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Revenue Recognition: Now – Next

973.822.2220

Learning Objectives

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Learning Objectives:

With illustrative examples and an examination of important rules and principles, participants will acquire the background and context to accurately identify and resolve revenue recognition issues. After completing this session you will be able to:

- Define and apply the Revenue Recognition principles within ASC 605 (SAB 104)
- Compare, contrast and apply the principles that are utilized to properly account for Revenue Arrangements with Multiple Deliverables under ASC 605 (EITF 00-21 and ASU 2009-13)
- Outline and apply the principles that are incorporated in Revenue Arrangements that Contain Software Elements under ASC 985-605 (ASU 2009-14)
- Understand the proposed new Joint Standard for Revenue Recognition

Program Prerequisites: 2 to 3 years of Public or Corporate accounting experience

Program/Course Level: Intermediate

Program Content:

Revenue recognition is one of the most important reporting areas faced by accountants and standard setters. Avoid the many traps related to recognizing revenue in the delivery of products and services while you become familiar with GAAP requirements of revenue recognition including multiple element arrangements.

Advance Preparation: None

Field of Study: Accounting

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ASC 605 (ASU 2009-13) **Revenue Arrangements with Multiple Deliverables**
ASC 985-605 (ASU 2009-14) **Certain Revenue Arrangements that Contain Software Elements**
Proposed New Joint Standard for Revenue Recognition

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ASC 605 (ASU 2009-13) **Revenue Arrangements with Multiple Deliverables**
ASC 985-605 (ASU 2009-14) **Certain Revenue Arrangements that Contain Software Elements**
Proposed New Joint Standard for Revenue Recognition

ASC 605 (ASU 2009-13) Revenue Arrangements with Multiple Deliverables

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I. ASC 605 (ASU 2009-13) Revenue Arrangements with Multiple Deliverables

Title	Guidance Superseded	Former GAAP Reference	ASU No.	Codification Topic
Revenue Arrangements with Multiple Deliverables	ASC 605 (EITF 00-21)	ASC 605 (ASU 2009-13)	2009-13	Revenue Recognition (Topic 605)
Certain Revenue Arrangements that Include Software Elements	~ ASC 605 (EITF 00-21)	FASB ASU 2009-14 (EITF 09-3)	2009-14	Software (Topic 985)

ASC 605 (ASU 2009-13) Revenue Arrangements with Multiple Deliverables

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A. **Background**

1. Provides revenue recognition guidance for multiple-element arrangements.
2. Amends ASC 605 (ASU 2009-13) to achieve financial reporting that better reflects the economics.
3. Separation and allocation guidance only: Look to other guidance on when criteria for revenue recognition are met.
4. May result in earlier revenue recognition as guidance results in more deliverables in an arrangement, leading to less revenue deferral.

ASC 605 (ASU 2009-13) Revenue Arrangements with Multiple Deliverables

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5. Major modifications from ASC 605 (ASU 2009-13) include:
   a. Eliminates fair value threshold requirement for separation.
   b. Establishes selling price hierarchy.
   c. Eliminates residual method of allocating arrangement consideration and replaces it with the relative selling price method.

KEY POINT
Align revenue recognition with economic substance.

ASC 605 (ASU 2009-13) Revenue Arrangements with Multiple Deliverables

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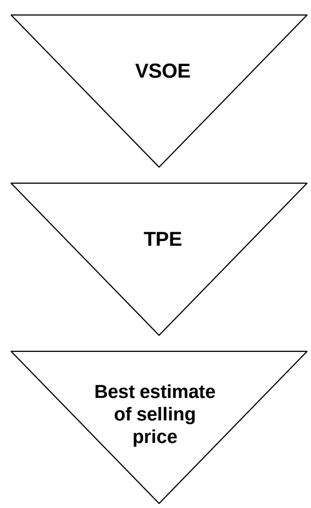
Selling Price Hierarchy

1. Significant judgment involved in identifying estimated selling price.
2. FASB ASU 2009-13 (EITF 08-1) does not provide guidance on determining selling price, but does provide examples.
3. Consult with controllership when making such determinations.



ASC 605 (ASU 2009-13) Revenue Arrangements with Multiple Deliverables

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Example

Delivery of Products and Services

Issue 00-21

Delivered Products

VSOE exists

+

Undelivered Services

No VSOE

No third-party reliable and objective evidence (TPE)

Estimated selling price exists

=

1 unit

(Use of estimated selling price is not allowed; therefore, cannot separate)

Issue 08-1

Delivered Products

VSOE exists

+

Undelivered Services

No VSOE

No TPE

Estimated selling price exists

=

2 units

(Use of estimated selling price is allowed; therefore, separate)

ASC 605 (ASU 2009-13) Revenue Arrangements with Multiple Deliverables

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Example

Change in Allocation Method

Facts:

Total consideration $1M

Two deliverables:

1. Delivered product (estimated selling price $800K, NO VSOE or TPE)
2. Undelivered services (VSOE is $400)

ASC 605 (EITF 00-21)

Residual Method:

Total Consideration $1M

-

Undelivered services $400K

=

Allocated to delivered product $600K

FASB ASU 2009-13 (EITF 08-1)

Residual Selling Price Method:

Delivered equipment selling price $800K

÷

Aggregate selling price equipment and installation $1.2M

x

Total Consideration $1M

=

Allocated to delivered product $667K

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ASC 605 (ASU 2009-13) Revenue Arrangements with Multiple Deliverables

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B. **General Principles**

1. "Revenue arrangements with multiple deliverables shall be divided into separate units of accounting if the deliverables in the arrangement meet the criteria in paragraph 9."[1]
2. "Arrangement consideration shall be allocated among the separate units of accounting based on their relative selling prices. The amount allocated to the delivered unit(s) of accounting is limited as discussed in paragraph 14."[2]
3. "Applicable revenue recognition criteria shall be considered separately for separate units of accounting."[3]

[1-3] Financial Accounting Standards Board. FASB Draft Abstract – EITF Issue No. 08-1. http://www.fasb.org/cs/BlobServer?blobcol=urldata&blobtable=MungoBlobs&blobkey=id&blobwhere=1175819938544&blobheader=application/pdf. (p. 6)

ASC 605 (ASU 2009-13) Revenue Arrangements with Multiple Deliverables

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C. **Application Guidance**

1. **Units of Accounting**
   a. Evaluate at the beginning of the arrangement to determine whether the deliverables represent separate units of accounting. This must be done as each item in the arrangement is delivered.
   b. In an arrangement with multiple deliverables, the delivered item(s) shall be considered a separate unit of accounting if both of the following criteria are met:
      1) The delivered item has value to the customer on a standalone basis. This can be shown if it is sold separately by any vendor or the customer could resell the delivered item on a standalone basis.
      2) If the arrangement includes a general right of return relative to the delivered item, delivery or performance of the undelivered item(s) is considered probable and substantially in the control of the vendor.[1]

[1] Financial Accounting Standards Board. FASB Draft Abstract – EITF Issue No. 08-1. http://www.fasb.org/cs/BlobServer?blobcol=urldata&blobtable=MungoBlobs&blobkey=id&blobwhere=1175819938544&blobheader=application/pdf. (p. 6)

ASC 605 (EITF 00-21) Revenue Arrangements with Multiple Deliverables (<u>Old</u> Rule)

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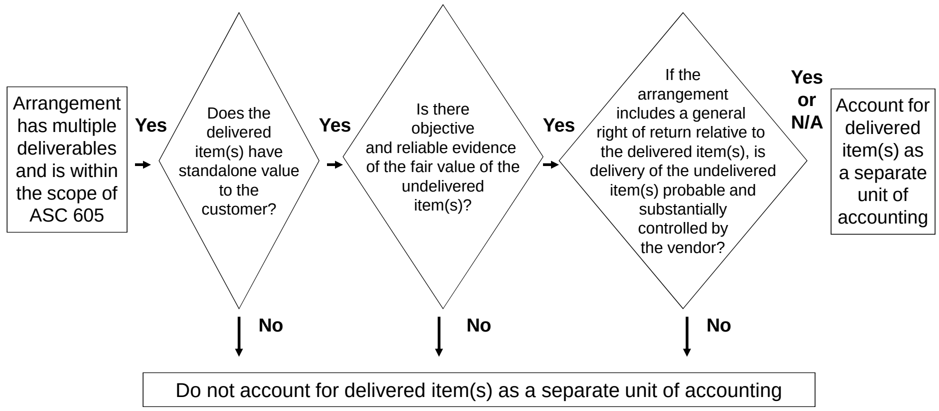
Determining Separate Units of Accounting



ASC 605 (ASU 2009-13) Revenue Arrangements with Multiple Deliverables (<u>New</u> Rule)

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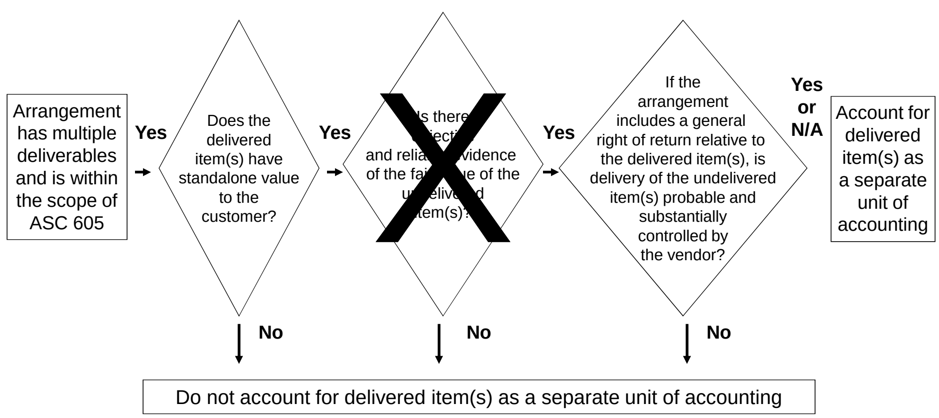
Determining Separate Units of Accounting



ASC 605 (ASU 2009-13) Revenue Arrangements with Multiple Deliverables

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c. A delivered item(s) that does not qualify as a separate unit of accounting within the arrangement shall be combined with the other applicable undelivered item(s) within the arrangement. The allocation of arrangement consideration and the recognition of revenue shall then be determined for those combined deliverables as a single unit of accounting.[1]

[1] Financial Accounting Standards Board. FASB Draft Abstract – EITF Issue No. 08-1. http://www.fasb.org/cs/BlobServer?blobcol=urldata&blobtable=MungoBlobs&blobkey=id&blobwhere=1175819938544&blobheader=application/pdf. (p. 6)

ASC 605 (ASU 2009-13) Revenue Arrangements with Multiple Deliverables

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D. **Allocation of Arrangement Consideration**

1. The amount of total arrangement consideration must be fixed or determinable other than with respect to the impact of any refund rights or performance bonuses to which the vendor may be entitled.
2. This consideration shall be allocated at the inception of the arrangement to all deliverables based on their relative selling price.[1]
   a. **Relative Selling Price**
      Determined by using VSOE of selling price or third-party evidence of selling price. If neither exists, the vendor shall use a best estimate of the selling price for that deliverable.
3. To the extent that any separate unit of accounting in the arrangement is required to be recorded at fair value, the amount allocated to that unit of accounting shall be its fair value.[2]

[1-2] Financial Accounting Standards Board. FASB Draft Abstract – EITF Issue No. 08-1. http://www.fasb.org/cs/BlobServer?blobcol=urldata&blobtable=MungoBlobs&blobkey=id&blobwhere=1175819938544&blobheader=application/pdf. (p. 6-8)

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ASC 605 (ASU 2009-13) Revenue Arrangements with Multiple Deliverables

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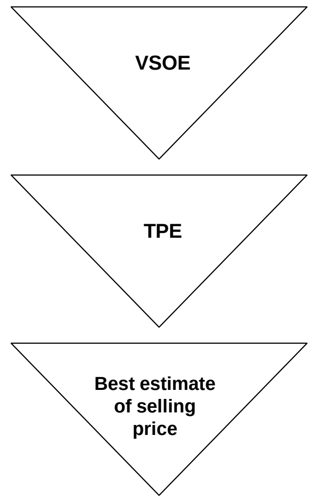
Selling Price Hierarchy

1. Significant judgment involved in identifying estimated selling price.
2. FASB ASU 2009-13 (EITF 08-1) does not provide guidance on determining selling price, but does provide examples.
3. Consult with controllership when making such determinations.



ASC 605 (ASU 2009-13) Revenue Arrangements with Multiple Deliverables

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4. The amount allocable to the delivered unit(s) of accounting is limited to the amount that is not contingent upon the delivery of additional items or meeting other specified performance conditions.
5. The measurement of revenue per period shall be limited to the measurement that results from assuming that cancellation of the arrangement will not occur. The amount recorded as an asset for the excess of revenue recognized under the arrangement over the amount of cash or other consideration received from the customer since the inception of the arrangement shall not exceed all amounts to which the vendor is legally entitled, including cancellation fees.
6. **VSOE of Selling Price**
   a. The price charged for a deliverable when it is sold separately,
   b. For a deliverable not yet being sold separately, the price is established by management[1].

[1] Financial Accounting Standards Board. FASB Draft Abstract – EITF Issue No. 08-1. http://www.fasb.org/cs/BlobServer?blobcol=urldata&blobtable=MungoBlobs&blobkey=id&blobwhere=1175819938544&blobheader=application/pdf. (p. 8)

ASC 605 (ASU 2009-13) Revenue Arrangements with Multiple Deliverables

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7. Vendor's best estimate of selling price should be the price at which the vendor would transact if the deliverable were sold by the vendor regularly on a standalone basis.
8. Contractually stated prices for individual products or services in an arrangement with multiple deliverables shall not be presumed to be representative of VSOE, third party evidence of selling price, or a vendor's best estimate of selling price.[1]

E. **Direct Costs**

The Task Force did not provide guidance on this issue due to the broad nature of the question.[2]

[1-2] Financial Accounting Standards Board. FASB Draft Abstract – EITF Issue No. 08-1. http://www.fasb.org/cs/BlobServer?blobcol=urldata&blobtable=MungoBlobs&blobkey=id&blobwhere=1175819938544&blobheader=application/pdf. (p. 8-9)

ASC 605 (ASU 2009-13) Revenue Arrangements with Multiple Deliverables

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F. **Disclosure**

A vendor shall disclose the following information:

1. The nature of its multiple-deliverable arrangements.
2. The significant deliverables within the arrangements.
3. The general timing of delivery or performance of service for the deliverables within the arrangements.
4. Performance, cancellation, termination and refund type provisions.
5. A discussion of the significant factors, inputs, assumptions and methods used to determine selling price for the significant deliverables.
6. Whether the significant deliverables in the arrangements qualify as separate units of accounting, and if not the reasons why this is so.
7. The general timing of revenue recognition for significant units of accounting[1].

[1] Financial Accounting Standards Board. FASB Draft Abstract – EITF Issue No. 08-1. http://www.fasb.org/cs/BlobServer?blobcol=urldata&blobtable=MungoBlobs&blobkey=id&blobwhere=1175819938544&blobheader=application/pdf. (p. 9-10)

ASC 605 (ASU 2009-13) Revenue Arrangements with Multiple Deliverables

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Separately, the effect of changes in either the selling price or the method of assumptions used to determine selling price for a specific unit of accounting if either one of those changes has a significant effect on the allocation of arrangement consideration.[1]

G. **Transition**

For each reporting year in the initial year of adoption, a vendor shall disclose the amount of its revenue recognized subject to the measurement requirements of this Issue and the amount of revenue that would have been recognized if the related transactions were subject to the measurement requirements of Issue 00-21.[2]

[1-2] Financial Accounting Standards Board. FASB Draft Abstract – EITF Issue No. 08-1. http://www.fasb.org/cs/BlobServer?blobcol=urldata&blobtable=MungoBlobs&blobkey=id&blobwhere=1175819938544&blobheader=application/pdf. (p. 10)

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ASC 605 (ASU 2009-13) Revenue Arrangements with Multiple Deliverables
ASC 985-605 (ASU 2009-14) Certain Revenue Arrangements that Contain Software Elements
Proposed New Joint Standard for Revenue Recognition

ASC 985-605 (ASU 2009-14) Certain Revenue Arrangements that Contain Software Elements

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II. ASC 985-605 (ASU 2009-14) Certain Revenue Arrangements that Contain Software Elements

A. **Objective**

To determine how arrangement consideration should be allocated to deliverables in a multiple-deliverable revenue arrangement that includes a tangible product and software that is more than incidental to
the product.

B. **Why Was ASU 2009-14 Needed?**

The scope of software guidance included increasing the number of tangible products with embedded software.

KEY POINT
Narrows focus for ASC 985-605 (SOP 97-2).

ASC 985-605 (ASU 2009-14) Certain Revenue Arrangements that Contain Software Elements

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C. **So What Does this Guidance Accomplish?**

1. Like FASB ASU 2009-13 (EITF 08-1), ASC 985-605 (ASU 2009-14) amends ASC 985-605 (SOP 97-2) to achieve financial reporting that better reflects the economics.
2. Modifies ASC 985-605 (SOP 97-2) to exclude:
    a. Nonsoftware components of software-reliant tangible products.
    b. Software components of tangible products sold, licensed, or leased with tangible products when the software components and nonsoftware components of the tangible product function together to deliver the tangible product's essential functionality.

KEY POINT
Narrows focus for ASC 985-605 (SOP 97-2).

ASC 985-605 (ASU 2009-14) Certain Revenue Arrangements that Contain Software Elements

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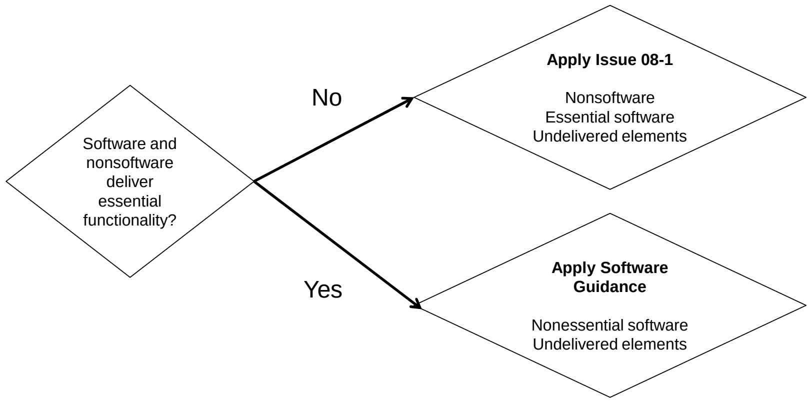
Issue 09-3 Decision Tree



KEY POINT
Requires use of factors and professional judgment.

ASC 985-605 (ASU 2009-14) Certain Revenue Arrangements that Contain Software Elements

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D. **Background**

Products or services that contain software "more than incidental" to the products or services as a whole are within the scope of ASC 985-605 (SOP 97-2). ASC 985-605 (SOP 97-2) requires the use of VSOE of selling price to separate deliverables in a multiple-element arrangement. ASC 985-605 (SOP 97-2) frequently includes within its scope certain software-enabled devices for which the vendor is seldom able to determine VSOE (since products are only sold in conjunction with other deliverables), which can result in an uneconomic pattern of revenue recognition.[1]

[1] Financial Accounting Standards Board. FASB Draft Abstract – EITF Issue No. 09-3. http://www.fasb.org/cs/ContentServer?c=Document_C&pagename=FASB/Document_C/DocumentPage&cid=1176156230641. (p. 2)

ASC 985-605 (ASU 2009-14) Certain Revenue Arrangements that Contain Software Elements

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E. Factors to consider when determining whether the software is "essential to the functionality."
   1. Is the product infrequently sold without the software?
   2. Are there products with similar functionality?
   3. Is the software sold separately?
   4. Is the software embedded?
   5. Do the nonsoftware elements substantially contribute to tangible product's essential functionality?

ASC 985-605 (ASU 2009-14) Certain Revenue Arrangements that Contain Software Elements

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Example 1
Separation Vendor sells a personal digital assistant (PDA). The PDA provides several functions—such as phone, camera and computing functionality—that allow the user to access and use various software programs, such as a music player and games. The PDA contains an operating system that allows the customer to access the functionality of the device, including the ability to utilize software necessary to provide the phone, camera and other functionality. The phone and camera software are frequently included on the PDA, but the music player and game software are excluded more often than infrequently. The phone, camera, and music player software are not sold separately, but the game software is sold separately.[1]

[1] Financial Accounting Standards Board. FASB Draft Abstract – EITF Issue No. 09-3. http://www.fasb.org/cs/ContentServer?c=Document_C&pagename=FASB/Document_C/DocumentPage&cid=1176156230641.

ASC 985-605 (ASU 2009-14) Certain Revenue Arrangements that Contain Software Elements

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Example 1 - continued

Consideration:	Essential to Functionality				
	Sold Without Software?	Products With Similar Functionality?	Is Software Sold Separately?	Is Software Embedded?	Does Nonsoftware Substantially Contribute to Functionality?
Personal digital assistance hardware					
Operating system					
Phone software					
Camera software					
Computing functionality					
Music player software					
Game software					

ASC 985-605 (ASU 2009-14) Certain Revenue Arrangements that Contain Software Elements

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Example 1 - continued

Consideration:	Essential to Functionality				
	Sold Without Software?	Products With Similar Functionality?	Is Software Sold Separately?	Is Software Embedded?	Does Nonsoftware Substantially Contribute to Functionality?
Personal digital assistance hardware	No	Yes	No	Yes	Yes
Operating system	No	Yes	No	Yes	Yes
Phone software	No	Yes	No	Yes	Yes
Camera software	No	Yes	No	Yes	Yes
Computing functionality					
Music player software	Yes	Yes	Yes	Yes	Yes
Game software	Yes	Yes	Yes	Yes	Yes

ASC 985-605 (ASU 2009-14) Certain Revenue Arrangements that Contain Software Elements

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Example 1 - continued
Answer: The personal digital assistant hardware, operating system, phone and camera software are essential to the functionality of the personal digital assistant and would be considered one deliverable outside the scope of this guidance. The music player and game software would be considered software deliverables within the scope of this guidance because the product also is sold more than infrequently without this software. Whether the product is sold separately does not affect the conclusion in this example.[1]

[1] Financial Accounting Standards Board. FASB Draft Abstract – EITF Issue No. 09-3. http://www.fasb.org/cs/ContentServer?c=Document_C&pagename=FASB/Document_C/DocumentPage&cid=1176156230641.

ASC 985-605 (ASU 2009-14) Certain Revenue Arrangements that Contain Software Elements

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F. **Scope**

1. The issue applies to multiple-deliverable revenue arrangements that include tangible products and software that is more than incidental to the tangible products.
2. Tangible products containing software components and non-software components that function together to deliver the tangible product's essential functionality are excluded from the scope of ASC 985-605 (SOP 97-2).
3. An entity shall consider the following when evaluating whether the software components and nonsoftware components function together to deliver a product's essential functionality:
   a. If the tangible product always contains the software components when the product is sold, the software components are considered essential to the functionality of the product.[1]

[1] Financial Accounting Standards Board. FASB Draft Abstract – EITF Issue No. 09-3. http://www.fasb.org/cs/ContentServer?c=Document_C&pagename=FASB/Document_C/DocumentPage&cid=1176156230641.

ASC 985-605 (ASU 2009-14) Certain Revenue Arrangements that Contain Software Elements

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b. An entity may sell products that provide similar functionality. If the only substantive difference between products is that one includes software that the other does not, the products shall be considered the same product for evaluating item (a).

c. An entity may sell a product containing software that it also sells on a standalone basis separate from the product. The separate sale of the software should not affect this evaluation.

d. Software components do not need to be embedded within the product to be considered essential to the product's functionality.[1]

[1] Financial Accounting Standards Board. FASB Draft Abstract – EITF Issue No. 09-3. http://www.fasb.org/cs/ContentServer?c=Document_C&pagename=FASB/Document_C/DocumentPage&cid=1176156230641. (p. 2)

ASC 985-605 (ASU 2009-14) Certain Revenue Arrangements that Contain Software Elements

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4. A multiple-deliverable revenue arrangement may include undelivered software elements relating to a tangible product (including software is essential to the product's functionality) that are excluded from the scope of ASC 985-605 (SOP 97-2). In such arrangements, the undelivered software elements are also excluded from the scope of ASC 985-605 (SOP 97-2). If a product contains software not essential to the product's functionality, that nonessential software is within the scope of ASC 985-605 (SOP 97-2). If an undelivered element relates to a deliverable within the scope of ASC 985-605 (SOP 97-2) and a deliverable excluded from the scope of ASC 985-605 (SOP 97-2), the undelivered element shall be bifurcated into a software and nonsoftware deliverable. The software deliverable is within the scope of ASC 985-605 (SOP 97-2) and the nonsoftware deliverable is not.[1]

[1] Financial Accounting Standards Board. FASB Draft Abstract – EITF Issue No. 09-3. http://www.fasb.org/cs/ContentServer?c=Document_C&pagename=FASB/Document_C/DocumentPage&cid=1176156230641. (p. 2)

ASC 985-605 (ASU 2009-14) Certain Revenue Arrangements that Contain Software Elements

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G. **Recognition**

If an arrangement includes deliverables within the scope of ASC 985-605 (SOP 97-2) and deliverables not within the scope of ASC 985-605 (SOP 97-2), an entity shall allocate arrangement consideration to each separate unit of accounting in accordance with ASC 605 (ASU 2009-13).

H. **Disclosure**

An entity shall provide the disclosures in ASC 605 (ASU 2009-13) for multiple-deliverable revenue arrangements affected by this guidance.[1]

[1] Financial Accounting Standards Board. FASB Draft Abstract – EITF Issue No. 09-3. http://www.fasb.org/cs/ContentServer?c=Document_C&pagename=FASB/Document_C/DocumentPage&cid=1176156230641. (p. 3)

ASC 985-605 (ASU 2009-14) Certain Revenue Arrangements that Contain Software Elements

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I. **Transition**

1. This guidance shall be applied on a prospective basis for revenue arrangements entered into or materially modified in fiscal years beginning on or after June 15, 2010. Earlier application is permitted as of the beginning of a vendor's fiscal year provided the vendor has not previously issued financial statements for any period within that year.
2. For each reporting period in the initial year of adoption, a vendor shall disclose the amount of its revenue recognized subject to the measurement requirements of this Issue and the amount of revenue that would have been recognized if the related transactions were subject to the measurement requirements of ASC 985-605 (SOP 97-2). A vendor shall also provide disclosures.[1]

[1] Financial Accounting Standards Board. FASB Draft Abstract – EITF Issue No. 09-3. http://www.fasb.org/cs/ContentServer?c=Document_C&pagename=FASB/Document_C/DocumentPage&cid=1176156230641. (p. 3)

ASC 985-605 (ASU 2009-14) Certain Revenue Arrangements that Contain Software Elements

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J. **FASB September 2009 Ratification of ASC 985-605 (ASU 2009-14)**

1. In September, the FASB issued ASU 2009-14.
2. ASC 985-605 (ASU 2009-14) modifies the scope of ASC 985-605 (SOP 97-2) to exclude sales of tangible products, which will allow certain software elements sold with tangible products to use the separation guidance in ASC 605 (ASU 2009-13) for revenue recognition.
3. This is to be applied beginning or after June 15, 2010.[1]

[1] Financial Accounting Standards Board. FASB Draft Abstract – EITF Issue No. 09-3. http://www.fasb.org/cs/ContentServer?c=Document_C&pagename=FASB/Document_C/DocumentPage&cid=1176156230641. (p. 3)

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ASC 605 (ASU 2009-13) **Revenue Arrangements with Multiple Deliverables**
ASC 985-605 (ASU 2009-14) **Certain Revenue Arrangements that Contain Software Elements**
Proposed New Joint Standard for Revenue Recognition

Proposed New Joint Standard for Revenue Recognition

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I. Proposed New Joint Standard for Revenue Recognition

A. **Background**

1. Exposure Draft issued on June 24, 2010.
2. Comments are due October 22, 2010.
3. FASB roundtable held in Q4 of 2010.[1,2]
4. Meetings were held to review comments on the Exposure Draft between December 2010 and June 2011 and changes were tentatively approved.

[1]FASB. Exposure Draft. http://www.fasb.org/cs/BlobServer?blobcol=urldata&blobtable=MungoBlobs&blobkey=id&blobwhere=1175820852272&blobheader=application%2Fpdf
[2]FASB. Current Technical Plan and Project Updates. http://www.fasb.org/jsp/FASB/Page/SectionPage&cid=1218220137074

Proposed New Joint Standard for Revenue Recognition

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5. The Boards at the June 14th meeting noted that they expect to re-expose the proposed standards again in Q3 of 2011 for a period of 120 days. Feedback on the re-exposure draft will be on the on the following topics:
   a) The extent to which the requirements are understandable and have not created unintended consequences for specific industries or contracts.
   b) A few specific aspects of the revised requirements which have not been detailed at this point.

[1]FASB. Exposure Draft. http://www.fasb.org/cs/BlobServer?blobcol=urldata&blobtable=MungoBlobs&blobkey=id&blobwhere=1175820852272&blobheader=application%2Fpdf
[2]FASB. Current Technical Plan and Project Updates. http://www.fasb.org/jsp/FASB/Page/SectionPage&cid=1218220137074

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B. **Stated Objectives**

1. The standard is designed to:
   a. Make accounting for revenue across industries more consistent.
   b. Require more disclosure about revenue.
   c. Propose guidance to clarify accounting for contract costs.
2. Exposure Draft: *"The objective of the proposed guidance is to establish the principles that an entity shall apply to report useful information to users of its financial statements about the amount, timing, and uncertainty of revenue and cash flows arising from a contract with a customer."*[1]

[1]FASB. Exposure Draft. http://www.fasb.org/cs/BlobServer?blobcol=urldata&blobtable=MungoBlobs&blobkey=id&blobwhere=1175820852272&blobheader=application%2Fpdf

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KEY POINT[1]
The new standard is expected to: 1) Remove inconsistencies and weaknesses in existing revenue recognition standards and practices. 2) Provide a more robust framework for addressing revenue recognition issues. 3) Improve comparability of revenue recognition practices across entities, industries, jurisdictions, and capital markets. 4) Simplify the preparation of financial statements by reducing the number of requirements to which entities must refer.[1]

[1]FASB. Exposure Draft. http://www.fasb.org/cs/BlobServer?blobcol=urldata&blobtable=MungoBlobs&blobkey=id&blobwhere=1175820852272&blobheader=application%2Fpdf

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C. **Scope**

The proposed guidance applies to all contracts with customers except:

1. Lease contracts within the scope of Topic 840 on leases.
2. Insurance contracts within the scope of Topic 944 on insurance.
3. Contractual rights or obligations within the scope of the following topics:
   a. Topic 310 on receivables.
   b. Topic 320 on debt and equity securities.
   c. Topic 405 on extinguishments of liabilities.
   d. Topic 470 on debt.
   e. Topic 815 on derivatives and hedging.
   f. Topic 825 on financial instruments.
   g. Topic 860 on transfers and servicing.[1]
   a. "Guarantees (other than product warranties) within the scope of Topic 460 on guarantees."
   b. "Nonmonetary exchanges between entities in the same line of business to facilitate sales to customers other than the parties to the exchange (for example, an exchange of oil to fulfill demand on a timely basis in a specified location)."[1]

[1]FASB. Exposure Draft. http://www.fasb.org/cs/BlobServer?blobcol=urldata&blobtable=MungoBlobs&blobkey=id&blobwhere=1175820852272&blobheader=application%2Fpdf

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D. **Main Proposals**

There are five steps to the Revenue Recognition Process under the Exposure Draft:

Step 1	Identify the contract(s) with customers
Step 2	Identify the separate performance obligations
Step 3	Determine the transaction price
Step 4	Allocate the transaction price to the performance obligations
Step 5	Recognize revenue when a performance obligation is satisfied

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1. A company would follow five steps to apply the revenue recognition proposals.
   - **a. Step 1**

     Identify the contract(s) with customers.

     1) "A company would account for two or more contracts together if the prices of those contracts are interdependent.

Source: Photos.com

[1]FASB. Exposure Draft. http://www.fasb.org/cs/BlobServer?blobcol=urldata&blobtable=MungoBlobs&blobkey=id&blobwhere=1175820852272&blobheader=application%2Fpdf

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KEY POINT[1]

Indicators that two or more contracts have interdependent prices include the following:

The indicators from the February 16th meeting will cover "two or more contracts that are entered into at or near the same time with the same customer (or related entities) if one or more of the following criteria are met:

- i. The contracts are negotiated as a package with a single commercial objective.
- ii. The amount of consideration in one contract depends on the other contract.
- iii. The goods and services in the contracts are interrelated in terms of design, technology, or function."

[1]Deloitte. IFRS in Focus: IASB Issues Revenue Recognition Exposure Draft. http://www.iasplus.com/iasplus/1006revenue.pdf

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KEY POINT[1]
There may be situations when an entity would combine two or more contracts as a single contract. According to the Exposure Draft, combining "contracts would be appropriate if the prices of those contracts are interdependent. Conversely, an entity may treat a single contract with a customer as two or more contracts if the entity identifies separate performance obligations in the contract.

[1]Deloitte. IFRS in Focus: IASB Issues Revenue Recognition Exposure Draft. http://www.iasplus.com/iasplus/1006revenue.pdf

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2) The original Exposure Draft (ED) contained a provision for accounting for a single contract as two or more contracts if some of the goods or services were priced independently of other goods and services.

   a) This provision was eliminated at the January 19th meeting so that separation of a contract is now only required if the entity identifies specific performance obligations in the contract.

KEY POINT
Separation of a contract is now only required if the entity identifies specific performance obligations in the contract.

[1]FASB. Exposure Draft. http://www.fasb.org/cs/BlobServer?blobcol=urldata&blobtable=MungoBlobs&blobkey=id&blobwhere=1175820852272&blobheader=application%2Fpdf

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b. **Step 2**

Identify the separate performance obligations.

1) A contract includes promises to provide goods or services to a customer. Those promises are called performance obligations. "A company would account for a performance obligation separately if the pattern of transfer is different from the pattern of the other goods or services and if the good or service has a distinct function."

[1]FASB. Exposure Draft. http://www.fasb.org/cs/BlobServer?blobcol=urldata&blobtable=MungoBlobs&blobkey=id&blobwhere=1175820852272&blobheader=application%2Fpdf

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2) At the January 19th meeting the Board requested the staff to analyze the following attributes of a distinct good or service and consider how entities would apply them.
   a) Distinct function.
   b) Separable Risks.
   c) Different pattern of transfer to the customer.
3) The Board also decided that the standard should clarify the objective for identifying separate performance obligations as "to depict the transfer of goods or services and the profit margin that is attributable to those goods or services."

[1]FASB. Exposure Draft. http://www.fasb.org/cs/BlobServer?blobcol=urldata&blobtable=MungoBlobs&blobkey=id&blobwhere=1175820852272&blobheader=application%2Fpdf

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KEY POINT
"A good or service has a distinct function if either: a) The entity regularly sells the good or service separately, or b) The customer can use the good or service either on its own or together with resources that are readily available to the customer."

[1]FASB. Exposure Draft. http://www.fasb.org/cs/BlobServer?blobcol=urldata&blobtable=MungoBlobs&blobkey=id&blobwhere=1175820852272&blobheader=application%2Fpdf

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Source: Photos.com

c. **Step 3**

Determine the transaction price.

1) "The transaction price is the amount of consideration a company expects to receive from the customer in exchange for transferring goods or services."
2) "The transaction price can be reasonably estimated only if both of the following conditions are met:"
   a) "The entity has experience with similar types of contracts (or access to the experience of other entities if it has no experience of its own)."
   b) "The entity's experience is relevant to the contract because the entity does not expect significant changes in circumstances."[1]

[1]FASB. Exposure Draft. http://www.fasb.org/cs/BlobServer?blobcol=urldata&blobtable=MungoBlobs&blobkey=id&blobwhere=1175820852272&blobheader=application%2Fpdf

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5) "If the transaction price cannot be reasonably estimated, an entity shall not recognize revenue from satisfying a performance obligation."
   a) "If circumstances change, the entity shall recognize revenue from satisfied performance obligations when the transaction price can be reasonably estimated."
   b) "If an entity can reasonably estimate some, but not all, of the consideration amount (for example, if part of the total consideration is a fixed amount), the transaction price includes only the amount that the entity can reasonably estimate."[1]

[1]FASB. Exposure Draft. http://www.fasb.org/cs/BlobServer?blobcol=urldata&blobtable=MungoBlobs&blobkey=id&blobwhere=1175820852272&blobheader=application%2Fpdf

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4) If the amount of promised consideration is uncertain, the entity should use the option below which is most predictive of the amount of consideration due:
   a) The probability-weighted amount.
   b) The most likely amount.
5) Revenue should be recognized at the amount allocated unless the entity is not reasonably assured to be entitled to that amount.

[1]FASB. Exposure Draft. http://www.fasb.org/cs/BlobServer?blobcol=urldata&blobtable=MungoBlobs&blobkey=id&blobwhere=1175820852272&blobheader=application%2Fpdf

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KEY POINT[1]
Causes of not having reasonable assurance of entitlement to the transaction value: a. "The customer could avoid paying an additional amount of consideration without breaching the contract (for example, a sales-based royalty). b. The entity has no experience with similar types of contracts (or no other persuasive evidence). c. The entity has experience, but that experience is not predictive of the outcome of the contract based on an evaluation of the factors proposed in the exposure draft (for example, susceptibility to factors outside the influence of the entity, the amount of time until the uncertainty is resolved, the extent of the entity's experience, and the number and variability of possible consideration amounts)."

[1]Deloitte. IFRS in Focus: IASB Issues Revenue Recognition Exposure Draft. http://www.iasplus.com/iasplus/1006revenue.pdf

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KEY POINT[1]
"When an entity has delivered goods or services, sometimes the amounts it will receive in the future are not fixed. Under the proposals, future variable consideration would be recognized using an 'expected value' approach, but only where that expected value can be measured reliably. Such an approach requires management to develop probabilities for each possible scenario based on the relevant past experience and assess whether it believes circumstances will change significantly."

[1]Deloitte. IFRS in Focus: IASB Issues Revenue Recognition Exposure Draft. http://www.iasplus.com/iasplus/1006revenue.pdf

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6) At the March 21st meeting the Boards tentatively decided that the promised amount of consideration should be adjusted to reflect the time value of money if the contract contains a significant financing component.
7) The following factors should be considered to determine if a significant financing component exists:
    a) If the amount paid would be substantially different if the customer paid in cash at the time of transfer.
    b) If there is a significant timing difference between the date of transfer and payment.

[1]FASB. Exposure Draft. http://www.fasb.org/cs/BlobServer?blobcol=urldata&blobtable=MungoBlobs&blobkey=id&blobwhere=1175820852272&blobheader=application%2Fpdf

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c) If the interest rate in the contract (whether explicit or implicit) is significant.

KEY POINT
An entity should not be required to assess whether a contract has a significant financing component if the period between payment by the customer and the transfer of the promised goods or services to the customer is one year or less.

[1]FASB. Exposure Draft. http://www.fasb.org/cs/BlobServer?blobcol=urldata&blobtable=MungoBlobs&blobkey=id&blobwhere=1175820852272&blobheader=application%2Fpdf

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KEY POINT[1]
"The time value of money should be considered when its effect is material. The adjustment for the time value of money would be applicable when a payment is due significantly before or after the transfer of goods and/or services. Therefore, it may become more common to adjust revenues for the time value of money when a prepayment is made by a customer or a credit period is granted to a customer."

[1]Deloitte. IFRS in Focus: IASB Issues Revenue Recognition Exposure Draft. http://www.iasplus.com/iasplus/1006revenue.pdf

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8) Collectibility

The original ED required an adjustment to the amount of revenue recognized to account for credit risk.

At the March 23, 2011 meeting the Board reversed its position and now anticipates that:

a) Revenue would be recognized at the stated contract price.

b) The entity should recognize an allowance for collectibility risk which should be classified and shown as a contra-revenue account on the profit & loss.

[1]FASB. Exposure Draft. http://www.fasb.org/cs/BlobServer?blobcol=urldata&blobtable=MungoBlobs&blobkey=id&blobwhere=1175820852272&blobheader=application%2Fpdf

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d. **Step 4**

Allocate the transaction price to the performance obligations.

1) "A company would allocate the transaction price to all separate performance obligations in proportion to the standalone selling price (estimated if necessary) of the good or service underlying each performance obligation."

2) "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." [1]

KEY POINT
"A contractually stated price or a list price for a good or service shall not be presumed to represent the standalone selling price of that good or service."

[1]FASB. Exposure Draft. http://www.fasb.org/cs/BlobServer?blobcol=urldata&blobtable=MungoBlobs&blobkey=id&blobwhere=1175820852272&blobheader=application%2Fpdf

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3) "If a standalone selling price is not directly observable, an entity shall estimate it."

4) "When estimating standalone selling prices, an entity shall maximize the use of observable inputs and shall apply estimation methods consistently for goods or services and customers with similar characteristics."

5) Suitable estimation methods include the following:[1]

[1]FASB. Exposure Draft. http://www.fasb.org/cs/BlobServer?blobcol=urldata&blobtable=MungoBlobs&blobkey=id&blobwhere=1175820852272&blobheader=application%2Fpdf

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a) Expected Cost Plus a Margin Approach

"An entity could forecast its expected costs of satisfying a performance obligation and then add the margin that the entity would require for that good or service."

b) Adjusted Market Assessment Approach

"An entity could evaluate the market in which it sells goods or services and estimate the price that customers in that market would be willing to pay for those goods or services. That approach might also 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."[1]

[1]FASB. Exposure Draft. http://www.fasb.org/cs/BlobServer?blobcol=urldata&blobtable=MungoBlobs&blobkey=id&blobwhere=1175820852272&blobheader=application%2F.pdf

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KEY POINT[1]
• At its April 14th discussed allocating the transaction price on a relative selling price basis. They tentatively decided that if the standalone price is highly variable then the appropriate technique is the residual approach. • The residual technique: requires an entity to determine a standalone selling price by reference to the total transaction price less the standalone selling prices of other goods or services in the contract.

[1]FASB. Exposure Draft. http://www.fasb.org/cs/BlobServer?blobcol=urldata&blobtable=MungoBlobs&blobkey=id&blobwhere=1175820852272&blobheader=application%2Fpdf

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6) If the transaction price changes then the change should be allocated to one or more performance obligations if the both following conditions are met:
   a) "The contingent payment terms of the contract relate specifically to the entity's efforts to satisfy that performance obligation or a specific outcome from satisfying that separate performance obligation."
   b) "The amount allocated… to that performance obligation is reasonable relative to all performance obligations and payment terms (including other potential contingent payments) in the contract."

[1]FASB. Exposure Draft. http://www.fasb.org/cs/BlobServer?blobcol=urldata&blobtable=MungoBlobs&blobkey=id&blobwhere=1175820852272&blobheader=application%2Fpdf

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e. **Step 5**

Recognize revenue when a performance obligation is satisfied.

1) "A company would recognize revenue when it satisfies a performance obligation by transferring the promised good or service to the customer, which is when the customer obtains control of the promised good or service. The amount of revenue recognized is the amount allocated to that performance obligation in Step 4."[1]

[1]FASB. Exposure Draft. http://www.fasb.org/cs/BlobServer?blobcol=urldata&blobtable=MungoBlobs&blobkey=id&blobwhere=1175820852272&blobheader=application%2Fpdf

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KEY POINT[1]
• The Exposure Draft provides the following indicators for determining whether control has passed to the customer, but emphasizes that none is individually determinative and that some will not always be relevant. The items below relate specifically to goods. i. The customer has an unconditional obligation to pay. ii. The customer has legal title. iii. The customer has physical possession. iv. Risks and rewards of ownership v. If goods and services are not distinct (bundled) then they will be accounted for as services rather than goods.

[1]FASB. Exposure Draft. http://www.fasb.org/cs/BlobServer?blobcol=urldata&blobtable=MungoBlobs&blobkey=id&blobwhere=1175820852272&blobheader=application%2Fpdf

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2) When control is deemed to be transferred continuously, an entity must determine how to recognize revenue.
3) At the February meeting the Boards decided that the final standard should:
   a) "Emphasize that the objective of measuring progress is to faithfully depict the entity's performance (that is the pattern of transfer of goods or services to a customer)."

[1]FASB. Exposure Draft. http://www.fasb.org/cs/BlobServer?blobcol=urldata&blobtable=MungoBlobs&blobkey=id&blobwhere=1175820852272&blobheader=application%2Fpdf

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***KEY POINT*[1]**
• To recognize revenue for services the entity needs to determine that performance obligations are met continuously. This requires meeting at least one of these criteria: .

i. The customer controls the work-in-process
ii. "The entity's performance does not create an asset with alternative use to the entity and at least one of the following is met:
   i. The customer receives a benefit as each task is performed.
   ii. Another entity would not need to re-perform the task in order to complete the contract obligations.
   iii. The entity has a right to payment for the tasks performed should the contract be cancelled."

[1]FASB. Exposure Draft. http://www.fasb.org/cs/BlobServer?blobcol=urldata&blobtable=MungoBlobs&blobkey=id&blobwhere=1175820852272&blobheader=application%2Fpdf

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Source: Photos.com

***KEY POINT*[1]**

The following are acceptable methods of recognizing revenue:

i. **Output methods:** that recognize revenue on the basis of units produced, units delivered, contract milestones, or surveys of work performed.
ii. **Input methods:** that recognize revenue on the basis of costs incurred, labor hours expended, or machine hours used.
iii. Time Methods: based on the passage of time.[1]
iv. The Board noted in its Feb. 16, 2011 meeting that it will clarify the descriptions above however we have not received the new language to date.

[1]FASB. Exposure Draft. http://www.fasb.org/cs/BlobServer?blobcol=urldata&blobtable=MungoBlobs&blobkey=id&blobwhere=1175820852272&blobheader=application%2Fpdf

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KEY POINT [1]
• "Revenue would be recognized when the customer obtains control of the goods or services. This aspect of the proposals is of fundamental importance to many, but it is also one that will likely require the most judgment. • The principle outlined is that 'a customer obtains control of a good or service when the customer has the ability to direct the use of, and receive the benefit from, the good or service.' • A customer has obtained control if it has the present right to use the asset for its remaining economic life or to consume the asset in the customer's activities, together with the present right to obtain substantially all of the potential cash flows from that asset. • The transfer of control of a product or service can be at a point in time or continuous."

[1]Deloitte. IFRS in Focus: IASB Issues Revenue Recognition Exposure Draft. http://www.iasplus.com/iasplus/1006revenue.pdf

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E. **Onerous Performance Obligations**

1. If a contract is determined to be onerous the entity must recognize the expense and establish a liability.
2. The test is to be performed each reporting period using the present value of the probability-weighted costs related to satisfying the performance obligation (direct costs).
3. Prior to recognizing a liability for onerous performance the entity should recognize any impairment loss that occurred on the assets related to the contract.

[1]Deloitte. IFRS in Focus: IASB Issues Revenue Recognition Exposure Draft. http://www.iasplus.com/iasplus/1006revenue.pdf

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4. During the February 16, 2011 meeting the “Boards tentatively decided that the unit of account for the onerous test should be the contract, specifically the remaining performance obligations in the contract.”
5. At the March 1, 2011 meeting the Boards determined that the onerous provisions apply to all contracts including those priced as loss leaders.

F. **Warranty**

1. There are two methods for treating warranties:
   a. As a cost accrual.
   b. As a separate performance obligation.

[1]Deloitte. IFRS in Focus: IASB Issues Revenue Recognition Exposure Draft. http://www.iasplus.com/iasplus/1006revenue.pdf

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***KEY POINT*[1]**
“If a customer has the option to purchase a warranty separately from the entity, the entity should account for the warranty as a separate performance obligation. Hence, the entity would allocate revenue to the warranty service. “ “If a customer does not have the option to purchase a warranty separately… the entity should account for the warranty as a cost accrual unless the warranty provides a service to the customer in addition to assurance that the entity’s past performance was as specified in the contract (in which case the entity would account for the warranty service as a separate performance obligation). “ The Boards will be providing guidance to determine when a warranty provides a service in addition to assurance.

[1]FASB. Exposure Draft. http://www.fasb.org/cs/BlobServer?blobcol=urldata&blobtable=MungoBlobs&blobkey=id&blobwhere=1175820852272&blobheader=application%2Fpdf

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G. **Sale and Repurchase Agreements**

1. The Board tentatively decided in April 2011 that if the customer in a sale/repurchase agreement has significant economic incentive to exercise the repurchase right that the they are effectively leasing the asset and the entity should account for the agreement as a lease.
2. One of the key factors in assessing economic incentive is the relationship between the repurchase price and the expected market value of the asset at the date of repurchase and the amount of time until the right expires
3. The Exposure Draft notes that when comparing the sale and repurchase prices that if material prices should be adjusted using the time value of money.

[1]Deloitte. IFRS in Focus: IASB Issues Revenue Recognition Exposure Draft. http://www.iasplus.com/iasplus/1006revenue.pdf

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H. **Retrospective Application of the Standard**

1. The Boards do expect the standard to be applied on a retrospective basis. To ease the burden in the first year they tentatively decided the following:
   a. Contracts which begin and end in the same reporting period do not need to be restated.
   b. An entity should be permitted to use hindsight in estimating variable consideration in the comparative reporting periods.
   c. The onerous test is only required at the effective date unless an onerous contract liability was recognized previously in a comparative period.
   d. An entity should not be required to disclose the maturity analyses of remaining performance for prior periods.

[1]Deloitte. IFRS in Focus: IASB Issues Revenue Recognition Exposure Draft. http://www.iasplus.com/iasplus/1006revenue.pdf

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2. If an entity uses any of the “relief” methods they must apply it consistently throughout all comparative periods and they must disclose the following information
   a. The reliefs they have used
   b. A qualitative assessment of the likely effect of applying those reliefs.

[1]Deloitte. IFRS in Focus: IASB Issues Revenue Recognition Exposure Draft. http://www.iasplus.com/iasplus/1006revenue.pdf

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I. **How Would the Proposals Affect U.S. GAAP and IFRS?**
   1. The FASB and IASB envision that the accounting for revenue arising from contracts within the scope of the proposed guidance would be the same in both U.S. GAAP and IFRS.
   2. However, differences might exist between U.S. GAAP and IFRS in the profit margin reported in those contracts because of differences in other standards relating to accounting for the costs of fulfilling a contract.
   3. For some contracts (for example, many retail transactions), the proposed guidance would have little, if any, effect on current practice.[1]

[1]FASB. Exposure Draft. http://www.fasb.org/cs/BlobServer?blobcol=urldata&blobtable=MungoBlobs&blobkey=id&blobwhere=1175820852272&blobheader=application%2Fpdf

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Polling Question:

Which is your preference?

A. Questions.

B. Comments.

C. Just give me my CPE Certificate!

Thank You!

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