Revenue recognition – Multiple element arrangements

Accounting Standards Codification 605-25
Revised March 2018
Many companies provide multiple products or services ("deliverables") to their customers as part of a single arrangement. These arrangements may range from relatively simple arrangements for the delivery of multiple products on a single date (e.g., when a retailer sells a personal computer and printer to a customer and delivers each concurrently) to highly customized, complex arrangements designed to provide an integrated solution to a customer’s business needs (e.g., when a vendor agrees to design and build equipment to increase the efficiency of a customer’s business process, and to then maintain the equipment and run it on an outsourced basis for an extended period).

Companies’ products and service offerings continue to evolve and become more complex in reaction to the needs of their customers. Bundled deliverables within an arrangement and with varying payment terms have become commonplace, consequently increasing the difficulty of accounting for such transactions. These payment terms may not always require payment at the product or service’s delivery date, but may instead precede or follow delivery. Accordingly, it may not be readily apparent which payment, or what portion of a payment, relates to which deliverable included in an arrangement. Practice questions frequently arise on whether, and if so, how, to allocate the arrangement consideration to the individual deliverables. Additionally, restatements resulting either from the misapplication of revenue recognition principles to a multiple-element arrangement or the improper allocation of arrangement consideration to the various elements included in a multiple-element arrangement remain common.

The guidance on accounting for arrangements with multiple deliverables is primarily codified in ASC 605-25, Revenue Recognition — Multiple-Element Arrangements. ASC 605-25 provides guidance on the separability of deliverables included in an arrangement into different units of accounting and the allocation of an arrangement’s consideration to those units of accounting. However, it does not address when revenue should be recognized for the units of accounting. Companies should apply other applicable revenue recognition guidance (e.g., the revenue recognition guidance in SAB Topic 13) to determine when arrangement consideration applicable to a deliverable that qualifies as a separate unit of accounting should be recognized as revenue.

Past and future modifications to the multiple-element arrangements guidance

In May 2014, the Financial Accounting Standards Board (FASB or Board) and the International Accounting Standards Board (IASB) (collectively, the Boards) issued largely converged revenue recognition standards. Once effective, this new guidance will replace virtually all current revenue recognition guidance, including the multiple-element arrangements guidance in ASC 605-25. See our Financial reporting developments (FRD), Revenue from contracts with customers (ASC 606) for additional guidance on the new revenue standard.

Under US GAAP, the standard is effective for public entities for fiscal years beginning after 15 December 2017, and for interim periods therein. Nonpublic entities are required to adopt the new guidance for fiscal years beginning after 15 December 2018, and interim periods within fiscal years beginning after 15 December 2019. US GAAP public and nonpublic entities will be permitted to adopt the standard as early as annual reporting periods beginning after 15 December 2016, and interim periods therein. Early adoption prior to that date is not permitted.
We hope this publication will help you understand and successfully apply the provisions of ASC 605-25. Ernst & Young professionals are prepared to assist you in your understanding and are ready to discuss your particular concerns and questions.

Ernst & Young LLP

March 2018
Contents

1 Identifying deliverables ........................................................................................................... 1
   1.1 Chapter summary ................................................................................................................. 1
   1.2 Arrangements with multiple deliverables ............................................................................. 2
      1.2.1 Identifying deliverables in an arrangement ................................................................. 2
      1.2.2 Options to purchase additional deliverables in the future ........................................... 3
      1.2.3 Options to purchase discounted products in the future .............................................. 3
      1.2.4 Exclusivity clauses within contracts ............................................................................. 5
      1.2.5 Deliverables included in repetitive transactions .......................................................... 6
      1.2.6 Contingent deliverables within an arrangement ........................................................... 7
      1.2.7 Trade-in rights ............................................................................................................. 8
      1.2.8 Specified upgrade rights ............................................................................................ 11

2 Scope and scope exceptions .................................................................................................. 12
   2.1 Chapter summary ................................................................................................................ 12
   2.2 Scope and scope exceptions ............................................................................................... 13
   2.3 Interaction of the multiple-element arrangements guidance with other guidance .......... 14
      2.3.1 Revenue recognition guidance .................................................................................... 15
      2.3.2 Interaction with other specific ASC guidance ............................................................... 15
      2.3.3 Interaction with the software revenue recognition guidance ....................................... 19
      2.3.4 Interaction with the separately priced extended warranty and product maintenance guidance .......................................................... 21
      2.3.5 Applicability to software customization contracts ....................................................... 23
      2.3.6 Interaction with the leasing guidance .......................................................................... 24
      2.3.7 Interaction with the construction-type and production-type guidance for services bundled with a construction contract.......................................................... 26

3 Determining units of accounting ......................................................................................... 27
   3.1 Chapter summary ................................................................................................................ 27
   3.2 Basic principles and contract combination or separation ................................................... 28
      3.2.1 Evaluating separate contracts as a single arrangement .............................................. 28
      3.2.2 Evaluating subsequent contracts and modifications to contracts originally accounted for under ASU 2009-13 ................................................................. 31
   3.3 Timing of evaluation of units of accounting ...................................................................... 33
      3.3.1 Evaluation of deliverables subsequent to the inception of the arrangement ............... 33
      3.3.2 Reporting changes in the unit of accounting ............................................................... 35
   3.4 Separating units of accounting ......................................................................................... 36
      3.4.1 Mandatory application of the separation criteria ......................................................... 36
      3.4.2 Impact of the order of deliverables .............................................................................. 36
      3.4.3 Factors to consider when evaluating standalone value ............................................... 37
      3.4.4 Interaction of general right of return with contingent revenue .................................... 40
      3.4.5 General right of return – factors to consider when evaluating probability of future performance ............................................................................................................... 41
3.5 Accounting for a combined unit of accounting ................................................................. 42
   3.5.1 Revenue recognition method for a combined unit of accounting .............................. 43
   3.5.2 Presentation of revenue when services and products are included in a combined unit of accounting ........................................................................................................ 44
3.6 Recognition of losses on undelivered items ...................................................................... 45

4 Measurement and allocation of arrangement consideration ........................................ 46
   4.1 Chapter summary ............................................................................................................ 46
   4.2 Measurement of arrangement consideration .................................................................... 47
      4.2.1 Inclusion of contingent fees in allocable arrangement consideration ....................... 47
   4.3 Use of relative-selling-price method to allocate arrangement consideration ................. 48
      4.3.1 Allocation of arrangement consideration for arrangements including a significant and incremental discount ................................................. 49
   4.4 Units of accounting measured at fair value ..................................................................... 51
      4.4.1 Allocation of arrangement consideration to deliverables for which fair value accounting is required ............................................................. 52
   4.5 Effect of contingent revenue on allocation .................................................................... 53
      4.5.1 Effect of general refund rights and contingent revenue features on the allocation of arrangement consideration ........................................ 53
      4.5.2 Consideration of the probability of a vendor’s successful performance when assessing contingent revenue features ..................................... 56
      4.5.3 Income statement classification of contingent revenue ......................................... 56
      4.5.4 Recording deferred revenue when contingent revenue exists ................................ 57
   4.6 Effect of cancellation provisions on measurement ......................................................... 58
   4.7 Determination of selling price ....................................................................................... 60
      4.7.1 Hierarchy for determining evidence of selling price when applying the relative-selling-price method .................................................... 61
      4.7.2 Required use of VSOE or TPE of selling price when available ................................. 61
      4.7.3 Effect of update to estimated selling price .............................................................. 62
      4.7.4 Establishing VSOE ................................................................................................ 62
      4.7.5 Evaluating third-party evidence of selling price ..................................................... 64
      4.7.6 Determining a vendor’s best estimate of the selling prices .................................... 65
      4.7.7 Determining selling price for a group of deliverables delivered together .................. 69
      4.7.8 Multiple estimates of selling price for a single deliverable ..................................... 70

5 Accounting for costs associated with a delivered item that cannot be accounted for separately ......................................................................................................................... 71
   5.1 Chapter summary ............................................................................................................ 71
   5.2 Accounting for costs associated with a delivered item not accounted for separately ....... 71
      5.2.1 Subsequent recognition of capitalized costs ............................................................ 76
      5.2.2 Capitalization of costs subsequent to revenue recognition ..................................... 76
   5.3 Accounting for costs of a delivered item accounted for separately when arrangement consideration allocated to that item is limited by contingent revenue provisions ........................................ 76
   5.4 Assessing the recoverability of capitalized costs ............................................................ 80

6 Disclosure ......................................................................................................................... 82
   6.1 Chapter summary ............................................................................................................ 82
   6.2 Disclosure requirements ................................................................................................. 82
7 Transitional considerations in adopting the revised guidance in ASU 2009-13 .......... 85
  7.1 Chapter summary .............................................................................................................. 85
  7.2 Evaluation of “materially modified” ................................................................................ 85
  7.3 Accounting for a materially modified arrangement .......................................................... 87
    7.3.1 Deferred revenue related to a materially modified arrangement ............................ 87

A Examples of the application of the multiple-element arrangements guidance .......... A-1
B Abbreviations used in this publication ............................................................................. B-1
C Summary of important changes ........................................................................................ C-1
Notice to readers:

This publication includes excerpts from and references to the FASB Accounting Standards Codification ("the Codification" or "ASC"). The Codification is the single source of authoritative nongovernmental US generally accepted accounting principles (US GAAP), with the exception of guidance issued by the SEC, and is effective for interim and annual periods ending after 15 September 2009. The Codification comprises all US GAAP issued by a standard setter, excluding those standards for state and local governments, and supersedes previously issued accounting standards.

The Codification uses a hierarchy that includes Topics, Subtopics, Sections and Paragraphs. Each Topic includes an Overall Subtopic that generally includes pervasive guidance for the topic, and additional Subtopics, as needed, with incremental or unique guidance. Each Subtopic includes Sections which in turn include numbered Paragraphs. Thus, a codification reference includes the Topic (XXX), Subtopic (YY), Section (ZZ) and Paragraph (PP).

Throughout this publication references to guidance in the codification are shown using these reference numbers. References are also made to certain pre-codification standards (and specific sections or paragraphs of pre-codification standards) in situations in which the content being discussed is excluded from the Codification.

Appendix A of this publication provides examples of the application of this ASC Topic, which are reproduced from the implementation guidance and illustrations section of this ASC Topic. Appendix B provides abbreviations for accounting standards used throughout this publication. Relevant terms from the glossary for this ASC Topic are indicated in bold type the first time used in this publication.

This publication has been carefully prepared but it necessarily contains information in summary form and is therefore intended for general guidance only; it is not intended to be a substitute for detailed research or the exercise of professional judgment. The information presented in this publication should not be construed as legal, tax, accounting or any other professional advice or service. Ernst & Young LLP can accept no responsibility for loss occasioned to any person acting or refraining from action as a result of any material in this publication. You should consult with Ernst & Young LLP or other professional advisors familiar with your particular factual situation for advice concerning specific audit, tax or other matters before making any decisions.
1 Identifying deliverables

1.1 Chapter summary

The multiple-element arrangements guidance included in ASC 605-25 is applicable to all arrangements that obligate a vendor to provide more than one product or service (deliverables or elements) and that are not subject to the scope of other specific accounting literature (see Section 2.3.2). For purposes of applying this guidance, arrangements are defined as contractually binding agreements, whether written, oral or implied. In certain circumstances, one arrangement may be comprised of multiple contractual agreements entered into with the same counterparty at or near the same time.

ASC 605-25 provides guidance relating to the separability of deliverables included in an arrangement into different units of accounting (see Chapter 3, Determining units of accounting) and the allocation of an arrangement’s consideration to those units of accounting (see Chapter 4, Measurement and allocation of arrangement consideration). It does not address when revenue should be recognized for deliverables determined to be a separate unit of accounting. Companies should apply other applicable revenue recognition guidance (such as the guidance in SAB Topic 13) to determine when arrangement consideration applicable to a separate unit of accounting should be recognized as revenue. However, the application of this guidance may affect the unit of accounting to which specific revenue recognition literature is applied, as well as the amount of revenue allocated to each unit of accounting. As such, this guidance may affect companies’ revenue recognition policies.

ASC 605-25 establishes the following two criteria, both of which must be met, in order for a deliverable to qualify as a separate unit of accounting:

- The delivered item(s) has value to the customer on a standalone basis.
- If a general right of return exists relative to the delivered item, delivery or performance of the undelivered item(s) is considered probable and substantially in the control of the vendor.

The following diagram demonstrates how to determine when multiple deliverables included in an arrangement represent separate units of accounting:

```
Arrangement has multiple deliverables and is within the scope of this Subtopic.

Do the delivered item or items have value to the customer on a standalone basis?

Yes

If the arrangement includes a general right of return relative to the delivered item or items, is delivery or performance of the undelivered item or items probable and substantially controlled by the vendor?

Yes

Accounting for delivered item or items as a separate unit of accounting.

No

Do not account for delivered item or items as a separate unit of accounting.

No

Financial reporting developments Revenue recognition -- Multiple element arrangements | 1
```
While the concept of “deliverables” is relatively straightforward, in practice it is sometimes difficult to identify the deliverables within an arrangement. Part of this difficulty arises from the fact that the term deliverables is not defined in accounting literature. Generally, however, deliverables include all performance obligations imposed on a vendor by an agreement. A deliverable may be an obligation to provide goods, an obligation to deliver services, a right or license to use an asset, or some other vendor performance obligation that was bargained for as part of the arrangement. (See Section 1.2.1 for a further discussion of the factors that we believe should be considered in identifying the elements or deliverables within an arrangement.)

1.2 Arrangements with multiple deliverables

Excerpt from Accounting Standards Codification
Revenue Recognition — Multiple-Element Arrangements

Overview and Background

605-25-05-1
This Subtopic addresses some aspects of the accounting by a vendor for arrangements under which it will perform multiple revenue-generating activities. Specifically, this Subtopic addresses how to determine whether an arrangement involving multiple deliverables contains more than one unit of accounting, and how arrangement consideration shall be measured and allocated to the separate units of accounting in the arrangement.

605-25-05-2
To meet their customers’ needs, vendors often provide multiple products, services, rights to use assets, or any combination thereof. These vendors transfer the deliverables to the customer and performance may occur at different times or over different periods of time, and the customer’s payments for these deliverables may be fixed, variable, or a combination of fixed and variable.

1.2.1 Identifying deliverables in an arrangement

ASC 605-25 only applies to arrangements with multiple deliverables but does not provide guidance on determining if an arrangement includes multiple deliverables. Since the term deliverable is not defined in accounting literature, analyzing arrangements may require the use of judgment to determine if a deliverable exists. Deliverables generally include all performance obligations imposed on a vendor by an agreement. A deliverable may be an obligation to provide goods, an obligation to deliver services, a right or license to use an asset, or some other vendor performance obligation that was bargained for as part of the arrangement. In general, we believe that an item should be presumed to be a deliverable if:

1) It is explicitly referred to as an obligation of the vendor in a contractual agreement
2) It requires a distinct action by the vendor
3) The vendor’s failure to complete an action would result in a significant contractual penalty
4) The inclusion or exclusion of the item in the arrangement reasonably would be expected to cause the arrangement consideration to vary by more than an insignificant amount

The facts and circumstances applicable to an arrangement should be considered when determining if an item is a deliverable.
1.2.2 Options to purchase additional deliverables in the future

Frequently, agreements include options for the customer to receive additional products or services in the future at agreed-upon prices. Whether or not these options should be treated as deliverables in the original contract depends on the facts and circumstances surrounding the options for additional products and services. If such an option is substantive (i.e., the customer is not required to purchase additional products), then the vendor is not obligated under the option to deliver goods and services unless and until such time as the customer elects to exercise the option. In such cases, the products or services to be delivered by the vendor upon the exercise of the option should not be considered elements included in the current arrangement.

Determining whether an option to acquire additional products or services is substantive requires an assessment as to whether the vendor is truly at risk as to whether the customer will choose to exercise the option. For example, if an arrangement includes an option to acquire services from a vendor that are essential to the functionality of other elements of the arrangement, and such services are only available from the vendor (i.e., there is a lack of other qualified service providers that can be engaged to perform the services), we do not believe the option should be considered substantive. If the option is not substantive, we believe the products or services to be delivered by the vendor on exercise of the option should be accounted for as an element of the current arrangement (see Chapter 4 for guidance on measuring and allocating the arrangement consideration).

Even if an option is substantive, an assessment should be made as to whether the specified additional products or services have been priced at a significant and incremental discount. If the prices contain a significant and incremental discount, the option resulting in the discount should be accounted for as an element of the arrangement (see Section 1.2.3).

If an option is substantive and not priced at a significant and incremental discount, the determination of the elements included in the arrangement should consider only the noncontingent elements, and sales arising from the customer’s exercise of the option to purchase additional products or services should be accounted for as such events occur.

1.2.3 Options to purchase discounted products in the future

Contractual arrangement terms that give customers the right to future purchases of additional products or services from a vendor for an amount below market value, in addition to the current products and services being purchased, generally should be considered an element in a multiple-element arrangement. In essence, the vendor is providing the customer with an in-the-money option to purchase future items at a specified price. This contractual element should be evaluated pursuant to the multiple-element arrangements guidance if the right represents a significant and incremental discount to the customer, based on an analogy to the guidance on identifying elements of an arrangement as significant and incremental discounts in ASC 985-605-15-3(d).

A discount on the purchase of future products or services provided to a customer in connection with a current arrangement is considered to be a significant and incremental discount if it meets all of the following criteria:

- The future discount is significant in the context of the overall transaction. For example, if an arrangement for which the total consideration is $200,000 includes the right to buy an item that normally sells for $2,000 for $1,000, that discount is not significant in the context of the overall transaction. Determining when a discount is significant to the overall transaction will require the use of professional judgment and will be dependent on the relevant facts and circumstances.
The future discount is incremental to the discounts, if any, inherent in the pricing of the other elements included in the arrangement. For example, if the customer was granted a discount of 20% on the other elements included in the arrangement, a 20% discount on future purchases would generally not be considered incremental.

The future discount is incremental to the discount typically provided to customers purchasing the same or similar products or services on a standalone basis. If the customer is not provided a discount that is incremental to that which other customers generally receive, no incremental value has been provided to the customer through the future discount.

The following example illustrates products sold with a future option priced at a significant and incremental discount:

**Illustration 1-1**

**Facts:**
A vendor sells products M and S along with a right to a future discount of 50% off list price, to a maximum of $200, on future purchase(s) of its other products, N through R, for a two-year period. Total arrangement consideration is $100. The vendor regularly sells products M and S for $60 and $40, respectively, and has list prices for Products N through R that range from $200 to $800. The vendor routinely sells products N through R on a standalone basis at discounts from list price ranging from 20% to 30%.

**Analysis:**
The 50% future discount should be considered an element of the arrangement. When considered in the context of the overall arrangement, the discount is significant and incremental to the 40% overall discount ($200/$500, which represents the maximum future discount divided by the sum of the selling prices of products M and S ($100) plus the amount of purchases ($400) required to obtain the maximum discount) inherent in the transaction. Additionally, the discount is incremental to discounts provided by the vendor to customers that purchase products N-R on a standalone basis.

The following example illustrates PCS sold at a discount that is not significant or incremental:

**Illustration 1-2**

**Facts:**
A vendor enters into an arrangement to sell product A bundled with an initial PCS period of one year for $1,400. The arrangement specifies that the customer may renew the PCS for additional one-year periods for $200 per year, a discount of $100 (33%) from VSOE of selling price of PCS, which the vendor has established as $300. The standalone selling price of product A, which is based upon management’s best estimate, is $2,000.

**Analysis:**
The discount on the bundled transaction is 39% (i.e., $1,400 transaction price compared to total standalone selling price of $2,300 for the two deliverables). As a result, the discount that the customer will receive on renewal of PCS (33%) is not incremental to the discount on the bundle.

Because the discount on renewals of PCS is not significant and incremental, there is no accounting at the inception of the arrangement for the option to renew PCS at a discount in the future.
The following example illustrates PCS sold at a discount that is significant and incremental:

### Illustration 1-3

**Facts:**
A vendor enters into an arrangement to sell product B bundled with an initial PCS period of one year for $1,100. In addition, the arrangement specifies that the customer may renew the PCS for additional one-year periods for $100 per year, a discount of $100 (50%) from VSOE of selling price of PCS, which the vendor has established as $200. The standalone selling price of product B, which is based upon management's best estimate, is $1,200. The estimated economic life of product B is three years.

**Analysis:**
The discount on the bundled package is 21% (i.e., $1,100 transaction price compared to the total standalone selling price for the two deliverables of $1,400). Conversely, the discount the customer will receive on the PCS renewals is 50%, or $100 per renewal period. Based on the estimated economic life of the product, the vendor expects the customer will renew the PCS two times, for a total discount of $200.

Therefore, the discount that the customer will receive on renewal of PCS is 1) significant in the context of the overall transaction, 2) incremental to the discounts on the bundle of product B and initial PCS and 3) incremental to the discount typically provided other customers renewing PCS for product B.

Because the discount on renewals of PCS is significant and incremental, the discount should be accounted for separately. The vendor should allocate the total arrangement consideration to the different elements in the arrangement using the relative-selling-price method. (See Chapter 4, Measurement and allocation of arrangement consideration for a further discussion of the allocation of the arrangement consideration.) The amount allocated to the significant and incremental discount would be deferred and recognized over the estimated two year discount period (i.e., ratably over years 2 and 3) or immediately if the customer does not renew PCS.

Section 4.3.1 discusses how arrangement consideration should be allocated when an arrangement contains a significant and incremental discount.

### 1.2.4 Exclusivity clauses within contracts

Arrangements involving the sale of products or services may contain exclusivity clauses whereby the vendor agrees that it will not provide the products or services to others or will do so only on a limited basis. Such provisions may restrict the distribution of the products or services in certain geographical areas, may prohibit the sale of the products or services to a customer’s competitors, or both. For example, a vendor that provides advertising on its website may agree to run a banner advertisement for one customer for a specified period of time, excluding advertisements for similar products or services from the advertiser’s competitors.

We are aware that there are differing views in practice associated with the treatment of exclusivity clauses. While we believe it is most appropriate to account for a separately bargained for exclusivity arrangement as a separate deliverable, some believe that exclusivity clauses should not be treated as a separate element within an arrangement and we would not object to such a conclusion. In such situations, any upfront payments received related to the exclusivity clause would be evaluated to determine if they represented an “upfront fee” that must be recognized over the expected customer relationship period in accordance with SAB Topic 13. Alternatively, such amounts would be allocated to the identified elements in the arrangement in accordance with the applicable guidance (ASC 605-25 or ASC 985-605) and recognized as appropriate. (Once an entity has established an approach regarding the treatment of exclusivity clauses, it should apply that approach consistently across all similar arrangements.)
For those entities that have established an accounting policy that exclusivity clauses may represent separate elements within an arrangement, each exclusivity clause must be evaluated to determine if it should be treated as a separate deliverable. In determining whether the exclusivity clause included in the arrangement represents a separate bargained-for element of the arrangement, the individual facts and circumstances must be considered. For example, in certain industries it may be common practice for arrangements to include certain exclusive rights such as the ability to sell certain licensed products within a particular geography (but not other geographies). However, these terms of the arrangement may be normal commercial terms such that they may not necessarily be bargained-for elements of the arrangements. If, due to the nature of the business or product, there is no expectation that the vendor would be entering into a similar arrangement with any other counterparty at the onset of the contract, a clause within the arrangement providing the counterparty an exclusive right may not be considered an exclusivity clause.

When an arrangement for the sale of a product or service includes an exclusivity clause that represents a separate bargained-for element and the entity’s accounting policy is to account for such clauses as separate deliverables, we believe the exclusivity clause should be accounted for as a deliverable in a multiple-element arrangement. As a result, a portion of the arrangement’s consideration should be allocated to the exclusivity clause (based on the relative-selling-price method, as described in Chapter 4, *Measurement and allocation of arrangement consideration*) and recognized ratably over the exclusivity period.

### 1.2.5 Deliverables included in repetitive transactions

Many arrangements require the repetitive delivery of a good or service over the term of the arrangement (e.g., the continuous processing of similar transactions). We believe that whether each individual delivery should be considered a deliverable in a multiple-element arrangement, depends on whether services or products are being provided, and the underlying nature of the items provided.

**Services** – The underlying nature of the service has to be considered in order to determine if each unit in a repetitive service transaction should be considered a separate deliverable. If the service represents the customer’s ability to have access to the stated service for a stated period, the contracted service as a whole would likely be considered the deliverable. Conversely, if the service is for a specified number of units, the vendor would likely determine that each instance of service being rendered represents a separate deliverable and would recognize a proportionate amount of the transaction price as each service is provided.

**Products** – Each unit in a transaction to deliver multiple products (including multiple units of the same product) should generally be considered a separate deliverable.
The following examples illustrate these concepts:

**Illustration 1-4**

**Facts:**
Company A operates a car wash. The company sells cards that entitle the owner to unlimited car washes during the 12-month period following the card’s purchase.

**Analysis:**
In this example, the company has a stand-ready obligation to perform at the customer’s request. Regardless of the company’s ability to estimate the average number of times that a customer will use the car wash service, the customer is acquiring the right to receive, on demand, a service from the company. Each instance that the service will be provided should not be considered a separate deliverable. The company should recognize revenue for the services provided using either a proportional performance model (if a pattern of performance can be determined) or ratably over the life of the contract (one year for the example provided). Conversely, if the customer had purchased a specified number of car washes to be provided within the next 12 months, the company would likely determine that each car wash represents a separate deliverable and would recognize a proportionate amount of the transaction price as each car wash is provided.

**Illustration 1-5**

**Facts:**
A garment manufacturer and distributor enters into an arrangement with a retail company to supply 1,000 fleece jackets. The total arrangement consideration is fixed at $20,000 according to the terms of the contract; however, the delivery times and locations are to be determined by the retailer.

**Analysis:**
In this example, each jacket represents a separate deliverable. Revenue would be recognized for each unit as it is delivered, assuming all other revenue recognition criteria have been met.

### 1.2.6 Contingent deliverables within an arrangement

Arrangements often include potential revenue-generating activities contingent upon the occurrence of a future event not exclusively within the control of the customer. If the future event occurs, the terms of the arrangement require the vendor to deliver specified products or services. For example, arrangements in the life sciences industry commonly require the vendor to provide certain services (e.g., manufacturing and marketing) after a product candidate is successfully developed and approved. The provision of such services may be considered contingent because they would be provided only upon the successful development and regulatory approval of the product candidate.

Questions arise as to whether contingent deliverables should be considered a deliverable prior to the resolution of the contingency and, therefore, considered in the allocation of arrangement consideration. The EITF deliberated this issue during its discussions of EITF 08-1 (issued as ASU 2009-13), but ultimately decided not to provide guidance on whether or how contingent deliverables affect an entity’s revenue attribution to deliverables in a multiple-element arrangement.
We believe it may be appropriate to exclude a contingent deliverable from the initial measurement and allocation of the arrangement consideration if (1) considerable uncertainty exists about the outcome of the contingency, and (2) the additional fee the customer would have to pay upon delivery of the contingent good or service is consistent with its estimated selling price. When these attributes are present, the contingent deliverable generally may be accounted for separately when the good or service is delivered. In contrast, when considerable uncertainty exists about the outcome, but the additional fee is below the estimated selling price of the contingent good or service (or there is no additional fee), a significant and incremental discount may be present.

To the extent a significant and incremental discount is embedded in the selling price of the contingent deliverables (i.e., the incremental fee associated with the contingent deliverable is not representative of the estimated selling price of that deliverable), we believe that a portion of the arrangement consideration representing the discount should be deferred and excluded from the allocation of arrangement consideration performed at inception for the noncontingent deliverables. See Section 4.3.1 for a discussion of the allocation of arrangement consideration to a significant and incremental discount.

1.2.7 Trade-in rights

Vendors may offer trade-in rights whereby customers acquire a product along with a right to, at some point in the future, “trade in” or return that product. The ability to exercise the trade-in right may or may not be contingent upon the customer’s purchase of new or upgraded product. Arrangements that include product trade-in rights should be carefully evaluated based on the applicable facts and circumstances as the accounting for such arrangements may differ significantly depending on the terms of the arrangement. Generally, however, trade-in rights that are based on the fair value of the product at the time of the trade in (e.g., transaction whereby a customer can trade in purchased product within five years of purchase for the product’s then current value) generally do not create any current obligations on the behalf of the vendor, and no accounting is required for such rights. In such situations, the vendor would recognize the revenue from the sale of the product once all revenue recognition criteria have been met. However, the accounting for arrangements providing specified-price trade-in rights will likely differ.

Specified-price trade-in rights not contingent upon future purchase

Some specified-price trade-in rights are not dependent upon the customer’s purchase of new or updated equipment. For example, vendors may provide their customers the ability to return purchased product in the future for a guaranteed resale or residual amount, regardless of whether that customer buys any new or upgraded product at the time of the trade in. Such arrangements are likely not considered sales. Rather, such arrangements generally must be accounted for under the lease guidance in ASC 840. See Section 5.5.3 of our separate Financial Reporting Development guide, *Lease accounting – A summary* (SCORE No. BB1793), for further information.

Specified-price trade-in rights contingent upon future purchase

Vendors may also provide customers specified-price trade-in rights that are contingent upon the customers’ purchase of new or upgraded equipment. These trade-in rights generally allow the customer to trade in their current product at a specified-price or percentage of original purchase price in exchange for a new or upgraded product at some point in the future. Additional consideration from the customer may or may not be required to obtain the new or upgraded product. Further, the trade-in right may relate to currently available products or products that are not yet available but are being developed. Arrangements that include such product trade-in rights should be carefully evaluated based on the applicable facts and circumstances to determine the actual benefit being conveyed to the customer. As discussed further below, we believe that in most transactions these specified-price trade-in rights represent a guarantee. However, in certain situations, an entity may determine it represents a right of return or a specified upgrade right.
Guarantee

If, at the time of the original transaction, a vendor provides a customer with the right to trade in purchased products at a specified value or percentage of the original sales price at some point in the future (which may or may not be specified) when subsequently purchasing new products from the vendor, we believe that, in most cases, the vendor has provided a guarantee to the customer that should be accounted for in accordance with ASC 460-10.

The guarantee should be accounted for as an element of a multiple-element arrangement, and, pursuant to ASC 605-25, recorded as a liability at its estimated fair value in accordance with the guidance in ASC 460-10. Pursuant to ASC 605-25, the full amount of the determined fair value (not an allocated relative fair value) is allocated to the guarantee, and only the remaining consideration is then allocated to the other elements in the arrangement as the literature on guarantees requires that guarantees be measured at fair value. Many factors will influence the vendor’s determination of the fair value of the guarantee, including but not limited to the following:

- The likelihood the trade-in right is going to be exercised and the expected timing of exercise of the trade-in right
- The difference between the specified trade-in amount and the expected fair value of the product at the time of trade in
- The expected sales price of the to-be-purchased product—For example, when the purchase price of the to-be-purchased product is not defined in the original transaction and the vendor has significant discretion in setting that future sales price, the fair value for the guarantee would likely be lower than in a transaction where either the purchase price of the to-be-purchased product is fixed or subject to less negotiation. That is, if the seller has the flexibility to increase the price it otherwise would charge for the new item to offset any losses on the guarantee, the purchaser’s ability to benefit from the guarantee may be significantly limited

Guarantee liabilities are generally recognized in earnings as the vendor is released from risk under the guarantee. Determining how and when risk is released under a guarantee can involve significant judgment. The method of recognizing the vendor’s release from risk is dependent on the nature of the guarantee and the applicable facts and circumstances of the arrangement. However, product trade-in right guarantees should typically be recognized either 1) when the trade-in right is exercised or the right expires, or 2) based on a systematic and rational amortization method. Under either approach, if the vendor concludes that it is probable that a loss will be recognized upon satisfaction of the trade-in right that exceeds the guarantee liability, that incremental probable loss would be recognized.

Right of return

While we believe that in most circumstances specified-price trade-in rights should be accounted for as guarantees, in some circumstances those product trade-in rights may be in-substance rights to return a product that should be accounted for pursuant to the rights of return guidance in ASC 605-15-25.

Determining when a trade-in right offered in an arrangement is in-substance a right of return that should be accounted for as such may require the use of significant professional judgment, and will be dependent on the applicable facts and circumstances of the arrangement. However, we believe the following factors may indicate a trade-in right included in an arrangement should be accounted for as a right of return:

- The period of time the trade-in right is exercisable. Generally, the longer the period, the less likely that the trade-in right is actually a right of return. The longer a customer can use a product prior to trading it in, the less value the product traded in will have to the vendor. The guidance surrounding rights of return generally contemplates that the vendor is receiving back the same product it provided to the customer (and therefore, a sale of that product never took place).
The likelihood that the trade-in right will be exercised. For example, when a vendor provides a customer with the option to return a product for a soon-to-be-released upgraded version and, based on the economics of the transaction, the vendor expects that the customer is highly likely to make that trade-in, it is likely that the vendor really provided the customer a right of return of the first product.

The amount of the specified-price trade-in value. In situations in which the specified-price trade-in value is equal to (or substantially equal to) the original purchase price, the customer may actually be receiving a right of return rather than a trade-in right. This is the case regardless of whether the specified-price trade-in right is associated with the purchase of a specified future product or can be for any future purchase.

The business purpose for the offered trade-in right. Offering trade-in rights in connection with a specific product or program, such as the launch of a new product, may indicate that the trade-in rights are actually a right of return. For example, if a vendor announces the future launch of a new product, and provides a trade-in right on purchases of the existing product from the date of the announcement until the new product has been launched, that may suggest the vendor is actually providing a right of return for the existing product.

The rights of return guidance requires that when an arrangement includes a right of return, the vendor must be able to make a reasonable estimate of the level of future returns in order to recognize revenue at the time of sale. If an estimate can be made, revenues and cost of sales should be recognized net of estimated returns. If a reasonable estimate cannot be made, revenues and cost of sales should not be recorded until the right of return expires or the ability to make a reasonable estimate of future returns is developed.

Products that are subject to return should remain recorded in the vendor’s inventory until the right of return expires or the inventory is deemed to be fully impaired prior to the product being returned or the right of return expiring. The vendor should evaluate the inventory for impairment at the outset of the arrangement, during the right of return period and at the time of return if the product is returned. The vendor’s impairment analysis should include estimated costs to refurbish and repackage the product, if applicable. In certain circumstances, the inventory may be impaired upon the execution of the arrangement. In this case, an impairment charge should be recorded at the time of sale (even if revenue related to the sale is deferred due to the inability to estimate future returns). The charge should be recorded as cost of sales and not as contra-revenue.

**Specified upgrade right**

Questions have arisen as to whether product trade-in rights may also be in substance a specified upgrade right. To the extent that the product trade-in right is associated with an intangible product (e.g., the right to trade-in a particular software license towards the purchase of a license for a new or upgraded software product) or an intangible element of a tangible product, we believe such trade-in rights may represent a specified upgrade right (see Section 1.2.8).

However, when product trade-in rights are associated with tangible products, we generally do not believe it would be appropriate to conclude that a specified upgrade right existed. We view an upgrade to include situations in which the original product need not be returned but a new product is received. Rather than receiving the right to obtain an upgraded product, a trade-in right of a tangible product allows a customer to exchange its current tangible product for an entirely different tangible product. We believe these trade-in rights should be accounted for as guarantees or rights of return, as discussed above.
1.2.8 Specified upgrade rights

Specified upgrade rights are commonly found in software arrangements, and ASC 985-605 specifically discusses how such rights should be accounted for when included in an arrangement subject to its scope. However, we believe that such rights can also be included in arrangements outside of the scope of ASC 985-605 (i.e., arrangements other than for the sale or license of software), primarily as a result of amendments made in October 2009 by ASU 2009-14 that results in certain software and related deliverables that are essential to the functionality of a tangible product falling within the scope of ASC 605-25 (see Section 2.3.3).

If the vendor has promised to provide a customer future enhancements to an existing licensed product that does not involve returning the original product (see Section 1.2.7), another element (a specified upgrade right) likely exists in the arrangement that must also be evaluated pursuant to the provisions of the multiple-element arrangements guidance. The specified upgrade right may result from an explicit promise of the vendor or may result from the vendor’s actions. The following factors may indicate an arrangement contains a specified upgrade right:

- During the sales process, the vendor provided the customer with a copy of its product development plans (a "roadmap") that described the features, functionality and release date of a future product enhancement in sufficient detail such that it is likely the vendor has created a customer expectation that it will receive a specific upgrade or enhancement (i.e., the information included in the roadmap was likely to have affected the customer’s current buying decision). Generally, the greater the level of detail and specificity contained in the roadmap, and the closer the anticipated release date of the enhancements to the origination of the arrangement with the customer, the more likely it is that the customer has formed an expectation regarding the release of the future product enhancement(s) that has affected its current purchasing decision.

- Payment of the arrangement consideration is linked to delivery of the enhanced version of the product.

- The customer cannot use the currently marketed product for its intended purpose.

When it has been determined that a specified upgrade right exists, the entity should identify that specified upgrade right as an additional deliverable within the contract. As a result, the entity will have to determine its best estimate of selling price for that specified upgrade right (because the upgrade right has not been sold previously, VSOE of selling price will not exist, and it is unlikely that TPE of selling price will exist). A portion of the transaction proceeds will then be allocated to the specified upgrade right, using the relative-selling-price method.
2 Scope and scope exceptions

2.1 Chapter summary

The multiple-element arrangements guidance applies to all deliverables within all industries except for certain transactions for which other existing literature provides guidance on the determination of units of accounting and the allocation of arrangement consideration. The interaction of the multiple-element arrangements guidance with this other literature is dependent on the guidance contained in the other literature applicable to the 1) separation of the deliverables included in a multiple-element arrangement into different units of accounting and 2) allocation of the arrangement consideration to those separate units of accounting. For example, a multiple-element arrangement may be within the scope of other specific ASC guidance, including:

- Leases, ASC 840
- Franchisors, ASC 952, specifically ASC 952-605 (Franchisors – Revenue Recognition)
- Property, plant and equipment, ASC 360, specifically ASC 360-20 (Property, Plant and Equipment – Real Estate Sales)
- Guarantees, ASC 460
- Revenue recognition, ASC 605, specifically ASC 605-20 (Revenue Recognition – Services) and ASC 605-35 (Revenue Recognition – Construction-Type and Production-Type Contracts)
- Software, ASC 985, specifically ASC 985-605 (Software – Revenue Recognition)
- Entertainment-films, ASC 926, specifically ASC 926-605 (Entertainment – Films – Revenue Recognition)

Deliverables in a multiple-element arrangement that fall within the scope of other literature may be separated from deliverables not covered by the scope of other literature by applying the guidance contained in that other literature or within the multiple-element arrangements guidance. Any further separation of deliverables within the scope of the other literature should be made pursuant to the provisions of that literature, and any further separation of deliverables outside the scope of that literature should be made pursuant to ASC 605-25. These concepts are discussed in greater detail in Section 2.3.2.

Additionally, ASC 605-25 specifically excludes from its scope transactions that are covered within ASC 605-50, Revenue Recognition – Customer Payments and Incentives. As a result, point and loyalty programs and volume discounts are excluded from the scope of the multiple-element arrangements guidance.
2.2 **Scope and scope exceptions**

<table>
<thead>
<tr>
<th>Excerpt from Accounting Standards Codification</th>
</tr>
</thead>
<tbody>
<tr>
<td>Revenue Recognition – Multiple-Element Arrangements</td>
</tr>
</tbody>
</table>

**Scope and Scope Exceptions**

**605-25-15-1**  
The guidance in this Subtopic applies to all entities.

**605-25-15-2**  
Except as described in the following paragraph, the guidance in this Subtopic applies to:

a. All deliverables (that is, products, services, or rights to use assets) within contractually binding arrangements (whether written, oral, or implied, and hereinafter referred to as arrangements) in all industries under which a vendor will perform multiple revenue-generating activities.

**605-25-15-2A**  
The guidance in this Subtopic does not apply to:

a. Arrangements that include vendor offers to a customer for either of the following addressed in Subtopic 605-50:
   1. Free or discounted products or services that will be delivered (either by the vendor or by another unrelated entity) at a future date if the customer completes a specified cumulative level of revenue transactions with the vendor or remains a customer of the vendor for a specified time period
   2. A rebate or refund of a determinable cash amount if the customer completes a specified cumulative level of revenue transactions with the vendor or remains a customer of the vendor for a specified time period.

b. Arrangements involving the sale of award credits by broad-based loyalty program operators (see Subtopic 605-50)

c. Payments relating to research or development deliverables that are accounted for under the milestone method of revenue recognition (see Subtopic 605-28).

---

**Question 2-1**  
Since many industries have specific revenue recognition guidance, is the guidance in ASC 605-25 applicable to only certain industries?

No. ASC 605-25 applies to all industries. However, this guidance provides an exception for certain transactions that fall within the scope of other specific ASC guidance if that other guidance addresses the 1) determination of accounting units when multiple deliverables are present and 2) allocation of arrangement consideration (see Section 2.3.2).

**Question 2-2**  
Do the provisions of the multiple-element arrangements guidance included in ASC 605-25 apply to consideration paid by a vendor to its customers as part of a multiple-element arrangement?

No. Pursuant to ASC 605-25-15-2A, arrangements that include vendor offers to customers for either free or discounted products or services or cash rebates or refunds in exchange for completing a specified number of purchases or remaining a customer for a specified time period are not within its scope. These types of arrangements generally should be accounted for pursuant to ASC 605-50, *Revenue Recognition – Customer Payments and Incentives.*
2.3 Interaction of the multiple-element arrangements guidance with other guidance

Excerpt from Accounting Standards Codification

Revenue Recognition — Multiple-Element Arrangements

Scope and Scope Exceptions

605-25-15-3

A multiple-deliverable arrangement may be within the scope of another Codification Topic. Those Topics include all of the following:

a. For leases, see Topic 840.

b. For franchisors, see Topics 952.

c. For property, plant, and equipment, see Topic 360; specifically, Subtopic 360-20.

d. For guarantees, see Topic 460.

e. For revenue recognition, see Topic 605; specifically, Subtopics 605-20 and 605-35.

f. For software, see Topic 985; specifically, Subtopic 985-605.

g. For entertainment-films, see Topic 926; specifically, Subtopic 926-605.

605-25-15-3A

Those Topics may provide guidance with respect to whether and how to allocate consideration of a multiple-deliverable arrangement. Whether deliverables are within the scope of those other Topics is determined by the scope provisions of those Topics, without regard to the order of delivery of that item in the arrangement. The following describes the three categories into which the other Codification Topics fall and the application of this Subtopic or the other Topics in determining separate units of accounting and allocating arrangement consideration:

a. Other Topics address both separation and allocation. If another Topic provides guidance regarding the determination of separate units of accounting and how to allocate arrangement consideration to those separate units of accounting, the arrangement or the deliverables in the arrangement that is within the scope of that Topic shall be accounted for in accordance with the relevant provisions of that Topic rather than the guidance in this Subtopic.

b. Other Topics address separation but not allocation. If another Topic provides guidance requiring separation of deliverables within the scope of that Topic from deliverables not within the scope that Topic, but does not specify how to allocate arrangement consideration to each separate unit of accounting, such allocation shall be based on the relative selling price of the deliverables within the scope of that Topic and the deliverables not within the scope of that Topic. For example, leased assets are required to be accounted for separately under the guidance in Subtopics 840-20 and 840-30. See paragraph 605-25-55-3. (For purposes of the allocation between deliverables within the scope of another Topic and deliverables not within the scope of that other Topic, the selling price shall be determined using the guidance as discussed in paragraphs 605-25-30-6A through 30-7.) Subsequent identification of separate units of accounting and allocation of arrangement consideration to the deliverables not subject to that other Topic would be governed by the provisions of this Subtopic.
2.3.1 Revenue recognition guidance

ASC 605-25 does not provide any guidance relating to when an arrangement’s consideration should be recognized as revenue. Rather, this guidance only addresses 1) how to determine when there is more than one unit of accounting in a multiple-element arrangement and 2) how arrangement consideration should be measured and allocated if multiple units of accounting exist. ASC 605-25 does not address revenue recognition for individual units of accounting.

While the multiple-element arrangements guidance may affect the number of separate units of accounting identified, companies are still required to apply the appropriate revenue recognition guidance (such as the overall revenue recognition guidance in SAB Topic 13, the guidance on revenue recognition for construction-type contracts in ASC 605-35 and the guidance on revenue recognition for software in ASC 985-605) for those identified units of accounting when products are delivered or services are performed. In some instances, the guidance within ASC 605-25 may affect the timing of revenue recognition by requiring deliverables in a multiple-element arrangement to be accounted for as a single unit of accounting, if the separation criteria contained in ASC 605-25-25-5 are not met.

2.3.2 Interaction with other specific ASC guidance

The interaction of the multiple-element arrangements guidance with other areas of the ASC is dependent on the type of guidance contained in the other ASC areas regarding the 1) separation of multiple elements contained in a single arrangement into units of accounting and 2) allocation of the arrangement consideration to the separate units of accounting, as described in the following three categories:

**Category 1** - Other ASC literature provides guidance on both the separation of multiple deliverables in a multiple-element arrangement into separate units of accounting and on the allocation of the arrangement consideration between the separate units of accounting. In such cases, if all the
deliverables fall within the scope of the other ASC literature, the guidance within that literature should be applied to the arrangement as a whole (and the guidance within the multiple-element arrangements literature would not be applied). If the arrangement contains deliverables that are within the scope of the other ASC literature and others that are not, the guidance in the other ASC literature would be applied to the deliverable(s) that falls within its scope, and the guidance in the multiple-element arrangements literature would be applied to the remaining deliverables to determine if separate units of accounting exist.

The following other ASC literature provides guidance on both the separation of multiple elements and the allocation of arrangement consideration:

- ASC 952-605, Franchisors – Revenue Recognition, provides guidance relating to both when and how to allocate the consideration in a franchise relationship that includes some or all of the following: individual and area initial franchise fees; tangible property; services; continuing franchise fees; and continuing product sales.

- ASC 360-20, Property, Plant, and Equipment – Real Estate Sales, provides guidance relating to revenue recognition for sales of real estate. When the seller of real estate has continuing involvement with the property sold, ASC 360-20 frequently precludes the separation of, and recognition of profit from, the sale of an ownership interest in real estate from continuing involvement with the property. However, ASC 360-20 does not address the accounting for other deliverables included in an arrangement. Those deliverables would be separated according to the guidance included in Category 3, which follows.

- ASC 460, Guarantees, provides that a liability should be recognized, based on the guarantee’s estimated fair value, when a guarantee is issued as part of a multiple-element arrangement. Any remaining arrangement consideration is allocated among the other elements included in the arrangement pursuant to the guidance within the multiple-element arrangements literature (or other ASC area, if applicable).

- ASC 605-20-25, Revenue Recognition – Services, pertaining to separately priced extended warranty and product maintenance contracts (see ASC 605-20-25-1 through 25-6), provides that the stated amount of a separately priced extended warranty and product maintenance contract should be separated from the associated products and recorded as deferred revenue.\(^1\) Example 5 included in ASC 605-25-55-30 through 55-36 provides an example of how to apply this guidance. Additionally, Section 2.3.4 discusses this topic in greater detail.

- ASC 926-605, Entertainment – Films, provides that when accounting for arrangements involving the licensing of single films, multiple films and film-related products, revenue generally should be allocated among the multiple deliverables using the relative-fair-value method. ASC 926-605 does not provide separation and allocation guidance when a film license agreement includes deliverables not within its scope. In such cases, the guidance discussed in Category 3, below, should be followed.

- ASC 985-605, Software – Revenue Recognition, provides a comprehensive accounting model for multiple-element software arrangements that fall within its scope. Section 2.3.3 discusses in greater detail the interaction between ASC 985-605 and ASC 605-25.

---

\(^1\) In practice, the “stated amount” is generally the difference between the price of the product exclusive of the extended warranty or maintenance contract and the bundled price for both.
Category 2 – Other ASC literature requires the separation of deliverables within its scope from deliverables not within its scope, but does not provide guidance as to how to allocate the arrangement consideration to the separate units of accounting. In such cases, the arrangement consideration should be allocated between the deliverables within the scope of that ASC literature and the other deliverables based on the relative selling price of each deliverable. For purposes of this allocation, the relative selling price of the deliverables is determined following the guidance in ASC 605-25-30-6A through 30-6C. (See Chapter 4, Measurement and allocation of arrangement consideration, for further discussion.)

Once an arrangement’s consideration has been allocated between deliverables within the scope of other ASC literature and other deliverables, any subsequent separation of, and allocation of arrangement consideration to, the other deliverables (i.e., the deliverables not within the scope of the other ASC literature) should be performed pursuant to the multiple-element arrangements guidance.

The following example illustrates this concept:

**Illustration 2-1**

**Facts:**
An arrangement is executed between a vendor and Customer A for 1) the lease of equipment under an operating lease, 2) an executory agreement for the maintenance of the leased equipment during the lease term, and 3) the sale of additional equipment unrelated to the leased equipment.

**Analysis:**
ASC 840, Leases, provides guidance regarding the allocation of an arrangement’s consideration between the lease and executory costs (in this example, the maintenance) within a contractual arrangement but refers to ASC 605-25 (specifically, ASC 605-25-15-3A(b)) for guidance on allocating the total consideration between the deliverables subject to ASC 840 and those that are not within the scope of ASC 840. Accordingly, the arrangement consideration should be allocated between the deliverables within the scope of ASC 840 (the leased assets and the maintenance) and the sold equipment sold based on the relative selling price of each deliverable. In applying the relative-selling-price method, management would use VSOE, TPE or best estimate of selling price, as discussed in ASC 605-25-30-6A through 30-6C. The amount allocated to the leased assets and maintenance would then be accounted for pursuant to ASC 840. The additional equipment would be accounted for pursuant to other applicable revenue recognition guidance.

Category 3 – Deliverables included in an arrangement are subject to other ASC literature, but that other ASC literature does not provide guidance on how to separate the deliverables within its scope from the deliverables in the arrangement that are outside its scope or how to allocate the arrangement consideration. In such cases, the deliverables should be separated, and the arrangement consideration allocated, pursuant to the guidance within the multiple-element arrangements literature, as discussed in Chapter 3, Determining units of accounting, and Chapter 4, Measurement and allocation of arrangement consideration.

In such situations, it is possible that deliverables within the scope of other ASC literature cannot be separated from other deliverables in the arrangement, based on the application of the criteria contained in ASC 605-25-25-5. If so, arrangement consideration should be allocated to the deliverables within the scope of other ASC literature and the other deliverables that are outside its scope as one unit of accounting and revenue should be recognized based on that one unit of accounting (see Section 3.5.1).

This concept is discussed in the implementation guidance in ASC 605-25-55-4 through 55-6 for an arrangement involving multiple deliverables in a production-type contract.
The following provides implementation guidance on multiple-element arrangements that contain deliverables that are within the scope of other Codification Topics where the other Topic does not provide guidance on how to separate deliverables or how to allocate arrangement consideration (see paragraph 605-25-15-3A(c)).

For example, Subtopic 605-35 provides separation and allocation guidance (segmentation provisions) for deliverables within its scope. However, that Subtopic does not provide separation and allocation guidance between construction and production deliverables and other deliverables. Consider an arrangement that includes designing complex electronic equipment, manufacturing complex electronic equipment (both deliverables subject to that Subtopic), and providing the service of running the equipment for a fixed period of time once the equipment is designed, manufactured, and placed in service (a deliverable not subject to that Subtopic). This Subtopic would be applied to identify separate units of accounting and to allocate arrangement consideration to those separate units of accounting.

If applying the guidance in this Subtopic results in the separation of the design and manufacture of the equipment from the service of running the equipment, the segmentation provisions of Subtopic 605-35 would be used to determine if it is appropriate to further segment the design deliverables from the manufacture deliverables in accordance with its segmentation provisions. If this Subtopic prohibits separation of the deliverables subject to that Subtopic from those that are not, then the amounts otherwise allocable to the design and manufacture deliverables and to the service of running the equipment would be combined. The appropriate recognition of revenue then would be determined for those combined deliverables as a single unit of accounting.

The following example illustrates these concepts:

**Illustration 2-2**

**Facts:**
A vendor enters into an arrangement to 1) design specialized equipment for Customer A, 2) manufacture the equipment, and 3) maintain the equipment once it is completed and placed in service.

**Analysis:**
The design and manufacture of the equipment are deliverables within the scope of ASC 605-35, *Revenue Recognition – Construction-Type and Production-Type Contracts*. ASC 605-35 does not provide guidance for the separation of, and allocation of arrangement consideration between, deliverables within its scope (the design and manufacturing services) and those not within its scope (the maintenance services). The criteria contained in ASC 605-25-25-5 should be applied to determine if the design and manufacturing services can be separated from the maintenance services.
2 Scope and scope exceptions

2.3.3 Interaction with the software revenue recognition guidance

ASC 985-605 provides guidance regarding the timing and amount of revenue recognition for licensing, selling, leasing or otherwise marketing computer software. ASC 985-605 also provides guidance relating to the separation of multiple deliverables included in a multiple-element software arrangement and for the allocation of arrangement consideration among units of accounting. Because ASC 985-605 provides guidance on both the separation of deliverables and the allocation of consideration, the guidance within ASC 985-605 should be applied to deliverables within its scope included in an arrangement (see Section 2.3.2).

However, tangible products that contain software and non-software elements that function together to deliver the tangible product's essential functionality, as well as undelivered elements that relate to the software that is essential to the tangible product’s functionality, are excluded from the scope of ASC 985-605. These arrangements are instead subject to general revenue recognition guidance, including the guidance in ASC 605-25.

If some, but not all, of the deliverables included in an arrangement involving the sale of software are determined to be outside the scope of ASC 985-605 (non-software deliverables), the arrangement consideration should be allocated to the software deliverables as a group and to the individual non-software deliverables in accordance with the multiple-element arrangements guidance in ASC 605-25-15-3A. After such allocation is made, the amount allocated to the software deliverables as a group will be accounted for pursuant to the software revenue recognition guidance in ASC 985-605.

The following example illustrates these concepts:

**Illustration 2-3**

**Facts:**

A vendor sells a personal computer that includes an operating system, productivity software and PCS on the operating system and the productivity software. The operating system provides the essential functionality of the personal computer including the ability to manage the computer and its hardware functions, the ability to manage and interact with a range of hardware peripherals, and the ability to communicate through a variety of computer networks. The vendor rarely sells the personal computer without the operating system. The vendor regularly sells the same computer with and without the productivity software and also sells the productivity software separately.

Total arrangement consideration is $2,000. The vendor has determined that its best estimate of selling price is $1,400 for the personal computer, $400 for the operating system, $400 for the productivity software and $160 for the PCS on both the operating system and the productivity software. For purposes of this example, assume that the PCS would not meet the requirements of ASC 605-20-25-1 through 25-6 to be treated as separately priced product maintenance.
Analysis:
The vendor would likely conclude that the personal computer and operating system are functioning together to deliver the essential functionality of the personal computer, so the combined product would not be subject to the provisions of the software revenue recognition guidance (see ASC 985-605); rather, it would be subject to the multiple-element arrangements guidance. However, the productivity software would not be considered essential to the functionality of the personal computer because it is simply one type of software application that can be used on the computer, but it is not always included on the computer and would therefore be subject to software revenue recognition guidance in ASC 985-605. The PCS relates to both essential software (the operating system, which for accounting purposes is considered a non-software deliverable) and non-essential software (the productivity software, which for accounting purposes is considered a software deliverable). Therefore, the PCS must be bifurcated between the non-software deliverable and software deliverables for purposes of revenue recognition. (In this scenario, the vendor determines that the PCS relates to both the operating system and the productivity software equally, based on its best estimate of selling price for each of the items.)

Since the arrangement contains both software and non-software deliverables, the arrangement consideration should first be allocated to each separate unit of accounting for the non-software deliverables (the personal computer, the operating system and PCS on the operating system) and to the software elements as a group (the productivity software and related PCS) based on their relative selling prices pursuant to the multiple-element arrangements guidance in ASC 605-25 as follows:

<table>
<thead>
<tr>
<th>Item</th>
<th>Best estimate of selling price</th>
<th>% of relative selling price</th>
<th>Allocated discount</th>
<th>Allocated arrangement consideration</th>
</tr>
</thead>
<tbody>
<tr>
<td>Personal computer</td>
<td>$1,400</td>
<td>59.3%</td>
<td>$(214)</td>
<td>$1,186</td>
</tr>
<tr>
<td>Operating system</td>
<td>400</td>
<td>17.0%</td>
<td>(60)</td>
<td>340</td>
</tr>
<tr>
<td>PCS on operating system</td>
<td>80</td>
<td>3.4%</td>
<td>(12)</td>
<td>68</td>
</tr>
<tr>
<td>Software deliverables</td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>(productivity software and</td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>related PCS)</td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td></td>
<td>480</td>
<td>20.3%</td>
<td>(74)</td>
<td>406</td>
</tr>
<tr>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td></td>
<td>$2,360</td>
<td></td>
<td>$(360)</td>
<td>$2,000</td>
</tr>
</tbody>
</table>

The consideration allocated to the non-software separate units of accounting (the personal computer, operating system and PCS on the operating system) should be recognized as revenue in accordance with the appropriate revenue recognition guidance, including the general revenue recognition criteria included in SAB Topic 13 and the multiple-element arrangements guidance in ASC 605-25. The $406 allocated to the software components (the productivity software and the related PCS) should be recognized as revenue in accordance with the software revenue recognition guidance in ASC 985-605.
2.3.4 Interaction with the separately priced extended warranty and product maintenance guidance

Vendors who sell software-enabled devices bundled with ongoing maintenance services (i.e., postcontract customer support (PCS)) will likely account for these entire arrangements pursuant to the multiple-element arrangements guidance in ASC 605-25 (assuming the elements qualify for the scope exception from the software revenue recognition guidance in ASC 985-605²). In analyzing these transactions, the vendor will need to determine if the ongoing maintenance provided by the vendor included in the transaction falls within the scope of the guidance on separately priced extended warranty and product maintenance contracts within ASC 605-20-25-1 through 25-6. We believe this requires the vendor to consider a number of factors, including the following:

- The vendor should consider whether, based on the vendor’s history, the maintenance or PCS is truly a product maintenance-type of arrangement (i.e., primarily maintenance on the tangible product and bug fixes) or the nature of the service provided under the PCS is something beyond maintenance (e.g., the vendor commonly and frequently provides product upgrades as a result of when- and if-available upgrades, and many customers purchase the PCS in order to obtain those upgrades).

- The purchase of the maintenance related to PCS should be a separate purchasing decision from the decision to purchase the software-enabled device.

- The guidance on separately priced extended warranty and product maintenance contracts contemplates that these contracts are separately priced. This indicates that the buyer should have the option of completing the transaction with or without the maintenance contract and that the difference in the transaction price depending on whether or not the customer elects to purchase the maintenance contract should be directly attributable to the contractual price of the maintenance contract. In order for the separately priced extended warranty and product maintenance guidance to apply, the vendor needs to be able to conclude that the customer is making a separate purchasing decision for the maintenance contract.

- The vendor should consider the attachment rate of the maintenance (i.e., how often the product is sold with the maintenance). As the maintenance attachment rates increase, it becomes more difficult for a vendor to conclude that the customer is making a separate purchasing decision. Conversely, lower attachment rates would likely support separate customer purchasing decisions, proving that the maintenance is less integral to the customer’s decision to purchase the product.

- The stated transaction price for the maintenance contract should be reasonable in relation to the maintenance services being purchased. For example, if the contract includes PCS priced at $10,000 for the first year, but the amount the vendor charges customers to renew PCS in subsequent years is $40,000, this would likely indicate that the stated contractual price is not reasonable.

- The vendor should consider whether other vendors could provide the maintenance services. Other vendors’ provision of the maintenance services introduces marketplace competition such that it is more likely that the maintenance contract will be priced reasonably in relation to the services. In addition, it supports the assertion that the customer has made a separate purchasing decision, as the customer could have procured those same maintenance services from a different vendor.

---

² Tangible products that contain software and non-software elements that function together to provide the product’s essential functionality are subject to the scope of the multiple-element arrangements guidance in ASC 605-25, as ASC 985-605 excludes such products from its scope. Additionally, the scope guidance in ASC 985-605-15-4 provides that when such tangible product (i.e., both the software and non-software elements functioning together to provide the product’s essential functionality) has been determined to be outside the scope of ASC 985-605, the undelivered elements relating to that tangible product (e.g., the PCS) are also excluded from the scope of ASC 985-605.
If the vendor determines that the maintenance included in the transaction falls within the scope of the guidance for separately priced extended warranty and product maintenance contracts, the vendor will allocate arrangement consideration to the maintenance or PCS equal to the stated contractual rate for the maintenance or PCS. This amount will be recognized as revenue in accordance with the provisions of ASC 605-20-25-1 through 25-6. The remainder of the arrangement consideration will be allocated among the remaining elements in accordance with the guidance in ASC 605-25.

The following example illustrates this concept:

**Illustration 2-4**

**Facts:**

A vendor sells a personal computer that includes an operating system, productivity software and maintenance on the operating system and the productivity software. The operating system provides the essential functionality of the personal computer, including the ability to manage the computer and its hardware functions, the ability to manage and interact with a range of hardware peripherals, and the ability to communicate through a variety of computer networks. The vendor rarely sells the personal computer without the operating system. The vendor regularly sells the same computer with and without the productivity software and also sells the productivity software separately.

Total arrangement consideration is $2,000. The vendor has determined that its best estimate of selling price is $1,400 for the personal computer, $400 for the operating system, $400 for the productivity software, $80 for the maintenance on the operating system and $80 for the maintenance on the productivity software. For purposes of this example, assume that the maintenance on the operating system meets the requirements of ASC 605-20-25-1 through 25-6 to be treated as a separately priced product maintenance agreement and the stated price of the maintenance in the contractual arrangement is also $80.

**Analysis:**

Similar to the analysis included in Illustration 2-3, the vendor would have to identify which deliverables are non-software components and which are software components and allocate the arrangement consideration to those deliverables. However, since the non-software components also include a deliverable that is considered a separately priced product maintenance agreement, ASC 605-20-25-1 through 25-6 requires that the contractual price be allocated to that deliverable. As a result, none of the discount inherent in the transaction would be allocated to the maintenance on the operating system. The arrangement consideration would be allocated as follows:

<table>
<thead>
<tr>
<th></th>
<th>Estimate of selling price</th>
<th>% of relative selling price</th>
<th>Allocated discount</th>
<th>Allocated arrangement consideration</th>
</tr>
</thead>
<tbody>
<tr>
<td>Personal computer</td>
<td>$ 1,400</td>
<td>61.4%</td>
<td>$ (221)</td>
<td>$ 1,179</td>
</tr>
<tr>
<td>Operating system</td>
<td>400</td>
<td>17.5%</td>
<td>(63)</td>
<td>337</td>
</tr>
<tr>
<td>Maintenance on operating system</td>
<td>80*</td>
<td>-</td>
<td>-</td>
<td>80</td>
</tr>
<tr>
<td>Software deliverables (productivity software and related maintenance)</td>
<td>480</td>
<td>21.1%</td>
<td>(76)</td>
<td>404</td>
</tr>
<tr>
<td></td>
<td>$ 2,360</td>
<td></td>
<td>(360)</td>
<td>$ 2,000</td>
</tr>
</tbody>
</table>

*Also represents contractual price for maintenance.
2.3.5 Applicability to software customization contracts

The software revenue recognition guidance included in ASC 985-605-25-2 provides that if a software arrangement to deliver software or a software system, either alone or together with other products or services, requires significant production, modification or customization of software, the entire arrangement should be accounted for in conformity with the construction contract revenue recognition guidance included in ASC 605-35, using the relevant guidance in ASC 985-605-25-88 through 25-107 on applying contract accounting to certain arrangements involving software.

A literal reading of ASC 985-605-25-2 would indicate that when an arrangement involves the production, modification or customization of software, all elements included in the arrangement, including those elements that would not otherwise be subject to the scope of either ASC 985-605 or ASC 605-35, should be accounted for pursuant to the provisions of ASC 605-35. Based on this view, the provisions of ASC 605-25 should not be applied to the arrangement because, pursuant to paragraph 605-25-15-3A(a), ASC 605-35 provides both separation and arrangement consideration allocation guidance. However, we believe an entity would first consider the guidance in ASC 985-605-15-3 and 15-4 to determine which of the deliverables are included or excluded from the scope of ASC 985-605, prior to applying the guidance in ASC 985-605-25-2. For example, based on the scope criteria of ASC 985-605, an entity would determine that any hardware included in the arrangement was not within its scope. Further, any software that was functioning with the hardware to deliver the essential functionality of the tangible product would also be outside the scope of ASC 985-605.

Even in situations in which an entity concludes that certain elements of an arrangement for the significant production, modification, or customization of software are outside the scope of ASC 985-605, the entity may still conclude that such elements fall within the guidance of ASC 605-35. Such guidance is applicable to contracts to design, develop, manufacture or modify complex equipment or electronics.

The following example illustrates this concept:

<table>
<thead>
<tr>
<th>Illustration 2-5</th>
</tr>
</thead>
<tbody>
<tr>
<td><strong>Facts:</strong></td>
</tr>
<tr>
<td>A vendor enters into an arrangement with a customer to 1) license software that will be customized to meet the customer’s needs, 2) license software that will not be customized and 3) supply certain computer hardware. The software that the vendor provides (both the customized and non-customized versions) does not work together with the hardware to deliver the essential functionality of the product (i.e., the hardware is not within the scope of ASC 985-605 but the software may be based on the application of the provisions of ASC 985-605-15-3 (see Section 2.3.3)).</td>
</tr>
<tr>
<td><strong>Analysis:</strong></td>
</tr>
<tr>
<td>The software license that is not customized is within the scope of the software revenue recognition guidance included in ASC 985-605. Conversely, the software license for the customized software (including the customization efforts) is within the scope of the construction contract revenue recognition guidance included in ASC 605-35 and, pursuant to that guidance, the relevant guidance in ASC 985-605-25-88 through 25-107 on applying contract accounting to certain arrangements involving software also should be applied. Because ASC 605-35 contains guidance on the separation of deliverables within its scope but does not provide guidance on the separation of deliverables outside its scope, an entity will have to apply the guidance in ASC 605-25-15-3A(c) to determine whether to separate the deliverables within the scope of ASC 605-35 from the deliverables not within its scope (see Section 2.3.7 for further discussion of this topic).</td>
</tr>
</tbody>
</table>
Section 2.3.2 discusses in greater detail the general interaction of ASC 605-25 with other ASC guidance.

2.3.6 Interaction with the leasing guidance

FASB standard setting

In February 2016, the FASB issued a new leases standard (ASU 2016-02). ASU 2016-02 will supersede ASC 840 on the accounting for leases. Those pending changes have not been reflected herein.

ASU 2016-02 will be effective for annual periods beginning after 15 December 2018 (i.e., 1 January 2019 for a calendar-year public entity), and interim periods within those years, for public business entities and both of the following:

- Not-for-profit entities that have issued, or are conduit bond obligors for, securities that are traded, listed or quoted on an exchange or an over-the-counter market
- Employee benefit plans that file or furnish financial statements with or to the SEC

For all other entities, ASU 2016-02 will be effective for annual periods beginning after 15 December 2019 (i.e., 1 January 2020 for a calendar-year entity), and interim periods beginning after 15 December 2020 (i.e., 1 January 2021 for a calendar-year entity). Early adoption is permitted for all entities.

ASC 840 provides guidance on how to determine whether an arrangement contains a lease that is within the scope of ASC 840, based on the following model:

- The arrangement involves the use of property, plant or equipment (i.e., land and/or depreciable assets)
- The property, plant or equipment in the arrangement is either explicitly or implicitly identified
- The arrangement conveys to the lessee the “right to use” the specified property, plant or equipment

ASC 840 provides that if a multiple-element arrangement contains a lease, then the classification, recognition, measurement and disclosure provisions of ASC 840 are applied by both the purchaser and the supplier to the lease elements of the arrangement. Non-lease elements of the arrangement (i.e., the elements other than the lease and related executory costs such as taxes, insurance and maintenance) are not within the scope of ASC 840 and are accounted for in accordance with other applicable generally accepted accounting principles. That is, ASC 840 requires that any lease in any arrangement must be separated and accounted for pursuant to ASC 840.

With respect to the allocation of the arrangement consideration among the lease and related executory costs and other deliverables included in an arrangement, ASC 840 refers to ASC 605-25. Specifically, the guidance in ASC 840-10-15-17 through 15-19 refers to ASC 605-25-15-3A(b) (see Section 2.3.2), which requires the arrangement consideration to be allocated between the lease deliverables (i.e., the lease and related executory costs) and the non-lease deliverables based on the relative selling price of the deliverables. If more than one non-lease deliverable exists, these should be further evaluated pursuant to ASC 605-25 or other applicable guidance to determine if they represent separate units of accounting (see Chapter 3, Determining units of accounting). If so, the remaining arrangement consideration should be allocated to those units of accounting pursuant to the provisions of ASC 605-25 (see Chapter 4, Measurement and allocation of arrangement consideration).

This concept is discussed in the implementation guidance in ASC 605-25-55-2 and 55-3 for an arrangement involving multiple deliverables that includes a lease.
The following provides implementation guidance on how to allocate arrangement consideration to each separate unit of accounting when a multiple-deliverable arrangement contains deliverables that are within the scope of other Topics and those Topics only provide guidance on how to separate the deliverables (see paragraph 605-25-15-3A(b)).

For example, leased assets are required to be accounted for separately under the guidance in Subtopics 840-20 and 840-30. Consider an arrangement that includes the lease of equipment under an operating lease, the maintenance of the leased equipment throughout the lease term (executory cost), and the sale of additional equipment unrelated to the leased equipment. The arrangement consideration should be allocated between the deliverables subject to the guidance in Subtopic 840-20 and the other deliverables using the relative selling price method. (Although Topic 840 does not provide guidance regarding the accounting for executory costs, it does provide guidance regarding the allocation of arrangement consideration between the lease and the executory cost elements of an arrangement. Therefore, this example refers to the leased equipment and the related maintenance as deliverables subject to the guidance in that Topic.) The guidance in Topic 840 would then be applied to separate the maintenance from the leased equipment and to allocate the related arrangement consideration to those two deliverables. This Subtopic would be applied to further separate any deliverables not subject to the guidance in Topic 840 and to allocate the related arrangement consideration.

The following example illustrates the above concepts regarding separating lease deliverables from non-lease deliverables:

**Illustration 2-6**

**Facts:**
A vendor enters into an arrangement with a customer to lease a photocopier for three years and supply a stated monthly quantity of paper and toner for the three-year period. The arrangement fee is $1,000 per month for both the photocopier lease and the paper and toner supply arrangement. Other vendors can supply the paper and toner, and the selling price for these products can be easily determined ($200 per month). In addition, the lessor typically leases this type of photocopier without a supply arrangement over a three-year period for a monthly rental of $900 per month.

**Analysis:**
The vendor must separate the lease elements from the supply contract and allocate the arrangement consideration using the relative-selling-price method. When applying the relative-selling-price method, the selling price of each deliverable is determined using VSOE, if it exists, or TPE, or if neither of those exists, the vendor’s best estimate of selling price. In this situation, the vendor is able to establish VSOE of selling price for the photocopier, as they regularly lease the photocopier on a standalone basis for $900. Also, the vendor has TPE of selling price for the paper and toner supply arrangement, as other vendors sell these products for $200 per month. Based on these facts, the vendor would allocate the arrangement consideration to the lease elements and the non-lease elements as follows:
Lease elements

\[
\frac{900}{(200+900)} \times 1,000 = 818
\]

Non-lease elements

\[
\frac{200}{(200+900)} \times 1,000 = 182
\]

Accordingly, $818 per month of the arrangement consideration would be allocated to the lease of the copier and $182 to the non-lease elements (i.e., the paper and toner supply arrangement). The non-lease elements would be analyzed under ASC 605-25 to determine whether further separation of the components of the paper and toner supply arrangement is required (e.g., if the paper is delivered monthly and the toner every other month for one monthly fee, then the monthly fee allocated to the paper and toner may need to be separated further). Revenue for the lease of the photocopier should be recognized pursuant to ASC 840 and for the paper and toner supply contract pursuant to the general revenue recognition criteria in ASC 605 or SAB Topic 13.

### 2.3.7 Interaction with the construction-type and production-type guidance for services bundled with a construction contract

ASC 605-35 applies to contracts for which specifications are provided by the customer for the construction of facilities or the production of goods and certain related services. Service contracts such as outsourcing and maintenance contracts are generally excluded from the scope of ASC 605-35. In some instances, vendors enter into arrangements in which deliverables that are within the scope of ASC 605-35 (e.g., long-term construction contracts) are combined with service contracts (e.g., maintenance to be performed on the completed asset) that are not within the scope of ASC 605-35.

Although ASC 605-35 provides guidance for the separation of deliverables that are within its scope, it does not provide guidance for the separation of deliverables that are outside its scope from those that are within its scope. Accordingly, such an arrangement should be evaluated pursuant to ASC 605-25-15-3A(c) (see Section 2.3.2). Pursuant to ASC 605-25-15-3A(c), the provisions of ASC 605-25 should be applied in order to determine whether to separate the deliverables within the scope of ASC 605-35 from the deliverables not within its scope, and if so, how to allocate the arrangement consideration (see Chapter 3, Determining units of accounting, and Chapter 4, Measurement and allocation of arrangement consideration, for further discussion relating to how deliverables should be separated and arrangement consideration allocated pursuant to ASC 605-25).

Pursuant to ASC 605-25, if the deliverable(s) that would otherwise be subject to ASC 605-35 cannot be separated from the deliverables that are not subject to ASC 605-35, the entire arrangement would be accounted for as one deliverable. In such cases, assessing the revenue recognition guidance that should be applied to the combined unit of accounting requires judgment (see Section 3.5.1).
3 Determining units of accounting

3.1 Chapter summary

Once a vendor has identified the scope of an arrangement (see Section 3.2.1), the deliverables contained therein (see Section 1.2.1), and determined that certain or all deliverables included in the arrangement are not subject to separation guidance contained in other specific ASC literature (see Section 2.3.2), it must evaluate the deliverables to determine if they can be accounted for as separate units of accounting.

One of the underlying principles of ASC 605-25 is that “revenue arrangements with multiple deliverables shall be divided into separate units of accounting if the deliverables in the arrangement meet the criteria in paragraph 605-25-25-5.” If these criteria are met, separation of the elements is not optional. The determination of whether the multiple deliverables included in an arrangement can be separated into multiple units of accounting should be performed at the inception of the arrangement and as the vendor satisfies each of its performance obligations (i.e., as each deliverable is delivered).

Pursuant to ASC 605-25-25-5, a delivered item is accounted for as a separate unit if 1) the delivered item has standalone value and 2) if the customer has a general right of return relative to the delivered item, delivery or performance of the undelivered item is probable and substantially within the vendor’s control.

Both of the separation criteria above must be met in order for a delivered item to be accounted for as a separate unit. An assessment of each criterion requires a careful analysis of the applicable facts and circumstances. For example, when determining if the delivered item has standalone value, the vendor should consider whether, in situations in which the vendor doesn’t sell the item separately, the delivered item can be resold by the customer, irrespective of whether a secondary market for that deliverable currently exists. This assessment may require judgment and careful consideration of the facts and circumstances. In certain circumstances, the customer’s legal right to resell the element and the resulting resale price, or the customer’s ability to use the delivered item for its intended purpose, may need to be considered. For example, the ability solely to sell the delivered item for scrap would not meet the standalone criterion established by this guidance.

Satisfaction of the second criterion also is required to ensure that the arrangement fee is fixed and determinable. That is, since the vendor is obligated to deliver the remaining elements, the customer may have additional leverage against the vendor that could be used to receive a discount or refund of a portion of the arrangement’s fee if delivery or performance of the undelivered items is not in the vendor’s control. If the customer is not able to influence delivery, the negotiated arrangement consideration would only be affected by general return considerations, consistent with the guidance in ASC 605-15.

If either of the separation criterion is not met for a delivered item in a multiple-element arrangement, the delivered item is accounted for as a combined unit of accounting with the undelivered item(s). In certain instances, there may be multiple undelivered items, one of which may qualify as a separate unit of accounting, but there would be at least one undelivered item that will be combined with the delivered item. Arrangement consideration would be allocated to the combined unit of accounting, and for revenue recognition purposes, the combined products or services would be considered a single unit of accounting. Revenue for a combined unit of accounting would generally be recognized based on the method appropriate for the last delivered item. For example, if a product is the last delivered item in a combined unit, revenue attributed to the combined unit would be recognized on delivery of that product (assuming all other revenue recognition criteria are met). When a service element, such as a one-year maintenance
agreement, is the last delivered item, arrangement consideration for the combined unit would generally be recognized ratably over the service period. However, revenue recognition models other than that applicable to the last delivered item may be appropriate in certain circumstances (see Section 3.5.1). Accordingly, the facts and circumstances for each arrangement that includes a combined unit of accounting should be thoroughly analyzed before determining the appropriate method of revenue recognition for the combined unit of accounting.

3.2 Basic principles and contract combination or separation

Excerpt from Accounting Standards Codification
Revenue Recognition – Multiple-Element Arrangements

Recognition

605-25-25-1
In an arrangement with multiple deliverables, the principles in paragraph 605-25-25-2 and application guidance in Section 605-25-30 and paragraphs 605-25-25-4 through 25-6 shall be used to determine both of the following:

a. Units of accounting, that is, whether the arrangement should be divided into separate units of accounting

b. Measurement and allocation of arrangement consideration, that is, how the arrangement consideration should be measured and allocated among the separate units of accounting.

605-25-25-2
The principles applicable to this Subtopic are as follows:

a. Revenue arrangements with multiple deliverables shall be divided into separate units of accounting if the deliverables in the arrangement meet the criteria in paragraph 605-25-25-5.

b. Arrangement consideration shall be allocated among the separate units of accounting based on their relative selling prices (or as otherwise provided in paragraph 605-25-30-4). The amount allocated to the delivered unit of accounting is limited as discussed in paragraph 605-25-30-5.

c. Applicable revenue recognition criteria shall be considered separately for separate units of accounting.

605-25-25-3
In applying the guidance in this Subtopic, separate contracts with the same entity or related parties that are entered into at or near the same time are presumed to have been negotiated as a package and shall, therefore, be evaluated as a single arrangement in considering whether there are one or more units of accounting. That presumption may be overcome if there is sufficient evidence to the contrary.

3.2.1 Evaluating separate contracts as a single arrangement

The multiple-element arrangements guidance contains a presumption that separate contracts entered into at or near the same time with the same entity or related parties were negotiated as a package and should be evaluated as a single agreement. Determining when this presumption may be overcome requires the use of judgment, and ASC 605-25 is clear that both the form and the substance of an arrangement must be considered in the evaluation. Often, vendors have continuing relationships with their customers, and this business relationship will lead to numerous signed or oral arrangements between the two parties. The existence of concurrent agreements suggests that these multiple agreements may represent a single arrangement, and, as such, the timing and measurement of revenue recognition might be affected by the various deliverables and payment terms of the overall arrangement.
We believe the guidance included in ASC 985-605-55-4 regarding software revenue recognition provides relevant analogous guidance that should be considered when assessing if multiple agreements or contracts between vendors and customers should be considered separate arrangements versus one multiple-element arrangement.

**Excerpt from Accounting Standards Codification**

*Software – Revenue Recognition*

*Implementation Guidance and Illustrations*

**985-605-55-4**

Software vendors may execute more than one contract or agreement with a single customer. However, a group of contracts may be so closely related that they are, in effect, parts of a single arrangement and should be viewed as one multiple-element arrangement when determining the appropriate amount of revenue to be recognized in accordance with this Subtopic. The form of an arrangement is not necessarily the only indicator of the substance of an arrangement. The existence of any of the following factors (which are not all-inclusive) may indicate that a group of contracts should be accounted for as a single multiple-element arrangement:

a. The contracts or agreements are negotiated or executed within a short timeframe of each other.

b. The different elements are closely interrelated or interdependent in terms of design, technology, or function.

c. The fee for one or more contracts or agreements is subject to refund, forfeiture, or other concession if another contract is not completed satisfactorily.

d. One or more elements in one contract or agreement are essential to the functionality of an element in another contract or agreement.

e. Payment terms under one contract or agreement coincide with performance criteria of another contract or agreement.

f. The negotiations are conducted jointly with two or more parties (for example, from different divisions of the same entity) to do what in essence is a single project.

In addition to the factors outlined above, we believe that the following are indicators that the contracts should be evaluated as a single arrangement:

- The separate contracts require delivery of the same product(s) or service(s)
- The separate contracts relate to the delivery of the same product(s) or service(s) to multiple customer locations
- The contracts were negotiated in contemplation of one another, regardless of the time frame over which the contracts are signed (a strong indicator)
- It was likely that a follow-on contract to provide services relating to a previously purchased product would be executed. In such cases, we believe that the original contract and the subsequent contracts should generally be considered one agreement. Factors that may indicate that such a follow-on contract is likely include:
  - The vendor performs such services for a majority of the customers that purchase its products
  - Pricing of the service contract is agreed to at the date the product was purchased
On the other hand, if the contracts were awarded by the customer pursuant to separate bona-fide competitive bid processes, we believe that such processes are a strong indicator that the contracts should be accounted for as standalone agreements.

While we do not believe that any single factor above is necessarily determinative, a presence of any one, or a combination, of the factors may indicate that contracts entered into at or near the same time should be evaluated as a single arrangement with multiple deliverables. Conversely, the absence of all of the above factors may overcome the presumption that separate contracts entered into at or near the same time are a single arrangement. All facts and circumstances applicable to an arrangement should be considered when making this determination.

The following examples illustrate these concepts:

**Illustration 3-1**

**Facts:**
Company A enters into an arrangement to manufacture a piece of machinery for Customer B. Company A provides installation services to the majority of its customers because proper installation is essential to the functionality of the machinery. However, Customer B initially believes that it will be able to complete the installation without any assistance from Company A and declines the installation services. No other vendors perform these installation services. Upon review of the product specifications and the complexity of the unit, Customer B determines that installation services should be provided by Company A. Within two weeks of signing the purchase agreement, Customer B enters into a separate agreement with Company A for the provision of the installation services at a price that was agreed to in connection with the original negotiations.

**Analysis:**
In this example, the purchase and installation arrangements should be treated as one multiple-element arrangement. The fact that 1) the contracts were agreed to within a short timeframe of each other, 2) the contracts are with the same customer, 3) the contracts relate to the same project, and 4) the installation is essential to the functionality of the machinery, are all indicators that these contracts should be combined.

**Illustration 3-2**

**Facts:**
A real estate developer enters into an agreement with a general contractor to manage the building process for a townhouse development project. The general contractor agrees to a fee of $300,000 per unit, based on the developer’s cost estimates for each unit. Within a month’s timeframe, the general contractor wins another contracting agreement with the same real estate developer for a second community in an adjacent town for a fee of $275,000 per unit. Negotiations for each contract were handled by the same employees within each company, but the contracts were awarded after competitive bids were obtained from other contractors and without regard to existing general contracting arrangements at other developments. Payments relating to each development project are independent of each other.
Analysis:

The general contractor should account for the two contracts separately. Although negotiated by the same employees within a short time frame, the contracts were not negotiated in contemplation of each other, were awarded pursuant to a competitive bid process, and the completion of one community, including related payment for the general contractor’s services, is not tied to the development of the other community.

Note: The above examples only relate to determining if the separate contracts represent, in substance, one arrangement, and do not address whether the deliverables (e.g., manufacturing and installation in the first example) represent separate units of accounting (refer to Section 3.4 for guidance on making this determination).

3.2.2 Evaluating subsequent contracts and modifications to contracts originally accounted for under ASU 2009-13

If a subsequent contract, or an amendment to an existing contract, is entered into by a vendor and its customer, and the vendor has not substantially completed its performance obligations pursuant to the original agreement, consideration should be given to whether the remaining performance obligations and the newly negotiated obligations are, in substance, one new arrangement, based on the factors discussed in Section 3.2.1. Although we generally would presume that an amendment to an existing contract should be evaluated with the remaining performance obligations from the original agreement as one arrangement, the factors discussed in ASC 985-605-55-4 and in Section 3.2.1 should be considered when making this evaluation.

Under this approach, an entity would evaluate all remaining undelivered elements within the modified contract and allocate to those elements (based on their relative selling prices) the sum of (1) additional consideration related to the new or modified deliverables and (2) any amounts allocated to the undelivered elements from the original contract in the initial allocation, using current estimated selling prices for each of the elements.

The following examples illustrate these concepts:

Illustration 3-3

Facts:

Company A enters into an arrangement to manufacture and install a piece of machinery for Customer B. Although Company A also offers maintenance services, many of its customers have their own personnel perform maintenance on the machinery. Customer B declines to enter into a maintenance agreement at the initial contract date. No terms relating to a potential maintenance agreement are discussed in connection with the initial contract negotiations. Manufacture and installation occur in approximately three months, and Customer B accepts the machinery after certain performance specifications are met. The consideration received by Company A for the manufacture and installation of the machinery is consistent with the typical selling price for such machinery, based on Company A’s VSOE of selling price.

---

3 Refer to Chapter 7 for guidance on accounting for modifications to contracts originally accounted for under ASC 605-25 prior to the adoption of ASU 2009-13.
One month after acceptance, Customer B decides that its employees do not have the training or expertise to perform the maintenance required on the machinery. Therefore, it enters into a separate three-year maintenance agreement with Company A. The consideration for the first arrangement is unrelated (i.e., no refunds, forfeitures, etc.) to the fee for the maintenance contract. The consideration received for the maintenance services is also consistent with the typical selling price, based on VSOE.

**Analysis:**

The maintenance arrangement should be treated as a separate arrangement. While both agreements are with the same customer and, in some respects, may be considered part of the same project, the maintenance is not essential to the functionality of the machinery or installation. All performance obligations imposed on the vendor by the original agreement have been completed prior to the execution of the maintenance agreement, the agreements were not negotiated in contemplation of each other, and each agreement has been priced at the typical selling price for the underlying product or service.

---

**Illustration 3-4**

**Facts:**

Company A enters into a seven-year contract to provide payroll outsourcing for Company B. At the time the payroll outsourcing contract is signed, Company A is also in negotiations to perform human resources (HR) outsourcing for Company B. Six months after Company A begins providing payroll outsourcing, Company B agrees to enter an HR outsourcing contract with a term ending at the same time as the payroll contract. Company A offers Company B favorable pricing on the HR outsourcing services, compared to what is offered to customers that utilize only the HR outsourcing services. Payments due on the HR services contract coincide with payments to be made under the remaining terms of the payroll outsourcing agreement.

**Analysis:**

Company A should consider the payroll outsourcing and HR outsourcing services as one arrangement. Company A’s pricing of the HR servicing agreement was negotiated with the known pricing of the payroll servicing contract. In addition, the payment dates for each individual contract coincide. While there was a six month lag between signing each contract, the duration of each outsourcing term and the fact that Company A was in negotiations with Company B for the HR outsourcing when the original payroll service contract was signed are indicators that these contracts were negotiated in contemplation of each other.

In such cases, we believe that the first contract generally should be accounted for as a standalone agreement in the periods prior to the execution of the subsequent contract. When the subsequent contract is executed, the agreements should then be evaluated as one arrangement subject to the provisions of the multiple-element arrangements guidance. However, if at the inception of the first contract, Company A has done extensive negotiation with Customer B in relation to performing the HR outsourcing services, and it is likely that the second contract will be executed and contain pricing terms that are significantly discounted as compared to the terms of the first contract, revenue relating to the first contract for payroll services should be deferred until the execution of the second contract.
3.3 Timing of evaluation of units of accounting

<table>
<thead>
<tr>
<th>Excerpt from Accounting Standards Codification</th>
</tr>
</thead>
<tbody>
<tr>
<td>Revenue Recognition – Multiple-Element Arrangements</td>
</tr>
<tr>
<td>Recognition</td>
</tr>
<tr>
<td>605-25-25-4</td>
</tr>
<tr>
<td>A vendor shall evaluate all deliverables in an arrangement to determine whether they represent separate units of accounting. That evaluation shall be performed at the inception of the arrangement and as each item in the arrangement is delivered.</td>
</tr>
</tbody>
</table>

3.3.1 Evaluation of deliverables subsequent to the inception of the arrangement

ASC 605-25-25-4 requires that deliverables be evaluated for separability “as each item in the arrangement is delivered,” as well as at the inception of the arrangement. We understand that the intention of this requirement was not to require a reassessment of whether all of the deliverables in the arrangement have been appropriately identified, but rather if the remaining deliverables should be separated or treated as a combined unit of accounting.

Subsequent to the delivery of an element(s) in an arrangement, a change in facts and circumstances may result in a requirement to either separate or combine deliverables. Potential changes in facts and circumstances may include (this list is not all-inclusive):

- Standalone value of delivered items may be established (e.g., by the entry of a new competitor, such as an installation provider, into the marketplace). Accordingly, the delivered item could now meet the separation criteria and qualify as a separate unit of accounting.

The following example illustrates this concept:

<table>
<thead>
<tr>
<th>Illustration 3-5</th>
</tr>
</thead>
<tbody>
<tr>
<td><strong>Facts:</strong></td>
</tr>
<tr>
<td>A vendor introduces a new product into the marketplace. The product consists of a number of tangible items delivered over a four to six month period and specialized installation services. (The product will not operate correctly without the specialized installation services on each of the tangible items.) At the launch of the product, the vendor is the only party offering installation services. However, the product achieves broad market acceptance, and other vendors begin offering installation services on a standalone basis. Additionally, a secondary market develops for the product.</td>
</tr>
</tbody>
</table>

| **Analysis:**    |
| At the date of the product's introduction, the vendor could not conclude that the delivered item had standalone value because its functionality was dependent on specialized installation services that only it provided, and without the installation services, the customer would not be able to recover a substantial portion of the purchase price through resale of the product (see Question 3-1). However, as the product gained marketplace acceptance and both a secondary market for the product developed and other vendors began offering installation services on a standalone basis, the vendor was able to conclude that standalone value of the product exists. As a result, the entity will likely reassess its conclusion regarding standalone value for those arrangements in which the product has only been partially delivered as of the date the entity determines standalone value exists. As the entity delivers the remaining tangible items, the entity will likely determine each of those items now has standalone value. |
The vendor may be required to substitute undelivered items, and the substitution does not qualify as a new arrangement. If the selling price of the substituted item differs from the original item, the amount of arrangement consideration allocated to each undelivered accounting unit may change.

The following example illustrates this concept:

### Illustration 3-6

**Facts:**

A retailer sells home appliances individually and in bundled arrangements. The retailer offers discounts to the customer when multiple appliances are purchased. Customer A enters into an arrangement to buy a washer, dryer and refrigerator for total arrangement consideration of $1,500. The washer, dryer and refrigerator are routinely sold by the vendor on a standalone basis for $400, $600 and $1,000, respectively. Using the relative-selling-price method to proportionately allocate the arrangement consideration to each item, the retailer allocates the consideration as follows:

<table>
<thead>
<tr>
<th></th>
<th>Standalone selling price</th>
<th>% of relative selling price</th>
<th>Allocated discount</th>
<th>Allocated arrangement consideration</th>
</tr>
</thead>
<tbody>
<tr>
<td>Washer</td>
<td>$400</td>
<td>20%</td>
<td>$(100)</td>
<td>$300</td>
</tr>
<tr>
<td>Dryer</td>
<td>600</td>
<td>30%</td>
<td>(150)</td>
<td>450</td>
</tr>
<tr>
<td>Refrigerator</td>
<td>1,000</td>
<td>50%</td>
<td>(250)</td>
<td>750</td>
</tr>
<tr>
<td><strong>Total</strong></td>
<td><strong>$2,000</strong></td>
<td><strong>50%</strong></td>
<td><strong>(500)</strong></td>
<td><strong>$1,500</strong></td>
</tr>
</tbody>
</table>

The retailer delivers the refrigerator and recognizes $750 of revenue. Subsequently, it realizes the contracted-for washer cannot be delivered because the appliance manufacturer has discontinued that specific model (in this case, the retailer does not always hold inventory, but instead orders the merchandise from the manufacturer as the customer-specified delivery date nears). To uphold the terms of the contract, the vendor agrees to provide a substitute washer, which it routinely sells for $600 on a standalone basis, at no extra cost to the customer.

**Analysis:**

The substitution of the more expensive washer results in a different allocation of the remaining arrangement consideration. Since the refrigerator has already been delivered, the portion of arrangement consideration allocated to it cannot be reallocated among the three deliverables, as would be required at the inception of the contract. Instead, the remaining consideration should be reallocated to the replacement washer and the dryer based on their respective relative selling prices, as follows.

<table>
<thead>
<tr>
<th></th>
<th>Standalone selling price</th>
<th>% of relative selling price</th>
<th>Allocated discount</th>
<th>Allocation of remaining arrangement consideration</th>
</tr>
</thead>
<tbody>
<tr>
<td>Washer</td>
<td>$600</td>
<td>50%</td>
<td>$(225)</td>
<td>$375</td>
</tr>
<tr>
<td>Dryer</td>
<td>600</td>
<td>50%</td>
<td>(225)</td>
<td>375</td>
</tr>
<tr>
<td><strong>Total</strong></td>
<td><strong>$1,200</strong></td>
<td><strong>50%</strong></td>
<td><strong>(450)</strong></td>
<td><strong>$750</strong></td>
</tr>
</tbody>
</table>
Determining units of accounting

Financial reporting developments
Revenue recognition — Multiple element arrangements

• A general right of return exists for the delivered item, and the vendor’s performance of a remaining obligation is no longer probable and substantially in the vendor’s control due to a change in circumstances. Alternatively, a vendor’s performance of a remaining obligation that was not originally judged to be probable or substantially in the vendor’s control may, upon reevaluation, be assessed differently due to a change in circumstances.

The following example illustrates this concept:

Illustration 3-7

Facts:
A manufacturer frequently sells products in bundled arrangements. At inception of the agreement, the vendor determines that multiple elements included in the arrangement comprise separate units of accounting. This evaluation is based, in part, on an assumption that the vendor will be able to complete the future deliverables within the period specified in the contract. When reevaluating the arrangement due to the delivery of an item for which a general right of return exists, the undelivered items are now on a significant back-order as a fire caused significant damage to the manufacturing plant.

Analysis:
Because the vendor’s production facilities were damaged, the delivery of the remaining undelivered item within the required period is no longer substantially in the vendor’s control. In such a situation, the currently delivered item is not separable from the future deliverables. See Section 3.3.2 for the accounting when a change in facts and circumstances occurs subsequent to the recognition of revenue for a delivered item.

3.3.2 Reporting changes in the unit of accounting

As a result of evaluating performance obligations as each item in the arrangement is delivered, an entity may have a change in the unit of accounting (e.g., a change from separate to combined units of accounting, or vice versa). Such changes are considered a change in accounting estimate in accordance with ASC 250, Accounting Changes and Error Corrections, and are accounted for on a prospective basis. Any previous accounting for the arrangement is not restated.

As a result of the change in accounting estimate, a company may also need to consider secondary accounting effects. For example, assume a vendor determines at the outset of an arrangement that multiple deliverables included in an arrangement constitute separate units of accounting. However, when reassessing the arrangement on subsequent delivery of an item, the vendor concludes that it can no longer assess its ability to deliver the undelivered items as probable and can no longer account for the multiple items in the arrangement as separate units of accounting (or vice versa, a combined unit can now be accounted for as individual units – see Section 3.3.1). Although this conclusion does not affect the accounting for any previously delivered items, the vendor should assess how its potential inability to deliver the remaining undelivered items affects its estimate for returns of those previously delivered items recorded pursuant to ASC 605-15. Any necessary changes in the estimated provision for returns should be reported in the current period. Any change in accounting estimate that is material to the financial statements should be disclosed in the financial statements.
3.4 Separating units of accounting

Excerpt from Accounting Standards Codification
Revenue Recognition – Multiple-Element Arrangements

Recognition

605-25-25-5
In an arrangement with multiple deliverables, the delivered item or items shall be considered a separate unit of accounting if both of the following criteria are met:

a. The delivered item or items have value to the customer on a standalone basis. The item or items have value on a standalone basis if they are sold separately by any vendor or the customer could resell the delivered item(s) on a standalone basis. In the context of a customer’s ability to resell the delivered item(s), this criterion does not require the existence of an observable market for the deliverable(s).

b. [Subparagraph superseded by Accounting Standards Update No. 2009-13]

c. If the arrangement includes a general right of return relative to the delivered item, delivery or performance of the undelivered item or items is considered probable and substantially in the control of the vendor.

See the flowchart in Paragraph 605-25-55-1 for an illustration of these criteria. The criteria for dividing an arrangement into separate units of accounting shall be applied consistently to arrangements with similar characteristics and in similar circumstances.

3.4.1 Mandatory application of the separation criteria

The guidance in ASC 605-25 makes clear that the separation of elements into different units of accounting when the specified criteria are met is not an election; it is a requirement. Deliverables in an arrangement that meet the separation criteria in the multiple-element arrangements guidance must be treated as separate units of accounting for purposes of revenue recognition.

3.4.2 Impact of the order of deliverables

The order in which items included in an arrangement are delivered can affect the determination of whether the items are separable into different units of accounting. Multiple items included in an arrangement are separable into different units of accounting only if the separation criteria are met. When performing this assessment, the first criterion relating to standalone value applies only to a delivered item in an arrangement. Accordingly, the sequence in which items are delivered in an arrangement can affect whether the items may be accounted for separately.
The following example illustrates this concept:

**Illustration 3-8**

**Facts:**
A vendor sells two products, A and B, with the following characteristics:

<table>
<thead>
<tr>
<th>Product</th>
<th>Standalone value</th>
</tr>
</thead>
<tbody>
<tr>
<td>A</td>
<td>Yes</td>
</tr>
<tr>
<td>B</td>
<td>No</td>
</tr>
</tbody>
</table>

The vendor enters into two arrangements to deliver products A and B to customers. The products are to be delivered in the following order for each arrangement:

<table>
<thead>
<tr>
<th>Arrangement</th>
<th>Delivered first</th>
<th>Delivered second</th>
</tr>
</thead>
<tbody>
<tr>
<td>1</td>
<td>Product A</td>
<td>Product B</td>
</tr>
<tr>
<td>2</td>
<td>Product B</td>
<td>Product A</td>
</tr>
</tbody>
</table>

No rights of return are provided to the customers by the vendor.

**Analysis:**
The vendor may separate the two products into separate units of accounting in the first arrangement, because delivered product A has standalone value. However, in the second arrangement, the vendor may not separate the products into individual units of accounting because delivered product B does not have standalone value.

### 3.4.3 Factors to consider when evaluating standalone value

ASC 605-25-25-5(a) states that a delivered item has standalone value to the customer when either 1) any vendor sells that item separately or 2) the customer could resell that item on a standalone basis.

In considering the first criterion, either the vendor or any other company can sell that item on a standalone basis. That is, while competing products have different brand names or may be marketed as having unique qualities or features, if those products or services could be used in place of the product or service that was delivered by the vendor, then the “sold separately” criterion generally would be met. Other factors that may indicate that a competing product could be used in place of the delivered product or service include similarities in marketing techniques and target customers, price, delivery and installation requirements, warranty provisions, customer acceptance provisions and post-sales support.

In considering the second criterion, we believe that the vendor should be able to conclude that if the customer were to immediately resell the delivered item, the customer can resell it at an amount that would substantially recover the original purchase price in order to meet the standalone value criterion. An observable secondary market for the resale of the delivered item is not required to conclude that the item has standalone value to the customer. However, if a secondary market does not exist, careful consideration should be given as to whether the absence of such a market indicates that the delivered item does not have value to the customer on a standalone basis. Finally, a customer’s ability to use the delivered item for its intended purpose without the receipt of the remaining deliverables may also indicate that the item has standalone value, as this indicates that the customer was able to obtain the value intended from the delivered item.
The following example illustrates these concepts:

**Illustration 3-9**

**Facts:**
A customer enters into a two-year service contract with a cellular phone company. In addition to the service contract, the customer purchases a phone to be used on that cellular network. The service contract contains a penalty for early termination; however, the phone remains the customer’s property if the service contract is terminated early. The company does not sell telephones without associated service contracts; however, certain of its competitors do. The company’s competitors market these phones similarly to the company, and the phones have similar functionality and warranties.

Additionally, there is an observable secondary market for pre-owned phones, the vendor will allow customers to use pre-owned phones to receive cellular services, and phones sold by the company will work on the cellular networks of certain of its competitors without modification.

**Analysis:**
The cellular phone acquired at origination of the arrangement has standalone value to the customer, based on the following factors:

- Phones with similar functionality and features are sold by the company’s competitors on a standalone basis.
- There is an observable secondary market for the phones.

**Question 3-1** Can a conclusion that an item has standalone value be supported solely based on the fact that the deliverable can be resold for scrap?

No. While an observable market is not a requirement to determine if a delivered item could be sold by the customer and therefore has standalone value, we do not believe that selling an item for scrap meets the objective of the standalone value criterion. The “sold for scrap” notion implies that the amount recovered from resale is not significant in relation to the original purchase price of that item (from the customer’s standpoint). We believe that if the determination of whether a deliverable has standalone value is based on the ability to sell the product, the customer must be able to resell the delivered item at an amount that would substantially recover the original purchase price in order to meet the standalone value criterion.

**Question 3-2** If the terms of an arrangement prohibit a customer from reselling a delivered item, can the vendor conclude that the delivered item has standalone value?

If a customer is contractually precluded from reselling a deliverable, this may indicate that the deliverable does not have standalone value to the customer. In such instances, the customer would be contractually precluded from being able to recover a substantial portion of the original purchase price of the delivered item through resale (see Section 3.4.3).

Determining when such a contractual provision precludes a vendor from concluding that a delivered item has standalone value will be dependent upon the applicable facts and circumstances and will require the use of professional judgment. However, the following factors may indicate that a delivered item has standalone value even if the customer is precluded from resale:

- The delivered item can be used by the customer for its intended purpose without receipt of the undelivered items included in the arrangement.
The vendor has provided a significant discount from the selling price to the customer, and does not want the customer to resell the delivered item at a profit.

The customer has obtained the right to use intellectual property routinely licensed by a vendor on a non-exclusive basis to multiple customers. In such cases, the vendor may prohibit customers from sublicensing the intellectual property to protect its ability to generate revenues from licenses to future customers.

**Question 3-3**  
Does standalone value exist if the vendor is the only provider of an undelivered item and no other vendor sells the delivered item separately?

ASC 605-25-25-5(a) states that a delivered item has standalone value to the customer when either 1) any vendor sells that item separately or 2) the customer could resell that item on a standalone basis. To the extent that the value of the delivered item is dependent on the undelivered item (e.g., the customer will be unable to resell the delivered item and recapture a substantial portion of its original cost because the value of the item would be significantly diminished without the delivery of the undelivered item), and there are no other vendors that provide the undelivered item (or a similar item that could be used instead), we believe the delivered item generally does not have standalone value.

The following examples illustrate these concepts:

**Illustration 3-10**

**Facts:**
A vendor sells a piece of equipment and installation services to a customer. The equipment is highly customized and requires specialized installation services to operate properly. Because of this, the vendor is the only party that provides the installation services. No other vendor sells similar equipment separately.

**Analysis:**
Because the equipment will not operate as intended if not properly installed, and the vendor is the only party that offers the installation services, the customer would not be likely to recover a substantial portion of the value of the equipment on resale absent the vendor’s installation services. Accordingly, the equipment does not have standalone value.

**Illustration 3-11**

**Facts:**
A cable television provider sells digital video recorder (DVR) units to new customers along with subscriptions for a minimum of 12 months of programming content. While other companies sell DVR equipment, the units sold by the cable company are not compatible with any other program content providers. However, the customer is permitted to resell the DVR, and the customer would likely recover a substantial portion of the original purchase price in such a transaction.

**Analysis:**
The transaction includes two separate units of accounting, the DVR and the subscription to the monthly programming content. Despite the fact that the customer is dependent on the vendor for the programming content to benefit from the full functionality of the DVR, the fact that other vendors sell similar DVRs separately and the customer has the ability to resell the DVR indicates that the DVR has standalone value.
If the vendor always sells the delivered element with the undelivered element (i.e., the customer cannot purchase the delivered item on its own), does standalone value exist for the delivered item?

ASC 605-25-25-5(a) states that a delivered item has standalone value to the customer when either 1) any vendor sells that item separately or 2) the customer could resell that item on a standalone basis. Assuming that no other vendors sell the element in question, the assessment of standalone value will depend on the customer’s ability to resell that element on a standalone basis. In such a situation, as long as the customer has the ability to resell the delivered element separate from the undelivered element (and recover a substantial portion of the purchase price of the delivered item), the delivered item likely has standalone value from the undelivered item. In determining whether the customer has the ability to resell the delivered element, consideration may need to be given as to the reason why the two elements are always sold together. For example, if the vendor simply packages those two items together because market conditions allow the vendor to require its customers to purchase of both elements, but the functionality of one is not connected to the other, it may be possible to conclude that the two elements can be treated as separate units of accounting. Further, if the customer can use the delivered item for its intended purpose without receipt of the undelivered item, the vendor may determine that the delivered item has standalone value. However, if the functionality of the delivered element is so reliant on the undelivered element that the customer will not be able to recover a substantial portion of the value of the delivered element by reselling that element, nor will the customer be able to obtain any value for the delivered element by using it (as it cannot be used for its intended purpose without the undelivered element), it seems unlikely that the delivered element has standalone value from the undelivered element.

Interaction of general right of return with contingent revenue

Questions frequently arise on how the concepts within the multiple-element arrangements guidance relating to revenue subject to a general right of return and revenue contingent on the future delivery of additional items interact. Although the guidance on revenue recognition when a right of return exists included in ASC 605-15 does not use the specific term “general right of return,” it can be inferred from the last sentence of ASC 605-25-30-5 that a general right of return under ASC 605-25 is synonymous with the “right of return” as it is discussed in ASC 605-15. Specifically, ASC 605-25-30-5 states that “the allocated amount is not adjusted for the impact of a general right of return pursuant to [Subtopic 605-15].”

A general right of return provides return rights to all or most customers and does not specifically require future performance on the part of the vendor (e.g., a 30-day money back guarantee). An example of a right of return under ASC 605-15 is a customer’s ability to return a product due to dissatisfaction. General return rights are generally broader in scope and shorter in term than a contingent revenue feature, but a contingent revenue feature should also be considered when assessing the criterion of ASC 605-25-25-5(c).

A contingent revenue feature in the context of the multiple-element arrangements guidance is a contractual provision that allows a customer to return a delivered item, or avoid or reduce payment for such an item, because the vendor does not successfully complete all of its performance obligations. The multiple-element arrangements guidance distinguishes between a general right of return and a contingent revenue feature when allocating arrangement consideration (see Section 4.5.1).
When assessing whether the ASC 605-25-25-5(c) criterion has been met, a vendor should assess a contingent revenue feature similarly to a general return right. The focus should be on whether it is probable that the vendor will be able to complete its remaining performance obligations for the undelivered items and whether such performance is substantially in its control (see Section 3.4.5). If so, and if the standalone value criterion described in ASC 605-25-25-5(a) is satisfied, a delivered item and an undelivered item should be considered separate units of accounting, and the vendor can recognize revenue for the delivered item (assuming the applicable revenue recognition criteria have been satisfied – see Section 2.3.1).

When a vendor has separated a delivered item from the remaining deliverables in an arrangement, and the delivered item has an associated general right of return, this right should be accounted for pursuant to the guidance in ASC 605-15. As the multiple-element arrangements guidance indicates, a general right of return does not limit the amount of arrangement consideration that may be allocable to the delivered item, but it may affect the amount of revenue recognized for the delivered item.

In contrast, pursuant to the multiple-element arrangements guidance, a contingent revenue feature limits the amount of arrangement consideration that is otherwise allocable to a delivered item determined to be a separate unit of accounting to the amount that is not contingent on the vendor’s completion of the remaining performance obligations, without considering the likelihood of the vendor’s performance.

Section 4.5 also discusses how general rights of return and contingent revenue features affect the amount of arrangement consideration that is allocable to a delivered item in a multiple-element arrangement when the deliverables are separable into differing units of accounting.

### 3.4.5 General right of return — factors to consider when evaluating probability of future performance

ASC 605-25-25-5(c) sets forth a requirement that if a general right of return exists relative to a delivered item included in an arrangement, delivery or performance of the undelivered item(s) must be considered probable and substantially in control of the vendor to conclude that the delivered item is separable from the undelivered item(s).

For purposes of making this assessment, we believe that the term probable should be interpreted using the definition contained in ASC 450, *Contingencies*, or as an event that is likely to occur. We also believe that the term “substantially in control of the vendor” should be interpreted to mean that there is a lack of factors that may substantially inhibit the vendor’s ability to successfully complete its remaining performance obligations.

When undelivered items are comprised of products or services that a vendor routinely delivers to its customers without difficulty, it may be relatively easy to conclude that this criterion is satisfied. However, the following factors may indicate that the vendor’s future performance may not be probable or substantially in its control:

- The vendor has a history of not successfully completing its obligations in similar arrangements
- The vendor has entered into a new line of business or is obligated to deliver products and services with which it is not highly experienced
- Products are highly customized and tailored to the customer’s demands
- Performance will occur over a relatively lengthy period
- The vendor must obtain external financing to complete its remaining obligations
• The vendor’s financial viability is uncertain

• The vendor’s ability to perform is dependent on others whose performance is unproven, uncertain or historically unreliable

• The vendor’s ability to perform is dependent on the ready availability of a scarce raw material, part, or component of the undelivered item

• The vendor’s ability to perform is dependent on the outcome of ongoing research and development activities

Determining when a vendor’s future performance may not be probable or substantially in its control will require the use of professional judgment and will be dependent on the applicable facts and circumstances.

The following example illustrates these concepts:

<table>
<thead>
<tr>
<th>Illustration 3-12</th>
</tr>
</thead>
<tbody>
<tr>
<td><strong>Facts:</strong></td>
</tr>
<tr>
<td>A vendor enters into an arrangement to deliver products A and B to a customer. Both products have standalone value. The vendor delivers product A and assesses whether it can be separated from product B for accounting purposes.</td>
</tr>
<tr>
<td>Product B is a specialized product, and the vendor’s ability to deliver this product is dependent on the specialized skills of its unionized workforce. At the time product A is delivered, the union is threatening to strike.</td>
</tr>
<tr>
<td><strong>Analysis:</strong></td>
</tr>
<tr>
<td>Because the required specialized skills necessary to complete the remaining undelivered item (product B) may not be readily available to the vendor, the delivery of the remaining undelivered items cannot be assessed as probable and substantially in the vendor’s control. Accordingly, the two products included in the arrangement should not be considered separate units of accounting.</td>
</tr>
</tbody>
</table>

### 3.5 Accounting for a combined unit of accounting

**Excerpt from Accounting Standards Codification**

**Revenue Recognition – Multiple-Element Arrangements**

**Recognition**

605-25-25-6

A delivered item or items that do not qualify as a separate unit of accounting within the arrangement shall be combined with the other applicable undelivered item(s) within the arrangement. The allocation of arrangement consideration and the recognition of revenue then shall be determined for those combined deliverables as a single unit of accounting.
3.5.1 Revenue recognition method for a combined unit of accounting

Determining the appropriate revenue recognition model in situations in which multiple deliverables are treated as a combined unit of accounting requires the use of professional judgment and is dependent on the relevant facts and circumstances.

However, we believe that there is a rebuttable presumption that the revenue recognition model applicable to the final deliverable included in the arrangement is the model that should be followed when recognizing revenue for the combined unit of accounting. The final deliverable model dictates that revenue is only recognized once the last item has been delivered, or over a performance period if the last deliverable is a service, assuming the other revenue recognition criteria have been met.

Additionally, we understand that the SEC staff will generally object to any revenue recognition model that results in revenue recognition as products are delivered or services are performed (i.e., any method other than the method applicable to the last deliverable included in the arrangement) if deliverables cannot be separated into multiple units of accounting due to a lack of standalone value. The SEC staff believes that recognizing revenue on the delivery of items that have no standalone value is contrary to the principles contained in the multiple-element arrangements guidance.

The presumption that revenue should be recognized when revenue can be recognized for the final deliverable may be overcome based on the facts and circumstances of the arrangement. For example, it may be inappropriate to apply a revenue recognition model based on the final deliverable included in the arrangement when one deliverable included in the arrangement clearly comprises the overwhelming majority of the value of the overall combined unit of accounting (i.e., it is the predominant deliverable included in the arrangement). In such cases, it may be appropriate to recognize revenue for the combined unit of accounting based on the revenue recognition guidance otherwise applicable to the predominant deliverable.

If the deliverables included in an arrangement are services that cannot be separated into different units of accounting, the revenue associated with the agreement may be recognized 1) over the period beginning with the commencement of the last service delivered, or 2) over the period of the entire arrangement using a proportional performance model of revenue recognition.

The proportional performance model can only be utilized when the vendor’s pattern of performance under the arrangement can be determined. In most cases, this focuses on the pattern in which service is provided to the customer (i.e., based on vendor outputs) and not the manner in which the vendor incurs costs or expends effort. Often it will be difficult to identify a common performance measurement for disparate services included in a multiple-element arrangement. The absence of such a measurement may preclude a vendor’s ability to utilize the proportional performance method for revenue recognition.

Application of the proportional performance model to service transactions may result in a revenue recognition pattern that is essentially based on the percentage of completion of the services. However, it is inappropriate to recognize the costs associated with the services in the same manner. The costs of providing services to a customer generally should be recognized as incurred, even if they are not incurred ratably as the services are provided. The “smoothing” of costs in a service transaction is not appropriate. To do so for a service contract accounted for using the proportional performance method of revenue recognition would effectively result in the application of percentage-of-completion accounting, as set forth in the contract accounting guidance included in ASC 605-35. The application of ASC 605-35 to service contracts is not appropriate as such contracts are not within its scope.

Regardless of the types of deliverables included in an arrangement, if they cannot be separated into multiple units of accounting pursuant to the criteria in the multiple-element arrangements guidance, a revenue recognition model that effectively accounts for them on a separate basis is not appropriate.
The following example illustrates this concept:

### Illustration 3-13

**Facts:**

A cloud computing services provider enters into an agreement with Customer A. The deliverables to be provided by the vendor include a one-year subscription license to the provider's service and customized programming of additional features in two phases (considered two separate deliverables). The contracted price for the subscription license is an upfront, nonrefundable $2 million payment. The provider sells similar subscriptions on a routine basis for a similar amount. The contracted rates for the programming of the customized features in phase one and two is $100,000 and $150,000, respectively. The provider has never performed the customized programming in the past, nor are there any other vendors who provide similar services. Further, the customer could not resell the customized programming. As a result, the provider determines that the customized services do not have standalone value.

**Analysis:**

Because the separation criteria in ASC 605-25 have not been met, the deliverables within this arrangement should be accounted for as one unit of accounting. The predominant deliverable in the arrangement is the subscription agreement. Absent the customization deliverables, nonrefundable payments associated with an agreement with a specified term typically are recognized ratably over the term of the contract. Accordingly, the arrangement consideration should be recognized ratably over the subscription period. However, of the total arrangement consideration of $2.25 million, $250,000 is contingent on the vendor's future delivery of additional features to the service and should not be recognized until the contingency has been resolved (i.e., performance is complete). Once the contingency is resolved, diversity in practice exists regarding the manner in which that amount is recognized ratably over the term of the agreement. For example, depending on the facts and circumstances, two acceptable methods include:

1. Straight-line recognition from the point in which the contingency has been resolved (i.e. performance is complete) over the remaining subscription period
2. Cumulative catch-up of recognition whereby, upon resolution of the contingency, the amount of revenue recognized is based on the cumulative amount attributable to the unit of accounting (i.e., the total arrangement consideration divided by the subscription period, times the number of months of subscription services provided)

### 3.5.2 Presentation of revenue when services and products are included in a combined unit of accounting

Rule 5-03(b) of Regulation S-X requires that public registrants separately present in the income statement revenues from the sale of products and revenues from providing services. In situations in which products and services included in an arrangement cannot be separated into differing units of accounting, questions have arisen on how a vendor should apply the provisions of this requirement (i.e., how should revenue be allocated between products and services for income statement presentation once recognized). This topic has been the subject of comments made by the SEC staff in a speech, as follows: (Note, this speech was made prior to the issuance of the ASC, so the technical references within the speech are to the pre-codification standards. Also, this speech was made prior to the amendments to ASC 605-25 by ASU 2009-13. Because the inability to separately account for deliverables in the past was predominantly due to the lack of VSOE or TPE of fair value, which are no longer required, we would expect the issues described in the speech to arise less frequently after the amendments to ASC 605-25.)
Excerpts of Speech by Mr. Mark Barrysmith

December 2007
AICPA National Conference on Current SEC and PCAOB Developments

(footnote references omitted)

Rule 5-03(b) of Regulation S-X requires, among other categories, that product and service revenue be displayed separately on the income statement. We realize that the question often arises as to how a vendor might adhere to the requirements of Rule 5-03(b) when the vendor is unable to separate its multiple element arrangement under the applicable revenue recognition guidance, such as EITF 00-21 or SOP 97-2.

In recognizing the importance that investors may place on the ability to distinguish between product and service revenue and the added transparency this breakout can provide, we do not believe that a vendor should be precluded from separately displaying product and service revenue solely because they are unable to separate the deliverables for recognition purposes. I focus on product and service revenue, but our views may be applicable to other categories of revenue.

Accordingly, we would not object to the separate presentation of product and service revenue stemming from an arrangement that could not be separated for recognition purposes, when a vendor has a reasonable basis for developing a separation methodology, so long as the method of separating is consistently applied, clearly disclosed and not misleading.

When determining how to separate product and service revenue, we would expect registrants to apply reasonable judgment. Purely a systematic allocation with no basis other than consistency or one based on contractually stated amounts would seem insufficient. However, rational and systematic estimates may result in a reasonable allocation of product and service revenue. For example, estimates based on verifiable inputs used to derive a reasonable approximation of fair value of the deliverables. Likewise, for arrangements within the scope of SOP 97-2, a comparison to peers (i.e., third-party evidence of fair value) with sufficiently comparable product and/or service offerings or the use of the residual method when a vendor customizes its core product may result in a reasonable allocation of product and service revenue.

In summary, we believe that a vendor’s basis for separately presenting product and service revenue will be a matter of judgment, dependent on the vendor’s specific facts and circumstances, including consideration of which form of presentation would be most meaningful to investors. And once again, we are willing to accept the use of judgment, so long as the vendor’s basis is reasonably grounded, consistently applied and clearly disclosed.

3.6 Recognition of losses on undelivered items

In certain multiple element transactions the allocation of arrangement consideration may result in the allocation of an amount to an individual unit of accounting that is less than the underlying cost of providing that unit of accounting. Notwithstanding the fact that the vendor expects to recognize a loss in the future upon delivery, we generally believe it is not appropriate to accrue a loss on uncompleted executory contracts, unless that contract is within the scope of other authoritative guidance that requires loss recognition in this circumstance (e.g., ASC 605-35 requires recognition of the entire loss on construction-type and production-type contracts within its scope in the period the loss first becomes evident). However, in such situations, entities should verify they have properly considered the guidance within the multiple element arrangements literature that prohibits recognition of revenue that is contingent upon the delivery of other items or meeting other specified performance conditions (see Section 4.5).
4 Measurement and allocation of arrangement consideration

4.1 Chapter summary

If multiple deliverables included in an arrangement are separable into different units of accounting (see Chapter 3, Determining units of accounting), the multiple-element arrangements guidance in ASC 605-25-30 addresses how to determine the amount of arrangement consideration that may be allocated to those units of accounting and how to perform the allocation.

The amount of allocable arrangement consideration is limited to amounts that are fixed or determinable, other than for the potential effects of refund rights, concessions or performance bonuses. This limitation differs from the requirement specified in SAB Topic 13 that the consideration be fixed or determinable before revenue can be recognized. SAB Topic 13 requires that the vendor consider the effect, if any, of refunds and concessions (and those factors should be evaluated for purposes of determining if and when the amount of arrangement consideration allocated to a unit of accounting may be recognized as revenue). Conversely, for purposes of allocating amounts to the units of accounting included in a multiple-element arrangement, fixed or determinable refers to an ability to determine the total amount of allocable arrangement consideration.

When determining the amount of allocable arrangement consideration:

- It should be assumed that the customer will purchase only the contractual minimum amount of goods and services. Contingent consideration, such as that arising from the exercise of a customer’s substantive option to purchase additional products or services, should not be included in allocable arrangement consideration.

- Performance bonuses receivable by the vendor (regardless of the probability of receipt) should not be included in allocable arrangement consideration prior to satisfaction of the associated performance criteria.

- Fees that would be received by the vendor only if the customer terminates the agreement should not be included in allocable arrangement consideration.

When customers purchase goods or services in a multiple-element arrangement, they often receive a discount from the total price that would be paid if each of the deliverables was purchased separately. This discount is allocated among the different units of accounting based on their relative selling prices (the relative-selling-price method), resulting in a pro-rata allocation of the discount among all of the units of accounting in an arrangement.

In applying the relative-selling-price method, the guidance provides a hierarchy to use when determining the selling price for each unit of accounting. Using VSOE, based on the price at which the item is regularly sold by the vendor on a standalone basis, is the preferred method. If VSOE of selling price of a product or service is not available, third-party evidence (e.g., published selling prices) of vendors selling similar goods to similarly situated customers on a standalone basis may be used to establish selling price. If neither VSOE nor TPE of selling price exists for a unit of accounting, the vendor should use its best estimate of the selling price for that unit of accounting. Vendors are required to estimate the selling price for a unit of accounting (i.e., a vendor cannot conclude that it is too difficult to estimate the selling price...
for a particular unit of accounting). The vendor’s best estimate of selling price must be consistent with
the objective of determining VSOE of selling price for the unit of accounting; that is, the price at which
the vendor would transact if the unit of accounting were sold by the vendor regularly on a standalone
basis. The vendor should consider market conditions and entity-specific factors when estimating the
selling price. Contractually stated prices should not be presumed to be representative of the selling price
of a unit of accounting.

The only exception to the relative-selling-price method relates to units of accounting included in an
arrangement that are required under GAAP to be reported at fair value. In such cases, the amount of
arrangement consideration allocated to such a unit of accounting should be its fair value. Any other
methods for the allocation of arrangement consideration are generally not permissible.

The amount of arrangement consideration otherwise allocable to a delivered item that is a separate unit
of accounting is also limited to the lesser of the amount that is not contingent on the vendor’s delivery of
additional items or its meeting other specified performance conditions.

4.2 Measurement of arrangement consideration

**Excerpt from Accounting Standards Codification**

Revenue Recognition — Multiple-Element Arrangements

*Initial Measurement*

605-25-30-1

The amount of total arrangement consideration must be fixed or determinable other than with respect
to the impact of either of the following:

a. Any refund rights or other concessions (collectively referred to as refund rights) to which the
customer may be entitled

b. Performance bonuses to which the vendor may be entitled.

4.2.1 Inclusion of contingent fees in allocable arrangement consideration

Arrangements frequently include fees that are contingent on the buyer’s or vendor’s performance (or
nonperformance). However, such fees should not be included in allocable arrangement consideration
until the events that give rise to the contingent consideration occur, even if it is probable that the event
will occur or amounts will be received by the vendor. An assumption should be made that both the
vendor and the buyer will perform at the minimum required level pursuant to the contractual terms of
the arrangement. That is, if the vendor is entitled to additional payments if it meets certain specified
performance criteria, or if the customer may exercise a substantive option to buy additional deliverables,
arrangement consideration attributed to these events should not be contemplated when determining the
amount of allocable arrangement consideration. However, if the option is not substantive (see Section 1.2.2),
we believe the consideration from the products or services to be delivered by the vendor on exercise of
the option should be included in the allocable arrangement consideration. However, as noted above, the
total arrangement consideration must be fixed or determinable. Additionally, the vendor should not assume
that it will receive a fee related to a contract being terminated prior to the end of its stated term, or that a
customer will cancel, subject to penalty, any portion of the services or products contracted for delivery.
The following example illustrates this concept:

**Illustration 4-1**

**Facts:**
Vendor A enters into an arrangement to sell and install manufacturing equipment to Customer B, and to provide maintenance on the equipment for a five-year period, in exchange for a minimum fee of $2 million. The equipment, installation services and maintenance are determined to be separate units of accounting pursuant to ASC 605-25-25-5 (see Chapter 3, Determining units of accounting).

Customer B also agrees to pay Vendor A royalties of 2% of the gross sales price for sales of products manufactured using the just-purchased equipment in excess of $25 million per year. It is uncertain if Customer B will achieve such sales.

Additionally, Vendor A is entitled to a performance bonus of $50,000 for each year of the contract that the vendor’s machines are operable for more than 350 days in a year. Based on Vendor A’s history of maintaining such machines for its customers, it is probable that these fees will be earned.

If Customer B decides to cancel the maintenance agreement at any point during the five-year period, it must pay a $200,000 termination penalty.

**Analysis:**
The amount of arrangement consideration allocable at the inception of the arrangement among the equipment, installation services and maintenance services is $2 million. The potential royalty income and performance and cancellation fees that Vendor A may receive pursuant to the contract should be recorded consistent with applicable GAAP and the vendor’s revenue recognition policy as earned, and are not considered when determining the initial accounting for the contract.

---

**Use of relative-selling-price method to allocate arrangement consideration**

**Excerpt from Accounting Standards Codification**

Revenue Recognition – Multiple-Element Arrangements

*Initial Measurement*

605-25-30-2
Arrangement consideration shall be allocated at the inception of the arrangement to all deliverables on the basis of their relative selling price (the relative selling price method), except as specified in paragraphs 605-25-30-4 through 30-5. When applying the relative selling price method, the selling price for each deliverable shall be determined using vendor-specific objective evidence of selling price, if it exists; otherwise, third-party evidence of selling price (as discussed in paragraph 605-25-30-6B). If neither vendor-specific objective evidence nor third-party evidence of selling price exists for a deliverable, the vendor shall use its best estimate of the selling price for that deliverable (as discussed in paragraph 605-25-30-6C) when applying the relative selling price method. In deciding whether the vendor can determine vendor-specific objective evidence or third-party evidence of selling price, the vendor shall not ignore information that is reasonably available without undue cost and effort.

605-25-30-3
[Paragraph superseded by Accounting Standards Update No. 2009-13]
Based on the above guidance, it is clear that the use of the relative-selling-price method is the only acceptable method for allocating arrangement consideration to the identified units of accounting. The EITF considered whether methods other than the relative-selling-price method could be used to allocate arrangement consideration but ultimately determined that, except for circumstances in which other accounting literature requires a separate unit of accounting to be recorded at fair value (see Section 4.4.1), the relative-selling-price method was the only acceptable method. Specifically, methodologies based on the residual method or on relative gross margins realized by the vendor for the units of accounting included in the arrangement were considered and rejected. Note, however, that the residual amount may be a data point that an entity considers in determining its best estimate of selling price for a separate unit of accounting, see Section 4.7 for a further discussion of estimating selling price.

### 4.3.1 Allocation of arrangement consideration for arrangements including a significant and incremental discount

As discussed in Section 1.2.3, the right to a discount on future purchases that represents a significant and incremental discount generally should be considered an additional element in a multiple-element arrangement. In essence, the vendor is providing the customer with an in-the-money option to purchase future items at a specified price or discount.

In determining how much arrangement consideration should be allocated to this element, we believe the vendor should treat this element in a manner similar to all of the other identified elements within the arrangement. That is, arrangement consideration should be allocated to the significant and incremental discount based on management’s estimate of the selling price for that element, using the relative-selling-price method. Given the nature of a significant and incremental discount, it is unlikely that VSOE or TPE of selling price exist for the discount (i.e., it is unlikely that either the vendor or another party sells that discount on a standalone basis); therefore, management will have to use its best estimate of selling price.

In certain situations, determining the best estimate of selling price may be relatively straightforward (e.g., if the maximum amount of discount provided is known or the discount can be applied to only specified products, all of which have a known selling price). In such situations, the best estimate of selling price likely will be an amount lower than the maximum amount of the discount, as a customer would not be willing to pay an amount equal to the maximum discount today, only to receive that discount in the future. In other situations, however, determining this estimate may require more judgment, such as in situations in which the total amount of the discount available is not quantifiable (e.g., the amount of discount available is unlimited, or the discount can be applied to products that are not yet priced).

In determining its best estimate of selling price of a significant and incremental discount, the vendor should consider many of the same factors considered in determining best estimate of selling price for other elements of an arrangement (see Section 4.7.6). However, the vendor likely will also consider some of the following factors (note, this list is not intended to be all-inclusive):

- What was the vendor’s expectation when the discount was being negotiated?
- To what extent does the vendor anticipate the customer will utilize the discount on future purchases?
- Does the vendor have any insight into the customer’s normal purchasing levels, and how does that relate to the future discount offered?
- Is the discount available on products the customer has purchased in the past?
- Does the vendor anticipate the provision of the discount will affect the customer’s historical purchasing patterns?
Has the customer provided any insight into its anticipated future purchases?

Is the discount available for a stated period of time or for an unlimited period of time?

Once the vendor has determined its best estimate of selling price for the significant and incremental discount, the vendor should allocate arrangement consideration to that element using the relative-selling-price method. Any amount allocated to the discount should be deferred and recognized as revenue as the future products or services are delivered to the customer (assuming that all other revenue recognition criteria are met). In determining the amount and period for which the deferred revenue associated with the significant and incremental discount should be recognized into revenue, the vendor should use the same data that was used to determine the best estimate of selling price.

The following example illustrates a future discount that is specified and pertains to an identified future product:

### Illustration 4-2

**Facts:**
An entity enters into an arrangement to sell Products M and S to a customer for a total of $200,000. Additionally, the vendor agrees to provide a discount of $30,000 if the customer purchases Products R, N or B within one year of inception of the arrangement. The vendor determines that the future discount is significant and incremental.

**Analysis:**
The vendor should allocate the total arrangement consideration to the different elements within the arrangement using the relative-selling-price method. The amount allocated to the significant and incremental discount would be deferred until such time that the customer purchases Products R, N or B and all other revenue recognition criteria related to that subsequent purchase have been met (or after a year has passed, if the customer does not purchase Products R, N or B). For example, the vendor may conclude that the best estimate of selling price for Product M, Product S and the discount is $140,000, $80,000 and $10,000, respectively. As a result, the vendor will allocate the total arrangement consideration of $200,000 to Product M, Product S and the discount as $122,000, $70,000 and $8,000, respectively.

The following example illustrates a future discount that is not clearly specified and pertains to a purchase of multiple products:

### Illustration 4-3

**Facts:**
An entity enters into an arrangement to sell Products CA and UK to a customer for a total of $500,000. Additionally, the vendor agrees to provide a discount of 30% on all future purchases the customer makes within one year of inception of the arrangement. The vendor determines that the future discount is significant and incremental.
Analysis:

The vendor should allocate the total arrangement consideration to the different elements within the arrangement using the relative-selling-price method. In determining its best estimate of selling price, the vendor would likely consider to what extent it expects the customer to make additional purchases over the next year (likely taking into consideration both historical purchasing patterns of the customer as well as the customer’s indications on expected future purchases). The amount allocated to the significant and incremental discount would be deferred and recognized as the customer makes future purchases. If, for example, the entity expected the customer to make $1.5 million in purchases in the coming year, and therefore receive $450,000 in future discounts, the amount of revenue deferred associated with that discount would be recognized ratably as the customer makes the $1.5 million in purchases.

If the vendor determines that changes to its original estimate of future customer purchases are necessary, the vendor should adjust the amount of deferred revenue recognized in connection with those future purchases accordingly. Such a change would be a change in estimate and should be accounted for prospectively. For example, assume the vendor estimates (based on communications with that customer regarding expected purchases) that after six months, the customer is going to make $2 million in future purchases rather than $1.5 million. At that time, the customer has made $1 million in purchases, so the vendor has recognized $300,000 of the deferred revenue associated with the significant and incremental discount. Based on the change in estimate, the vendor would recognize the remaining $150,000 of deferred revenue proportionately over the customer’s next $1 million in purchases.

**Question 4-1**

Does a right to purchase an unlimited or unspecified number of goods or services at a fixed price-per-unit affect the allocation of arrangement consideration and, if so, how?

When a contractual arrangement provides the customer the option to purchase, at its election, an indeterminate number of deliverables at a fixed price-per-unit, that option must be evaluated to determine if it represents a deliverable within the arrangement (see Section 1.2.2) and if not, if whether the price-per-unit provides the customer with a significant and incremental discount that should be evaluated as a separate element of the arrangement (see Section 1.2.3). If so, the vendor may be required to allocate a portion of the arrangement consideration to the significant and incremental discount (see Section 4.3.1). No separate accounting is required if the per-unit pricing is at (or above) that unit’s VSOE, TPE or best estimate of selling price, whichever is applicable. Additionally, proceeds to be received from anticipated future purchases should not be included in allocable arrangement consideration (see Section 4.2.1).

### 4.4 Units of accounting measured at fair value

**Excerpt from Accounting Standards Codification**

**Revenue Recognition — Multiple-Element Arrangements**

**Initial Measurement**

605-25-30-4

To the extent that any separate unit of accounting in the arrangement is required by guidance included in another Topic to be recorded at fair value (and subsequently measured at fair value each reporting period thereafter), the amount allocated to that unit of accounting shall be its fair value. Under those circumstances, the remainder of arrangement consideration shall be allocated to the other units of accounting in accordance with the requirements in paragraph 605-25-30-2.
4.4.1 Allocation of arrangement consideration to deliverables for which fair value accounting is required

Units of accounting that are recognized at fair value pursuant to other GAAP and subsequently remeasured at fair value (regardless of whether the subsequent adjustments to the deliverable’s recorded amount are recognized in income or other comprehensive income) must be allocated an amount of arrangement consideration equal to fair value. Accordingly, the fair value of such a unit of accounting must be separated from the total arrangement consideration and any remaining arrangement consideration further allocated among the remaining units of accounting based on the relative-selling-price method.

Although we believe that this guidance often primarily will be applicable to derivative instruments identified as a separate unit of accounting in a multiple-element arrangement, it is not limited to those instruments. Pursuant to the guidance in ASC 815, Derivatives and Hedging, such instruments are generally reported at fair value and remeasured at fair value in each reporting period. In addition to derivatives, any unit of accounting that is initially measured at fair value and remeasured at fair value each reporting period, such as debt and equity securities reported as available-for-sale or trading securities pursuant to the guidance in ASC 320, Investments — Debt and Equity Securities, or other financial instruments for which the vendor has elected the fair value option pursuant to ASC 825-10, Financial Instruments — Overall, should also be allocated an amount of arrangement consideration equal to fair value.

The following example illustrates these concepts:

**Illustration 4-4**

**Facts:**
Company A, an oil producer, agrees to sell and immediately delivers 1,200 barrels of crude oil to Customer B. As part of the agreement, Company A also writes an option for Company B to purchase an additional 1,000 barrels of crude oil in six months. The written option does not qualify for the normal purchases and sales exception in the derivatives and hedging guidance in ASC 815 and is accounted for as a derivative. The crude oil and the written option can be separately accounted for pursuant to the multiple-element arrangements guidance.

Total arrangement consideration is $50,000. The established VSOE of selling price of the delivered crude oil and the fair value of the written option are $48,000 and $7,000, respectively.

**Analysis:**
Because ASC 815 requires that derivatives be recorded at fair value and remeasured at fair value in subsequent accounting periods, an amount of arrangement consideration equal to the option’s fair value should be allocated to it. The allocation of the total arrangement consideration is as follows:

<table>
<thead>
<tr>
<th></th>
<th>Selling price and fair value</th>
<th>% Allocated discount</th>
<th>Allocated discount</th>
<th>Arrangement consideration allocation</th>
</tr>
</thead>
<tbody>
<tr>
<td>Crude oil</td>
<td>$48,000</td>
<td>100%</td>
<td>$5,000</td>
<td>$43,000</td>
</tr>
<tr>
<td>Written option</td>
<td>7,000</td>
<td>0%</td>
<td>-</td>
<td>7,000</td>
</tr>
<tr>
<td><strong>Total</strong></td>
<td><strong>$55,000</strong></td>
<td></td>
<td><strong>$5,000</strong></td>
<td><strong>$50,000</strong></td>
</tr>
</tbody>
</table>
When a financial instrument that has an amount of arrangement consideration equal to its fair value allocated to it is remeasured at fair value in subsequent reporting periods, the adjustment is accounted for pursuant to other GAAP (e.g., ASC 815). That is, subsequent adjustments of the financial instrument have no effect on the amount of arrangement consideration previously allocated to any units of accounting included in the arrangement.

Deliverables that, pursuant to other GAAP, must initially be recognized at fair value, but are not remeasured at fair value in subsequent reporting periods, require that an amount of arrangement consideration equal to fair value be allocated to them only when required by other ASC literature that provides guidance as to the separation of deliverables in a multiple-element arrangement and the allocation of arrangement consideration to the deliverables (see Section 2.3.2). For example, ASC 460, Guarantees, generally requires a guarantee issued as part of a multiple-element arrangement to be recognized at fair value at the guarantee’s inception.

4.5 Effect of contingent revenue on allocation

Excerpt from Accounting Standards Codification

Revenue Recognition — Multiple-Element Arrangements

Initial Measurement

605-25-30-5
The amount allocable to the delivered unit or units of accounting is limited to the amount that is not contingent upon the delivery of additional items or meeting other specified performance conditions (the noncontingent amount). That is, the amount allocable to the delivered unit or units of accounting is the lesser of the amount otherwise allocable in accordance with paragraphs 605-25-30-2 and 605-25-30-4, or the noncontingent amount. Additionally, although Subtopic 605-15 may affect the amount of revenue recognized, the allocated amount is not adjusted for the impact of a general right of return pursuant to that Subtopic. See the Example in paragraphs 605-25-55-13 through 55-18.

4.5.1 Effect of general refund rights and contingent revenue features on the allocation of arrangement consideration

Questions frequently arise whether a general refund right provided to a customer by a vendor limits the amount of arrangement consideration that may be otherwise allocated to a delivered item that is a separate unit of accounting and whether a contingent revenue feature affect the allocation of arrangement consideration differently than a general refund right.

Although the guidance pertaining to revenue recognition when a right of return exists (included in ASC 605-15) does not use the specific term “general right of return,” it can be inferred from the last sentence of ASC 605-25-30-5 that a general right of return under this guidance is synonymous with the “right of return” as it is discussed in ASC 605-15. A general right of return provides return rights to all or most customers and does not specifically require future performance on the part of the vendor. An example of a right of return under ASC 605-15 is a customer’s ability to return a product due to dissatisfaction, or a 30-day money back guarantee.

General return rights are generally broader in scope than a contingent revenue feature. A contingent revenue feature of an arrangement is a contractual provision that allows a customer to return a delivered item, receive a refund without return, or avoid or reduce payment for a delivered item because

---

4 A contingent revenue feature is also referred to as a specific refund right.
the vendor does not successfully complete all of its performance obligations (i.e., the vendor’s right to receive or retain a portion of the arrangement consideration is linked to its successful delivery of the undelivered items to the customer). The multiple-element arrangements guidance distinguishes between a general right of return and a contingent revenue feature when allocating arrangement consideration.

Pursuant to ASC 605-25-30-5, a contingent revenue feature limits the amount of arrangement consideration that is otherwise allocable to a delivered item that can be separately accounted for to the amount that is not contingent on the vendor’s completion of the remaining performance obligations, without considering the likelihood of the vendor’s performance (see Section 4.5.2). However, this limitation may not apply if the vendor would be entitled to certain contractually specified penalties in the event of the customer’s termination of the agreement due to its nonperformance and certain other conditions are met (see Section 4.6).

This provision was included in the multiple-element arrangements guidance because the EITF believed that the recognition of revenue as units of accounting are delivered should be limited in instances in which the arrangement terms link payment for the delivered item to the successful delivery of the undelivered items. The EITF concluded that revenue in such cases has not been earned for the delivered item, because receipt or retention of the arrangement consideration is contingent on the vendor’s future performance.

This limitation has no effect on the allocation of arrangement consideration if the contingent amount is equal to or less than the amount of arrangement consideration allocated to the undelivered items. In such cases, none of the arrangement consideration allocated to the delivered item is at risk. If, however, the contingent amount is greater than the amount of arrangement consideration otherwise allocable to the undelivered items, the excess amount represents consideration otherwise attributable to the delivered item that the vendor may have to forfeit if its remaining performance obligations are not completed successfully. The amount that is at risk of forfeiture should not be allocated to the delivered item. In effect, a two-step process should be applied when allocating arrangement consideration to units of accounting in an arrangement with contingent revenue features:

**Step 1:** Determine the amount of arrangement consideration allocable to each unit of accounting using the applicable allocation methodology (generally the relative-selling-price method).

**Step 2:** Determine if the amount of arrangement consideration determined in Step 1 should be limited by contingent revenue features of the arrangement pursuant to ASC 605-25-30-5.

The following examples illustrate these concepts:

**Illustration 4-5**

**Facts:**
A vendor agrees to sell a bedroom furniture set that includes a matching bed frame, dresser and night table for $1,500. The vendor also sells these items separately for $1,000, $600 and $400, respectively. Each piece is handmade and delivered separately, and the contracted payment terms are $500 due on delivery of each item. The vendor concludes that each item is a separate unit of accounting based on the application of the separation criteria. The items are delivered in the following order: the bed frame first, then the dresser, then the night table.

**Analysis:**
Using the relative-selling-price method, arrangement consideration of $750, $450 and $300 is allocable to the bed frame, dresser and night table, respectively. However, because the vendor is only entitled to receive $500 as each item is delivered, the amount of consideration allocable to any delivered item is limited to this amount.
Accordingly, the amount of arrangement consideration that the vendor may allocate to the first delivered item (the bed frame) is limited to $500, as the vendor's receipt of the remaining $250 of arrangement consideration otherwise allocable to it is contingent on delivery of the dresser and night table. An additional $500 is allocable to the second delivered item (the dresser), which includes $50 of the contingent revenue that was not allocable to the bed frame. The remaining $500 of arrangement consideration is allocable to the night table.

If the delivery order was reversed, such that the night table was delivered first, followed by the dresser and then the bed frame, the allocation of arrangement consideration would not be affected by the payment terms as the contingent amounts would be less than the amount of arrangement consideration allocated to the undelivered items.

Illustration 4-6

Facts:
A vendor sells a software-enabled tangible product whereby the hardware and software of the tangible product function together to provide the tangible product's essential functionality. Additionally, the arrangement includes 12 months of PCS; however, the customer has the right to cancel the PCS at any time during the contractual period and receive a pro-rata refund for the remaining contract period. The contractual price for the entire contract is $8,000, including $1,200 for the PCS, and the vendor has determined its best estimate of selling price for the software-enabled tangible product and the PCS is $7,300 and $1,200, respectively. The vendor has determined that both deliverables have standalone value.

Analysis:
The vendor would allocate the selling price between the two deliverables as follows:

<table>
<thead>
<tr>
<th></th>
<th>Estimated selling price</th>
<th>% Allocated discount</th>
<th>Allocated discount</th>
<th>Arrangement consideration allocation</th>
</tr>
</thead>
<tbody>
<tr>
<td>Tangible product</td>
<td>$ 7,300</td>
<td>86%</td>
<td>$ (430)</td>
<td>$ 6,870</td>
</tr>
<tr>
<td>PCS</td>
<td>$ 1,200</td>
<td>14%</td>
<td>(70)</td>
<td>1,130</td>
</tr>
<tr>
<td><strong>Total</strong></td>
<td><strong>$ 8,500</strong></td>
<td><strong>14%</strong></td>
<td><strong>(500)</strong></td>
<td><strong>$ 8,000</strong></td>
</tr>
</tbody>
</table>

Assuming all other revenue recognition criteria have been met, the vendor would recognize the revenue associated with the tangible product upon delivery of that product and the revenue associated with the PCS ratably over the PCS period. However, since the revenue associated with the PCS is contingent, the vendor would be precluded from recognizing any of the $1,200 associated with the PCS prior to the resolution of the contingency (i.e., the provision of the PCS services). As a result, upon the delivery of the tangible product, the amount of revenue recognizable under the arrangement is limited to $6,800 (or the noncontingent amount). See Section 4.5.3 for the income statement classification of contingent revenue as it is recognized.

Contingent revenue features differ from general refund rights in that the former can limit the amount of arrangement consideration that can be allocated to a delivered item that is a separate unit of accounting. General refund rights do not affect the allocation of arrangement consideration but may affect the timing of the revenue recognition for a unit of accounting.
General refund rights must be considered when determining if a vendor’s fees meet the basic fixed or determinable revenue recognition criteria. ASC 605-15 specifies criteria for when a vendor may recognize revenue on delivery when a buyer has a general refund right, which include a requirement that the vendor has the ability to make a reasonable estimate of the amount of future refunds. If any of the conditions set forth by ASC 605-15 are not met, revenue should be recognized as the return or refund provisions expire or when a reasonable estimate of future returns can be made.

4.5.2 Consideration of the probability of a vendor’s successful performance when assessing contingent revenue features

When determining whether the amount of arrangement consideration otherwise allocable to a delivered item that is a separate unit of accounting is limited due to contingent revenue features of the arrangement (see Section 4.5.1), the probability that the vendor will successfully complete its remaining performance obligations is not considered – even if the vendor can demonstrate a history of successful performance.

4.5.3 Income statement classification of contingent revenue

A contingent revenue feature may limit the amount of arrangement consideration that may otherwise be allocated to a delivered item that is a separate unit of accounting (see Section 4.5.1). In such cases, a vendor may have to consider how arrangement consideration that would be allocated to the delivered item absent the contingent revenue feature be classified in the income statement as the vendor’s remaining performance obligations are completed and revenue is recognized. That is, an entity must decide if the revenue classification should be consistent with that of either 1) the allocation of revenue to deliverables under the relative-selling-price allocation or 2) to the delivery of the item that triggered recognition of the contingent revenue (if applicable).

This classification issue is not directly addressed by the multiple-element arrangements guidance in ASC 605-25. Absent authoritative guidance, vendors should determine the appropriate classification of the arrangement consideration once recognized as revenue based on an evaluation of the applicable facts and circumstances. Once determined, that classification should be consistently applied to all similar arrangements. When material amounts of arrangement consideration otherwise allocable to delivered items are limited by contingent revenue features, a vendor should disclose how the amounts have been classified when recognized as revenue upon the successful delivery of the undelivered items included in the arrangement.

Conceptually, we believe it is more appropriate for vendors to classify the revenue consistent with the relative-selling-price allocation. That is, if the vendor were to update its relative-selling-price allocation, the amounts used for estimated selling price would not change. Therefore, while the amount of allocable consideration would now reflect the contingent revenue, the proportionate share of each deliverables’ share of the allocable revenue would remain constant. This approach results in gross margins for both products and services being increased proportionately. However, in certain circumstances, vendors may determine it is more appropriate to recognize the contingent revenue consistent with the classification of revenue for the undelivered item(s). For example, some vendors may find that this approach is less costly to implement and that the potential benefit of reclassifying the contingent revenue when received between the different deliverables within the arrangement is not sufficient to justify the cost required to do so.
4.5.4 Recording deferred revenue when contingent revenue exists

When the amount of arrangement consideration allocable to a delivered item that is a separate unit of accounting is limited by a contingent revenue feature (see Section 4.5.1), a vendor should not record a receivable for the difference between 1) the amount of arrangement consideration otherwise allocable to a delivered item pursuant to the relative-selling-price method and 2) the amount allocated when limited by a contingent revenue feature. Because receipt of the additional amount is contingent on the vendor’s future satisfaction of the remaining terms of the contractual arrangement (i.e., delivery of additional products or services has not occurred), it is not appropriate to record a receivable and deferred revenue.

However, if a vendor receives amounts in connection with the delivery of an item that are forfeitable if its remaining obligations are not successfully completed, such amounts should be recorded as deferred revenue.

Because the vendor’s performance obligations remain until all the contingencies have been met, any transfer of rights to the contingent revenue by a vendor to a third party would be subject to the provisions of ASC 470-10, Debt – Overall (see ASC 470-10-25-1 and 25-2 and ASC 470-10-35-3), and would not be a transfer of a financial instrument within the scope of ASC 860, Transfers and Servicing.

Question 4-2 How should the provisions of ASC 605-25-30-5 be evaluated when the contractual arrangement does not specify the customer’s rights with respect to delivered items in the event the vendor does not successfully complete its remaining performance obligations, but such rights exist based on the vendor’s historical practices or law?

This issue is not directly addressed in the multiple-element arrangements guidance in ASC 605-25. We believe that when evaluating whether the amount of arrangement consideration allocable to a delivered item that is a separate unit of accounting should be limited due to a contingent revenue feature of an arrangement, the vendor’s historical business practices and the applicable laws in the jurisdiction governing the arrangement should be considered in addition to the terms specified in the agreement between the vendor and the customer.

If the vendor has a history of allowing customers to return delivered items, or receive a refund relating to delivered items, when it does not successfully deliver undelivered items included in a multiple-element arrangement, this may be indicative that an implied contingent revenue feature exists that should limit the amount of arrangement consideration otherwise allocable to the delivered item – even if the contractual agreement does not specifically attribute such rights to the customer.

Additionally, a vendor should evaluate rights accorded to its customer pursuant to the applicable laws (e.g., the Uniform Commercial Code or other applicable contract law) of the jurisdiction governing the arrangement to determine if a statutory contingent revenue feature exists that may limit the amount of arrangement consideration that is otherwise allocable to a delivered item. Consultation with legal counsel may be required in making this evaluation.

Question 4-3 Are liquidating damages or other similar clauses considered contingent revenue features?

Some contracts provide for liquidating damages or similar features that specify damages in the event the vendor fails to deliver future goods or services or the vendor’s performance fails to achieve certain specifications. We believe that the nature of the liquidating damages (or similar clauses) and the type of “triggering event” for those damages needs to be considered in determining whether such clauses are contingent revenue features as contemplated by ASC 605-25. Many liquidating damage clauses will likely be considered contingent revenue. For example, we believe a clause providing for liquidating damages if the vendor fails to deliver a specified number of products within a designated timeframe (e.g., damages in the amount of twice the agreed selling price on the undelivered products) would result in contingent
Measurement and allocation of arrangement consideration

Financial reporting developments

Revenue recognition — Multiple element arrangements

revenue and be subject to this guidance. In that example, a portion of the transaction price allocated to the delivered items would be considered contingent revenue (i.e., the amount of liquidating damages that exceeds the transaction price allocated to the undelivered items) and would reduce the amount of consideration that is allocable to the delivered products.

Conversely, not all amounts associated with liquidating damage clauses would represent contingent revenue as contemplated by ASC 605-25. Amounts that are based on the actual performance of a delivered good in many cases would be considered similar to a warranty provision (e.g., the good will perform to promised specifications). For example, certain arrangements include a clause whereby the vendor guarantees that the provided good will perform to a specified level, and the failure to maintain that performance level results in the vendor being subject to certain fines or penalties. Depending on the facts and circumstances, an entity may determine that these performance guarantees do not represent contingent revenue. In these situations, the amount of consideration allocated to the delivered items would not be limited by the contingent revenue provisions in ASC 605-25; however, any cash fines or penalties paid to a customer generally should be evaluated under the guidance on consideration payable/paid to a customer in ASC 605-50. In addition, any promises to provide additional goods or services to compensate the customer and/or repair the product would be evaluated to determine if they are additional elements in the arrangement.

However, if a liquidating damages clause is determined to be contingent revenue in accordance with the guidance in ASC 605-25, we generally believe that an approach based on accruing potential liquidating damages based on the anticipated likelihood of occurrence (e.g., based on analogy to the guidance in ASC 605-35 or ASC 450) is not appropriate for multiple-element arrangements. As discussed in Section 4.5.2, the probability of performance does not affect the accounting for contingent revenue features. Note that in certain circumstances the potential liquidating damages specified in the contract may exceed the total arrangement consideration. In such situations, we believe it would be appropriate to apply the guidance in ASC 450 in determining if any accounting recognition is necessary for those excess amounts (i.e., loss contingencies).

4.6 Effect of cancellation provisions on measurement

**Excerpt from Accounting Standards Codification**

**Revenue Recognition — Multiple-Element Arrangements**

**Initial Measurement**

605-25-30-6

The measurement of revenue per period shall be limited to the measurement that results from assuming that cancellation of the arrangement will not occur. The amount recorded as an asset for the excess of revenue recognized under the arrangement over the amount of cash or other consideration received from the customer since the inception of the arrangement shall not exceed all amounts to which the vendor is legally entitled, including cancellation fees (in the event of customer cancellation). However, whether a vendor intends to enforce its contractual rights in the event of customer cancellation shall be considered in determining the extent to which an asset should be recorded.

Section 4.5 discusses the limitations on the amount of arrangement consideration that can be allocated to a unit of accounting if the arrangement includes a contingent revenue feature. However, if a contractual arrangement includes a contingent revenue feature, the amount of arrangement consideration otherwise allocable to a delivered item that is a separate unit of accounting may not be limited if the arrangement also contains a contractually specified penalty that would be incurred by the customer if it chose to terminate the arrangement, and all of the following conditions are met:

- The vendor can demonstrate a historical practice of successfully enforcing the terms of similar contractual penalties in the event of a customer termination
The vendor intends to enforce its contractual rights to the cancellation penalty if the customer terminates the arrangement.

The cancellation clause is applicable in the event of termination due to nonperformance by the vendor as well as termination by the customer for convenience.

We believe that it will be uncommon for a customer to agree to the payment of a penalty for contract termination due to a vendor’s nonperformance. Accordingly, we believe it will be relatively rare that a cancellation clause will meet the above criteria and thus allow a vendor to overcome the limitations on the allocation of arrangement consideration to a delivered item stipulated by ASC 605-25-30-5 when a contingent revenue feature exists.

Even if a termination clause exists that meets the above criteria, no amount of arrangement consideration should be allocated to a delivered item that is in excess of the amount allocable as determined using the relative-selling-price method, even if the amount that vendor would be entitled to on cancellation of the agreement is in excess of that amount.

Additionally, if a vendor records a receivable relating to a multiple-element arrangement because the amount of revenue recognized (based on the amount of arrangement consideration allocated to delivered items) exceeds the cash received, the recorded receivable should not be in excess of the amount of consideration that the vendor is legally entitled to receive from the customer based on its performance to date. This amount may include cancellation fees, as long as those fees meet the criteria above.

The following example illustrates these concepts:

<table>
<thead>
<tr>
<th>Illustration 4-7</th>
</tr>
</thead>
<tbody>
<tr>
<td><strong>Facts:</strong></td>
</tr>
<tr>
<td>A vendor agrees to sell a bedroom furniture set that includes a matching bed frame, dresser and night table for $1,500. The vendor also sells these items separately for $1,000, $600 and $400, respectively. Each piece is handmade and delivered separately, and the contracted payment terms are $500 due on delivery of each item. The vendor concludes that each item is a separate unit of accounting based on the application of the separation criteria. The items are delivered in the following order: the bed frame first, then the dresser, then the night table. The contractual arrangement also specifies that if the customer elects to cancel the arrangement for any reason (including vendor nonperformance through failure to deliver the undelivered furniture), the customer is required to pay to the vendor the full retail price of the delivered item(s) when sold separately, less any amounts previously paid. The vendor has a history of successfully enforcing such clauses and intends to do so in the future.</td>
</tr>
<tr>
<td><strong>Analysis:</strong></td>
</tr>
<tr>
<td>Using the relative-selling-price method, arrangement consideration of $750, $450 and $300 is allocable to the bed frame, dresser and night table, respectively. However, because the vendor is only entitled to receive $500 as each item is delivered, receipt of any amounts in excess of $500 for a delivered item represents a contingent revenue feature that may limit the amount of arrangement consideration otherwise allocable to a delivered item.</td>
</tr>
</tbody>
</table>
In this example, however, the amount of arrangement consideration is not limited by the contingent revenue features of the arrangement (arising from the payment terms) because of the existence of the cancellation clause. At the date of delivery of the bed frame, the vendor is entitled to receive a payment of $500 from the customer. Additionally, if the customer were to terminate the arrangement for any reason (including the vendor’s nonperformance) prior to delivery of either of the additional items, the vendor would be entitled to an additional $500 (the difference between the $500 received on delivery of the bed frame and the full retail price of the bed frame when sold separately). Because the vendor would be entitled to an amount exceeding the amount of arrangement consideration otherwise allocable using the relative-selling-price method, the $750 may be allocated to the bed frame.

### Determination of selling price

**Excerpt from Accounting Standards Codification**

**Revenue Recognition – Multiple-Element Arrangements**

**Initial Measurement**

*605-25-30-6A*

Vendor-specific objective evidence of selling price is limited to either of the following:

a. The price charged for a deliverable when it is sold separately

b. For a deliverable not yet being sold separately, the price established by management having the relevant authority (it must be probable that the price, once established, will not change before the separate introduction of the deliverable into the marketplace).

*605-25-30-6B*

Third-party evidence of selling price is the price of the vendor’s or any competitor’s largely interchangeable products or services in standalone sales to similarly situated customers.

*605-25-30-6C*

The vendor’s best estimate of selling price shall be consistent with the objective of determining vendor-specific objective evidence of selling price for the deliverable; that is, the price at which the vendor would transact if the deliverable were sold by the vendor regularly on a standalone basis. The vendor shall consider market conditions as well as entity-specific factors when estimating the selling price.

*605-25-30-7*

Contractually stated prices for individual products or services in an arrangement with multiple deliverables shall not be presumed to be representative of vendor-specific objective evidence, third-party evidence, or a vendor’s best estimate of selling price.

*605-25-30-8*

[Paragraph superseded by Accounting Standards Update 2009-13]

*605-25-30-9*

[Paragraph superseded by Accounting Standards Update 2009-13]
4.7.1 Hierarchy for determining evidence of selling price when applying the relative-selling-price method

The guidance in ASC 605-25 requires the following hierarchy of evidence be followed when determining if evidence of the selling price of an item exists:

- The best evidence of selling price of a unit of accounting is VSOE, or the price at which the vendor regularly sells the item on a standalone basis. ASC 605-25-30-6A explains that VSOE of selling price is limited to 1) the price charged when a deliverable is sold separately (see Section 4.7.4) or 2) for a deliverable not yet being sold separately, the price established by management having the relevant authority (see Section 4.7.4). While ASC 605-25 specifies that VSOE of selling price must be used if it exists, the guidance does not require a company to establish VSOE of selling price if doing so requires undue cost or effort. However, if a company is able to obtain VSOE of selling price without undue cost or effort, then VSOE is presumed to be the most objective and reliable evidence of the standalone selling price of a deliverable. If a company has previously established VSOE of selling price for a deliverable, we would expect a company to continue to use VSOE for determining the selling prices of those deliverables upon adoption of ASU 2009-13 absent a change in facts and circumstances to warrant a change in the method for determining selling prices. To the extent a company can no longer maintain VSOE of selling price (e.g., due to changes in its business practices of how certain products are priced), a company would not be required to use VSOE of selling price and would instead look to TPE of selling price or develop its best estimate of selling price, to the extent TPE of selling price is not available.

- When VSOE is not available to determine selling price, relevant third-party evidence of selling price should be used, if available. Section 4.7.5 discusses factors to consider when evaluating whether third-party evidence is relevant and may be relied on for the selling price of items included in a multiple-element arrangement. Historically, TPE of selling price has been challenging for many companies to obtain due to the many factors discussed in Section 4.7.5 (e.g., relatively few observable competitor transactions, varying customization of products that make it difficult to compare to competitors' products, a wide range of prices for similar products, or differing customer bases or geographies that rendered comparison to competitors unreliable). Determining when third-party evidence is a relevant and reliable indicator of the selling price of an item included in a multiple-element arrangement will be dependent on the applicable facts and circumstances and will require the use of professional judgment.

- When neither VSOE nor third-party evidence of selling price for similar deliverables exists, management must use its best estimate of selling price considering all relevant information that is available without undue cost and effort (see Section 4.7.6).

Further, ASC 605-25-30-7 is clear that contractually stated prices for items included in an arrangement with multiple deliverables should not be presumed to be representative of VSOE, TPE or a vendor’s best estimate of selling price.

4.7.2 Required use of VSOE or TPE of selling price when available

The guidance in ASC 605-25-30-2 requires VSOE of selling price to be used if available; otherwise TPE of selling price must be used. The guidance goes on to state that only if neither of those is available, a vendor should use its best estimate of the selling price for a given deliverable. Additionally, the guidance indicates that in deciding whether the vendor can determine VSOE or TPE of selling price, “the vendor shall not ignore information that is reasonably available without undue cost and effort.” (See Section 4.7.1 for a discussion of the hierarchy of VSOE, TPE and best estimate of selling price.)
Based on this guidance, we believe vendors that have previously established VSOE or TPE of selling price cannot ignore that information in applying the relative-selling-price method. Further, in cases in which a vendor has already established procedures and analyses to determine if VSOE or TPE of selling price exists, and maintaining such analyses does not require undue cost or effort, we expect that a vendor will continue to perform such analyses. However, if a vendor has historically been unable to establish VSOE or TPE of selling price for a unit of accounting (e.g., due to a lack of consistency in pricing, lack of visibility as to third-party prices or other factors), or is unable to maintain VSOE of selling price (e.g., due to changes in pricing strategies), the vendor is not required to expend “undue cost and effort” to establish VSOE or TPE of selling price for that unit of accounting prior to using its best estimate of selling price. In such situations, we expect a reasonable effort to establish VSOE or TPE of selling price and documentation of why neither is available will be sufficient.

We also believe that any evidence used in attempting to establish VSOE or TPE of selling price should be considered in determining management’s best estimate of selling price and should not be ignored or disregarded when estimating selling price. See Section 4.7.6 for further discussion of determining best estimate of selling price.

4.7.3 Effect of update to estimated selling price

Changes in the determination of the best estimate of selling price are considered a change in accounting estimate in accordance with ASC 250, *Accounting Changes and Error Corrections*, and are accounted for on a prospective basis. Any previous accounting for the arrangement is not restated. Additionally, the change in the estimated selling price is not applied to any undelivered elements as the allocation guidance in ASC 605-25 requires that arrangement consideration be allocated at the inception of the arrangement to all deliverables based on their relative selling price. While ASC 605-25 does require the identification of deliverables to be updated as each item is delivered, it does not require (nor permit) the estimated selling price used to allocate the arrangement consideration to be updated.

4.7.4 Establishing VSOE

Although the concept of VSOE of selling price may appear to be quite simple, in practice, establishing VSOE of selling price can be quite difficult. To support an assertion that VSOE of the selling price of an item included in a multiple-element arrangement exists based on reference to the price of an item when sold separately, a vendor should perform and document a VSOE analysis. The principal objective of this analysis should be to demonstrate that a substantial majority of the recent standalone sales of the item are priced within a relatively narrow range. For example, if a vendor can demonstrate that the pricing of 80% of the standalone sales fall within a range of plus or minus 15% from the midpoint of the range (e.g., if the midpoint of the range is $1,000 and 80% of the standalone transactions fall between $850 and $1,150), the vendor would have a reasonable basis to support the existence of VSOE of the selling price of the item. To the extent that a significant number of transactions fall outside of such a reasonably narrow range, it will be difficult for a vendor to conclude that it has established VSOE of selling price (although this data should be considered if the vendor allocates consideration based on its estimate of selling price).

In the example cited in the preceding paragraph, the range (i.e., +/- $150 of $1,000) represents VSOE of selling price, and not a single point within the range. When a range is used to establish VSOE of the selling price of an item, we believe it is most appropriate to use the low end of the range as VSOE of the selling price of an item for purposes of applying the provisions of the multiple-element arrangements guidance. However, it also would be acceptable to use the midpoint of the range or potentially other points within the range. For example, using the amounts cited above, a vendor could use either $850 (the low end of the range) or $1,000 (the midpoint of the range) as VSOE of an item when applying the provisions of the multiple-element arrangements guidance. Regardless of the method selected, it should be applied consistently.
The frequency and level of the VSOE analysis that a vendor must perform will vary based on the nature and complexity of its business and the level of flexibility in pricing that it allows its sales personnel. However, we believe vendors that use VSOE as evidence of selling price for items included in multiple-element arrangements should perform a VSOE analysis at least annually. This test may be performed on a “lag” basis (e.g., a trailing 12 months of sales data through the previous quarter). The VSOE analysis should be performed more often by any vendor that has or expects to have more than minimal variability in its pricing, such as those operating in highly competitive pricing environments or those whose products are subject to rapid technological obsolescence.

Generally, this analysis should be designed to encompass all standalone sales of the item that occurred during the period under analysis. If a sampling approach is used to perform the analysis, it is important to document and demonstrate how the sample is representative of the entire population of sales. We believe that the use of a sample of standalone sales to establish VSOE of selling price should be limited to those vendors who have a policy that significantly limits variability in the pricing of an item and that historically have had minimal variability in pricing.

The analysis does not necessarily have to be based on one company-wide population of sales transactions of the item. A vendor’s pricing for a product or service may differ based on the type or size of customer, the amount of product or services purchased, distribution channel, geographic location or other factors. Accordingly, a vendor may choose to stratify its analysis to determine if VSOE of selling price exists by class of customer. While a stratification methodology may be appropriate in certain circumstances, it rarely would be acceptable to use this methodology to exclude any data from the analysis, even if it is deemed to be an “outlier” transaction. In fact, it is particularly important to include outliers because the purpose of the analysis is to determine whether an acceptable level of pricing consistency exists to establish VSOE of the selling price of an item. Any transactions excluded from a VSOE analysis (e.g., because the population has been stratified) must be separately analyzed to determine if VSOE of selling price exists for those transactions.

**Question 4-4**

What factors should be considered when evaluating if a vendor has established VSOE of the selling price of an item not yet sold separately by reference to a price established by management?

When determining if VSOE of the selling price of an item that is not yet being sold separately can be established by reference to a price set by management, the following factors must be considered:

- Management that established the price must have the relevant authority to do so.
- The period of time until the item is expected to be sold separately should be short.
- It must be probable that the price established by management will not change once that deliverable is introduced into the marketplace. It is often very difficult to assess the likelihood that a price established by management will not change, particularly when the vendor operates in a highly competitive market, the product does not have proven acceptance in the marketplace, the product has (or is anticipated to have) a long sales cycle, or the vendor does not have a history of successfully selling new products into the marketplace at prices set by management. In such cases, it will not be possible to conclude that VSOE has been established by reference to a price established by management.

Because of these factors, we believe that the ability of a vendor to use this approach to establish VSOE of selling price will be limited. Given this limitation and a vendor’s ability to use best estimate of selling price when VSOE or TPE of selling price do not exist, we do not believe that vendors will invest much time or effort in attempting to establish VSOE of selling price using a price set by management.
Can a vendor establish VSOE of selling price for an item included in a multiple-element arrangement solely by reference to the price at which the item has been sold separately if the item has only been sold separately once, or on a limited basis?

No. When a vendor attempts to establish VSOE by reference to an item’s price when it is sold on a standalone basis, it must be able to demonstrate that a substantial majority of the recent standalone sales of the item are priced within a relatively narrow range. Inherent in this concept is that the number of transactions is sufficiently large to allow a conclusion to be reached as to whether VSOE of selling price does or does not exist. Accordingly, we believe that VSOE generally cannot be established solely by reference to the price at which the item has been sold separately for an item that has sold on a standalone basis only once, or on a limited basis. However, such evidence should be contemplated by vendors in making their best estimate of selling price of such an item.

4.7.5 Evaluating third-party evidence of selling price

If a vendor cannot establish VSOE of selling price for an item included in a multiple-element arrangement, ASC 605-25 requires that a vendor next look to third-party evidence. When evaluating whether third-party evidence is a relevant and reliable basis for establishing the selling price of an item included in a multiple-element arrangement, the following should be considered:

- The third-party evidence should be based on sales of a comparable amount of similar, or identical, items on a standalone basis to similarly situated customers. For example, a third-party sale of 10,000 units of a product to a very large customer on a standalone basis may not be a relevant and reliable indicator of the selling price of one hundred units included by a vendor in a multiple-element arrangement with a much smaller customer.

- The items sold by the third party must be similar to those of the vendor. Items are generally similar if they are largely interchangeable and can be used in similar situations by similar customers.

- Evidence should be gathered from as many data sources as possible to determine a range of prices of similar items offered by multiple third parties. If there is a wide range of prices, this may indicate that some, or all, of the items are not similar due to differences in features, quality, brand or other factors that result in disparate selling prices.

- The degree of customization, if any, associated with a vendor’s products should be considered. When products are highly customized, the use of third-party evidence often will not be appropriate.

- If the item is a service, factors such as 1) the comparability of the services rendered, 2) the length of time required to complete the service, and 3) the level of skill and training necessary to perform the service should be considered.

- The number of observable third-party sales of similar deliverables on a standalone basis should be considered. Generally, a larger population of observable third-party standalone transactions will be considered a more relevant and reliable measure of selling price than a smaller population. A single sales transaction, or limited population of observable third-party sales transactions, generally will not be a reliable indicator of selling price.

Determining when third-party evidence is a relevant and reliable indicator of the selling price of an item included in a multiple-element arrangement will be dependent on the applicable facts and circumstances and will require the use of professional judgment. Additionally, vendors may conclude that, due to the above factors or other reasons, TPE of selling price does not exist but that it is appropriate to consider the evidence gathered in making such a determination when estimating the selling price for such an item.
4.7.6 Determining a vendor's best estimate of the selling prices

When neither VSOE nor TPE of selling price exist, a vendor should determine its best estimate of selling price. ASC 605-25-30-6C makes clear that the objective of determining the best estimate of selling price for a unit of accounting should be consistent with the objective of determining VSOE – that is, the price at which the vendor would transact if the deliverable were sold regularly on a standalone basis. In making this estimate, vendors should consider all reasonably available information, including both market data and conditions and entity-specific factors, when estimating the selling price.

Examples of market conditions include but are not limited to:

- Are there potential limitations to the selling price of a product?
- What is competitor pricing for a similar or identical product?
- What is the market awareness of and perception of the product?
- Are there current market trends that will likely affect the pricing?
- What is the entity's market share and position (e.g., what is its ability to dictate pricing)?
- Does the geographic area affect the pricing?
- How does customization affect the pricing?
- What is the expected technological life of the product?
- Are significant industry-specific technological advancements expected in the near term?

Examples of entity-specific factors include but are not limited to:

- What are the profit objectives and internal cost structure?
- What are the pricing practices and pricing objectives (including desired gross profit margin)?
- What are the pricing objectives used to establish pricing of bundled products?
- How does customization affect the pricing?
- Do specifics of the proposed transaction affect the pricing (e.g., the size of the deal or the characteristics of the targeted customer)?
- What is the expected technological life of the product? Are significant vendor-specific technological advancements expected in the near term?

Further, products that are included in a multiple-element arrangement that have not been fully developed (e.g., specified upgrades) may require the consideration of additional factors. These factors might include:

- What is the lead-time until the product is marketed?
- What is the stage of the development for the product?
- How does the functionality of the product under development compare to the functionality of existing products (of either the vendor or of the vendor’s competitors)?
A vendor should consider all factors contemplated in negotiating the arrangement with the customer and the vendor’s normal pricing practices factoring in the most objective and reliable information that is available. While some entities already may have robust processes in place regarding the pricing of products and services, many entities may find improved processes are needed in order to develop estimates of selling prices, particularly for those deliverables for which VSOE or TPE of selling price does not exist. It is likely that these estimation processes will require a greater level of communication and interaction between accounting, finance and sales personnel than companies may have had in the past.

The guidance is clear that contractually stated prices for products and services within an arrangement should not be presumed to be representative of selling price. Additionally, in situations in which a vendor has established VSOE of selling price for some but not all of the deliverables, it would not be appropriate for the vendor to presume that the best estimate of selling price for those deliverables for which no VSOE of selling price exists is the total arrangement consideration less the amount representing VSOE of selling price for the other deliverables. However, as discussed in Question 4-6, the residual amount may be a data point a vendor considers in determining its best estimate of selling price. Given the significant flexibility provided by the guidance, there are many methods management may use to determine the best estimate of selling price. In practice, we have seen a number of different approaches in determining the estimated selling price, including the factors considered and the relative weight given to each factor. Given the flexibility in the guidance, it is not only appropriate, but also necessary, to tailor the approach used to determine best estimate of selling price to the vendor’s specific facts and circumstances.

Regardless of the specific approach taken, we believe in any approach a vendor should consider the facts contemplated in negotiating the arrangement with the customer and the entity’s normal pricing practices, considering the most objective and reliable information that is available. For example, an appropriate method likely would start with management considering the company’s overall pricing model and objectives, including the facts and conditions the company considers in making its pricing decisions. From there, management will consider how the relevant market conditions and entity-specific factors affect those pricing objectives. For example, management may determine that the company’s overall pricing model and objective lead to their stated list-prices; however, list-prices must be adjusted to reflect various market conditions and entity-specific factors to determine the standalone selling price for a particular product.

Examples 6 and 7 included in the illustrative guidance in ASC 605-25 (specifically ASC 605-25-55-37 through 55-47 and ASC 605-25-55-51 through 55-57), and reproduced in Appendix A of this publication, provide additional information that can be considered to establish best estimate of selling prices.

Question 4-6

When determining the best estimate of selling price, does the vendor have to consider historical pricing for the sale of the product involved?

Yes, we believe that the vendor should consider historical pricing in all circumstances. However, we do not believe historical pricing is necessarily conclusive in determining best estimate of selling price. Historical pricing is likely an important data point that encompasses both market conditions and entity-specific factors and can provide supporting evidence as to the reasonableness of management’s determined best estimate. For example, if management determines based on consideration of its pricing policies and competition in the market that the selling price of its deliverable is X, historical transactions in which the deliverable is sold on a stand-alone basis priced within a reasonable range of X would provide supporting evidence for management’s conclusion. However, if historical pricing was only 50% of X, this may indicate that either factors have changed such that historical pricing is no longer relevant or that management’s determination of best estimate of selling price is flawed.
Depending on the facts and circumstances, some vendors may find historical pricing a significant factor in determining best estimate of selling price while others may conclude that other factors are more significant, such as internal pricing practices. Where historical pricing was established using the vendor’s normal pricing policies and procedures, it is more likely such information will be relevant in the determination of estimated selling price.

In situations in which the vendor either has sold the product separately or has information on competitor pricing for a similar product, the vendor likely would find such historical data highly relevant in its estimate of selling price, even if that data does not result in estimates that qualify as VSOE or TPE of selling price, respectively (see Sections 4.7.4 and 4.7.5). For example, if a VSOE analysis resulted in a range of prices that was too large to qualify as VSOE of selling price, we would nonetheless expect that the vendor’s best estimate of selling price would fall within that range. Additionally, we believe it may be appropriate for entities to stratify selling prices to assist in the estimation of selling prices. A vendor’s pricing for a product or service may differ based on the type or size of customer, the amount of product or services purchased, distribution channel, geographic location or other factors. Accordingly, a vendor may choose to stratify its analysis to determine best estimate of selling price for each class of customer.

When considering historical pricing, a vendor also may want to consider prices charged for the product when the product is part of a bundled arrangement but VSOE exists for the other products included in that arrangement (e.g., the sales of a software-enabled tangible product always combined with PCS and VSOE of the PCS exists). While this analysis alone likely will not be sufficient to develop a best estimate of selling price (because the analysis is based on a residual allocation rather than the price at which the vendor would sell the product on a standalone basis), we believe that this residual information may provide a useful data point for management to consider in determining its best estimate of selling price (i.e., a floor for estimated selling price). However, in situations in which historical pricing shows significant variation from transaction to transaction, the usefulness of this data point in the analysis will be reduced.

**Question 4-7**

*Can a vendor develop its best estimate of selling price based on cost of plus a reasonable margin?*

Examples 6 and 11 in ASC 605-25 (specifically ASC 605-25-55-37 through 55-47 and ASC 605-25-55-75 through 55-85) illustrate the determination of a best estimate of selling price based on a cost plus a reasonable margin. This approach is useful in many situations, especially when the deliverable involved has a clearly determinable direct fulfillment cost (e.g., a tangible product or an hourly service). However, in other situations this approach is less helpful, such as when there are not clearly identifiable direct fulfillment costs or the amount of those costs is not known (e.g., new software licenses or specified upgrade rights).

When an entity elects to use cost plus a reasonable margin as a data point in estimating standalone selling price, it is important that the entity use a reasonable margin. Determination of a reasonable margin will likely require the use of significant judgment and will involve the consideration of many market conditions and entity specific factors discussed above. For example, it would not be appropriate to determine that the entity’s estimate of selling price is cost plus a 30% margin when a review of market conditions demonstrates that customers are only willing to pay the equivalent of cost plus a 12% margin for a comparable product. Similarly, it would be inappropriate to determine that cost plus a specified margin is representative of best estimate of selling price if competitors are selling a comparable product at twice the determined best estimate. Further, the determined margin will likely have to be adjusted for differences in products, geographies, customers and other factors.
Question 4-8  When determining the best estimate of selling price, does the vendor have to identify a point estimate or can a range of prices be used?

The objective of determining the estimate of selling price should be consistent with the concept of VSOE of selling price, and similar to the variations allowed in determining VSOE, we believe it is reasonable that a vendor’s best estimate of selling price may fall within a range of estimates. That is, we do not believe that a vendor would be required to determine a point estimate for each estimated selling price to the extent a range is a more practical means of estimating the selling price for a product or service. Historically, VSOE of selling price can be established when a large portion of the standalone sales fall within a narrow range (e.g., when the vendor can demonstrate that the pricing of 80% of the standalone sales fall within a range of plus or minus 15% from the midpoint of the range). We believe a similar range would be acceptable for determining estimates of selling prices. To the extent the stated contractual price fell within the vendor’s calculated range for best estimate of selling price, the vendor could allocate arrangement consideration using the stated contractual price. However, if the stated contractual price for the deliverable was outside of the range, the selling price would need to be adjusted to a point within the established range in order to allocate arrangement consideration using the relative-selling-price method. In these situations, the vendor would need to determine which point in the range is most appropriate to use (e.g., the midpoint of the range or the outer limit nearest to the stated contractual price). We believe vendors should establish a policy regarding the point in the range that will be used (e.g., low-point or midpoint of range) and apply that policy consistently.

While the use of a range is appropriate for determining the best estimate of selling price, we believe that certain proposed approaches to identifying this range do not meet the requirements of the guidance. An example of this would be estimating a single price point for best estimate of selling price and then adding an arbitrary range on either side of that point estimate. Another would be taking the historical prices and creating a range around the midpoint until such time as a significant portion of the historical transactions fall within that band.

To illustrate, assume a vendor determines that 60% of its historical prices fall within +/- 15% of $100 (and therefore the entity lacks the level of consistent pricing needed to establish VSOE). However the vendor determines that 80% of the historical prices fall within +/- 30% of $100 and proposes a range for best estimate of selling price of $70-$130. Given that the objective of determining best estimate of selling price is meant to be consistent with the objective of determining VSOE, the wider the range necessary to encompass a high proportion of historical transactions, the less relevant the range is in terms of providing a useful data point for determining best estimate of selling price.

Conversely, if management’s internal analysis and consideration of market conditions and entity-specific factors resulted in management determining that the best estimate of selling price is $85-$115, we believe the historical data showing that 60% of the transactions falling within that range, while likely not determinative, could be used as supporting evidence for management’s conclusion. In such a scenario, management should analyze those transactions falling outside the range to determine if there are similar characteristics for those transactions indicating that those transactions have a different best estimate of selling price (i.e., they should be evaluated as a separate customer class).

Question 4-9  How frequently must a vendor update its best estimate of selling price?

While the multiple-element arrangements guidance does not specifically address the frequency in which the estimate of selling price must be updated, current information should be used each time a vendor develops its best estimate of selling price. To the extent that there have not been changes in the information used to determine best estimate of selling price for previous similar transactions, we believe it is reasonable for a vendor to use that previously determined best estimate of selling price. However, to ensure that changes in circumstances are reflected in the estimate in a timely manner, we believe a vendor should implement a policy to update this estimate on a regular basis. How frequently that update is required should be based on the particular facts and circumstances of the deliverable for which the estimate of selling price is made.
Many of the same factors that need to be considered in determining the best estimate of selling price also will likely affect the frequency with which that best estimate of selling price will need to be updated. For example, if a vendor frequently includes a specified upgrade in its multiple-element arrangements, the best estimate of the selling price for that specified upgrade may have to be updated as the vendor approaches the final development of that specified upgrade and more information becomes available regarding the expected pricing of that upgrade. Alternatively, a vendor may be able to update the best estimate of selling price for a deliverable that is not subject to significant technological changes or competitive market pressures less frequently.

**Question 4-10** Are there any special considerations relating to the support needed to document a vendor’s best estimate of selling price?

The determination of best estimate of selling price, like the determination of VSOE and TPE of selling price, is a judgmental process for which a vendor will want to ensure it has sufficient supporting documentation. Vendors will likely need to create internal policies and procedures for estimating and documenting their estimates of selling price (whether it is VSOE, TPE or best estimate) in order to create contemporaneous documentation supporting management’s estimates.

However, while the determination of VSOE and TPE of selling price is, to some extent, based on the analysis of quantitative data (e.g., historical or competitor selling prices of a unit of accounting), the determination of the best estimate of selling price often may be more judgmental. Different facts and circumstances may have to be considered from transaction to transaction and for different products. For example, in situations in which a vendor was unable to establish VSOE due to a larger-than-acceptable range of standalone selling prices, that analysis may provide significant input into the vendor’s best estimate of selling price. Conversely, if the unit of accounting has never been sold separately, the vendor may base its analysis less on historical pricing and more on its analysis of current market conditions and internal pricing strategies. In all situations, vendors should ensure they have clearly documented the factors considered and the reasons for the conclusions reached. As a best practice, vendors should prepare robust documentation of the market conditions and entity-specific factors considered (including those considered but not deemed relevant, and why). As this determination is a judgmental estimation, management should prepare sufficient documentation to demonstrate a reasonable basis for this estimate.

**Question 4-11** Can a vendor conclude that it is unable to reasonably estimate the selling price of a deliverable, for example, because of a limited amount of information available for similar transactions, and thus elect to not estimate the selling price of that deliverable?

No. While the EITF considered the issue of whether there may be situations in which it is very difficult to reasonably estimate selling price, the EITF ultimately determined that even in instances in which limited information is available, the vendor should still have sufficient information to develop a reasonable estimate and that use of such a judgmental estimate is preferable to deferring all the revenue for a delivered item. As a result, the multiple-element arrangements guidance requires that a vendor estimate the selling price for all elements for which VSOE or TPE of selling price does not exist.

### 4.7.7 Determining selling price for a group of deliverables delivered together

Questions have arisen surrounding whether selling price (whether it be VSOE, TPE, or best estimate) may be estimated for a group of deliverables, rather than for each deliverable separately. Although a vendor may not separately sell all of the individual elements included in a multiple-element arrangement, it may routinely sell two or more elements together on a separate basis (e.g., a tangible product bundled with software where the tangible product and the software together provide the essential functionality of the product). In such situations, the vendor may decide that it is appropriate to determine the selling price
(VSOE, TPE or best estimate of selling price, whichever is applicable) of those elements on a combined basis in circumstances in which they are delivered together in the arrangement under analysis. However, if the elements are not delivered at the same time, the vendor would be required to estimate selling price for each element independently.

4.7.8 Multiple estimates of selling price for a single deliverable

ASC 605-25 is silent as to whether a single deliverable can have multiple best estimates of selling price. However, given that the underlying objective is to determine the price at which management would sell the deliverable on a standalone basis, we believe it may be appropriate for a vendor to identify multiple estimated selling price amounts. For example, a vendor may be willing to sell a deliverable for different prices to differing customers for a number of reasons (e.g., type or buying power of customer). Further, a vendor may have different pricing points in different geographies in which it operates or in markets using different methods to distribute its products (e.g., use of a distributor or reseller versus selling directly to end customer). Accordingly, a vendor may need to stratify its analysis to determine best estimate of selling price for each class of customer.
5 Accounting for costs associated with a delivered item that cannot be accounted for separately

5.1 Chapter summary

When the multiple-element arrangements guidance was originally developed (as part of EITF 00-21), the EITF was asked to consider “how to account for direct costs incurred related to an arrangement that (a) are not associated with a specific deliverable or (b) are associated with a specific deliverable but that deliverable is required to be combined with another deliverable (or other deliverables).” However, in the final consensus, the EITF did not address this issue because it believed that this issue was broad and applicable to many arrangements, not just those including multiple elements. This remains unchanged with the modifications to the multiple-element arrangements guidance contained in ASU 2009-13.

Many transactions result in costs being incurred prior to a company having the ability to recognize revenue for that specific transaction. Costs may be incurred either 1) before an enforceable contract exists (e.g., solicitation costs and costs to negotiate the terms of the contract) or 2) once a contractual arrangement exists but before revenue can be recognized (e.g., set-up costs, installation costs and delivery or performance costs incurred prior to a company's ability to recognize revenue for those related products or services).

Limited guidance currently exists that addresses the accounting for such costs. Accordingly, the accounting for such costs must be based on the conceptual framework and analogies to the limited guidance that does exist. No costs should be deferred if they do not create or add value to an existing asset. Additionally, costs generally should not be deferred unless they are directly related to the contractual arrangement or delivered item (see Section 5.2). Further, any costs that are deferred must be evaluated for recoverability (see Section 5.4). Costs in excess of those that are recoverable through the future net revenue streams of the related contractual arrangement should be expensed as incurred.

5.2 Accounting for costs associated with a delivered item not accounted for separately

In certain transactions, a vendor has delivered a product or service, but is unable to recognize revenue on delivery because the delivered item cannot be separated from the undelivered items included in the arrangement. In those situations, questions frequently arise on whether the costs associated with the delivered item be capitalized.

The accounting for certain costs associated with a revenue transaction is established in authoritative accounting literature. Examples of such costs include the manufacture or purchase of inventory held for resale (which is generally classified as inventory until the revenue recognition criteria are met) or the depreciation for a capital asset expenditure that will benefit a specific customer. Other costs of revenue transactions for which there is explicit existing accounting guidance include:
<table>
<thead>
<tr>
<th>Codification reference</th>
<th>Type of cost</th>
</tr>
</thead>
<tbody>
<tr>
<td>ASC 310-10</td>
<td>Lending activity related costs</td>
</tr>
<tr>
<td>ASC 310-20</td>
<td></td>
</tr>
<tr>
<td>ASC 330</td>
<td>Inventory costs</td>
</tr>
<tr>
<td>ASC 340-10-25</td>
<td>Pre-production costs for long-term supply arrangements</td>
</tr>
<tr>
<td>ASC 350</td>
<td>Intangible assets</td>
</tr>
<tr>
<td>ASC 350-40</td>
<td>Internal-use software development costs</td>
</tr>
<tr>
<td>ASC 350-50</td>
<td>Web site development costs</td>
</tr>
<tr>
<td>ASC 720-15</td>
<td>Start-up costs</td>
</tr>
<tr>
<td>ASC 720-35</td>
<td>Advertising costs</td>
</tr>
<tr>
<td>ASC 840</td>
<td>Lease inducement costs</td>
</tr>
<tr>
<td>ASC 926</td>
<td>Film costs</td>
</tr>
<tr>
<td>ASC 944</td>
<td>Insurance acquisition costs</td>
</tr>
<tr>
<td>ASC 970</td>
<td>Real estate project costs</td>
</tr>
<tr>
<td>ASC 985-20</td>
<td>External-use software development costs</td>
</tr>
</tbody>
</table>

When costs associated with a delivered item are within the scope of any of the guidance listed above, they should be accounted for in accordance with the provisions of the applicable guidance. Despite the list above, there are many other costs of revenue transactions that are not specifically addressed in existing accounting literature.

The multiple-element arrangements guidance does not address how to account for costs associated with a delivered item that cannot be separated from the undelivered items included in the arrangement. Accordingly, the accounting for such costs must be based on the conceptual framework and analogies to the limited guidance that does exist. Based on this guidance, we believe that although costs associated with a delivered item may almost always be expensed as incurred, these costs may be capitalized if 1) they create an asset or add to the value of an existing asset, 2) accounting for these costs is not specifically addressed by other authoritative literature, and the vendor has adopted and consistently applies a policy of deferring such costs in a transaction that results in the deferral of revenue, 3) the vendor has an enforceable contract for the remaining deliverables, and 4) delivery of the remaining items included in the arrangement is expected to generate positive margins allowing realization of the capitalized costs (see Section 5.4).

Costs should not be capitalized to normalize margins. Additionally, costs should not be capitalized because the amount of arrangement consideration allocated to a delivered item that can be accounted for separately from the undelivered items included in the arrangement is less than the associated costs. Furthermore, costs should not be capitalized even if the amount of arrangement consideration allocated to the delivered item is less than its selling price (unless the amount of arrangement consideration applicable to the delivered item is limited by the contingent revenue provisions of the multiple-element arrangements guidance as discussed in Chapter 4, Measurement and allocation of arrangement consideration – see Section 5.3).

The conceptual framework is clear that costs should not be capitalized if they do not create an asset or add to the value of an existing asset. CON 6 defines an asset as “probable future economic benefits obtained or controlled by a particular entity as a result of past transactions or events.” CON 6 further states that “(a)n asset has three essential characteristics: (a) it embodies a probable future benefit that involves a capacity, singly or in combination with other assets, to contribute directly or indirectly to future net cash inflows, (b) a particular entity can obtain the benefit and control others’ access to it, and (c) the transaction or other event giving rise to the entity’s right to or control of the benefit has already occurred.” Generally, costs relating to a delivered item for which revenue has been deferred will meet the definition of an asset because the transaction giving rise to the asset has occurred (the delivery of the
item to the customer), and there is probable future economic benefit that can be obtained by the vendor (the recognition of the deferred revenue associated with the delivered item or future cash flows on delivery of the undelivered items).

In practice, the accounting for such costs has been based on an analogy to either ASC 310-20, Receivables – Nonrefundable Fees and Other Costs, which addresses the deferral of loan origination costs, or ASC 605-20-25-1 through 25-6, which address the deferral of costs related to the sale of separately priced extended warranty and product maintenance contracts.

SAB Topic 13 recognizes the analogies to ASC 310-20 and ASC 605-20-25-1 through 25-6 when accounting for direct costs incurred prior to the recognition of revenue, stating “(t)he staff believes that the incremental direct costs (ASC 310-20 provides an analogous definition) incurred related to the acquisition or origination of a customer contract in a transaction that results in the deferral of revenue, unless specifically provided for in the authoritative literature, may be either expensed as incurred or accounted for in accordance with ASC 605-20-25-4 or ASC 310-20. The staff believes the accounting policy chosen for these costs should be disclosed and applied consistently” (SAB Topic 13(AX3)(f), Question 3). SAB Topic 13 clarifies that the capitalization of costs incurred prior to a company having the ability to recognize revenue for that specific transaction is not required – such costs may almost always be expensed as incurred.

The underlying principle of the guidance for deferral of loan origination costs and for separately priced extended warranty and product maintenance contracts is that there are certain costs of a revenue transaction that are so integral to the revenue generating activities that recognition of the costs in a period other than the same one in which the revenue is recognized is inappropriate. However, a policy election to apply by analogy the guidance for the deferral of loan origination costs may result in a different amount of capitalized costs than a policy election to apply by analogy the guidance for separately priced extended warranty and product maintenance contracts. The accounting policy selected should be applied consistently and disclosed in the financial statements.

ASC 310-20

ASC 310-20 provides guidance for fees incurred to solicit and originate new loans. This guidance states that direct loan costs may be capitalized and ultimately recognized over the period over which revenues (i.e., interest income) will be recognized on the loan. As defined in ASC 310-20-20, “direct loan origination costs of a completed loan shall include only (a) incremental direct costs of loan origination incurred in transactions with independent third parties for that loan and (b) certain costs directly related to specified activities performed by the lender for that loan. Those activities are: evaluating the prospective borrower’s financial condition; evaluating and recording guarantees, collateral, and other security arrangements; negotiating loan terms; preparing and processing loan documents; and closing the transaction. The costs directly related to those activities shall include only that portion of the employees’ total compensation and payroll-related fringe benefits directly related to time spent performing those activities for that loan and other costs related to those activities that would not have been incurred but for that loan.”

Based on this guidance, certain costs directly related to (1) the origination of a contract or (2) the delivery of an item that cannot be accounted for separately from the undelivered items included in the arrangement may be capitalized by vendors electing a policy analogizing to ASC 310-20. Incremental direct costs paid to third parties associated with the above activities are capitalized in full. With respect to compensation paid to employees, only a percentage of the employees’ total compensation, including salaries, benefits, commissions and bonuses, is capitalized. That percentage is calculated as the time spent directly on the successful origination of an arrangement or the delivery of an inseparable good or service divided by total time worked. That percentage is then multiplied by the employees’ total compensation.
ASC 605-20-25-1 through 25-6

ASC 605-20-25-1 through 25-6 provide guidance on accounting for costs associated with separately priced extended warranty and product maintenance contracts. ASC 605-20-25-4 states that “costs directly related to the acquisition of a contract, that would not have been incurred but for the acquisition of that contract (incremental direct acquisition costs), should be deferred and charged to expense in proportion to the revenue recognized.” Therefore, unlike ASC 310-20, costs that would have been otherwise incurred (i.e., costs that are not incremental), regardless of whether the warranty or maintenance contract was obtained, do not qualify for capitalization. Only those direct and incremental costs that would have not been incurred otherwise qualify for capitalization under the guidance in ASC 605-20-25-1 through 25-6. Costs such as employees’ salaries generally cannot be capitalized because most employee costs are incurred regardless of whether warranty or maintenance contracts are sold. However, an exception exists for sales commissions earned only if and when a sale is consummated.

Based on this guidance, only the direct and incremental costs paid to a third party or employees directly related to the delivery of an item that cannot be separately accounted for may be capitalized by vendors electing a policy analogizing to the guidance in ASC 605-20-25-1 through 25-6.

The following example illustrates the capitalization of costs based on a policy analogizing to either the guidance for nonrefundable fees and other costs (pursuant to ASC 310-20) or separately priced extended warranty and product maintenance contracts (pursuant to ASC 605-20-25-1 through 25-6):

Illustration 5-1

Facts:
A company sells home security systems. In addition to the hardware components of the security system, the company provides installation, maintenance and monitoring services. A customer enters into an agreement to purchase a system, including installation and maintenance, along with monitoring services for an initial three-year period. The contract terms require an upfront, nonrefundable payment for the hardware and installation effort, along with monthly payments for the ongoing monitoring services that will be provided. Cancellation of the contract by the customer prior to the end of the initial term requires that the customer pay an early termination fee.

The company incurs the following costs related to this contract:

- $200 in hardware costs for components purchased from a third-party manufacturer.
- $100 in labor costs (calculated as salary ÷ hours worked in a year × hours spent on the installation) for the company’s existing employees to install and test the equipment, and to activate the security system’s ability to interact with the centrally located monitoring systems.
- $50 in labor costs (calculated as described above) for the company’s existing employees to perform contract origination services (i.e., customer credit check and paperwork processing).
- $50 in commissions paid to the salesperson that sold the contract to the customer. The salesperson is a member of the company’s dedicated sales department.

The company would need to apply the guidance in ASC 605-25 to determine whether the multiple elements within this arrangement should be considered separate units of accounting. For purposes of this example, we assume the delivered items do not have standalone value (we would expect that in these circumstances the deliverables may have standalone value) and therefore the hardware, installation and maintenance are not separable from the ongoing monitoring services (see Chapter 3, Determining units of accounting).
Analysis:
An individual analysis of the accounting for each cost incurred by the company by analogy to ASC 310-20 and ASC 605-20-25-1 through 25-6 is as follows:

- Hardware – The purchased cost of the hardware components would likely be considered an investment in the remaining contract and, as long as they are recoverable from future cash flows of the contract, could be capitalized.

- Installation and activation (i.e., set-up costs) – The salary and benefit costs for installation, testing and activation of the system would be considered a direct cost because those costs relate to set-up activities. While ASC 310-20 allows for the capitalization of costs related to these activities, an entity must be able to determine the amount of time the employee spent on installation and activation activities in total in order to determine the amount to capitalize. For example, if a company determines an employee spends a specified percentage of his or her time on qualifying activities, that percentage of the employee's compensation would be capitalized ($150 in our example). Further, a pro-rata portion of fringe benefits also would be capitalized (ignored in this example). (Note, if these activities were performed by a third party, the cost of those third party's services would be capitalizable in their entirety.)

While these types of costs may also be capitalizable under ASC 605-20-25-1 through 25-6, the approach for determining what is capitalizable is different. In order for such costs to meet the capitalization requirements under ASC 605-20-25-1 through 25-6, a determination as to whether the costs are incremental would be required. For example, a company with a salaried technician, whose only job function is to perform set-up activities, will incur salary costs regardless of whether the security system is sold. In this example, the installation and activation costs would not be capitalized by a vendor adopting a policy that analogizes to ASC 605-20-25-1 through 25-6 because the installation is performed by existing employees of the company. However, if the technicians are paid on an hourly basis and only paid to the extent they are working on available projects, these amounts would be capitalized.

- Origination costs – The salary and benefit costs for the employees performing credit checks and preparing and processing the contractual information are direct origination costs as defined in ASC 310-20. Similar to the installation and activation costs discussed above, a portion of an employee's total compensation costs based on the percentage of time the employee spends on successful origination activities, would be capitalizable. However, these costs generally would not be capitalized pursuant to ASC 605-20-25-1 through 25-6 if the costs would otherwise have been incurred, irrespective of the new revenue generating contract.

- Commission expense – The commission costs of compensating an employee whose sole focus is selling activities would meet the capitalization requirements under ASC 605-20-25-1 through 25-6. These costs would be considered both direct and incremental, as the costs would not be incurred absent the sale of the security system. However, no portion of a salesperson's salary would be capitalized under ASC 605-20-25 as such costs would not be considered incremental. Under ASC 310-20, the amount capitalized would be based on a pro-rata portion of total compensation based on the time spent on qualifying activities. For example, if 5% of an employee's total hours for the year were spent on qualifying activities in originating a contract, 5% of total compensation, including 5% of all commissions for the year, would be capitalized.
5.2.1 Subsequent recognition of capitalized costs

Capitalized costs generally should be recognized in income as the revenue associated with the multiple-element arrangement is recognized. In accordance with SAB Topic 13, if deferred revenue in an amount equal to or in excess of the capitalized costs has also been recorded, the capitalized costs should be recognized as expense over the same periods and in the same manner as the deferred revenue (SAB Topic 13(A)(3)(f), Question 5).

If there is no deferred revenue, or if the capitalized costs exceed the amount of deferred revenue recorded by the vendor, the costs (or the costs in excess of the deferred revenues recorded) should be recognized in income in a manner that is consistent with the anticipated revenue recognition pattern for the arrangement as a whole. If no pattern of revenue recognition can be reasonably predicted for the arrangement, the capitalized costs should be amortized into income on a straight-line basis.

5.2.2 Capitalization of costs subsequent to revenue recognition

In certain arrangements, the multiple deliverables included in the arrangement cannot be accounted for as separate units of accounting pursuant to ASC 605-25, and revenue recognition commences for the combined unit of accounting prior to delivery of the final deliverable (e.g., if a proportional performance model is used to recognize revenue for bundled services – see Section 3.5.1). In those situations, questions arise on whether costs associated with undelivered elements can be capitalized based upon the analogies to the guidance for nonrefundable fees and other costs of originating a loan (pursuant to ASC 310-20) or to the guidance for separately priced extended warranty and product maintenance contracts (pursuant to ASC 605-20-25-1 through 25-6) discussed in Section 5.2.

We believe that once revenue recognition commences for a combined unit of accounting, costs associated with that unit of accounting generally should be expensed as incurred, unless specific authoritative literature requires otherwise (e.g., certain costs associated with developing internal-use software to be used in rendering an undelivered service included in a combined unit of accounting may be required to be capitalized pursuant to the provisions of ASC 350-40, Intangibles – Internal-Use Software).

Capitalization of costs associated with an undelivered item included in a combined unit of accounting based upon an analogy to the guidance in either ASC 310-20 or ASC 605-20-25-1 through 25-6 subsequent to the commencement of revenue recognition results in the undelivered item effectively being accounted for as a separate unit of accounting for cost capitalization purposes. Such treatment is inconsistent with the conclusion that the delivered and undelivered items included in the arrangement should be accounted for as a combined unit of accounting.

5.3 Accounting for costs of a delivered item accounted for separately when arrangement consideration allocated to that item is limited by contingent revenue provisions

As discussed in Section 4.5, in certain transactions, the vendor is limited to the amount of arrangement consideration it may allocate to a delivered item due to the arrangement containing contingent revenue feature(s). In such situations, the costs associated with the delivered item may exceed the amount of allocable arrangement consideration. Generally, costs should not be capitalized if the arrangement consideration allocated to a delivered item that can be accounted for separately from the undelivered items is less than the associated costs (i.e., when the vendor will recognize a loss upon delivery), even if the amount of arrangement consideration allocated to the delivered item is less than its selling price.
However, in certain arrangements, contingent revenue features may limit, potentially to zero, the amount of arrangement consideration that may be allocated to the delivered item based on the provisions of ASC 605-25-30-5 (see Section 4.5.1). In such situations, recognizing the costs associated with the delivered item may result in the recognition of a loss on delivery and higher profits as the other items included in the arrangement are delivered in future periods.

In such cases, we believe the vendor may elect to defer the direct and incremental costs associated with the delivered item that are in excess of the allocated arrangement consideration if assets are generated. For example, the costs in excess of the allocated transaction price might appropriately be capitalized as contractually guaranteed reimbursable costs. Alternatively, the loss might be considered an investment in the remainder of the contract if the loss is recoverable from the revenue allocated to the remaining deliverables. We believe that recoverability should be assessed by comparing the potential asset to the deferred revenue in excess of the transaction price allocated to the remaining deliverables, as illustrated in the example below. For example, if all deliverables in the transaction were profitable before applying the contingent revenue provisions of ASC 605-25, the asset would be recoverable.

The following example illustrates these concepts:

**Illustration 5-2**

**Facts:**
A vendor sells a piece of equipment and installation services to a customer for $20,000. The equipment has standalone value, and separate selling prices for the equipment and installation are $20,000 and $5,000, respectively. Completion of the installation services is considered probable and substantially in the control of the vendor. The customer is required to pay $10,000 on delivery of the equipment, with the remainder due on completion of the installation services.

Pursuant to ASC 605-25-30-2, the arrangement consideration is allocated to each deliverable using the relative-selling-price method, such that the amount of arrangement consideration allocated to the equipment and the installation services is $16,000 and $4,000, respectively. Because the receipt of payment in excess of $10,000 is contingent on successful installation, the vendor is limited to recognizing revenue of $10,000 on delivery of the equipment (see Section 4.5.1). The vendor incurs direct and incremental costs totaling $14,000 associated with the delivery of the equipment, and expects to incur costs of $3,000 relating to the installation of the equipment.

**Analysis:**
The vendor concludes that the cost of the delivered equipment in excess of the revenue recognized represents an investment in the contract. That investment of $4,000 is recoverable because the excess of the remaining revenue to be recognized ($10,000) over the relative selling price of the remaining deliverable ($5,000) exceeds the $4,000 asset amount. Accordingly, the vendor should recognize $10,000 of the $14,000 direct and incremental costs associated with the delivery of the equipment in the period that the equipment is delivered. The remaining $4,000 of costs may be capitalized and recognized in income on the successful installation of the equipment.

Costs should not be capitalized if the amount of arrangement consideration allocated to the delivered item results in either a zero or positive margin (because costs do not exceed allocated arrangement consideration). That is, costs should not be capitalized so that a “normal” profit margin is recognized for the delivered item.

This topic has been the subject of comments made by the SEC staff in a speech, as follows: (Note, this speech was made prior to the issuance of the ASC, so the technical references within the speech are to the pre-codification standards. Also, this speech was made prior to the amendments to ASC 605-25 by ASU 2009-13.)
Excerpts of Speech by Mr. Russell Hodge

December 2003

AICPA National Conference on Current SEC Developments

(footnote references omitted)

When the application of 00-21 results in a loss on a delivered item solely as a result of the application of the contingent revenue provision, the SEC staff has been asked to consider various "solutions" to relieve the perceived anomalous results. For example, we have been asked whether a registrant can elect not to separate deliverables even though the separation criteria have been met. However, the SEC staff would object to that approach since separation was not intended to be an election under Issue 00-21. In addition, if the separation criteria have been met, we believe it is clear that the revenue allocated to a deliverable should be recognized once all other revenue recognition criteria have been met for that deliverable.

Cost of Revenue Transactions

The obvious question that follows is how to account for the direct cost incurred in a revenue arrangement in which little or no revenue is allocated to a delivered item. The cost accounting question is certainly not a new one. Even without 00-21, there are a number of reasons that costs can be incurred prior to the related revenue being recognized. For example, there are costs incurred to solicit a customer, negotiate a contract or to perform set-up activities in a service contract.

It is fair to say that Issue 00-21 is expected to increase the frequency of the cost related questions, in large part as a result of the contingent revenue provision. In analyzing the issue, it is important to note that, when applicable, the contingent revenue limitation usually does not result in the recognition of deferred revenue. That is, deferred revenue should not be recognized for the difference between the cash received or amounts billed and the relative fair value of the delivered item. The contingent revenue is merely allocated to future deliverables. The significance of that distinction is that, historically, the SEC staff has objected to costs being capitalized in excess of deferred revenues, except in limited situations where, at a minimum, an enforceable contractual arrangement exists.

Unfortunately, the existing literature in this area is very narrow in scope and does not address the majority of situations where the cost capitalization questions surface. While there are several analogies used in practice to account for set-up type costs, including Statement 91 and Technical Bulletin 90-1, there are very few analogies that are appropriate for fulfillment costs. As a result, in analyzing the issue with respect to fulfillment costs, the SEC staff believes that the focus should be on whether assets are generated and should be recognized in connection with the revenue arrangement.

With that end in mind, I thought it might be helpful to provide some examples of how at least some have thought about the circumstances in which the incurrence of costs in a revenue arrangement may result in the recognition of an asset.

- For example, product sales could be in-substance consignment sales. For instance, if a vendor does not have the right to bill for a product that has been delivered, it raises a question as to whether the risks and rewards of ownership have been transferred to the customer. If a consignment sale has occurred, ARB 43 would continue to apply and would require capitalization of the costs as consigned inventory.
Also, the costs incurred might appropriately be capitalized as contractually guaranteed reimbursable costs. EITF 99-5 addresses the accounting for pre-production costs related to certain long-term supply arrangements and provides a model for capitalization of costs that would otherwise be expensed when a contractual guarantee for reimbursement exists.

Lastly, but perhaps most significantly, to the extent a loss is incurred on items that have been delivered, the loss might be considered an investment in the remainder of the contract if the revenue allocated to the remaining deliverables is an amount greater than the fair value of such deliverables.

In summary, there may be circumstances where it is appropriate to recognize an asset in connection with a multiple deliverable arrangement with contingent revenues. However, we believe that those circumstances are limited to situations where a loss has been incurred on the delivered item. For example, deferral of costs to produce normal margins for a delivered item or unit of accounting would be inappropriate.

In a recent fact pattern that we were asked to consider, we did not object to the recognition of an asset that was considered an investment in an existing contract. The asset recognized was equal to the loss incurred on the delivery of the first item in the arrangement. The remaining services to be provided under the contract were at above-market terms as a result of the revenue otherwise allocable to the first deliverable being allocated to the remaining deliverables due to the contingent payment terms. The asset would be tested for future impairment based on the cash flows expected to be generated through the performance of the remaining services under the contract.

It is important to note that, while we believe there are situations, such as the one I just discussed, in which recognition of an asset is appropriate, we do not believe that it would be appropriate in all circumstances. Unfortunately, the conclusion that the recognition of an asset may be appropriate in certain circumstances only raises more questions than answers. For example:

- What is the nature of the costs that should be considered in calculating the loss on a delivered item?
- How and over what periods should the asset be amortized?
- If the asset is recognized, what should be considered in evaluating future impairment?
- Should losses be recognized upon the execution of a contract for items expected to be delivered at a loss even though the overall arrangement is expected to be profitable?
- Should losses on contracts during the execution of the arrangements be evaluated at the unit of accounting level or be based on the profitability of the overall contract?

Interestingly, the EITF made a conscious decision not to address the cost issue in the consensus because the issue was considered too broad. As a result, registrants are on their own to a great extent in determining how to answer these questions. The SEC staff recognizes the position that registrants are in and we will do what we can to help. Unfortunately, for the same reasons that the EITF decided not to address the issue in the consensus, we do not have a "one size fits all" model. By the way, for those of you who have developed a workable model and would like to share it with the staff, by all means, please do. As you might expect, our assessments of the recent 00-21 cost deferral issues have, out of necessity, been very dependent upon the specific facts and circumstances and that will continue to be the case. So if you have questions or concerns about your cost deferral policy, please do not hesitate to discuss them with the SEC staff.
5.4 Assessing the recoverability of capitalized costs

Capitalized costs in a revenue transaction are an asset, and similar to all other recorded assets, the recoverability of such costs should be assessed prior to their initial recognition and at each reporting date thereafter. Factors to consider when performing this assessment include 1) the terms of the contractual arrangement with the customer, including whether the vendor intends to enforce such terms and 2) the amount of nonrefundable deferred revenue, if any, recorded in connection with the transaction.

Capitalized costs that are less than or equal to the amount of deferred revenue recorded for a delivered item are generally considered recoverable through the future recognition of the deferred revenue. When capitalized costs exceed deferred revenue (or no deferred revenue has been recorded), a more detailed recoverability analysis should be performed. In order to conclude the capitalized costs can be realized, the following factors should be present:

- A legally enforceable contractual arrangement exists.
- The company’s management intends to enforce the terms of the contract.
- Objective evidence exists supporting that net revenues less related direct costs will exceed the amount of capitalized costs recorded based on the terms of the contractual arrangement. Future operating margins may consider revenues (and related costs) in excess of contractual minimums if those revenues and costs are probable of occurring and are objectively supportable. For example, contingent revenue amounts such as add-on services requested by the customer should not be considered unless those revenues are probable and can be objectively determined.

Capitalized costs should be periodically assessed for recoverability as changing facts and circumstances may indicate a need to recognize an impairment of the recorded asset. If costs cannot be assessed as recoverable upon reassessment, the amount of the capitalized costs in excess of the future net revenues less related direct costs should be expensed as a period cost.

The following example illustrates these concepts:

<table>
<thead>
<tr>
<th>Illustration 5-3</th>
</tr>
</thead>
<tbody>
<tr>
<td><strong>Facts:</strong></td>
</tr>
<tr>
<td>A company sells home security systems. In addition to the hardware components of the security system, the company provides installation, maintenance and monitoring services. A customer enters into an agreement to purchase a system, including installation and maintenance, along with monitoring services for an initial three-year period. The contract terms require an upfront, nonrefundable payment for the hardware and installation effort, along with monthly payments for the ongoing monitoring services that will be provided. Cancellation of the contract by the customer prior to the end of the initial term will result in a $250 penalty for early termination.</td>
</tr>
</tbody>
</table>
The company incurs the following costs related to this contract:

- $200 in hardware costs for components purchased from a third-party manufacturer.
- $100 in labor costs for the company’s existing employees to install and test the equipment, and to activate the security system’s ability to interact with the centrally located monitoring systems.
- $50 in labor costs for the company’s existing employees to perform contract origination services (i.e., customer credit check and paperwork processing).
- $50 in commissions paid to the salesperson that sold the contract to the customer. The salesperson is a member of the company’s dedicated sales department.

The company would need to apply the guidance in ASC 605-25 to determine whether the multiple elements within this arrangement should be considered separate units of accounting. For purposes of this example, we need to assume the delivered items do not have standalone value (we would expect that in these circumstances the deliverables may have standalone value) and therefore the hardware, installation and maintenance are not separable from the ongoing monitoring services.

The company has elected to use a direct and incremental cost capitalization methodology based on an analogy to the guidance for nonrefundable fees and other costs of originating a loan (pursuant to ASC 310-20). As a result of obtaining the new customer, the company has capitalized $400 of direct and incremental costs (see the example included in Section 5.2 for computation of this amount). Additionally, 1) the ongoing monthly monitoring service fee is $30, and the associated monitoring costs are $15 per month, 2) the company has a legally enforceable contract with its customer, 3) an upfront nonrefundable payment of $200 was made by the customer when the contract was signed, which was recorded as deferred revenue, and 4) future operating margins are probable and can objectively be determined. While the vendor is constantly offering add-on products and services to existing customers, the vendor does not believe that additional revenue can be objectively determined.

Analysis:

Of the $400 in capitalized costs, $200 can be realized through recognition of the deferred revenue recorded on receipt of the nonrefundable upfront payment. The remaining $200 must be assessed based on the anticipated future net operating margins realized through the provision of the ongoing monitoring services to the customer. The company anticipates that during the three-year contract operating margins will be $540 ($15 per month multiplied by 36 months). The additional capitalized direct and incremental costs of $200 are considered recoverable, as the company can objectively estimate future operating margins, the company has a legally binding contract that it intends to enforce (including a $250 early-termination penalty clause) and its history supports both the operating margins and the intentions of enforcing its contracts.
6 Disclosure

6.1 Chapter summary

As discussed in the previous chapters of this publication, the revenue recognition policies and the period in which revenue is recognized can be affected by the inclusion of multiple deliverables in an arrangement. Accordingly, ASC 605-25-50-1 includes an overall objective that the disclosures regarding the recognition of revenue for multiple-element arrangements provide “both qualitative and quantitative information regarding the significant judgments made about the application of this Subtopic and changes in those judgments or in the application of this Subtopic that may significantly affect the timing or amount of revenue recognition.” In creating these requirements, the EITF intentionally created a broad objective for companies to consider in order to make the disclosure requirements scalable depending on the significance of multiple-element arrangements and the nature of judgments and estimates used in accounting for those arrangements. In order for companies to be able to apply the principle to achieve both consistency and transparency in financial reporting of their revenue transactions, the EITF also developed a list of eight specific disclosure requirements in ASC 605-25-50-2. Management will need to apply judgment in determining the extent of their multiple-element arrangements disclosures based on the overall objective and the eight specific requirements.

These disclosures would be in addition to the disclosures related to the company’s policies on revenue recognition required by SAB Topic 13 or other applicable literature.

6.2 Disclosure requirements

Excerpt from Accounting Standards Codification

Revenue Recognition – Multiple-Element Arrangements

Disclosure

605-25-50-1

The objective of the disclosure guidance in this Section is to provide both qualitative and quantitative information about a vendor’s revenue arrangements and about the significant judgments made about the application of this Subtopic and changes in those judgments or in the application of this Subtopic that may significantly affect the timing or amount of revenue recognition. Therefore, in addition to the required disclosures, a vendor shall also disclose other qualitative and quantitative information as necessary to comply with this objective.

605-25-50-2

A vendor shall disclose all of the following information by similar type of arrangement:

a. The nature of its multiple-deliverable arrangements
b. The significant deliverables within the arrangements
c. The general timing of delivery or performance of service for the deliverables within the arrangements
d. Performance-, cancellation-, termination-, and refund-type provisions
e. A discussion of the significant factors, inputs, assumptions, and methods used to determine selling price (whether vendor-specific objective evidence, third-party evidence, or estimated selling price) for the significant deliverables

f. Whether the significant deliverables in the arrangements qualify as separate units of accounting, and the reasons that they do not qualify as separate units of accounting, if applicable

g. The general timing of revenue recognition for significant units of accounting

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

Question 6-1 Are SEC registrants required to disclose information about multiple-element arrangements beyond that required by ASC 605-25?

SAB Topic 13 requires registrants entering into sales transactions involving multiple deliverables to clearly disclose the accounting policy for each unit of accounting in addition to how the units of accounting are determined and valued (SAB Topic 13B, Question 1).

In addition to the requirements of SAB Topic 13, the 30 November 2006 publication entitled Current Accounting and Disclosure Issues in the Division of Corporation Finance sets forth the SEC staff’s belief that each registrant should disclose a description of its major revenue generating products and services and the arrangements (including multiple-element arrangements) used to deliver those products and services to its customers. This disclosure should include a discussion of the essential terms of major contracts, or groups of similar contracts, including a discussion of payment terms and any unusual provisions or conditions. These disclosures may be particularly important for a vendor that utilizes multiple-element arrangements.

Several of the suggested disclosures cited in the November 2006 publication are included in the required disclosures in 605-25-50-2 (specifically, 605-25-50-2(e) through 50-2(g)). In addition, the publication noted that registrants should also discuss whether multiple contracts with a single counterparty are combined and accounted for as one arrangement or as separate arrangements (see Section 3.2.1).

In addition, public companies should consider whether the assumptions used to separate deliverables and allocate arrangement consideration should be considered significant judgments. Significant judgments may require disclosure as part of the critical accounting policy disclosures included in Management’s Discussion and Analysis of Financial Condition and Results of Operations pursuant to the SEC’s Release FR 60, Cautionary Advice Regarding Disclosure of Critical Accounting Policies.

Question 6-2 Does the guidance provide an illustrative disclosure for an entity that utilizes multiple-element arrangements?

No. The EITF, partially in response to comments received during the development of the revised multiple-element arrangements guidance contained in ASU 2009-13, decided to not include an illustrative disclosure. As discussed prior, the EITF instead created a broad, overall objective stating the purpose of the disclosures. However, the EITF wanted to provide entities some flexibility to scale these disclosures as appropriate for their individual facts and circumstances.
**Question 6-3**  
Do the disclosure requirements (as revised by ASU 2009-13) apply to all multiple-element arrangements or just those initiated or materially modified subsequent to the adoption of ASU 2009-13?

Entities are required to provide the disclosures contained in ASC 605-25-50-1 and 50-2 for all multiple-element arrangements once the entity has adopted the provisions in ASU 2009-13. Therefore, the disclosure requirements apply to arrangements initiated or materially modified subsequent to the adoption of ASU 2009-13, arrangements subject to ASC 605-25 (as revised by ASU 2009-13) that were formerly subject to the scope of ASC 985-605 prior to the adoption of ASU 2009-14 and arrangements subject to the historical multiple-element arrangements guidance (those arrangements that remain under ASC 605-25 prior to the amendments from ASU 2009-13, previously EITF 00-21). That is, it is not appropriate for an entity to apply the disclosure requirements in ASC 605-25-50-1 and 50-2 to only those arrangements subject to the provisions of ASU 2009-13.
7 Transitional considerations in adopting the revised guidance in ASU 2009-13

7.1 Chapter summary

The multiple-element arrangements guidance codified in ASC 605-25 was modified as a result of the final consensus reached on EITF Issue No. 08-1, “Revenue Arrangements with Multiple Deliverables,” which was codified by ASU 2009-13. The guidance in ASU 2009-13 supersedes the existing guidance on such arrangements.

ASC 605-25-65-1 provides transition guidance for entities adopting the provisions of ASU 2009-13. ASU 2009-13 provides flexibility in the timing and manner in which an entity elects to adopt the revised multiple-element revenue arrangements guidance. The revised guidance was required to be adopted by all entities no later than fiscal years beginning on or after 15 June 2010 (e.g., 1 January 2011 for calendar-year entities).

ASC 605-25 allows entities to adopt the revised guidance through either of the following methods:

- **Prospective application** to all revenue arrangements entered into or materially modified after the date of adoption
- **Retrospective application** to all revenue arrangements for all periods presented

In practice, we noted that the majority of companies elected to adopt the revised guidance on a prospective basis. As a result, while those entities already have adopted ASU 2009-13 for all arrangements entered into since the date of adoption, they may still have to apply the transition provisions of the standard if they have long-term arrangements that were entered into before the date of adoption but materially modified those arrangements after the date of adoption. Section 7.2 addresses the determination whether an arrangement has been materially modified, while Section 7.3 addresses the accounting for those materially modified arrangements.

7.2 Evaluation of “materially modified”

While ASU 2009-13 stated that, for entities that adopted the guidance on a prospective basis, the provisions should be applied to new and “materially modified” arrangements from the date of adoption forward, ASU 2009-13 does not provide a definition of or factors to consider in determining whether contracts have been “materially modified.” During the deliberations for EITF 08-1, the EITF discussed whether the final guidance should include factors for entities to consider in determining whether a contract was materially modified. However, the EITF concluded that the determination of materially modified should be based on the relevant facts and circumstances and is a matter of professional judgment.

In making the determination of when an arrangement has been materially modified, we believe entities should consider the nature of the modifications and the expected effect on the existing arrangement. To the extent a modification results in a substantive change to the overall arrangement, this likely will be considered a material modification. Essentially, we believe a material modification could result from any material change to the arrangement that is the result of bona fide negotiations between the two parties that in some way changes the nature or timing of the delivery of elements in the arrangement. We
believe such modifications could include, but are not limited to, the following changes that result from negotiations between the parties:

- An increase or decrease in the total arrangement consideration that is more than insignificant
- A significant change in the contracted deliverables (e.g., modifying or removing existing deliverables)
- A significant change in the period of the arrangement (i.e., extending or shortening the original contracted term that does not result from the unilateral exercise of an option held by either party) — however, extending the term of the arrangement without any changes in pricing may represent an incremental (i.e., new) contract, even if the incremental contract was effected through a change in an existing contract (see further discussion below)
- A significant modification to the delivery schedule for contracted deliverables

To the contrary, nonsubstantive changes to an arrangement would not constitute a material modification. Such modifications could include changes that do not materially affect the underlying terms and conditions of the arrangement and that lack economic substance (e.g., administrative changes such as changes to general customer or vendor information, changes of a delivery address, changes in legal terms and conditions that do not substantively affect the overall arrangement, or changes to consideration or deliverables, or the timing thereof, that are not significant). Additionally, we believe that modifying a contract to provide for the delivery of additional products or services at the same rates as in the existing contract generally would constitute a new arrangement, not a material modification. For example, an entity has an existing contract to provide 1,000 widgets at $200 each to a customer. If the customer requests an additional 200 widgets be delivered at the same price of $200 per widget, we believe this change is in substance a new contract, not a material modification of the existing contract.

Each modification to an arrangement will need to be evaluated separately to determine the potential effect on the arrangement immediately preceding the modification. We also believe that entities should evaluate whether a series of immaterial modifications rise to the level of a material modification when considered in the aggregate. For example, an entity may have three modifications to an arrangement over a two-month period. The entity may evaluate each modification as immaterial to the overall arrangement; however, in evaluating the effect of the three modifications on the arrangement prior to the amendments, the entity concludes that the modifications in total are material. Therefore, the entity may determine it is appropriate to remeasure the arrangement using the provisions of ASU 2009-13. In such situations, an entity will need not only to evaluate the magnitude of the modification(s), it also will have to evaluate the period over which the assessment is made. Depending on the number and type of modifications, it may be appropriate for an entity to evaluate all modifications made to an arrangement within a particular quarter, while other entities may evaluate changes made during a rolling 12-month period. In all cases, entities will need to apply judgment in assessing whether a modification to an existing arrangement is material.

Further, based on our discussions with the SEC staff, we believe that the staff expects entities will provide robust Management’s Discussion and Analysis in their Form 10-K (and Form 10-Q) surrounding the business purposes for making material modifications to existing contracts, as well as the effect of the modification on current period revenues and operating results (i.e., the amount of previously deferred revenue that was recognized upon modification by applying the provisions of ASU 2009-13 – see Section 7.3.1), if the modifications materially affect current year results and overall trends.
7.3 Accounting for a materially modified arrangement

If an entity materially modifies an arrangement after the adoption of ASU 2009-13, and the arrangement was previously accounted for using the prior multiple-element guidance (i.e., the arrangement was entered into prior to the date of adoption for ASU 2009-13 and the entity elected a prospective application method), the entity must now account for that arrangement under ASU 2009-13. This requires the entity to record an adjustment as of the date of the material modification to reflect the accounting that would have resulted had the entity applied the requirements of ASU 2009-13 from the date of inception of the contract.

For arrangements in which the entity was able to treat the identified deliverables as separate units of accounting and had established VSOE or TPE for each of the units of accounting, the application of ASU 2009-13 will have no effect on the prior accounting. For arrangements in which the entity treated each of the deliverables as separate units of accounting but allocated the arrangement consideration using the residual method (i.e., the entity did not have VSOE for all of the units of accounting), the entity will have to reflect the effects of switching from a residual method to a relative-selling-price method.

Finally, entities that were unable to separate certain deliverables into individual units of accounting due to a lack of objective evidence of fair value will have to re-evaluate if the deliverables could now be separated under the revised guidance and treated as separate units of accounting. Frequently, when deliverables were unable to be separated, the entity may have deferred revenue on its balance sheet associated with the delivered elements. As a result, this deferred revenue will have to be adjusted as of the date of the material modification. This scenario is discussed further in Section 7.3.1.

7.3.1 Deferred revenue related to a materially modified arrangement

As a result of applying the existing guidance in ASC 605-25 (prior to the adoption of ASU 2009-13), an entity may have deferred revenue recorded on its balance sheet related to delivered elements because the separation criteria within that guidance were not met. However, if that contract is materially modified (see Section 7.2 for a discussion on determining when a contract is materially modified) after the date the entity adopts the provisions in ASU 2009-13, that contract should now be accounted for in accordance with the revised guidance. Under the revised guidance, it is more likely that the elements within the arrangement will meet the separation criteria and, therefore, revenue could be recognized for those delivered elements. It is important to note, however, that if the delivered element giving rise to the deferred revenue still does not meet the separation criteria based on the provisions of ASU 2009-13, then no adjustment to the deferred revenue would be appropriate.

For an entity that adopts ASU 2009-13 prospectively, the guidance requires that its provisions be applied to contracts that are materially modified after the date of adoption. This is even if the original contract was entered into prior to the year of adoption. However, ASU 2009-13 does not specifically address how deferred revenue should be adjusted upon the material modification of a contract. As a result, we believe there may be more than one acceptable method entities could use to calculate the adjustment to deferred revenue, as follows:

- Alternative A – Reallocate the arrangement consideration to all of the identified elements in the arrangement (both delivered and undelivered) based on the information available today. Allocated consideration is recognized in revenue for all delivered elements (adjusting deferred revenue as appropriate), and consideration attributable to the undelivered elements is recognized in the future as those elements are delivered. As discussed further below, we believe this approach is preferable but may be difficult to apply in all situations.
Alternative B – Determine the estimated selling price (using VSOE, TPE or best estimate, as appropriate) for the remaining undelivered elements as of the date of the material modification and allocate arrangement consideration equal to that estimated selling price to the undelivered items. This amount is deducted from the sum of the consideration to be received in the future plus any deferred revenue, with the remainder recognized as revenue on the modification date.

Each of these two alternatives is discussed further below.

Some have suggested a possible third alternative is to not recognize any adjustment of the deferred revenue at the date of the material modification of the contract and instead allocate that deferred revenue plus any remaining consideration to be received to the remaining undelivered elements, based on the relative-selling-price method. However, we do not believe that this is an acceptable method of accounting for material modifications of contracts with original inception dates that preceded the adoption of ASU 2009-13. The deferred revenue relates to delivered elements that did not meet the previous separation criteria within ASC 605-25. Upon adoption of the provisions within ASU 2009-13, failing to adjust the deferred revenue to reflect the revenue associated with the delivered elements does not conform to the provisions of the ASU.

Alternative A – Adjustment of deferred revenue based on reallocation of arrangement consideration to all elements

Under this alternative, an entity would identify all of the elements in the arrangement (based on the terms of the modified contract), including those elements that were previously delivered, and reallocate the total arrangement consideration to these elements on the date of a material modification. While we believe that this approach is most consistent with the underlying principles contained in ASU 2009-13, we also acknowledge that it may be very difficult to apply in certain situations. Under this alternative, an entity would have to use the most appropriate information available to determine estimated selling price for each of the elements. One approach to applying this alternative would be to use current information for any undelivered elements as of the date of modification and historical information for the delivered elements (i.e., based on information that was available at the inception of the arrangement). However, entities may not have the historical information necessary to apply this approach, especially for longer-term contracts. In such situations, an entity may determine that using current information for all elements is the most appropriate basis for determining estimated selling price. However, this approach also has its limitations, as current data may not provide relevant information for all delivered elements, particularly if their value has changed significantly since the inception of the contract.

We believe that entities that elect to follow Alternative A should consistently apply this approach in all situations where it is practicable, but in situations where it is not practicable, apply Alternative B.

The following example illustrates this concept:

**Illustration 7-1**

**Facts:**

Entity K entered into a long-term outsourcing agreement with Customer P in 2007 that included a significant upfront “build” of a hardware system (priced at $100 million) and five years of related services (priced at $225 million per year). Under the previous multiple-element arrangements guidance, Entity K was not able to separate the upfront hardware build from the on-going services because Entity K did not have evidence of fair value (VSOE or TPE) of the undelivered services. Therefore, Entity K accounted for the consideration received for the upfront hardware build as deferred revenue and recognized that revenue over the stated service period. These outsourcing agreements frequently provide customers the ability to renegotiate pricing and other terms of the agreement at specified points during the five-year service period, if market prices for similar services change significantly.
Entity K adopted the provisions of ASU 2009-13 as of the beginning of 2009. At the end of 2009, the contract was re-negotiated, and the price of the services was reduced by 20% (to $180 million per year) and an additional two years of services were added to the agreement. Entity K concludes that these changes to the contract constitute a material modification. At the date of the contract modification, Entity K has a $40 million deferred revenue balance relating to the delivered hardware.

Analysis:

Following the method described for Alternative A, Entity K would reallocate the entire amount of arrangement consideration to all of the identified deliverables. The total arrangement consideration on the date of modification is $1.495 billion, calculated as follows: $100 million for the hardware build, $225 million per year for the first three years of services and $180 million per year for the next four years of services.

In determining how to allocate the total arrangement consideration of $1.495 billion using the relative-selling-price method, Entity K will have to establish a consistent methodology for determining best estimate of selling price. Entity K may elect to base best estimate of selling price for the remaining four years of services on information available as of the date of material modification and base best estimate for the hardware build and the first three years of services on information that was available to Entity K when the contract was originally entered into in 2007. Under this approach, Entity K may determine that the best estimates of the hardware build and first three years of services (based on historical data) are $105 million and $230 million per year, respectively. Entity K may also determine that the best estimate of selling price for the last four years of services (based on current data) is $185 million per year. Using this information, Entity K would allocate the total arrangement consideration of $1.495 billion to the identified elements using the relative-selling-price method as follows:

<table>
<thead>
<tr>
<th>Deliverable</th>
<th>Contract price (in 000s)</th>
<th>Estimated selling price (in 000s)</th>
<th>Percentage of total</th>
<th>Allocated consideration (in 000s)</th>
</tr>
</thead>
<tbody>
<tr>
<td>Construction build</td>
<td>$100,000</td>
<td>$105,000</td>
<td>6.8%</td>
<td>$101,660</td>
</tr>
<tr>
<td>On-going services, years 1–3</td>
<td>675,000</td>
<td>690,000</td>
<td>45.0</td>
<td>672,750</td>
</tr>
<tr>
<td>On-going services, years 4–7</td>
<td>720,000</td>
<td>740,000</td>
<td>48.2</td>
<td>720,590</td>
</tr>
<tr>
<td>Total</td>
<td>$1,495,000</td>
<td>$1,535,000</td>
<td>48.2</td>
<td>$1,495,000</td>
</tr>
</tbody>
</table>

Based on the above relative-selling-price allocation, Entity K determined that, as of the contract modification date, revenue to be recognized on the undelivered services equals $720,590. As a result, Entity K would reduce the deferred revenue balance by $39,410, to $590 (such that remaining consideration to be received of $720,000 plus the deferred revenue balance of $590 equal the revenue allocated ($720,590) to the undelivered elements of the arrangement). The excess amount of $39,410 of deferred revenue would be recognized in revenue as of the date of the contract modification.

However, Entity K may not have the historical information needed to determine estimated selling prices for the delivered elements, especially because of the long-term nature of its contracts. As a result, Entity K may determine that using current information for all elements is the most appropriate basis for determining estimated selling price. However, this approach also has its limitations. For example, if Entity K determines its best estimate of selling price for hardware using cost plus an acceptable margin, the current cost of hardware components may not be comparable to the cost of those same components three years ago (and those components may not even be available today).
Alternative B – Adjustment of deferred revenue based on determination of estimated selling price for the undelivered elements

Alternative B focuses only on the undelivered elements in the arrangement at the time of the contract modification. While this approach may not align with the principles of the guidance in ASU 2009-13 as well as Alternative A, we believe this alternative is a more practical approach that does not conflict with the provisions of ASU 2009-13.

Under this approach, an entity would evaluate the remaining undelivered elements within the arrangement upon the material modification of a contract. The entity would determine an estimated selling price for each of those elements (using either VSOE, TPE or best estimate of selling price, whichever is appropriate). The entity would then ensure this amount is available for future revenue recognition, either through consideration still to be received or through the recognition of deferred revenue. To the extent that there is any excess deferred revenue at the date of contract modification, this amount would be recognized into revenue upon the material modification of the contract.

The following example illustrates this concept:

**Illustration 7-2**

**Facts:**

This example uses the same fact pattern as described in Illustration 7-1.

**Analysis:**

Under Alternative B, the entity determines that the best estimate of selling price of the remaining four years of services is $185 million per year, or $740 million. Pursuant to the contract, Entity K will receive $720 million in consideration from Customer P during the remaining service period. Therefore, Entity K determines that the deferred revenue at the date of contract modification should be $20 million. The excess $20 million in deferred revenue (i.e., the $40 million balance less the $20 million allocated to future deliverables) would be recognized in revenue as of the date of the contract modification.

Given the complexities surrounding the accounting for deferred revenue, we believe the disclosures of the accounting for deferred revenue when pre-ASU 2009-13 contracts are materially modified are extremely important. While not a specific requirement in ASU 2009-13, we believe that in order to comply with the objective of the transitional disclosure requirements, an entity should disclose both its accounting policy for treatment of deferred revenue upon material modification of a contract and the amount of revenue recognized during the period due to contract modifications. In addition, based on our discussions with the SEC staff, we believe the staff will expect robust disclosures within Management’s Discussion and Analysis within their Form 10-K (and Form 10-Q) to the extent that the recognition of deferred revenue upon material modification of contracts materially affects current year results and overall trends.
A Examples of the application of the multiple-element arrangements guidance

The examples below are reproduced from the implementation guidance and illustrations section of the multiple-element arrangements guidance (ASC 605-25-55). These examples provide guidance for determining whether deliverables included in a multiple-element arrangement are separable into different units of accounting and, if so, how to measure and allocate arrangement consideration but do not address when the criteria for revenue recognition are met.

---

**Excerpt from Accounting Standards Codification**

**Revenue Recognition — Multiple-Element Arrangements**

Implementation Guidance and Illustrations

605-25-55-7

The following Examples provide guidance only with respect to determining whether a multiple-deliverable revenue arrangement contains more than one unit of accounting and, if so, how to measure and allocate the arrangement consideration to the separate units of accounting. As discussed in paragraph 605-25-15-4, this Subtopic (including the Examples) does not address (for any unit of accounting) when the criteria for revenue recognition are met or provide revenue recognition guidance. The examples illustrate potential application of this Subtopic based on the limited facts presented. The evaluations following each of the example fact patterns are not intended to represent the only manner in which the guidance in this Subtopic could be applied. Additional facts would most likely be required to fully evaluate the deliverables, units of accounting, and presentation issues related to these arrangements.

**Example 1: Cellular Telephone Contract**

605-25-55-8

This Example illustrates the unit of accounting guidance in paragraph 605-25-25-5 and the allocation and contingencies guidance in paragraphs 605-25-30-2 through 30-5.

605-25-55-9

CellularCo runs a promotion in which new customers who sign a two-year contract receive a free phone. There is a one-time activation fee of $50 and a monthly fee of $40 for the ongoing service. The same monthly fee is charged by CellularCo regardless of whether a free phone is provided. The phone costs CellularCo $100. Further, assume that CellularCo frequently sells the phone separately for $120. CellularCo is not required to refund any portion of the fees paid for any reason. CellularCo is a sufficiently capitalized, experienced, and profitable business and has no reason to believe that the two-year service requirement will not be met.

605-25-55-10

CellularCo is considering whether the phone and the phone service (that is, the airtime) are separable deliverables in the arrangement. The activation fee is simply considered additional arrangement consideration to be allocated. The phone and activation are delivered first, followed by the phone service, which is provided over the two-year period of the arrangement.
Based on an evaluation of the circumstances, the first condition for separation is met for the phone. That is, the phone has value on a standalone basis because it is sold separately by CellularCo. The second condition is also met because there are no general rights of return in this arrangement. Therefore, the phone and the phone service should be accounted for as separate units of accounting.

The total arrangement consideration is $1,010. The selling price of the phone service is $960 ($40 × 24 months), the price charged by CellularCo when sold separately. The selling price of the phone is $120, the price of the phone when sold separately by CellularCo. Without considering whether any portion of the amount allocable to the phone is contingent upon CellularCo’s providing the phone service, CellularCo would allocate the arrangement consideration on a relative selling price basis as follows: $112.22 ($1,010 × ($120 / ($120 + $960))) to the phone and $897.78 ($1,010 × ($960 / ($120 + $960))) to the phone service. However, because a free phone is provided in the arrangement and the customer has no obligation to CellularCo if phone service is not provided, $62.22 (assuming the customer has paid the nonrefundable activation fee) is contingent upon CellularCo’s providing the phone service. Therefore, the amount allocable to the phone is limited to $50 ($112.22 − $62.22), and the amount allocable to the phone service is increased to $960.

Example 2: Can Manufacturing Equipment

Entity C sells high-speed aerosol can manufacturing equipment. Entity C sells a complete manufacturing process, which consists of Equipment X, Y, and Z. Entity C does not sell Equipment X, Y, and Z separately; however, other entities do sell the same equipment separately and there is a market for used equipment. Installation is not considered in this Example.

Entity C is evaluating whether Equipment X, Y, and Z are separate units of accounting under the following scenario.

Entity C delivered Equipment X and Z on March 27, but did not deliver Equipment Y until April 6. Without Equipment Y, the customer does not have use of Equipment X and Z. However, there is an active market for new Equipment X, Y, and Z on a separate basis, as the equipment is often bought separately from other vendors as replacements become necessary. The contract provides that if all pieces of equipment are not delivered, the customer may return Equipment X and Z and have no liability to Entity C. The contract requires delivery of all equipment prior to June 1, and Entity C has sufficient production capacity and inventory to deliver all of the equipment prior to that contractual deadline.

Based on an evaluation of the circumstances, the first condition for separation is met for Equipment X and Z. Equipment X and Z have value on a standalone basis because they are sold separately by other vendors. The second condition is also met because there is no general right of return in the arrangement.
Therefore, Equipment X, Y, and Z should be accounted for as separate units of accounting. However, even though accounted for as separate units of accounting, the arrangement consideration allocable to both Equipment X and Z is $0 because the full amount otherwise allocable to those separate deliverables is contingent upon the delivery of Equipment Y.

Example 3: Standard Equipment and Installation

Entity E is an experienced manufacturer of equipment used in the construction industry. Entity E’s products range from small to large individual pieces of automated machinery to complex systems containing numerous components. Unit selling prices range from $200,000 to $2.5 million. Unit selling prices are quoted inclusive of installation.

Each equipment model has standard performance specifications and is not otherwise customized for the specific needs of a buyer. Entity E extensively tests the equipment against those specifications prior to shipment. The installation process does not involve changes to the features or capabilities of the equipment and does not require proprietary information about the equipment in order for the installed equipment to perform to specifications.

While there are others in the industry with sufficient knowledge about the installation process for the equipment, as a practical matter, most purchasers engage Entity E to perform the installation services. However, some customers choose not to have the equipment installation performed by Entity E for various reasons (for example, their proprietary use of the equipment, their preference that installation be performed by their own employees or other vendors with whom the customers have established relationships, or for their own convenience). If a potential customer wishes to purchase equipment without installation, Entity E will not reduce the quoted selling price for the commensurate value of the installation. If a customer chooses to purchase equipment without installation, there is only one deliverable.

Assume that a customer enters into an arrangement to purchase equipment with a price of $200,000 (the price at which Entity E regularly sells the equipment without installation) from Entity E and chooses to have Entity E perform the installation for that equipment. The customer is obligated to pay Entity E the arrangement consideration upon delivery of the equipment. The price of the installation service when it is performed by vendors other than Entity E is $8,000 (third-party evidence of selling price). There are no refund rights (general or otherwise) in the arrangement. Entity E is considering whether the equipment and the installation service are separable units of accounting in the arrangement.

Based on an evaluation of the circumstances, the first condition for separation is met for the equipment. The equipment has standalone value as it is sometimes sold separately. The second condition for separation is also met because there are no general refund rights. Therefore, the equipment and the installation are considered separate units of accounting in the arrangement.
Regardless of whether the installation is performed, the total arrangement consideration is $200,000. Entity E has either vendor-specific objective evidence or third-party evidence of selling price for all units of accounting in the arrangement. The arrangement consideration of $200,000 should be allocated to the separate units of accounting using the relative selling price method. Thus, allocation of the arrangement consideration would be $192,308 \left[\frac{200,000 \times (200,000)}{200,000 + 8,000}\right]$ to the equipment and $7,692 \left[\frac{200,000 \times (8,000)}{200,000 + 8,000}\right]$ to the installation service. Additionally, none of the amount allocable to the equipment is contingent upon performing the installation.

**Example 4: Automobiles Sold with Lifetime Maintenance Services**

This Example illustrates the unit of accounting guidance in paragraph 605-25-25-5 and the allocation guidance in paragraph 605-25-30-2.

Entity A is an established auto dealer. Entity A’s service center provides all scheduled maintenance services (including oil changes) at no additional charge (other than for parts) for any customer who purchases an automobile from Entity A for the period that the customer owns the automobile. The customer also may choose to have the maintenance services performed by others without affecting the vehicle warranty, but most customers utilize Entity A’s maintenance services unless they move to a distant location. Neither Entity A nor any other dealer sells the automobile without the lifetime maintenance services. However, Entity A sells maintenance services separately to customers who did not purchase their vehicles from Entity A. The automobiles are sold subject to a limited warranty and there are no refund rights in the arrangement. Customers are obligated to Entity A for all arrangement consideration upon taking delivery of the automobile. Since lifetime maintenance services are not separately priced when a customer purchases an automobile from Entity A, they are not within the scope of Subtopic 605-20.

Based on an evaluation of the circumstances, the first condition for separation is met for the automobile because, even though the automobile is not sold separately by any vendor, it is considered to have standalone value because the customer could resell the automobile on a standalone basis. The second condition for separation also is met because there are no refund rights (general or otherwise) in the arrangement. Therefore, the automobile and the maintenance services should be considered separate units of accounting in the arrangement.

Because no entity sells the automobile separately, neither vendor-specific objective evidence nor third-party evidence of selling price exists for the automobile. However, there is vendor-specific objective evidence of selling price of the maintenance services (as evidenced by the amount charged on a standalone basis by Entity A for maintenance services and data available from which to estimate the volume and types of maintenance services provided during a typical customer’s ownership of the vehicle). As a result, when applying the relative selling price method, Entity A should use its best estimate of selling price for the automobile and vendor-specific objective evidence of selling price for the maintenance. Additionally, none of the amount allocable to the automobile is contingent upon providing the maintenance services.
Example 5: Sale of Home Appliances with Installation and Maintenance Services

605-25-55-30
This Example illustrates the unit of accounting guidance in paragraph 605-25-25-5 and the interplay between the accounting for a separately priced maintenance agreement in Subtopic 605-20 and the allocation guidance in paragraph 605-25-30-2.

605-25-55-31
Entity S is an experienced home appliance dealer. Entity S also offers a number of services together with the home appliances that it sells. Assume that Entity S regularly sells Appliance W on a standalone basis. Entity S also sells installation services and maintenance services for Appliance W. However, Entity S does not offer installation or maintenance services to customers that buy Appliance W from other vendors. Pricing for Appliance W is as follows:

a. Appliance W only: $800
b. Appliance W with installation service: $850
c. Appliance W with maintenance services: $975
d. Appliance W with installation and maintenance services: $1,000

605-25-55-32
In each instance in which maintenance services are provided, the maintenance service is separately priced within the arrangement at $175. Additionally, the incremental amount charged by Entity S for installation of $50 approximates the amount charged by independent third parties.

605-25-55-33
Appliance W is sold subject to a general right of return. If a customer purchases Appliance W with installation and/or maintenance services, and Entity S does not complete the services satisfactorily, the customer is entitled to a refund only of the portion of the fee that exceeds $800.

605-25-55-34
Assume that a customer purchases Appliance W with both installation and maintenance services for $1,000. Based on its experience, Entity S believes that it is probable that installation of the equipment will be performed satisfactorily to the customer. The maintenance services are priced separately and should be accounted for based on the guidance in Subtopic 605-20. Entity S is evaluating whether Appliance W and the installation service represent separate units of accounting.

605-25-55-35
Based on an evaluation of the circumstances, the first condition for separation is met for Appliance W because it sometimes is sold separately by Entity S. The second condition for separation is also met because, even though a general right of return exists, performance of the appliance installation is probable and within the control of Entity S. Therefore, Appliance W and installation should be accounted for as separate units of accounting.

605-25-55-36
Entity S would allocate $175 of the arrangement consideration to the maintenance services based on the guidance in Subtopic 605-20. Without considering whether any of the amount otherwise allocable to Appliance W is contingent upon the performance of the installation, Entity S would allocate the remainder of the arrangement consideration ($825) to Appliance W and the installation service using the relative selling price method. The vendor-specific objective evidence of selling price of Appliance W
Example 6: Human Resources Outsourcing Services

605-25-55-37
This Example illustrates an approach to estimating the selling price of deliverables under paragraph 605-25-30-6C when neither vendor-specific objective evidence nor third-party evidence of selling price exists. The approach in this example should not be considered the only appropriate approach to estimating the selling price of the deliverables.

605-25-55-38
Entity HR provides its customers with human resource solutions (for example, support and guidance in areas such as employee relations, payroll and taxes, health benefits administration, 401(k) administration). Customers may do one of the following:

a. Choose a prepackaged bundle of services.
b. Customize an existing bundle of services.
c. Select the individual services they require.

Because of the many services provided by Entity HR and its customers' varying needs, no two arrangements are exactly alike. Entity HR prices its arrangements on the basis of the unique bundle of services to be provided. As a result, Entity HR does not have vendor-specific objective evidence of selling price for any individual service that it provides. Although each service is sold separately by other vendors, and while Entity HR has some information about its competitors' pricing, it is unable to obtain third-party evidence of selling price for any individual service.

605-25-55-39
Assume that on January 1, 20X1, Entity HR begins providing human resource solution services to Customer Y under a three-year arrangement. Under the arrangement, Entity HR agrees to provide Customer Y with payroll processing, three periodic training events, employee handbook development, and an executive compensation assessment. The executive compensation assessment and employee handbook development are expected to be completed by June 30, 20X1 and 20X2, respectively. Entity HR expects to provide one training event annually. Total compensation under the arrangement is $1,275,000. Entity HR receives compensation under the arrangement as follows: an upfront payment of $375,000 and monthly payments of $25,000. There are no general refund rights included in the arrangement.

605-25-55-40
Entity HR is evaluating whether all of the following represent separate units of accounting and how to allocate arrangement consideration to the separate units of accounting:

a. Payroll processing
b. Periodic training
c. Employee handbook development
d. Executive compensation assessment.
Based on an evaluation of the circumstances, Entity HR concludes that there are no units of accounting at inception of the arrangement because no item in the arrangement has been delivered at that date. However, Entity HR will reassess whether a delivered item should be considered a separate unit of accounting each time it performs under the arrangement.

Entity HR determines that each of the deliverables in the arrangement has standalone value. Because Entity HR does not have either vendor-specific objective evidence or third-party evidence of selling price for the deliverables in the arrangement, Entity HR must use its best estimate of selling price for each deliverable when allocating arrangement consideration under the relative selling price method.

In estimating the selling price for the deliverables, Entity HR considered all of the following:

a. Its internal costs
b. Its profit objectives
c. The pricing practices it used to establish the bundled price for its services
d. Whether any market constraints exist that may limit its selling price (for example, whether competitors could charge a lower price for the same service or whether the price for the service exceeds the cost savings to its customers). Entity HR believes that as the price for its service begins to exceed the customers' internal cost, the customers will be less likely to purchase the service.

When determining the price for its bundled services, Entity HR typically applies a gross profit margin to the cost (primarily labor and other time and expenses) it will incur in providing the contracted services. The profit margin varies with the types of services to be provided and generally includes a discount based on the number of services being purchased. For example, Entity HR typically includes the following gross profit margins, which have been developed over time (by a relevant, authorized level of management) on the basis of available market data and demand for the services:

a. A 26 percent gross profit margin on its payroll processing services
b. A 15 percent gross profit margin on its employee handbook development services and executive compensation assessments
c. A 22 percent gross profit margin on its training services before considering any discount on the total arrangement.

Entity HR believes that these returns are consistent with the gross margins sought by its competitors. In addition, Entity HR has no information that would indicate that a competitor would charge a price that could affect the price Entity HR could charge for its service, either by limiting the price that Entity HR could charge or by allowing Entity HR to increase its price. In addition, Entity HR's analysis also indicates that the price of the individual services calculated using its internal gross profit margins would be in a range in which the service would still be attractive to its customers (that is, the cost of the service would be less than the internal costs for the same service if the customers had to provide the service themselves).
Using its internal gross profit margins and the total estimated costs it will incur to deliver the remaining units of accounting and after considering market constraints, Entity HR estimates the selling price for the undelivered units of accounting as follows.

Costs to be incurred for payroll processing for 3 years $ 976,250
(1 − Payroll processing gross profit margin of 26 percent) $ 1,319,257
Estimated selling price for payroll processing $ 74,774

Cost to be incurred for executive compensation assessment $ 45,223
(1 − Executive compensation assessment gross profit margin of 15 percent) $ 53,204
Estimated selling price for executive compensation assessment $ 7,981

Cost to be incurred for employee handbook $ 56,113
(1 − Employee handbook gross profit margin of 15 percent) $ 66,015
Estimated selling price for employee handbook $ 9,902

Cost to be incurred for 3 training events $ 40,706
(1 − Training event gross profit margin of 22 percent) $ 52,187
Estimated selling price for training events $ 11,481

Total estimated selling price of all deliverables $ 1,490,663

Therefore, at January 1, 20X1, Entity HR allocates the arrangement consideration ($1,275,000) as follows (before determining whether any individual deliverable should be considered a separate unit of accounting).

<table>
<thead>
<tr>
<th>Deliverable</th>
<th>Amount Calculated</th>
</tr>
</thead>
<tbody>
<tr>
<td>Payroll processing</td>
<td>$ 1,128,392</td>
</tr>
<tr>
<td>Executive compensation</td>
<td>45,507</td>
</tr>
<tr>
<td>Employee handbook</td>
<td>56,464</td>
</tr>
<tr>
<td>3 training events</td>
<td>44,637</td>
</tr>
<tr>
<td>Total consideration</td>
<td>$ 1,275,000</td>
</tr>
</tbody>
</table>

At the inception of the arrangement and as each item in the arrangement is delivered, Entity HR must perform an evaluation to determine whether the delivered item represents a separate unit of accounting. If the delivered item does not qualify as a separate unit of accounting, the arrangement consideration allocable to the delivered item shall be combined with the amount allocable to the other applicable undelivered item(s) within the arrangement.

Example 7: Sale of Medical Equipment with Cartridges and Installation

This Example illustrates the unit of accounting guidance in paragraph 605-25-5 and the allocation guidance in paragraph 605-25-30-2.
Entity M manufactures and sells complex medical equipment to physicians and hospitals for medical scanning purposes. Prior to shipment, each piece of equipment is tested extensively to meet entity and Food and Drug Administration specifications. The equipment is shipped fully assembled, but some installation and setup is required. No other entities sell the same or largely interchangeable equipment.

Installation is a standard process, outlined in the owner’s manual, consisting principally of uncrating, calibrating, and testing the equipment. A purchaser of the equipment could complete the process using the information in the owner’s manual, although it would probably take significantly longer than it would take Entity M’s technicians to perform the tasks. Although other vendors do not install Entity M’s equipment, other vendors do provide largely interchangeable installation services for $25,000.

Historically, Entity M has never sold the equipment without installation. Most installations are performed by Entity M within 7 to 24 days of shipment. Installation is included in the overall sales price of the equipment.

In addition, the customer must pay for cartridges that record images. Entity M is the only manufacturer of the cartridges and it only sells them on a standalone basis to wholesalers through a wide network of distributors. The distributors’ retail price for each cartridge is $250. Each cartridge can handle only a specific number of scans. Once a cartridge is exhausted, a new one must be purchased in order to use the equipment. Entity M always sells its equipment with a starter supply of 20 cartridges.

The sales price of the arrangement that consists of the equipment, installation, and 20 cartridges is $400,000. The customer is obligated to pay in full upon delivery of the equipment. The customer is entitled to a refund of $25,000 if Entity M does not perform the installation or if the 20 cartridges are not delivered. On March 15, Entity M delivers the equipment and on April 5 delivers the 20 cartridges and performs the installation. Entity M is evaluating whether delivery of the equipment represents a separate unit of accounting.

Based on an evaluation of the circumstances, the first condition for separation is met for the equipment because, even though Entity M has never sold the equipment without the cartridges, a customer could resell the equipment (in a primary or secondary market). The second condition for separation also is met because there are no general rights of return involved in this arrangement. Therefore, the equipment should be accounted for as a separate unit of accounting.

Entity M does not have vendor-specific objective evidence of selling price for the equipment because it does not sell the equipment separately (without installation services and cartridges). In addition, third-party evidence of selling price does not exist as no vendor separately sells the same or largely interchangeable equipment. Therefore, Entity M must use its best estimate of selling price when allocating arrangement consideration. For the cartridges, Entity M uses third-party evidence of the price charged when sold separately by its distributors ($5,000 = 20 × $250). In addition, Entity M has third-party evidence of selling price for the installation ($25,000).

In estimating its selling price for the equipment, Entity M considered its cost to produce the equipment, its profit margin for similar arrangements, customer demand, effect of competitors on Entity M’s equipment, and other market constraints. After weighing the relevance of the available data points, Entity M estimates its standalone selling price for the equipment to be $385,000. Total selling price for all deliverables in the arrangement on a standalone basis is $415,000.
When applying the relative selling price method, Entity M should use its best estimate of selling price for the equipment, third-party evidence of selling price for the cartridges, and third-party evidence of selling price for the installation. Accordingly, without considering whether any portion of the amount allocable to the equipment is contingent upon delivery of the other items, the amount allocable to the equipment, cartridges, and installation is as follows:

a. $371,084 to the equipment ($400,000 × [$385,000 ÷ 415,000])

b. $4,819 to the cartridges ($400,000 × [$5,000 ÷ 415,000])

c. $24,097 to the installation ($400,000 × [$25,000 ÷ 415,000]).

Additionally, no portion of the amount allocable to the equipment is contingent upon the delivery of the cartridges or performance of the installation. That is, if the cartridges are not delivered and the installation is not performed, Entity M would be entitled to $375,000.

**Example 8: Sale of Computer System**

Entity B sells computer systems. On April 20, a customer purchases a computer system from Entity B for $1,000. The system consists of a central processing unit (CPU), a monitor, and a keyboard. Solely for purposes of simplifying this illustration of the application of the guidance in this Subtopic, it is assumed that the provisions of Subtopic 985-605 do not apply. On April 30, Entity B delivers the CPU to the customer without the monitor or keyboard. Each of the items is regularly sold separately at a price of $700 for the CPU, $300 for the monitor, and $100 for the keyboard. The CPU could function with monitors or keyboards manufactured by others, who have them readily available. The customer is entitled to a refund equal to the separate price of any item composing the system that is not delivered. The arrangement does not include any general rights of return. Entity B is evaluating whether delivery of the CPU represents a separate unit of accounting.

Based on an evaluation of the circumstances, the first condition for separation is met for the CPU, as it is sold separately by Entity B. The second condition for separation is met because there are no general rights of return. Therefore, the CPU would be accounted for as a separate unit of accounting.

Entity B has vendor-specific objective evidence of selling price for all deliverables in the arrangement as each is sold regularly on a standalone basis. Without considering whether any portion of the amount allocable to the CPU is contingent upon delivery of the other items, Entity B would allocate the arrangement consideration using the relative selling price method. Therefore, the portion of the arrangement fee otherwise allocable to the CPU is $636.36 ($1,000 × [$700 ÷ $1,100]), of which $36.36 ($636.36 − [$1,000 − $300 − $100]) is subject to refund if the monitor and keyboard are not delivered. Therefore, the amount allocable to the CPU is limited to $600, which is the amount that is not contingent upon delivery of the monitor and keyboard.
**Example 9: Sale of Bolts of Fabric**

This Example illustrates the unit of accounting guidance in paragraph 605-25-25-5 and the limitation in paragraph 605-25-30-6 to all amounts to which the vendor is entitled, including cancellation fees.

Entity D sells fabric for use in manufacturing clothing. Customers may purchase fabric from Entity D in individual 50-yard bolts or in bulk lots consisting of multiple bolts. One of Entity D’s customers (Customer A) is a manufacturer of band uniforms that prefers to purchase the fabric in bulk because it needs the fabric to have a high level of consistency in color and quality. Customer A enters into an arrangement with Entity D to purchase a 12-bolt bulk lot of fabric that is to be delivered by Entity D in 3 4-bolt installments over a period of 3 months.

At Customer A’s request, Entity D provides a customer satisfaction guarantee that it will refund double the price (up to a maximum of the total arrangement fee) for each bolt of fabric that is not delivered or not delivered from the same dye lot as the initial installment. That is, the double-money-back guarantee provides that, in addition to having no obligation for bolts of fabric not delivered or not delivered from the appropriate dye lot, the customer will receive a refund for (or will not be obligated to pay for) an equal number of bolts.

There are no general rights of return included in the arrangement. The price for an individual 50-yard bolt of fabric is $160, and the price for a 12-bolt bulk lot is $1,824.

In determining the units of accounting under the arrangement, Entity D considered the following.

Entity D sold the 12-bolt bulk lot of fabric to Customer A on November 1, 20X2. Entity D will deliver the first of three four-bolt installments of fabric on November 15 and will deliver the remaining installments on December 15, 20X2, and January 15, 20X3. Customer A is obligated to Entity D for the full price of the fabric on November 15, 20X2, subject to the money-back guarantee. Entity D has sufficient production capacity and inventory to deliver all of the fabric in accordance with the installment provisions of the arrangement and, therefore, believes that it will do so. In addition, Entity D has entered into similar arrangements with many other customers in the past and rarely has failed to deliver fabric from the appropriate dye lot under its bulk-sale arrangements.

Based on an evaluation of the circumstances, the first condition for separation is met for the delivered fabric because Entity D also sells bolts of fabric individually. The second condition for separation is also met because there are no general rights of return in the arrangement. Therefore, the delivered fabric should be accounted for as a separate unit of accounting.
Without considering whether any portion of the amount allocable to the individual bolts of fabric are contingent upon delivery of the other bolts of fabric, Entity D would allocate the arrangement consideration evenly among the 12 bolts of fabric using the relative selling price method because each bolt has an identical selling price. Therefore, the portion of the arrangement fee otherwise allocable to each bolt of fabric is $152 ($1,824 ÷ 12). However, in allocating the arrangement consideration, no amount is allocable to the initial delivered fabric because the arrangement provides the customer with a double-money-back guarantee for each bolt of fabric not delivered from the same dye lot as the initial installment. However, upon delivery of the second four-bolt installment (assuming that installment is delivered from the same dye lot as the initial installment), the amount allocable to that installment would be the amount related to four bolts of fabric, $608 ($152 × 4 bolts of fabric). That is, if the third installment was not delivered or was not delivered from the same dye lot as the initial installment, Entity D would be entitled only to the price charged for four bolts of fabric.

**Example 10: Painting Contract**

This Example illustrates the unit of accounting guidance in paragraph 605-25-25-5 and the limitation in paragraph 605-25-30-5 to noncontingent amounts.

PainterCo is a contractor that provides painting services for commercial and private residences. PainterCo contracts with a customer to paint the customer’s house for $3,000. The price is inclusive of all paint, which is obtained by PainterCo at a cost of $800. The customer is given the right to purchase paint separately if so desired (although the customer did not opt to do so in this Example). The paint would have cost the customer $900 if purchased from a hardware store. The painting service would have cost $2,150 if purchased without the paint.

All paint necessary to complete the project is delivered to the customer’s house prior to the beginning of the work. The customer has a general right of return with respect to any unopened can of paint. Further, the customer may receive a full refund of the sales price for all of the paint (whether or not the cans were opened) if PainterCo does not paint the house. PainterCo has always completed the painting service in accordance with contract terms and, therefore, believes that performance of the painting service in this arrangement is probable. PainterCo does not sell paint without providing the painting service.

Based on an evaluation of the circumstances, the first condition for separation is met because the paint is sold separately by other vendors. The second condition for separation is also met because, even though a general right of return exists, performance of the painting service is probable and within the control of PainterCo. Therefore, the paint and the painting service are considered separate units of accounting.

However, in allocating the arrangement consideration, no amount would be allocated to the paint because, in the event that PainterCo does not perform the painting service, the customer may return all of the paint for a full refund.
Example 11: Agricultural Equipment

This Example illustrates the unit of accounting guidance in paragraph 605-25-25-5 and an approach to estimating the selling price of deliverables under paragraph 605-25-40-6C when neither vendor-specific objective evidence nor third-party evidence of selling price exists. The approach in this Example should not be considered the only appropriate approach to estimating the selling price of the deliverables.

Entity A, a public entity, engages in the manufacture and distribution of farm equipment and related service parts, including tractors, harvesters, integrated agricultural management systems technology, and precision agricultural irrigation equipment. Each product has standard performance specifications but can be customized to meet the specific needs of any buyer. Entity A extensively tests the equipment against the standard and customer specifications before shipment.

On December 29, 20X8, Entity A enters into an arrangement to deliver a tractor and customized irrigation equipment to Customer M for a fee of $270,000. For purposes of this example, the irrigation equipment is accounted for in accordance with section 605-10-S99. The customer is obligated to pay $100,000 upon delivery of the tractor and the remainder of the arrangement consideration upon delivery of the irrigation equipment. On December 31, 20X8, Entity A delivers the tractor, and on April 5, 20X9, Entity A delivers the irrigation equipment. Neither product requires installation.

The tractor in this arrangement is often sold separately by Entity A for a price of $100,000, which is considered vendor-specific objective evidence of selling price. The irrigation equipment is also sold separately; however, because of the customized nature of the product, Entity A has neither vendor-specific objective evidence nor third-party evidence of selling price.

Entity A is considering whether the tractor is a separate unit of accounting and, if so, how to allocate the arrangement consideration at December 31, 20X8.

Based on an evaluation of the circumstances, the first condition for separation is met for the tractor. The tractor has standalone value as it is sold separately by Entity A. The second condition for separation is also met as there are no general rights of return. Therefore, the tractor should be accounted for as a separate unit of accounting.

Entity A has vendor-specific objective evidence of selling price for the tractor but has neither vendor-specific objective evidence nor third-party evidence of selling price for the irrigation equipment. Therefore, Entity A must estimate the selling price for the irrigation equipment.

Entity A considered all of the following in estimating the standalone selling price for the irrigation equipment:

a. Entity A’s cost to produce the customized irrigation equipment is $110,000.
b. The division of Entity A that produces the irrigation equipment and other similar products earns an average gross profit margin of approximately 30 percent. The range of profit margins within the irrigation product line varies from 10 to 45 percent. Entity A generally receives a higher profit margin on the more specialized or customized products.

c. When selling noncustomized irrigation equipment, Entity A averages, on a worldwide basis, a selling price of approximately $140,000, which includes a gross profit margin of 25 percent.

d. Customer M is located in Asia where high demand has resulted in Entity A being able to command 10 to 15 percent higher prices for its irrigation product line than it commands in other markets it serves. This pricing is also consistent with Entity A’s ongoing marketing strategy in Asia.

e. Direct competitors to Entity A’s irrigation product line, Entity D and Entity E, earn average gross profit margins in Asia of 30 percent and 32 percent, respectively, based on a review of their periodic filings.

f. The customized irrigation equipment includes enhanced functionality that Entity A does not believe its competitors can provide. Entity A believes that this enhanced functionality has additional value in the marketplace.

g. Entity A’s price list provided to prospective customers lists the price for irrigation equipment before customization at $155,000.

605-25-55-83

After weighing the relevance of the available data points, Entity A estimates its standalone selling price for the irrigation equipment to be $185,000. The determination of that estimated selling price was based on the cost of the irrigation equipment of $110,000 plus an estimated gross profit margin of 40 percent. The 40 percent gross profit margin is management’s best estimate based on the margin they would expect to earn on the irrigation equipment if sold separately in Asia. The estimated margin of 40 percent is higher than the 30 percent average margin of the division because the 30 percent average margin includes lower margin products. Entity A also notes that it could command higher margins in Asia than the average margin due to the high demand in that market and the recent history combined with its ongoing pricing strategy. Entity A also considered the margins reported by its competitors and believes its estimated 40 percent margin is reasonable in relation to the competitor margins considering the enhanced functionality it believes the irrigation equipment has over its competitors’ products.

605-25-55-84

Entity A did not rely on the $170,000 price of the irrigation equipment that was stated in the arrangement because the stated prices were negotiated to provide for more cash consideration earlier in the arrangement rather than to reflect the standalone selling price of the products. In addition, the arrangement prices are net of any discount embedded in the bundled arrangement rather than standalone selling prices of the products. Considering the customized nature of the irrigation equipment, Entity A did not consider the estimated selling price of $185,000 to be inconsistent with the list price of $155,000 for uncustomized irrigation equipment.

605-25-55-85

Accordingly, at December 31, 20X8, using the relative selling price method, Entity A would allocate $94,736 ($270,000 × ($100,000 ÷ $285,000)) to the tractor and $175,264 ($270,000 × ($185,000 ÷ $285,000)) to the irrigation equipment. Additionally, none of the amount allocable to the tractor is limited by the amount of payment contingent upon delivery of the irrigation equipment.
Example 12 – Biotech License and Research and Development Agreement

605-25-55-86
This Example illustrates the accounting for deliverables combined into one unit-of-accounting required by paragraph 605-25-25-6.

605-25-55-87
The entity, Biotech, enters into an agreement with a pharmaceutical entity, Pharma. The agreement includes the following, as detailed in paragraphs 605-25-55-88 through 55-93:

a. Biotech licensing certain rights to Pharma
b. Biotech providing research and development services to Pharma.

605-25-55-88
License. Biotech licenses certain rights on an exclusive basis to Pharma for a period of 10 years. The license gives Pharma the exclusive right to market, distribute, and manufacture Drug B as developed using Technology A. Biotech retains all ownership rights to Technology A and Drug B. There are no when-and-if-available clauses or other performance obligations associated with the license, except as described in paragraphs 605-25-55-89 through 55-93.

605-25-55-89
Research and development. Biotech agrees to provide research and development services on a best-efforts basis to Pharma. Biotech agrees to devote four full-time equivalent employees to the research and development activities, and Pharma expects to devote several full-time equivalent employees to the research and development activities as well. The objective of the research and development services is to develop Drug B using Technology A. The ultimate objective is to receive U.S. Food and Drug Administration approval on Drug B.

605-25-55-90
Compensation under the arrangement is as follows:

a. Biotech receives $5 million up-front upon signing the agreement.

b. Biotech receives $250,000 per year for each full-time equivalent employee who performs research and development activities.

605-25-55-91
None of these payments, once received, is refundable, even if U.S. Food and Drug Administration approval is never received. In addition, Biotech must perform on a best-efforts basis.

605-25-55-92
Pharma must use Biotech to perform the research and development activities necessary to develop Drug B using Technology A because the know-how and expertise related to Technology A is proprietary to Biotech. In other words, Biotech is the only party capable of performing the level and type of research and development services required by Pharma under the agreement. Biotech has determined that the fees charged for the research and development services (that is, the $250,000 per year for each full-time equivalent employee who performs research and development activities) are competitive with the price other third-party vendors charge for similar research and development services (that is, they represent third-party evidence of selling price for those services).
Based on an evaluation of the circumstances, there are two deliverables in this arrangement that should be considered for separation:

a. A license deliverable
b. A research and development activities deliverable.

The license deliverable does not meet the first criterion for separation because it does not have standalone value to Pharma. Because Drug B has not yet been developed, the license is of no value to Pharma and could not be sold without the accompanying research and development activities using Technology A, which is proprietary to Biotech. Likewise, Pharma could not sell the license on a standalone basis to another party (that is, because without Biotech agreeing to provide the research and development activities for that other party, the other party would not purchase the license). Therefore, the license and research and development activities should be considered a single unit of accounting in the arrangement.
# Abbreviations used in this publication

## B.1 ASC abbreviations

<table>
<thead>
<tr>
<th>Abbreviation</th>
<th>FASB Accounting Standards Codification</th>
</tr>
</thead>
<tbody>
<tr>
<td>ASC 250</td>
<td>FASB ASC Topic 250, Accounting Changes and Error Corrections</td>
</tr>
<tr>
<td>ASC 310</td>
<td>FASB ASC Topic 310, Receivables</td>
</tr>
<tr>
<td>ASC 320</td>
<td>FASB ASC Topic 320, Investments—Debt and Equity Securities</td>
</tr>
<tr>
<td>ASC 330</td>
<td>FASB ASC Topic 330, Inventory</td>
</tr>
<tr>
<td>ASC 350</td>
<td>FASB ASC Topic 350, Intangibles</td>
</tr>
<tr>
<td>ASC 360</td>
<td>FASB ASC Topic 360, Property, Plant, and Equipment</td>
</tr>
<tr>
<td>ASC 450</td>
<td>FASB ASC Topic 450, Contingencies</td>
</tr>
<tr>
<td>ASC 460</td>
<td>FASB ASC Topic 460, Guarantees</td>
</tr>
<tr>
<td>ASC 470</td>
<td>FASB ASC Topic 470, Debt</td>
</tr>
<tr>
<td>ASC 605</td>
<td>FASB ASC Topic 605, Revenue Recognition</td>
</tr>
<tr>
<td>ASC 815</td>
<td>FASB ASC Topic 815, Derivatives and Hedging</td>
</tr>
<tr>
<td>ASC 825</td>
<td>FASB ASC Topic 825, Financial Instruments</td>
</tr>
<tr>
<td>ASC 840</td>
<td>FASB ASC Topic 840, Leases</td>
</tr>
<tr>
<td>ASC 860</td>
<td>FASB ASC Topic 860, Transfers and Servicing</td>
</tr>
<tr>
<td>ASC 926</td>
<td>FASB ASC Topic 926, Entertainment — Films</td>
</tr>
<tr>
<td>ASC 952</td>
<td>FASB ASC Topic 952, Franchisors</td>
</tr>
<tr>
<td>ASC 985</td>
<td>FASB ASC Topic 985, Software</td>
</tr>
<tr>
<td>ASU 2009-13</td>
<td>FASB Accounting Standards Update No. 2009-13, Multiple-Deliverable Revenue Arrangements</td>
</tr>
<tr>
<td>ASU 2009-14</td>
<td>FASB Accounting Standards Update No. 2009-14, Certain Revenue Arrangements that Include Software Elements</td>
</tr>
</tbody>
</table>

<table>
<thead>
<tr>
<th>Abbreviation</th>
<th>Other Authoritative Standards</th>
</tr>
</thead>
<tbody>
<tr>
<td>SAB Topic 13</td>
<td>SEC Staff Accounting Bulletin No. 104, Revenue Recognition (Topic 13)</td>
</tr>
</tbody>
</table>

<table>
<thead>
<tr>
<th>Abbreviation</th>
<th>Non-Authoritative Standards</th>
</tr>
</thead>
<tbody>
<tr>
<td>CON 6</td>
<td>FASB Statement of Financial Accounting Concepts No. 6, Elements of Financial Statements</td>
</tr>
<tr>
<td>EITF 00-21</td>
<td>EITF Issue No. 00-21, “Revenue Arrangements with Multiple Deliverables”</td>
</tr>
<tr>
<td>EITF 08-1</td>
<td>EITF Issue No. 08-1, “Revenue Arrangements with Multiple Deliverables”</td>
</tr>
<tr>
<td>SOP 97-2</td>
<td>AICPA Statement of Position No. 97-2, Software Revenue Recognition</td>
</tr>
</tbody>
</table>
C Summary of important changes

There have been no significant changes since the September 2016 edition.
About EY
EY is a global leader in assurance, tax, transaction and advisory services. The insights and quality services we deliver help build trust and confidence in the capital markets and in economies the world over. We develop outstanding leaders who team to deliver on our promises to all of our stakeholders. In so doing, we play a critical role in building a better working world for our people, for our clients and for our communities.

EY refers to the global organization, and may refer to one or more, of the member firms of Ernst & Young Global Limited, each of which is a separate legal entity. Ernst & Young Global Limited, a UK company limited by guarantee, does not provide services to clients. For more information about our organization, please visit ey.com.

Ernst & Young LLP is a client-serving member firm of Ernst & Young Global Limited operating in the US.

© 2018 Ernst & Young LLP.
All Rights Reserved.
SCORE no. BB1843
(Revised March 2018)

This and many of the publications produced by our US Professional Practice Group, are available free on AccountingLink at www.ey.com/us/accountinglink.

This material has been prepared for general informational purposes only and is not intended to be relied upon as accounting, tax, or other professional advice. Please refer to your advisors for specific advice.