

FINANCIAL ACCOUNTING SERIES



No. 2014-09
May 2014

Revenue from Contracts with Customers (Topic 606)

An Amendment of the *FASB Accounting Standards Codification*®

Financial Accounting Standards Board

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Accounting Standards Update

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Summary

Why Is the FASB Issuing This Accounting Standards Update (Update)?

Revenue is an important number to users of financial statements in assessing an entity's financial performance and position. However, previous revenue recognition requirements in U.S. generally accepted accounting principles (GAAP) differ from those in International Financial Reporting Standards (IFRS), and both sets of requirements were in need of improvement. Previous revenue recognition guidance in U.S. GAAP comprised broad revenue recognition concepts together with numerous revenue requirements for particular industries or transactions, which sometimes resulted in different accounting for economically similar transactions. In contrast, IFRS provided limited guidance and, consequently, the two main revenue recognition standards, IAS 18, *Revenue*, and IAS 11, *Construction Contracts*, could be difficult to apply to complex transactions. Additionally, IAS 18 provides limited guidance on important revenue topics such as accounting for multiple-element arrangements.

Accordingly, the Financial Accounting Standards Board (FASB) and the International Accounting Standards Board (IASB) initiated a joint project to clarify the principles for recognizing revenue and to develop a common revenue standard for U.S. GAAP and IFRS that would:

1. Remove inconsistencies and weaknesses in revenue requirements.
2. Provide a more robust framework for addressing revenue issues.
3. Improve comparability of revenue recognition practices across entities, industries, jurisdictions, and capital markets.
4. Provide more useful information to users of financial statements through improved disclosure requirements.
5. Simplify the preparation of financial statements by reducing the number of requirements to which an entity must refer.

To meet those objectives, the FASB is amending the *FASB Accounting Standards Codification*[®] and creating a new Topic 606, *Revenue from Contracts with Customers*, and the IASB is issuing IFRS 15, *Revenue from Contracts with Customers*. The issuance of these documents completes the joint effort by the FASB and the IASB to meet those objectives and improve financial reporting by creating common revenue recognition guidance for U.S. GAAP and IFRS.

Who Is Affected by the Amendments in This Update?

The guidance in this Update affects any entity that either enters into contracts with customers to transfer goods or services or enters into contracts for the

transfer of nonfinancial assets unless those contracts are within the scope of other standards (for example, insurance contracts or lease contracts).

The guidance in this Update supersedes the revenue recognition requirements in Topic 605, Revenue Recognition, and most industry-specific guidance throughout the Industry Topics of the Codification. Additionally, this Update supersedes some cost guidance included in Subtopic 605-35, Revenue Recognition—Construction-Type and Production-Type Contracts.

In addition, the existing requirements for the recognition of a gain or loss on the transfer of nonfinancial assets that are not in a contract with a customer (for example, assets within the scope of Topic 360, Property, Plant, and Equipment, and intangible assets within the scope of Topic 350, Intangibles—Goodwill and Other) are amended to be consistent with the guidance on recognition and measurement (including the constraint on revenue) in this Update.

What Are the Main Provisions?

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

To achieve that core principle, an entity should apply the following steps:

- Step 1: Identify the contract(s) with a customer.
- Step 2: Identify the performance obligations in the contract.
- Step 3: Determine the transaction price.
- Step 4: Allocate the transaction price to the performance obligations in the contract.
- Step 5: Recognize revenue when (or as) the entity satisfies a performance obligation.

Step 1: Identify the Contract with a Customer

A *contract* is an agreement between two or more parties that creates enforceable rights and obligations. An entity should apply the requirements to each contract that meets the following criteria:

1. Approval and commitment of the parties
2. Identification of the rights of the parties
3. Identification of the payment terms
4. The contract has commercial substance
5. It is probable that the entity will collect the consideration to which it will be entitled in exchange for the goods or services that will be transferred to the customer.

In some cases, an entity should combine contracts and account for them as one contract. In addition, there is guidance on the accounting for contract modifications.

Step 2: Identify the Performance Obligations in the Contract

A *performance obligation* is a promise in a contract with a customer to transfer a good or service to the customer. If an entity promises in a contract to transfer more than one good or service to the customer, the entity should account for each promised good or service as a performance obligation only if it is (1) distinct or (2) a series of distinct goods or services that are substantially the same and have the same pattern of transfer.

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

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

A good or service that is not distinct should be combined with other promised goods or services until the entity identifies a bundle of goods or services that is distinct.

Step 3: Determine the Transaction Price

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

1. **Variable consideration**—If the amount of consideration in a contract is variable, an entity should determine the amount to include in the transaction price by estimating either the expected value (that is, probability-weighted amount) or the most likely amount, depending on which method the entity expects to better predict the amount of consideration to which the entity will be entitled.
2. **Constraining estimates of variable consideration**—An entity should include in the transaction price some or all of an estimate of variable consideration only to the extent it is probable that a significant reversal in the amount of cumulative revenue recognized will not occur when the uncertainty associated with the variable consideration is subsequently resolved.
3. **The existence of a significant financing component**—An entity should adjust the promised amount of consideration for the effects of

the time value of money if the timing of the payments agreed upon by the parties to the contract (either explicitly or implicitly) provides the customer or the entity with a significant benefit of financing for the transfer of goods or services to the customer. In assessing whether a financing component exists and is significant to a contract, an entity should consider various factors. As a practical expedient, an entity need not assess whether a contract has a significant financing component if the entity expects at contract inception that the period between payment by the customer and the transfer of the promised goods or services to the customer will be one year or less.

4. **Noncash consideration**—If a customer promises consideration in a form other than cash, an entity should measure the noncash consideration (or promise of noncash consideration) at fair value. If an entity cannot reasonably estimate the fair value of the noncash consideration, it should measure the consideration indirectly by reference to the standalone selling price of the goods or services promised in exchange for the consideration. If the noncash consideration is variable, an entity should consider the guidance on constraining estimates of variable consideration.
5. **Consideration payable to the customer**—If an entity pays, or expects to pay, consideration to a customer (or to other parties that purchase the entity's goods or services from the customer) in the form of cash or items (for example, credit, a coupon, or a voucher) that the customer can apply against amounts owed to the entity (or to other parties that purchase the entity's goods or services from the customer), the entity should account for the payment (or expectation of payment) as a reduction of the transaction price or as a payment for a distinct good or service (or both). If the consideration payable to a customer is a variable amount and accounted for as a reduction in the transaction price, an entity should consider the guidance on constraining estimates of variable consideration.

Step 4: Allocate the Transaction Price to the Performance Obligations in the Contract

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

To allocate an appropriate amount of consideration to each performance obligation, an entity must determine the *standalone selling price* at contract inception of the distinct goods or services underlying each performance obligation and would typically allocate the transaction price on a relative standalone selling price basis. If a standalone selling price is not observable, an entity must estimate it. Sometimes, the transaction price includes a discount or

variable consideration that relates entirely to one of the performance obligations in a contract. The requirements specify when an entity should allocate the discount or variable consideration to one (or some) performance obligation(s) rather than to all performance obligations in the contract.

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

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

An entity should recognize revenue when (or as) it satisfies a performance obligation by transferring a promised good or service to a customer. A good or service is transferred when (or as) the customer obtains control of that good or service.

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

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

1. The customer simultaneously receives and consumes the benefits provided by the entity's performance as the entity performs.
2. The entity's performance creates or enhances an asset (for example, work in process) that the customer controls as the asset is created or enhanced.
3. The entity's performance does not create an asset with an alternative use to the entity, and the entity has an enforceable right to payment for performance completed to date.

If a performance obligation is not satisfied over time, an entity satisfies the performance obligation at a point in time. To determine the point in time at which a customer obtains control of a promised asset and an entity satisfies a performance obligation, the entity would consider indicators of the transfer of control, which include, but are not limited to, the following:

1. The entity has a present right to payment for the asset.
2. The customer has legal title to the asset.
3. The entity has transferred physical possession of the asset.

4. The customer has the significant risks and rewards of ownership of the asset.
5. The customer has accepted the asset.

For each performance obligation that an entity satisfies over time, an entity shall recognize revenue over time by consistently applying a method of measuring the progress toward complete satisfaction of that performance obligation. Appropriate methods of measuring progress include output methods and input methods. As circumstances change over time, an entity should update its measure of progress to depict the entity's performance completed to date.

Costs to Obtain or Fulfill a Contract with a Customer

The guidance also specifies the accounting for some costs to obtain or fulfill a contract with a customer.

Incremental costs of obtaining a contract—An entity should recognize as an asset the incremental costs of obtaining a contract that the entity expects to recover. Incremental costs are those costs that the entity would not have incurred if the contract had not been obtained. As a practical expedient, an entity may expense these costs when incurred if the amortization period is one year or less.

Costs to fulfill a contract—To account for the costs of fulfilling a contract with a customer, an entity should apply the requirements of other standards (for example, Topic 330, Inventory; Subtopic 350-40; Internal-Use Software; Topic 360, Property, Plant, and Equipment; and Subtopic 985-20, Costs of Software to Be Sold, Leased, or Marketed), if applicable. Otherwise, an entity should recognize an asset from the costs to fulfill a contract if those costs meet all of the following criteria:

1. Relate directly to a contract (or a specific anticipated contract)
2. Generate or enhance resources of the entity that will be used in satisfying performance obligations in the future
3. Are expected to be recovered.

Disclosures

An entity should disclose sufficient information to enable users of financial statements to understand the nature, amount, timing, and uncertainty of revenue and cash flows arising from contracts with customers. Qualitative and quantitative information is required about:

1. Contracts with customers—including revenue and impairments recognized, disaggregation of revenue, and information about contract balances and performance obligations (including the transaction price allocated to the remaining performance obligations)
2. Significant judgments and changes in judgments—determining the timing of satisfaction of performance obligations (over time or at a point

- in time), and determining the transaction price and amounts allocated to performance obligations
3. Assets recognized from the costs to obtain or fulfill a contract.

How Do the Main Provisions Differ from Current U.S. Generally Accepted Accounting Principles (GAAP) and Why Are They an Improvement?

In setting the project objectives, the Board observed that revenue is commonly viewed as a critical number to users of financial statements in assessing an entity's financial performance and position. Additionally, the Board noted that revenue recognition requirements in U.S. GAAP differ from those in IFRS. The introduction of a comprehensive and converged standard on revenue recognition will enable users to better understand and consistently analyze an entity's revenue across industries, transactions, and geographies.

The guidance on revenue recognition in U.S. GAAP was initially limited to the general guidance in Concepts Statement No. 5, *Recognition and Measurement in Financial Statements of Business Enterprises*. Concepts Statement 5 specifies that an entity should recognize revenue only when realized or realizable and earned. Those recognition and measurement concepts were codified in Subtopic 605-10, Revenue Recognition—Overall. Additionally, FASB Concepts Statement No. 6, *Elements of Financial Statements*, defines *revenues* as inflows or other enhancements of assets of an entity or settlements of its liabilities (or a combination of both) from delivering or producing goods, rendering services, or other activities that constitute the entity's ongoing major or central operations.

In 1999, the Securities and Exchange Commission (SEC) issued Staff Accounting Bulletin (SAB) No. 101, *Revenue Recognition*, which provides interpretive guidance on how a public entity should apply the realized or realizable and earned criteria in Concepts Statement 5 to arrangements not within the scope of other, specific authoritative literature on revenue recognition. SAB 101 (amended in 2003 by SAB No. 104, *Revenue Recognition*, and codified into SAB Topic 13), requires an entity to satisfy specific criteria before recognizing revenue. Nonpublic entities are not subject to this guidance; however, the Board understands that some apply it in practice by analogy.

Additional guidance for recognizing revenue in U.S. GAAP consists of numerous industry-specific and transaction-specific standards (for example, Subtopic 985-605, Software—Revenue Recognition, Subtopic 605-35, Revenue Recognition—Construction-Type and Production-Type Contracts, Subtopic 360-20, Property, Plant, and Equipment—Real Estate Sales, and Subtopic 605-25, Revenue Recognition—Multiple-Element Arrangements). Those requirements were developed by various standard setters often to address narrow issues or transactions without reference to a common framework. Consequently, issues

about recognizing revenue were often difficult to resolve, and economically similar transactions sometimes yielded differing revenue recognition.

The guidance for recognizing revenue in IFRS was comparatively limited and was based on different fundamental principles. IFRS lacked guidance on particular topics that were challenging to address in practice (for example, multiple-element arrangements). Consequently, the guidance for recognizing revenue under IFRS was difficult to apply to many complex transactions, and many times in the absence of specific guidance an entity may use, or analogize, to U.S. GAAP.

Under current U.S. GAAP, the required disclosures about revenue were limited and lacked cohesion. General disclosure requirements about revenue recognition were limited to descriptions of an entity's related accounting policies and the effect on revenue of those policies, including rights of return, the entity's role as a principal or an agent, and customer payments and incentives. Some industry-specific or transaction-specific revenue recognition guidance required more extensive disclosures; however, investors and other users of financial statements indicated that the previous disclosure requirements about revenue in both U.S. GAAP and IFRS were insufficient for analyzing an entity's revenue.

The Board considered the existing guidance on revenue recognition and concluded that the new revenue recognition guidance in this Update will provide an improvement to financial reporting.

As compared to existing guidance on revenue recognition, this Update will significantly enhance comparability of revenue recognition practices across entities, industries, jurisdictions, and capital markets. The largely principles-based guidance in this Update provides a framework for addressing revenue recognition issues comprehensively for entities that apply U.S. GAAP in addition to those entities that apply IFRS. Because the guidance in this Update is principles-based, it can be applied to all contracts with customers regardless of industry-specific or transaction-specific fact patterns. Additionally, the Board concluded that a framework for revenue recognition best ensures that the guidance remains relevant as markets and transactions evolve.

The guidance in this Update also improves U.S. GAAP by reducing the number of requirements to which an entity must consider in recognizing revenue. For example, before this Update an entity would have potentially considered industry-specific revenue guidance for some transactions, in addition to general revenue guidance and potentially other relevant guidance that commonly affects revenue transactions. Rather than referring to several locations for guidance, this Update provides a comprehensive framework within Topic 606. As a result of issuing this Update, the Board concluded that over time the guidance for recognizing revenue in U.S. GAAP should be less complex than current guidance.

Additionally, the guidance requires improved disclosures to help users of financial statements better understand the nature, amount, timing, and

uncertainty of revenue that is recognized. The comprehensive disclosure package will improve the understandability of revenue, which is a critical part of the analysis of an entity's performance and prospects. Furthermore, this Update provides guidance for transactions that are not addressed comprehensively (for example, service revenue, contract modifications, and licenses of intellectual property). Finally, the guidance will apply to all entities, including nonpublic entities that previously did not have extensive guidance.

When Will the Amendments Be Effective?

For a public entity, the amendments in this Update are effective for annual reporting periods beginning after December 15, 2016, including interim periods within that reporting period. Early application is not permitted.

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

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

For all other entities (nonpublic entities), the amendments in this Update are effective for annual reporting periods beginning after December 15, 2017, and interim periods within annual periods beginning after December 15, 2018. A nonpublic entity may elect to apply this guidance earlier, however, only as of the following:

1. An annual reporting period beginning after December 15, 2016, including interim periods within that reporting period (public entity effective date)
2. An annual reporting period beginning after December 15, 2016, and interim periods within annual periods beginning after December 15, 2017
3. An annual reporting period beginning after December 15, 2017, including interim periods within that reporting period.

An entity should apply the amendments in this Update using one of the following two methods:

1. Retrospectively to each prior reporting period presented and the entity may elect any of the following practical expedients:
 - a. For completed contracts, an entity need not restate contracts that begin and end within the same annual reporting period.
 - b. For completed contracts that have variable consideration, an entity may use the transaction price at the date the contract was

- completed rather than estimating variable consideration amounts in the comparative reporting periods.
- c. For all reporting periods presented before the date of initial application, an entity need not disclose the amount of the transaction price allocated to remaining performance obligations and an explanation of when the entity expects to recognize that amount as revenue.
2. Retrospectively with the cumulative effect of initially applying this Update recognized at the date of initial application. If an entity elects this transition method it also should provide the additional disclosures in reporting periods that include the date of initial application of:
 - a. The amount by which each financial statement line item is affected in the current reporting period by the application of this Update as compared to the guidance that was in effect before the change.
 - b. An explanation of the reasons for significant changes.

How Do the Provisions Compare with International Financial Reporting Standards (IFRS)?

This Update, together with the IASB's IFRS 15, completes a joint effort by the FASB and the IASB to improve financial reporting by creating common revenue recognition guidance for U.S. GAAP and IFRS that clarifies the principles for recognizing revenue and that can be applied consistently across various transactions, industries, and capital markets. In this Update and IFRS 15, the Boards achieved their goal of reaching the same conclusions on all requirements for the accounting for revenue from contracts with customers. However, there are some minor differences as follows:

1. **Collectibility threshold**—The Boards included an explicit collectibility threshold as one of the criteria that a contract must meet before an entity can recognize revenue. For a contract to meet that criterion, an entity must conclude that it is probable that it will collect the consideration to which it will be entitled in exchange for the goods or services that will be transferred to the customer. In setting the threshold, the Boards acknowledged that the term *probable* has different meanings in U.S. GAAP and IFRS. However, the Boards decided to set the threshold at a level that is consistent with previous revenue recognition practices and requirements in U.S. GAAP and IFRS.
2. **Interim disclosure requirements**—The Boards noted that the general guidance in their respective interim reporting guidance (Topic 270, Interim Reporting, and IAS 34, *Interim Financial Reporting*) would apply to revenue from contracts with customers. However, the IASB decided to also amend IAS 34 to specifically require the disclosure of disaggregated information of revenue from contracts with customers in interim financial statements. The FASB similarly decided to amend

Topic 270 to require a public entity to disclose disaggregated revenue information in interim financial statements, but also made amendments to require information about both contract balances and remaining performance obligations to be disclosed on an interim basis.

3. **Early application and effective date**—The guidance in this Update prohibits an entity from applying the requirements earlier than the effective date, whereas IFRS 15 allows an entity to apply the requirements early. Nonpublic entities may apply the requirements earlier than the nonpublic effective date but no earlier than the public entity effective date. In addition, the effective date for IFRS 15 is for annual reporting periods beginning on or after January 1, 2017, whereas Topic 606 has an effective date for public entities for annual reporting periods beginning after December 15, 2016.
4. **Impairment loss reversal**—Consistent with other areas of U.S. GAAP, the amendments in this Update do not allow an entity to reverse an impairment loss on an asset that is recognized in accordance with the guidance on costs to obtain or fulfill a contract. In contrast, IFRS 15 requires an entity to reverse impairment losses, which is consistent with the requirements on the impairment of assets within the scope of IAS 36, *Impairment of Assets*.
5. **Nonpublic entity requirements**—This Update applies to nonpublic entities and includes some specific reliefs relating to disclosure, transition, and effective date. No such guidance is included within IFRS 15. *IFRS for Small and Medium-sized Entities* is available for entities that do not have public accountability.

Amendments to the *FASB Accounting Standards Codification*[®]

Introduction

1. This Update is organized into two sections:
 - a. Revenue from Contracts with Customers—Amendments in this section codify the Board’s decisions in the revenue project and create a new Topic 606, Revenue from Contracts with Customers and a new Subtopic 340-40, Other Assets and Deferred Costs—Contracts with Customers. For those amendments, see Section A.
 - b. Conforming Amendments—Amendments in this section conform guidance throughout the Codification as a result of the Board’s decisions in the revenue project. For those amendments, see Section B.
2. The Conforming Amendments (Section B), described in paragraphs 8–623, have been made for the following three reasons based on the Board’s decisions: a direct change, a conforming change, and an editorial change. An explanation about some of the amendments made as a direct result of the Board’s decisions is included in the basis for conclusions. The other conforming and editorial amendments resulting from the overall decisions reached are further explained in a basis paragraph that precedes each amendment.
3. The Codification is amended as described in paragraphs 4–623. In some cases, to put the change in context, not only are the amended paragraphs shown but also the preceding and following paragraphs. Terms from the Master Terms are linked (in **bold** type) the first time they appear in each Section and the first time they appear after a “>” symbol and a “>>” symbol heading. In the Implementation Guidance part of Section 55, Glossary terms are linked the first time they appear after a “>>” symbol heading and a “>>>” symbol heading. Paragraphs presented in **bold** type in Topic 606 and Subtopic 340-40 state the main principles, while the words not bolded are terms in the Master Glossary. Added text is underlined, and deleted text is ~~struck out~~.

Section A—Revenue from Contracts with Customers: Amendments to the Accounting Standards Codification

Addition of Topic 606

4. Topic 606, Revenue from Contracts with Customers, has been added to codify the new guidance on revenue from contracts with customers. See the basis for conclusions for further discussion and rationale for decisions reached in this Subtopic.

5. Add Subtopic 606-10, with a link to transition paragraph 606-10-65-1, as follows:

[For ease of readability, the new Topic is not underlined.]

Revenue from Contracts with Customers—Overall

Overview and Background

General

606-10-05-1 This Topic specifies the accounting for **revenue** from **contracts** with **customers**.

606-10-05-2 This Topic establishes principles for reporting useful information to users of financial statements about the nature, amount, timing, and uncertainty of revenue and cash flows arising from the entity's contracts with customers.

606-10-05-3 The core principle of this Topic is that an entity recognizes revenue to depict the transfer of promised goods or services to customers in an amount that reflects the consideration to which the entity expects to be entitled in exchange for those goods or services.

606-10-05-4 An entity recognizes revenue in accordance with that core principle by applying the following steps:

- a. Step 1: Identify the contract(s) with a customer—A **contract** is an agreement between two or more parties that creates enforceable rights and obligations. The guidance in this Topic applies to each contract that has been agreed upon with a customer and meets specified criteria. In some cases, this Topic requires an entity to combine contracts and account for them as one contract. This Topic also provides requirements for the accounting for contract modifications. (See paragraphs 606-10-25-1 through 25-13.)

- b. Step 2: Identify the performance obligations in the contract—A contract includes promises to transfer goods or services to a customer. If those goods or services are distinct, the promises are **performance obligations** and are accounted for separately. A good or service is distinct if the customer can benefit from the good or service on its own or together with other resources that are readily available to the customer and the entity's promise to transfer the good or service to the customer is separately identifiable from other promises in the contract. (See paragraphs 606-10-25-14 through 25-22.)
- c. Step 3: Determine the transaction price—The **transaction price** is the amount of consideration in a contract to which an entity expects to be entitled in exchange for transferring promised goods or services to a customer. The transaction price can be a fixed amount of customer consideration, but it may sometimes include variable consideration or consideration in a form other than cash. The transaction price also is adjusted for the effects of the time value of money if the contract includes a significant financing component and for any consideration payable to the customer. If the consideration is variable, an entity estimates the amount of consideration to which it will be entitled in exchange for the promised goods or services. The estimated amount of variable consideration will be included in the transaction price only to the extent that it is **probable** that a significant reversal in the amount of cumulative revenue recognized will not occur when the uncertainty associated with the variable consideration is subsequently resolved. (See paragraphs 606-10-32-2 through 32-27.)
- d. Step 4: Allocate the transaction price to the performance obligations in the contract—An entity typically allocates the transaction price to each performance obligation on the basis of the relative **standalone selling prices** of each distinct good or service promised in the contract. If a standalone selling price is not observable, an entity estimates it. Sometimes, the transaction price includes a discount or a variable amount of consideration that relates entirely to a part of the contract. The requirements specify when an entity allocates the discount or variable consideration to one or more, but not all, performance obligations (or distinct goods or services) in the contract. (See paragraphs 606-10-32-28 through 32-41.)
- e. Step 5: Recognize revenue when (or as) the entity satisfies a performance obligation—An entity recognizes revenue when (or as) it satisfies a performance obligation by transferring a promised good or service to a customer (which is when the customer obtains control of that good or service). The amount of revenue recognized is the amount allocated to the satisfied performance obligation. A performance obligation may be satisfied at a point in time (typically for promises to transfer goods to a customer) or over time (typically for promises to transfer services to a customer). For performance obligations satisfied over time, an entity recognizes revenue over time by selecting an

appropriate method for measuring the entity's progress toward complete satisfaction of that performance obligation. (See paragraphs 606-10-25-23 through 25-30.)

606-10-05-5 This Topic also includes a cohesive set of disclosure requirements that would result in an entity providing users of financial statements with comprehensive information about the nature, amount, timing, and uncertainty of revenue and cash flows arising from the entity's contracts with customers. Specifically, Section 606-10-50 requires an entity to provide information about:

- a. Revenue recognized from contracts with customers, including the disaggregation of revenue into appropriate categories
- b. Contract balances, including the opening and closing balances of receivables, **contract assets**, and **contract liabilities**
- c. Performance obligations, including when the entity typically satisfies its performance obligations and the transaction price that is allocated to the remaining performance obligations in a contract
- d. Significant judgments, and changes in judgments, made in applying the requirements to those contracts.

Additionally, Section 340-40-50 requires an entity to provide quantitative and/or qualitative information about assets recognized from the costs to obtain or fulfill a contract with a customer.

606-10-05-6 Paragraphs presented in **bold type** in this Topic state the main principles. All paragraphs have equal authority.

Objectives

General

606-10-10-1 The objective of the guidance in this Topic is to establish the principles that an entity shall apply to report useful information to users of financial statements about the nature, amount, timing, and uncertainty of revenue and cash flows arising from a contract with a customer.

> Meeting the Objective

606-10-10-2 To meet the objective in paragraph 606-10-10-1, the core principle of the guidance in this Topic is that an entity shall recognize **revenue** to depict the transfer of promised goods or services to customers in an amount that reflects the consideration to which the entity expects to be entitled in exchange for those goods or services.

606-10-10-3 An entity shall consider the terms of the **contract** and all relevant facts and circumstances when applying this guidance. An entity shall apply this

guidance, including the use of any practical expedients, consistently to contracts with similar characteristics and in similar circumstances.

606-10-10-4 This guidance specifies the accounting for an individual contract with a customer. However, as a practical expedient, an entity may apply this guidance to a portfolio of contracts (or **performance obligations**) with similar characteristics if the entity reasonably expects that the effects on the financial statements of applying this guidance to the portfolio would not differ materially from applying this guidance to the individual contracts (or performance obligations) within that portfolio. When accounting for a portfolio, an entity shall use estimates and assumptions that reflect the size and composition of the portfolio.

Scope and Scope Exceptions

General

> Entities

606-10-15-1 The guidance in this Subtopic applies to all entities.

> Transactions

606-10-15-2 An entity shall apply the guidance in this Topic to all **contracts** with **customers**, except the following:

- a. Lease contracts within the scope of Topic 840, Leases.
- b. Insurance contracts within the scope of Topic 944, Financial Services—Insurance.
- c. Financial instruments and other contractual rights or obligations within the scope of the following Topics:
 1. Topic 310, Receivables
 2. Topic 320, Investments—Debt and Equity Securities
 3. Topic 323, Investments—Equity Method and Joint Ventures
 4. Topic 325, Investments—Other
 5. Topic 405, Liabilities
 6. Topic 470, Debt
 7. Topic 815, Derivatives and Hedging
 8. Topic 825, Financial Instruments
 9. Topic 860, Transfers and Servicing.
- d. Guarantees (other than product or service warranties) within the scope of Topic 460, Guarantees.
- e. Nonmonetary exchanges between entities in the same line of business to facilitate sales to customers or potential customers. For example, this Topic would not apply to a contract between two oil companies that agree to an exchange of oil to fulfill demand from their customers in different specified locations on a timely basis. Topic 845 on

nonmonetary transactions may apply to nonmonetary exchanges that are not within the scope of this Topic.

606-10-15-3 An entity shall apply the guidance in this Topic to a contract (other than a contract listed in paragraph 606-10-15-2) only if the counterparty to the contract is a customer. A customer is a party that has contracted with an entity to obtain goods or services that are an output of the entity's ordinary activities in exchange for consideration. A counterparty to the contract would not be a customer if, for example, the counterparty has contracted with the entity to participate in an activity or process in which the parties to the contract share in the risks and benefits that result from the activity or process (such as developing an asset in a collaboration arrangement) rather than to obtain the output of the entity's ordinary activities.

606-10-15-4 A contract with a customer may be partially within the scope of this Topic and partially within the scope of other Topics listed in paragraph 606-10-15-2.

- a. If the other Topics specify how to separate and/or initially measure one or more parts of the contract, then an entity shall first apply the separation and/or measurement guidance in those Topics. An entity shall exclude from the **transaction price** the amount of the part (or parts) of the contract that are initially measured in accordance with other Topics and shall apply paragraphs 606-10-32-28 through 32-41 to allocate the amount of the transaction price that remains (if any) to each **performance obligation** within the scope of this Topic and to any other parts of the contract identified by paragraph 606-10-15-4(b).
- b. If the other Topics do not specify how to separate and/or initially measure one or more parts of the contract, then the entity shall apply the guidance in this Topic to separate and/or initially measure the part (or parts) of the contract.

606-10-15-5 Subtopic 340-40 on other assets and deferred costs from contracts with customers includes guidance on accounting for the incremental costs of obtaining a contract with a customer and for the costs incurred to fulfill a contract with a customer if those costs are not within the scope of another Topic (see Subtopic 340-40). An entity shall apply that guidance only to the costs incurred that relate to a contract with a customer (or part of that contract) that is within the scope of the guidance in this Topic.

Glossary

Contract

An agreement between two or more parties that creates enforceable rights and obligations.

Contract Asset

An entity's right to consideration in exchange for goods or services that the entity has transferred to a **customer** when that right is conditioned on something other than the passage of time (for example, the entity's future performance).

Contract Liability

An entity's obligation to transfer goods or services to a **customer** for which the entity has received consideration (or the amount is due) from the customer.

Customer

A party that has contracted with an entity to obtain goods or services that are an output of the entity's ordinary activities in exchange for consideration.

Not-for-Profit Entity

An entity that possesses the following characteristics, in varying degrees, that distinguish it from a business entity:

- a. Contributions of significant amounts of resources from resource providers who do not expect commensurate or proportionate pecuniary return
- b. Operating purposes other than to provide goods or services at a profit
- c. Absence of ownership interests like those of business entities.

Entities that clearly fall outside this definition include the following:

- a. All investor-owned entities
- b. Entities that provide dividends, lower costs, or other economic benefits directly and proportionately to their owners, members, or participants, such as mutual insurance entities, credit unions, farm and rural electric cooperatives, and employee benefit plans.

Performance Obligation

A promise in a **contract** with a **customer** to transfer to the customer either:

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

Probable (second definition)

The future event or events are likely to occur.

Public Business Entity

A public business entity is a business entity meeting any one of the criteria below. Neither a **not-for-profit entity** nor an employee benefit plan is a business entity.

- a. It is required by the U.S. Securities and Exchange Commission (SEC) to file or furnish financial statements, or does file or furnish financial statements (including voluntary filers), with the SEC (including other entities whose financial statements or financial information are required to be or are included in a filing).
- b. It is required by the Securities Exchange Act of 1934 (the Act), as amended, or rules or regulations promulgated under the Act, to file or furnish financial statements with a regulatory agency other than the SEC.
- c. It is required to file or furnish financial statements with a foreign or domestic regulatory agency in preparation for the sale of or for purposes of issuing securities that are not subject to contractual restrictions on transfer.
- d. It has issued, or is a conduit bond obligor for, securities that are traded, listed, or quoted on an exchange or an over-the-counter market.
- e. It has one or more securities that are not subject to contractual restrictions on transfer, and it is required by law, contract, or regulation to prepare U.S. GAAP financial statements (including footnotes) and make them publicly available on a periodic basis (for example, interim or annual periods). An entity must meet both of these conditions to meet this criterion.

An entity may meet the definition of a public business entity solely because its financial statements or financial information is included in another entity's filing with the SEC. In that case, the entity is only a public business entity for purposes of financial statements that are filed or furnished with the SEC.

Revenue

Inflows or other enhancements of assets of an entity or settlements of its liabilities (or a combination of both) from delivering or producing goods, rendering services, or other activities that constitute the entity's ongoing major or central operations.

Standalone Selling Price

The price at which an entity would sell a promised good or service separately to a **customer**.

Transaction Price

The amount of consideration to which an entity expects to be entitled in exchange for transferring promised goods or services to a **customer**, excluding amounts collected on behalf of third parties.

Recognition

General

> Identifying the Contract

606-10-25-1 An entity shall account for a contract with a customer that is within the scope of this Topic only when all of the following criteria are met:

- a. The parties to the contract have approved the contract (in writing, orally, or in accordance with other customary business practices) and are committed to perform their respective obligations.
- b. The entity can identify each party's rights regarding the goods or services to be transferred.
- c. The entity can identify the payment terms for the goods or services to be transferred.
- d. The contract has commercial substance (that is, the risk, timing, or amount of the entity's future cash flows is expected to change as a result of the contract).
- e. It is probable that the entity will collect the consideration to which it will be entitled in exchange for the goods or services that will be transferred to the customer. In evaluating whether collectibility of an amount of consideration is probable, an entity shall consider only the customer's ability and intention to pay that amount of consideration when it is due. The amount of consideration to which the entity will be entitled may be less than the price stated in the contract if the consideration is variable because the entity may offer the customer a price concession (see paragraph 606-10-32-7).

606-10-25-2 A contract is an agreement between two or more parties that creates enforceable rights and obligations. Enforceability of the rights and obligations in a contract is a matter of law. Contracts can be written, oral, or implied by an entity's customary business practices. The practices and processes for establishing contracts with customers vary across legal jurisdictions, industries, and entities. In addition, they may vary within an entity

(for example, they may depend on the class of customer or the nature of the promised goods or services). An entity shall consider those practices and processes in determining whether and when an agreement with a customer creates enforceable rights and obligations.

606-10-25-3 Some contracts with customers may have no fixed duration and can be terminated or modified by either party at any time. Other contracts may automatically renew on a periodic basis that is specified in the contract. An entity shall apply the guidance in this Topic to the duration of the contract (that is, the contractual period) in which the parties to the contract have present enforceable rights and obligations.

606-10-25-4 For the purpose of applying the guidance in this Topic, a contract does not exist if each party to the contract has the unilateral enforceable right to terminate a wholly unperformed contract without compensating the other party (or parties). A contract is wholly unperformed if both of the following criteria are met:

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

606-10-25-5 If a contract with a customer meets the criteria in paragraph 606-10-25-1 at contract inception, an entity shall not reassess those criteria unless there is an indication of a significant change in facts and circumstances. For example, if a customer's ability to pay the consideration deteriorates significantly, an entity would reassess whether it is probable that the entity will collect the consideration to which the entity will be entitled in exchange for the remaining goods or services that will be transferred to the customer.

606-10-25-6 If a contract with a customer does not meet the criteria in paragraph 606-10-25-1, an entity shall continue to assess the contract to determine whether the criteria in paragraph 606-10-25-1 are subsequently met.

606-10-25-7 When a contract with a customer does not meet the criteria in paragraph 606-10-25-1 and an entity receives consideration from the customer, the entity shall recognize the consideration received as **revenue** only when either of the following events has occurred:

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

606-10-25-8 An entity shall recognize the consideration received from a customer as a liability until one of the events in paragraph 606-10-25-7 occurs or until the criteria in paragraph 606-10-25-1 are subsequently met (see paragraph 606-10-25-6).

Depending on the facts and circumstances relating to the contract, the liability recognized represents the entity's obligation to either transfer goods or services in the future or refund the consideration received. In either case, the liability shall be measured at the amount of consideration received from the customer.

> **Combination of Contracts**

606-10-25-9 An entity shall combine two or more **contracts** entered into at or near the same time with the same **customer** (or related parties of the customer) and account for the contracts as a single contract if one or more of the following criteria are met:

- a. The contracts are negotiated as a package with a single commercial objective.
- b. The amount of consideration to be paid in one contract depends on the price or performance of the other contract.
- c. The goods or services promised in the contracts (or some goods or services promised in each of the contracts) are a single **performance obligation** in accordance with paragraphs 606-10-25-14 through 25-22.

> **Contract Modifications**

606-10-25-10 A contract modification is a change in the scope or price (or both) of a **contract** that is approved by the parties to the contract. In some industries and jurisdictions, a contract modification may be described as a change order, a variation, or an amendment. A contract modification exists when the parties to a contract approve a modification that either creates new or changes existing enforceable rights and obligations of the parties to the contract. A contract modification could be approved in writing, by oral agreement, or implied by customary business practices. If the parties to the contract have not approved a contract modification, an entity shall continue to apply the guidance in this Topic to the existing contract until the contract modification is approved.

606-10-25-11 A contract modification may exist even though the parties to the contract have a dispute about the scope or price (or both) of the modification or the parties have approved a change in the scope of the contract but have not yet determined the corresponding change in price. In determining whether the rights and obligations that are created or changed by a modification are enforceable, an entity shall consider all relevant facts and circumstances including the terms of the contract and other evidence. If the parties to a contract have approved a change in the scope of the contract but have not yet determined the corresponding change in price, an entity shall estimate the change to the **transaction price** arising from the modification in accordance with paragraphs 606-10-32-5 through 32-9 on estimating variable consideration and paragraphs 606-10-32-11 through 32-13 on constraining estimates of variable consideration.

606-10-25-12 An entity shall account for a contract modification as a separate contract if both of the following conditions are present:

- a. The scope of the contract increases because of the addition of promised goods or services that are distinct (in accordance with paragraphs 606-10-25-18 through 25-22).
- b. The price of the contract increases by an amount of consideration that reflects the entity's **standalone selling prices** of the additional promised goods or services and any appropriate adjustments to that price to reflect the circumstances of the particular contract. For example, an entity may adjust the standalone selling price of an additional good or service for a discount that the customer receives, because it is not necessary for the entity to incur the selling-related costs that it would incur when selling a similar good or service to a new customer.

606-10-25-13 If a contract modification is not accounted for as a separate contract in accordance with paragraph 606-10-25-12, an entity shall account for the promised goods or services not yet transferred at the date of the contract modification (that is, the remaining promised goods or services) in whichever of the following ways is applicable:

- a. An entity shall account for the contract modification as if it were a termination of the existing contract, and the creation of a new contract, if the remaining goods or services are distinct from the goods or services transferred on or before the date of the contract modification. The amount of consideration to be allocated to the remaining **performance obligations** (or to the remaining distinct goods or services in a single performance obligation identified in accordance with paragraph 606-10-25-14(b)) is the sum of:
 - 1. The consideration promised by the customer (including amounts already received from the customer) that was included in the estimate of the transaction price and that had not been recognized as **revenue** and
 - 2. The consideration promised as part of the contract modification.
- b. An entity shall account for the contract modification as if it were a part of the existing contract if the remaining goods or services are not distinct and, therefore, form part of a single performance obligation that is partially satisfied at the date of the contract modification. The effect that the contract modification has on the transaction price, and on the entity's measure of progress toward complete satisfaction of the performance obligation, is recognized as an adjustment to revenue (either as an increase in or a reduction of revenue) at the date of the contract modification (that is, the adjustment to revenue is made on a cumulative catch-up basis).
- c. If the remaining goods or services are a combination of items (a) and (b), then the entity shall account for the effects of the modification on the unsatisfied (including partially unsatisfied) performance obligations in

the modified contract in a manner that is consistent with the objectives of this paragraph.

> Identifying Performance Obligations

606-10-25-14 At contract inception, an entity shall assess the goods or services promised in a contract with a customer and shall identify as a performance obligation each promise to transfer to the customer either:

- a. A good or service (or a bundle of goods or services) that is distinct
- b. A series of distinct goods or services that are substantially the same and that have the same pattern of transfer to the customer (see paragraph 606-10-25-15).

606-10-25-15 A series of distinct goods or services has the same pattern of transfer to the customer if both of the following criteria are met:

- a. Each distinct good or service in the series that the entity promises to transfer to the customer would meet the criteria in paragraph 606-10-25-27 to be a performance obligation satisfied over time.
- b. In accordance with paragraphs 606-10-25-31 through 25-32, the same method would be used to measure the entity's progress toward complete satisfaction of the performance obligation to transfer each distinct good or service in the series to the customer.

>> Promises in Contracts with Customers

606-10-25-16 A contract with a customer generally explicitly states the goods or services that an entity promises to transfer to a customer. However, the performance obligations identified in a contract with a customer may not be limited to the goods or services that are explicitly stated in that contract. This is because a contract with a customer also may include promises that are implied by an entity's customary business practices, published policies, or specific statements if, at the time of entering into the contract, those promises create a valid expectation of the customer that the entity will transfer a good or service to the customer.

606-10-25-17 Performance obligations do not include activities that an entity must undertake to fulfill a contract unless those activities transfer a good or service to a customer. For example, a services provider may need to perform various administrative tasks to set up a contract. The performance of those tasks does not transfer a service to the customer as the tasks are performed. Therefore, those setup activities are not a performance obligation.

>> Distinct Goods or Services

606-10-25-18 Depending on the contract, promised goods or services may include, but are not limited to, the following:

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

606-10-25-19 A good or service that is promised to a customer is distinct if both of the following criteria are met:

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

606-10-25-20 A customer can benefit from a good or service in accordance with paragraph 606-10-25-19(a) if the good or service could be used, consumed, sold for an amount that is greater than scrap value, or otherwise held in a way that generates economic benefits. For some goods or services, a customer may be able to benefit from a good or service on its own. For other goods or services, a customer may be able to benefit from the good or service only in conjunction with other readily available resources. A readily available resource is a good or service that is sold separately (by the entity or another entity) or a resource that the customer has already obtained from the entity (including goods or services that the entity will have already transferred to the customer under the contract) or

from other transactions or events. Various factors may provide evidence that the customer can benefit from a good or service either on its own or in conjunction with other readily available resources. For example, the fact that the entity regularly sells a good or service separately would indicate that a customer can benefit from the good or service on its own or with other readily available resources.

606-10-25-21 Factors that indicate that an entity's promise to transfer a good or service to a customer is separately identifiable (in accordance with paragraph 606-10-25-19(b)) include, but are not limited to, the following:

- a. The entity does not provide a significant service of integrating the good or service with other goods or services promised in the contract into a bundle of goods or services that represent the combined output for which the customer has contracted. In other words, the entity is not using the good or service as an input to produce or deliver the combined output specified by the customer.
- b. The good or service does not significantly modify or customize another good or service promised in the contract.
- c. The good or service is not highly dependent on, or highly interrelated with, other goods or services promised in the contract. For example, the fact that a customer could decide to not purchase the good or service without significantly affecting the other promised goods or services in the contract might indicate that the good or service is not highly dependent on, or highly interrelated with, those other promised goods or services.

606-10-25-22 If a promised good or service is not distinct, an entity shall combine that good or service with other promised goods or services until it identifies a bundle of goods or services that is distinct. In some cases, that would result in the entity accounting for all the goods or services promised in a contract as a single **performance obligation**.

> Satisfaction of Performance Obligations

606-10-25-23 An entity shall recognize revenue when (or as) the entity satisfies a performance obligation **by transferring a promised good or service (that is, an asset) to a customer. An asset is transferred when (or as) the customer obtains control of that asset.**

606-10-25-24 For each performance obligation identified in accordance with paragraphs 606-10-25-14 through 25-22, an entity shall determine at contract inception whether it satisfies the performance obligation over time (in accordance with paragraphs 606-10-25-27 through 25-29) or satisfies the performance obligation at a point in time (in accordance with paragraph 606-10-25-30). If an entity does not satisfy a performance obligation over time, the performance obligation is satisfied at a point in time.

606-10-25-25 Goods and services are assets, even if only momentarily, when they are received and used (as in the case of many services). Control of an asset refers to the ability to direct the use of, and obtain substantially all of the remaining benefits from, the asset. Control includes the ability to prevent other entities from directing the use of, and obtaining the benefits from, an asset. The benefits of an asset are the potential cash flows (inflows or savings in outflows) that can be obtained directly or indirectly in many ways, such as by:

- a. Using the asset to produce goods or provide services (including public services)
- b. Using the asset to enhance the value of other assets
- c. Using the asset to settle liabilities or reduce expenses
- d. Selling or exchanging the asset
- e. Pledging the asset to secure a loan
- f. Holding the asset.

606-10-25-26 When evaluating whether a customer obtains control of an asset, an entity shall consider any agreement to repurchase the asset (see paragraphs 606-10-55-66 through 55-78).

> > Performance Obligations Satisfied Over Time

606-10-25-27 An entity transfers control of a good or service over time and, therefore, satisfies a **performance obligation** and recognizes **revenue** over time, if one of the following criteria is met:

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

606-10-25-28 An asset created by an entity's performance does not have an alternative use to an entity if the entity is either restricted contractually from readily directing the asset for another use during the creation or enhancement of that asset or limited practically from readily directing the asset in its completed state for another use. The assessment of whether an asset has an alternative use to the entity is made at contract inception. After contract inception, an entity shall not update the assessment of the alternative use of an asset unless the parties to the **contract** approve a contract modification that substantively changes the performance obligation. Paragraphs 606-10-55-8 through 55-10 provide guidance for assessing whether an asset has an alternative use to an entity.

606-10-25-29 An entity shall consider the terms of the contract, as well as any laws that apply to the contract, when evaluating whether it has an enforceable right to payment for performance completed to date in accordance with paragraph 606-10-25-27(c). The right to payment for performance completed to date does not need to be for a fixed amount. However, at all times throughout the duration of the contract, the entity must be entitled to an amount that at least compensates the entity for performance completed to date if the contract is terminated by the customer or another party for reasons other than the entity's failure to perform as promised. Paragraphs 606-10-55-11 through 55-15 provide guidance for assessing the existence and enforceability of a right to payment and whether an entity's right to payment would entitle the entity to be paid for its performance completed to date.

> > Performance Obligations Satisfied at a Point in Time

606-10-25-30 If a **performance obligation** is not satisfied over time in accordance with paragraphs 606-10-25-27 through 25-29, an entity satisfies the performance obligation at a point in time. To determine the point in time at which a **customer** obtains control of a promised asset and the entity satisfies a performance obligation, the entity shall consider the guidance on control in paragraphs 606-10-25-23 through 25-26. In addition, an entity shall consider indicators of the transfer of control, which include, but are not limited to, the following:

- a. The entity has a present right to payment for the asset—If a customer presently is obliged to pay for an asset, then that may indicate that the customer has obtained the ability to direct the use of, and obtain substantially all of the remaining benefits from, the asset in exchange.
- b. The customer has legal title to the asset—Legal title may indicate which party to a **contract** has the ability to direct the use of, and obtain substantially all of the remaining benefits from, an asset or to restrict the access of other entities to those benefits. Therefore, the transfer of legal title of an asset may indicate that the customer has obtained control of the asset. If an entity retains legal title solely as protection against the customer's failure to pay, those rights of the entity would not preclude the customer from obtaining control of an asset.
- c. The entity has transferred physical possession of the asset—The customer's physical possession of an asset may indicate that the customer has the ability to direct the use of, and obtain substantially all of the remaining benefits from, the asset or to restrict the access of other entities to those benefits. However, physical possession may not coincide with control of an asset. For example, in some repurchase agreements and in some consignment arrangements, a customer or consignee may have physical possession of an asset that the entity controls. Conversely, in some bill-and-hold arrangements, the entity may have physical possession of an asset that the customer controls. Paragraphs 606-10-55-66 through 55-78, 606-10-55-79 through 55-80,

and 606-10-55-81 through 55-84 provide guidance on accounting for repurchase agreements, consignment arrangements, and bill-and-hold arrangements, respectively.

- d. The customer has the significant risks and rewards of ownership of the asset—The transfer of the significant risks and rewards of ownership of an asset to the customer may indicate that the customer has obtained the ability to direct the use of, and obtain substantially all of the remaining benefits from, the asset. However, when evaluating the risks and rewards of ownership of a promised asset, an entity shall exclude any risks that give rise to a separate performance obligation in addition to the performance obligation to transfer the asset. For example, an entity may have transferred control of an asset to a customer but not yet satisfied an additional performance obligation to provide maintenance services related to the transferred asset.
- e. The customer has accepted the asset—The customer's acceptance of an asset may indicate that it has obtained the ability to direct the use of, and obtain substantially all of the remaining benefits from, the asset. To evaluate the effect of a contractual customer acceptance clause on when control of an asset is transferred, an entity shall consider the guidance in paragraphs 606-10-55-85 through 55-88.

> > **Measuring Progress toward Complete Satisfaction of a Performance Obligation**

606-10-25-31 For each **performance obligation** satisfied over time in accordance with paragraphs 606-10-25-27 through 25-29, an entity shall recognize **revenue** over time by measuring the progress toward complete satisfaction of that performance obligation. The objective when measuring progress is to depict an entity's performance in transferring control of goods or services promised to a **customer** (that is, the satisfaction of an entity's performance obligation).

606-10-25-32 An entity shall apply a single method of measuring progress for each performance obligation satisfied over time, and the entity shall apply that method consistently to similar performance obligations and in similar circumstances. At the end of each reporting period, an entity shall remeasure its progress toward complete satisfaction of a performance obligation satisfied over time.

> > > **Methods for Measuring Progress**

606-10-25-33 Appropriate methods of measuring progress include output methods and input methods. Paragraphs 606-10-55-16 through 55-21 provide guidance for using output methods and input methods to measure an entity's progress toward complete satisfaction of a performance obligation. In determining the appropriate method for measuring progress, an entity shall

consider the nature of the good or service that the entity promised to transfer to the customer.

606-10-25-34 When applying a method for measuring progress, an entity shall exclude from the measure of progress any goods or services for which the entity does not transfer control to a customer. Conversely, an entity shall include in the measure of progress any goods or services for which the entity does transfer control to a customer when satisfying that performance obligation.

606-10-25-35 As circumstances change over time, an entity shall update its measure of progress to reflect any changes in the outcome of the performance obligation. Such changes to an entity's measure of progress shall be accounted for as a change in accounting estimate in accordance with Subtopic 250-10 on accounting changes and error corrections.

> > Reasonable Measures of Progress

606-10-25-36 An entity shall recognize revenue for a performance obligation satisfied over time only if the entity can reasonably measure its progress toward complete satisfaction of the performance obligation. An entity would not be able to reasonably measure its progress toward complete satisfaction of a performance obligation if it lacks reliable information that would be required to apply an appropriate method of measuring progress.

606-10-25-37 In some circumstances (for example, in the early stages of a contract), an entity may not be able to reasonably measure the outcome of a performance obligation, but the entity expects to recover the costs incurred in satisfying the performance obligation. In those circumstances, the entity shall recognize revenue only to the extent of the costs incurred until such time that it can reasonably measure the outcome of the performance obligation.

Measurement

General Note: The Measurement Section provides guidance on both initial and subsequent measurement. Specifically, this Section provides the criteria and amounts used to measure a particular item at the date of initial recognition. In addition, this Section provides guidance on an entity's subsequent measurement and subsequent recognition of an item. Situations that may result in subsequent changes to carrying amounts include impairment, fair value adjustments, depreciation and amortization, and so forth.

General

606-10-32-1 When (or as) a performance obligation is satisfied, an entity shall recognize as revenue the amount of the transaction price (which excludes estimates of variable consideration that are constrained in accordance with

paragraphs 606-10-32-11 through 32-13) that is allocated to that performance obligation.

> Determining the Transaction Price

606-10-32-2 An entity shall consider the terms of the contract and its customary business practices to determine the transaction price. The transaction price is the amount of consideration to which an entity expects to be entitled in exchange for transferring promised goods or services to a customer, excluding amounts collected on behalf of third parties (for example, some sales taxes). The consideration promised in a contract with a customer may include fixed amounts, variable amounts, or both.

606-10-32-3 The nature, timing, and amount of consideration promised by a customer affect the estimate of the transaction price. When determining the transaction price, an entity shall consider the effects of all of the following:

- a. Variable consideration (see paragraphs 606-10-32-5 through 32-10 and 606-10-32-14)
- b. Constraining estimates of variable consideration (see paragraphs 606-10-32-11 through 32-13)
- c. The existence of a significant financing component in the contract (see paragraphs 606-10-32-15 through 32-20)
- d. Noncash consideration (see paragraphs 606-10-32-21 through 32-24)
- e. Consideration payable to a customer (see paragraphs 606-10-32-25 through 32-27).

606-10-32-4 For the purpose of determining the transaction price, an entity shall assume that the goods or services will be transferred to the customer as promised in accordance with the existing contract and that the contract will not be cancelled, renewed, or modified.

> > Variable Consideration

606-10-32-5 If the consideration promised in a **contract** includes a variable amount, an entity shall estimate the amount of consideration to which the entity will be entitled in exchange for transferring the promised goods or services to a **customer**.

606-10-32-6 An amount of consideration can vary because of discounts, rebates, refunds, credits, price concessions, incentives, performance bonuses, penalties, or other similar items. The promised consideration also can vary if an entity's entitlement to the consideration is contingent on the occurrence or nonoccurrence of a future event. For example, an amount of consideration would be variable if either a product was sold with a right of return or a fixed amount is promised as a performance bonus on achievement of a specified milestone.

606-10-32-7 The variability relating to the consideration promised by a customer may be explicitly stated in the contract. In addition to the terms of the contract, the promised consideration is variable if either of the following circumstances exists:

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

606-10-32-8 An entity shall estimate an amount of variable consideration by using either of the following methods, depending on which method the entity expects to better predict the amount of consideration to which it will be entitled:

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

606-10-32-9 An entity shall apply one method consistently throughout the contract when estimating the effect of an uncertainty on an amount of variable consideration to which the entity will be entitled. In addition, an entity shall consider all the information (historical, current, and forecast) that is reasonably available to the entity and shall identify a reasonable number of possible consideration amounts. The information that an entity uses to estimate the amount of variable consideration typically would be similar to the information that the entity's management uses during the bid-and-proposal process and in establishing prices for promised goods or services.

>>> Refund Liabilities

606-10-32-10 An entity shall recognize a refund liability if the entity receives consideration from a customer and expects to refund some or all of that consideration to the customer. A refund liability is measured at the amount of consideration received (or receivable) for which the entity does not expect to be entitled (that is, amounts not included in the **transaction price**). The refund

liability (and corresponding change in the transaction price and, therefore, the **contract liability**) shall be updated at the end of each reporting period for changes in circumstances. To account for a refund liability relating to a sale with a right of return, an entity shall apply the guidance in paragraphs 606-10-55-22 through 55-29.

> > > **Constraining Estimates of Variable Consideration**

606-10-32-11 An entity shall include in the transaction price some or all of an amount of variable consideration estimated in accordance with paragraph 606-10-32-8 only to the extent that it is **probable** that a significant reversal in the amount of cumulative **revenue** recognized will not occur when the uncertainty associated with the variable consideration is subsequently resolved.

606-10-32-12 In assessing whether it is probable that a significant reversal in the amount of cumulative revenue recognized will not occur once the uncertainty related to the variable consideration is subsequently resolved, an entity shall consider both the likelihood and the magnitude of the revenue reversal. Factors that could increase the likelihood or the magnitude of a revenue reversal include, but are not limited to, any of the following:

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

606-10-32-13 An entity shall apply paragraph 606-10-55-65 to account for consideration in the form of a sales-based or usage-based royalty that is promised in exchange for a license of intellectual property.

> > > **Reassessment of Variable Consideration**

606-10-32-14 At the end of each reporting period, an entity shall update the estimated transaction price (including updating its assessment of whether an estimate of variable consideration is constrained) to represent faithfully the circumstances present at the end of the reporting period and the changes in circumstances during the reporting period. The entity shall account for changes

in the transaction price in accordance with paragraphs 606-10-32-42 through 32-45.

> > **The Existence of a Significant Financing Component in the Contract**

606-10-32-15 In determining the transaction price, an entity shall adjust the promised amount of consideration for the effects of the time value of money if the timing of payments agreed to by the parties to the **contract** (either explicitly or implicitly) provides the **customer** or the entity with a significant benefit of financing the transfer of goods or services to the customer. In those circumstances, the contract contains a significant financing component. A significant financing component may exist regardless of whether the promise of financing is explicitly stated in the contract or implied by the payment terms agreed to by the parties to the contract.

606-10-32-16 The objective when adjusting the promised amount of consideration for a significant financing component is for an entity to recognize **revenue** at an amount that reflects the price that a customer would have paid for the promised goods or services if the customer had paid cash for those goods or services when (or as) they transfer to the customer (that is, the cash selling price). An entity shall consider all relevant facts and circumstances in assessing whether a contract contains a financing component and whether that financing component is significant to the contract, including both of the following:

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

606-10-32-17 Notwithstanding the assessment in paragraph 606-10-32-16, a contract with a customer would not have a significant financing component if any of the following factors exist:

- a. The customer paid for the goods or services in advance, and the timing of the transfer of those goods or services is at the discretion of the customer.
- b. A substantial amount of the consideration promised by the customer is variable, and the amount or timing of that consideration varies on the basis of the occurrence or nonoccurrence of a future event that is not substantially within the control of the customer or the entity (for example, if the consideration is a sales-based royalty).
- c. The difference between the promised consideration and the cash selling price of the good or service (as described in paragraph 606-10-32-16) arises for reasons other than the provision of finance to either the customer or the entity, and the difference between those amounts is

proportional to the reason for the difference. For example, the payment terms might provide the entity or the customer with protection from the other party failing to adequately complete some or all of its obligations under the contract.

606-10-32-18 As a practical expedient, an entity need not adjust the promised amount of consideration for the effects of a significant financing component if the entity expects, at contract inception, that the period between when the entity transfers a promised good or service to a customer and when the customer pays for that good or service will be one year or less.

606-10-32-19 To meet the objective in paragraph 606-10-32-16 when adjusting the promised amount of consideration for a significant financing component, an entity shall use the discount rate that would be reflected in a separate financing transaction between the entity and its customer at contract inception. That rate would reflect the credit characteristics of the party receiving financing in the contract, as well as any collateral or security provided by the customer or the entity, including assets transferred in the contract. An entity may be able to determine that rate by identifying the rate that discounts the nominal amount of the promised consideration to the price that the customer would pay in cash for the goods or services when (or as) they transfer to the customer. After contract inception, an entity shall not update the discount rate for changes in interest rates or other circumstances (such as a change in the assessment of the customer's credit risk).

606-10-32-20 An entity shall present the effects of financing (interest income or interest expense) separately from revenue from contracts with customers in the statement of comprehensive income (statement of activities). Interest income or interest expense is recognized only to the extent that a **contract asset** (or receivable) or a **contract liability** is recognized in accounting for a contract with a customer. In accounting for the effects of the time value of money, an entity also shall consider the subsequent measurement guidance in Subtopic 835-30, specifically the guidance in paragraphs 835-30-45-1A through 45-3 on presentation of the discount and premium in the financial statements and the guidance in paragraphs 835-30-55-2 through 55-3 on the application of the interest method.

>> Noncash Consideration

606-10-32-21 To determine the **transaction price** for **contracts** in which a **customer** promises consideration in a form other than cash, an entity shall measure the noncash consideration (or promise of noncash consideration) at fair value.

606-10-32-22 If an entity cannot reasonably estimate the fair value of the noncash consideration, the entity shall measure the consideration indirectly by reference to the **standalone selling price** of the goods or services promised to the customer (or class of customer) in exchange for the consideration.

606-10-32-23 The fair value of the noncash consideration may vary because of the form of the consideration (for example, a change in the price of a share to which an entity is entitled to receive from a customer). If the fair value of the noncash consideration promised by a customer varies for reasons other than only the form of the consideration (for example, the fair value could vary because of the entity's performance), an entity shall apply the guidance in paragraphs 606-10-32-11 through 32-13.

606-10-32-24 If a customer contributes goods or services (for example, materials, equipment, or labor) to facilitate an entity's fulfillment of the contract, the entity shall assess whether it obtains control of those contributed goods or services. If so, the entity shall account for the contributed goods or services as noncash consideration received from the customer.

> > Consideration Payable to a Customer

606-10-32-25 Consideration payable to a **customer** includes cash amounts that an entity pays, or expects to pay, to the customer (or to other parties that purchase the entity's goods or services from the customer). Consideration payable to a customer also includes credit or other items (for example, a coupon or voucher) that can be applied against amounts owed to the entity (or to other parties that purchase the entity's goods or services from the customer). An entity shall account for consideration payable to a customer as a reduction of the **transaction price** and, therefore, of **revenue** unless the payment to the customer is in exchange for a distinct good or service (as described in paragraphs 606-10-25-18 through 25-22) that the customer transfers to the entity. If the consideration payable to a customer includes a variable amount, an entity shall estimate the transaction price (including assessing whether the estimate of variable consideration is constrained) in accordance with paragraphs 606-10-32-5 through 32-13.

606-10-32-26 If consideration payable to a customer is a payment for a distinct good or service from the customer, then an entity shall account for the purchase of the good or service in the same way that it accounts for other purchases from suppliers. If the amount of consideration payable to the customer exceeds the fair value of the distinct good or service that the entity receives from the customer, then the entity shall account for such an excess as a reduction of the transaction price. If the entity cannot reasonably estimate the fair value of the good or service received from the customer, it shall account for all of the consideration payable to the customer as a reduction of the transaction price.

606-10-32-27 Accordingly, if consideration payable to a customer is accounted for as a reduction of the transaction price, an entity shall recognize the reduction of revenue when (or as) the later of either of the following events occurs:

- a. The entity recognizes revenue for the transfer of the related goods or services to the customer.
- b. The entity pays or promises to pay the consideration (even if the

payment is conditional on a future event). That promise might be implied by the entity's customary business practices.

> Allocating the Transaction Price to Performance Obligations

606-10-32-28 The objective when allocating the transaction price is for an entity to allocate the transaction price to each performance obligation (or distinct good or service) in an amount that depicts the amount of consideration to which the entity expects to be entitled in exchange for transferring the promised goods or services to the customer.

606-10-32-29 To meet the allocation objective, an entity shall allocate the transaction price to each performance obligation identified in the **contract** on a relative **standalone selling price** basis in accordance with paragraphs 606-10-32-31 through 32-35, except as specified in paragraphs 606-10-32-36 through 32-38 (for allocating discounts) and paragraphs 606-10-32-39 through 32-41 (for allocating consideration that includes variable amounts).

606-10-32-30 Paragraphs 606-10-32-31 through 32-41 do not apply if a contract has only one performance obligation. However, paragraphs 606-10-32-39 through 32-41 may apply if an entity promises to transfer a series of distinct goods or services identified as a single performance obligation in accordance with paragraph 606-10-25-14(b) and the promised consideration includes variable amounts.

> > Allocation Based on Standalone Selling Prices

606-10-32-31 To allocate the **transaction price** to each **performance obligation** on a relative **standalone selling price** basis, an entity shall determine the standalone selling price at contract inception of the distinct good or service underlying each performance obligation in the **contract** and allocate the transaction price in proportion to those standalone selling prices.

606-10-32-32 The standalone selling price is the price at which an entity would sell a promised good or service separately to a **customer**. The best evidence of a standalone selling price is the observable price of a good or service when the entity sells that good or service separately in similar circumstances and to similar customers. A contractually stated price or a list price for a good or service may be (but shall not be presumed to be) the standalone selling price of that good or service.

606-10-32-33 If a standalone selling price is not directly observable, an entity shall estimate the standalone selling price at an amount that would result in the allocation of the transaction price meeting the allocation objective in paragraph 606-10-32-28. When estimating a standalone selling price, an entity shall consider all information (including market conditions, entity-specific factors, and information about the customer or class of customer) that is reasonably available

to the entity. In doing so, an entity shall maximize the use of observable inputs and apply estimation methods consistently in similar circumstances.

606-10-32-34 Suitable methods for estimating the standalone selling price of a good or service include, but are not limited to, the following:

- a. Adjusted market assessment approach—An entity could evaluate the market in which it sells goods or services and estimate the price that a customer in that market would be willing to pay for those goods or services. That approach also might include referring to prices from the entity's competitors for similar goods or services and adjusting those prices as necessary to reflect the entity's costs and margins.
- b. Expected cost plus a margin approach—An entity could forecast its expected costs of satisfying a performance obligation and then add an appropriate margin for that good or service.
- c. Residual approach—An entity may estimate the standalone selling price by reference to the total transaction price less the sum of the observable standalone selling prices of other goods or services promised in the contract. However, an entity may use a residual approach to estimate, in accordance with paragraph 606-10-32-33, the standalone selling price of a good or service only if one of the following criteria is met:
 1. The entity sells the same good or service to different customers (at or near the same time) for a broad range of amounts (that is, the selling price is highly variable because a representative standalone selling price is not discernible from past transactions or other observable evidence).
 2. The entity has not yet established a price for that good or service, and the good or service has not previously been sold on a standalone basis (that is, the selling price is uncertain).

606-10-32-35 A combination of methods may need to be used to estimate the standalone selling prices of the goods or services promised in the contract if two or more of those goods or services have highly variable or uncertain standalone selling prices. For example, an entity may use a residual approach to estimate the aggregate standalone selling price for those promised goods or services with highly variable or uncertain standalone selling prices and then use another method to estimate the standalone selling prices of the individual goods or services relative to that estimated aggregate standalone selling price determined by the residual approach. When an entity uses a combination of methods to estimate the standalone selling price of each promised good or service in the contract, the entity shall evaluate whether allocating the transaction price at those estimated standalone selling prices would be consistent with the allocation objective in paragraph 606-10-32-28 and the guidance on estimating standalone selling prices in paragraph 606-10-32-33.

> > Allocation of a Discount

606-10-32-36 A **customer** receives a discount for purchasing a bundle of goods

or services if the sum of the **standalone selling prices** of those promised goods or services in the **contract** exceeds the promised consideration in a contract. Except when an entity has observable evidence in accordance with paragraph 606-10-32-37 that the entire discount relates to only one or more, but not all, **performance obligations** in a contract, the entity shall allocate a discount proportionately to all performance obligations in the contract. The proportionate allocation of the discount in those circumstances is a consequence of the entity allocating the **transaction price** to each performance obligation on the basis of the relative standalone selling prices of the underlying distinct goods or services.

606-10-32-37 An entity shall allocate a discount entirely to one or more, but not all, performance obligations in the contract if all of the following criteria are met:

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

606-10-32-38 If a discount is allocated entirely to one or more performance obligations in the contract in accordance with paragraph 606-10-32-37, an entity shall allocate the discount before using the residual approach to estimate the standalone selling price of a good or service in accordance with paragraph 606-10-32-34(c).

> > Allocation of Variable Consideration

606-10-32-39 Variable consideration that is promised in a **contract** may be attributable to the entire contract or to a specific part of the contract, such as either of the following:

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

606-10-32-40 An entity shall allocate a variable amount (and subsequent changes to that amount) entirely to a performance obligation or to a distinct good

or service that forms part of a single performance obligation in accordance with paragraph 606-10-25-14(b) if both of the following criteria are met:

- a. The terms of a variable payment relate specifically to the entity's efforts to satisfy the performance obligation or transfer the distinct good or service (or to a specific outcome from satisfying the performance obligation or transferring the distinct good or service).
- b. Allocating the variable amount of consideration entirely to the performance obligation or the distinct good or service is consistent with the allocation objective in paragraph 606-10-32-28 when considering all of the performance obligations and payment terms in the contract.

606-10-32-41 The allocation requirements in paragraphs 606-10-32-28 through 32-38 shall be applied to allocate the remaining amount of the transaction price that does not meet the criteria in paragraph 606-10-32-40.

> Changes in the Transaction Price

606-10-32-42 After contract inception, the **transaction price** can change for various reasons, including the resolution of uncertain events or other changes in circumstances that change the amount of consideration to which an entity expects to be entitled in exchange for the promised goods or services.

606-10-32-43 An entity shall allocate to the **performance obligations** in the **contract** any subsequent changes in the transaction price on the same basis as at contract inception. Consequently, an entity shall not reallocate the transaction price to reflect changes in **standalone selling prices** after contract inception. Amounts allocated to a satisfied performance obligation shall be recognized as **revenue**, or as a reduction of revenue, in the period in which the transaction price changes.

606-10-32-44 An entity shall allocate a change in the transaction price entirely to one or more, but not all, performance obligations or distinct goods or services promised in a series that forms part of a single performance obligation in accordance with paragraph 606-10-25-14(b) only if the criteria in paragraph 606-10-32-40 on allocating variable consideration are met.

606-10-32-45 An entity shall account for a change in the transaction price that arises as a result of a contract modification in accordance with paragraphs 606-10-25-10 through 25-13. However, for a change in the transaction price that occurs after a contract modification, an entity shall apply paragraphs 606-10-32-42 through 32-44 to allocate the change in the transaction price in whichever of the following ways is applicable:

- a. An entity shall allocate the change in the transaction price to the performance obligations identified in the contract before the modification if, and to the extent that, the change in the transaction price is attributable to an amount of variable consideration promised before the

- modification and the modification is accounted for in accordance with paragraph 606-10-25-13(a).
- b. In all other cases in which the modification was not accounted for as a separate contract in accordance with paragraph 606-10-25-12, an entity shall allocate the change in the transaction price to the performance obligations in the modified contract (that is, the performance obligations that were unsatisfied or partially unsatisfied immediately after the modification).

Other Presentation Matters

General

606-10-45-1 When either party to a contract has performed, an entity shall present the contract in the statement of financial position as a contract asset or a contract liability, depending on the relationship between the entity's performance and the customer's payment. An entity shall present any unconditional rights to consideration separately as a receivable.

606-10-45-2 If a customer pays consideration, or an entity has a right to an amount of consideration that is unconditional (that is, a receivable), before the entity transfers a good or service to the customer, the entity shall present the contract as a contract liability when the payment is made or the payment is due (whichever is earlier). A contract liability is an entity's obligation to transfer goods or services to a customer for which the entity has received consideration (or an amount of consideration is due) from the customer.

606-10-45-3 If an entity performs by transferring goods or services to a customer before the customer pays consideration or before payment is due, the entity shall present the contract as a **contract asset**, excluding any amounts presented as a receivable. A contract asset is an entity's right to consideration in exchange for goods or services that the entity has transferred to a customer. An entity shall assess a contract asset for impairment in accordance with Topic 310 on receivables. An impairment of a contract asset shall be measured, presented, and disclosed in accordance with Topic 310 (see also paragraph 606-10-50-4(b)).

606-10-45-4 A receivable is an entity's right to consideration that is unconditional. A right to consideration is unconditional if only the passage of time is required before payment of that consideration is due. For example, an entity would recognize a receivable if it has a present right to payment even though that amount may be subject to refund in the future. An entity shall account for a receivable in accordance with Topic 310. Upon initial recognition of a receivable from a contract with a customer, any difference between the measurement of the receivable in accordance with Topic 310 and the corresponding amount of **revenue** recognized shall be presented as an expense (for example, as an impairment loss).

606-10-45-5 This guidance uses the terms *contract asset* and *contract liability* but does not prohibit an entity from using alternative descriptions in the statement of financial position for those items. If an entity uses an alternative description for a contract asset, the entity shall provide sufficient information for a user of the financial statements to distinguish between receivables and contract assets.

Disclosure

General

606-10-50-1 The objective of the disclosure requirements in this Topic is for an entity to disclose sufficient information to enable users of financial statements to understand the nature, amount, timing, and uncertainty of revenue and cash flows arising from contracts with customers. To achieve that objective, an entity shall disclose qualitative and quantitative information about all of the following:

- a. Its contracts with customers (see paragraphs 606-10-50-4 through 50-16)
- b. The significant judgments, and changes in the judgments, made in applying the guidance in this Topic to those contracts (see paragraphs 606-10-50-17 through 50-21)
- c. Any assets recognized from the costs to obtain or fulfill a contract with a customer in accordance with paragraph 340-40-25-1 or 340-40-25-5 (see paragraphs 340-40-50-1 through 50-6).

606-10-50-2 An entity shall consider the level of detail necessary to satisfy the disclosure objective and how much emphasis to place on each of the various requirements. An entity shall aggregate or disaggregate disclosures so that useful information is not obscured by either the inclusion of a large amount of insignificant detail or the aggregation of items that have substantially different characteristics.

606-10-50-3 Amounts disclosed are for each reporting period for which a statement of comprehensive income (statement of activities) is presented and as of each reporting period for which a statement of financial position is presented. An entity need not disclose information in accordance with the guidance in this Topic if it has provided the information in accordance with another Topic.

> Contracts with Customers

606-10-50-4 An entity shall disclose all of the following amounts for the reporting period unless those amounts are presented separately in the statement of comprehensive income (statement of activities) in accordance with other Topics:

- a. **Revenue** recognized from **contracts** with **customers**, which the entity shall disclose separately from its other sources of revenue

- b. Any impairment losses recognized (in accordance with Topic 310 on receivables) on any receivables or **contract assets** arising from an entity's contracts with customers, which the entity shall disclose separately from impairment losses from other contracts.

>> Disaggregation of Revenue

606-10-50-5 An entity shall disaggregate **revenue** recognized from **contracts** with **customers** into categories that depict how the nature, amount, timing, and uncertainty of revenue and cash flows are affected by economic factors. An entity shall apply the guidance in paragraphs 606-10-55-89 through 55-91 when selecting the categories to use to disaggregate revenue.

606-10-50-6 In addition, an entity shall disclose sufficient information to enable users of financial statements to understand the relationship between the disclosure of disaggregated revenue (in accordance with paragraph 606-10-50-5) and revenue information that is disclosed for each reportable segment, if the entity applies Topic 280 on segment reporting.

606-10-50-7 An entity, except for a **public business entity**, a **not-for-profit entity** that has issued, or is a conduit bond obligor for, securities that are traded, listed, or quoted on an exchange or an over-the-counter market, or an employee benefit plan that files or furnishes financial statements with or to the Securities and Exchange Commission (SEC), may elect not to apply the quantitative disaggregation disclosure guidance in paragraphs 606-10-50-5 through 50-6 and 606-10-55-89 through 55-91. If an entity elects not to provide those disclosures, the entity shall disclose, at a minimum, revenue disaggregated according to the timing of transfer of goods or services (for example, revenue from goods or services transferred to customers at a point in time and revenue from goods or services transferred to customers over time) and 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.

>> Contract Balances

606-10-50-8 An entity shall disclose all of the following:

- a. The opening and closing balances of receivables, **contract assets**, and **contract liabilities** from **contracts** with **customers**, if not otherwise separately presented or disclosed
- b. **Revenue** recognized in the reporting period that was included in the contract liability balance at the beginning of the period
- c. Revenue recognized in the reporting period from **performance obligations** satisfied (or partially satisfied) in previous periods (for example, changes in **transaction price**).

606-10-50-9 An entity shall explain how the timing of satisfaction of its performance obligations (see paragraph 606-10-50-12(a)) relates to the typical

timing of payment (see paragraph 606-10-50-12(b)) and the effect that those factors have on the contract asset and the contract liability balances. The explanation provided may use qualitative information.

606-10-50-10 An entity shall provide an explanation of the significant changes in the contract asset and the contract liability balances during the reporting period. The explanation shall include qualitative and quantitative information. Examples of changes in the entity's balances of contract assets and contract liabilities include any of the following:

- a. Changes due to business combinations
- b. Cumulative catch-up adjustments to revenue that affect the corresponding contract asset or contract liability, including adjustments arising from a change in the measure of progress, a change in an estimate of the transaction price (including any changes in the assessment of whether an estimate of variable consideration is constrained), or a contract modification
- c. Impairment of a contract asset
- d. A change in the time frame for a right to consideration to become unconditional (that is, for a contract asset to be reclassified to a receivable)
- e. A change in the time frame for a performance obligation to be satisfied (that is, for the recognition of revenue arising from a contract liability).

606-10-50-11 An entity, except for a **public business entity**, a **not-for-profit entity** that has issued, or is a conduit bond obligor for, securities that are traded, listed, or quoted on an exchange or an over-the-counter market, or an employee benefit plan that files or furnishes financial statements with or to the SEC, may elect not to provide any or all of the disclosures in paragraphs 606-10-50-8 through 50-10. However, if an entity elects not to provide the disclosures in paragraphs 606-10-50-8 through 50-10, the entity shall provide the disclosure in paragraph 606-10-50-8(a), which requires the disclosure of the opening and closing balances of receivables, contract assets, and contract liabilities from contracts with customers, if not otherwise separately presented or disclosed.

> > Performance Obligations

606-10-50-12 An entity shall disclose information about its **performance obligations in contracts with customers**, including a description of all of the following:

- a. When the entity typically satisfies its performance obligations (for example, upon shipment, upon delivery, as services are rendered, or upon completion of service) including when performance obligations are satisfied in a bill-and-hold arrangement
- b. The significant payment terms (for example, when payment typically is due, whether the contract has a significant financing component, whether the consideration amount is variable, and whether the estimate

of variable consideration is typically constrained in accordance with paragraphs 606-10-32-11 through 32-13)

- c. The nature of the goods or services that the entity has promised to transfer, highlighting any performance obligations to arrange for another party to transfer goods or services (that is, if the entity is acting as an agent)
- d. Obligations for returns, refunds, and other similar obligations
- e. Types of warranties and related obligations.

> > **Transaction Price Allocated to the Remaining Performance Obligations**

606-10-50-13 An entity shall disclose the following information about its remaining **performance obligations**:

- a. The aggregate amount of the **transaction price** allocated to the performance obligations that are unsatisfied (or partially unsatisfied) as of the end of the reporting period
- b. An explanation of when the entity expects to recognize as **revenue** the amount disclosed in accordance with paragraph 606-10-50-13(a), which the entity shall disclose in either of the following ways:
 1. On a quantitative basis using the time bands that would be most appropriate for the duration of the remaining performance obligations
 2. By using qualitative information.

606-10-50-14 As a practical expedient, an entity need not disclose the information in paragraph 606-10-50-13 for a performance obligation if either of the following conditions is met:

- a. The performance obligation is part of a **contract** that has an original expected duration of one year or less.
- b. The entity recognizes revenue from the satisfaction of the performance obligation in accordance with paragraph 606-10-55-18.

606-10-50-15 An entity shall explain qualitatively whether it is applying the practical expedient in paragraph 606-10-50-14 and whether any consideration from contracts with **customers** is not included in the transaction price and, therefore, not included in the information disclosed in accordance with paragraph 606-10-50-13. For example, an estimate of the transaction price would not include any estimated amounts of variable consideration that are constrained (see paragraphs 606-10-32-11 through 32-13).

606-10-50-16 An entity, except for a **public business entity**, a **not-for-profit entity** that has issued, or is a conduit bond obligor for, securities that are traded, listed, or quoted on an exchange or an over-the-counter market, or an employee benefit plan that files or furnishes financial statements with or to the SEC, may elect not to provide the disclosures in paragraphs 606-10-50-13 through 50-15.

> Significant Judgments in the Application of the Guidance in This Topic

606-10-50-17 An entity shall disclose the judgments, and changes in the judgments, made in applying the guidance in this Topic that significantly affect the determination of the amount and timing of **revenue** from **contracts** with **customers**. In particular, an entity shall explain the judgments, and changes in the judgments, used in determining both of the following:

- a. The timing of satisfaction of **performance obligations** (see paragraphs 606-10-50-18 through 50-19)
- b. The **transaction price** and the amounts allocated to performance obligations (see paragraph 606-10-50-20).

> > Determining the Timing of Satisfaction of Performance Obligations

606-10-50-18 For **performance obligations** that an entity satisfies over time, an entity shall disclose both of the following:

- a. The methods used to recognize **revenue** (for example, a description of the output methods or input methods used and how those methods are applied)
- b. An explanation of why the methods used provide a faithful depiction of the transfer of goods or services.

606-10-50-19 For performance obligations satisfied at a point in time, an entity shall disclose the significant judgments made in evaluating when a **customer** obtains control of promised goods or services.

> > Determining the Transaction Price and the Amounts Allocated to Performance Obligations

606-10-50-20 An entity shall disclose information about the methods, inputs, and assumptions used for all of the following:

- a. Determining the **transaction price**, which includes, but is not limited to, estimating variable consideration, adjusting the consideration for the effects of the time value of money, and measuring noncash consideration
- b. Assessing whether an estimate of variable consideration is constrained
- c. Allocating the transaction price, including estimating **standalone selling prices** of promised goods or services and allocating discounts and variable consideration to a specific part of the **contract** (if applicable)
- d. Measuring obligations for returns, refunds, and other similar obligations.

606-10-50-21 An entity except for a **public business entity**, a **not-for-profit entity** that has issued, or is a conduit bond obligor for, securities that are traded, listed, or quoted on an exchange or an over-the-counter market, or an employee

benefit plan that files or furnishes financial statements with or to the SEC, may elect not to provide any or all of the following disclosures:

- a. Paragraph 606-10-50-18(b), which states that an entity shall disclose, for **performance obligations** satisfied over time, an explanation of why the methods used to recognize **revenue** provide a faithful depiction of the transfer of goods or services to a **customer**
- b. Paragraph 606-10-50-19, which states that an entity shall disclose, for performance obligations satisfied at a point in time, the significant judgments made in evaluating when a customer obtains control of promised goods or services
- c. Paragraph 606-10-50-20, which states that an entity shall disclose the methods, inputs, and assumptions used to determine the transaction price and to allocate the transaction price. However, if an entity elects not to provide the disclosures in paragraph 606-10-50-20, the entity shall provide the disclosure in paragraph 606-10-50-20(b), which states that an entity shall disclose the methods, inputs, and assumptions used to assess whether an estimate of variable consideration is constrained.

> Practical Expedients

606-10-50-22 If an entity elects to use the practical expedient in either paragraph 606-10-32-18 (about the existence of a significant financing component) or paragraph 340-40-25-4 (about the incremental costs of obtaining a **contract**), the entity shall disclose that fact.

606-10-50-23 An entity, except for a **public business entity**, a **not-for-profit entity** that has issued, or is a conduit bond obligor for, securities that are traded, listed, or quoted on an exchange or an over-the-counter market, or an employee benefit plan that files or furnishes financial statements with or to the SEC, may elect not to provide the disclosures in paragraph 606-10-50-22.

Implementation Guidance and Illustrations

606-10-55-1 The implementation guidance and illustrations Section is organized as follows:

- a. Implementation guidance is provided in paragraphs 606-10-55-2 through 55-91 with a listing of contents in paragraph 606-10-55-3.
- b. Illustrations are provided in paragraphs 606-10-55-92 through 55-429 with a listing of contents in paragraph 606-10-55-93.

> Implementation Guidance

606-10-55-2 Paragraphs 606-10-55-2 through 55-91 are an integral part of this Topic. These paragraphs provide additional guidance that addresses the application of the guidance on **revenue** from **contracts** with **customers**.

606-10-55-3 This implementation guidance is organized into the following categories:

- a. **Performance obligations** satisfied over time (paragraphs 606-10-55-4 through 55-15)
- b. Methods for measuring progress toward complete satisfaction of a performance obligation (paragraphs 606-10-55-16 through 55-21)
- c. Sale with a right of return (paragraphs 606-10-55-22 through 55-29)
- d. Warranties (paragraphs 606-10-55-30 through 55-35)
- e. Principal versus agent considerations (paragraphs 606-10-55-36 through 55-40)
- f. Customer options for additional goods or services (paragraphs 606-10-55-41 through 55-45)
- g. Customers' unexercised rights (paragraphs 606-10-55-46 through 55-49)
- h. Nonrefundable upfront fees (and some related costs) (paragraphs 606-10-55-50 through 55-53)
- i. Licensing (paragraphs 606-10-55-54 through 55-65)
- j. Repurchase agreements (paragraphs 606-10-55-66 through 55-78)
- k. Consignment arrangements (paragraphs 606-10-55-79 through 55-80)
- l. Bill-and-hold arrangements (paragraphs 606-10-55-81 through 55-84)
- m. Customer acceptance (paragraphs 606-10-55-85 through 55-88)
- n. Disclosure of disaggregated revenue (paragraphs 606-10-55-89 through 55-91).

> > Performance Obligations Satisfied Over Time

606-10-55-4 In accordance with paragraph 606-10-25-27, a **performance obligation** is satisfied over time if one of the following criteria is met:

- a. The **customer** simultaneously receives and consumes the benefits provided by the entity's performance as the entity performs (see paragraphs 606-10-55-5 through 55-6).
- b. The entity's performance creates or enhances an asset (for example, work in process) that the customer controls as the asset is created or enhanced (see paragraph 606-10-55-7).
- c. The entity's performance does not create an asset with an alternative use to the entity (see paragraphs 606-10-55-8 through 55-10), and the entity has an enforceable right to payment for performance completed to date (see paragraphs 606-10-55-11 through 55-15).

> > > Simultaneous Receipt and Consumption of the Benefits of the Entity's Performance (paragraph 606-10-25-27(a))

606-10-55-5 For some types of **performance obligations**, the assessment of whether a **customer** receives the benefits of an entity's performance as the entity performs and simultaneously consumes those benefits as they are

received will be straightforward. Examples include routine or recurring services (such as a cleaning service) in which the receipt and simultaneous consumption by the customer of the benefits of the entity's performance can be readily identified.

606-10-55-6 For other types of performance obligations, an entity may not be able to readily identify whether a customer simultaneously receives and consumes the benefits from the entity's performance as the entity performs. In those circumstances, a performance obligation is satisfied over time if an entity determines that another entity would not need to substantially reperform the work that the entity has completed to date if that other entity were to fulfill the remaining performance obligation to the customer. In determining whether another entity would not need to substantially reperform the work the entity has completed to date, an entity should make both of the following assumptions:

- a. Disregard potential contractual restrictions or practical limitations that otherwise would prevent the entity from transferring the remaining performance obligation to another entity
- b. Presume that another entity fulfilling the remainder of the performance obligation would not have the benefit of any asset that is presently controlled by the entity and that would remain controlled by the entity if the performance obligation were to transfer to another entity.

> > > Customer Controls the Asset As It Is Created or Enhanced (paragraph 606-10-25-27(b))

606-10-55-7 In determining whether a **customer** controls an asset as it is created or enhanced in accordance with paragraph 606-10-25-27(b), an entity should apply the guidance on control in paragraphs 606-10-25-23 through 25-26 and 606-10-25-30. The asset that is being created or enhanced (for example, a work in process asset) could be either tangible or intangible.

> > > Entity's Performance Does Not Create an Asset with an Alternative Use (paragraph 606-10-25-27(c))

606-10-55-8 In assessing whether an asset has an alternative use to an entity in accordance with paragraph 606-10-25-28, an entity should consider the effects of contractual restrictions and practical limitations on the entity's ability to readily direct that asset for another use, such as selling it to a different **customer**. The possibility of the **contract** with the customer being terminated is not a relevant consideration in assessing whether the entity would be able to readily direct the asset for another use.

606-10-55-9 A contractual restriction on an entity's ability to direct an asset for another use must be substantive for the asset not to have an alternative use to the entity. A contractual restriction is substantive if a customer could enforce its rights to the promised asset if the entity sought to direct the asset for another use. In contrast, a contractual restriction is not substantive if, for example, an

asset is largely interchangeable with other assets that the entity could transfer to another customer without breaching the contract and without incurring significant costs that otherwise would not have been incurred in relation to that contract.

606-10-55-10 A practical limitation on an entity's ability to direct an asset for another use exists if an entity would incur significant economic losses to direct the asset for another use. A significant economic loss could arise because the entity either would incur significant costs to rework the asset or would only be able to sell the asset at a significant loss. For example, an entity may be practically limited from redirecting assets that either have design specifications that are unique to a customer or are located in remote areas.

> > > **Right to Payment for Performance Completed to Date (paragraph 606-10-25-27(c))**

606-10-55-11 In accordance with paragraph 606-10-25-29, an entity has a right to payment for performance completed to date if the entity would be entitled to an amount that at least compensates the entity for its performance completed to date in the event that the **customer** or another party terminates the **contract** for reasons other than the entity's failure to perform as promised. An amount that would compensate an entity for performance completed to date would be an amount that approximates the selling price of the goods or services transferred to date (for example, recovery of the costs incurred by an entity in satisfying the **performance obligation** plus a reasonable profit margin) rather than compensation for only the entity's potential loss of profit if the contract were to be terminated. Compensation for a reasonable profit margin need not equal the profit margin expected if the contract was fulfilled as promised, but an entity should be entitled to compensation for either of the following amounts:

- a. A proportion of the expected profit margin in the contract that reasonably reflects the extent of the entity's performance under the contract before termination by the customer (or another party)
- b. A reasonable return on the entity's cost of capital for similar contracts (or the entity's typical operating margin for similar contracts) if the contract-specific margin is higher than the return the entity usually generates from similar contracts.

606-10-55-12 An entity's right to payment for performance completed to date need not be a present unconditional right to payment. In many cases, an entity will have an unconditional right to payment only at an agreed-upon milestone or upon complete satisfaction of the performance obligation. In assessing whether it has a right to payment for performance completed to date, an entity should consider whether it would have an enforceable right to demand or retain payment for performance completed to date if the contract were to be terminated before completion for reasons other than the entity's failure to perform as promised.

606-10-55-13 In some contracts, a customer may have a right to terminate the contract only at specified times during the life of the contract or the customer

might not have any right to terminate the contract. If a customer acts to terminate a contract without having the right to terminate the contract at that time (including when a customer fails to perform its obligations as promised), the contract (or other laws) might entitle the entity to continue to transfer to the customer the goods or services promised in the contract and require the customer to pay the consideration promised in exchange for those goods or services. In those circumstances, an entity has a right to payment for performance completed to date because the entity has a right to continue to perform its obligations in accordance with the contract and to require the customer to perform its obligations (which include paying the promised consideration).

606-10-55-14 In assessing the existence and enforceability of a right to payment for performance completed to date, an entity should consider the contractual terms as well as any legislation or legal precedent that could supplement or override those contractual terms. This would include an assessment of whether:

- a. Legislation, administrative practice, or legal precedent confers upon the entity a right to payment for performance to date even though that right is not specified in the contract with the customer.
- b. Relevant legal precedent indicates that similar rights to payment for performance completed to date in similar contracts have no binding legal effect.
- c. An entity's customary business practices of choosing not to enforce a right to payment has resulted in the right being rendered unenforceable in that legal environment. However, notwithstanding that an entity may choose to waive its right to payment in similar contracts, an entity would continue to have a right to payment to date if, in the contract with the customer, its right to payment for performance to date remains enforceable.

606-10-55-15 The payment schedule specified in a contract does not necessarily indicate whether an entity has an enforceable right to payment for performance completed to date. Although the payment schedule in a contract specifies the timing and amount of consideration that is payable by a customer, the payment schedule might not necessarily provide evidence of the entity's right to payment for performance completed to date. This is because, for example, the contract could specify that the consideration received from the customer is refundable for reasons other than the entity failing to perform as promised in the contract.

> > Methods for Measuring Progress toward Complete Satisfaction of a Performance Obligation

606-10-55-16 Methods that can be used to measure an entity's progress toward complete satisfaction of a **performance obligation** satisfied over time in accordance with paragraphs 606-10-25-27 through 25-29 include the following:

- a. Output methods (see paragraphs 606-10-55-17 through 55-19)
- b. Input methods (see paragraphs 606-10-55-20 through 55-21).

> > > Output Methods

606-10-55-17 Output methods recognize **revenue** on the basis of direct measurements of the value to the **customer** of the goods or services transferred to date relative to the remaining goods or services promised under the **contract**. Output methods include methods such as surveys of performance completed to date, appraisals of results achieved, milestones reached, time elapsed, and units produced or units delivered. When an entity evaluates whether to apply an output method to measure its progress, the entity should consider whether the output selected would faithfully depict the entity's performance toward complete satisfaction of the **performance obligation**. An output method would not provide a faithful depiction of the entity's performance if the output selected would fail to measure some of the goods or services for which control has transferred to the customer. For example, output methods based on units produced or units delivered would not faithfully depict an entity's performance in satisfying a performance obligation if, at the end of the reporting period, the entity's performance has produced work in process or finished goods controlled by the customer that are not included in the measurement of the output.

606-10-55-18 As a practical expedient, if an entity has a right to consideration from a customer in an amount that corresponds directly with the value to the customer of the entity's performance completed to date (for example, a service contract in which an entity bills a fixed amount for each hour of service provided), the entity may recognize revenue in the amount to which the entity has a right to invoice.

606-10-55-19 The disadvantages of output methods are that the outputs used to measure progress may not be directly observable and the information required to apply them may not be available to an entity without undue cost. Therefore, an input method may be necessary.

> > > Input Methods

606-10-55-20 Input methods recognize **revenue** on the basis of the entity's efforts or inputs to the satisfaction of a **performance obligation** (for example, resources consumed, labor hours expended, costs incurred, time elapsed, or machine hours used) relative to the total expected inputs to the satisfaction of that performance obligation. If the entity's efforts or inputs are expended evenly throughout the performance period, it may be appropriate for the entity to recognize revenue on a straight-line basis.

606-10-55-21 A shortcoming of input methods is that there may not be a direct relationship between an entity's inputs and the transfer of control of goods or services to a **customer**. Therefore, an entity should exclude from an input method the effects of any inputs that, in accordance with the objective of

measuring progress in paragraph 606-10-25-31, do not depict the entity's performance in transferring control of goods or services to the customer. For instance, when using a cost-based input method, an adjustment to the measure of progress may be required in the following circumstances:

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

> > Sale with a Right of Return

606-10-55-22 In some **contracts**, an entity transfers control of a product to a **customer** and also grants the customer the right to return the product for various reasons (such as dissatisfaction with the product) and receive any combination of the following:

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

606-10-55-23 To account for the transfer of products with a right of return (and for some services that are provided subject to a refund), an entity should recognize all of the following:

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

606-10-55-24 An entity's promise to stand ready to accept a returned product during the return period should not be accounted for as a **performance obligation** in addition to the obligation to provide a refund.

606-10-55-25 An entity should apply the guidance in paragraphs 606-10-32-2 through 32-27 (including the guidance on constraining estimates of variable consideration in paragraphs 606-10-32-11 through 32-13) to determine the amount of consideration to which the entity expects to be entitled (that is, excluding the products expected to be returned). For any amounts received (or receivable) for which an entity does not expect to be entitled, the entity should not recognize revenue when it transfers products to customers but should recognize those amounts received (or receivable) as a refund liability. Subsequently, at the end of each reporting period, the entity should update its assessment of amounts for which it expects to be entitled in exchange for the transferred products and make a corresponding change to the **transaction price** and, therefore, in the amount of revenue recognized.

606-10-55-26 An entity should update the measurement of the refund liability at the end of each reporting period for changes in expectations about the amount of refunds. An entity should recognize corresponding adjustments as revenue (or reductions of revenue).

606-10-55-27 An asset recognized for an entity's right to recover products from a customer on settling a refund liability initially should be measured by reference to the former carrying amount of the product (for example, inventory) less any expected costs to recover those products (including potential decreases in the value to the entity of returned products). At the end of each reporting period, an entity should update the measurement of the asset arising from changes in expectations about products to be returned. An entity should present the asset separately from the refund liability.

606-10-55-28 Exchanges by customers of one product for another of the same type, quality, condition, and price (for example, one color or size for another) are not considered returns for the purposes of applying the guidance in this Topic.

606-10-55-29 Contracts in which a customer may return a defective product in exchange for a functioning product should be evaluated in accordance with the guidance on warranties in paragraphs 606-10-55-30 through 55-35.

> > Warranties

606-10-55-30 It is common for an entity to provide (in accordance with the **contract**, the law, or the entity's customary business practices) a warranty in connection with the sale of a product (whether a good or service). The nature of a warranty can vary significantly across industries and contracts. Some warranties provide a **customer** with assurance that the related product will function as the parties intended because it complies with agreed-upon specifications. Other warranties provide the customer with a service in addition to the assurance that the product complies with agreed-upon specifications.

606-10-55-31 If a customer has the option to purchase a warranty separately (for example, because the warranty is priced or negotiated separately), the warranty is a distinct service because the entity promises to provide the service to the customer in addition to the product that has the functionality described in the contract. In those circumstances, an entity should account for the promised warranty as a **performance obligation** in accordance with paragraphs 606-10-25-14 through 25-22 and allocate a portion of the **transaction price** to that performance obligation in accordance with paragraphs 606-10-32-28 through 32-41.

606-10-55-32 If a customer does not have the option to purchase a warranty separately, an entity should account for the warranty in accordance with the guidance on product warranties in Subtopic 460-10 on guarantees, unless the promised warranty, or a part of the promised warranty, provides the customer with a service in addition to the assurance that the product complies with agreed-upon specifications.

606-10-55-33 In assessing whether a warranty provides a customer with a service in addition to the assurance that the product complies with agreed-upon specifications, an entity should consider factors such as:

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

606-10-55-34 If a warranty, or a part of a warranty, provides a customer with a service in addition to the assurance that the product complies with agreed-upon specifications, the promised service is a performance obligation. Therefore, an entity should allocate the transaction price to the product and the service. If an entity promises both an assurance-type warranty and a service-type warranty but cannot reasonably account for them separately, the entity should account for both of the warranties together as a single performance obligation.

606-10-55-35 A law that requires an entity to pay compensation if its products cause harm or damage does not give rise to a performance obligation. For example, a manufacturer might sell products in a jurisdiction in which the law holds the manufacturer liable for any damages (for example, to personal property) that might be caused by a consumer using a product for its intended purpose. Similarly, an entity's promise to indemnify the customer for liabilities and damages arising from claims of patent, copyright, trademark, or other infringement by the entity's products does not give rise to a performance obligation. The entity should account for such obligations in accordance with the guidance on loss contingencies in Subtopic 450-20 on contingencies.

> > Principal versus Agent Considerations

606-10-55-36 When another party is involved in providing goods or services to a **customer**, the entity should determine whether the nature of its promise is a **performance obligation** to provide the specified goods or services itself (that is, the entity is a principal) or to arrange for the other party to provide those goods or services (that is, the entity is an agent).

606-10-55-37 An entity is a principal if the entity controls a promised good or service before the entity transfers the good or service to a customer. However, an entity is not necessarily acting as a principal if the entity obtains legal title of a product only momentarily before legal title is transferred to a customer. An entity that is a principal in a **contract** may satisfy a performance obligation by itself or it may engage another party (for example, a subcontractor) to satisfy some or all of a performance obligation on its behalf. When an entity that is a principal satisfies a performance obligation, the entity recognizes **revenue** in the gross amount of consideration to which it expects to be entitled in exchange for those goods or services transferred.

606-10-55-38 An entity is an agent if the entity's performance obligation is to arrange for the provision of goods or services by another party. When an entity that is an agent satisfies a performance obligation, the entity recognizes revenue in the amount of any fee or commission to which it expects to be entitled in exchange for arranging for the other party to provide its goods or services. An entity's fee or commission might be the net amount of consideration that the entity retains after paying the other party the consideration received in exchange for the goods or services to be provided by that party.

606-10-55-39 Indicators that an entity is an agent (and therefore does not control the good or service before it is provided to a customer) include the following:

- a. Another party is primarily responsible for fulfilling the contract.
- b. The entity does not have inventory risk before or after the goods have been ordered by a customer, during shipping, or on return.
- c. The entity does not have discretion in establishing prices for the other party's goods or services and, therefore, the benefit that the entity can receive from those goods or services is limited.
- d. The entity's consideration is in the form of a commission.
- e. The entity is not exposed to credit risk for the amount receivable from a customer in exchange for the other party's goods or services.

606-10-55-40 If another entity assumes the entity's performance obligations and contractual rights in the contract so that the entity is no longer obliged to satisfy the performance obligation to transfer the promised good or service to the customer (that is, the entity is no longer acting as the principal), the entity should not recognize revenue for that performance obligation. Instead, the entity should evaluate whether to recognize revenue for satisfying a performance obligation to obtain a contract for the other party (that is, whether the entity is acting as an agent).

> > Customer Options for Additional Goods or Services

606-10-55-41 Customer options to acquire additional goods or services for free or at a discount come in many forms, including sales incentives, customer award credits (or points), contract renewal options, or other discounts on future goods or services.

606-10-55-42 If, in a **contract**, an entity grants a **customer** the option to acquire additional goods or services, that option gives rise to a **performance obligation** in the contract only if the option provides a material right to the customer that it would not receive without entering into that contract (for example, a discount that is incremental to the range of discounts typically given for those goods or services to that class of customer in that geographical area or market). If the option provides a material right to the customer, the customer in effect pays the entity in advance for future goods or services, and the entity recognizes **revenue** when those future goods or services are transferred or when the option expires.

606-10-55-43 If a customer has the option to acquire an additional good or service at a price that would reflect the **standalone selling price** for that good or service, that option does not provide the customer with a material right even if the option can be exercised only by entering into a previous contract. In those cases, the entity has made a marketing offer that it should account for in accordance with the guidance in this Topic only when the customer exercises the option to purchase the additional goods or services.

606-10-55-44 Paragraph 606-10-32-29 requires an entity to allocate the **transaction price** to performance obligations on a relative standalone selling price basis. If the standalone selling price for a customer's option to acquire additional goods or services is not directly observable, an entity should estimate it. That estimate should reflect the discount that the customer would obtain when exercising the option, adjusted for both of the following:

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

606-10-55-45 If a customer has a material right to acquire future goods or services and those goods or services are similar to the original goods or services in the contract and are provided in accordance with the terms of the original contract, then an entity may, as a practical alternative to estimating the standalone selling price of the option, allocate the transaction price to the optional goods or services by reference to the goods or services expected to be provided and the corresponding expected consideration. Typically, those types of options are for contract renewals.

> > Customers' Unexercised Rights

606-10-55-46 In accordance with paragraph 606-10-45-2, upon receipt of a prepayment from a **customer**, an entity should recognize a **contract liability** in the amount of the prepayment for its **performance obligation** to transfer, or to stand ready to transfer, goods or services in the future. An entity should derecognize that contract liability (and recognize **revenue**) when it transfers those goods or services and, therefore, satisfies its performance obligation.

606-10-55-47 A customer's nonrefundable prepayment to an entity gives the customer a right to receive a good or service in the future (and obliges the entity to stand ready to transfer a good or service). However, customers may not exercise all of their contractual rights. Those unexercised rights are often referred to as breakage.

606-10-55-48 If an entity expects to be entitled to a breakage amount in a contract liability, the entity should recognize the expected breakage amount as revenue in proportion to the pattern of rights exercised by the customer. If an entity does not expect to be entitled to a breakage amount, the entity should recognize the expected breakage amount as revenue when the likelihood of the customer exercising its remaining rights becomes remote. To determine whether an entity expects to be entitled to a breakage amount, the entity should consider the guidance in paragraphs 606-10-32-11 through 32-13 on constraining estimates of variable consideration.

606-10-55-49 An entity should recognize a liability (and not revenue) for any consideration received that is attributable to a customer's unexercised rights for

which the entity is required to remit to another party, for example, a government entity in accordance with applicable unclaimed property laws.

> > Nonrefundable Upfront Fees (and Some Related Costs)

606-10-55-50 In some **contracts**, an entity charges a **customer** a nonrefundable upfront fee at or near contract inception. Examples include joining fees in health club membership contracts, activation fees in telecommunication contracts, setup fees in some services contracts, and initial fees in some supply contracts.

606-10-55-51 To identify **performance obligations** in such contracts, an entity should assess whether the fee relates to the transfer of a promised good or service. In many cases, even though a nonrefundable upfront fee relates to an activity that the entity is required to undertake at or near contract inception to fulfill the contract, that activity does not result in the transfer of a promised good or service to the customer (see paragraph 606-10-25-17). Instead, the upfront fee is an advance payment for future goods or services and, therefore, would be recognized as **revenue** when those future goods or services are provided. The revenue recognition period would extend beyond the initial contractual period if the entity grants the customer the option to renew the contract and that option provides the customer with a material right as described in paragraph 606-10-55-42.

606-10-55-52 If the nonrefundable upfront fee relates to a good or service, the entity should evaluate whether to account for the good or service as a separate performance obligation in accordance with paragraphs 606-10-25-14 through 25-22.

606-10-55-53 An entity may charge a nonrefundable fee in part as compensation for costs incurred in setting up a contract (or other administrative tasks as described in paragraph 606-10-25-17). If those setup activities do not satisfy a performance obligation, the entity should disregard those activities (and related costs) when measuring progress in accordance with paragraph 606-10-55-21. That is because the costs of setup activities do not depict the transfer of services to the customer. The entity should assess whether costs incurred in setting up a contract have resulted in an asset that should be recognized in accordance with paragraph 340-40-25-5.

> > Licensing

606-10-55-54 A license establishes a customer's rights to the intellectual property of an entity. Licenses of intellectual property may include, but are not limited to, any of the following:

- a. Software and technology
- b. Motion pictures, music, and other forms of media and entertainment
- c. Franchises
- d. Patents, trademarks, and copyrights.

606-10-55-55 In addition to a promise to grant a license to a **customer**, an entity may also promise to transfer other goods or services to the customer. Those promises may be explicitly stated in the **contract** or implied by an entity's customary business practices, published policies, or specific statements (see paragraph 606-10-25-16). As with other types of contracts, when a contract with a customer includes a promise to grant a license in addition to other promised goods or services, an entity applies paragraphs 606-10-25-14 through 25-22 to identify each of the **performance obligations** in the contract.

606-10-55-56 If the promise to grant a license is not distinct from other promised goods or services in the contract in accordance with paragraphs 606-10-25-18 through 25-22, an entity should account for the promise to grant a license and those other promised goods or services together as a single performance obligation. Examples of licenses that are not distinct from other goods or services promised in the contract include the following:

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

606-10-55-57 If the license is not distinct, an entity should apply paragraphs 606-10-25-23 through 25-30 to determine whether the performance obligation (which includes the promised license) is a performance obligation that is satisfied over time or satisfied at a point in time.

606-10-55-58 If the promise to grant the license is distinct from the other promised goods or services in the contract and, therefore, the promise to grant the license is a separate performance obligation, an entity should determine whether the license transfers to a customer either at a point in time or over time. In making this determination, an entity should consider whether the nature of the entity's promise in granting the license to a customer is to provide the customer with either:

- a. A right to access the entity's intellectual property as it exists throughout the license period
- b. A right to use the entity's intellectual property as it exists at the point in time at which the license is granted.

>>> **Determining the Nature of the Entity's Promise**

606-10-55-59 To determine whether an entity's promise to grant a license provides a **customer** with either a right to access an entity's intellectual property or a right to use an entity's intellectual property, an entity should consider whether a customer can direct the use of, and obtain substantially all of the remaining benefits from, a license at the point in time at which the license is granted. A customer cannot direct the use of, and obtain substantially all of the

remaining benefits from, a license at the point in time at which the license is granted if the intellectual property to which the customer has rights changes throughout the license period. The intellectual property will change (and thus affect the entity's assessment of when the customer controls the license) when the entity continues to be involved with its intellectual property and the entity undertakes activities that significantly affect the intellectual property to which the customer has rights. In these cases, the license provides the customer with a right to access the entity's intellectual property (see paragraph 606-10-55-60). In contrast, a customer can direct the use of, and obtain substantially all of the remaining benefits from, the license at the point in time at which the license is granted if the intellectual property to which the customer has rights will not change (see paragraph 606-10-55-63). In those cases, any activities undertaken by the entity merely change its own asset (that is, the underlying intellectual property), which may affect the entity's ability to provide future licenses; however, those activities would not affect the determination of what the license provides or what the customer controls.

606-10-55-60 The nature of an entity's promise in granting a license is a promise to provide a right to access the entity's intellectual property if all of the following criteria are met:

- a. The **contract** requires, or the customer reasonably expects, that the entity will undertake activities that significantly affect the intellectual property to which the customer has rights (see paragraph 606-10-55-61).
- b. The rights granted by the license directly expose the customer to any positive or negative effects of the entity's activities identified in paragraph 606-10-55-60(a).
- c. Those activities do not result in the transfer of a good or a service to the customer as those activities occur (see paragraph 606-10-25-17).

606-10-55-61 Factors that may indicate that a customer could reasonably expect that an entity will undertake activities that significantly affect the intellectual property include the entity's customary business practices, published policies, or specific statements. Although not determinative, the existence of a shared economic interest (for example, a sales-based royalty) between the entity and the customer related to the intellectual property to which the customer has rights may also indicate that the customer could reasonably expect that the entity will undertake such activities.

606-10-55-62 If the criteria in paragraph 606-10-55-60 are met, an entity should account for the promise to grant a license as a **performance obligation** satisfied over time because the customer will simultaneously receive and consume the benefit from the entity's performance of providing access to its intellectual property as the performance occurs (see paragraph 606-10-25-27(a)). An entity should apply paragraphs 606-10-25-31 through 25-37 to select an appropriate

method to measure its progress toward complete satisfaction of that performance obligation to provide access.

606-10-55-63 If the criteria in paragraph 606-10-55-60 are not met, the nature of an entity's promise is to provide a right to use the entity's intellectual property as that intellectual property exists (in terms of form and functionality) at the point in time at which the license is granted to the customer. This means that the customer can direct the use of, and obtain substantially all of the remaining benefits from, the license at the point in time at which the license transfers. An entity should account for the promise to provide a right to use the entity's intellectual property as a performance obligation satisfied at a point in time. An entity should apply paragraph 606-10-25-30 to determine the point in time at which the license transfers to the customer. However, **revenue** cannot be recognized for a license that provides a right to use the entity's intellectual property before the beginning of the period during which the customer is able to use and benefit from the license. For example, if a software license period begins before an entity provides (or otherwise makes available) to the customer a code that enables the customer to immediately use the software, the entity would not recognize revenue before that code has been provided (or otherwise made available).

606-10-55-64 An entity should disregard the following factors when determining whether a license provides a right to access the entity's intellectual property or a right to use the entity's intellectual property:

- a. Restrictions of time, geographical region, or use—Those restrictions define the attributes of the promised license, rather than define whether the entity satisfies its performance obligation at a point in time or over time.
- b. Guarantees provided by the entity that it has a valid patent to intellectual property and that it will defend that patent from unauthorized use—A promise to defend a patent right is not a performance obligation because the act of defending a patent protects the value of the entity's intellectual property assets and provides assurance to the customer that the license transferred meets the specifications of the license promised in the contract.

>>> Sales-Based or Usage-Based Royalties

606-10-55-65 Notwithstanding the guidance in paragraphs 606-10-32-11 through 32-14, an entity should recognize **revenue** for a sales-based or usage-based royalty promised in exchange for a license of intellectual property only when (or as) the later of the following events occurs:

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

> > Repurchase Agreements

606-10-55-66 A repurchase agreement is a **contract** in which an entity sells an asset and also promises or has the option (either in the same contract or in another contract) to repurchase the asset. The repurchased asset may be the asset that was originally sold to the **customer**, an asset that is substantially the same as that asset, or another asset of which the asset that was originally sold is a component.

606-10-55-67 Repurchase agreements generally come in three forms:

- a. An entity's obligation to repurchase the asset (a forward)
- b. An entity's right to repurchase the asset (a call option)
- c. An entity's obligation to repurchase the asset at the customer's request (a put option).

> > > A Forward or a Call Option

606-10-55-68 If an entity has an obligation or a right to repurchase the asset (a forward or a call option), a **customer** does not obtain control of the asset because the customer is limited in its ability to direct the use of, and obtain substantially all of the remaining benefits from, the asset even though the customer may have physical possession of the asset. Consequently, the entity should account for the **contract** as either of the following:

- a. A lease in accordance with Topic 840 on leases, if the entity can or must repurchase the asset for an amount that is less than the original selling price of the asset unless the contract is part of a sale-leaseback transaction. If the contract is part of a sale-leaseback transaction, the entity should account for the contract as a financing arrangement and not as a sale-leaseback in accordance with Subtopic 840-40.
- b. A financing arrangement in accordance with paragraph 606-10-55-70, if the entity can or must repurchase the asset for an amount that is equal to or more than the original selling price of the asset.

606-10-55-69 When comparing the repurchase price with the selling price, an entity should consider the time value of money.

606-10-55-70 If the repurchase agreement is a financing arrangement, the entity should continue to recognize the asset and also recognize a financial liability for any consideration received from the customer. The entity should recognize the difference between the amount of consideration received from the customer and the amount of consideration to be paid to the customer as interest and, if applicable, as processing or holding costs (for example, insurance).

606-10-55-71 If the option lapses unexercised, an entity should derecognize the liability and recognize **revenue**.

>>> A Put Option

606-10-55-72 If an entity has an obligation to repurchase the asset at the **customer's** request (a put option) at a price that is lower than the original selling price of the asset, the entity should consider at contract inception whether the customer has a significant economic incentive to exercise that right. The customer's exercising of that right results in the customer effectively paying the entity consideration for the right to use a specified asset for a period of time. Therefore, if the customer has a significant economic incentive to exercise that right, the entity should account for the agreement as a lease in accordance with Topic 840 on leases unless the contract is part of a sale-leaseback transaction. If the contract is part of a sale-leaseback transaction, the entity should account for the contract as a financing arrangement and not as a sale-leaseback in accordance with Subtopic 840-40.

606-10-55-73 To determine whether a customer has a significant economic incentive to exercise its right, an entity should consider various factors, including the relationship of the repurchase price to the expected market value of the asset at the date of the repurchase and the amount of time until the right expires. For example, if the repurchase price is expected to significantly exceed the market value of the asset, this may indicate that the customer has a significant economic incentive to exercise the put option.

606-10-55-74 If the customer does not have a significant economic incentive to exercise its right at a price that is lower than the original selling price of the asset, the entity should account for the agreement as if it were the sale of a product with a right of return as described in paragraphs 606-10-55-22 through 55-29.

606-10-55-75 If the repurchase price of the asset is equal to or greater than the original selling price and is more than the expected market value of the asset, the contract is in effect a financing arrangement and, therefore, should be accounted for as described in paragraph 606-10-55-70.

606-10-55-76 If the repurchase price of the asset is equal to or greater than the original selling price and is less than or equal to the expected market value of the asset, and the customer does not have a significant economic incentive to exercise its right, then the entity should account for the agreement as if it were the sale of a product with a right of return as described in paragraphs 606-10-55-22 through 55-29.

606-10-55-77 When comparing the repurchase price with the selling price, an entity should consider the time value of money.

606-10-55-78 If the option lapses unexercised, an entity should derecognize the liability and recognize **revenue**.

>> Consignment Arrangements

606-10-55-79 When an entity delivers a product to another party (such as a

dealer or a distributor) for sale to end **customers**, the entity should evaluate whether that other party has obtained control of the product at that point in time. A product that has been delivered to another party may be held in a consignment arrangement if that other party has not obtained control of the product. Accordingly, an entity should not recognize **revenue** upon delivery of a product to another party if the delivered product is held on consignment.

606-10-55-80 Indicators that an arrangement is a consignment arrangement include, but are not limited to, the following:

- a. The product is controlled by the entity until a specified event occurs, such as the sale of the product to a customer of the dealer, or until a specified period expires.
- b. The entity is able to require the return of the product or transfer the product to a third party (such as another dealer).
- c. The dealer does not have an unconditional obligation to pay for the product (although it might be required to pay a deposit).

> > **Bill-and-Hold Arrangements**

606-10-55-81 A bill-and-hold arrangement is a **contract** under which an entity bills a **customer** for a product but the entity retains physical possession of the product until it is transferred to the customer at a point in time in the future. For example, a customer may request an entity to enter into such a contract because of the customer's lack of available space for the product or because of delays in the customer's production schedules.

606-10-55-82 An entity should determine when it has satisfied its performance obligation to transfer a product by evaluating when a customer obtains control of that product (see paragraph 606-10-25-30). For some contracts, control is transferred either when the product is delivered to the customer's site or when the product is shipped, depending on the terms of the contract (including delivery and shipping terms). However, for some contracts, a customer may obtain control of a product even though that product remains in an entity's physical possession. In that case, the customer has the ability to direct the use of, and obtain substantially all of the remaining benefits from, the product even though it has decided not to exercise its right to take physical possession of that product. Consequently, the entity does not control the product. Instead, the entity provides custodial services to the customer over the customer's asset.

606-10-55-83 In addition to applying the guidance in paragraph 606-10-25-30, for a customer to have obtained control of a product in a bill-and-hold arrangement, all of the following criteria must be met:

- a. The reason for the bill-and-hold arrangement must be substantive (for example, the customer has requested the arrangement).
- b. The product must be identified separately as belonging to the customer.

- c. The product currently must be ready for physical transfer to the customer.
- d. The entity cannot have the ability to use the product or to direct it to another customer.

606-10-55-84 If an entity recognizes **revenue** for the sale of a product on a bill-and-hold basis, the entity should consider whether it has remaining performance obligations (for example, for custodial services) in accordance with paragraphs 606-10-25-14 through 25-22 to which the entity should allocate a portion of the **transaction price** in accordance with paragraphs 606-10-32-28 through 32-41.

> > Customer Acceptance

606-10-55-85 In accordance with paragraph 606-10-25-30(e), a **customer's** acceptance of an asset may indicate that the customer has obtained control of the asset. Customer acceptance clauses allow a customer to cancel a **contract** or require an entity to take remedial action if a good or service does not meet agreed-upon specifications. An entity should consider such clauses when evaluating when a customer obtains control of a good or service.

606-10-55-86 If an entity can objectively determine that control of a good or service has been transferred to the customer in accordance with the agreed-upon specifications in the contract, then customer acceptance is a formality that would not affect the entity's determination of when the customer has obtained control of the good or service. For example, if the customer acceptance clause is based on meeting specified size and weight characteristics, an entity would be able to determine whether those criteria have been met before receiving confirmation of the customer's acceptance. The entity's experience with contracts for similar goods or services may provide evidence that a good or service provided to the customer is in accordance with the agreed-upon specifications in the contract. If **revenue** is recognized before customer acceptance, the entity still must consider whether there are any remaining **performance obligations** (for example, installation of equipment) and evaluate whether to account for them separately.

606-10-55-87 However, if an entity cannot objectively determine that the good or service provided to the customer is in accordance with the agreed-upon specifications in the contract, then the entity would not be able to conclude that the customer has obtained control until the entity receives the customer's acceptance. That is because, in that circumstance the entity cannot determine that the customer has the ability to direct the use of, and obtain substantially all of the remaining benefits from, the good or service.

606-10-55-88 If an entity delivers products to a customer for trial or evaluation purposes and the customer is not committed to pay any consideration until the trial period lapses, control of the product is not transferred to the customer until either the customer accepts the product or the trial period lapses.

> > Disclosure of Disaggregated Revenue

606-10-55-89 Paragraph 606-10-50-5 requires an entity to disaggregate **revenue** from **contracts** with **customers** into categories that depict how the nature, amount, timing, and uncertainty of revenue and cash flows are affected by economic factors. Consequently, the extent to which an entity's revenue is disaggregated for the purposes of this disclosure depends on the facts and circumstances that pertain to the entity's contracts with customers. Some entities may need to use more than one type of category to meet the objective in paragraph 606-10-50-5 for disaggregating revenue. Other entities may meet the objective by using only one type of category to disaggregate revenue.

606-10-55-90 When selecting the type of category (or categories) to use to disaggregate revenue, an entity should consider how information about the entity's revenue has been presented for other purposes, including all of the following:

- a. Disclosures presented outside the financial statements (for example, in earnings releases, annual reports, or investor presentations)
- b. Information regularly reviewed by the chief operating decision maker for evaluating the financial performance of operating segments
- c. Other information that is similar to the types of information identified in (a) and (b) and that is used by the entity or users of the entity's financial statements to evaluate the entity's financial performance or make resource allocation decisions.

606-10-55-91 Examples of categories that might be appropriate include, but are not limited to, all of the following:

- a. Type of good or service (for example, major product lines)
- b. Geographical region (for example, country or region)
- c. Market or type of customer (for example, government and nongovernment customers)
- d. Type of contract (for example, fixed-price and time-and-materials contracts)
- e. Contract duration (for example, short-term and long-term contracts)
- f. Timing of transfer of goods or services (for example, revenue from goods or services transferred to customers at a point in time and revenue from goods or services transferred over time)
- g. Sales channels (for example, goods sold directly to consumers and goods sold through intermediaries).

> Illustrations

606-10-55-92 These Examples portray hypothetical situations illustrating how an entity might apply some of the guidance in this Topic to particular aspects of a **contract** with a **customer** on the basis of the limited facts presented. The

analysis in each Example is not intended to represent the only manner in which the guidance could be applied, nor are the Examples intended to only apply to the specific industry illustrated. Although some aspects of the Examples may be present in actual fact patterns, all relevant facts and circumstances of a particular fact pattern would need to be evaluated when applying the guidance in this Topic.

606-10-55-93 The Examples are organized as follows:

- a. Identifying the Contract
 - Example 1—Collectibility of the Consideration
 - Example 2—Consideration Is Not the Stated Price—Implicit Price Concession
 - Example 3—Implicit Price Concession
 - Example 4—Reassessing the Criteria for Identifying a Contract
- b. Contract Modifications
 - Example 5—Modification of a Contract for Goods
 - Example 6—Change in the Transaction Price after a Contract Modification
 - Example 7—Modification of a Services Contract
 - Example 8—Modification Resulting in a Cumulative Catch-Up Adjustment to Revenue
 - Example 9—Unapproved Change in Scope and Price
- c. Identifying Performance Obligations
 - Example 10—Goods and Services Are Not Distinct
 - Example 11—Determining Whether Goods or Services Are Distinct
 - Example 12—Explicit and Implicit Promises in a Contract
- d. Performance Obligations Satisfied Over Time
 - Example 13—Customer Simultaneously Receives and Consumes the Benefits
 - Example 14—Assessing Alternative Use and Right to Payment
 - Example 15—Asset Has No Alternative Use to the Entity
 - Example 16—Enforceable Right to Payment for Performance Completed to Date
 - Example 17—Assessing Whether a Performance Obligation Is Satisfied at a Point in Time or Over Time
- e. Measuring Progress toward Complete Satisfaction of a Performance Obligation
 - Example 18—Measuring Progress When Making Goods or Services Available
 - Example 19—Uninstalled Materials
- f. Variable Consideration
 - Example 20—Penalty Gives Rise to Variable Consideration
 - Example 21—Estimating Variable Consideration
- g. Constraining Estimates of Variable Consideration
 - Example 22—Right of Return

- Example 23—Price Concessions
 - Example 24—Volume Discount Incentive
 - Example 25—Management Fees Subject to the Constraint
- h. The Existence of a Significant Financing Component in the Contract
 - Example 26—Significant Financing Component and Right of Return
 - Example 27—Withheld Payments on a Long-Term Contract
 - Example 28—Determining the Discount Rate
 - Example 29—Advance Payment and Assessment of the Discount Rate
 - Example 30—Advance Payment
- i. Noncash Consideration
 - Example 31—Entitlement to Noncash Consideration
- j. Consideration Payable to a Customer
 - Example 32—Consideration Payable to a Customer
- k. Allocating the Transaction Price to Performance Obligations
 - Example 33—Allocation Methodology
 - Example 34—Allocating a Discount
 - Example 35—Allocation of Variable Consideration
- l. Contract Costs
 - Example 36—Incremental Costs of Obtaining a Contract
 - Example 37—Costs That Give Rise to an Asset
- m. Presentation
 - Example 38—Contract Liability and Receivable
 - Example 39—Contract Asset Recognized for the Entity's Performance
 - Example 40—Receivable Recognized for the Entity's Performance
- n. Disclosure
 - Example 41—Disaggregation of Revenue Quantitative Disclosure
 - Example 42—Disclosure of the Transaction Price Allocated to the Remaining Performance Obligations
 - Example 43—Disclosure of the Transaction Price Allocated to the Remaining Performance Obligations—Qualitative
- o. Warranties
 - Example 44—Warranties
- p. Principal versus Agent Considerations
 - Example 45—Arranging for the Provision of Goods or Services (Entity Is an Agent)
 - Example 46—Promise to Provide Goods or Services (Entity Is a Principal)
 - Example 47—Promise to Provide Goods or Services (Entity Is a Principal)
 - Example 48—Arranging for the Provision of Goods or Services (Entity Is an Agent)
- q. Customer Options for Additional Goods or Services

- Example 49—Option That Provides the Customer with a Material Right (Discount Voucher)
- Example 50—Option That Does Not Provide the Customer with a Material Right (Additional Goods or Services)
- Example 51—Option That Provides the Customer with a Material Right (Renewal Option)
- Example 52—Customer Loyalty Program
- r. Nonrefundable Upfront Fees
 - Example 53—Nonrefundable Upfront Fee
- s. Licensing
 - Example 54—Right to Use Intellectual Property
 - Example 55—License of Intellectual Property
 - Example 56—Identifying a Distinct License
 - Example 57—Franchise Rights
 - Example 58—Access to Intellectual Property
 - Example 59—Right to Use Intellectual Property
 - Example 60—Access to Intellectual Property
 - Example 61—Access to Intellectual Property
- t. Repurchase Agreements
 - Example 62—Repurchase Agreements
- u. Bill-and-Hold Arrangements
 - Example 63—Bill-and-Hold Arrangement

> > Identifying the Contract

606-10-55-94 Examples 1–4 illustrate the guidance in paragraphs 606-10-25-1 through 25-8 on identifying the contract. In addition, the following guidance is illustrated in these Examples:

- a. The interaction of paragraph 606-10-25-1 with paragraphs 606-10-32-2 and 606-10-32-7 on estimating variable consideration (Examples 2 and 3)
- b. Paragraph 606-10-55-65 on consideration in the form of sales-based or usage-based royalties on licenses of intellectual property (Example 4).

> > > Example 1—Collectibility of the Consideration

606-10-55-95 An entity, a real estate developer, enters into a contract with a customer for the sale of a building for \$1 million. The customer intends to open a restaurant in the building. The building is located in an area where new restaurants face high levels of competition, and the customer has little experience in the restaurant industry.

606-10-55-96 The customer pays a nonrefundable deposit of \$50,000 at inception of the contract and enters into a long-term financing agreement with the entity for the remaining 95 percent of the promised consideration. The financing arrangement is provided on a nonrecourse basis, which means that if the

customer defaults, the entity can repossess the building but cannot seek further compensation from the customer, even if the collateral does not cover the full value of the amount owed. The entity's cost of the building is \$600,000. The customer obtains control of the building at contract inception.

606-10-55-97 In assessing whether the contract meets the criteria in paragraph 606-10-25-1, the entity concludes that the criterion in paragraph 606-10-25-1(e) is not met because it is not probable that the entity will collect the consideration to which it is entitled in exchange for the transfer of the building. In reaching this conclusion, the entity observes that the customer's ability and intention to pay may be in doubt because of the following factors:

- a. The customer intends to repay the loan (which has a significant balance) primarily from income derived from its restaurant business (which is a business facing significant risks because of high competition in the industry and the customer's limited experience).
- b. The customer lacks other income or assets that could be used to repay the loan.
- c. The customer's liability under the loan is limited because the loan is nonrecourse.

606-10-55-98 Because the criteria in paragraph 606-10-25-1 are not met, the entity applies paragraphs 606-10-25-7 through 25-8 to determine the accounting for the nonrefundable deposit of \$50,000. The entity observes that none of the events described in paragraph 606-10-25-7 have occurred—that is, the entity has not received substantially all of the consideration and it has not terminated the contract. Consequently, in accordance with paragraph 606-10-25-8, the entity accounts for the nonrefundable \$50,000 payment as a deposit liability. The entity continues to account for the initial deposit, as well as any future payments of principal and interest, as a deposit liability and does not derecognize the real estate asset. Also, the entity does not recognize a receivable until such time that the entity concludes that the criteria in paragraph 606-10-25-1 are met (that is, the entity is able to conclude that it is probable that the entity will collect the consideration) or one of the events in paragraph 606-10-25-7 has occurred. The entity continues to assess the contract in accordance with paragraph 606-10-25-6 to determine whether the criteria in paragraph 606-10-25-1 are subsequently met or whether the events in paragraph 606-10-25-7 have occurred.

> > > Example 2—Consideration Is Not the Stated Price—Implicit Price Concession

606-10-55-99 An entity sells 1,000 units of a prescription drug to a customer for promised consideration of \$1 million. This is the entity's first sale to a customer in a new region, which is experiencing significant economic difficulty. Thus, the entity expects that it will not be able to collect from the customer the full amount of the promised consideration. Despite the possibility of not collecting the full amount, the entity expects the region's economy to recover over the next two to

three years and determines that a relationship with the customer could help it to forge relationships with other potential customers in the region.

606-10-55-100 When assessing whether the criterion in paragraph 606-10-25-1(e) is met, the entity also considers paragraphs 606-10-32-2 and 606-10-32-7(b). Based on the assessment of the facts and circumstances, the entity determines that it expects to provide a price concession and accept a lower amount of consideration from the customer. Accordingly, the entity concludes that the transaction price is not \$1 million and, therefore, the promised consideration is variable. The entity estimates the variable consideration and determines that it expects to be entitled to \$400,000.

606-10-55-101 The entity considers the customer's ability and intention to pay the consideration and concludes that even though the region is experiencing economic difficulty it is probable that it will collect \$400,000 from the customer. Consequently, the entity concludes that the criterion in paragraph 606-10-25-1(e) is met based on an estimate of variable consideration of \$400,000. In addition, based on an evaluation of the contract terms and other facts and circumstances, the entity concludes that the other criteria in paragraph 606-10-25-1 are also met. Consequently, the entity accounts for the contract with the customer in accordance with the guidance in this Topic.

> > > Example 3—Implicit Price Concession

606-10-55-102 An entity, a hospital, provides medical services to an uninsured patient in the emergency room. The entity has not previously provided medical services to this patient but is required by law to provide medical services to all emergency room patients. Because of the patient's condition upon arrival at the hospital, the entity provides the services immediately and, therefore, before the entity can determine whether the patient is committed to perform its obligations under the contract in exchange for the medical services provided. Consequently, the contract does not meet the criteria in paragraph 606-10-25-1, and in accordance with paragraph 606-10-25-6, the entity will continue to assess its conclusion based on updated facts and circumstances.

606-10-55-103 After providing services, the entity obtains additional information about the patient including a review of the services provided, standard rates for such services, and the patient's ability and intention to pay the entity for the services provided. During the review, the entity notes its standard rate for the services provided in the emergency room is \$10,000. The entity also reviews the patient's information and to be consistent with its policies designates the patient to a customer class based on the entity's assessment of the patient's ability and intention to pay. The entity determines that the services provided are not charity care based on the entity's internal policy and the patient's income level. In addition, the patient does not qualify for governmental subsidies.

606-10-55-104 Before reassessing whether the criteria in paragraph 606-10-25-1 have been met, the entity considers paragraphs 606-10-32-2 and 606-10-32-

7(b). Although the standard rate for the services is \$10,000 (which may be the amount invoiced to the patient), the entity expects to accept a lower amount of consideration in exchange for the services. Accordingly, the entity concludes that the transaction price is not \$10,000 and, therefore, the promised consideration is variable. The entity reviews its historical cash collections from this customer class and other relevant information about the patient. The entity estimates the variable consideration and determines that it expects to be entitled to \$1,000.

606-10-55-105 In accordance with paragraph 606-10-25-1(e), the entity evaluates the patient's ability and intention to pay (that is, the credit risk of the patient). On the basis of its collection history from patients in this customer class, the entity concludes it is probable that the entity will collect \$1,000 (which is the estimate of variable consideration). In addition, on the basis of an assessment of the contract terms and other facts and circumstances, the entity concludes that the other criteria in paragraph 606-10-25-1 also are met. Consequently, the entity accounts for the contract with the patient in accordance with the guidance in this Topic.

> > > **Example 4—Reassessing the Criteria for Identifying a Contract**

606-10-55-106 An entity licenses a patent to a customer in exchange for a usage-based royalty. At contract inception, the contract meets all the criteria in paragraph 606-10-25-1, and the entity accounts for the contract with the customer in accordance with the guidance in this Topic. The entity recognizes revenue when the customer's subsequent usage occurs in accordance with paragraph 606-10-55-65.

606-10-55-107 Throughout the first year of the contract, the customer provides quarterly reports of usage and pays within the agreed-upon period.

606-10-55-108 During the second year of the contract, the customer continues to use the entity's patent, but the customer's financial condition declines. The customer's current access to credit and available cash on hand are limited. The entity continues to recognize revenue on the basis of the customer's usage throughout the second year. The customer pays the first quarter's royalties but makes nominal payments for the usage of the patent in quarters 2–4. The entity accounts for any impairment of the existing receivable in accordance with Topic 310 on receivables.

606-10-55-109 During the third year of the contract, the customer continues to use the entity's patent. However, the entity learns that the customer has lost access to credit and its major customers and thus the customer's ability to pay significantly deteriorates. The entity therefore concludes that it is unlikely that the customer will be able to make any further royalty payments for ongoing usage of the entity's patent. As a result of this significant change in facts and circumstances, in accordance with paragraph 606-10-25-5, the entity reassesses the criteria in paragraph 606-10-25-1 and determines that they are not met because it is no longer probable that the entity will collect the consideration to

which it will be entitled. Accordingly, the entity does not recognize any further revenue associated with the customer's future usage of its patent. The entity accounts for any impairment of the existing receivable in accordance with Topic 310 on receivables.

> > Contract Modifications

606-10-55-110 Examples 5–9 illustrate the guidance in paragraphs 606-10-25-10 through 25-13 on contract modifications. In addition, the following guidance is illustrated in these Examples:

- a. Paragraphs 606-10-25-14 through 25-22 on identifying performance obligations (Examples 7 and 8)
- b. Paragraphs 606-10-32-11 through 32-13 on constraining estimates of variable consideration (Examples 6, 8, and 9)
- c. Paragraphs 606-10-32-42 through 32-45 on changes in the transaction price (Example 6).

> > > Example 5—Modification of a Contract for Goods

606-10-55-111 An entity promises to sell 120 products to a customer for \$12,000 (\$100 per product). The products are transferred to the customer over a six-month period. The entity transfers control of each product at a point in time. After the entity has transferred control of 60 products to the customer, the contract is modified to require the delivery of an additional 30 products (a total of 150 identical products) to the customer. The additional 30 products were not included in the initial contract.

> > > Case A—Additional Products for a Price That Reflects the Standalone Selling Price

606-10-55-112 When the contract is modified, the price of the contract modification for the additional 30 products is an additional \$2,850 or \$95 per product. The pricing for the additional products reflects the standalone selling price of the products at the time of the contract modification, and the additional products are distinct (in accordance with paragraph 606-10-25-19) from the original products.

606-10-55-113 In accordance with paragraph 606-10-25-12, the contract modification for the additional 30 products is, in effect, a new and separate contract for future products that does not affect the accounting for the existing contract. The entity recognizes revenue of \$100 per product for the 120 products in the original contract and \$95 per product for the 30 products in the new contract.

> > > Case B—Additional Products for a Price That Does Not Reflect the Standalone Selling Price

606-10-55-114 During the process of negotiating the purchase of an additional 30 products, the parties initially agree on a price of \$80 per product. However, the customer discovers that the initial 60 products transferred to the customer contained minor defects that were unique to those delivered products. The entity promises a partial credit of \$15 per product to compensate the customer for the poor quality of those products. The entity and the customer agree to incorporate the credit of \$900 (\$15 credit × 60 products) into the price that the entity charges for the additional 30 products. Consequently, the contract modification specifies that the price of the additional 30 products is \$1,500 or \$50 per product. That price comprises the agreed-upon price for the additional 30 products of \$2,400, or \$80 per product, less the credit of \$900.

606-10-55-115 At the time of modification, the entity recognizes the \$900 as a reduction of the transaction price and, therefore, as a reduction of revenue for the initial 60 products transferred. In accounting for the sale of the additional 30 products, the entity determines that the negotiated price of \$80 per product does not reflect the standalone selling price of the additional products. Consequently, the contract modification does not meet the conditions in paragraph 606-10-25-12 to be accounted for as a separate contract. Because the remaining products to be delivered are distinct from those already transferred, the entity applies the guidance in paragraph 606-10-25-13(a) and accounts for the modification as a termination of the original contract and the creation of a new contract.

606-10-55-116 Consequently, the amount recognized as revenue for each of the remaining products is a blended price of \$93.33 $\{[(\$100 \times 60 \text{ products not yet transferred under the original contract}) + (\$80 \times 30 \text{ products to be transferred under the contract modification})] \div 90 \text{ remaining products}\}$.

> > > Example 6—Change in the Transaction Price after a Contract Modification

606-10-55-117 On July 1, 20X0, an entity promises to transfer two distinct products to a customer. Product X transfers to the customer at contract inception and Product Y transfers on March 31, 20X1. The consideration promised by the customer includes fixed consideration of \$1,000 and variable consideration that is estimated to be \$200. The entity includes its estimate of variable consideration in the transaction price because it concludes that it is probable that a significant reversal in cumulative revenue recognized will not occur when the uncertainty is resolved.

606-10-55-118 The transaction price of \$1,200 is allocated equally to the performance obligation for Product X and the performance obligation for Product Y. This is because both products have the same standalone selling prices and the variable consideration does not meet the criteria in paragraph 606-10-32-40 that requires allocation of the variable consideration to one but not both of the performance obligations.

606-10-55-119 When Product X transfers to the customer at contract inception, the entity recognizes revenue of \$600.

606-10-55-120 On November 30, 20X0, the scope of the contract is modified to include the promise to transfer Product Z (in addition to the undelivered Product Y) to the customer on June 30, 20X1, and the price of the contract is increased by \$300 (fixed consideration), which does not represent the standalone selling price of Product Z. The standalone selling price of Product Z is the same as the standalone selling prices of Products X and Y.

606-10-55-121 The entity accounts for the modification as if it were the termination of the existing contract and the creation of a new contract. This is because the remaining Products Y and Z are distinct from Product X, which had transferred to the customer before the modification, and the promised consideration for the additional Product Z does not represent its standalone selling price. Consequently, in accordance with paragraph 606-10-25-13(a), the consideration to be allocated to the remaining performance obligations comprises the consideration that had been allocated to the performance obligation for Product Y (which is measured at an allocated transaction price amount of \$600) and the consideration promised in the modification (fixed consideration of \$300). The transaction price for the modified contract is \$900, and that amount is allocated equally to the performance obligation for Product Y and the performance obligation for Product Z (that is, \$450 is allocated to each performance obligation).

606-10-55-122 After the modification but before the delivery of Products Y and Z, the entity revises its estimate of the amount of variable consideration to which it expects to be entitled to \$240 (rather than the previous estimate of \$200). The entity concludes that the change in estimate of the variable consideration can be included in the transaction price because it is probable that a significant reversal in cumulative revenue recognized will not occur when the uncertainty is resolved. Even though the modification was accounted for as if it were the termination of the existing contract and the creation of a new contract in accordance with paragraph 606-10-25-13(a), the increase in the transaction price of \$40 is attributable to variable consideration promised before the modification. Therefore, in accordance with paragraph 606-10-32-45, the change in the transaction price is allocated to the performance obligations for Product X and Product Y on the same basis as at contract inception. Consequently, the entity recognizes revenue of \$20 for Product X in the period in which the change in the transaction price occurs. Because Product Y had not transferred to the customer before the contract modification, the change in the transaction price that is attributable to Product Y is allocated to the remaining performance obligations at the time of the contract modification. This is consistent with the accounting that would have been required by paragraph 606-10-25-13(a) if that amount of variable consideration had been estimated and included in the transaction price at the time of the contract modification.

606-10-55-123 The entity also allocates the \$20 increase in the transaction price for the modified contract equally to the performance obligations for Product Y and Product Z. This is because the products have the same standalone selling prices and the variable consideration does not meet the criteria in paragraph 606-10-32-40 that require allocation of the variable consideration to one but not both of the performance obligations. Consequently, the amount of the transaction price allocated to the performance obligations for Product Y and Product Z increases by \$10 to \$460 each.

606-10-55-124 On March 31, 20X1, Product Y is transferred to the customer, and the entity recognizes revenue of \$460. On June 30, 20X1, Product Z is transferred to the customer, and the entity recognizes revenue of \$460.

>>> Example 7—Modification of a Services Contract

606-10-55-125 An entity enters into a three-year contract to clean a customer's offices on a weekly basis. The customer promises to pay \$100,000 per year. The standalone selling price of the services at contract inception is \$100,000 per year. The entity recognizes revenue of \$100,000 per year during the first 2 years of providing services. At the end of the second year, the contract is modified and the fee for the third year is reduced to \$80,000. In addition, the customer agrees to extend the contract for 3 additional years for consideration of \$200,000 payable in 3 equal annual installments of \$66,667 at the beginning of years 4, 5, and 6. After the modification, the contract has 4 years remaining in exchange for total consideration of \$280,000. The standalone selling price of the services at the beginning of the third year is \$80,000 per year. The entity's standalone selling price at the beginning of the third year, multiplied by the remaining number of years to provide services, is deemed to be an appropriate estimate of the standalone selling price of the multiyear contract (that is, the standalone selling price is 4 years × \$80,000 per year = \$320,000).

606-10-55-126 At contract inception, the entity assesses that each week of cleaning service is distinct in accordance with paragraph 606-10-25-19. Notwithstanding that each week of cleaning service is distinct, the entity accounts for the cleaning contract as a single performance obligation in accordance with paragraph 606-10-25-14(b). This is because the weekly cleaning services are a series of distinct services that are substantially the same and have the same pattern of transfer to the customer (the services transfer to the customer over time and use the same method to measure progress—that is, a time-based measure of progress).

606-10-55-127 At the date of the modification, the entity assesses the remaining services to be provided and concludes that they are distinct. However, the amount of remaining consideration to be paid (\$280,000) does not reflect the standalone selling price of the services to be provided (\$320,000).

606-10-55-128 Consequently, the entity accounts for the modification in accordance with paragraph 606-10-25-13(a) as a termination of the original

contract and the creation of a new contract with consideration of \$280,000 for 4 years of cleaning service. The entity recognizes revenue of \$70,000 per year ($\$280,000 \div 4$ years) as the services are provided over the remaining 4 years.

>>> Example 8—Modification Resulting in a Cumulative Catch-Up Adjustment to Revenue

606-10-55-129 An entity, a construction company, enters into a contract to construct a commercial building for a customer on customer-owned land for promised consideration of \$1 million and a bonus of \$200,000 if the building is completed within 24 months. The entity accounts for the promised bundle of goods and services as a single performance obligation satisfied over time in accordance with paragraph 606-10-25-27(b) because the customer controls the building during construction. At the inception of the contract, the entity expects the following:

Transaction price	\$ 1,000,000
Expected costs	<u>700,000</u>
Expected profit (30%)	<u><u>\$ 300,000</u></u>

606-10-55-130 At contract inception, the entity excludes the \$200,000 bonus from the transaction price because it cannot conclude that it is probable that a significant reversal in the amount of cumulative revenue recognized will not occur. Completion of the building is highly susceptible to factors outside the entity's influence, including weather and regulatory approvals. In addition, the entity has limited experience with similar types of contracts.

606-10-55-131 The entity determines that the input measure, on the basis of costs incurred, provides an appropriate measure of progress toward complete satisfaction of the performance obligation. By the end of the first year, the entity has satisfied 60 percent of its performance obligation on the basis of costs incurred to date (\$420,000) relative to total expected costs (\$700,000). The entity reassesses the variable consideration and concludes that the amount is still constrained in accordance with paragraphs 606-10-32-11 through 32-13. Consequently, the cumulative revenue and costs recognized for the first year are as follows:

Revenue	\$ 600,000
Costs	<u>420,000</u>
Gross profit	<u><u>\$ 180,000</u></u>

606-10-55-132 In the first quarter of the second year, the parties to the contract agree to modify the contract by changing the floor plan of the building. As a result, the fixed consideration and expected costs increase by \$150,000 and

\$120,000, respectively. Total potential consideration after the modification is \$1,350,000 (\$1,150,000 fixed consideration + \$200,000 completion bonus). In addition, the allowable time for achieving the \$200,000 bonus is extended by 6 months to 30 months from the original contract inception date. At the date of the modification, on the basis of its experience and the remaining work to be performed, which is primarily inside the building and not subject to weather conditions, the entity concludes that it is probable that including the bonus in the transaction price will not result in a significant reversal in the amount of cumulative revenue recognized in accordance with paragraph 606-10-32-11 and includes the \$200,000 in the transaction price. In assessing the contract modification, the entity evaluates paragraph 606-10-25-19(b) and concludes (on the basis of the factors in paragraph 606-10-25-21) that the remaining goods and services to be provided using the modified contract are not distinct from the goods and services transferred on or before the date of contract modification; that is, the contract remains a single performance obligation.

606-10-55-133 Consequently, the entity accounts for the contract modification as if it were part of the original contract (in accordance with paragraph 606-10-25-13(b)). The entity updates its measure of progress and estimates that it has satisfied 51.2 percent of its performance obligation (\$420,000 actual costs incurred ÷ \$820,000 total expected costs). The entity recognizes additional revenue of \$91,200 [(51.2 percent complete × \$1,350,000 modified transaction price) – \$600,000 revenue recognized to date] at the date of the modification as a cumulative catch-up adjustment.

> > > **Example 9—Unapproved Change in Scope and Price**

606-10-55-134 An entity enters into a contract with a customer to construct a building on customer-owned land. The contract states that the customer will provide the entity with access to the land within 30 days of contract inception. However, the entity was not provided access until 120 days after contract inception because of storm damage to the site that occurred after contract inception. The contract specifically identifies any delay (including force majeure) in the entity's access to customer-owned land as an event that entitles the entity to compensation that is equal to actual costs incurred as a direct result of the delay. The entity is able to demonstrate that the specific direct costs were incurred as a result of the delay in accordance with the terms of the contract and prepares a claim. The customer initially disagreed with the entity's claim.

606-10-55-135 The entity assesses the legal basis of the claim and determines, on the basis of the underlying contractual terms, that it has enforceable rights. Consequently, it accounts for the claim as a contract modification in accordance with paragraphs 606-10-25-10 through 25-13. The modification does not result in any additional goods and services being provided to the customer. In addition, all of the remaining goods and services after the modification are not distinct and form part of a single performance obligation. Consequently, the entity accounts for the modification in accordance with paragraph 606-10-25-13(b) by updating

the transaction price and the measure of progress toward complete satisfaction of the performance obligation. The entity considers the constraint on estimates of variable consideration in paragraphs 606-10-32-11 through 32-13 when estimating the transaction price.

> > Identifying Performance Obligations

606-10-55-136 Examples 10–12 illustrate the guidance in paragraphs 606-10-25-14 through 25-22 on identifying performance obligations.

> > > Example 10—Goods and Services Are Not Distinct

606-10-55-137 An entity, a contractor, enters into a contract to build a hospital for a customer. The entity is responsible for the overall management of the project and identifies various goods and services to be provided, including engineering, site clearance, foundation, procurement, construction of the structure, piping and wiring, installation of equipment, and finishing.

606-10-55-138 The promised goods and services are capable of being distinct in accordance with paragraph 606-10-25-19(a). That is, the customer can benefit from the goods and services either on their own or together with other readily available resources. This is evidenced by the fact that the entity, or competitors of the entity, regularly sells many of these goods and services separately to other customers. In addition, the customer could generate economic benefit from the individual goods and services by using, consuming, selling, or holding those goods or services.

606-10-55-139 However, the goods and services are not distinct within the context of the contract in accordance with paragraph 606-10-25-19(b) (on the basis of the factors in paragraph 606-10-25-21). That is, the entity's promise to transfer individual goods and services in the contract are not separately identifiable from other promises in the contract. This is evidenced by the fact that the entity provides a significant service of integrating the goods and services (the inputs) into the hospital (the combined output) for which the customer has contracted.

606-10-55-140 Because both criteria in paragraph 606-10-25-19 are not met, the goods and services are not distinct. The entity accounts for all of the goods and services in the contract as a single performance obligation.

> > > Example 11—Determining Whether Goods or Services Are Distinct

> > > > Case A—Distinct Goods or Services

606-10-55-141 An entity, a software developer, enters into a contract with a customer to transfer a software license, perform an installation service, and provide unspecified software updates and technical support (online and telephone) for a two-year period. The entity sells the license, installation

service, and technical support separately. The installation service includes changing the web screen for each type of user (for example, marketing, inventory management, and information technology). The installation service is routinely performed by other entities and does not significantly modify the software. The software remains functional without the updates and the technical support.

606-10-55-142 The entity assesses the goods and services promised to the customer to determine which goods and services are distinct in accordance with paragraph 606-10-25-19. The entity observes that the software is delivered before the other goods and services and remains functional without the updates and the technical support. Thus, the entity concludes that the customer can benefit from each of the goods and services either on their own or together with the other goods and services that are readily available and the criterion in paragraph 606-10-25-19(a) is met.

606-10-55-143 The entity also considers the factors in paragraph 606-10-25-21 and determines that the promise to transfer each good and service to the customer is separately identifiable from each of the other promises (thus, the criterion in paragraph 606-10-25-19(b) is met). In particular, the entity observes that the installation service does not significantly modify or customize the software itself, and, as such, the software and the installation service are separate outputs promised by the entity instead of inputs used to produce a combined output.

606-10-55-144 On the basis of this assessment, the entity identifies four performance obligations in the contract for the following goods or services:

- a. The software license
- b. An installation service
- c. Software updates
- d. Technical support.

606-10-55-145 The entity applies paragraphs 606-10-25-23 through 25-30 to determine whether each of the performance obligations for the installation service, software updates, and technical support are satisfied at a point in time or over time. The entity also assesses the nature of the entity's promise to transfer the software license in accordance with paragraph 606-10-55-60 (see Example 54 in paragraphs 606-10-55-362 through 55-363).

>>> **Case B—Significant Customization**

606-10-55-146 The promised goods and services are the same as in Case A, except that the contract specifies that, as part of the installation service, the software is to be substantially customized to add significant new functionality to enable the software to interface with other customized software applications used by the customer. The customized installation service can be provided by other entities.

606-10-55-147 The entity assesses the goods and services promised to the customer to determine which goods and services are distinct in accordance with paragraph 606-10-25-19. The entity observes that the terms of the contract result in a promise to provide a significant service of integrating the licensed software into the existing software system by performing a customized installation service as specified in the contract. In other words, the entity is using the license and the customized installation service as inputs to produce the combined output (that is, a functional and integrated software system) specified in the contract (see paragraph 606-10-25-21(a)). In addition, the software is significantly modified and customized by the service (see paragraph 606-10-25-21(b)). Although the customized installation service can be provided by other entities, the entity determines that within the context of the contract, the promise to transfer the license is not separately identifiable from the customized installation service and, therefore, the criterion in paragraph 606-10-25-19(b) (on the basis of the factors in paragraph 606-10-25-21) is not met. Thus, the software license and the customized installation service are not distinct.

606-10-55-148 As in Case A, the entity concludes that the software updates and technical support are distinct from the other promises in the contract. This is because the customer can benefit from the updates and technical support either on their own or together with the other goods and services that are readily available and because the promise to transfer the software updates and the technical support to the customer are separately identifiable from each of the other promises.

606-10-55-149 On the basis of this assessment, the entity identifies three performance obligations in the contract for the following goods or services:

- a. Customized installation service (that includes the software license)
- b. Software updates
- c. Technical support.

606-10-55-150 The entity applies paragraphs 606-10-25-23 through 25-30 to determine whether each performance obligation is satisfied at a point in time or over time.

>>> **Example 12—Explicit and Implicit Promises in a Contract**

606-10-55-151 An entity, a manufacturer, sells a product to a distributor (that is, its customer), who will then resell it to an end customer.

>>>> **Case A—Explicit Promise of Service**

606-10-55-152 In the contract with the distributor, the entity promises to provide maintenance services for no additional consideration (that is, “free”) to any party (that is, the end customer) that purchases the product from the distributor. The entity outsources the performance of the maintenance services to the distributor and pays the distributor an agreed-upon amount for providing those services on

the entity's behalf. If the end customer does not use the maintenance services, the entity is not obliged to pay the distributor.

606-10-55-153 Because the promise of maintenance services is a promise to transfer goods or services in the future and is part of the negotiated exchange between the entity and the distributor, the entity determines that the promise to provide maintenance services is a performance obligation (see paragraph 606-10-25-18(g)). The entity concludes that the promise would represent a performance obligation regardless of whether the entity, the distributor, or a third party provides the service. Consequently, the entity allocates a portion of the transaction price to the promise to provide maintenance services.

> > > **Case B—Implicit Promise of Service**

606-10-55-154 The entity has historically provided maintenance services for no additional consideration (that is, “free”) to end customers that purchase the entity's product from the distributor. The entity does not explicitly promise maintenance services during negotiations with the distributor, and the final contract between the entity and the distributor does not specify terms or conditions for those services.

606-10-55-155 However, on the basis of its customary business practice, the entity determines at contract inception that it has made an implicit promise to provide maintenance services as part of the negotiated exchange with the distributor. That is, the entity's past practices of providing these services create valid expectations of the entity's customers (that is, the distributor and end customers) in accordance with paragraph 606-10-25-16. Consequently, the entity identifies the promise of maintenance services as a performance obligation to which it allocates a portion of the transaction price.

> > > **Case C—Services Are Not a Performance Obligation**

606-10-55-156 In the contract with the distributor, the entity does not promise to provide any maintenance services. In addition, the entity typically does not provide maintenance services, and, therefore, the entity's customary business practices, published policies, and specific statements at the time of entering into the contract have not created an implicit promise to provide goods or services to its customers. The entity transfers control of the product to the distributor and, therefore, the contract is completed. However, before the sale to the end customer, the entity makes an offer to provide maintenance services to any party that purchases the product from the distributor for no additional promised consideration.

606-10-55-157 The promise of maintenance is not included in the contract between the entity and the distributor at contract inception. That is, in accordance with paragraph 606-10-25-16, the entity does not explicitly or implicitly promise to provide maintenance services to the distributor or the end customers. Consequently, the entity does not identify the promise to provide maintenance

services as a performance obligation. Instead, the obligation to provide maintenance services is accounted for in accordance with Topic 450 on contingencies.

> > Performance Obligations Satisfied over Time

606-10-55-158 Examples 13–17 illustrate the guidance in paragraphs 606-10-25-27 through 25-29 and 606-10-55-4 through 55-15 on performance obligations satisfied over time. In addition, the following guidance is illustrated in these Examples:

- a. Paragraphs 606-10-25-27(a) and 606-10-55-5 through 55-6 on when a customer simultaneously receives and consumes the benefits provided by the entity's performance as the entity performs (Examples 13 and 14)
- b. Paragraphs 606-10-25-27(c) and 606-10-25-28 through 25-29 and 606-10-55-8 through 55-15 on an entity's performance that does not create an asset with an alternative use and an entity's enforceable right to payment for performance completed to date (Examples 14–17)
- c. Paragraph 606-10-25-30 on performance obligations satisfied at a point in time (Example 17).

> > > Example 13—Customer Simultaneously Receives and Consumes the Benefits

606-10-55-159 An entity enters into a contract to provide monthly payroll processing services to a customer for one year.

606-10-55-160 The promised payroll processing services are accounted for as a single performance obligation in accordance with paragraph 606-10-25-14(b). The performance obligation is satisfied over time in accordance with paragraph 606-10-25-27(a) because the customer simultaneously receives and consumes the benefits of the entity's performance in processing each payroll transaction as and when each transaction is processed. The fact that another entity would not need to reperform payroll processing services for the service that the entity has provided to date also demonstrates that the customer simultaneously receives and consumes the benefits of the entity's performance as the entity performs. (The entity disregards any practical limitations on transferring the remaining performance obligation, including setup activities that would need to be undertaken by another entity.) The entity recognizes revenue over time by measuring its progress toward complete satisfaction of that performance obligation in accordance with paragraphs 606-10-25-31 through 25-37 and 606-10-55-16 through 55-21.

> > > Example 14—Assessing Alternative Use and Right to Payment

606-10-55-161 An entity enters into a contract with a customer to provide a consulting service that results in the entity providing a professional opinion to the customer. The professional opinion relates to facts and circumstances that are

specific to the customer. If the customer were to terminate the consulting contract for reasons other than the entity's failure to perform as promised, the contract requires the customer to compensate the entity for its costs incurred plus a 15 percent margin. The 15 percent margin approximates the profit margin that the entity earns from similar contracts.

606-10-55-162 The entity considers the criterion in paragraph 606-10-25-27(a) and the guidance in paragraphs 606-10-55-5 through 55-6 to determine whether the customer simultaneously receives and consumes the benefits of the entity's performance. If the entity were to be unable to satisfy its obligation and the customer hired another consulting firm to provide the opinion, the other consulting firm would need to substantially reperform the work that the entity had completed to date because the other consulting firm would not have the benefit of any work in progress performed by the entity. The nature of the professional opinion is such that the customer will receive the benefits of the entity's performance only when the customer receives the professional opinion. Consequently, the entity concludes that the criterion in paragraph 606-10-25-27(a) is not met.

606-10-55-163 However, the entity's performance obligation meets the criterion in paragraph 606-10-25-27(c) and is a performance obligation satisfied over time because of both of the following factors:

- a. In accordance with paragraphs 606-10-25-28 and 606-10-55-8 through 55-10, the development of the professional opinion does not create an asset with alternative use to the entity because the professional opinion relates to facts and circumstances that are specific to the customer. Therefore, there is a practical limitation on the entity's ability to readily direct the asset to another customer.
- b. In accordance with paragraphs 606-10-25-29 and 606-10-55-11 through 55-15, the entity has an enforceable right to payment for its performance completed to date for its costs plus a reasonable margin, which approximates the profit margin in other contracts.

606-10-55-164 Consequently, the entity recognizes revenue over time by measuring the progress toward complete satisfaction of the performance obligation in accordance with paragraphs 606-10-25-31 through 25-37 and 606-10-55-16 through 55-21.

> > > **Example 15—Asset Has No Alternative Use to the Entity**

606-10-55-165 An entity enters into a contract with a customer, a government agency, to build a specialized satellite. The entity builds satellites for various customers, such as governments and commercial entities. The design and construction of each satellite differ substantially, on the basis of each customer's needs and the type of technology that is incorporated into the satellite.

606-10-55-166 At contract inception, the entity assesses whether its performance obligation to build the satellite is a performance obligation satisfied over time in accordance with paragraph 606-10-25-27.

606-10-55-167 As part of that assessment, the entity considers whether the satellite in its completed state will have an alternative use to the entity. Although the contract does not preclude the entity from directing the completed satellite to another customer, the entity would incur significant costs to rework the design and function of the satellite to direct that asset to another customer. Consequently, the asset has no alternative use to the entity (see paragraphs 606-10-25-27(c), 606-10-25-28, and 606-10-55-8 through 55-10) because the customer-specific design of the satellite limits the entity's practical ability to readily direct the satellite to another customer.

606-10-55-168 For the entity's performance obligation to be satisfied over time when building the satellite, paragraph 606-10-25-27(c) also requires the entity to have an enforceable right to payment for performance completed to date. This condition is not illustrated in this Example.

> > > Example 16—Enforceable Right to Payment for Performance Completed to Date

606-10-55-169 An entity enters into a contract with a customer to build an item of equipment. The payment schedule in the contract specifies that the customer must make an advance payment at contract inception of 10 percent of the contract price, regular payments throughout the construction period (amounting to 50 percent of the contract price), and a final payment of 40 percent of the contract price after construction is completed and the equipment has passed the prescribed performance tests. The payments are nonrefundable unless the entity fails to perform as promised. If the customer terminates the contract, the entity is entitled only to retain any progress payments received from the customer. The entity has no further rights to compensation from the customer.

606-10-55-170 At contract inception, the entity assesses whether its performance obligation to build the equipment is a performance obligation satisfied over time in accordance with paragraph 606-10-25-27.

606-10-55-171 As part of that assessment, the entity considers whether it has an enforceable right to payment for performance completed to date in accordance with paragraphs 606-10-25-27(c), 606-10-25-29, and 606-10-55-11 through 55-15 if the customer were to terminate the contract for reasons other than the entity's failure to perform as promised. Even though the payments made by the customer are nonrefundable, the cumulative amount of those payments is not expected, at all times throughout the contract, to at least correspond to the amount that would be necessary to compensate the entity for performance completed to date. This is because at various times during construction the cumulative amount of consideration paid by the customer might be less than the selling price of the partially completed item of equipment at that time.

Consequently, the entity does not have a right to payment for performance completed to date.

606-10-55-172 Because the entity does not have a right to payment for performance completed to date, the entity's performance obligation is not satisfied over time in accordance with paragraph 606-10-25-27(c). Accordingly, the entity does not need to assess whether the equipment would have an alternative use to the entity. The entity also concludes that it does not meet the criteria in paragraph 606-10-25-27(a) or (b), and, thus, the entity accounts for the construction of the equipment as a performance obligation satisfied at a point in time in accordance with paragraph 606-10-25-30.

> > > Example 17—Assessing Whether a Performance Obligation Is Satisfied at a Point in Time or Over Time

606-10-55-173 An entity is developing a multi-unit residential complex. A customer enters into a binding sales contract with the entity for a specified unit that is under construction. Each unit has a similar floor plan and is of a similar size, but other attributes of the units are different (for example, the location of the unit within the complex).

> > > > Case A—Entity Does Not Have an Enforceable Right to Payment for Performance Completed to Date

606-10-55-174 The customer pays a deposit upon entering into the contract, and the deposit is refundable only if the entity fails to complete construction of the unit in accordance with the contract. The remainder of the contract price is payable on completion of the contract when the customer obtains physical possession of the unit. If the customer defaults on the contract before completion of the unit, the entity only has the right to retain the deposit.

606-10-55-175 At contract inception, the entity applies paragraph 606-10-25-27(c) to determine whether its promise to construct and transfer the unit to the customer is a performance obligation satisfied over time. The entity determines that it does not have an enforceable right to payment for performance completed to date because until construction of the unit is complete, the entity only has a right to the deposit paid by the customer. Because the entity does not have a right to payment for work completed to date, the entity's performance obligation is not a performance obligation satisfied over time in accordance with paragraph 606-10-25-27(c). Instead, the entity accounts for the sale of the unit as a performance obligation satisfied at a point in time in accordance with paragraph 606-10-25-30.

> > > > Case B—Entity Has an Enforceable Right to Payment for Performance Completed to Date

606-10-55-176 The customer pays a nonrefundable deposit upon entering into the contract and will make progress payments during construction of the unit.

The contract has substantive terms that preclude the entity from being able to direct the unit to another customer. In addition, the customer does not have the right to terminate the contract unless the entity fails to perform as promised. If the customer defaults on its obligations by failing to make the promised progress payments as and when they are due, the entity would have a right to all of the consideration promised in the contract if it completes the construction of the unit. The courts have previously upheld similar rights that entitle developers to require the customer to perform, subject to the entity meeting its obligations under the contract.

606-10-55-177 At contract inception, the entity applies paragraph 606-10-25-27(c) to determine whether its promise to construct and transfer the unit to the customer is a performance obligation satisfied over time. The entity determines that the asset (unit) created by the entity's performance does not have an alternative use to the entity because the contract precludes the entity from transferring the specified unit to another customer. The entity does not consider the possibility of a contract termination in assessing whether the entity is able to direct the asset to another customer.

606-10-55-178 The entity also has a right to payment for performance completed to date in accordance with paragraphs 606-10-25-29 and 606-10-55-11 through 55-15. This is because if the customer were to default on its obligations, the entity would have an enforceable right to all of the consideration promised under the contract if it continues to perform as promised.

606-10-55-179 Therefore, the terms of the contract and the practices in the legal jurisdiction indicate that there is a right to payment for performance completed to date. Consequently, the criteria in paragraph 606-10-25-27(c) are met, and the entity has a performance obligation that it satisfies over time. To recognize revenue for that performance obligation satisfied over time, the entity measures its progress toward complete satisfaction of its performance obligation in accordance with paragraphs 606-10-25-31 through 25-37 and 606-10-55-16 through 55-21.

606-10-55-180 In the construction of a multi-unit residential complex, the entity may have many contracts with individual customers for the construction of individual units within the complex. The entity would account for each contract separately. However, depending on the nature of the construction, the entity's performance in undertaking the initial construction works (that is, the foundation and the basic structure), as well as the construction of common areas, may need to be reflected when measuring its progress toward complete satisfaction of its performance obligations in each contract.

> > > Case C—Entity Has an Enforceable Right to Payment for Performance Completed to Date

606-10-55-181 The same facts as in Case B apply to Case C, except that in the event of a default by the customer, either the entity can require the customer to

perform as required under the contract or the entity can cancel the contract in exchange for the asset under construction and an entitlement to a penalty of a proportion of the contract price.

606-10-55-182 Notwithstanding that the entity could cancel the contract (in which case the customer's obligation to the entity would be limited to transferring control of the partially completed asset to the entity and paying the penalty prescribed), the entity has a right to payment for performance completed to date because the entity also could choose to enforce its rights to full payment under the contract. The fact that the entity may choose to cancel the contract in the event the customer defaults on its obligations would not affect that assessment (see paragraph 606-10-55-13), provided that the entity's rights to require the customer to continue to perform as required under the contract (that is, pay the promised consideration) are enforceable.

> > Measuring Progress toward Complete Satisfaction of a Performance Obligation

606-10-55-183 Examples 18 and 19 illustrate the guidance in paragraphs 606-10-25-31 through 25-37 on measuring progress toward complete satisfaction of a performance obligation satisfied over time. Example 19 also illustrates the guidance in paragraph 606-10-55-21 on uninstalled materials when costs incurred are not proportionate to the entity's progress in satisfying a performance obligation.

> > > Example 18—Measuring Progress When Making Goods or Services Available

606-10-55-184 An entity, an owner and manager of health clubs, enters into a contract with a customer for one year of access to any of its health clubs. The customer has unlimited use of the health clubs and promises to pay \$100 per month.

606-10-55-185 The entity determines that its promise to the customer is to provide a service of making the health clubs available for the customer to use as and when the customer wishes. This is because the extent to which the customer uses the health clubs does not affect the amount of the remaining goods and services to which the customer is entitled. The entity concludes that the customer simultaneously receives and consumes the benefits of the entity's performance as it performs by making the health clubs available. Consequently, the entity's performance obligation is satisfied over time in accordance with paragraph 606-10-25-27(a).

606-10-55-186 The entity also determines that the customer benefits from the entity's service of making the health clubs available evenly throughout the year. (That is, the customer benefits from having the health clubs available, regardless of whether the customer uses it or not.) Consequently, the entity concludes that the best measure of progress toward complete satisfaction of the performance

obligation over time is a time-based measure, and it recognizes revenue on a straight-line basis throughout the year at \$100 per month.

> > > Example 19—Uninstalled Materials

606-10-55-187 In November 20X2, an entity contracts with a customer to refurbish a 3-story building and install new elevators for total consideration of \$5 million. The promised refurbishment service, including the installation of elevators, is a single performance obligation satisfied over time. Total expected costs are \$4 million, including \$1.5 million for the elevators. The entity determines that it acts as a principal in accordance with paragraphs 606-10-55-36 through 55-40 because it obtains control of the elevators before they are transferred to the customer.

606-10-55-188 A summary of the transaction price and expected costs is as follows:

Transaction price	\$ 5,000,000
Expected costs:	
Elevators	1,500,000
Other costs	<u>2,500,000</u>
Total expected costs	<u><u>\$ 4,000,000</u></u>

606-10-55-189 The entity uses an input method based on costs incurred to measure its progress toward complete satisfaction of the performance obligation. The entity assesses whether the costs incurred to procure the elevators are proportionate to the entity's progress in satisfying the performance obligation in accordance with paragraph 606-10-55-21. The customer obtains control of the elevators when they are delivered to the site in December 20X2, although the elevators will not be installed until June 20X3. The costs to procure the elevators (\$1.5 million) are significant relative to the total expected costs to completely satisfy the performance obligation (\$4 million). The entity is not involved in designing or manufacturing the elevators.

606-10-55-190 The entity concludes that including the costs to procure the elevators in the measure of progress would overstate the extent of the entity's performance. Consequently, in accordance with paragraph 606-10-55-21, the entity adjusts its measure of progress to exclude the costs to procure the elevators from the measure of costs incurred and from the transaction price. The entity recognizes revenue for the transfer of the elevators in an amount equal to the costs to procure the elevators (that is, at a zero margin).

606-10-55-191 As of December 31, 20X2, the entity observes that:

- a. Other costs incurred (excluding elevators) are \$500,000.
- b. Performance is 20% complete (that is, $\$500,000 \div \$2,500,000$).

606-10-55-192 Consequently, at December 31, 20X2, the entity recognizes the following:

Revenue	\$ 2,200,000 ^(a)
Costs of goods sold	<u>2,000,000 ^(b)</u>
Profit	<u>\$ 200,000</u>

(a) Revenue recognized is calculated as $(20\% \times \$3,500,000) + \$1,500,000$. (\$3,500,000 is \$5,000,000 transaction price – \$1,500,000 costs of elevators.)

(b) Cost of goods sold is \$500,000 of costs incurred + \$1,500,000 costs of elevators.

> > Variable Consideration

606-10-55-193 Examples 20 and 21 illustrate the guidance in paragraphs 606-10-32-5 through 32-9 on identifying variable consideration.

> > > Example 20—Penalty Gives Rise to Variable Consideration

606-10-55-194 An entity enters into a contract with a customer to build an asset for \$1 million. In addition, the terms of the contract include a penalty of \$100,000 if the construction is not completed within 3 months of a date specified in the contract.

606-10-55-195 The entity concludes that the consideration promised in the contract includes a fixed amount of \$900,000 and a variable amount of \$100,000 (arising from the penalty).

606-10-55-196 The entity estimates the variable consideration in accordance with paragraphs 606-10-32-5 through 32-9 and considers the guidance in paragraphs 606-10-32-11 through 32-13 on constraining estimates of variable consideration.

> > > Example 21—Estimating Variable Consideration

606-10-55-197 An entity enters into a contract with a customer to build a customized asset. The promise to transfer the asset is a performance obligation that is satisfied over time. The promised consideration is \$2.5 million, but that amount will be reduced or increased depending on the timing of completion of the asset. Specifically, for each day after March 31, 20X7 that the asset is incomplete, the promised consideration is reduced by \$10,000. For each day before March 31, 20X7 that the asset is complete, the promised consideration increases by \$10,000.

606-10-55-198 In addition, upon completion of the asset, a third party will inspect the asset and assign a rating based on metrics that are defined in the contract. If the asset receives a specified rating, the entity will be entitled to an incentive bonus of \$150,000.

606-10-55-199 In determining the transaction price, the entity prepares a separate estimate for each element of variable consideration to which the entity will be entitled using the estimation methods described in paragraph 606-10-32-8:

- a. The entity decides to use the expected value method to estimate the variable consideration associated with the daily penalty or incentive (that is, \$2.5 million, plus or minus \$10,000 per day). This is because it is the method that the entity expects to better predict the amount of consideration to which it will be entitled.
- b. The entity decides to use the most likely amount to estimate the variable consideration associated with the incentive bonus. This is because there are only 2 possible outcomes (\$150,000 or \$0) and it is the method that the entity expects to better predict the amount of consideration to which it will be entitled.

606-10-55-200 The entity considers the guidance in paragraphs 606-10-32-11 through 32-13 on constraining estimates of variable consideration to determine whether the entity should include some or all of its estimate of variable consideration in the transaction price.

> > **Constraining Estimates of Variable Consideration**

606-10-55-201 Examples 22–25 illustrate the guidance in paragraphs 606-10-32-11 through 32-13 on constraining estimates of variable consideration. In addition, the following guidance is illustrated in these Examples:

- a. Paragraph 606-10-32-10 on refund liabilities (Example 22)
- b. Paragraphs 606-10-55-22 through 55-29 on sales with a right of return (Example 22)
- c. Paragraphs 606-10-32-39 through 32-41 on allocating variable consideration to performance obligations (Example 25).

> > **Example 22—Right of Return**

606-10-55-202 An entity enters into 100 contracts with customers. Each contract includes the sale of 1 product for \$100 (100 total products × \$100 = \$10,000 total consideration). Cash is received when control of a product transfers. The entity's customary business practice is to allow a customer to return any unused product within 30 days and receive a full refund. The entity's cost of each product is \$60.

606-10-55-203 The entity applies the guidance in this Topic to the portfolio of 100 contracts because it reasonably expects that, in accordance with paragraph 606-10-10-4, the effects on the financial statements from applying this guidance to

the portfolio would not differ materially from applying the guidance to the individual contracts within the portfolio.

606-10-55-204 Because the contract allows a customer to return the products, the consideration received from the customer is variable. To estimate the variable consideration to which the entity will be entitled, the entity decides to use the expected value method (see paragraph 606-10-32-8(a)) because it is the method that the entity expects to better predict the amount of consideration to which it will be entitled. Using the expected value method, the entity estimates that 97 products will not be returned.

606-10-55-205 The entity also considers the guidance in paragraphs 606-10-32-11 through 32-13 on constraining estimates of variable consideration to determine whether the estimated amount of variable consideration of \$9,700 ($\100×97 products not expected to be returned) can be included in the transaction price. The entity considers the factors in paragraph 606-10-32-12 and determines that although the returns are outside the entity's influence, it has significant experience in estimating returns for this product and customer class. In addition, the uncertainty will be resolved within a short time frame (that is, the 30-day return period). Thus, the entity concludes that it is probable that a significant reversal in the cumulative amount of revenue recognized (that is, \$9,700) will not occur as the uncertainty is resolved (that is, over the return period).

606-10-55-206 The entity estimates that the costs of recovering the products will be immaterial and expects that the returned products can be resold at a profit.

606-10-55-207 Upon transfer of control of the 100 products, the entity does not recognize revenue for the 3 products that it expects to be returned. Consequently, in accordance with paragraphs 606-10-32-10 and 606-10-55-23, the entity recognizes the following:

Cash	\$10,000	($\$100 \times 100$ products transferred)
Revenue	\$9,700	($\$100 \times 97$ products not expected to be returned)
Refund liability	\$300	($\$100$ refund \times 3 products expected to be returned)
Cost of sales	\$5,820	($\$60 \times 97$ products not expected to be returned)
Asset	\$180	($\$60 \times 3$ products for its right to recover products from customers on settling the refund liability)
Inventory	\$6,000	($\$60 \times 100$ products)

> > > Example 23—Price Concessions

606-10-55-208 An entity enters into a contract with a customer, a distributor, on December 1, 20X7. The entity transfers 1,000 products at contract inception for a price stated in the contract of \$100 per product (total consideration is \$100,000). Payment from the customer is due when the customer sells the products to the end customers. The entity's customer generally sells the products within 90 days

of obtaining them. Control of the products transfers to the customer on December 1, 20X7.

606-10-55-209 On the basis of its past practices and to maintain its relationship with the customer, the entity anticipates granting a price concession to its customer because this will enable the customer to discount the product and thereby move the product through the distribution chain. Consequently, the consideration in the contract is variable.

> > > Case A—Estimate of Variable Consideration Is Not Constrained

606-10-55-210 The entity has significant experience selling this and similar products. The observable data indicate that historically the entity grants a price concession of approximately 20 percent of the sales price for these products. Current market information suggests that a 20 percent reduction in price will be sufficient to move the products through the distribution chain. The entity has not granted a price concession significantly greater than 20 percent in many years.

606-10-55-211 To estimate the variable consideration to which the entity will be entitled, the entity decides to use the expected value method (see paragraph 606-10-32-8(a)) because it is the method that the entity expects to better predict the amount of consideration to which it will be entitled. Using the expected value method, the entity estimates the transaction price to be \$80,000 ($\$80 \times 1,000$ products).

606-10-55-212 The entity also considers the guidance in paragraphs 606-10-32-11 through 32-13 on constraining estimates of variable consideration to determine whether the estimated amount of variable consideration of \$80,000 can be included in the transaction price. The entity considers the factors in paragraph 606-10-32-12 and determines that it has significant previous experience with this product and current market information that supports its estimate. In addition, despite some uncertainty resulting from factors outside its influence, based on its current market estimates, the entity expects the price to be resolved within a short time frame. Thus, the entity concludes that it is probable that a significant reversal in the cumulative amount of revenue recognized (that is, \$80,000) will not occur when the uncertainty is resolved (that is, when the total amount of price concessions is determined). Consequently, the entity recognizes \$80,000 as revenue when the products are transferred on December 1, 20X7.

> > > Case B—Estimate of Variable Consideration Is Constrained

606-10-55-213 The entity has experience selling similar products. However, the entity's products have a high risk of obsolescence, and the entity is experiencing high volatility in the pricing of its products. The observable data indicate that historically the entity grants a broad range of price concessions ranging from 20 to 60 percent of the sales price for similar products. Current market information

also suggests that a 15 to 50 percent reduction in price may be necessary to move the products through the distribution chain.

606-10-55-214 To estimate the variable consideration to which the entity will be entitled, the entity decides to use the expected value method (see paragraph 606-10-32-8(a)) because it is the method that the entity expects to better predict the amount of consideration to which it will be entitled. Using the expected value method, the entity estimates that a discount of 40 percent will be provided and, therefore, the estimate of the variable consideration is \$60,000 ($\$60 \times 1,000$ products).

606-10-55-215 The entity also considers the guidance in paragraphs 606-10-32-11 through 32-13 on constraining estimates of variable consideration to determine whether some or all of the estimated amount of variable consideration of \$60,000 can be included in the transaction price. The entity considers the factors in paragraph 606-10-32-12 and observes that the amount of consideration is highly susceptible to factors outside the entity's influence (that is, risk of obsolescence) and it is likely that the entity may be required to provide a broad range of price concessions to move the products through the distribution chain. Consequently, the entity cannot include its estimate of \$60,000 (that is, a discount of 40 percent) in the transaction price because it cannot conclude that it is probable that a significant reversal in the amount of cumulative revenue recognized will not occur. Although the entity's historical price concessions have ranged from 20 to 60 percent, market information currently suggests that a price concession of 15 to 50 percent will be necessary. The entity's actual results have been consistent with then-current market information in previous, similar transactions. Consequently, the entity concludes that it is probable that a significant reversal in the cumulative amount of revenue recognized will not occur if the entity includes \$50,000 in the transaction price (\$100 sales price and a 50 percent price concession) and, therefore, recognizes revenue at that amount. Therefore, the entity recognizes revenue of \$50,000 when the products are transferred and reassesses the estimates of the transaction price at each reporting date until the uncertainty is resolved in accordance with paragraph 606-10-32-14.

> > > Example 24—Volume Discount Incentive

606-10-55-216 An entity enters into a contract with a customer on January 1, 20X8, to sell Product A for \$100 per unit. If the customer purchases more than 1,000 units of Product A in a calendar year, the contract specifies that the price per unit is retrospectively reduced to \$90 per unit. Consequently, the consideration in the contract is variable.

606-10-55-217 For the first quarter ended March 31, 20X8, the entity sells 75 units of Product A to the customer. The entity estimates that the customer's purchases will not exceed the 1,000-unit threshold required for the volume discount in the calendar year.

606-10-55-218 The entity considers the guidance in paragraphs 606-10-32-11 through 32-13 on constraining estimates of variable consideration, including the factors in paragraph 606-10-32-12. The entity determines that it has significant experience with this product and with the purchasing pattern of the entity. Thus, the entity concludes that it is probable that a significant reversal in the cumulative amount of revenue recognized (that is, \$100 per unit) will not occur when the uncertainty is resolved (that is, when the total amount of purchases is known). Consequently, the entity recognizes revenue of \$7,500 (75 units × \$100 per unit) for the quarter ended March 31, 20X8.

606-10-55-219 In May 20X8, the entity's customer acquires another company and in the second quarter ended June 30, 20X8, the entity sells an additional 500 units of Product A to the customer. In light of the new fact, the entity estimates that the customer's purchases will exceed the 1,000-unit threshold for the calendar year and, therefore, it will be required to retrospectively reduce the price per unit to \$90.

606-10-55-220 Consequently, the entity recognizes revenue of \$44,250 for the quarter ended June 30, 20X8. That amount is calculated from \$45,000 for the sale of 500 units (500 units × \$90 per unit) less the change in transaction price of \$750 (75 units × \$10 price reduction) for the reduction of revenue relating to units sold for the quarter ended March 31, 20X8 (see paragraphs 606-10-32-42 through 32-43).

>>> Example 25—Management Fees Subject to the Constraint

606-10-55-221 On January 1, 20X8, an entity enters into a contract with a client to provide asset management services for five years. The entity receives a 2 percent quarterly management fee based on the client's assets under management at the end of each quarter. In addition, the entity receives a performance-based incentive fee of 20 percent of the fund's return in excess of the return of an observable market index over the 5-year period. Consequently, both the management fee and the performance fee in the contract are variable consideration.

606-10-55-222 The entity accounts for the services as a single performance obligation in accordance with paragraph 606-10-25-14(b), because it is providing a series of distinct services that are substantially the same and have the same pattern of transfer (the services transfer to the customer over time and use the same method to measure progress—that is, a time-based measure of progress).

606-10-55-223 At contract inception, the entity considers the guidance in paragraphs 606-10-32-5 through 32-9 on estimating variable consideration and the guidance in paragraphs 606-10-32-11 through 32-13 on constraining estimates of variable consideration, including the factors in paragraph 606-10-32-12. The entity observes that the promised consideration is dependent on the market and, thus, is highly susceptible to factors outside the entity's influence. In addition, the incentive fee has a large number and a broad range of possible

consideration amounts. The entity also observes that although it has experience with similar contracts, that experience is of little predictive value in determining the future performance of the market. Therefore, at contract inception, the entity cannot conclude that it is probable that a significant reversal in the cumulative amount of revenue recognized would not occur if the entity included its estimate of the management fee or the incentive fee in the transaction price.

606-10-55-224 At each reporting date, the entity updates its estimate of the transaction price. Consequently, at the end of each quarter, the entity concludes that it can include in the transaction price the actual amount of the quarterly management fee because the uncertainty is resolved. However, the entity concludes that it cannot include its estimate of the incentive fee in the transaction price at those dates. This is because there has not been a change in its assessment from contract inception—the variability of the fee based on the market index indicates that the entity cannot conclude that it is probable that a significant reversal in the cumulative amount of revenue recognized would not occur if the entity included its estimate of the incentive fee in the transaction price. At March 31, 20X8, the client's assets under management are \$100 million. Therefore, the resulting quarterly management fee and the transaction price is \$2 million.

606-10-55-225 At the end of each quarter, the entity allocates the quarterly management fee to the distinct services provided during the quarter in accordance with paragraphs 606-10-32-39(b) and 606-10-32-40. This is because the fee relates specifically to the entity's efforts to transfer the services for that quarter, which are distinct from the services provided in other quarters, and the resulting allocation will be consistent with the allocation objective in paragraph 606-10-32-28. Consequently, the entity recognizes \$2 million as revenue for the quarter ended March 31, 20X8.

> > The Existence of a Significant Financing Component in the Contract

606-10-55-226 Examples 26–30 illustrate the guidance in paragraphs 606-10-32-15 through 32-20 on the existence of a significant financing component in the contract. In addition, the following guidance is illustrated in Example 26:

- a. Paragraphs 606-10-32-11 through 32-13 on constraining estimates of variable consideration
- b. Paragraphs 606-10-55-22 through 55-29 on sales with a right of return.

> > > Example 26—Significant Financing Component and Right of Return

606-10-55-227 An entity sells a product to a customer for \$121 that is payable 24 months after delivery. The customer obtains control of the product at contract inception. The contract permits the customer to return the product within 90 days.

The product is new, and the entity has no relevant historical evidence of product returns or other available market evidence.

606-10-55-228 The cash selling price of the product is \$100, which represents the amount that the customer would pay upon delivery for the same product sold under otherwise identical terms and conditions as at contract inception. The entity's cost of the product is \$80.

606-10-55-229 The entity does not recognize revenue when control of the product transfers to the customer. This is because the existence of the right of return and the lack of relevant historical evidence means that the entity cannot conclude that it is probable that a significant reversal in the amount of cumulative revenue recognized will not occur in accordance with paragraphs 606-10-32-11 through 32-13. Consequently, revenue is recognized after three months when the right of return lapses.

606-10-55-230 The contract includes a significant financing component, in accordance with paragraphs 606-10-32-15 through 32-17. This is evident from the difference between the amount of promised consideration of \$121 and the cash selling price of \$100 at the date that the goods are transferred to the customer.

606-10-55-231 The contract includes an implicit interest rate of 10 percent (that is, the interest rate that over 24 months discounts the promised consideration of \$121 to the cash selling price of \$100). The entity evaluates the rate and concludes that it is commensurate with the rate that would be reflected in a separate financing transaction between the entity and its customer at contract inception. The following journal entries illustrate how the entity accounts for this contract in accordance with paragraphs 606-10-55-22 through 55-29:

- a. When the product is transferred to the customer, in accordance with paragraph 606-10-55-23.

Asset for right to recover product to be returned	\$80 ^(a)	
Inventory		\$80

- (a) This Example does not consider expected costs to recover the asset.

- b. During the three-month right of return period, no interest is recognized in accordance with paragraph 606-10-32-20 because no contract asset or receivable has been recognized.

- c. When the right of return lapses (the product is not returned).

Receivable	\$100 ^(b)	
Revenue		\$100
Cost of sales	\$80	
Asset for product to be returned		\$80

- (b) The receivable recognized would be measured in accordance with Topic 310 on receivables. This Example does not consider the impairment accounting for the receivable.

606-10-55-232 Until the entity receives the cash payment from the customer, interest income would be recognized consistently with the subsequent measurement guidance in Subtopic 835-30 on imputation of interest. The entity would accrete the receivable up to \$121 from the time the right of return lapses until customer payment.

> > > Example 27—Withheld Payments on a Long-Term Contract

606-10-55-233 An entity enters into a contract for the construction of a building that includes scheduled milestone payments for the performance by the entity throughout the contract term of three years. The performance obligation will be satisfied over time, and the milestone payments are scheduled to coincide with the entity's expected performance. The contract provides that a specified percentage of each milestone payment is to be withheld (that is, retained) by the customer throughout the arrangement and paid to the entity only when the building is complete.

606-10-55-234 The entity concludes that the contract does not include a significant financing component. The milestone payments coincide with the entity's performance, and the contract requires amounts to be retained for reasons other than the provision of finance in accordance with paragraph 606-10-32-17(c). The withholding of a specified percentage of each milestone payment is intended to protect the customer from the contractor failing to adequately complete its obligations under the contract.

> > > Example 28—Determining the Discount Rate

606-10-55-235 An entity enters into a contract with a customer to sell equipment. Control of the equipment transfers to the customer when the contract is signed. The price stated in the contract is \$1 million plus a 5 percent contractual rate of interest, payable in 60 monthly installments of \$18,871.

> > > Case A—Contractual Discount Rate Reflects the Rate in a Separate Financing Transaction

606-10-55-236 In evaluating the discount rate in the contract that contains a significant financing component, the entity observes that the 5 percent contractual rate of interest reflects the rate that would be used in a separate financing transaction between the entity and its customer at contract inception (that is, the contractual rate of interest of 5 percent reflects the credit characteristics of the customer).

606-10-55-237 The market terms of the financing mean that the cash selling price of the equipment is \$1 million. This amount is recognized as revenue and as a loan receivable when control of the equipment transfers to the customer.

The entity accounts for the receivable in accordance with Topic 310 on receivables and Subtopic 835-30 on the imputation of interest.

> > > **Case B—Contractual Discount Rate Does Not Reflect the Rate in a Separate Financing Transaction**

606-10-55-238 In evaluating the discount rate in the contract that contains a significant financing component, the entity observes that the 5 percent contractual rate of interest is significantly lower than the 12 percent interest rate that would be used in a separate financing transaction between the entity and its customer at contract inception (that is, the contractual rate of interest of 5 percent does not reflect the credit characteristics of the customer). This suggests that the cash selling price is less than \$1 million.

606-10-55-239 In accordance with paragraph 606-10-32-19, the entity determines the transaction price by adjusting the promised amount of consideration to reflect the contractual payments using the 12 percent interest rate that reflects the credit characteristics of the customer. Consequently, the entity determines that the transaction price is \$848,357 (60 monthly payments of \$18,871 discounted at 12 percent). The entity recognizes revenue and a loan receivable for that amount. The entity accounts for the loan receivable in accordance with Topic 310 on receivables and Subtopic 835-30 on the imputation of interest.

> > > **Example 29—Advance Payment and Assessment of Discount Rate**

606-10-55-240 An entity enters into a contract with a customer to sell an asset. Control of the asset will transfer to the customer in two years (that is, the performance obligation will be satisfied at a point in time). The contract includes 2 alternative payment options: payment of \$5,000 in 2 years when the customer obtains control of the asset or payment of \$4,000 when the contract is signed. The customer elects to pay \$4,000 when the contract is signed.

606-10-55-241 The entity concludes that the contract contains a significant financing component because of the length of time between when the customer pays for the asset and when the entity transfers the asset to the customer, as well as the prevailing interest rates in the market.

606-10-55-242 The interest rate implicit in the transaction is 11.8 percent, which is the interest rate necessary to make the 2 alternative payment options economically equivalent. However, the entity determines that, in accordance with paragraph 606-10-32-19, the rate that should be used in adjusting the promised consideration is 6 percent, which is the entity's incremental borrowing rate.

606-10-55-243 The following journal entries illustrate how the entity would account for the significant financing component.

- a. Recognize a contract liability for the \$4,000 payment received at contract inception.

Cash \$4,000
 Contract liability \$4,000

- b. During the 2 years from contract inception until the transfer of the asset, the entity adjusts the promised amount of consideration (in accordance with paragraph 606-10-32-20) and accretes the contract liability by recognizing interest on \$4,000 at 6 percent for 2 years.

Interest expense \$494 ^(a)
 Contract liability \$494

(a) $\$494 = \$4,000 \text{ contract liability} \times (6 \text{ percent interest per year for 2 years})$

- c. Recognize revenue for the transfer of the asset.

Contract liability \$4,494
 Revenue \$4,494

> > Example 30—Advance Payment

606-10-55-244 An entity, a technology product manufacturer, enters into a contract with a customer to provide global telephone technology support and repair coverage for three years along with its technology product. The customer purchases this support service at the time of buying the product. Consideration for the service is an additional \$300. Customers electing to buy this service must pay for it upfront (that is, a monthly payment option is not available).

606-10-55-245 To determine whether there is a significant financing component in the contract, the entity considers the nature of the service being offered and the purpose of the payment terms. The entity charges a single upfront amount, not with the primary purpose of obtaining financing from the customer but, instead, to maximize profitability, taking into consideration the risks associated with providing the service. Specifically, if customers could pay monthly, they would be less likely to renew, and the population of customers that continue to use the support service in the later years may become smaller and less diverse over time (that is, customers that choose to renew historically are those that make greater use of the service, thereby increasing the entity's costs). In addition, customers tend to use services more if they pay monthly rather than making an upfront payment. Finally, the entity would incur higher administration costs such as the costs related to administering renewals and collection of monthly payments.

606-10-55-246 In assessing the guidance in paragraph 606-10-32-17(c), the entity determines that the payment terms were structured primarily for reasons other than the provision of finance to the entity. The entity charges a single upfront amount for the services because other payment terms (such as a monthly payment plan) would affect the nature of the risks assumed by the entity to provide the service and may make it uneconomical to provide the service. As a

result of its analysis, the entity concludes that there is not a significant financing component.

> > **Noncash Consideration**

606-10-55-247 Example 31 illustrates the guidance in paragraphs 606-10-32-21 through 32-24 on noncash consideration. In addition, the following guidance is illustrated in this Example:

- a. Paragraph 606-10-25-14 on identifying performance obligations
- b. Paragraphs 606-10-32-11 through 32-13 on constraining estimates of variable consideration.

> > > **Example 31—Entitlement to Noncash Consideration**

606-10-55-248 An entity enters into a contract with a customer to provide a weekly service for one year. The contract is signed on January 1, 20X1, and work begins immediately. The entity concludes that the service is a single performance obligation in accordance with paragraph 606-10-25-14(b). This is because the entity is providing a series of distinct services that are substantially the same and have the same pattern of transfer (the services transfer to the customer over time and use the same method to measure progress—that is, a time-based measure of progress).

606-10-55-249 In exchange for the service, the customer promises 100 shares of its common stock per week of service (a total of 5,200 shares for the contract). The terms in the contract require that the shares must be paid upon the successful completion of each week of service.

606-10-55-250 The entity measures its progress toward complete satisfaction of the performance obligation as each week of service is complete. To determine the transaction price (and the amount of revenue to be recognized), the entity measures the fair value of 100 shares that are received upon completion of each weekly service. The entity does not reflect any subsequent changes in the fair value of the shares received (or receivable) in revenue.

> > **Consideration Payable to a Customer**

606-10-55-251 Example 32 illustrates the guidance in paragraphs 606-10-32-25 through 32-27 on consideration payable to a customer.

> > > **Example 32—Consideration Payable to a Customer**

606-10-55-252 An entity that manufactures consumer goods enters into a one-year contract to sell goods to a customer that is a large global chain of retail stores. The customer commits to buy at least \$15 million of products during the year. The contract also requires the entity to make a nonrefundable payment of \$1.5 million to the customer at the inception of the contract. The \$1.5 million

payment will compensate the customer for the changes it needs to make to its shelving to accommodate the entity's products.

606-10-55-253 The entity considers the guidance in paragraphs 606-10-32-25 through 32-27 and concludes that the payment to the customer is not in exchange for a distinct good or service that transfers to the entity. This is because the entity does not obtain control of any rights to the customer's shelves. Consequently, the entity determines that, in accordance with paragraph 606-10-32-25, the \$1.5 million payment is a reduction of the transaction price.

606-10-55-254 The entity applies the guidance in paragraph 606-10-32-27 and concludes that the consideration payable is accounted for as a reduction in the transaction price when the entity recognizes revenue for the transfer of the goods. Consequently, as the entity transfers goods to the customer, the entity reduces the transaction price for each good by 10 percent ($\$1.5 \text{ million} \div \15 million). Therefore, in the first month in which the entity transfers goods to the customer, the entity recognizes revenue of \$1.8 million ($\$2.0 \text{ million invoiced amount} - \$0.2 \text{ million of consideration payable to the customer}$).

> > Allocating the Transaction Price to Performance Obligations

606-10-55-255 Examples 33–35 illustrate the guidance in paragraphs 606-10-32-28 through 32-41 on allocating the transaction price to performance obligations. In addition, the following guidance is illustrated in Example 35:

- a. Paragraph 606-10-32-8 on variable consideration
- b. Paragraph 606-10-55-65 on consideration in the form of sales-based or usage-based royalties on licenses of intellectual property.

> > > Example 33—Allocation Methodology

606-10-55-256 An entity enters into a contract with a customer to sell Products A, B, and C in exchange for \$100. The entity will satisfy the performance obligations for each of the products at different points in time. The entity regularly sells Product A separately, and, therefore the standalone selling price is directly observable. The standalone selling prices of Products B and C are not directly observable.

606-10-55-257 Because the standalone selling prices for Products B and C are not directly observable, the entity must estimate them. To estimate the standalone selling prices, the entity uses the adjusted market assessment approach for Product B and the expected cost plus a margin approach for Product C. In making those estimates, the entity maximizes the use of observable inputs (in accordance with paragraph 606-10-32-33). The entity estimates the standalone selling prices as follows:

Product	Standalone Selling Price	Method
Product A	\$ 50	Directly observable (see paragraph 606-10-32-32)
Product B	25	Adjusted market assessment approach (see paragraph 606-10-32-34(a))
Product C	75	Expected cost plus a margin approach (see paragraph 606-10-32-34(b))
Total	\$ 150	

606-10-55-258 The customer receives a discount for purchasing the bundle of goods because the sum of the standalone selling prices (\$150) exceeds the promised consideration (\$100). The entity considers whether it has observable evidence about the performance obligation to which the entire discount belongs (in accordance with paragraph 606-10-32-37) and concludes that it does not. Consequently, in accordance with paragraphs 606-10-32-31 and 606-10-32-36, the discount is allocated proportionately across Products A, B, and C. The discount, and therefore the transaction price, is allocated as follows:

Product	Allocated Transaction Price	
Product A	\$ 33	$(\$50 \div \$150 \times \$100)$
Product B	17	$(\$25 \div \$150 \times \$100)$
Product C	50	$(\$75 \div \$150 \times \$100)$
Total	\$ 100	

> > Example 34—Allocating a Discount

606-10-55-259 An entity regularly sells Products A, B, and C individually, thereby establishing the following standalone selling prices:

Product	Standalone Selling Price
Product A	\$ 40
Product B	55
Product C	45
Total	\$ 140

606-10-55-260 In addition, the entity regularly sells Products B and C together for \$60.

>>> Case A—Allocating a Discount to One or More Performance Obligations

606-10-55-261 The entity enters into a contract with a customer to sell Products A, B, and C in exchange for \$100. The entity will satisfy the performance obligations for each of the products at different points in time.

606-10-55-262 The contract includes a discount of \$40 on the overall transaction, which would be allocated proportionately to all 3 performance obligations when allocating the transaction price using the relative standalone selling price method (in accordance with paragraph 606-10-32-36). However, because the entity regularly sells Products B and C together for \$60 and Product A for \$40, it has evidence that the entire discount should be allocated to the promises to transfer Products B and C in accordance with paragraph 606-10-32-37.

606-10-55-263 If the entity transfers control of Products B and C at the same point in time, then the entity could, as a practical matter, account for the transfer of those products as a single performance obligation. That is, the entity could allocate \$60 of the transaction price to the single performance obligation and recognize revenue of \$60 when Products B and C simultaneously transfer to the customer.

606-10-55-264 If the contract requires the entity to transfer control of Products B and C at different points in time, then the allocated amount of \$60 is individually allocated to the promises to transfer Product B (standalone selling price of \$55) and Product C (standalone selling price of \$45) as follows:

Product	Allocated Transaction Price	
Product B	\$ 33	$(\$55 \div \$100 \text{ total standalone selling price} \times \$60)$
Product C	<u>27</u>	$(\$45 \div \$100 \text{ total standalone selling price} \times \$60)$
Total	<u>\$ 60</u>	

>>> Case B—Residual Approach Is Appropriate

606-10-55-265 The entity enters into a contract with a customer to sell Products A, B, and C as described in Case A. The contract also includes a promise to transfer Product D. Total consideration in the contract is \$130. The standalone selling price for Product D is highly variable (see paragraph 606-10-32-34(c)(1)) because the entity sells Product D to different customers for a broad range of amounts (\$15 – \$45). Consequently, the entity decides to estimate the standalone selling price of Product D using the residual approach.

606-10-55-266 Before estimating the standalone selling price of Product D using the residual approach, the entity determines whether any discount should be

allocated to the other performance obligations in the contract in accordance with paragraphs 606-10-32-37 through 32-38.

606-10-55-267 As in Case A, because the entity regularly sells Products B and C together for \$60 and Product A for \$40, it has observable evidence that \$100 should be allocated to those 3 products and a \$40 discount should be allocated to the promises to transfer Products B and C in accordance with paragraph 606-10-32-37. Using the residual approach, the entity estimates the standalone selling price of Product D to be \$30 as follows:

Product	Standalone Selling Price	Method
Product A	\$ 40	Directly observable (see paragraph 606-10-32-32)
Products B and C	60	Directly observable with discount (see paragraph 606-10-32-37)
Product D	30	Residual approach (see paragraph 606-10-32-34(c))
Total	\$ 130	

606-10-55-268 The entity observes that the resulting \$30 allocated to Product D is within the range of its observable selling prices (\$15 – \$45). Therefore, the resulting allocation (see above table) is consistent with the allocation objective in paragraph 606-10-32-28 and the guidance in paragraph 606-10-32-33.

> > > Case C—Residual Approach Is Inappropriate

606-10-55-269 The same facts as in Case B apply to Case C except the transaction price is \$105 instead of \$130. Consequently, the application of the residual approach would result in a standalone selling price of \$5 for Product D (\$105 transaction price less \$100 allocated to Products A, B, and C). The entity concludes that \$5 would not faithfully depict the amount of consideration to which the entity expects to be entitled in exchange for satisfying its performance obligation to transfer Product D because \$5 does not approximate the standalone selling price of Product D, which ranges from \$15 – \$45. Consequently, the entity reviews its observable data, including sales and margin reports, to estimate the standalone selling price of Product D using another suitable method. The entity allocates the transaction price of \$130 to Products A, B, C, and D using the relative standalone selling prices of those products in accordance with paragraphs 606-10-32-28 through 32-35.

> > > Example 35—Allocation of Variable Consideration

606-10-55-270 An entity enters into a contract with a customer for two intellectual property licenses (Licenses X and Y), which the entity determines to represent two performance obligations each satisfied at a point in time. The standalone selling prices of Licenses X and Y are \$800 and \$1,000, respectively.

>>> Case A—Variable Consideration Allocated Entirely to One Performance Obligation

606-10-55-271 The price stated in the contract for License X is a fixed amount of \$800, and for License Y the consideration is 3 percent of the customer's future sales of products that use License Y. For purposes of allocation, the entity estimates its sales-based royalties (that is, the variable consideration) to be \$1,000, in accordance with paragraph 606-10-32-8.

606-10-55-272 To allocate the transaction price, the entity considers the criteria in paragraph 606-10-32-40 and concludes that the variable consideration (that is, the sales-based royalties) should be allocated entirely to License Y. The entity concludes that the criteria in paragraph 606-10-32-40 are met for the following reasons:

- a. The variable payment relates specifically to an outcome from the performance obligation to transfer License Y (that is, the customer's subsequent sales of products that use License Y).
- b. Allocating the expected royalty amounts of \$1,000 entirely to License Y is consistent with the allocation objective in paragraph 606-10-32-28. This is because the entity's estimate of the amount of sales-based royalties (\$1,000) approximates the standalone selling price of License Y and the fixed amount of \$800 approximates the standalone selling price of License X. The entity allocates \$800 to License X in accordance with paragraph 606-10-32-41. This is because, based on an assessment of the facts and circumstances relating to both licenses, allocating to License Y some of the fixed consideration in addition to all of the variable consideration would not meet the allocation objective in paragraph 606-10-32-28.

606-10-55-273 The entity transfers License Y at inception of the contract and transfers License X one month later. Upon the transfer of License Y, the entity does not recognize revenue because the consideration allocated to License Y is in the form of a sales-based royalty. Therefore, in accordance with paragraph 606-10-55-65, the entity recognizes revenue for the sales-based royalty when those subsequent sales occur.

606-10-55-274 When License X is transferred, the entity recognizes as revenue the \$800 allocated to License X.

>>> Case B—Variable Consideration Allocated on the Basis of Standalone Selling Prices

606-10-55-275 The price stated in the contract for License X is a fixed amount of \$300, and for License Y the consideration is 5 percent of the customer's future sales of products that use License Y. The entity's estimate of the sales-based royalties (that is, the variable consideration) is \$1,500 in accordance with paragraph 606-10-32-8.

606-10-55-276 To allocate the transaction price, the entity applies the criteria in paragraph 606-10-32-40 to determine whether to allocate the variable consideration (that is, the sales-based royalties) entirely to License Y. In applying the criteria, the entity concludes that even though the variable payments relate specifically to an outcome from the performance obligation to transfer License Y (that is, the customer's subsequent sales of products that use License Y), allocating the variable consideration entirely to License Y would be inconsistent with the principle for allocating the transaction price. Allocating \$300 to License X and \$1,500 to License Y does not reflect a reasonable allocation of the transaction price on the basis of the standalone selling prices of Licenses X and Y of \$800 and \$1,000, respectively. Consequently, the entity applies the general allocation requirements in paragraphs 606-10-32-31 through 32-35.

606-10-55-277 The entity allocates the transaction price of \$300 to Licenses X and Y on the basis of relative standalone selling prices of \$800 and \$1,000, respectively. The entity also allocates the consideration related to the sales-based royalty on a relative standalone selling price basis. However, in accordance with paragraph 606-10-55-65, when an entity licenses intellectual property in which the consideration is in the form of a sales-based royalty, the entity cannot recognize revenue until the later of the following events: the subsequent sales occur or the performance obligation is satisfied (or partially satisfied).

606-10-55-278 License Y is transferred to the customer at the inception of the contract, and License X is transferred three months later. When License Y is transferred, the entity recognizes as revenue the \$167 ($\$1,000 \div \$1,800 \times \300) allocated to License Y. When License X is transferred, the entity recognizes as revenue the \$133 ($\$800 \div \$1,800 \times \300) allocated to License X.

606-10-55-279 In the first month, the royalty due from the customer's first month of sales is \$200. Consequently, in accordance with paragraph 606-10-55-65, the entity recognizes as revenue the \$111 ($\$1,000 \div \$1,800 \times \200) allocated to License Y (which has been transferred to the customer and is therefore a satisfied performance obligation). The entity recognizes a contract liability for the \$89 ($\$800 \div \$1,800 \times \200) allocated to License X. This is because although the subsequent sale by the entity's customer has occurred, the performance obligation to which the royalty has been allocated has not been satisfied.

>> Contract Costs

606-10-55-280 Examples 36 and 37 illustrate the guidance in paragraphs 340-40-25-1 through 25-4 on incremental costs of obtaining a contract, paragraphs 340-40-25-5 through 25-8 on costs to fulfill a contract, and paragraphs 340-40-35-1 through 35-6 on amortization and impairment of contract costs.

>>> Example 36—Incremental Costs of Obtaining a Contract

606-10-55-281 For an illustration of the incremental costs of obtaining a contract, see Example 1 in Subtopic 340-40 on other assets and deferred costs—costs related to a contract with a customer (paragraphs 340-40-55-2 through 55-4).

>>> Example 37—Costs That Give Rise to an Asset

606-10-55-282 For an illustration of costs that give rise to an asset, see Example 2 in Subtopic 340-40 on other assets and deferred costs—costs related to a contract with a customer (paragraphs 340-40-55-5 through 55-9).

>> Presentation

606-10-55-283 Examples 38–40 illustrate the guidance in paragraphs 606-10-45-1 through 45-5 on the presentation of contract balances.

>>> Example 38—Contract Liability and Receivable

>>>> Case A—Cancellable Contract

606-10-55-284 On January 1, 20X9, an entity enters into a cancellable contract to transfer a product to a customer on March 31, 20X9. The contract requires the customer to pay consideration of \$1,000 in advance on January 31, 20X9. The customer pays the consideration on March 1, 20X9. The entity transfers the product on March 31, 20X9. The following journal entries illustrate how the entity accounts for the contract:

- a. The entity receives cash of \$1,000 on March 1, 20X9 (cash is received in advance of performance).

Cash	\$1,000	
Contract liability		\$1,000

- b. The entity satisfies the performance obligation on March 31, 20X9.

Contract liability	\$1,000	
Revenue		\$1,000

>>>> Case B—Noncancellable Contract

606-10-55-285 The same facts as in Case A apply to Case B except that the contract is noncancellable. The following journal entries illustrate how the entity accounts for the contract:

- a. The amount of consideration is due on January 31, 20X9 (which is when the entity recognizes a receivable because it has an unconditional right to consideration).

Receivable	\$1,000	
Contract liability		\$1,000

- b. The entity receives the cash on March 1, 20X9.

Cash	\$1,000	
Receivable		\$1,000

- c. The entity satisfies the performance obligation on March 31, 20X9.

Contract liability	\$1,000	
Revenue		\$1,000

606-10-55-286 If the entity issued the invoice before January 31, 20X9 (the due date of the consideration), the entity would not present the receivable and the contract liability on a gross basis in the statement of financial position because the entity does not yet have a right to consideration that is unconditional.

>>> Example 39—Contract Asset Recognized for the Entity’s Performance

606-10-55-287 On January 1, 20X8, an entity enters into a contract to transfer Products A and B to a customer in exchange for \$1,000. The contract requires Product A to be delivered first and states that payment for the delivery of Product A is conditional on the delivery of Product B. In other words, the consideration of \$1,000 is due only after the entity has transferred both Products A and B to the customer. Consequently, the entity does not have a right to consideration that is unconditional (a receivable) until both Products A and B are transferred to the customer.

606-10-55-288 The entity identifies the promises to transfer Products A and B as performance obligations and allocates \$400 to the performance obligation to transfer Product A and \$600 to the performance obligation to transfer Product B on the basis of their relative standalone selling prices. The entity recognizes revenue for each respective performance obligation when control of the product transfers to the customer.

606-10-55-289 The entity satisfies the performance obligation to transfer Product A.

Contract asset	\$400	
Revenue		\$400

606-10-55-290 The entity satisfies the performance obligation to transfer Product B and to recognize the unconditional right to consideration.

Receivable	\$1,000	
Contract asset		\$400
Revenue		\$600

>>> Example 40—Receivable Recognized for the Entity's Performance

606-10-55-291 An entity enters into a contract with a customer on January 1, 20X9, to transfer products to the customer for \$150 per product. If the customer purchases more than 1 million products in a calendar year, the contract indicates that the price per unit is retrospectively reduced to \$125 per product.

606-10-55-292 Consideration is due when control of the products transfer to the customer. Therefore, the entity has an unconditional right to consideration (that is, a receivable) for \$150 per product until the retrospective price reduction applies (that is, after 1 million products are shipped).

606-10-55-293 In determining the transaction price, the entity concludes at contract inception that the customer will meet the 1 million products threshold and therefore estimates that the transaction price is \$125 per product. Consequently, upon the first shipment to the customer of 100 products the entity recognizes the following.

Receivable	\$15,000 ^(a)	
Revenue		\$12,500 ^(b)
Refund liability (contract liability)		\$ 2,500

(a) \$150 per product × 100 products
(b) \$125 transaction price per product × 100 products

606-10-55-294 The refund liability (see paragraph 606-10-32-10) represents a refund of \$25 per product, which is expected to be provided to the customer for the volume-based rebate (that is, the difference between the \$150 price stated in the contract that the entity has an unconditional right to receive and the \$125 estimated transaction price).

>> Disclosure

606-10-55-295 Example 41 illustrates the guidance in paragraphs 606-10-50-5 through 50-6 and 606-10-55-89 through 55-91 on the disaggregation of revenue disclosure. Examples 42 and 43 illustrate the guidance in paragraphs 606-10-50-13 through 50-15 on the disclosure of the transaction price allocated to the remaining performance obligations. In addition, the following guidance is illustrated in Example 42:

- Paragraph 606-10-32-12 on constraining estimates of variable consideration
- Paragraph 606-10-55-18 on methods for measuring progress toward complete satisfaction of a performance obligation.

>>> Example 41—Disaggregation of Revenue—Quantitative Disclosure

606-10-55-296 An entity reports the following segments: consumer products, transportation, and energy, in accordance with Topic 280 on segment reporting. When the entity prepares its investor presentations, it disaggregates revenue into primary geographical markets, major product lines, and timing of revenue recognition (that is, goods transferred at a point in time or services transferred over time).

606-10-55-297 The entity determines that the categories used in the investor presentations can be used to meet the objective of the disaggregation disclosure requirement in paragraph 606-10-50-5, which is to disaggregate revenue from contracts with customers into categories that depict how the nature, amount, timing, and uncertainty of revenue and cash flows are affected by economic factors. The following table illustrates the disaggregation disclosure by primary geographical market, major product line, and timing of revenue recognition, including a reconciliation of how the disaggregated revenue ties in with the consumer products, transportation, and energy segments in accordance with paragraphs 606-10-50-6.

<u>Segments</u>	<u>Consumer Products</u>	<u>Transportation</u>	<u>Energy</u>	<u>Total</u>
<u>Primary Geographical Markets</u>				
North America	\$ 990	\$ 2,250	\$ 5,250	\$ 8,490
Europe	300	750	1,000	2,050
Asia	700	260	-	960
	<u>\$ 1,990</u>	<u>\$ 3,260</u>	<u>\$ 6,250</u>	<u>\$ 11,500</u>
<u>Major Goods/Service Lines</u>				
Office supplies	\$ 600	-	-	\$ 600
Appliances	990	-	-	990
Clothing	400	-	-	400
Motorcycles	-	500	-	500
Automobiles	-	2,760	-	2,760
Solar panels	-	-	1,000	1,000
Power plant	-	-	5,250	5,250
	<u>\$ 1,990</u>	<u>\$ 3,260</u>	<u>\$ 6,250</u>	<u>\$ 11,500</u>
<u>Timing of Revenue Recognition</u>				
Goods transferred at a point in time	\$ 1,990	\$ 3,260	\$ 1,000	\$ 6,250
Services transferred over time	-	-	5,250	5,250
	<u>\$ 1,990</u>	<u>\$ 3,260</u>	<u>\$ 6,250</u>	<u>\$ 11,500</u>

>>> Example 42—Disclosure of the Transaction Price Allocated to the Remaining Performance Obligations

606-10-55-298 On June 30, 20X7, an entity enters into three contracts (Contracts A, B, and C) with separate customers to provide services. Each contract has a

two-year noncancellable term. The entity considers the guidance in paragraphs 606-10-50-13 through 50-15 in determining the information in each contract to be included in the disclosure of the transaction price allocated to the remaining performance obligations at December 31, 20X7.

>>> Contract A

606-10-55-299 Cleaning services are to be provided over the next two years typically at least once per month. For services provided, the customer pays an hourly rate of \$25.

606-10-55-300 Because the entity bills a fixed amount for each hour of service provided, the entity has a right to invoice the customer in the amount that corresponds directly with the value of the entity’s performance completed to date in accordance with paragraph 606-10-55-18. Consequently, no disclosure is necessary if the entity elects to apply the practical expedient in paragraph 606-10-50-14(b).

>>> Contract B

606-10-55-301 Cleaning services and lawn maintenance services are to be provided as and when needed with a maximum of four visits per month over the next two years. The customer pays a fixed price of \$400 per month for both services. The entity measures its progress toward complete satisfaction of the performance obligation using a time-based measure.

606-10-55-302 The entity discloses the amount of the transaction price that has not yet been recognized as revenue in a table with quantitative time bands that illustrates when the entity expects to recognize the amount as revenue. The information for Contract B included in the overall disclosure is as follows.

	20X8	20X9	Total
Revenue expected to be recognized on this contract as of December 31, 20X7	\$ 4,800	(a) \$ 2,400	(b) \$ 7,200

(a) \$4,800 = \$400 × 12 months

(b) \$2,400 = \$400 × 6 months

>>> Contract C

606-10-55-303 Cleaning services are to be provided as and when needed over the next two years. The customer pays fixed consideration of \$100 per month plus a one-time variable consideration payment ranging from \$0 – \$1,000 corresponding to a one-time regulatory review and certification of the customer’s facility (that is, a performance bonus). The entity estimates that it will be entitled to \$750 of the variable consideration. On the basis of the entity’s assessment of the factors in paragraph 606-10-32-12, the entity includes its estimate of \$750 of variable consideration in the transaction price because it is probable that a significant reversal in the amount of cumulative revenue recognized will not

occur. The entity measures its progress toward complete satisfaction of the performance obligation using a time-based measure.

606-10-55-304 The entity discloses the amount of the transaction price that has not yet been recognized as revenue in a table with quantitative time bands that illustrates when the entity expects to recognize the amount as revenue. The entity also includes a qualitative discussion about any significant variable consideration that is not included in the disclosure. The information for Contract C included in the overall disclosure is as follows.

	<u>20X8</u>	<u>20X9</u>	<u>Total</u>
Revenue expected to be recognized on this contract as of December 31, 20X7	\$ 1,575	(a) \$ 788 (b)	\$ 2,363

(a) Transaction price = \$3,150 ($\100×24 months + \$750 variable consideration) recognized evenly over 24 months at \$1,575 per year

(b) $\$1,575 \div 2 = \788 (that is, for 6 months of the year)

606-10-55-305 In addition, in accordance with paragraph 606-10-50-15, the entity discloses qualitatively that part of the performance bonus has been excluded from the disclosure because it was not included in the transaction price. That part of the performance bonus was excluded from the transaction price in accordance with the guidance on constraining estimates of variable consideration.

>>> Example 43—Disclosure of the Transaction Price Allocated to the Remaining Performance Obligations—Qualitative Disclosure

606-10-55-306 On January 1, 20X2, an entity enters into a contract with a customer to construct a commercial building for fixed consideration of \$10 million. The construction of the building is a single performance obligation that the entity satisfies over time. As of December 31, 20X2, the entity has recognized \$3.2 million of revenue. The entity estimates that construction will be completed in 20X3 but it is possible that the project will be completed in the first half of 20X4.

606-10-55-307 At December 31, 20X2, the entity discloses the amount of the transaction price that has not yet been recognized as revenue in its disclosure of the transaction price allocated to the remaining performance obligations. The entity also discloses an explanation of when the entity expects to recognize that amount as revenue. The explanation can be disclosed either on a quantitative basis using time bands that are most appropriate for the duration of the remaining performance obligation or by providing a qualitative explanation. Because the entity is uncertain about the timing of revenue recognition, the entity discloses this information qualitatively as follows:

As of December 31, 20X2, the aggregate amount of the transaction price allocated to the remaining performance obligation is \$6.8 million, and the entity will recognize this revenue as the building is completed, which is expected to occur over the next 12–18 months.

> > Warranties

606-10-55-308 Example 44 illustrates the guidance in paragraphs 606-10-55-30 through 55-35 on warranties. In addition, Example 44 illustrates the guidance in paragraphs 606-10-25-19 through 25-21 on identifying performance obligations.

> > Example 44—Warranties

606-10-55-309 An entity, a manufacturer, provides its customer with a warranty with the purchase of a product. The warranty provides assurance that the product complies with agreed-upon specifications and will operate as promised for one year from the date of purchase. The contract also provides the customer with the right to receive up to 20 hours of training services on how to operate the product at no additional cost.

606-10-55-310 The entity assesses the goods and services in the contract to determine whether they are distinct and therefore give rise to separate performance obligations.

606-10-55-311 The product is distinct because it meets both criteria in paragraph 606-10-25-19. The product is capable of being distinct in accordance with paragraphs 606-10-25-19(a) and 606-10-25-20 because the customer can benefit from the product on its own without the training services. The entity regularly sells the product separately without the training services. In addition, the product is distinct within the context of the contract in accordance with paragraphs 606-10-25-19(b) and 606-10-25-21 because the entity's promise to transfer the product is separately identifiable from other promises in the contract.

606-10-55-312 In addition, the training services are distinct because they meet both criteria in paragraph 606-10-25-19. The training services are capable of being distinct in accordance with paragraphs 606-10-25-19(a) and 606-10-25-20 because the customer can benefit from the training services together with the product that has already been provided by the entity. In addition, the training services are distinct within the context of the contract in accordance with paragraphs 606-10-25-19(b) and 606-10-25-21 because the entity's promise to transfer the training services are separately identifiable from other promises in the contract. The entity does not provide a significant service of integrating the training services with the product (see paragraph 606-10-25-21(a)). The training services are not significantly modified or customized by the product (see paragraph 606-10-25-21(b)). The training services are not highly dependent on, or highly interrelated with, the product as described in paragraph 606-10-25-21(c).

606-10-55-313 The product and training services are each distinct and therefore give rise to two separate performance obligations.

606-10-55-314 Finally, the entity assesses the promise to provide a warranty and observes that the warranty provides the customer with the assurance that the product will function as intended for one year. The entity concludes, in accordance with paragraphs 606-10-55-30 through 55-35, that the warranty does not provide the customer with a good or service in addition to that assurance and, therefore, the entity does not account for it as a performance obligation. The entity accounts for the assurance-type warranty in accordance with the requirements on product warranties in Subtopic 460-10.

606-10-55-315 As a result, the entity allocates the transaction price to the two performance obligations (the product and the training services) and recognizes revenue when (or as) those performance obligations are satisfied.

> > Principal versus Agent Considerations

606-10-55-316 Examples 45–48 illustrate the guidance in paragraphs 606-10-55-36 through 55-40 on principal versus agent considerations.

> > > Example 45—Arranging for the Provision of Goods or Services (Entity Is an Agent)

606-10-55-317 An entity operates a website that enables customers to purchase goods from a range of suppliers who deliver the goods directly to the customers. When a good is purchased via the website, the entity is entitled to a commission that is equal to 10 percent of the sales price. The entity’s website facilitates payment between the supplier and the customer at prices that are set by the supplier. The entity requires payment from customers before orders are processed, and all orders are nonrefundable. The entity has no further obligations to the customer after arranging for the products to be provided to the customer.

606-10-55-318 To determine whether the entity’s performance obligation is to provide the specified goods itself (that is, the entity is a principal) or to arrange for the supplier to provide those goods (that is, the entity is an agent), the entity considers the nature of its promise. Specifically, the entity observes that the supplier of the goods delivers its goods directly to the customer and, thus, the entity does not obtain control of the goods. Instead, the entity’s promise is to arrange for the supplier to provide those goods to the customer. In reaching that conclusion the entity considers the following indicators from paragraph 606-10-55-39 as follows:

- a. The supplier is primarily responsible for fulfilling the contract—that is, by shipping the goods to the customer.
- b. The entity does not take inventory risk at any time during the transaction because the goods are shipped directly by the supplier to the customer.

- c. The entity's consideration is in the form of a commission (10 percent of the sales price).
- d. The entity does not have discretion in establishing prices for the supplier's goods and, therefore, the benefit the entity can receive from those goods is limited.
- e. Neither the entity nor the supplier has credit risk because payments from customers are made in advance.

606-10-55-319 Consequently, the entity concludes that it is an agent and its performance obligation is to arrange for the provision of goods by the supplier. When the entity satisfies its promise to arrange for the goods to be provided by the supplier to the customer (which, in this example, is when goods are purchased by the customer), the entity recognizes revenue in the amount of the commission to which it is entitled.

> > > Example 46—Promise to Provide Goods or Services (Entity Is a Principal)

606-10-55-320 An entity enters into a contract with a customer for equipment with unique specifications. The entity and the customer develop the specifications for the equipment, which the entity communicates to a supplier that the entity contracts with to manufacture the equipment. The entity also arranges to have the supplier deliver the equipment directly to the customer. Upon delivery of the equipment to the customer, the terms of the contract require the entity to pay the supplier the price agreed to by the entity and the supplier for manufacturing the equipment.

606-10-55-321 The entity and the customer negotiate the selling price, and the entity invoices the customer for the agreed-upon price with 30-day payment terms. The entity's profit is based on the difference between the sales price negotiated with the customer and the price charged by the supplier.

606-10-55-322 The contract between the entity and the customer requires the customer to seek remedies for defects in the equipment from the supplier under the supplier's warranty. However, the entity is responsible for any corrections to the equipment required resulting from errors in specifications.

606-10-55-323 To determine whether the entity's performance obligation is to provide the specified goods or services itself (that is, the entity is a principal) or to arrange for another party to provide those goods or services (that is, the entity is an agent), the entity considers the nature of its promise. The entity has promised to provide the customer with specialized equipment; however, the entity has subcontracted the manufacturing of the equipment to the supplier. In determining whether the entity obtains control of the equipment before control transfers to the customer and whether the entity is a principal, the entity considers the indicators in paragraph 606-10-55-39 as follows:

- a. The entity is primarily responsible for fulfilling the contract. Although the entity subcontracted the manufacturing, the entity is ultimately responsible for ensuring that the equipment meets the specifications for which the customer has contracted.
- b. The entity has inventory risk because of its responsibility for corrections to the equipment resulting from errors in specifications, even though the supplier has inventory risk during production and before shipment.
- c. The entity has discretion in establishing the selling price with the customer, and the profit earned by the entity is an amount that is equal to the difference between the selling price negotiated with the customer and the amount to be paid to the supplier.
- d. The entity's consideration is not in the form of a commission.
- e. The entity has credit risk for the amount receivable from the customer in exchange for the equipment.

606-10-55-324 The entity concludes that its promise is to provide the equipment to the customer. On the basis of the indicators in paragraph 606-10-55-39, the entity concludes that it controls the equipment before it is transferred to the customer. Thus, the entity is a principal in the transaction and recognizes revenue in the gross amount of consideration to which it is entitled from the customer in exchange for the equipment.

>>> **Example 47—Promise to Provide Goods or Services (Entity Is a Principal)**

606-10-55-325 An entity negotiates with major airlines to purchase tickets at reduced rates compared with the price of tickets sold directly by the airlines to the public. The entity agrees to buy a specific number of tickets and must pay for those tickets regardless of whether it is able to resell them. The reduced rate paid by the entity for each ticket purchased is negotiated and agreed in advance.

606-10-55-326 The entity determines the prices at which the airline tickets will be sold to its customers. The entity sells the tickets and collects the consideration from customers when the tickets are purchased; therefore, there is no credit risk.

606-10-55-327 The entity also assists the customers in resolving complaints with the service provided by airlines. However, each airline is responsible for fulfilling obligations associated with the ticket, including remedies to a customer for dissatisfaction with the service.

606-10-55-328 To determine whether the entity's performance obligation is to provide the specified goods or services itself (that is, the entity is a principal) or to arrange for another party to provide those goods or services (that is, the entity is an agent), the entity considers the nature of its promise. The entity determines that its promise is to provide the customer with a ticket, which provides the right to fly on the specified flight or another flight if the specified flight is changed or cancelled. In determining whether the entity obtains control of the right to fly

before control transfers to the customer and whether the entity is a principal, the entity considers the indicators in paragraph 606-10-55-39 as follows:

- a. The entity is primarily responsible for fulfilling the contract, which is providing the right to fly. However, the entity is not responsible for providing the flight itself, which will be provided by the airline.
- b. The entity has inventory risk for the tickets because they are purchased before they are sold to the entity's customers and the entity is exposed to any loss as a result of not being able to sell the tickets for more than the entity's cost.
- c. The entity has discretion in setting the sales prices for tickets to its customers.
- d. As a result of the entity's ability to set the sales prices, the amount that the entity earns is not in the form of a commission but, instead, depends on the sales price it sets and the costs of the tickets that were negotiated with the airline.

606-10-55-329 The entity concludes that its promise is to provide a ticket (that is, a right to fly) to the customer. On the basis of the indicators in paragraph 606-10-55-39, the entity concludes that it controls the ticket before it is transferred to the customer. Thus, the entity concludes that it is a principal in the transaction and recognizes revenue in the gross amount of consideration to which it is entitled in exchange for the tickets transferred.

> > > Example 48—Arranging for the Provision of Goods or Services (Entity Is an Agent)

606-10-55-330 An entity sells vouchers that entitle customers to future meals at specified restaurants. These vouchers are sold by the entity, and the sales price of the voucher provides the customer with a significant discount when compared with the normal selling prices of the meals (for example, a customer pays \$100 for a voucher that entitles the customer to a meal at a restaurant that would otherwise cost \$200). The entity does not purchase vouchers in advance; instead, it purchases vouchers only as they are requested by the customers. The entity sells the vouchers through its website, and the vouchers are nonrefundable.

606-10-55-331 The entity and the restaurants jointly determine the prices at which the vouchers will be sold to customers. The entity is entitled to 30 percent of the voucher price when it sells the voucher. The entity has no credit risk because the customers pay for the vouchers when purchased.

606-10-55-332 The entity also assists the customers in resolving complaints about the meals and has a buyer satisfaction program. However, the restaurant is responsible for fulfilling obligations associated with the voucher, including remedies to a customer for dissatisfaction with the service.

606-10-55-333 To determine whether the entity is a principal or an agent, the entity considers the nature of its promise and whether it takes control of the voucher (that is, a right) before control transfers to the customer. In making this determination, the entity considers the indicators in paragraph 606-10-55-39 as follows:

- a. The entity is not responsible for providing the meals itself, which will be provided by the restaurants.
- b. The entity does not have inventory risk for the vouchers because they are not purchased before being sold to customers and the vouchers are nonrefundable.
- c. The entity has some discretion in setting the sales prices for vouchers to customers, but the sales prices are jointly determined with the restaurants.
- d. The entity's consideration is in the form of a commission, because it is entitled to a stipulated percentage (30 percent) of the voucher price.

606-10-55-334 The entity concludes that its promise is to arrange for goods or services to be provided to customers (the purchasers of the vouchers) in exchange for a commission. On the basis of the indicators in paragraph 606-10-55-39, the entity concludes that it does not control the vouchers that provide a right to meals before they are transferred to the customers. Thus, the entity concludes that it is an agent in the arrangement and recognizes revenue in the net amount of consideration to which the entity will be entitled in exchange for the service, which is the 30 percent commission it is entitled to upon the sale of each voucher.

> > Customer Options for Additional Goods or Services

606-10-55-335 Examples 49–52 illustrate the guidance in paragraphs 606-10-55-41 through 55-45 on customer options for additional goods or services. Example 50 illustrates the guidance in paragraphs 606-10-25-19 through 25-21 on identifying performance obligations. Example 52 illustrates a customer loyalty program. That Example may not apply to all customer loyalty arrangements because the terms and conditions may differ. In particular, when there are more than two parties to the arrangement, an entity should consider all facts and circumstances to determine the customer in the transaction that gives rise to the award credits.

> > > Example 49—Option That Provides the Customer with a Material Right (Discount Voucher)

606-10-55-336 An entity enters into a contract for the sale of Product A for \$100. As part of the contract, the entity gives the customer a 40 percent discount voucher for any future purchases up to \$100 in the next 30 days. The entity intends to offer a 10 percent discount on all sales during the next 30 days as part

of a seasonal promotion. The 10 percent discount cannot be used in addition to the 40 percent discount voucher.

606-10-55-337 Because all customers will receive a 10 percent discount on purchases during the next 30 days, the only discount that provides the customer with a material right is the discount that is incremental to that 10 percent (that is, the additional 30 percent discount). The entity accounts for the promise to provide the incremental discount as a performance obligation in the contract for the sale of Product A.

606-10-55-338 To estimate the standalone selling price of the discount voucher in accordance with paragraph 606-10-55-44, the entity estimates an 80 percent likelihood that a customer will redeem the voucher and that a customer will, on average, purchase \$50 of additional products. Consequently, the entity's estimated standalone selling price of the discount voucher is \$12 (\$50 average purchase price of additional products × 30 percent incremental discount × 80 percent likelihood of exercising the option). The standalone selling prices of Product A and the discount voucher and the resulting allocation of the \$100 transaction price are as follows:

<u>Performance Obligation</u>	<u>Standalone Selling Price</u>
Product A	\$ 100
Discount voucher	12
Total	<u>\$ 112</u>

<u>Performance Obligation</u>	<u>Allocated Transaction Price</u>	
Product A	\$ 89	(\$100 ÷ \$112 × \$100)
Discount voucher	11	(\$12 ÷ \$112 × \$100)
Total	<u>\$ 100</u>	

606-10-55-339 The entity allocates \$89 to Product A and recognizes revenue for Product A when control transfers. The entity allocates \$11 to the discount voucher and recognizes revenue for the voucher when the customer redeems it for goods or services or when it expires.

> > > Example 50—Option That Does Not Provide the Customer with a Material Right (Additional Goods or Services)

606-10-55-340 An entity in the telecommunications industry enters into a contract with a customer to provide a handset and monthly network service for two years.

The network service includes up to 1,000 call minutes and 1,500 text messages each month for a fixed monthly fee. The contract specifies the price for any additional call minutes or texts that the customer may choose to purchase in any month. The prices for those services are equal to their standalone selling prices.

606-10-55-341 The entity determines that the promises to provide the handset and network service are each separate performance obligations. This is because the customer can benefit from the handset and network service either on their own or together with other resources that are readily available to the customer in accordance with the criterion in paragraph 606-10-25-19(a). In addition, the handset and network service are separately identifiable in accordance with the criterion in paragraph 606-10-25-19(b) (on the basis of the factors in paragraph 606-10-25-21).

606-10-55-342 The entity determines that the option to purchase the additional call minutes and texts does not provide a material right that the customer would not receive without entering into the contract (see paragraph 606-10-55-43). This is because the prices of the additional call minutes and texts reflect the standalone selling prices for those services. Because the option for additional call minutes and texts does not grant the customer a material right, the entity concludes it is not a performance obligation in the contract. Consequently, the entity does not allocate any of the transaction price to the option for additional call minutes or texts. The entity will recognize revenue for the additional call minutes or texts if and when the entity provides those services.

> > > Example 51—Option That Provides the Customer with a Material Right (Renewal Option)

606-10-55-343 An entity enters into 100 separate contracts with customers to provide 1 year of maintenance services for \$1,000 per contract. The terms of the contracts specify that at the end of the year, each customer has the option to renew the maintenance contract for a second year by paying an additional \$1,000. Customers who renew for a second year also are granted the option to renew for a third year for \$1,000. The entity charges significantly higher prices for maintenance services to customers that do not sign up for the maintenance services initially (that is, when the products are new). That is, the entity charges \$3,000 in Year 2 and \$5,000 in Year 3 for annual maintenance services if a customer does not initially purchase the service or allows the service to lapse.

606-10-55-344 The entity concludes that the renewal option provides a material right to the customer that it would not receive without entering into the contract because the price for maintenance services are significantly higher if the customer elects to purchase the services only in Year 2 or 3. Part of each customer's payment of \$1,000 in the first year is, in effect, a nonrefundable prepayment of the services to be provided in a subsequent year. Consequently, the entity concludes that the promise to provide the option is a performance obligation.

606-10-55-345 The renewal option is for a continuation of maintenance services, and those services are provided in accordance with the terms of the existing contract. Instead of determining the standalone selling prices for the renewal options directly, the entity allocates the transaction price by determining the consideration that it expects to receive in exchange for all the services that it expects to provide in accordance with paragraph 606-10-55-45.

606-10-55-346 The entity expects 90 customers to renew at the end of Year 1 (90 percent of contracts sold) and 81 customers to renew at the end of Year 2 (90 percent of the 90 customers that renewed at the end of Year 1 will also renew at the end of Year 2, that is 81 percent of contracts sold).

606-10-55-347 At contract inception, the entity determines the expected consideration for each contract is \$2,710 [$\$1,000 + (90 \text{ percent} \times \$1,000) + (81 \text{ percent} \times \$1,000)$]. The entity also determines that recognizing revenue on the basis of costs incurred relative to the total expected costs depicts the transfer of services to the customer. Estimated costs for a three-year contract are as follows:

Year 1	\$ 600
Year 2	\$ 750
Year 3	\$1,000

606-10-55-348 Accordingly, the pattern of revenue recognition expected at contract inception for each contract is as follows:

	Expected Costs Adjusted for		Allocation of Consideration Expected	
	Likelihood of Contract Renewal			
Year 1	\$ 600	$(\$600 \times 100\%)$	\$ 780	$[(\$600 \div \$2,085) \times \$2,710]$
Year 2	675	$(\$750 \times 90\%)$	877	$[(\$675 \div \$2,085) \times \$2,710]$
Year 3	<u>810</u>	$(\$1,000 \times 81\%)$	<u>1,053</u>	$[(\$810 \div \$2,085) \times \$2,710]$
Total	<u>\$ 2,085</u>		<u>\$ 2,710</u>	

606-10-55-349 Consequently, at contract inception, the entity allocates to the option to renew at the end of Year 1 \$22,000 of the consideration received to date [cash of \$100,000 – revenue to be recognized in Year 1 of \$78,000 ($\780×100)].

606-10-55-350 Assuming there is no change in the entity's expectations and the 90 customers renew as expected, at the end of the first year, the entity has collected cash of \$190,000 [$(100 \times \$1,000) + (90 \times \$1,000)$], has recognized revenue of \$78,000 ($\780×100), and has recognized a contract liability of \$112,000.

606-10-55-351 Consequently, upon renewal at the end of the first year, the entity allocates \$24,300 to the option to renew at the end of Year 2 [cumulative cash of \$190,000 – cumulative revenue recognized in Year 1 and to be recognized in Year 2 of \$165,700 (\$78,000 + \$877 × 100)].

606-10-55-352 If the actual number of contract renewals was different than what the entity expected, the entity would update the transaction price and the revenue recognized accordingly.

>>> Example 52—Customer Loyalty Program

606-10-55-353 An entity has a customer loyalty program that rewards a customer with 1 customer loyalty point for every \$10 of purchases. Each point is redeemable for a \$1 discount on any future purchases of the entity's products. During a reporting period, customers purchase products for \$100,000 and earn 10,000 points that are redeemable for future purchases. The consideration is fixed, and the standalone selling price of the purchased products is \$100,000. The entity expects 9,500 points to be redeemed. The entity estimates a standalone selling price of \$0.95 per point (totalling \$9,500) on the basis of the likelihood of redemption in accordance with paragraph 606-10-55-44.

606-10-55-354 The points provide a material right to customers that they would not receive without entering into a contract. Consequently, the entity concludes that the promise to provide points to the customer is a performance obligation. The entity allocates the transaction price (\$100,000) to the product and the points on a relative standalone selling price basis as follows:

Product	\$91,324 [$\$100,000 \times (\$100,000 \text{ standalone selling price} \div \$109,500)$]
Points	\$8,676 [$\$100,000 \times (\$9,500 \text{ standalone selling price} \div \$109,500)$]

606-10-55-355 At the end of the first reporting period, 4,500 points have been redeemed, and the entity continues to expect 9,500 points to be redeemed in total. The entity recognizes revenue for the loyalty points of \$4,110 [(4,500 points ÷ 9,500 points) × \$8,676] and recognizes a contract liability of \$4,566 (\$8,676 – \$4,110) for the unredeemed points at the end of the first reporting period.

606-10-55-356 At the end of the second reporting period, 8,500 points have been redeemed cumulatively. The entity updates its estimate of the points that will be redeemed and now expects that 9,700 points will be redeemed. The entity recognizes revenue for the loyalty points of \$3,493 [(8,500 total points redeemed ÷ 9,700 total points expected to be redeemed) × \$8,676 initial allocation] – \$4,110 recognized in the first reporting period). The contract liability balance is \$1,073 (\$8,676 initial allocation – \$7,603 of cumulative revenue recognized).

>> Nonrefundable Upfront Fees

606-10-55-357 Example 53 illustrates the guidance in paragraphs 606-10-55-50 through 55-53 on nonrefundable upfront fees.

> > > Example 53—Nonrefundable Upfront Fee

606-10-55-358 An entity enters into a contract with a customer for one year of transaction processing services. The entity's contracts have standard terms that are the same for all customers. The contract requires the customer to pay an upfront fee to set up the customer on the entity's systems and processes. The fee is a nominal amount and is nonrefundable. The customer can renew the contract each year without paying an additional fee.

606-10-55-359 The entity's setup activities do not transfer a good or service to the customer and, therefore, do not give rise to a performance obligation.

606-10-55-360 The entity concludes that the renewal option does not provide a material right to the customer that it would not receive without entering into that contract (see paragraph 606-10-55-42). The upfront fee is, in effect, an advance payment for the future transaction processing services. Consequently, the entity determines the transaction price, which includes the nonrefundable upfront fee, and recognizes revenue for the transaction processing services as those services are provided in accordance with paragraph 606-10-55-51.

> > Licensing

606-10-55-361 Examples 54–61 illustrate the guidance in paragraphs 606-10-25-14 through 25-22 on identifying performance obligations and paragraphs 606-10-55-54 through 55-65 on licensing. These Examples also illustrate other guidance as follows:

- a. Paragraphs 606-10-25-31 through 25-37 on measuring progress toward complete satisfaction of a performance obligation (Example 58)
- b. Paragraphs 606-10-32-39 through 32-41 on allocating variable consideration to performance obligations (Example 57)
- c. Paragraph 606-10-55-65 on consideration in the form of sales-based or usage-based royalties on licenses of intellectual property (Examples 57 and 61).

> > > Example 54—Right to Use Intellectual Property

606-10-55-362 Using the same facts as in Case A in Example 11 (see paragraphs 606-10-55-141 through 55-145), the entity identifies four performance obligations in a contract:

- a. The software license
- b. Installation services
- c. Software updates
- d. Technical support.

606-10-55-363 The entity assesses the nature of its promise to transfer the software license in accordance with paragraph 606-10-55-60. The entity observes that the software is functional at the time that the license transfers to

the customer, and the customer can direct the use of, and obtain substantially all of the remaining benefits from, the software when the license transfers to the customer. Furthermore, the entity concludes that because the software is functional when it transfers to the customer, the customer does not reasonably expect the entity to undertake activities that significantly affect the intellectual property to which the license relates. This is because at the point in time that the license is transferred to the customer, the intellectual property will not change throughout the license period. The entity does not consider in its assessment of the criteria in paragraph 606-10-55-60 the promise to provide software updates because they represent a separate performance obligation. Therefore, the entity concludes that none of the criteria in paragraph 606-10-55-60 are met and that the nature of the entity's promise in transferring the license is to provide a right to use the entity's intellectual property as it exists at a point in time—that is, the intellectual property to which the customer has rights is static. Consequently, the entity accounts for the license as a performance obligation satisfied at a point in time.

> > > Example 55—License of Intellectual Property

606-10-55-364 An entity enters into a contract with a customer to license (for a period of three years) intellectual property related to the design and production processes for a good. The contract also specifies that the customer will obtain any updates to that intellectual property for new designs or production processes that may be developed by the entity. The updates are essential to the customer's ability to use the license because the customer operates in an industry in which technologies change rapidly. The entity does not sell the updates separately, and the customer does not have the option to purchase the license without the updates.

606-10-55-365 The entity assesses the goods and services promised to the customer to determine which goods and services are distinct in accordance with paragraph 606-10-25-19. The entity determines that although the entity can conclude that the customer can obtain benefit from the license on its own without the updates (see paragraph 606-10-25-19(a)), that benefit would be limited because the updates are critical to the customer's ability to continue to make use of the license in the rapidly changing technological environment in which the customer operates. In assessing whether the criterion in paragraph 606-10-25-19(b) is met, the entity observes that the customer does not have the option to purchase the license without the updates and the customer obtains limited benefit from the license without the updates. Therefore, the entity concludes that the license and the updates are highly interrelated and the promise to grant the license is not distinct within the context of the contract because the license is not separately identifiable from the promise to provide the updates (in accordance with the criterion in paragraph 606-10-25-19(b) and the factors in paragraph 606-10-25-21).

606-10-55-366 The entity applies paragraphs 606-10-25-23 through 25-30 to determine whether the performance obligation (which includes the license and the updates) is satisfied at a point in time or over time. The entity concludes that because the customer simultaneously receives and consumes the benefits of the entity's performance as it occurs, the performance obligation is satisfied over time in accordance with paragraph 606-10-25-27(a).

> > > **Example 56—Identifying a Distinct License**

606-10-55-367 An entity, a pharmaceutical company, licenses to a customer its patent rights to an approved drug compound for 10 years and also promises to manufacture the drug for the customer. The drug is a mature product; therefore, the entity will not undertake any activities to support the drug, which is consistent with its customary business practices.

> > > > **Case A—License Is Not Distinct**

606-10-55-368 In this case, no other entity can manufacture this drug because of the highly specialized nature of the manufacturing process. As a result, the license cannot be purchased separately from the manufacturing services.

606-10-55-369 The entity assesses the goods and services promised to the customer to determine which goods and services are distinct in accordance with paragraph 606-10-25-19. The entity determines that the customer cannot benefit from the license without the manufacturing service; therefore, the criterion in paragraph 606-10-25-19(a) is not met. Consequently, the license and the manufacturing service are not distinct, and the entity accounts for the license and the manufacturing service as a single performance obligation.

606-10-55-370 The entity applies paragraphs 606-10-25-23 through 25-30 to determine whether the performance obligation (that is, the bundle of the license and the manufacturing services) is a performance obligation satisfied at a point in time or over time.

> > > > **Case B—License Is Distinct**

606-10-55-371 In this case, the manufacturing process used to produce the drug is not unique or specialized, and several other entities can also manufacture the drug for the customer.

606-10-55-372 The entity assesses the goods and services promised to the customer to determine which goods and services are distinct in accordance with paragraph 606-10-25-19. Because the manufacturing process can be provided by other entities, the entity concludes that the customer can benefit from the license on its own (that is, without the manufacturing service) and that the license is separately identifiable from the manufacturing process (that is, the criteria in paragraph 606-10-25-19 are met). Consequently, the entity concludes that the license and the manufacturing service are distinct and the entity has two performance obligations:

- a. License of patent rights
- b. Manufacturing service.

606-10-55-373 The entity assesses, in accordance with paragraph 606-10-55-60, the nature of the entity's promise to grant the license. The drug is a mature product (that is, it has been approved, is currently being manufactured, and has been sold commercially for the last several years). For these types of mature products, the entity's customary business practices are not to undertake any activities to support the drug. Consequently, the entity concludes that the criteria in paragraph 606-10-55-60 are not met because the contract does not require, and the customer does not reasonably expect, the entity to undertake activities that significantly affect the intellectual property to which the customer has rights. In its assessment of the criteria in paragraph 606-10-55-60, the entity does not take into consideration the separate performance obligation of promising to provide a manufacturing service. Consequently, the nature of the entity's promise in transferring the license is to provide a right to use the entity's intellectual property in the form and the functionality with which it exists at the point in time that it is granted to the customer. Consequently, the entity accounts for the license as a performance obligation satisfied at a point in time.

606-10-55-374 The entity applies paragraphs 606-10-25-23 through 25-30 to determine whether the manufacturing service is a performance obligation satisfied at a point in time or over time.

>>> Example 57—Franchise Rights

606-10-55-375 An entity enters into a contract with a customer and promises to grant a franchise license that provides the customer with the right to use the entity's trade name and sell the entity's products for 10 years. In addition to the license, the entity also promises to provide the equipment necessary to operate a franchise store. In exchange for granting the license, the entity receives a sales-based royalty of 5 percent of the customer's monthly sales. The fixed consideration for the equipment is \$150,000 payable when the equipment is delivered.

>>> Identifying Performance Obligations

606-10-55-376 The entity assesses the goods and services promised to the customer to determine which goods and services are distinct in accordance with paragraph 606-10-25-19. The entity observes that the entity, as a franchisor, has developed a customary business practice to undertake activities such as analyzing the customer's changing preferences and implementing product improvements, pricing strategies, marketing campaigns, and operational efficiencies to support the franchise name. However, the entity concludes that these activities do not directly transfer goods or services to the customer because they are part of the entity's promise to grant a license and, in effect, change the intellectual property to which the customer has rights.

606-10-55-377 The entity determines that it has two promises to transfer goods or services: a promise to grant a license and a promise to transfer equipment. In addition, the entity concludes that the promise to grant the license and the promise to transfer the equipment are distinct. This is because the customer can benefit from each promise (that is, the promise of the license and the promise of the equipment) on their own or together with other resources that are readily available (see paragraph 606-10-25-19(a)). (That is, the customer can benefit from the license together with the equipment that is delivered before the opening of the franchise, and the equipment can be used in the franchise or sold for an amount other than scrap value.) The entity also determines that the franchise license and equipment are separately identifiable in accordance with the criterion in paragraph 606-10-25-19(b), because none of the factors in paragraph 606-10-25-21 are present. Consequently, the entity has two performance obligations:

- a. The franchise license
- b. The equipment.

> > > **Allocating the Transaction Price**

606-10-55-378 The entity determines that the transaction price includes fixed consideration of \$150,000 and variable consideration (5 percent of customer sales).

606-10-55-379 The entity applies paragraph 606-10-32-40 to determine whether the variable consideration should be allocated entirely to the performance obligation to transfer the franchise license. The entity concludes that the variable consideration (that is, the sales-based royalty) should be allocated entirely to the franchise license because the variable consideration relates entirely to the entity's promise to grant the franchise license. In addition, the entity observes that allocating \$150,000 to the equipment and the sales-based royalty to the franchise license would be consistent with an allocation based on the entity's relative standalone selling prices in similar contracts. That is, the standalone selling price of the equipment is \$150,000 and the entity regularly licenses franchises in exchange for 5 percent of customer sales. Consequently, the entity concludes that the variable consideration (that is, the sales-based royalty) should be allocated entirely to the performance obligation to grant the franchise license.

> > > **Licensing**

606-10-55-380 The entity assesses, in accordance with paragraph 606-10-55-60, the nature of the entity's promise to grant the franchise license. The entity concludes that the criteria in paragraph 606-10-55-60 are met and the nature of the entity's promise is to provide access to the entity's intellectual property in its current form throughout the license period. This is because:

- a. The entity concludes that the customer would reasonably expect that the entity will undertake activities that will affect the intellectual property to which the customer has rights. This is on the basis of the entity's

customary business practice to undertake activities such as analyzing the customer's changing preferences and implementing product improvements, pricing strategies, marketing campaigns, and operational efficiencies. In addition, the entity observes that because part of its compensation is dependent on the success of the franchisee (as evidenced through the sales-based royalty), the entity has a shared economic interest with the customer that indicates that the customer will expect the entity to undertake those activities to maximize earnings.

- b. The entity also observes that the franchise license requires the customer to implement any changes that result from those activities and thus exposes the customer to any positive or negative effects of those activities.
- c. The entity also observes that even though the customer may benefit from the activities through the rights granted by the license, they do not transfer a good or service to the customer as those activities occur.

606-10-55-381 Because the criteria in paragraph 606-10-55-60 are met, the entity concludes that the promise to transfer the license is a performance obligation satisfied over time in accordance with paragraph 606-10-25-27(a).

606-10-55-382 The entity also concludes that because the consideration is in the form of a sales-based royalty, the entity applies paragraph 606-10-55-65 and, after the transfer of the franchise license, the entity recognizes revenue as and when those sales occur.

> > > Example 58—Access to Intellectual Property

606-10-55-383 An entity, a creator of comic strips, licenses the use of the images and names of its comic strip characters in three of its comic strips to a customer for a four-year term. There are main characters involved in each of the comic strips. However, newly created characters appear regularly and the images of the characters evolve over time. The customer, an operator of cruise ships, can use the entity's characters in various ways, such as in shows or parades, within reasonable guidelines. The contract requires the customer to use the latest images of the characters.

606-10-55-384 In exchange for granting the license, the entity receives a fixed payment of \$1 million in each year of the 4-year term.

606-10-55-385 In accordance with paragraph 606-10-25-19, the entity assesses the goods and services promised to the customer to determine which goods and services are distinct. The entity concludes that it has no other performance obligations other than the promise to grant a license. That is, the additional activities associated with the license do not directly transfer a good or service to the customer because they are part of the entity's promise to grant a license and, in effect, change the intellectual property to which the customer has rights.

606-10-55-386 The entity assesses the nature of the entity's promise to transfer the license in accordance with paragraph 606-10-55-60. In assessing the criteria the entity considers the following:

- a. The customer reasonably expects (arising from the entity's customary business practices) that the entity will undertake activities that will affect the intellectual property to which the customer has rights (that is, the characters). Those activities include development of the characters and the publishing of a weekly comic strip that includes the characters.
- b. The rights granted by the license directly expose the customer to any positive or negative effects of the entity's activities because the contract requires the customer to use the latest characters.
- c. Even though the customer may benefit from those activities through the rights granted by the license, they do not transfer a good or service to the customer as those activities occur.

606-10-55-387 Consequently, the entity concludes that the criteria in paragraph 606-10-55-60 are met and that the nature of the entity's promise to transfer the license is to provide the customer with access to the entity's intellectual property as it exists throughout the license period. Consequently, the entity accounts for the promised license as a performance obligation satisfied over time (that is, the criterion in paragraph 606-10-25-27(a) is met).

606-10-55-388 The entity applies paragraphs 606-10-25-31 through 25-37 to identify the method that best depicts its performance in the license. Because the contract provides the customer with unlimited use of the licensed characters for a fixed term, the entity determines that a time-based method would be the most appropriate measure of progress toward complete satisfaction of the performance obligation.

> > > Example 59—Right to Use Intellectual Property

606-10-55-389 An entity, a music record label, licenses to a customer a 1975 recording of a classical symphony by a noted orchestra. The customer, a consumer products company, has the right to use the recorded symphony in all commercials, including television, radio, and online advertisements for two years in Country A. In exchange for providing the license, the entity receives fixed consideration of \$10,000 per month. The contract does not include any other goods or services to be provided by the entity. The contract is noncancellable.

606-10-55-390 The entity assesses the goods and services promised to the customer to determine which goods and services are distinct in accordance with paragraph 606-10-25-19. The entity concludes that its only performance obligation is to grant the license.

606-10-55-391 In accordance with paragraph 606-10-55-60, the entity assesses the nature of the entity's promise to grant the license. The entity does not have any contractual or implied obligations to change the licensed recording. Thus, the

intellectual property to which the customer has rights is static. Consequently, the entity concludes that the nature of its promise in transferring the license is to provide the customer with a right to use the entity's intellectual property as it exists at the point in time that it is granted. Therefore, the promise to grant the license is a performance obligation satisfied at a point in time. The entity recognizes all of the revenue at the point in time when the customer can direct the use of, and obtain substantially all of the remaining benefits from, the licensed intellectual property.

606-10-55-392 Because of the length of time between the entity's performance (at the beginning of the period) and the customer's monthly payments over two years (which are noncancellable), the entity considers the guidance in paragraphs 606-10-32-15 through 32-20 to determine whether a significant financing component exists.

> > > Example 60—Access to Intellectual Property

606-10-55-393 An entity, a movie distribution company, licenses Movie XYZ to a customer. The customer, an operator of cinemas, has the right to show the movie in its cinemas for six weeks. In exchange for providing the license, the entity will receive a portion of the operator's ticket sales for Movie XYZ (that is, variable consideration in the form of a sales-based royalty). The entity concludes that its only performance obligation is the promise to grant the license.

606-10-55-394 The entity observes that regardless of whether the promise to grant the license represents a right to access the entity's intellectual property or a right to use the entity's intellectual property, the entity applies paragraph 606-10-55-65 and recognizes revenue as and when the ticket sales occur. This is because the consideration for its license of intellectual property is a sales-based royalty and the entity has already transferred the license to the movie to which the sales-based royalty relates.

> > > Example 61—Access to Intellectual Property

606-10-55-395 An entity, a well-known sports team, licenses the use of its name and logo to a customer. The customer, an apparel designer, has the right to use the sports team's name and logo on items including t-shirts, caps, mugs, and towels for one year. In exchange for providing the license, the entity will receive fixed consideration of \$2 million and a royalty of 5 percent of the sales price of any items using the team name or logo. The customer expects that the entity will continue to play games and provide a competitive team.

606-10-55-396 The entity assesses the goods and services promised to the customer to determine which goods and services are distinct in accordance with paragraph 606-10-25-19. The entity concludes that its only performance obligation is to transfer the license. That is, the additional activities associated with the license do not directly transfer a good or service to the customer

because they are part of the entity's promise to grant the license and, in effect, change the intellectual property to which the customer has rights.

606-10-55-397 The entity assesses the nature of the entity's promise to transfer the license in accordance with paragraph 606-10-55-60. In assessing the criteria, the entity considers the following:

- a. The entity concludes that the customer would reasonably expect that the entity will undertake activities that will affect the intellectual property (that is, the team name and logo) to which the customer has rights. This is on the basis of the entity's customary business practice to undertake activities such as continuing to play and providing a competitive team. In addition, the entity observes that because some of its consideration is dependent on the success of the customer (through the sales-based royalty), the entity has a shared economic interest with the customer, which indicates that the customer will expect the entity to undertake those activities to maximize earnings.
- b. The entity observes that the rights granted by the license (that is, the use of the team's name and logo) directly expose the customer to any positive or negative effects of the entity's activities.
- c. The entity also observes that even though the customer may benefit from the activities through the rights granted by the license, they do not transfer a good or service to the customer as those activities occur.

606-10-55-398 The entity concludes that the criteria in paragraph 606-10-55-60 are met and the nature of the entity's promise to grant the license is to provide the customer with access to the entity's intellectual property as it exists throughout the license period. Consequently, the entity accounts for the promised license as a performance obligation satisfied over time (that is, the criterion in paragraph 606-10-25-27(a) is met).

606-10-55-399 The entity then applies paragraphs 606-10-25-31 through 25-37 to determine a measure of progress that will depict the entity's performance for the fixed consideration. For the consideration that is in the form of a sales-based royalty, paragraph 606-10-55-65 applies; therefore, the entity recognizes revenue as and when the sales of items using the team name or logo occur.

> > Repurchase Agreements

606-10-55-400 Example 62 illustrates the guidance in paragraphs 606-10-55-66 through 55-78 on repurchase agreements.

> > > Example 62—Repurchase Agreements

606-10-55-401 An entity enters into a contract with a customer for the sale of a tangible asset on January 1, 20X7, for \$1 million.

> > > Case A—Call Option: Financing

606-10-55-402 The contract includes a call option that gives the entity the right to repurchase the asset for \$1.1 million on or before December 31, 20X7.

606-10-55-403 Control of the asset does not transfer to the customer on December 31, 20X7, because the entity has a right to repurchase the asset and therefore the customer is limited in its ability to direct the use of, and obtain substantially all of the remaining benefits from, the asset. Consequently, in accordance with paragraph 606-10-55-68(b), the entity accounts for the transaction as a financing arrangement because the exercise price is more than the original selling price. In accordance with paragraph 606-10-55-70, the entity does not derecognize the asset and instead recognizes the cash received as a financial liability. The entity also recognizes interest expense for the difference between the exercise price (\$1.1 million) and the cash received (\$1 million), which increases the liability.

606-10-55-404 On December 31, 20X7, the option lapses unexercised; therefore, the entity derecognizes the liability and recognizes revenue of \$1.1 million.

> > > **Case B—Put Option: Lease**

606-10-55-405 Instead of having a call option, the contract includes a put option that obliges the entity to repurchase the asset at the customer's request for \$900,000 on or before December 31, 20X7. The market value is expected to be \$750,000 on December 31, 20X7.

606-10-55-406 At the inception of the contract, the entity assesses whether the customer has a significant economic incentive to exercise the put option, to determine the accounting for the transfer of the asset (see paragraphs 606-10-55-72 through 55-78). The entity concludes that the customer has a significant economic incentive to exercise the put option because the repurchase price significantly exceeds the expected market value of the asset at the date of repurchase. The entity determines there are no other relevant factors to consider when assessing whether the customer has a significant economic incentive to exercise the put option. Consequently, the entity concludes that control of the asset does not transfer to the customer because the customer is limited in its ability to direct the use of, and obtain substantially all of the remaining benefits from, the asset.

606-10-55-407 In accordance with paragraphs 606-10-55-72 through 55-73, the entity accounts for the transaction as a lease in accordance with Topic 840 on leases.

> > **Bill-and-Hold Arrangements**

606-10-55-408 Example 63 illustrates the guidance in paragraphs 606-10-55-81 through 55-84 on bill-and-hold arrangements.

> > > **Example 63—Bill-and-Hold Arrangement**

606-10-55-409 An entity enters into a contract with a customer on January 1, 20X8, for the sale of a machine and spare parts. The manufacturing lead time for the machine and spare parts is two years.

606-10-55-410 Upon completion of manufacturing, the entity demonstrates that the machine and spare parts meet the agreed-upon specifications in the contract. The promises to transfer the machine and spare parts are distinct and result in two performance obligations that each will be satisfied at a point in time. On December 31, 20X9, the customer pays for the machine and spare parts but only takes physical possession of the machine. Although the customer inspects and accepts the spare parts, the customer requests that the spare parts be stored at the entity's warehouse because of its close proximity to the customer's factory. The customer has legal title to the spare parts, and the parts can be identified as belonging to the customer. Furthermore, the entity stores the spare parts in a separate section of its warehouse, and the parts are ready for immediate shipment at the customer's request. The entity expects to hold the spare parts for two to four years, and the entity does not have the ability to use the spare parts or direct them to another customer.

606-10-55-411 The entity identifies the promise to provide custodial services as a performance obligation because it is a service provided to the customer and it is distinct from the machine and spare parts. Consequently, the entity accounts for three performance obligations in the contract (the promises to provide the machine, the spare parts, and the custodial services). The transaction price is allocated to the three performance obligations and revenue is recognized when (or as) control transfers to the customer.

606-10-55-412 Control of the machine transfers to the customer on December 31, 20X9, when the customer takes physical possession. The entity assesses the indicators in paragraph 606-10-25-30 to determine the point in time at which control of the spare parts transfers to the customer, noting that the entity has received payment, the customer has legal title to the spare parts, and the customer has inspected and accepted the spare parts. In addition, the entity concludes that all of the criteria in paragraph 606-10-55-83 are met, which is necessary for the entity to recognize revenue in a bill-and-hold arrangement. The entity recognizes revenue for the spare parts on December 31, 20X9, when control transfers to the customer.

606-10-55-413 The performance obligation to provide custodial services is satisfied over time as the services are provided. The entity considers whether the payment terms include a significant financing component in accordance with paragraphs 606-10-32-15 through 32-20.

Relationships

General

> Costs Related to a Contract with a Customer

> > Other Assets and Deferred Costs—Costs Related to a Contract with a Customer

606-10-60-1 For guidance on the costs related to a **contract** with a **customer** that is within the scope of this Topic, see Subtopic 340-40.

> Revenue Recognition

> > Agriculture—Revenue Recognition

606-10-60-2 For guidance on recognizing **revenue** from **contracts** that are not within scope of this Topic by entities in the agriculture industry, see Subtopic 905-605.

> > Financial Services—Insurance—Revenue Recognition

606-10-60-3 For guidance on recognizing revenue from contracts that are not within scope of this Topic by insurance entities, see Subtopic 944-605.

> > Health Care Entities—Revenue Recognition

606-10-60-4 For guidance on recognizing revenue from contracts that are not within scope of this Topic by health care entities, see Subtopic 954-605.

> > Not-for-Profit-Entities—Revenue Recognition

606-10-60-5 For guidance on recognizing revenue from contracts that are not within scope of this Topic by not-for-profit entities, see Subtopic 958-605.

> > Regulated Operations—Revenue Recognition

606-10-60-6 For guidance on recognizing revenue and disclosure requirements for contracts that are not within scope of this Topic by entities with regulated operations, see Subtopic 980-605.

> Provision for Losses

> > Software—Revenue Recognition—Provision for Losses

606-10-60-7 For guidance on determining the need for a provision for losses on certain software arrangements, see Subtopic 985-605.

606-10-60-8 For guidance on determining the need for a provision for losses on certain reinsurance **contracts**, See Subtopic 944-605.

> > Revenue Recognition—Provision for Losses on Construction-Type and Production-Type Contracts

606-10-60-9 For guidance on determining the need for a provision for losses for construction-type and production-type contracts, see Subtopic 605-35.

> > Revenue Recognition—Provision for Losses on Separately Priced Extended Warranty and Product Maintenance Contracts

606-10-60-10 For guidance on recognizing a loss on separately priced extended warranty and product maintenance contracts, see Subtopic 605-20.

> > Health Care Entities—Commitments

606-10-60-11 For guidance on determining whether a liability should be recognized for a continuing care retirement community for its obligation to provide future services and the use of facilities to current residents, see Sections 954-440-25 and 954-440-35.

> > Health Care Entities—Contingencies

606-10-60-12 For guidance on determining when to recognize a loss under prepaid health care services contracts, see paragraph 954-450-30-4.

> > Regulated Operations—Intangibles—Goodwill and Other

606-10-60-13 For guidance on recognizing a loss on long-term power sales contracts, see paragraph 980-350-35-3.

> > Contractors—Federal Government—Contract Costs

606-10-60-14 For guidance on the presentation of a loss on a termination of a contract for default, see paragraph 912-20-25-4.

> Interest—Imputation of Interest

606-10-60-15 For guidance on imputation of interest on contracts that are not within scope of Topic 606, see Subtopic 835-30.

> Nonmonetary Transactions

> > Nonmonetary Transactions—Transactions including Noncash Consideration

606-10-60-16 For guidance on nonmonetary transactions (that is, transactions including noncash consideration) in contracts that are not within scope of this Topic, see Subtopic 845-10.

Transition and Open Effective Date Information

General

> Transition Related to Accounting Standards Update No. 2014-09, *Revenue from Contracts with Customers (Topic 606)*

606-10-65-1 The following represents the transition and effective date information related to Accounting Standards Update No. 2014-09, *Revenue from Contracts with Customers (Topic 606)*:

- a. A **public business entity**, a **not-for-profit entity** that has issued, or is a conduit bond obligor for, securities that are traded, listed, or quoted on an exchange or an over-the-counter market, and an employee benefit plan that files or furnishes financial statements with or to the Securities and Exchange Commission shall apply the pending content that links to this paragraph for annual reporting periods beginning after December 15, 2016, including interim reporting periods within that reporting period. Earlier application is not permitted.
- b. All other entities shall apply the pending content that links to this paragraph for annual reporting periods beginning after December 15, 2017, and interim reporting periods within annual reporting periods beginning after December 15, 2018. However, all other entities may elect to apply the pending content that links to this paragraph earlier only as of:
 1. An annual reporting period beginning after December 15, 2016, including interim reporting periods within that reporting period (public entity effective date).
 2. An annual reporting period beginning after December 15, 2016, and interim reporting periods within annual reporting periods beginning after December 15, 2017.
 3. An annual reporting period beginning after December 15, 2017, including interim reporting periods within that reporting period.
- c. For the purposes of the transition guidance in (d) through (i):
 1. The date of initial application is the start of the reporting period in which an entity first applies the pending content that links to this paragraph.
 2. A completed contract is a **contract** for which the entity has transferred all of the goods or services identified in accordance with **revenue** guidance that is in effect before the date of initial application.
- d. An entity shall apply the pending content that links to this paragraph using one of the following two methods:
 1. Retrospectively to each prior reporting period presented in accordance with the guidance on accounting changes in paragraphs 250-10-45-5 through 45-10 subject to the expedients in (f).
 2. Retrospectively with the cumulative effect of initially applying the

- pending content that links to this paragraph recognized at the date of initial application in accordance with (h) through (i).
- e. If an entity elects to apply the pending content that links to this paragraph retrospectively in accordance with (d)(1), the entity shall provide the disclosures required in paragraphs 250-10-50-1 through 50-3 in the period of adoption.
 - f. An entity may use one or more of the following practical expedients when applying the pending content that links to this paragraph retrospectively in accordance with (d)(1):
 1. For completed contracts, an entity need not restate contracts that begin and end within the same annual reporting period.
 2. For completed contracts that have variable consideration, an entity may use the **transaction price** at the date the contract was completed rather than estimating variable consideration amounts in the comparative reporting periods.
 3. For all reporting periods presented before the date of initial application, an entity need not disclose the amount of the transaction price allocated to the remaining **performance obligations** and an explanation of when the entity expects to recognize that amount as revenue (see paragraph 606-10-50-13).
 - g. For any of the practical expedients in (f) that an entity uses, the entity shall apply that expedient consistently to all contracts within all reporting periods presented. In addition, the entity shall disclose all of the following information:
 1. The expedients that have been used
 2. To the extent reasonably possible, a qualitative assessment of the estimated effect of applying each of those expedients.
 - h. If an entity elects to apply the pending content that links to this paragraph retrospectively in accordance with (d)(2), the entity shall recognize the cumulative effect of initially applying the pending content that links to this paragraph as an adjustment to the opening balance of retained earnings (or other appropriate components of equity or net assets in the statement of financial position) of the annual reporting period that includes the date of initial application. Under this transition method, an entity shall apply this guidance retrospectively only to contracts that are not completed contracts at the date of initial application (for example, January 1, 2017, for an entity with a December 31 year-end).

- i. For reporting periods that include the date of initial application, an entity shall provide both of the following additional disclosures if the pending content that links to this paragraph is applied retrospectively in accordance with (d)(2):
 1. The amount by which each financial statement line item is affected in the current reporting period by the application of the pending content that links to this paragraph as compared with the guidance that was in effect before the change
 2. An explanation of the reasons for significant changes identified in (i)(1).

Addition of Subtopic 340-40

6. The following Subtopic has been added to codify the guidance on other assets and deferred costs, contracts with customers, consistent with the Board's overall objective in its revenue recognition project. See the basis for conclusions for further discussion and rationale for decisions reached in this Subtopic.

7. Add Subtopic 340-40, with a link to transition paragraph 606-10-65-1, as follows:

[For ease of readability, the new Subtopic is not underlined.]

Other Assets and Deferred Costs—Contracts with Customers

Overview and Background

General

340-40-05-1 This Subtopic provides accounting guidance for the following costs related to a **contract** with a **customer** within the scope of Topic 606 on **revenue** from contracts with customers:

- a. Incremental costs of obtaining a contract with a customer
- b. Costs incurred in fulfilling a contract with a customer that are not in the scope of another Topic.

340-40-05-2 Paragraphs presented in **bold type** in this Subtopic state the main principles. All paragraphs have equal authority.

Scope and Scope Exceptions

General

> Overall Guidance

340-40-15-1 This Subtopic follows the same Scope and Scope Exceptions as outlined in the Overall Subtopic (see Section 340-10-15), with specific qualifications and exceptions noted below.

> Transactions

> > Incremental Costs of Obtaining a Contract with a Customer

340-40-15-2 The guidance in this Subtopic applies to the incremental costs of obtaining a **contract** with a **customer** within the scope of Topic 606 on **revenue** from contracts with customers (excluding any consideration payable to a customer, see paragraphs 606-10-32-25 through 32-27).

> > Costs Incurred in Fulfilling a Contract with a Customer

340-40-15-3 The guidance in this Subtopic applies to the costs incurred in fulfilling a **contract** with a **customer** within the scope of Topic 606 on **revenue** from contracts with customers, unless the costs are within the scope of another Topic or Subtopic, including, but not limited to, any of the following:

- a. Topic 330 on inventory
- b. Paragraphs 340-10-25-1 through 25-4 on preproduction costs related to long-term supply arrangements
- c. Subtopic 350-40 on internal-use software
- d. Topic 360 on property, plant, and equipment
- e. Subtopic 985-20 on costs of software to be sold, leased, or otherwise marketed.

Glossary

Contract

An agreement between two or more parties that creates enforceable rights and obligations.

Customer

A party that has contracted with an entity to obtain goods or services that are an output of the entity's ordinary activities in exchange for consideration.

Not-for-Profit Entity

An entity that possesses the following characteristics, in varying degrees, that distinguish it from a business entity:

- a. Contributions of significant amounts of resources from resource providers who do not expect commensurate or proportionate pecuniary return
- b. Operating purposes other than to provide goods or services at a profit
- c. Absence of ownership interests like those of business entities.

Entities that clearly fall outside this definition include the following:

- a. All investor-owned entities
- b. Entities that provide dividends, lower costs, or other economic benefits directly and proportionately to their owners, members, or participants, such as mutual insurance entities, credit unions, farm and rural electric cooperatives, and employee benefit plans.

Performance Obligation

A promise in a **contract** with a **customer** to transfer to the customer either:

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

Public Business Entity

A public business entity is a business entity meeting any one of the criteria below. Neither a **not-for-profit entity** nor an employee benefit plan is a business entity.

- a. It is required by the U.S. Securities and Exchange Commission (SEC) to file or furnish financial statements, or does file or furnish financial statements (including voluntary filers), with the SEC (including other entities whose financial statements or financial information are required to be or are included in a filing).
- b. It is required by the Securities Exchange Act of 1934 (the Act), as amended, or rules or regulations promulgated under the Act, to file or furnish financial statements with a regulatory agency other than the SEC.
- c. It is required to file or furnish financial statements with a foreign or domestic regulatory agency in preparation for the sale of or for purposes of issuing securities that are not subject to contractual restrictions on transfer.
- d. It has issued, or is a conduit bond obligor for, securities that are traded, listed, or quoted on an exchange or an over-the-counter market.

- e. It has one or more securities that are not subject to contractual restrictions on transfer, and it is required by law, contract, or regulation to prepare U.S. GAAP financial statements (including footnotes) and make them publicly available on a periodic basis (for example, interim or annual periods). An entity must meet both of these conditions to meet this criterion.

An entity may meet the definition of a public business entity solely because its financial statements or financial information is included in another entity's filing with the SEC. In that case, the entity is only a public business entity for purposes of financial statements that are filed or furnished with the SEC.

Revenue

Inflows or other enhancements of assets of an entity or settlements of its liabilities (or a combination of both) from delivering or producing goods, rendering services, or other activities that constitute the entity's ongoing major or central operations.

Transaction Price

The amount of consideration to which an entity expects to be entitled in exchange for transferring promised goods or services to a **customer**, excluding amounts collected on behalf of third parties.

Recognition

> Contract Costs

>> Incremental Costs of Obtaining a Contract

340-40-25-1 An entity shall recognize as an asset the incremental costs of obtaining a contract with a customer if the entity expects to recover those costs.

340-40-25-2 The incremental costs of obtaining a contract are those costs that an entity incurs to obtain a contract with a customer that it would not have incurred if the contract had not been obtained (for example, a sales commission).

340-40-25-3 Costs to obtain a contract that would have been incurred regardless of whether the contract was obtained shall be recognized as an expense when incurred, unless those costs are explicitly chargeable to the customer regardless of whether the contract is obtained.

340-40-25-4 As a practical expedient, an entity may recognize the incremental costs of obtaining a contract as an expense when incurred if the amortization period of the asset that the entity otherwise would have recognized is one year or less.

>> Costs to Fulfill a Contract

340-40-25-5 An entity shall recognize an asset from the costs incurred to fulfill a contract only if those costs meet all of the following criteria:

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

340-40-25-6 For costs incurred in fulfilling a contract with a **customer** that are within the scope of another Topic (for example, Topic 330 on inventory; paragraphs 340-10-25-1 through 25-4 on preproduction costs related to long-term supply arrangements; Subtopic 350-40 on internal-use software; Topic 360 on property, plant, and equipment; or Subtopic 985-20 on costs of software to be sold, leased, or otherwise marketed), an entity shall account for those costs in accordance with those other Topics or Subtopics.

340-40-25-7 Costs that relate directly to a contract (or a specific anticipated contract) include any of the following:

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

340-40-25-8 An entity shall recognize the following costs as expenses when incurred:

- a. General and administrative costs (unless those costs are explicitly chargeable to the customer under the contract, in which case an entity shall evaluate those costs in accordance with paragraph 340-40-25-7)
- b. Costs of wasted materials, labor, or other resources to fulfill the contract that were not reflected in the price of the contract

- c. Costs that relate to satisfied performance obligations (or partially satisfied performance obligations) in the contract (that is, costs that relate to past performance)
- d. Costs for which an entity cannot distinguish whether the costs relate to unsatisfied performance obligations or to satisfied performance obligations (or partially satisfied performance obligations).

Subsequent Measurement

General

> Amortization and Impairment

340-40-35-1 An asset recognized in accordance with paragraph 340-40-25-1 or 340-40-25-5 shall be amortized on a systematic basis that is consistent with the transfer to the **customer** of the goods or services to which the asset relates. The asset may relate to goods or services to be transferred under a specific anticipated **contract** (as described in paragraph 340-40-25-5(a)).

340-40-35-2 An entity shall update the amortization to reflect a significant change in the entity's expected timing of transfer to the customer of the goods or services to which the asset relates. Such a change shall be accounted for as a change in accounting estimate in accordance with Subtopic 250-10 on accounting changes and error corrections.

340-40-35-3 An entity shall recognize an impairment loss in profit or loss to the extent that the carrying amount of an asset recognized in accordance with paragraph 340-40-25-1 or 340-40-25-5 exceeds:

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

340-40-35-4 For the purposes of applying paragraph 340-40-35-3 to determine the amount of consideration that an entity expects to receive, an entity shall use the principles for determining the **transaction price** (except for the guidance in paragraphs 606-10-32-11 through 32-13 on constraining estimates of variable consideration) and adjust that amount to reflect the effects of the customer's credit risk.

340-40-35-5 Before an entity recognizes an impairment loss for an asset recognized in accordance with paragraph 340-40-25-1 or 340-40-25-5, the entity shall recognize any impairment loss for assets related to the contract that are recognized in accordance with another Topic (for example, Topic 330 on inventory; Subtopic 985-20 on costs of software to be sold, leased, or otherwise

marketed; Topic 360 on property, plant, and equipment; and Topic 350 on goodwill and other intangibles). After applying the impairment test in paragraph 340-40-35-3, an entity shall include the resulting carrying amount of the asset recognized in accordance with paragraph 340-40-25-1 or 340-40-25-5 in the carrying amount of the asset group or reporting unit to which it belongs for the purpose of applying the guidance in Topics 360 and 350 to that asset group or reporting unit.

340-40-35-6 An entity shall not recognize a reversal of an impairment loss previously recognized.

Disclosure

General

> Assets Recognized from the Costs to Obtain or Fulfill a Contract with a Customer

340-40-50-1 Consistent with the overall disclosure objective in paragraph 606-10-50-1 and the guidance in paragraphs 606-10-50-2 through 50-3, an entity shall provide the following disclosures of assets recognized from the costs to obtain or fulfill a **contract with a customer** in accordance with paragraphs 340-40-25-1 or 340-40-25-5.

340-40-50-2 An entity shall describe both of the following:

- a. The judgments made in determining the amount of the costs incurred to obtain or fulfill a contract with a customer (in accordance with paragraph 340-40-25-1 or 340-40-25-5)
- b. The method it uses to determine the amortization for each reporting period.

340-40-50-3 An entity shall disclose all of the following:

- a. The closing balances of assets recognized from the costs incurred to obtain or fulfill a contract with a customer (in accordance with paragraph 340-40-25-1 or 340-40-25-5), by main category of asset (for example, costs to obtain contracts with customers, precontract costs, and setup costs)
- b. The amount of amortization and any impairment losses recognized in the reporting period.

340-40-50-4 An entity, except for a **public business entity**, a **not-for-profit entity** that has issued, or is a conduit bond obligor for, securities that are traded, listed, or quoted on an exchange or an over-the-counter market, or an employee benefit plan that files or furnishes financial statements with or to the Securities and Exchange Commission, may elect not to provide the disclosures in paragraphs 340-40-50-2 through 50-3.

> Practical Expedients

340-40-50-5 If an entity elects to use the practical expedient in paragraph 340-40-25-4 on the incremental costs of obtaining a contract, the entity shall disclose that fact.

340-40-50-6 An entity, except for a **public business entity**, a **not-for-profit entity** that has issued, or is a conduit bond obligor for, securities that are traded, listed, or quoted on an exchange or an over-the-counter market, or an employee benefit plan that files or furnishes financial statements with or to the Securities and Exchange Commission, may elect not to provide the disclosure in paragraph 340-40-50-5.

Implementation Guidance and Illustrations

General

> Illustrations

>> Contract Costs

340-40-55-1 Examples 1 and 2 illustrate the guidance in paragraphs 340-40-25-1 through 25-4 on incremental costs of obtaining a **contract**, paragraphs 340-40-25-5 through 25-8 on costs to fulfill a contract, and paragraphs 340-40-35-1 through 35-6 on amortization and impairment of contract costs.

>>> Example 1—Incremental Costs of Obtaining a Contract

340-40-55-2 An entity, a provider of consulting services, wins a competitive bid to provide consulting services to a new **customer**. The entity incurred the following costs to obtain the contract:

External legal fees for due diligence	\$ 15,000
Travel costs to deliver proposal	25,000
Commissions to sales employees	<u>10,000</u>
Total costs incurred	<u>\$ 50,000</u>

340-40-55-3 In accordance with paragraph 340-40-25-1, the entity recognizes an asset for the \$10,000 incremental costs of obtaining the contract arising from the commissions to sales employees because the entity expects to recover those costs through future fees for the consulting services. The entity also pays discretionary annual bonuses to sales supervisors based on annual sales targets, overall profitability of the entity, and individual performance evaluations. In accordance with paragraph 340-40-25-1, the entity does not recognize an asset for the bonuses paid to sales supervisors because the bonuses are not incremental to obtaining a contract. The amounts are discretionary and are

based on other factors, including the profitability of the entity and the individuals' performance. The bonuses are not directly attributable to identifiable contracts.

340-40-55-4 The entity observes that the external legal fees and travel costs would have been incurred regardless of whether the contract was obtained. Therefore, in accordance with paragraph 340-40-25-3, those costs are recognized as expenses when incurred, unless they are within the scope of another Topic, in which case, the guidance in that Topic applies.

> > > Example 2—Costs That Give Rise to an Asset

340-40-55-5 An entity enters into a service contract to manage a customer's information technology data center for five years. The contract is renewable for subsequent one-year periods. The average customer term is seven years. The entity pays an employee a \$10,000 sales commission upon the customer signing the contract. Before providing the services, the entity designs and builds a technology platform for the entity's internal use that interfaces with the customer's systems. That platform is not transferred to the customer but will be used to deliver services to the customer.

> > > Incremental Costs of Obtaining a Contract

340-40-55-6 In accordance with paragraph 340-40-25-1, the entity recognizes an asset for the \$10,000 incremental costs of obtaining the contract for the sales commission because the entity expects to recover those costs through future fees for the services to be provided. The entity amortizes the asset over seven years in accordance with paragraph 340-40-35-1 because the asset relates to the services transferred to the customer during the contract term of five years and the entity anticipates that the contract will be renewed for two subsequent one-year periods.

> > > Costs to Fulfill a Contract

340-40-55-7 The initial costs incurred to set up the technology platform are as follows:

Design services	\$ 40,000
Hardware	120,000
Software	90,000
Migration and testing of data center	<u>100,000</u>
Total costs	<u>\$ 350,000</u>

340-40-55-8 The initial setup costs relate primarily to activities to fulfill the contract but do not transfer goods or services to the customer. The entity accounts for the initial setup costs as follows:

- a. Hardware costs—accounted for in accordance with Topic 360 on property, plant, and equipment
- b. Software costs—accounted for in accordance with Subtopic 350-40 on internal-use software
- c. Costs of the design, migration, and testing of the data center—assessed in accordance with paragraph 340-40-25-5 to determine whether an asset can be recognized for the costs to fulfill the contract. Any resulting asset would be amortized on a systematic basis over the seven-year period (that is, the five-year contract term and two anticipated one-year renewal periods) that the entity expects to provide services related to the data center.

340-40-55-9 In addition to the initial costs to set up the technology platform, the entity also assigns two employees who are primarily responsible for providing the service to the customer. Although the costs for these two employees are incurred as part of providing the service to the customer, the entity concludes that the costs do not generate or enhance resources of the entity (see paragraph 340-40-25-5(b)). Therefore, the costs do not meet the criteria in paragraph 340-40-25-5 and cannot be recognized as an asset using this Topic. In accordance with paragraph 340-40-25-8, the entity recognizes the payroll expense for these two employees when incurred.

Relationships

General

> Revenue from Contracts with Customers

340-40-60-1 For guidance on **revenue** from **contracts** with **customers**, see Topic 606.

> Financial Services—Insurance

340-40-60-2 For guidance regarding direct response advertising costs, see Subtopic 944-30.