

Technical Line

FASB – proposed guidance

A snapshot of the new joint revenue model

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What you need to know

- ▶ The Boards have completed their redeliberations on their proposal to replace US GAAP and IFRS revenue guidance and have made significant changes from their initial proposal last year.
- ▶ The Boards have modified the criteria for determining whether a good or service is a distinct performance obligation, developed a separate model for services, changed how onerous performance obligations are determined and decided that accounting for warranties would be similar to current practice under US GAAP.
- ▶ The Boards plan to issue a second exposure draft in the next 90 days. A 120-day comment period will follow.

Overview

The Financial Accounting Standard Board (the FASB) and the International Accounting Standards Board (the IASB) (collectively, the Boards) have completed their redeliberations on their June 2010 proposal¹ on revenue recognition. They plan to issue a new exposure draft (ED) for public comment because they have made significant changes to the proposal during redeliberations.

At their July meetings, the Boards addressed the remaining topics in their redeliberation plan and finalized the revised model. We expect the new ED to be issued within the next 90 days. The Boards have agreed to provide a 120-day comment period. We also expect the staff to continue performing targeted outreach during and after the comment period.

The Boards are trying to create a single revenue model that can be applied to most contracts with customers. Leases, insurance contracts, financial instruments, guarantees and certain nonmonetary transactions would be excluded from the proposal.

Under the revised proposal, an entity would recognize revenue in amounts that reflect the consideration the entity expects to receive in exchange for goods or services it transfers to customers. The model would have the following five steps:

- ▶ Identify the contract(s) with a customer
- ▶ Identify the separate performance obligations in the contract
- ▶ Determine the transaction price
- ▶ Allocate the transaction price to the separate performance obligations
- ▶ Recognize revenue when the entity satisfies each performance obligation

This publication discusses each of the steps in more detail. The Appendix compares the revised model with the original proposal.

We prepared this publication based on our understanding of the tentative conclusions reached by the FASB and the IASB during redeliberation. The upcoming exposure draft may reflect differences from our understanding of the tentative decisions.

Step 1: Identifying the contract(s) with the customer

Contracts that create enforceable obligations fall under the scope of the proposed guidance. They may be written, oral or implied by the entity's customary business practice. However, they must have commercial substance, be appropriately approved, define each party's enforceable rights and specify the payment terms to qualify as a contract to be accounted for under the proposed model.

It is important to note that the transaction price need not be fixed nor does it have to be stated in the contract with the customer to meet the above criteria. For example, if a contract does not state a transaction price, but the entity has the ability to estimate it (see discussion below), the contract would be in the scope of the proposed model.

A contract would not exist if both parties have the unilateral right to terminate a "wholly unperformed" contract without penalty.

Multiple contracts and contract modifications

When two or more contracts are linked to one another economically or functionally, the proposed guidance would require an entity to combine them and account for them as a single contract. The Boards tentatively concluded that an entity should combine two or more contracts with the same customer if the contracts are entered into at or near the same time and when any of the following criteria are met:

- ▶ The contracts are negotiated as a package with a single economic objective
- ▶ The amount of consideration in one contract depends on the performance of the other contract
- ▶ The goods or services in the contracts are interrelated in terms of design, technology or function

Contract modifications may require upward or downward cumulative revenue adjustments if some performance obligations have already been satisfied.

Similarly, when the parties modify a contract after inception, the entity must determine whether the modification creates a new, separate contract or whether the contract modification should be combined with the existing contract for accounting purposes.

A modification that leads to a new, separate performance obligation priced commensurate with the value of that additional performance obligation would be accounted for as a separate contract. Otherwise, the modification would be combined with the existing contract.

Step 2: Identifying separate performance obligations

A performance obligation is defined as a promise (whether explicit or implicit) in a contract with a customer to transfer a good or service to the customer. The Boards have made clear that constructive obligations based on factors outside of a written contract (e.g., past business practice, industry norms) must also be considered, even if those obligations are not legally enforceable.

The proposal provides the following examples of goods or services that may give rise to a performance obligation:

- ▶ Goods produced by an entity for sale (e.g., inventory of a manufacturer)
- ▶ Goods purchased by an entity for resale (e.g., merchandise of a retailer)
- ▶ Arranging for another party to transfer goods or services (e.g., acting as an agent of another party)
- ▶ Standing ready to provide goods or services (e.g., when- and if-available software products)
- ▶ Constructing or developing an asset on behalf of a customer
- ▶ Granting licenses, rights to use and options
- ▶ Performing a contractually agreed task (or tasks)

Properly identifying the individual performance obligations is a critical component of the proposed revenue model, as revenue allocated to each performance obligation is recognized as each performance obligation is satisfied.

Distinct goods and services

After identifying the promised goods and services, an entity would determine which of those goods and services are distinct from one another. That is, distinct goods and services would be considered separate performance obligations, or individual units of account.

The Boards have proposed the following two-step process for identifying separable performance obligations:

- ▶ Account for a bundle of promised goods or services as one performance obligation if the entity provides a service of integrating those goods or services into a single item that the entity provides to the customer.

- ▶ Promised goods and services are separate performance obligations when both of the following conditions are met:
 - ▶ The good or service has a different pattern of transfer to the customer from other goods and services in the contract.
 - ▶ The good or service has a distinct function. A good or service has a distinct function if either of these criteria applies:
 - ▶ The entity regularly sells the good or service separately.
 - ▶ The customer can use the good or service either on its own or with resources that are readily available to the customer. Resources that are readily available to the customer include resources obtained in previous transfers of goods or services (including those transferred under the same contract) or that the customer could purchase separately from the entity or another entity.

The first step was designed to address long-term contracts to provide goods, or a single good, to the customer (e.g., transactions in the construction industry). The Boards concluded that in a contract to construct an asset, a construction firm has only one performance obligation – to deliver a completed product to the customer. It is unclear, however, how broadly this principle would apply to contracts outside of a typical construction arrangement.

The second step would require an entity to determine which performance obligations are distinct, which may require the use of judgment. Goods or services that are not distinct from other goods and services in the contract would be combined until a bundle of goods or services is distinct for purposes of applying the proposed model.

Customer options for future purchases would represent separate performance obligations if the options give the customer a material right.

Customer options for additional goods

Many sales contracts allow customers the option to purchase additional goods or services, which may be discounted or offered free of charge. Options to acquire additional goods or services at a discount can come in many forms, including sales incentives (e.g., free telephones), customer award credits (e.g., frequent-flier programs), contract renewal options (e.g., waiver of certain fees, reduced future rates) or other discounts on future goods or services.

The proposed guidance would require that an option to acquire additional goods or services be treated as a separate performance obligation only if it provides a material right to the customer. The right would be material only if it results in a discount that the customer would not receive otherwise (e.g., 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 discounted price in the option is within the range of prices typically offered to other similar customers (separate from any existing relationship or contract), the entity would be deemed to have made a marketing offer, and the offer does not represent a separate performance obligation.

Step 3: Determine the transaction price

The proposed guidance defines the transaction price as the amount of consideration that an entity receives, or expects to receive, from the customer in exchange for transferring goods or services, excluding amounts collected on behalf of third parties (e.g., taxes). In many cases, the transaction price is readily determinable because the entity receives a fixed payment at the time it transfers the promised goods or services.

Determining the transaction price may be more challenging when it is variable in amount, when payment is received at a time different from when the entity provides goods or services or when payment is in a form other than cash. Consideration paid or payable to the customer also may affect the determination of transaction price.

Variable consideration

A portion of the transaction price could vary in amount and timing for such things as discounts, rebates, refunds, credits, incentives, bonuses and (or) penalties, contingencies or concessions. An entity would estimate the transaction price using either a probability-weighted estimate or an estimate of the amount most likely to be received, whichever best predicts the consideration expected to be received.

Under the probability-weighted approach, the entity's estimate identifies the possible outcomes of a contract and the probabilities of those outcomes. The Boards favored this approach because they believe it best reflects how contracts are negotiated and priced and it provides more consistent accounting for similar contracts than alternative approaches.

The alternative would measure the transaction price at the most likely amount expected to be received.

These two methods can be best illustrated with a simple example. Assume that a vendor has a 40% chance of receiving a \$100 performance bonus. Under the probability-weighted approach, the vendor would include \$40 in the transaction price. But under the most likely outcome approach, the vendor would not include the performance bonus in the transaction price. If in the next reporting period the vendor's likelihood of receiving the bonus rises to 55%, the vendor would recognize \$55 under the probability-weighted approach and \$100 under the most likely outcome approach.

The example shows that a small change in the likelihood of success can result in a very large change in the transaction price under the most likely outcome approach. It also shows that the probability-weighted approach results in a measurement of revenue at an amount that does not represent the final outcome.

Reasonably assured

As performance obligations are satisfied, the entity would recognize only revenue that is "reasonably assured" to be received. The Boards concluded that amounts expected to be received would not be reasonably assured if the entity does not have experience with similar contracts or it cannot estimate the amounts expected to be received based on its experience. For example, the length of time leading up to the satisfaction of the performance obligation and the influence of factors outside the

entity's control (e.g., market factors) may indicate that prior experience cannot be used to predict the outcome. In addition, if the customer could avoid paying a sales-based royalty (e.g., by not selling the item to which the royalty relates), the amounts would not be reasonably assured.

How we see it

Many entities would recognize revenue earlier than they do now, because they would be able to estimate variable or uncertain consideration. However, the changes made to the model for royalties would result in less acceleration of revenue than the original proposal. Further, the "reasonably assured" provision could delay recognition for entities that apply the guidance for performance-based incentive fees in ASC 605-20-S99 (e.g., asset managers, hotel management companies). They might conclude that performance incentives are not reasonably assured until the end of the performance period. Those entities currently have an option to recognize revenue based on interim measurements.

Collectibility

The original Exposure Draft proposed that in determining the transaction price, the entity would also have to consider collectibility – that is, the customer's ability to pay the amount of promised consideration. That model would have required that an entity reduce the transaction price for the initial estimate of uncollectible amounts, while subsequent changes in that estimate would have been recognized as an expense.

During redeliberations, the Boards decided that estimates of uncollectible amounts would not affect the transaction price. Rather, those estimates would be presented as contra-revenue directly below revenue in the statement of operations. Revenue would be presented gross. Any changes in the amounts expected to be collected or actually collected after the performance obligation is satisfied would also be recognized in the contra-revenue line.

How we see it

The proposed model is very similar to current US GAAP in terms of the timing and amount of bad debts recognized in the income statement. But requiring the presentation of these bad debt amounts as contra-revenue would reduce reported gross margins, because bad debt amounts generally are reported as an expense below gross margin.

Time value of money

For certain transactions, the timing of the payment does not match the timing of the transfer of goods or services to the customer (e.g., the consideration is prepaid or is paid well after the services are provided). When the customer pays in arrears, the entity is effectively providing financing to the customer. Conversely, when the customer pays in advance, the entity has effectively received financing from the customer. In such situations, an entity would adjust the transaction price for the time value of money, but only if the effect is significant. The Boards agreed that an entity would not be required to consider the time value of money when the period between the customer's payment and the entity's satisfaction of the performance obligation is less than one year.

Timing differences of more than one year between vendor performance and customer payment generally will require an adjustment to the transaction price for the time value of money.

The financing element would be presented separately from the revenue recognized for the goods or services transferred as interest expense (when the customer pays in advance) or interest income (when the customer pays in arrears). The interest income or expense would be recognized over the financing period using the interest method described in ASC 835, *Interest*.

Noncash consideration

Customer consideration might be in the form of goods, services or other noncash consideration. When an entity receives noncash consideration, the transaction price would be the fair value of goods or services received.² If an entity cannot reasonably estimate the fair value of noncash consideration, it would measure the consideration indirectly by using the selling price of the promised goods or services.

In some transactions, a customer contributes goods or services, such as equipment or labor. If the entity obtains control of the contributed goods or services, it would consider them noncash consideration and account for that consideration as described above.

Consideration paid or payable to a customer

Many entities make payments to their customers from time to time. In some cases, the payments are for the purchase of goods or services offered by the customer that satisfy a business need of the entity. In other cases, the payments represent incentives given by the entity to entice the customer to purchase, or continue purchasing, its goods or services.

Consideration paid or payable to customers commonly takes the form of discounts, coupons, free products or services and equity instruments, among others. In addition, some entities make payments to the customers of resellers or distributors that purchase directly from the entity (e.g., food manufacturers commonly offer coupons to the consumers of their products, although the manufacturer's direct customers are distributors that sell to the grocery store or the grocery stores that sell to the consumers).

To determine the appropriate accounting, an entity must first determine whether the consideration paid or payable to a customer is (1) a reduction of the transaction price, (2) a payment for a distinct good or service or (3) a combination of both.

If the consideration paid or payable to a customer is a discount or refund for goods or services provided to the customer, an entity would reduce the transaction price, and thus revenue, by the amount paid or payable to the customer. This reduction would be recognized at the later of when the entity transfers the promised goods or services to the customer or when the entity promises to pay the consideration, even if the payment is conditional on a future event.

If the consideration paid or payable to a customer is in exchange for distinct goods or services received from the customer, an entity would account for the goods or services received in the same way as it would account for any other purchases in the normal course of business.

In some cases, payments between a vendor and a customer are considered to be for both a distinct good or service received and a reduction of the transaction price for a good or service provided. Under the proposed model, the entity would determine the

fair value of the good or service it receives from the customer and compare it to the consideration payable to the customer. Any excess of the consideration payable over the fair value of the distinct goods or services received would reduce the transaction price. If the entity cannot reasonably estimate the fair value of the good or service received from the customer, the entity would account for the entire consideration payable to the customer as a reduction of the transaction price.

Nonrefundable up-front fees

In certain circumstances, entities may receive payments from customers in advance of rendering a contracted service or delivering a good. Up-front fees generally relate to the initiation, activation or setup of a good to be used or a service to be rendered in the future. Up-front fees also may be paid to grant access to or a right to use a facility, product or service. In many cases, the up-front amounts paid by the customer are nonrefundable. Common examples of up-front fees are fees paid for membership to a health or buying club and activation fees for phone, cable or internet usage.

An entity must evaluate whether nonrefundable up-front fees relate to the transfer of a good or service. In most situations, the up-front fee would not have been paid without continuing use of the good or service. Therefore, the fee does not relate to the actual transfer of a separate good or service. Instead, the up-front fee is an advance payment for future goods or services and therefore should be recognized as revenue when those goods or services are transferred.

There may be some situations in which an entity determines that a nonrefundable up-front fee does relate to the transfer of a separate good or service. In this case, the entity would need to determine whether the good or service associated with the nonrefundable up-front fee is a distinct performance obligation (i.e., separate unit of account).

Step 4: Allocate the transaction price

The proposed model would require an entity to allocate the transaction price to the performance obligation, generally in proportion to the estimated standalone selling prices (i.e., on a relative standalone selling price basis). Any discount would be allocated proportionally to all of the separate performance obligations in the contract when the transaction price is allocated based on relative standalone selling prices.

When uncertain (variable) consideration exists, however, the Boards concluded that the uncertain consideration would be allocated entirely to a single performance obligation if both of the following conditions are met:

- ▶ The contingent payment relates specifically to the entity's efforts to satisfy that performance obligation
- ▶ The amount allocated (including the change in the transaction price due to the contingent payment) to that particular performance obligation is reasonable relative to all of the performance obligations and payment terms (including other potential contingent payments) in the contract

How we see it

It is not clear how fixed consideration would be allocated at inception if uncertain consideration is to be allocated entirely to a single performance obligation. For example, if there are three separate performance obligations (A, B and C) and all of the uncertain consideration is allocated to performance obligation C, would any of the fixed consideration also be allocated to performance obligation C? We hope the Boards will clarify this in the ED.

Estimating standalone selling prices

The estimated standalone selling price represents the price at which an entity would sell a good or service on a standalone basis at contract inception. The proposed model indicates that, when available, the observable price of a good or service sold separately provides the best evidence of standalone selling price. In situations in which the standalone selling price is not readily observable, the entity would estimate the amount for which it would sell each performance obligation on a standalone basis.

The proposed model describes two possible approaches to estimating standalone selling price – an expected-cost-plus-a-margin approach and an adjusted-market-assessment approach. However, these approaches are not the only estimation methods available, and the proposed model does not preclude or prescribe any particular method for estimating standalone selling prices.

In a change from the original exposure drafts, the Boards will propose allowing the use of a residual technique to estimate standalone selling prices when the standalone selling price of a good or service is highly variable. For example, an entity that frequently sells software, professional services and maintenance bundled together at prices that vary widely and that also sells the professional services and maintenance deliverables individually at relatively stable prices may estimate the standalone selling price for the software as the difference between the total transaction price and the estimated selling price of the professional services and maintenance.

When an entity must estimate the standalone selling price because it does not meet the criteria for using a residual technique, the proposed model is clear that the entity should not presume that a contractually stated price or a list price for a good or service represents the standalone selling price.

How we see it

A residual technique, in most instances, would result in a very similar allocation of a transaction price to the residual method under the current guidance for software revenue in ASC 985-605. Many software companies said it would be difficult to determine standalone selling prices for their software licenses because they have historically sold these licenses at a wide range of prices. Those companies are likely to welcome this revision to the proposed model.

The Boards agreed to allow use of a residual technique for estimating the standalone selling price of a delivered item with highly variable pricing.

Changes in transaction price after contract inception

The standalone selling price would be determined only at contract inception. While the amounts allocated to performance obligations would be updated to reflect changes in the estimated transaction price as goods and services are delivered, the standalone selling prices used to perform the allocation would not be updated to reflect changes after contract inception.

Step 5: Satisfying the performance obligations

An entity would recognize revenue when a performance obligation is satisfied by transferring the promised good or service to a customer. A good or service would generally be transferred when the customer obtains control. This determination is usually straightforward, but it can be complex in some cases.

To help entities determine whether a customer has obtained control of a particular good or service, the Boards agreed on the following indicators:

- ▶ The customer has an unconditional obligation to pay
- ▶ The customer has legal title
- ▶ The customer has physical possession
- ▶ The customer has the risks and rewards of ownership

The Boards acknowledge that some of the indicators may not be relevant to certain transactions. Additionally, none of the indicators are meant to be individually determinative of whether the customer has gained control of the good or service.

Continuous transfer of goods and services

Service arrangements and certain other supply or long-term contracting agreements (collectively, services) may provide for the continuous delivery of goods or services over the course of the contract period.

To help entities determine whether an offering represents a good (control transfers at a point in time) or a service (control transfers continuously), the Boards proposed the following criteria, either of which would indicate that a performance obligation is satisfied continuously:

- ▶ The entity's performance creates or enhances an asset that the customer controls as the asset is being created
- ▶ The entity's performance does not create an asset with alternative use to the entity and at least one of the following conditions is met:
 - ▶ The customer receives a benefit as each task is being performed (e.g., training services)
 - ▶ Another entity would not need to re-perform all of the task(s) performed to date if it were to fulfill the remaining obligation to the customer (e.g., shipping services)
 - ▶ The entity has a right to payment for performance to date even if the customer or the entity could cancel the contract for convenience (e.g., certain government contracts)

The determination of whether a performance obligation is satisfied continuously or at a point in time would affect the timing of the revenue recognition, both in terms of how an entity would recognize revenue for identified performance obligations and how an entity would identify separate performance obligations. For example, performance obligations that involve the delivery of integrated goods and services would generally be accounted for as services.

When the entity determines that control transfers continuously, the entity must select a single revenue recognition method for the relevant performance obligation that best depicts this continuous transfer. The performance obligation would be accounted for under the selected method until it has been fully satisfied. The proposed guidance would also require that the selected method be applied to similar arrangements containing similar performance obligations.

Suitable methods of recognizing revenue to depict the continuous transfer of goods or services would include output methods, input methods or methods based on the passage of time.

Output methods result in recognition of revenue on the basis of units produced or delivered, contract milestones or surveys of goods or services transferred to date relative to the total goods or services to be transferred. Output methods often result in the most faithful depiction of the transfer of goods or services. However, other methods that are easier to apply may also provide a faithful depiction.

Input methods result in recognition on the basis of efforts expended to date (e.g., costs of resources consumed, labor hours expended and machine hours used) relative to total efforts expected to be expended. Inputs often are more directly observable than outputs. When using an input method, an entity would exclude the effects of any inputs that do not depict the transfer of goods or services to the customer (e.g., the costs of abnormal amounts of wasted materials, labor or other resources to fulfill the contract).

Methods based on the passage of time generally result in recognition on a straight-line basis over the expected duration of the contract if services are transferred evenly over time.

Contracts for both goods and services

Because the proposed model provides different revenue recognition guidance for goods and services, the Boards also addressed accounting for transactions containing both goods and services. They concluded that if the goods and services are separable, they would be accounted for separately using the appropriate model.

However, if the goods and services are not separable (i.e., they represent an integrated bundle that must be accounted for as a single performance obligation or they do not have distinct function from one another), the model for services would be applied to the combined unit. The Boards believe this would more faithfully depict the economics of the transaction.

Recognizing revenue when a right of return exists

The Boards concluded that a right of return does not represent a separate performance obligation. Instead, the existence of a right of return affects the amount of revenue an entity can recognize for satisfied performance obligations.

Similar to the accounting for variable consideration, if returns are reasonably estimable, the entity would estimate the transaction price giving consideration to the expected returns. An entity would recognize the amount of expected returns as a refund liability, representing the entity's obligation to return the customer's consideration for expected failed sales. If the entity is unable to estimate a level of expected returns, it would not recognize revenue until the returns can be reasonably estimated, which may be at the end of the return period.

An entity would remeasure refund liabilities, once established, at each financial reporting date giving effect to any changes in assumptions regarding expected returns. Any adjustments made to the estimate would result in a corresponding adjustment to amounts allocated to the satisfied performance obligations (e.g., if the entity expects the number of returns to be higher than originally estimated, it would have to decrease the amount of revenue recognized and increase the refund liability).

Finally, when customers exercise their rights of return, the entity may receive the returned product in salable or repairable condition. Under the proposed guidance, when the initial sale is recognized as revenue, the entity also would recognize an asset separate from inventory (and adjust cost of sales) for its right to recover the goods returned by the customer. The asset would initially be measured at the former carrying amount of the inventory less any expected costs to recover the goods. The entity would update the measurement of this asset at each financial reporting date for any revisions to its expected level of returns. The asset recorded also would be subject to impairment.

Repurchase agreements

Certain sale transactions include repurchase provisions, either as a component of a sales contract or as a separate contract that relates to the same or similar goods in the original agreement. The proposed model addresses whether a customer has obtained control of an asset in arrangements containing the following repurchase provisions:

- ▶ A customer's unconditional right to require the selling entity to repurchase the asset (essentially a written put option)
- ▶ An entity's unconditional obligation to repurchase the asset in the original contract (essentially a forward contract)
- ▶ An entity's unconditional right to repurchase the asset in the original contract (essentially a purchased call option)

Written put option held by the customer

The proposed model indicates that if the customer has the ability to require the entity to repurchase the asset, the customer has obtained control of the asset (i.e., the customer has the ability to direct the use of the asset), and a sale generally should be recorded. These arrangements would be treated essentially the same as sales with rights of return. Therefore, upon recognizing the sale, the entity also would recognize a liability for the expected returns, and an asset for product expected to be returned.

However, if the customer has a significant economic incentive to exercise its right to require the seller to repurchase the asset, the customer is effectively paying the entity for the right to use the asset for the option period. The entity would account for such transactions under the leasing guidance.

Forward or call option held by the entity

If the entity has an unconditional obligation or right to repurchase the asset, the customer has not obtained control of the asset, because it is constrained in its ability to direct the use of the asset. Therefore, the transaction likely represents a lease or a financing transaction rather than a sale. The proposed guidance indicates that if the entity is obligated to repurchase the asset or has the right to repurchase the asset at a price less than the original sales price, the entity would account for the transaction as a lease. If the entity is obligated or has the right to repurchase the asset at a price equal to or greater than the original sales price, it would account for the arrangement as a financing.

How we see it

Because the proposed model does not consider the likelihood of exercise of a call option held by the entity in determining the accounting treatment, we believe the potential exists for counterintuitive accounting results. For example, in certain transactions, an entity may have an unconditional right to repurchase an asset at an amount greater than the original sales price. The proposed model would require the entity to account for all such transactions as a financing, even in situations in which it is highly unlikely the entity will exercise the call option.

Although a performance obligation related to the transfer of IP is satisfied at a point in time, the reasonably assured criteria would prevent immediate revenue recognition for most royalties.

Licensing and rights to use

A license granted to a customer represents the customer's right to use the intellectual property (IP) developed or owned by the entity for its intended use. The proposed guidance for licenses and other rights of use (collectively, licenses) provides that the promise to grant a license would be accounted for as a single performance obligation in which the entity recognizes revenue when the customer obtains the right to use and benefit from the asset, generally at the time of transfer of the license.

Bill-and-hold arrangements

Certain sales transactions may result in the selling entity fulfilling its obligations under the sales contract and billing the customer for the work performed but not shipping the goods until a later date. These transactions are referred to as "bill-and-hold" transactions. Bill-and-hold transactions are usually designed this way at the request of the purchaser for a number of reasons, including a lack of storage capacity or delays in its ability to use the goods.

Under the proposed model, the selling entity would have to evaluate whether the customer obtained control of the goods to determine whether the performance obligation has been satisfied and to recognize the related revenue. Because the customer has not taken possession of the goods in a bill-and-hold transaction, the proposed guidance includes the following criteria that must be met for a customer to have obtained control of a product in a bill-and-hold arrangement:

- ▶ The customer must have requested the contract to be on a bill-and-hold basis
- ▶ The product must be identified separately as the customer's
- ▶ The product currently must be ready for delivery at the location and time specified, or to be specified, by the customer
- ▶ The entity cannot use the product or sell it to another customer

If the above conditions are met, the selling entity is no longer able to direct the use of the goods, but instead acts as a custodian for the customer and the performance obligation for the good has been satisfied. In that case, the selling entity must consider whether custodial services are a material separate performance obligation for which a portion of the transaction price would be allocated and recognized as revenue during the custodial period.

Customer acceptance

Certain sales contracts include customer acceptance clauses specifying that the customer must approve (accept) the goods before the customer becomes obligated to pay for them. The determination of whether the customer has obtained control of the good or service must consider any customer acceptance clauses. That is, without satisfying the customer acceptance clauses in the contract, the entity may not have satisfied its performance obligations or be entitled to consideration.

The proposed model states that if an entity can objectively determine that the transferred good or service meets the agreed specifications in the contract, customer acceptance is a formality. In such situations, the acceptance clause would not affect an entity's determination of when the customer has obtained control of the good or service. Contractually specified height, weight or other measurements are examples of customer acceptance requirements that could be objectively determined. Conversely, if the entity is unable to objectively determine that the good or service meets the contractual specifications, it would be unable to conclude that the customer has obtained control before the customer's acceptance of the goods. A clause that allows the customers to visually inspect, test and apply judgment to determine whether a particular good is suitable may represent a customer acceptance criterion that is not objectively determinable.

Breakage and prepayments for future goods or services

In certain industries, customers pay for goods or services but may not ultimately exercise their rights under the contract (referred to as breakage). This is often the case for retailers that sell gift cards that are not completely redeemed and other entities, such as airlines, that sell tickets to customers who allow tickets to expire unused. The June 2010 ED did not address the accounting for breakage.

In their redeliberations, the Boards concluded that when an entity can reasonably estimate breakage, the entity should recognize the expected breakage as revenue in proportion to the pattern of transfer of goods or services to the customer. Conversely, if an entity cannot reasonably estimate breakage, it should recognize the expected breakage as revenue when the likelihood of the customer exercising his or her rights to remaining balances becomes remote.

Other measurement and recognition topics

Onerous performance obligations

The proposed model requires that an entity recognize a liability and a corresponding expense when any performance obligation satisfied over time becomes onerous. Under the proposed model, an onerous performance obligation would be measured by the amount that specified costs exceed the transaction price allocated to that performance obligation.

Costs included in the onerous test would include the lesser of (1) the costs directly related to satisfying the performance obligation or (2) the amount the entity would have to pay to exit the contract. (Using the lesser of these two amounts is based on a presumption that an entity would generally elect to cancel a contract rather than fulfill it if canceling would cost less.)

Consistent with the guidance on contract costs, costs that relate directly to satisfying the performance obligation would include direct labor, direct materials, allocated costs that relate directly to the performance obligation's activities (e.g., depreciation), costs explicitly chargeable to the customer based on the contract terms and other costs incurred only because the entity entered into the contact with the customer.

The proposed guidance requires companies to assess whether a performance obligation is onerous only for performance obligations satisfied over time. Performance obligations satisfied at a point in time (i.e., goods) would not be subject to the onerous test.

The proposed guidance also explains that, before recognizing a liability for an onerous performance obligation, the entity is required to determine whether the assets related to the contracts are impaired (e.g., inventory or capitalized costs of obtaining a contract) and recognize any impairment loss that has occurred. Once the entity has recorded a liability and corresponding expense for an onerous performance obligation, the entity would remeasure the obligation at each financial reporting date to include changes in assumptions or new information.

Performance obligations satisfied at a point in time would be exempt from the onerous test.

How we see it

In principle, the notion of recognizing a liability and corresponding expense for onerous performance obligations would not result in a significant change in practice for entities that follow the construction-type and production-type contracting guidance in ASC 605-35. However, this proposed guidance would likely represent a significant change for most other transactions satisfied over time. Under current US GAAP, many companies do not recognize losses on executory contracts unless there is specific guidance that requires such losses to be recognized (such as the guidance in ASC 605-35).

The measurement of the amount of loss to be recognized under the proposed model also differs from current US GAAP. Currently, expected losses generally are measured at the contract level, not the performance obligation level.

Contract costs

The proposed model also provides guidance for accounting for an entity's costs incurred in obtaining and fulfilling a contract to provide goods and services to customers. This guidance would apply to both contracts obtained and contracts under negotiation. This differs from the current revenue recognition guidance under US GAAP, which applies only to contracts an entity has obtained.

Fulfillment costs

The proposed model differentiates between fulfillment costs that give rise to an asset and fulfillment costs that should be expensed as incurred. Under the proposed model, costs incurred that are not eligible for capitalization in accordance with other authoritative guidance (e.g., inventory, property, plant and equipment, software) may be capitalized if the costs meet all of the following criteria:

- ▶ The costs relate directly to the contract (or a specific contract under negotiation) – costs may include direct labor, direct materials, costs that may be directly allocated to the activities involved in fulfilling the contract, costs that are explicitly chargeable to the customer under the contract and other costs incurred only because the entity entered into the contract (e.g., costs related to the use of subcontractors). Costs that relate directly to a contract include costs that are incurred before the contract is obtained if those costs relate specifically to an anticipated contract
- ▶ The costs generate or enhance resources of the entity to be used in satisfying performance obligations in the future – for example, intangible design or engineering costs that relate to future performance and will continue to provide benefit
- ▶ The costs are expected to be recovered

The proposed model would require that if the costs incurred in fulfilling a contract do not give rise to an asset under the criteria above, the costs would be expensed as incurred. Costs that would be expensed as incurred include:

- ▶ Costs that relate to previously satisfied performance obligations for which there is no future benefit
- ▶ Costs of abnormal amounts of wasted materials, excess labor or other materials used to fulfill the contract that were not considered in the price of the contract

An entity would also expense costs as incurred when it cannot determine whether the costs relate to past or future performance.

Costs of obtaining a contract

The proposal would require an entity to recognize the incremental costs of obtaining a contract as an asset for contracts that are longer than one year in duration. Contract acquisition costs for contracts with a duration of one year or less may be capitalized, but are not required to be capitalized. Incremental costs are costs that would not have been incurred if the contract had not been obtained. Similar to the assets recorded for fulfillment costs, contract acquisition costs would be capitalized only when they are recoverable, either directly (i.e., reimbursable under the contract) or through the margin inherent in the contract. This guidance would apply to costs on contracts that have been obtained and contracts that are under negotiation.

How we see it

The proposed guidance on contract acquisition costs would represent a significant change from current practice under US GAAP for many entities. Entities that currently expense contract acquisition costs, such as sales bonuses, would be required to capitalize them if they relate to long-term contracts. Entities that currently capitalize these costs by analogy to other authoritative guidance may not be significantly affected. However, the proposed guidance implies that the unit of account for costs of obtaining a contract is the contract (rather than a pool of contracts), which may force those entities to analyze contract acquisition costs in more detail than they currently do.

Amortization and impairment of contract costs

Any contract costs that the entity capitalizes would ultimately be expensed as the entity transfers the related goods or services to the customer. The proposed guidance would require that assets be amortized in a manner consistent with the pattern of the transfer of goods and services to which the asset relates. This amortization period could extend beyond a single contract if the capitalized costs relate to goods or services being transferred under multiple contracts to the same customer, or the customer is expected to continue to purchase goods or services from the entity after the stated contract period.

Any asset recorded by the entity would also be subject to ongoing assessment of impairment. Costs giving rise to an asset must initially be recoverable to meet the criteria for capitalization but must also continue to be recoverable throughout the life of the asset. An impairment would exist if the carrying amount of any asset(s) exceeds the transaction price allocated to the remaining performance obligations less the costs of satisfying those performance obligations.

Accounting for product warranties

The proposed model would require warranties to be accounted for in one of two ways:

- ▶ Cost accrual – Warranties would be treated as “warranty liabilities” using a cost accrual approach. Revenue would be recognized for the good or service delivered, and the costs of satisfying the warranty on the good or service would be accrued.
- ▶ Performance obligation – Warranties would be treated as distinct performance obligations that result in deferral of revenue for the warranty obligation. No costs would be accrued for the warranty obligation until they are incurred to satisfy the warranty performance obligation.

If the warranty provides the customer with assurance that the delivered product is as specified in the contract, an entity would account for a warranty liability in accordance with the FASB’s guidance on contingencies.³ Only warranties that provide a service to the customer in addition to that assurance would be treated as separate performance obligations.

The Boards discussed various scenarios and reached the following conclusions:

- ▶ If a customer could purchase a warranty separately from the entity, the warranty would be a separate performance obligation (i.e., revenue would be deferred).
- ▶ If a customer could not purchase a warranty separately from the entity and the warranty is offered to all similarly situated customers, the warranty would likely be accounted for as a warranty liability (i.e., cost accrual).
- ▶ If a warranty is included with the good only to satisfy statutory or legal requirements, the warranty would be accounted for as a warranty liability (i.e., cost accrual).
- ▶ If the entity provides a single customer or group of customers with a warranty that includes coverage beyond that provided to other customers, the entity must evaluate whether that special warranty includes services in addition to the warranty (e.g., more comprehensive coverage, extended time period). If so, the services (not the quality assurance warranty) would be accounted for as a separate performance obligation (i.e., revenue deferral).

How we see it

Although the proposed model is very similar to today's accounting under US GAAP, it would result in changes for some entities.

Under current revenue recognition guidance for services,⁴ entities that provide separate extended warranties defer an amount equal to the stated price of the warranty and record that amount as revenue over the warranty period. Under the revised proposal, an entity would instead defer an allocated amount, generally based on a relative-selling-price allocation.

The proposed revenue model would also apply to sales of nonfinancial assets, such as real estate.

Sale of nonfinancial assets

The proposed guidance would also apply to the sale of certain nonfinancial assets that are not an output of the entity's ordinary activities (i.e., not revenue). This would include the sale of intangible assets and the sale of property, plant and equipment (including real estate). As a result, the proposed model would provide guidance on the measurement and recognition of any gain or loss associated with the sale of such assets.

While the FASB has not yet published any proposed language for the new guidance, based on the FASB staff discussion papers on this issue, we believe that the proposed model would require an entity to derecognize the asset when the buyer obtains control of the asset. At that same time, the entity would recognize the gain or loss from the transaction based on the difference between the transaction price and the carrying amount of the asset. Consistent with the discussion above, the determination of transaction price would take into consideration a number of factors and would be limited to the amounts that can be reasonably estimated.

How we see it

The guidance in the proposed model differs significantly from the stringent requirements that currently exist for sales of real estate. ASC 360-20 includes specific criteria that must be met to recognize a sale of real estate as well as a number of additional requirements that must be met to recognize profit on a sale of real estate. For example, under ASC 360-20, profit recognition on the sale of real estate is not appropriate if the seller finances the transaction and the buyer's initial investment (i.e., down payment) "does not demonstrate a commitment to pay for the property." Under the proposed model, a gain may be recognized for a transaction that does not meet the requirements of ASC 360-20, provided that the expected transaction consideration is reasonably estimable and exceeds the carrying amount of the real estate sold.

Presentation and disclosure

The proposed guidance would require that an entity present the assets and liabilities associated with a contract in the statement of financial position as a contract asset or contract liability when either party to the contract has performed. Receivables related to contracts (i.e., the entity has fully satisfied its performance obligations and has an unconditional right to receive consideration from the customer) would be presented separately from other contract assets.

In addition to the contract asset or liability that is established when either party to the contract performs, an entity could also have recorded other assets (e.g., costs incurred that meet the criteria for capitalization) or liabilities (e.g., onerous performance obligations). The proposed guidance would require that any such assets and liabilities be presented separately from contract assets and contract liabilities in the statement of financial position (assuming they are material).

The proposed model would require significant levels of disclosure around contracts with customers. The proposal would require disclosures related to the following:

- ▶ Revenue from contracts with customers – quantitative information disaggregated into categories to illustrate how the amount, timing and uncertainty of revenue and cash flows are affected by economic factors. For example, categories may include (1) the type of good or service, (2) the geography in which the goods or services are sold, (3) the market or type of buyer, such as governmental versus private sector and (4) the type of contract (e.g., fixed price, time-and-materials)
- ▶ Contract assets and liabilities – rollforward of contract asset and contract liability balances in the aggregate. The beginning and ending balances of the rollforward must reconcile to the statement of financial position and provide details of items such as (1) the amount(s) recognized in the statement of comprehensive income, (2) cash received, (3) amounts transferred to receivables, (4) noncash consideration received and (5) contracts acquired in business combinations

- ▶ Performance obligations – quantitative and qualitative disclosures describing (1) the goods or services the entity has promised to transfer, (2) when the entity typically satisfies its performance obligations, (3) the significant payment terms, (4) obligations for returns and refunds, and (5) types of warranties and related obligations
- ▶ Onerous performance obligations – quantitative and qualitative information such as (1) a description of the nature and amount of the performance obligations for which the liability has been recognized, (2) a description of why those performance obligations have become onerous, (3) an indication of when the entity expects to satisfy the onerous performance obligations and (4) changes in the measure of an onerous liability during the period
- ▶ Significant judgments – quantitative and qualitative information about specific classes of transactions (e.g., methods to measure revenue for transactions that involve performance obligation satisfied continuously) and judgments made in estimating transaction prices and standalone selling prices, estimating returns and identifying onerous performance obligations.

The proposed standard would allow for certain quantitative disclosures to be streamlined or eliminated for nonpublic entities preparing financial statements under US GAAP.

Transition and effective date

The Boards have not yet concluded on an effective date for the new standard. However, the Boards have indicated that a final standard would not be effective before fiscal years beginning in 2015. The FASB also concluded that early adoption of the final standard would be prohibited for US GAAP preparers.

For many entities, one of the more problematic areas of a new revenue standard may be the transition from current practice. All entities would be required to apply the proposed standard retrospectively, but the Boards agreed to the following relief from full retrospective application:

- ▶ Entities would not be required to restate comparative periods for contracts that begin and end within the same annual accounting period.
- ▶ Entities would be able to use hindsight in estimating variable consideration in the transaction price.
- ▶ Entities would not be required to perform an onerous test in comparative periods unless a liability previously was recognized for an onerous contract.
- ▶ Certain ongoing disclosures required in the proposed model would not be required for comparative periods.

The proposed standard would allow full retrospective application for entities that choose not to apply the relief provided. Entities that choose to adopt the final standard using some or all of the types of relief would be required to provide additional qualitative disclosures, such as which types of relief were chosen and the likely effects of applying them.

Next steps

We expect the Boards to publish the revised exposure draft within the next 90 days, and give constituents 120 days to provide feedback. Many aspects of the proposed model are significantly different from the exposure draft published in June 2010 (see the Appendix for a summary of the significant changes). We strongly encourage entities to provide feedback to the Boards on the revised model, especially on any areas where the proposal would result in accounting that does not appropriately reflect the economics of specific revenue arrangements.

Endnotes:

- ¹ Proposed Accounting Standards Update, *Revenue from Contracts with Customers*
- ² This statement applies only to transactions that are in the scope of the proposed guidance. Nonmonetary exchanges between entities in the same line of business that are arranged to facilitate sales to third parties (i.e., the entities involved in the exchange are not the end consumer) are excluded from the scope of the proposed guidance.
- ³ ASC 450, *Contingencies*
- ⁴ ASC 605-20, *Revenue Recognition – Services*

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Appendix: Summary of significant changes since the exposure draft

Original Exposure Draft		Upcoming Exposure Draft
Identifying the contract(s) with the customer		
Existence of a contract	<ul style="list-style-type: none"> ▶ Contracts may be oral, written or implied ▶ Parties to a valid contract must be able to identify the terms and manner of payment for the goods and services. 	<ul style="list-style-type: none"> ▶ Same as the original ED, but clarifying guidance provided to indicate that in some cases a written agreement may be required to show that the parties to the contract are committed to fulfilling their respective obligations. ▶ The transaction price need not be specified for a company to recognize revenue for satisfied performance obligations. A company would apply the model for estimating transaction price and account for the contract accordingly.
Combining contracts	<ul style="list-style-type: none"> ▶ An entity would combine contracts that are linked economically or in some other way and comprise one arrangement among the parties for accounting purposes when there are indicators of price interdependence. ▶ Indicators that two or more contracts have price interdependence include: <ul style="list-style-type: none"> ▶ The contracts are entered into at or near the same time ▶ The contracts are negotiated as a package with a single commercial objective ▶ The contracts are performed either concurrently or consecutively 	<ul style="list-style-type: none"> ▶ An entity would conclude that contracts are interrelated and should be combined when they are executed at or near the same time, generally with the same counterparty, and when any of the following conditions are met: <ul style="list-style-type: none"> ▶ The contracts are negotiated as a package with a single commercial objective. ▶ The amount of consideration received in one contract depends on the performance of the other contract. ▶ The goods and services in the contracts are closely interrelated and interdependent in terms of design, technology or function.
Modifying contracts	<ul style="list-style-type: none"> ▶ A contract modification should be treated as part of the original contract if the two exhibit price interdependence. 	<ul style="list-style-type: none"> ▶ A contract modification that leads to a new, separate performance obligation (priced commensurate with the value of that additional performance obligation) would be accounted for as a separate contract. Otherwise, the modification would lead to reevaluating the performance obligations and reallocating the transaction price with a cumulative adjustment for satisfied performance obligations.
Segmenting a contract	<ul style="list-style-type: none"> ▶ An entity would segment a single contract when the prices of the goods and services in the contract are priced independently. 	<ul style="list-style-type: none"> ▶ The Boards eliminated the requirement to segment a contract.
Identifying the separate performance obligations		
Defining a performance obligation	<ul style="list-style-type: none"> ▶ A performance obligation was defined as “an enforceable promise (whether explicit or implicit) in a contract with a customer to transfer a good or service to the customer.” 	<ul style="list-style-type: none"> ▶ A performance obligation need not be legally enforceable to be considered in the proposed model. Therefore, the definition of performance obligation would not include the word “enforceable.” ▶ A performance obligation should be viewed from the perspective of the customer. That is, a performance obligation exists when the customer reasonably expects performance by the entity.

	Original Exposure Draft	Upcoming Exposure Draft
Distinct performance obligations	<ul style="list-style-type: none"> ▶ A good or service is distinct if the entity, or another entity, sells an identical or similar good or service separately or if the entity could sell the good or service separately because it meets both of the following conditions: <ul style="list-style-type: none"> ▶ The good or service can be used, either on its own or together with other goods and services available in the marketplace (from other entities) ▶ The good or service has a distinct profit margin 	<ul style="list-style-type: none"> ▶ An entity would account for a bundle of promised goods or services as one performance obligation if the entity provides a service of integrating the goods or services into a single item that the entity provides to the customer ▶ An entity would account for a promised good or service, or a bundle of goods or services, as a separate performance obligation if (1) the good or service has a different pattern of transfer to the customer (from other goods and services in the contract) and (2) the good or service has a distinct function. <ul style="list-style-type: none"> ▶ A good or service has a distinct function if (1) the entity regularly sells the good or service separately or (2) the customer can use the good or service either on its own or with resources that are readily available to the customer
Estimating the transaction price		
Variable (uncertain) consideration	<ul style="list-style-type: none"> ▶ An entity would estimate the transaction price at the inception of the contract based on the probability-weighted amount it expects to receive. ▶ An entity would recognize revenue allocated to completed performance obligations, including uncertain consideration, as long as the entity could reasonably estimate the transaction price. ▶ To have the ability to estimate the transaction price, the entity must have experience with similar types of contracts and the entity's experience must be relevant to the contract because the entity does not expect significant changes in circumstances. 	<ul style="list-style-type: none"> ▶ An entity would estimate the transaction price using the probability-weighted approach or based on the most likely amount to be received, whichever best predicts the outcome. ▶ Uncertain consideration would be recognized in revenue only if it is reasonably assured to be received. Consideration is not reasonably assured if the customer can avoid paying the variable amount without breaching the contract. Consideration is also not reasonably assured if an entity has no experience with similar types of revenue contracts, or prior experience is not predictive of future outcomes.
Collectibility	<ul style="list-style-type: none"> ▶ In determining the transaction price, an entity must consider the effects of collectibility, adjusting the estimated transaction price for amounts expected to be uncollectible. ▶ Amounts estimated to be uncollectible at the time the performance obligation is satisfied would be reflected as a reduction of revenue. Subsequent changes in the estimate of uncollectible amounts would be recorded as other income or expense. 	<ul style="list-style-type: none"> ▶ An entity would present revenue without giving effect to amounts that may not be collectible and present amounts expected to be uncollectible on a separate contra-revenue line immediately below gross revenue. The contra-revenue line would include the recognition of the initial allowance as well as the effects of subsequent changes in collectibility.

	Original Exposure Draft	Upcoming Exposure Draft
<i>Time value of money</i>	<ul style="list-style-type: none"> ▶ An entity would consider the effects of the time value of money when there is a timing difference between customer payment and the entity's satisfaction of the performance obligation (e.g., when the consideration is prepaid or is paid well after the services are provided). 	<ul style="list-style-type: none"> ▶ An entity would consider the effect of the time value of money only when an arrangement contains a financing component that is significant to the contract. An entity should consider the following factors to determine whether a contract contains a significant financing component: <ul style="list-style-type: none"> ▶ The amount of customer consideration would be substantially different if the customer paid in cash at the time of transfer of the goods or service ▶ There is a significant difference in the timing of the provision of goods and services and the receipt of payment ▶ The interest rate in the contract (implicit or explicit) is significant ▶ An entity is not required to consider the time value of money when the period between the customer's payment and the entity's satisfaction of the performance obligation is less than one year.
Allocating the transaction price		
<i>Allocating the estimated transaction price</i>	<ul style="list-style-type: none"> ▶ An entity would allocate the transaction price to the performance obligations in proportion to their estimated standalone selling prices (i.e., on a relative standalone selling price basis). Any discount in the contract is allocated proportionally to all of the separate performance obligations in the contract. 	<ul style="list-style-type: none"> ▶ An entity generally would allocate the transaction price (including variable consideration) to the performance obligations in proportion to their estimated standalone selling prices (i.e., on a relative standalone selling price basis). Any discount in the contract is allocated proportionally to all of the separate performance obligations in the contract. ▶ A residual technique may be used to estimate the standalone selling price of a good or service that has a selling price that is highly variable. ▶ When uncertain consideration exists, the uncertain consideration would be allocated entirely to a single performance obligation if both of the following conditions are met: <ul style="list-style-type: none"> ▶ The contingent payment relates specifically to the entity's efforts to satisfy that performance obligation ▶ The amount allocated (including the change in the transaction price due to the contingent payment) to that particular performance obligation is reasonable relative to all of the performance obligations and payment terms (including other potential contingent payments) in the contract

Original Exposure Draft		Upcoming Exposure Draft
Satisfying the performance obligations		
<i>Transfer of control</i>	<ul style="list-style-type: none"> ▶ Revenue allocated to a particular performance obligation should be recognized at the point the customer obtains control of the underlying good or service. The customer “obtains control of a good or service when the customer has the ability to direct the use of, and receive the benefit from, the good or service.” ▶ An entity would assess the transfer of control of goods for each separate performance obligation. Indicators that the customer has obtained control include: <ul style="list-style-type: none"> ▶ The customer has an unconditional obligation to pay ▶ The customer has legal title ▶ The customer has physical possession ▶ The design or function of the good or service is customer-specific 	<ul style="list-style-type: none"> ▶ The core principle related to the transfer of control continues to exist; however, the definition of “control” would not be included in the final standard. ▶ Instead of a definition of control, the following indicators would be included to help entities determine whether a customer has obtained control of a particular good: <ul style="list-style-type: none"> ▶ The customer has an unconditional obligation to pay ▶ The customer has legal title ▶ The customer has physical possession ▶ The customer has the risks and rewards of ownership ▶ Further, control of services would be presumed to occur at the time the services are provided.
<i>Determining whether a promised item represents a good or a service</i>	<p>Did not distinguish between goods and services.</p>	<p>A service is any performance obligation that is satisfied continuously. A performance obligation is satisfied continuously if one of the following criteria is met:</p> <ul style="list-style-type: none"> ▶ The entity’s performance creates or enhances an asset that the customer controls as the asset is being created ▶ The entity’s performance does not create an asset with alternative use to the entity and at least one of the following conditions is met: <ul style="list-style-type: none"> ▶ The customer receives a benefit as each task is being performed ▶ Another entity would not need to re-perform the task(s) performed to date if that other entity were to fulfill the remaining obligation to the customer ▶ The entity has a right to payment for performance to date even if the customer or the entity could cancel the contract for convenience

	Original Exposure Draft	Upcoming Exposure Draft
Measuring progress to completion for performance obligations satisfied continuously	<ul style="list-style-type: none"> ▶ For a performance obligations in which control transfers continuously, an entity must select an appropriate measure of progress toward completion. The entity would select a single revenue recognition method that best depicts the continuous transfer of that service (using an output method, input method or a method based on the passage of time). That method would be applied to all arrangements containing similar performance obligations. 	<ul style="list-style-type: none"> ▶ Once an entity determines that a performance obligation is a service (control is transferred continuously) based on the criteria specified above, it must select an appropriate measure of progress toward completion. The entity would select a single revenue recognition method that best depicts the continuous transfer of that service (using an output method, input method or a method based on the passage of time). That method would be applied to all arrangements containing similar performance obligations. ▶ In situations in which the goods are being procured for the arrangement but have not yet been integrated (e.g., steel for an office building has been delivered but not erected), an entity using an input method (e.g., cost-to-cost) would record revenue at an amount equal to the cost of the good. Once the entity installs the material or places the item(s) in service, it would record revenue equal to the profit component of that good (e.g., as the steel structure is erected, profit would be recognized on the portion of the structure erected, but not on the unused supply of steel).
Contracts for both goods and services	<ul style="list-style-type: none"> ▶ Did not address separately contracts for both goods and services. 	<ul style="list-style-type: none"> ▶ If the goods and services are separable, they should be accounted for separately using the appropriate model. ▶ If the goods and services are not separable (i.e., they represent an integrated bundle that must be accounted for as a single performance obligation or they do not have distinct function from one another), the model for performance obligations satisfied continuously should be applied to the combined unit.
Breakage and prepayments for future goods or services	<ul style="list-style-type: none"> ▶ Did not address the accounting for breakage and prepayments for future goods and services. 	<ul style="list-style-type: none"> ▶ When an entity can reasonably estimate breakage, the entity should recognize the expected breakage as revenue in proportion to the pattern of transfer of goods or services to the customer. ▶ If an entity cannot reasonably estimate breakage, it should recognize the expected breakage as revenue when the likelihood of the customer exercising his or her rights on remaining balances becomes remote.

	Original Exposure Draft	Upcoming Exposure Draft
Licenses and rights of use	<ul style="list-style-type: none"> ▶ Licenses (both exclusive and nonexclusive) would be considered a sale if the customer obtains control over substantially all of the rights associated with the intellectual property (i.e., exclusive license for the duration of its economic life). ▶ If the entity has promised to grant exclusive rights to the customer and the customer does not obtain control over substantially all of the rights associated with the intellectual property, the performance obligation is satisfied over time. ▶ In nonexclusive license arrangements, the promised asset is the license itself and is a single performance obligation. Revenue is recognized when the customer is able to use it and benefit from the asset. 	<ul style="list-style-type: none"> ▶ A promise to grant a license or right of use would be accounted for as a single performance obligation in which the entity recognizes revenue when the customer obtains the right to use and benefit from the asset.
Repurchase options	<ul style="list-style-type: none"> ▶ When a customer is granted an option that, if exercised, gives it the ability to require the vendor to repurchase the transferred asset, the customer has obtained control of the asset (i.e., the customer has the ability to direct the use of the asset), and a sale should be recorded by the vendor. 	<ul style="list-style-type: none"> ▶ When a customer is granted an option that, if exercised, gives it the ability to require the vendor to repurchase the asset, the customer has obtained control of the asset (i.e., the customer has the ability to direct the use of the asset) and a sale should be recorded by the vendor except as discussed below. ▶ The vendor must determine whether the customer has a significant economic incentive to exercise its option. If the customer has a significant economic incentive to exercise the option, the vendor would account for the transactions under the leasing guidance.
Other measurement and recognition topics		
Costs of obtaining a contract	<ul style="list-style-type: none"> ▶ Costs incurred to obtain a contract with a customer would be expensed as incurred unless they can be capitalized under other authoritative guidance. 	<ul style="list-style-type: none"> ▶ An entity would recognize the incremental costs of obtaining a contract (i.e., costs that would not have been incurred if the contract had not been obtained) as an asset for contracts more than one year in duration. For contracts with durations of one year or less, contract acquisition costs may be, but are not required to be, deferred. ▶ Costs should be capitalized only when they are recoverable, either directly (i.e., reimbursable under the contract) or through the margin inherent in the contract. ▶ Capitalized costs would be recorded as a separate asset and amortized systematically over the period that the goods or services are transferred, which may include contracts that are under negotiation as well as contracts that have already been obtained.
Onerous contracts	<ul style="list-style-type: none"> ▶ An entity would test each of its remaining performance obligations to determine whether the probability-weighted present value of the expected direct costs of satisfying the performance obligation exceed the transaction price allocated to that performance obligation. If the direct costs exceed the amount of transaction consideration, a liability and corresponding loss would be recorded. 	<ul style="list-style-type: none"> ▶ An entity would assess whether a performance obligation is onerous only for performance obligations satisfied over time. ▶ In its assessment, an entity would compare the allocated transaction price of the performance obligation to the lesser of (1) the costs directly related to satisfying the performance obligation and (2) the amount the entity would have to pay to exit the contract.

	Original Exposure Draft	Upcoming Exposure Draft
Product warranties	<ul style="list-style-type: none"> ▶ If the objective of the product warranty is to cover defects that existed when the asset was transferred to the customer (latent defects), that warranty does not give rise to a performance obligation; instead, the entity must evaluate whether it has satisfied the performance obligation. <ul style="list-style-type: none"> ▶ If the entity is obligated to replace the asset, it has not fulfilled the related performance obligation, therefore does not recognize revenue for those defective products. ▶ If entity is obligated to repair the asset, it has only partially fulfilled the performance obligation and cannot recognize that portion of the transaction price attributed to the product's components expected to be repaired. ▶ If the objective of the warranty is to provide coverage for faults arising after the product is transferred, the warranty is considered a performance obligation. 	<ul style="list-style-type: none"> ▶ If the warranty provides the customer with assurance that the delivered product is as specified in the contract, an entity would account for a warranty obligation in accordance with the FASB's guidance on contingencies. ▶ Warranties that provide a service to the customer in addition to assurance that the delivered product is as specified in the contract would be treated as a separate performance obligation.
Transition and disclosure		
Transition	<ul style="list-style-type: none"> ▶ The proposed guidance would be applied retrospectively in accordance with ASC 250. 	<ul style="list-style-type: none"> ▶ The proposed guidance would be applied retrospectively in accordance with ASC 250 with the following types of relief: <ul style="list-style-type: none"> ▶ Entities would not be required to restate comparative periods for contracts that begin and end within the same annual accounting period. ▶ Entities would be able to use hindsight in estimating variable consideration in the transaction price. ▶ Entities would not be required to perform an onerous test in comparative periods unless a liability previously was recognized for an onerous contract. ▶ Certain ongoing disclosures required in the proposed model would not be required for comparative periods. ▶ An entity that chooses to apply some or all of the types of relief would be required to provide additional qualitative disclosures, such as which types of relief were chosen and the likely effects of applying them.
Disclosures – nonpublic companies	<ul style="list-style-type: none"> ▶ Did not separately address disclosures for nonpublic companies. 	<ul style="list-style-type: none"> ▶ Certain quantitative disclosures would be streamlined or eliminated for nonpublic companies.