

Technical Line

FASB – final guidance

How the new revenue standard affects banks

In this issue:

Overview	1
Key industry considerations	2
Scope considerations	2
Fee-generating activities ...	3
Sales of real estate	4
Appendix: The five-step revenue model and contract costs.....	7

What you need to know

- ▶ The Joint Transition Resource Group for Revenue Recognition generally agreed that credit card fees and fees for financial guarantees and servicing are not in the scope of the new revenue recognition standard, but deposit-related fees are in the scope of the new guidance.
- ▶ The new standard requires banks to evaluate real estate sales by applying a principles-based approach instead of the prescriptive requirements of ASC 360-20.

Overview

The new revenue recognition standard¹ issued by the Financial Accounting Standards Board (FASB or Board) requires entities in the banking industry to make additional judgments and estimates, such as whether it will be able to collect substantially all of the purchase price in sales of real estate.

This publication highlights key aspects of applying the FASB's standard to a banking entity's contracts with its customers, addresses significant changes to legacy practice and reflects the latest implementation insights.

As a reminder, the FASB deferred² the effective date to annual periods beginning after 15 December 2019 and interim periods in annual periods beginning after 15 December 2020, for entities that had not yet issued (or made available for issuance) financial statements that reflected the standard as of 3 June 2020 (i.e., certain private and not-for-profit entities). Early adoption is permitted. The deferral is intended to give these entities more time to

implement the standard, given the operational and financial reporting challenges of the COVID-19 pandemic. Public entities, as defined by the standard, and some private and not-for-profit entities were already required to adopt the standard.

This publication, which contains a summary of the standard in the Appendix, supplements our Financial reporting developments (FRD) publication, ***Revenue from contracts with customers (ASC 606)***, and should be read in conjunction with it. The views we express in this publication may continue to evolve as implementation continues and additional issues are identified.

Banking entities should also keep in mind that, when they adopt the new credit impairment standard³, they will need to estimate full lifetime expected credit losses for their accounts receivable and contract assets. As a reminder, they will need to do this after assessing collectibility under the revenue guidance to determine whether they have a contract with a customer. Refer to our FRD, ***Credit impairment for short-term receivables under ASC 326***, for more information.

For a discussion of services provided by broker-dealers (e.g., underwriting, trade execution and custody services, advisory services), see our Technical Line, ***How the new revenue standard affects brokers and dealers in securities***. For a discussion of asset management services, see our Technical Line, ***How the new revenue standard affects asset managers***.

Key industry considerations

Scope considerations

The new revenue guidance applies to all contracts with customers to provide goods or services in the ordinary course of business, except for the following contracts that are specifically excluded from the scope:

- ▶ Financial instruments and other contractual rights or obligations within the scope of Accounting Standards Codification (ASC) 310, ASC 320, ASC 321, ASC 323, ASC 325, ASC 405, ASC 470, ASC 815, ASC 825 and ASC 860 (e.g., receivables, debt and equity securities, derivatives)⁴
- ▶ Guarantees (other than product or service warranties) within the scope of ASC 460⁵
- ▶ Insurance contracts within the scope of ASC 944⁶
- ▶ Lease contracts within the scope of ASC 840 or ASC 842⁷
- ▶ Nonmonetary exchanges between entities in the same line of business to facilitate sales to customers other than the parties to the exchange⁸

Because financial instruments are outside the scope of the revenue standard, a bank won't use the new standard to account for gains and losses on its investments in securities, loans and derivatives. Banks also won't use the standard to account for interest and dividend income on financial instruments they own or those included in reverse repurchase agreements and a bank's securities lending activities.

However, the new standard provides guidance for arrangements partially within the scope of the revenue standard and partially in the scope of other standards. If that is the case, an entity needs to first apply the separation and measurement guidance of other topics, if any. An entity should apply the separation and measurement guidance in the revenue standard to any portion of the contract not accounted for in accordance with another topic. For example, a customer contract that includes a line of credit and a fee for administrative services for customer deposit accounts is partially in the scope of the revenue standard (i.e., the portion related to administrative services) and partially in the scope of other standards (i.e., the accounting for the line of credit and any related borrowings is subject to ASC 310).

Credit card fees and fees for financial guarantees and servicing are not in the scope of the standard, but deposit-related fees are in the scope of the standard.

Fee-generating activities

US GAAP stakeholders raised questions about whether certain fee-generating activities of banks are in the scope of ASC 606.

Credit cards

Banks continue to account for credit card receivables and interest they charge on outstanding balances under ASC 310.

ASC 310-20⁹ addresses credit card fees, which are defined as “the periodic uniform fees that entitle cardholders to use credit cards.” Fees that meet the definition of credit card fees are considered loan commitment fees and are deferred and recognized on a straight-line basis over the period the fee entitles the cardholder to use the card.

Because the new revenue standard did not amend ASC 310-20, FASB Transition Resource Group (TRG) members generally agreed¹⁰ that credit card fees that are accounted for under ASC 310 are not in the scope of ASC 606. This includes annual fees that may entitle cardholders to ancillary services. FASB TRG members noted that this conclusion is consistent with legacy accounting for credit card fees. However, the Securities and Exchange Commission Staff Observer at the TRG meeting noted, and FASB TRG members agreed, that the nature of the arrangement must be that of a credit card lending arrangement to be in the scope of ASC 310, and banks will need to continue to evaluate their arrangements as new programs develop.

FASB TRG members also generally agreed that if all consideration (i.e., credit card fees) related to a credit card rewards program is determined to be in the scope of ASC 310, the rewards program is not in the scope of ASC 606 (i.e., revenue would not need to be allocated to the rewards and deferred until the rewards are exercised). However, this determination has to be made based on the facts and circumstances due to the wide variety of credit card reward programs.

Banks earn interchange fees for providing authorization and settlement services for credit card transactions. These fees are in the scope of ASC 606 if the services are transferred to a customer, are an output of the bank’s ordinary activities and are not within the scope of other accounting literature.

Financial guarantees

A financial institution may receive a fee for providing a guarantee of a loan. FASB TRG members generally agreed¹¹ that fees from providing financial guarantees are in the scope of ASC 460 or ASC 815 and therefore are not in the scope of ASC 606. This is because ASC 606 contains a scope exception for contracts that fall under those topics, which provide principles an entity can follow to determine the appropriate accounting to reflect the financial guarantor’s release from risk (and credit to earnings).

Servicing of a financial asset

Certain banks provide specific administrative functions for the owner(s) of a financial asset (e.g., residential mortgage loan) or group of financial assets. FASB TRG members generally agreed that income from servicing financial assets (e.g., loans) is not in the scope of ASC 606. An asset servicer performs various services, such as communication with the borrower and payment collection, in exchange for a fee. FASB TRG members generally agreed that an entity should look to ASC 860 to determine the appropriate accounting for these fees. This is because ASC 606 contains a scope exception for contracts that fall under ASC 860, which provides guidance on the accounting for the fees (despite not providing explicit guidance on revenue accounting).

Deposit-related fees

FASB TRG members generally agreed¹² that deposit-related fees and charges are in the scope of ASC 606, even though ASC 405 is listed as a scope exception in the standard. That's because ASC 405, which financial institutions apply to determine the appropriate liability accounting for customer deposits, does not provide a model for recognizing fees related to customer deposits (e.g., automated teller machine fees, nonsufficient funds fees, account maintenance or dormancy fees).

Sales of real estate

Mortgage loans are often collateralized by real estate, meaning that when a borrower defaults on its loan, the lender may foreclose on the real estate under the terms of the loan agreement. Banks generally record real estate at fair value less costs to sell upon foreclosure. A bank's objective is typically to sell foreclosed real estate (also referred to as other real estate owned, or OREO) within a short period of time because of regulatory and capital requirements. After foreclosure, these assets are carried at the lower of their carrying amount or their fair value less selling costs, so significant gains and losses are uncommon upon sale.

OREO is often sold in a transaction that, under the standard, may not be considered a contract with a customer because the sale of the asset may not be an output of the entity's ordinary activities. However, sales of nonfinancial assets, including in substance nonfinancial assets, should be accounted for using new guidance in ASC 610-20, *Other Income – Gains and Losses from the Derecognition of Nonfinancial Assets*, which requires entities to apply certain measurement and recognition concepts of ASC 606. Accordingly, banks generally will recognize the sale of a real estate property, along with any associated gain or loss, when control of the property transfers to the buyer. For sales of existing real estate properties, this generally will occur at a point in time. The guidance in ASC 610-20 refers to indicators of the transfer of control in ASC 606-10-25-30 to determine when control of the underlying asset has transferred to the buyer. These indicators include the following:

- ▶ The seller has a present right to payment for the asset.
- ▶ The buyer has legal title to the asset.
- ▶ The seller has transferred physical possession of the asset.
- ▶ The buyer has the significant risks and rewards of ownership of the asset.
- ▶ The buyer has accepted the asset.

These criteria, which may require more judgment than the legacy real estate derecognition criteria in ASC 360-20 (e.g., initial and continuing investment thresholds), will often be satisfied at the closing date of most real estate sale transactions.

Banks may determine it is advantageous to finance a portion of the purchase price paid by the buyer. In these cases, a seller will need to apply judgment to evaluate, at contract inception, whether the contract criteria are met, including whether it is probable that it will collect substantially all of the consideration to which it will be entitled. The FASB indicated that entities should assess both the buyer's intent and ability (i.e., capacity) to pay substantially all of the amount to which the entity will be entitled. The standard specifically precludes an entity from evaluating its ability to repossess an asset as part of the collectibility assessment. The FASB noted¹³ that the ability to repossess an asset does not mitigate an entity's exposure to credit risk for the consideration promised in the contract. However, that ability may affect the entity's assessment of whether it has transferred control of the asset to the buyer. Judgment may be required to determine whether an entity's expectation that it will receive less than the stated purchase price indicates that it is not probable that the entity will collect substantially all of the consideration to which it will be entitled.

If it is not probable that the entity will collect substantially all of the consideration to which it expects to be entitled (or any of the other contract criteria described in the Appendix are not met), an entity would not account for the arrangement using the model in the standard until the concerns about collectibility are resolved and the other contract criteria are met.

In cases in which the arrangement does not meet the criteria to be a contract (and continues not to meet them), an entity should include nonrefundable consideration received in the gain or loss calculation only when one of the following events has occurred:

- The entity has fully performed, and substantially all of the consideration has been received.
- The contract has been terminated.
- The entity has transferred control of the goods or services and has stopped transferring (and has no obligation under the contract to transfer) additional goods or services to the buyer, if applicable.

Until one of these events happens, any consideration received from the buyer is initially accounted for as a liability (not revenue), and the liability is measured at the amount of consideration received from the buyer.

Significant judgment is required to determine whether a bank has transferred control of real estate when collection of the consideration is not probable.

Significant judgment is required to determine whether a bank has transferred control of the real estate (a requirement of the third event) when it has determined that it is not probable that it will collect substantially all of the consideration to which it will be entitled. For example, a bank will need to assess whether it has transferred the risks and rewards of ownership of the real estate.

If a bank determines that it has met the third event because it has transferred control of the real estate, it will only include the nonrefundable consideration received, and not the transaction price, in the gain or loss calculation. Therefore, the bank would recognize a loss if the nonrefundable consideration received to date is less than the carrying amount of the real estate.

How we see it

ASC 360-20-55-1 to 55-2 provides specific guidance on the minimum initial investment required for an entity to recognize the full profit on a sale (i.e., the full accrual method). This guidance was retained to evaluate sales-leaseback transactions but should no longer be referenced when entities evaluate real estate sales under ASC 610-20. Banks therefore may be required to exercise more judgment in determining whether gain or loss recognition is appropriate.

It is likely that substantially all sales of real estate that previously qualified for full accrual profit recognition under ASC 360-20 will continue to meet the criteria for sale (and associated profit) recognition under the new guidance. However, in some cases, sales of real estate that did not previously qualify for full accrual profit recognition will now meet the criteria for sale recognition under the new guidance.

Refer to our separate Technical Line, [***How the new revenue standard affects operating real estate entities***](#), for a more comprehensive summary of considerations related to real estate sales.

Endnotes:

- ¹ ASC 606, *Revenue from Contracts with Customers*, as amended, was created by Accounting Standards Update (ASU) 2014-09, *Revenue from Contracts with Customers*, and various amendments.
- ² ASU 2020-05, *Revenue from Contracts with Customers (Topic 606) and Leases (Topic 842): Effective Dates for Certain Entities*.
- ³ ASU 2016-13, *Financial Instruments – Credit Losses (Topic 326): Measurement of Credit Losses on Financial Instruments*.
- ⁴ ASC 310, *Receivables*; ASC 320, *Investments – Debt and Equity Securities*; ASC 321, *Investments – Equity Securities*; ASC 323, *Investments – Equity Method and Joint Ventures*; ASC 325, *Investments – Other*; ASC 405, *Liabilities*; ASC 470, *Debt*; ASC 815, *Derivatives and Hedging*; ASC 825, *Financial Instruments*; and ASC 860, *Transfers and Servicing*.
- ⁵ ASC 460, *Guarantees*.
- ⁶ ASC 944, *Financial Services – Insurance*.
- ⁷ ASC 840, *Leases*, or ASC 842, *Leases*. ASC 842 is effective for public entities and certain not-for-profit entities and employee benefit plans for annual periods beginning after 15 December 2018 and interim periods within those years. For all other entities, it is effective for annual periods beginning after 15 December 2019 and interim periods the following year. Early adoption is permitted for all entities.
- ⁸ ASC 845, *Nonmonetary Transactions*.
- ⁹ ASC 310-20, *Receivables – Nonrefundable Fees and Other Costs*.
- ¹⁰ 13 July 2015 FASB TRG meeting; agenda paper no. 36.
- ¹¹ 18 April 2016 FASB TRG meeting; agenda paper no. 52.
- ¹² Paragraph BC15 of ASU 2016-12, *Revenue from Contracts with Customers (Topic 606): Narrow-Scope Improvements and Practical Expedients*.
- ¹³ See March 2017 Call Report Supplemental Instructions at https://www.ffeec.gov/PDF/FFIEC_forms/FFIEC031_FFIEC041_FFIEC051_suppinst_201703.pdf.

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Appendix: The five-step revenue model and contract costs

The standard's core principle is that an entity recognizes revenue at an amount that reflects the consideration to which the entity expects to be entitled in exchange for transferring goods or services to a customer. That principle is applied using five steps that require entities to exercise judgment when considering the terms of their contract(s) and all relevant facts and circumstances. Entities have to apply the requirements of the standard consistently to contracts with similar characteristics and in similar circumstances. This table summarizes the new revenue model and the guidance for contract costs.

Step 1: Identify the contract(s) with the customer
<p><i>Definition of a contract</i></p> <p>An entity must first identify the contract, or contracts, to provide goods and services to customers. A contract must create enforceable rights and obligations to fall within the scope of the model in the standard. Such contracts may be written, oral or implied by an entity's customary business practices but must meet the following criteria:</p> <ul style="list-style-type: none"> ▶ The parties to the contract have approved the contract (in writing, orally or based on their customary business practices) and are committed to perform their respective obligations. ▶ The entity can identify each party's rights regarding the goods or services to be transferred. ▶ The entity can identify the payment terms for the goods or services to be transferred. ▶ The contract has commercial substance (i.e., the risk, timing or amount of the entity's future cash flows is expected to change as a result of the contract). ▶ It is probable that the entity will collect substantially all of the consideration to which it will be entitled in exchange for the goods or services that will be transferred to the customer. <p>If these criteria are not met, an entity would not account for the arrangement using the model in the standard and would recognize any nonrefundable consideration received as revenue only when certain events have occurred.</p> <p><i>Contract combination</i></p> <p>The standard requires entities to combine contracts entered into at or near the same time with the same customer (or related parties of the customer) if they meet any of the following criteria:</p> <ul style="list-style-type: none"> ▶ The contracts are negotiated as a package with a single commercial objective. ▶ The amount of consideration to be paid in one contract depends on the price or performance of another contract. ▶ The goods or services promised in the contracts (or some goods or services promised in each of the contracts) are a single performance obligation. <p><i>Contract modifications</i></p> <p>A contract modification is a change in the scope and/or price of a contract. A contract modification is accounted for as a new contract separate from the original contract if the modification adds distinct goods or services at a price that reflects the standalone selling prices of those goods or services. Contract modifications that are not accounted for as separate contracts are considered changes to the original contract and are accounted for as follows:</p> <ul style="list-style-type: none"> ▶ If the goods and services to be transferred after the contract modification are distinct from the goods or services transferred on or before the contract modification, the entity should account for the modification as if it were the termination of the old contract and the creation of a new contract. ▶ If the goods and services to be transferred after the contract modification are not distinct from the goods and services already provided and, therefore, form part of a single performance obligation that is partially satisfied at the date of modification, the entity should account for the contract modification as if it were part of the original contract. ▶ A combination of the two approaches above: a modification of the existing contract for the partially satisfied performance obligations and the creation of a new contract for the distinct goods and services

Step 2: Identify the performance obligation(s) in the contract

An entity must identify the promised goods and services within the contract and determine which of those goods and services (or bundles of goods and services) are separate performance obligations (i.e., the unit of accounting for purposes of applying the standard). An entity is not required to assess whether promised goods or services are performance obligations if they are immaterial in the context of the contract.

A promised good or service represents a performance obligation if (1) the good or service is distinct (by itself or as part of a bundle of goods or services) or (2) the good or service is part of a series of distinct goods or services that are substantially the same and have the same pattern of transfer to the customer.

A good or service (or bundle of goods or services) is distinct if both of the following criteria are met:

- ▶ 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 (i.e., the good or service is capable of being distinct).
- ▶ The entity's promise to transfer the good or service to the customer is separately identifiable from other promises in the contract (i.e., the promise to transfer the good or service is distinct within the context of the contract).

In assessing whether an entity's promise to transfer a good or service is separately identifiable from other promises in the contract, entities need to consider whether the nature of the promise is to transfer each of those goods or services individually or to transfer a combined item or items to which the promised goods or services are inputs. Factors that indicate two or more promises to transfer goods or services are not separately identifiable include, but are not limited to, the following:

- ▶ The entity provides a significant service of integrating the goods or services with other goods or services promised in the contract into a bundle of goods or services that represent the combined output or outputs for which the customer has contracted.
- ▶ One or more of the goods or services significantly modify or customize, or are significantly modified or customized by, one or more of the other goods or services promised in the contract.
- ▶ The goods or services are highly interdependent or highly interrelated. In other words, each of the goods or services is significantly affected by one or more of the other goods or services in the contract.

If a promised good or service is not distinct, an entity is required to combine that good or service with other promised goods or services until it identifies a bundle of goods or services that is distinct.

Series guidance

Goods or services that are part of a series of distinct goods or services that are substantially the same and have the same pattern of transfer to the customer must be combined into one performance obligation. To meet the same pattern of transfer criterion, each distinct good or service in the series must represent a performance obligation that would be satisfied over time and would have the same measure of progress toward satisfaction of the performance obligation (both discussed in Step 5), if accounted for separately.

Customer options for additional goods or services

A customer's option to acquire additional goods or services (e.g., an option for free or discounted goods or services) is accounted for as a separate performance obligation if it provides a material right to the customer that the customer would not receive without entering into the contract (e.g., a discount that exceeds the range of discounts typically given for those goods or services to that class of customer in that geographical area or market).

Principal vs. agent considerations

When more than one party is involved in providing goods or services to a customer, an entity must determine whether it is a principal or an agent in these transactions by evaluating the nature of its promise to the customer. An entity is a principal and, therefore, records revenue on a gross basis if it controls the specified good or service before transferring that good or service to the customer. An entity is an agent and records as revenue the net amount it retains for its agency services if its

role is to arrange for another entity to provide the specified goods or services. Because it is not always clear whether an entity controls a specified good or service in some contracts (e.g., those involving intangible goods and/or services), the standard also provides indicators of when an entity may control the specified good or service as follows:

- ▶ The entity is primarily responsible for fulfilling the promise to provide the specified good or service.
- ▶ The entity has inventory risk before the specified good or service has been transferred to a customer or after transfer of control to the customer (e.g., if the customer has a right of return).
- ▶ The entity has discretion in establishing the price for the specified good or service.

Step 3: 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. When determining the transaction price, entities need to consider the effects of all of the following:

Variable consideration

An entity needs to estimate any variable consideration (e.g., amounts that vary due to discounts, rebates, refunds, price concessions, bonuses) using either the expected value method (i.e., a probability-weighted amount method) or the most likely amount method (i.e., a method to choose the single most likely amount in a range of possible amounts). An entity's method selection is not a "free choice" and must be based on which method better predicts the amount of consideration to which the entity will be entitled. To include variable consideration in the estimated transaction price, the entity has to conclude that it is probable that a significant revenue reversal will not occur in future periods. This "constraint" on variable consideration is based on the probability of a reversal of an amount that is significant relative to cumulative revenue recognized for the contract. The standard provides factors that increase the likelihood or magnitude of a revenue reversal, including the following: the amount of consideration is highly susceptible to factors outside the entity's influence, the entity's experience with similar types of contracts is limited or that experience has limited predictive value, or the contract has a large number and broad range of possible outcomes. The standard requires an entity to estimate variable consideration, including the application of the constraint, at contract inception and update that estimate at each reporting date.

Significant financing component

An entity needs to adjust the transaction price for the effects of the time value of money if the timing of payments agreed to by the parties to the contract provides the customer or the entity with a significant financing benefit. As a practical expedient, an entity can elect not to adjust the transaction price for the effects of a significant financing component if the entity expects at contract inception that the period between payment and performance will be one year or less.

Noncash consideration

When an entity receives, or expects to receive, noncash consideration (e.g., property, plant or equipment; a financial instrument), the fair value of the noncash consideration at contract inception is included in the transaction price.

Consideration paid or payable to the customer

Consideration payable to the customer includes cash amounts that an entity pays, or expects to pay, to the customer, credits or other items (vouchers or coupons) that can be applied against amounts owed to the entity, or equity instruments granted in conjunction with selling goods or services. An entity should account for consideration paid or payable to the 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. However, if the payment to the customer exceeds the fair value of the distinct good or service received, the entity should account for the excess amount as a reduction of the transaction price.

Step 4: Allocate the transaction price to the performance obligations in the contract

For contracts that have multiple performance obligations, the standard generally requires an entity to allocate the transaction price to the performance obligations in proportion to their standalone selling prices (i.e., on a relative standalone selling price basis). When allocating on a relative standalone selling price basis, any discount within the contract generally is allocated proportionately to all of the performance obligations in the contract. However, there are two exceptions.

One exception requires variable consideration to be allocated entirely to a specific part of a contract, such as one or more (but not all) performance obligations or 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, if both of the following criteria are met:

- ▶ 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.
- ▶ Allocating the variable consideration entirely to the performance obligation or the distinct good or service is consistent with the objective of allocating consideration in an amount that depicts the consideration to which the entity expects to be entitled in exchange for transferring the promised goods or services to the customer.

The other exception requires an entity to allocate a contract's entire discount to only those goods or services to which it relates if certain criteria are met.

To allocate the transaction price on a relative standalone selling price basis, an entity must first determine the standalone selling price of the distinct good or service underlying each performance obligation. The standalone selling price is the price at which an entity would sell a good or service on a standalone (or separate) basis at contract inception. Under the model, the observable price of a good or service sold separately in similar circumstances to similar customers provides the best evidence of standalone selling price. However, in many situations, standalone selling prices will not be readily observable. In those cases, the entity must estimate the standalone selling price by considering all information that is reasonably available to it, maximizing the use of observable inputs and applying estimation methods consistently in similar circumstances. The standard states that suitable estimation methods include, but are not limited to, an adjusted market assessment approach, an expected cost plus a margin approach or a residual approach (if certain conditions are met).

Step 5: Recognize revenue when (or as) the entity satisfies a performance obligation

An entity recognizes revenue only when (or as) it satisfies a performance obligation by transferring control of the promised good(s) or service(s) to a customer. The transfer of control can occur over time or at a point in time.

A performance obligation is satisfied at a point in time unless it meets one of the following criteria, in which case it is satisfied over time:

- ▶ The customer simultaneously receives and consumes the benefits provided by the entity's performance as the entity performs.
- ▶ The entity's performance creates or enhances an asset that the customer controls as the asset is created or enhanced.
- ▶ 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.

The transaction price allocated to performance obligations satisfied at a point in time is recognized as revenue when control of the goods or services transfers to the customer. If the performance obligation is satisfied over time, the transaction price allocated to that performance obligation is recognized as revenue as the performance obligation is satisfied. To do this, the standard requires an entity to select a single revenue recognition method (i.e., measure of progress) that faithfully depicts the pattern of the transfer of control over time (i.e., an input method or an output method).

Licenses of intellectual property

The standard provides guidance on the recognition of revenue for licenses of intellectual property (IP) that differs from the model for other promised goods and services. The nature of the promise in granting a license of IP to a customer is either:

- ▶ A right to access the entity's IP throughout the license period (a right to access)
- ▶ A right to use the entity's IP as it exists at the point in time in which the license is granted (a right to use)

To determine whether the entity's promise is to provide a right to access its IP or a right to use its IP, the entity should consider the nature of the IP to which the customer will have rights. The standard requires entities to classify IP in one of two categories:

- ▶ **Functional:** This IP has significant standalone functionality (e.g., many types of software; completed media content, such as films, television shows and music). Licenses of functional IP generally grant a right to use the entity's IP, and revenue for these licenses generally is recognized at the point in time when the IP is made available for the customer's use and benefit. This is the case if the functionality is not expected to change substantially as a result of the licensor's ongoing activities that do not transfer an additional promised good or service to the customer. If the functionality of the IP is expected to substantively change because of activities of the licensor that do not transfer additional promised goods or services, and the customer is contractually or practically required to use the latest version of the IP, revenue for the license is recognized over time. However, we expect licenses of functional IP to meet the criteria to be recognized over time infrequently, if at all.
- ▶ **Symbolic:** This IP does not have significant standalone functionality (e.g., brands, team and trade names, character images). The utility (i.e., the ability to provide benefit or value) of symbolic IP is largely derived from the licensor's ongoing or past activities (e.g., activities that support the value of character images). Licenses of symbolic IP grant a right to access an entity's IP, and revenue from these licenses is recognized over time as the performance obligation is satisfied (e.g., over the license period).

Revenue cannot be recognized from a license of IP before both (1) an entity provides (or otherwise makes available) a copy of the IP to the customer and (2) the beginning of the period during which the customer is able to use and benefit from its right to access or its right to use the IP.

The standard specifies that sales- and usage-based royalties on licenses of IP are recognized when the later of the following events occurs: (1) the subsequent sales or usage occurs or (2) 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). This guidance must be applied to the overall royalty stream when the sole or predominant item to which the royalty relates is a license of IP (i.e., these types of arrangements are either entirely in the scope of this guidance or entirely in the scope of the general variable consideration constraint guidance).

Contract costs

ASC 340-40, *Other Assets and Deferred Costs – Contracts with Customers*, specifies the accounting for costs an entity incurs to obtain and fulfill a contract to provide goods and services to customers. The incremental costs of obtaining a contract (i.e., costs that would not have been incurred if the contract had not been obtained) are recognized as an asset if the entity expects to recover them. ASC 340-40 cites commissions as a type of incremental cost that may require capitalization. The standard provides a practical expedient that permits an entity to immediately expense contract acquisition costs when the asset that would have resulted from capitalizing these costs would have been amortized in one year or less.

An entity accounts for costs incurred to fulfill a contract with a customer that are within the scope of other authoritative guidance (e.g., inventory; property, plant and equipment; internal-use software) in accordance with that guidance. If the costs are not in the scope of other accounting guidance, an entity recognizes an asset from the costs incurred to fulfill a contract only if those costs meet all of the following criteria:

- ▶ The costs relate directly to a contract or to an anticipated contract that the entity can specifically identify.
- ▶ 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.
- ▶ The costs are expected to be recovered.

Any capitalized contract costs are amortized, with the expense recognized as an entity transfers the related goods or services to the customer. Any asset recorded by the entity is subject to an impairment assessment.