
<td><strong>revenue</strong></td>
<td>• By product line</td>
<td></td>
</tr>
<tr>
<td></td>
<td>• By customer type, such as governmental versus corporate entities</td>
<td></td>
</tr>
<tr>
<td></td>
<td>• By timing of revenue recognition (over time or at a point in time)</td>
<td></td>
</tr>
<tr>
<td></td>
<td>• By sales channel (goods sold through distributors versus goods sold directly to end users)</td>
<td></td>
</tr>
<tr>
<td></td>
<td>• By any other breakdown that would be helpful for users of the financial statements</td>
<td></td>
</tr>
<tr>
<td></td>
<td>The FASB expects that most companies will disclose multiple categories of disaggregated information. Note that for public entities, this information will likely not conform to information presented in the segments footnote. As a result, the two disclosures will need to be reconciled.</td>
<td></td>
</tr>
<tr>
<td><strong>Information about</strong></td>
<td>Public entities must disclose the opening and closing balances of contract assets (such as unbilled receivables), contract liabilities (perhaps deferred revenue and refund liabilities), and receivables. Public entities must also disclose:</td>
<td>In lieu of providing the disclosures at left, a nonpublic entities may simply disclose the opening and closing balances of receivables, contract assets, and contract liabilities from contracts with customers.</td>
</tr>
<tr>
<td><strong>contract balances</strong></td>
<td>• Revenue recognized in the reporting period that was included in the contract liability balance at the beginning of the period</td>
<td></td>
</tr>
<tr>
<td></td>
<td>• Revenue recognized in the reporting period from performance obligations satisfied in previous periods—due to changes in transaction price, for example</td>
<td></td>
</tr>
<tr>
<td></td>
<td>In addition, public entities must disclose the significant changes in contract assets and contract liabilities during the reporting period using both qualitative and quantitative information.</td>
<td></td>
</tr>
<tr>
<td><strong>Information about</strong></td>
<td>Public entities must disclose the amount of the transaction price that’s been allocated to performance obligations that haven’t been satisfied as of the balance sheet date as well as the approximate timing for when those performance obligations are expected to result in recognition of revenue, using either quantitative time bands—1–2 years or 2–3 years, for example—or qualitative information.</td>
<td>Nonpublic entities can omit all of the disclosures at left.</td>
</tr>
<tr>
<td><strong>the timing of future</strong></td>
<td></td>
<td></td>
</tr>
<tr>
<td><strong>revenue recognition</strong></td>
<td></td>
<td></td>
</tr>
</tbody>
</table>
We’re Here to Help

The American Institute of CPAs (AICPA) Revenue Recognition Task Force has developed an Audit and Accounting Guide on Revenue Recognition to assist financial statement preparers. The publication includes many implementation issues arising from the new standard, including 16 industry-specific chapters with illustrative examples. The guide is updated with developments on a frequent basis.

To stay up-to-date, you can subscribe at mossadams.com/subscribe to receive Alerts and Insights on this topic. If you have questions on how the new standard could affect your business, contact your Moss Adams professional.

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