



Financial Reporting Insights

REVENUE RECOGNITION FOR BUSINESS AND PROFESSIONAL SERVICES

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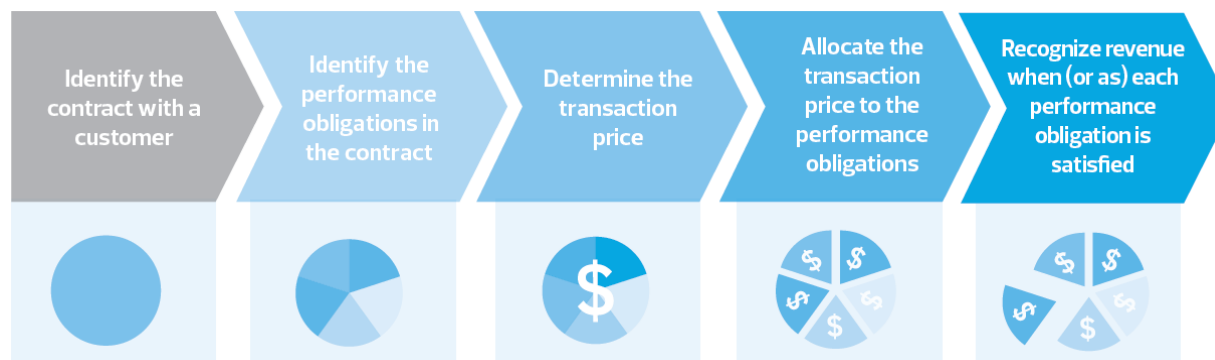
1. Introduction

In 2014, the Financial Accounting Standards Board (FASB) issued Accounting Standards Update (ASU) 2014-09, *Revenue from Contracts with Customers (Topic 606)* to provide a robust framework and comprehensive principles for addressing revenue recognition issues. Additionally, the guidance on accounting for certain costs related to a contract with a customer in the scope of ASC 606 was codified in ASC 340-40, *Other Assets and Deferred Costs – Contracts with Customers*.

While virtually all aspects of ASC 606 and ASC 340-40 are relevant to business and professional services (BPS) entities, this white paper highlights aspects of the guidance that are particularly pertinent for BPS entities that did not fall within the scope of technology or construction services related industry-specific guidance. For additional guidance on technology or construction services, refer to [Revenue recognition for construction contractors](#) and [Revenue recognition in the technology industry](#). For additional information about all of the revenue recognition guidance, including those aspects discussed in this white paper, as well as numerous examples illustrating how to apply the guidance, refer to [our revenue recognition guide](#).

2. Core principle and key steps

To put the specific aspects of the revenue recognition guidance discussed in this white paper into proper context, it is important to know that the core principle included in the guidance (ASC 606-10-10-2) is to “recognize revenue to depict the transfer of promised goods or services to customers in an amount that reflects the consideration to which the entity expects to be entitled in exchange for those goods or services.” In addition, the guidance sets out the following steps for an entity to follow when applying the core principle to its revenue-generating transactions:



3. Step 1: Identifying the contract with a customer

A contract is defined in ASC 606-10-25-2 as “an agreement between two or more parties that creates enforceable rights and obligations.” To account for a contract in accordance with the guidance, the following five contract existence criteria must be met:

- Approvals have been obtained and a commitment to perform exists on the part of both parties
- Rights of both parties are identifiable
- Payment terms are identifiable
- Commercial substance exists
- Collection of substantially all of the amount to which the entity will be entitled in exchange for the goods or services that will be transferred to the customer is probable (i.e., likely to occur)

Most BPS entities enter into written contracts in which the criteria for contract existence are clearly evidenced within the contract terms. The one criterion which is most likely to require additional judgment is whether collection of substantially all of the amount to which the entity will be entitled in exchange for the goods or services that will be transferred to the customer is probable. Making this determination is partly forward looking and requires consideration of all the relevant facts and circumstances, which include contractual terms as well as the entity's customary business practices and knowledge of the customer.

When all of the contract existence criteria are met, the remaining steps in the five-step revenue recognition model are applied to the contract. When all of the contract existence criteria are not met, revenue is deferred and the contract existence criteria continue to be evaluated to determine whether they are subsequently met. Absent meeting the contract existence criteria, revenue is only recognized under very limited circumstances, which could result in the initial deferral of revenue for what may be a significant period of time, even if nonrefundable cash has been received.

3.1 Accounting for contract modifications

Certain service providers commonly enter into multiyear contracts with customers. It is not uncommon for many of these contracts to be modified at some point over the duration. For example, a five-year contract for transaction processing services may be modified by the service provider and its customer to incorporate an additional transaction stream that the customer wants the service provider to process. A comprehensive model is provided in the guidance related to accounting for contract modifications. This model depends on a number of factors, including the pricing of the modification, whether any new goods or services added by the modification are distinct, and whether any of the remaining goods or services are part of a partially satisfied single performance obligation. Following this guidance could result in accounting for a contract modification as any of the following depending on the facts and circumstances: (a) a separate contract, (b) the termination of one contract and execution of a new contract (which results in prospective treatment) or (c) part of the original contract (which could result in recognition of a cumulative catch-up adjustment). Consider the following example.



Example 3-1: Accounting for a contract modification that increases the term of a services contract and reduces the price per year (ASC 606-10-55-125 to 55-128)

An entity enters into a three-year contract to clean a customer's offices on a weekly basis. The customer promises to pay \$100,000 per year. The standalone selling price of the services at contract inception is \$100,000 per year. The entity recognizes revenue of \$100,000 per year during the first 2 years of providing services. At the end of the second year, the contract is modified and the fee for the third year is reduced to \$80,000. In addition, the customer agrees to extend the contract for 3 additional years for consideration of \$200,000 payable in 3 equal annual installments of \$66,667 at the beginning of years 4, 5, and 6. The standalone selling price of the services for years 4 through 6 at the beginning of the third year is \$80,000 per year. The entity's standalone selling price at the beginning of the third year, multiplied by the additional 3 years of services, is \$240,000, which is deemed to be an appropriate estimate of the standalone selling price of the multiyear contract.

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

At the date of the modification, the entity assesses the additional services to be provided and concludes that they are distinct. However, the price change does not reflect the standalone selling price.

Consequently, the entity accounts for the modification in accordance with paragraph 606-10-25-13(a) as if it were a termination of the original contract and the creation of a new contract with consideration of \$280,000 for 4 years of cleaning service. The entity recognizes revenue of \$70,000 per year ($\$280,000 \div 4$ years) as the services are provided over the remaining 4 years.

4. Step 2: Identifying performance obligations in the contract

Contracts with customers for BPS often include promises to provide multiple services. For example, the services provided by an executive recruiting firm may include interviewing candidates and performing background checks. In these situations, the BPS entity must identify the units of account. In other words, the BPS entity must determine whether (a) all of the services it provides to a customer should be accounted for as one unit of account or (b) one or more of the services it provides to the customer should be accounted for separately. There are generally two steps a BPS entity must perform when identifying the units of account in a customer contract:

- *Identifying all of the promises to provide services.* Detailed guidance on identifying all of the promised goods or services in a customer contract is provided in Section 6.1 of [our revenue recognition guide](#).
- *Determining whether the promised goods or services that will be transferred should each be considered performance obligations and accounted for separately.* The determining factor in this analysis is whether each promised good or service is distinct. A promised good or service is considered distinct if it meets both of the following criteria: (a) it is capable of being distinct and (b) it is distinct within the context of the contract. A promised good or service that is considered distinct is accounted for separately as a performance obligation unless the series exception applies (see [Section 4.3](#)).

4.1 Promised goods or services that are immaterial in the context of the contract

A BPS entity may choose not to identify for further evaluation under ASC 606 those promised goods or services that are immaterial in the context of the contract. However, if the BPS entity chooses not to identify such promised goods or services for further evaluation, the costs related to the goods or services that are immaterial in the context of the contract should be accrued if revenue related to the performance obligation in which those goods or services are included is recognized before those goods or services are transferred to the customer. In addition, a BPS entity should consistently apply this election to contracts with similar promised goods or services in similar circumstances.

A BPS entity's decision to not identify promised goods or services that are immaterial in the context of the contract for further evaluation under ASC 606 does not change the requirements in ASC 606 to evaluate optional goods or services to determine whether they represent a material right to the customer (see [Section 4.2](#)).

If a BPS entity elects to treat a promised good or service as immaterial in the context of the contract, it should document the evaluation performed in arriving at a conclusion that the promised good or service is immaterial in the context of the contract. This evaluation should consider whether the promises are either quantitatively or qualitatively material to the customer. Because the guidance indicates that the promised good or service must be immaterial in the context of the contract to not be identified for further evaluation under ASC 606, the BPS entity is not required to aggregate the promised goods or services that are immaterial in the context of the related contracts for purposes of evaluating whether those promised goods or services are material as a whole to the financial statements.

4.2 Customer options for additional goods or services

As part of a contract, a BPS entity may provide its customer with options for additional goods or services, such as a contract renewal right that can be exercised in the future.

If an option provides a material right to the customer that the customer would not have received without entering into the contract with the BPS entity, the option itself is a performance obligation. In other words: (a) the goods or services that would be provided to the customer if the option were exercised are not identified as promised goods or services or performance obligations and (b) the transaction price does not include the amounts to which the BPS entity would expect to be entitled in exchange for transferring control of any promised goods or services the customer elects to purchase upon exercising the option.

4.2.1. Contract renewal and contract termination rights

A contract renewal right is an option that should be evaluated under ASC 606 to determine whether it provides the customer with a material right that should be accounted for as a performance obligation. Depending on the facts and circumstances, contract termination rights may provide a customer with what is essentially a contract renewal right that also should be evaluated under ASC 606 to determine whether it provides the customer with a material right that should be accounted for as a performance obligation.

As discussed in Section 5.3.2 of [our revenue recognition guide](#), the contract term for purposes of ASC 606 should include the period subject to an enforceable termination right if exercising that right results in a substantive termination penalty or other substantive required payment. When a termination penalty or other required payment upon termination of the contract is not substantive (or is nonexistent), the period subject to the enforceable termination right is not included in the contract term for purposes of ASC 606. Instead, the BPS entity should evaluate the contract as one with a contract renewal right. In essence, requiring no or a nonsubstantive termination penalty or other required payment upon exercising a termination right turns that termination right into a renewal right for accounting purposes.

Consider a situation in which a BPS entity enters into a three-year contract that provides the customer with the option to terminate the contract after two years without having to pay any termination penalty. This situation is economically the same as the BPS entity entering into a two-year contract that provides the customer with an option to renew the contract for an additional year. To reflect this economic substance in the accounting for the contract, the BPS entity's accounting for the contract should reflect a two-year term and a renewal option for a third year that should be evaluated to determine whether it provides the customer with a material right that should be accounted for as a performance obligation.



Example 4-1: Determining whether contract renewal rights (resulting from termination rights) provide the customer with a material right when the entity makes an upfront nonrefundable payment to the customer (Question 21 of [FASB's Revenue Recognition Implementation Q&As](#))

Example 2

A vendor enters into a five-year contract to provide a service to a customer with payments due monthly (assume collection is probable and pricing reflects standalone selling price throughout the contract term). To secure the contract, the vendor makes an upfront payment to the customer. Contractually, the customer has the right to terminate the contract at any time with 30 days of notice without penalty. The vendor does not have the right to terminate the contract. Most customers do not terminate the contract, in part because of the time and effort required for set-up on the vendor's system and the cost that would be incurred to change vendors.

The contract is a month-to-month contract because the termination clause is akin to a renewal right. Because the prices charged for each month are at the standalone selling price there is no material right.

The upfront payment made to the customer by the vendor does not affect the analysis of the material right because the failure to renew does not affect the customer's ability to retain the payment from the vendor and, therefore, would not be considered a penalty. As such, only the future options are considered and paragraph 606-10-55-43 clarifies that even if the contract provides a right to exercise an option because of a present contract, that option is considered a marketing offer if there is not a material right.



Example 4-2: Evaluating whether a nonrefundable upfront fee and contract renewal right result in an option that provides the customer with a material right (Question 13 of [FASB's Revenue Recognition Implementation Q&As](#))

Example 2 - Nonrefundable upfront fee

Entity A and Customer Y enter into a 12-month service contract for \$60 per month. All customers are required to agree to a 12-month contract. In addition to the monthly fee, Customer Y also must pay a \$120 nonrefundable fee at contract inception. The upfront fee is not considered to transfer a promised good or service. Customer Y will only pay the \$120 fee once as long as it continuously remains a customer of Entity A. Entity A's customers have multiple service providers available to them in their geographic area. While monthly service fees are similar throughout the geographic area, some of those service providers do not charge customers upfront fees to initiate services for customers who are existing customers of a competitor.

The contract also contains a renewal option that allows Customer Y to renew the contract on a month-to-month basis. The contract does not stipulate the renewal price, but Entity A does not operate in a volatile industry and service rates have historically remained relatively stable (that is, the monthly fee is not expected to significantly increase or decrease). As a practical alternative to estimating the standalone selling price of the renewal option, Entity A evaluates the renewal option by reference to the services provided (in accordance with paragraph 606-10-55-45).

Entity A would evaluate the quantitative factors based on an evaluation of whether its customers receive a material right with respect to renewal of the services because they do not have to pay an additional \$120 upfront fee at the beginning of the renewal period. In this case, Entity A would consider whether the renewal price that Customer Y will pay (that is, \$60/month) compared with the allocated price that a new customer would pay for the same services ($\$120/12 = \$10 + \$60/\text{month fee} = \70) provides the customer with a material right. Entity A would also consider qualitative factors such as the availability and pricing of service alternatives. For example, Entity A might consider the fact that after the one-year fixed term, Customer Y could get substantially similar services from one of Entity A's competitors at the same price as it would receive those services from Entity A (that is, \$60/month). This might call into question whether the option to renew Entity A's services at \$60/month provides Customer Y with a material right that it would not have received without entering into the initial services contract with Entity A.



RSM COMMENTARY: This example illustrates that the entity should take into consideration more than just quantitative information when evaluating whether payment of an upfront nonrefundable fee together with the contract renewal right provides the customer with a material right. In other words, it also should consider qualitative information, such as whether its competitors charge an upfront nonrefundable fee. [Example 6-28](#) in [our revenue recognition guide](#) illustrates how to account for a contract renewal right that includes an option that provides the customer with a material right. Section 7.1.2 [our revenue recognition guide](#) discusses the accounting for nonrefundable upfront fees.

4.3 The series exception

A series of distinct promised goods or services that are substantially the same *should* be considered a single performance obligation and accounted for as one unit of account if each of the goods or services has the same pattern of transfer to the customer as a result of (a) each of the goods or services otherwise being considered satisfied over time (see [Chapter 7](#)) and (b) the BPS entity otherwise having to use the same method of measuring progress toward complete satisfaction of each good or service. This exception commonly is referred to as the series exception. The series exception is common among providers of BPS, as most services are satisfied over time, with each period of service being distinct, and revenue often is recognized using a time-based measure of progress for each period. Examples of the types of contracts that may, depending on the facts and circumstances, fall under this exception are long-term contracts for hotel management services, transaction processing services and asset management services. Consider the following example.



Example 4-3: Identifying the performance obligations in a contract that includes a series of distinct goods or services related to providing hotel management services (ASC 606-10-55-157B to 55-157E)

An entity, a hotel manager, enters into a contract with a customer to manage a customer-owned property for 20 years. The entity receives consideration monthly that is equal to 1 percent of the revenue from the customer-owned property.

The entity evaluates the nature of its promise to the customer in this contract and determines that its promise is to provide a hotel management service. The service comprises various activities that may vary each day (for example, cleaning services, reservation services, and property maintenance). However, those tasks are activities to fulfill the hotel management service and are not separate promises in the contract. The entity determines that each increment of the promised service (for example, each day of the management service) is distinct in accordance with paragraph 606-10-25-19. This is because the customer can benefit from each increment of service on its own (that is, it is capable of being distinct) and each increment of service is separately identifiable because no day of service significantly modifies or customizes another and no day of service significantly affects either the entity's ability to fulfill another day of service or the benefit to the customer of another day of service.

The entity also evaluates whether it is providing a series of distinct goods or services in accordance with paragraphs 606-10-25-14 through 25-15. First, the entity determines that the services provided each day are substantially the same. This is because the nature of the entity's promise is the same each day and the entity is providing the same overall management service each day (although the underlying tasks or activities the entity performs to provide that service may vary from day to day). The entity then determines that the services have the same pattern of transfer to the customer because both criteria in paragraph 606-10-25-15 are met. The entity determines that the criterion in paragraph 606-10-25-15(a) is met because each distinct service meets the criteria in paragraph 606-10-25-27 to be a performance obligation satisfied over time. The customer simultaneously receives and consumes the benefits provided by the entity as it performs. The entity determines that the criterion in paragraph 606-10-25-15(b) also is met because the same measure of progress (in this case, a time-based output method) would be used to measure the entity's progress toward satisfying its promise to provide the hotel management service each day.

After determining that the entity is providing a series of distinct daily hotel management services over the 20-year management period, the entity next determines the transaction price. The entity determines that the entire amount of the consideration is variable consideration. The entity considers whether the variable consideration may be allocated to one or more, but not all, of the distinct days of service in the series in accordance with paragraph 606-10-32-39(b). The entity evaluates the criteria in paragraph 606-10-32-40 and determines that the terms of the variable consideration relate specifically to the entity's efforts to

transfer each distinct daily service and that allocation of the variable consideration earned based on the activities performed by the entity each day to the distinct day in which those activities are performed is consistent with the overall allocation objective. Therefore, as each distinct daily service is completed, the variable consideration allocated to that period may be recognized, subject to the constraint on variable consideration.



RSM COMMENTARY: Determining whether distinct services are substantially the same is discussed in Question 6Q.3.6 of [our revenue recognition guide](#).

4.4 Stand-ready obligations

Some service provider contracts include a promise to stand ready to provide goods or services or to make goods or services available for a customer to use as and when the customer decides. This type of promise is known as a stand-ready obligation. The customer benefits from a stand-ready obligation in that it obtains assurance that a good or service will be provided to it when needed or desired.

ASC 606-10-25-18(e) lists the following as an example of a promised good or service that could be included in a contract: “Providing a service of standing ready to provide goods or services (for example, unspecified updates to software that are provided on a when-and-if-available basis) or of making goods or services available for a customer to use as and when the customer decides.”

As per [Question 22 of FASB's Revenue Recognition Implementation Q&As](#), the FASB staff identified the following four types of stand-ready obligations, the first three of which were not explicitly addressed as stand-ready obligations in ASC 606.

Type	Nature	Example
A	The entity controls delivery of the good, service or intellectual property (IP) that is subject to the stand-ready obligation.	A when-and-if-available software upgrade right, because the entity must complete the upgrade before it can be delivered
B	Neither the entity nor the customer controls delivery of the good, service or IP that is subject to the stand-ready obligation.	Snow removal services on an as-needed basis, because neither the entity nor the customer control when or how much it will snow
C	The customer controls delivery of the good, service or IP that is subject to the stand-ready obligation.	Periodic equipment maintenance that will be provided after the customer reaches specific usage thresholds
D	The entity makes the good, service or IP that is subject to the stand-ready obligation continuously available to the customer.	Annual health club membership

A key question the BPS entity should consider in determining whether a contract includes a stand-ready obligation is whether the type or quantity of services the BPS entity will provide is known (or specified) or unknown (or unspecified). When the type or quantity of services the BPS entity will provide is unknown or unspecified, that is a strong indication that the nature of the promised good or service is a stand-ready obligation. Consider the following examples:

**Example 4-4: Determining whether a stand-ready obligation exists**

Example	Does a stand-ready obligation exist?
Promise to transfer unspecified software upgrade rights over the contract term	Yes, this is a Type A stand-ready obligation because the BPS entity controls delivery of the upgrade rights and likely does not know the nature or quantity of software upgrades it will be obligated to provide to the customer over the contract term.
Promise to transfer a particular upgrade right that is not specified in the contract, but that the customer expects to receive because: (a) the customer is entitled to when-and-if-available software upgrades and (b) the BPS entity made the customer aware of the nearly completed upgrade during the sales process	No, the implicit promise to transfer the specific upgrade right is not a stand-ready obligation; however, it is a promised good or service that should be evaluated to determine whether it is a performance obligation.
Promise to provide snow removal services over the contract term	Yes, this is a Type B stand-ready obligation because neither the entity nor the customer controls the timing or extent of the snow removal services the entity will be obligated to provide to the customer over the contract term.
Promise to provide printer repair services over the contract term on an as-needed basis	Yes, this is a Type C stand-ready obligation because the customer (and not the entity) controls when the repair services will be provided during the contract term, resulting in the entity not knowing the specific type or quantity of repair services it will be obligated to provide over the contract term.
Promise to provide regular printer maintenance services (i.e., regular tune ups) every four months over the contract term	No, this is not a stand-ready obligation because the BPS entity knows that it will go to the customer's site every four months to perform regular printer maintenance.
Promise to continuously make the health club available during normal operating hours for the member's use over the membership period	Yes, this is a Type D stand-ready obligation because the BPS entity does not know when or how often the member will use the health club it is obligated to continuously make available to the member over the membership period.
Promise to provide 10 spin classes over a one-year period	No, this is not a stand-ready obligation because the BPS entity knows it is obligated to provide the customer with a defined number of spin classes.

Promise to provide extended warranty services on an as-needed basis over the contract term	Yes, this is a Type C stand-ready obligation because the customer (and not the BPS entity) controls when the warranty services will be provided during the contract term, resulting in the BPS entity not knowing the nature or extent of the goods or services it will be obligated to provide in remediating the warranty issues that arise over the contract term.
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Other questions the BPS entity should consider in determining whether a contract includes a stand-ready obligation include the following:

- *Is the nature of the BPS entity's obligation affected by the extent to which the customer calls on the entity to provide goods or services under the contract?* If not, that would indicate that the nature of the BPS entity's obligation is to stand ready. For example, the nature of a stand-ready obligation to provide a member with continuous access to a health club is not affected by whether the customer uses the health club every day or never.
- *Is the customer obligated to pay the BPS entity regardless of whether it uses the services the entity is obligated to provide on an as-needed or as-desired basis?* If so, that would indicate that the nature of the BPS entity's obligation is to stand ready. For example, if a customer is obligated to pay the BPS entity for printer maintenance services even if it never calls upon the BPS entity to provide such services, this would be indicative of a stand-ready obligation.

If one of the promised goods or services in a contract is a stand-ready obligation, the BPS entity would need to evaluate that stand-ready obligation to determine whether it is a performance obligation that should be accounted for separately. Recognizing revenue for a stand-ready obligation that is a performance obligation is discussed in [Section 7.1](#).

5. Step 3: Determining the transaction price

5.1 General requirements for determining the transaction price

Transaction price is defined in ASC 606-10-32-2 as “the amount of consideration to which an entity expects to be entitled in exchange for transferring promised goods or services to a customer, excluding amounts collected on behalf of third parties (for example, some sales taxes).” A BPS entity may elect an accounting policy under which it excludes from the transaction price taxes it collects from its customers that were assessed by a government authority on (or contemporaneous with) the BPS entity's revenue-generating transactions with its customers. Examples of taxes to which this accounting policy would apply if elected are sales taxes, use taxes, value-added taxes, excise taxes and other similar taxes. Examples of taxes to which this accounting policy would not apply if elected are gross receipts taxes and taxes imposed during the inventory procurement process.

If a BPS entity elects this accounting policy, it must apply the policy to all sales and similar taxes. In other words, a BPS entity cannot choose to apply the policy to some sales and similar taxes and not apply the policy to other sales and similar taxes. In addition, if the BPS entity elects the accounting policy, the accounting policy disclosure requirements in ASC 235 apply.

If a BPS entity does not elect the accounting policy, it must determine whether it is a principal or an agent with respect to each sale or similar tax assessed on its revenue-generating transactions. If it is a principal, the sales or similar tax is included in the transaction price. If it is an agent, the sales or similar tax is not

included in the transaction price. Making the determination as to whether the BPS entity is a principal or an agent with respect to each sale or similar tax in every tax jurisdiction in which its revenue-generating transactions are subject to such taxes could be a very onerous exercise. It is for this reason that the FASB provided the option to elect an alternative accounting policy.

5.2 Nonrefundable upfront fees

In general, a nonrefundable upfront fee is only recognized as revenue upfront if it relates to a good or service that is a performance obligation that is satisfied upfront. The facts and circumstances that are necessary for that accounting result, as well as the other potential accounting results for nonrefundable upfront fees, are illustrated in detail in the flowchart in Chapter 7 of [our revenue recognition guide](#).

The timing of when a nonrefundable upfront fee should be recognized (whether upfront or otherwise) depends on the nature of the performance obligations in the contract. If one of those performance obligations is a contract renewal option that provides the customer with a material right (see [Section 4.2](#)), the period over which (or in which) the upfront nonrefundable fee is recognized could extend beyond the contract term as determined for purposes of applying ASC 606. In addition, the presence of a nonrefundable upfront fee can, in certain circumstances, lead to a conclusion that a contract renewal option provides the customer with a material right that it would not have received without entering into the contract with the customer. Consider the following examples.



Example 5-1: Accounting for a nonrefundable upfront activation fee and a contract renewal right (Question 52 of [FASB's Revenue Recognition Implementation Q&As](#))

Entity charges a \$50 one-time activation fee and agrees to provide Customer with services on a month-to-month basis at a price of \$100 per month. Customer is under no obligation to continue to purchase the monthly service and Entity has not committed to any pricing levels for the service in future months. Because the activity of signing up Customer for service does not result in the transfer of a good or service, it does not represent an additional promised service. Rather, the activation fee is an advance payment for Entity's services and should, therefore, be deferred and recognized as the future service is provided. Entity's average customer life is two years.

The period over which the activation fee will be recognized depends on whether the activation fee provides the customer with a material right with respect to renewing Entity's services. When determining whether a nonrefundable upfront fee provides a material right, Entity would consider both quantitative and qualitative factors. For example, Entity would consider whether the renewal price that Customer will pay (that is, \$100 per month) compared with the price that a new customer would pay for the same service (that is, \$150, consisting of a \$50 activation fee and \$100 monthly service) provides Customer with a material right. Entity also would consider the availability and pricing of service alternatives (for example, whether Customer could obtain substantially equivalent services from another provider without paying the activation fee). Entity's average customer life also might be an indication of whether the activation fee provides a material right. That is, an average customer life that extends well beyond the one-month contractual period might be an indication that the activation fee incentivizes Entity's customers to continue services because those customers would not incur an activation fee that they may otherwise incur if they switch service providers.

If Entity concludes that the activation fee provides a material right, the fee would be recognized over the service periods during which Customer is expected to benefit from not having to pay an activation fee upon renewal of service. Determining the expected period of benefit often will require judgment.

Conversely, if Entity concludes that the activation fee does not provide the customer with a material right, the activation fee is, in effect, an advance payment solely on the contracted services (for example, the one-month contract term). Consequently, Entity would recognize the transaction price (that is, \$150

comprised of the service and activation fees) as revenue as those services are provided in accordance with paragraph 606-10-55-51.



Example 5-2: Accounting for an upfront nonrefundable fee related to setup activities (ASC 606-10-55-358 to 55-360)

An entity enters into a contract with a customer for one year of transaction processing services. The entity's contracts have standard terms that are the same for all customers. The contract requires the customer to pay an upfront fee to set up the customer on the entity's systems and processes. The fee is a nominal amount and is nonrefundable. The customer can renew the contract each year without paying an additional fee.

The entity's setup activities do not transfer a good or service to the customer and, therefore, do not give rise to a performance obligation.

The entity concludes that the renewal option does not provide a material right to the customer that it would not receive without entering into that contract (see paragraph 606-10-55-42). The upfront fee is, in effect, an advance payment for the future transaction processing services. Consequently, the entity determines the transaction price, which includes the nonrefundable upfront fee, and recognizes revenue for the transaction processing services as those services are provided in accordance with paragraph 606-10-55-51.



RSM COMMENTARY: Because the nonrefundable upfront fee relates to activities performed upfront that do not, in and of themselves, represent a promised good or service, the nonrefundable upfront fee represents an advance payment for the transaction processing services, which is the only performance obligation in the contract, given that the contract renewal option does not provide the customer with a material right. As a result, the nonrefundable upfront fee is recognized as revenue over the contract term as control of the transaction processing services is transferred to the customer.

5.3 Accounting for variable consideration

The transaction price should reflect the amount to which the BPS entity expects to be entitled in exchange for transferring promised goods or services to a customer, which often includes variable consideration. Common forms of variable consideration include early payment discounts, rebates, price concessions and incentive payments. Variability in the amount of consideration to which the BPS entity is entitled may be caused by explicit terms in the contract, or it may be caused by an implicit price concession, discount, refund or credit the entity intends to offer the customer or the customer has a valid expectation to receive based on the BPS entity's customary business practices, published policies or specific statements.

There are certain scenarios in which an entity may not be required to estimate variable consideration as follows:

- An entity provides a series of distinct good or services for which the variable payments relate specifically to the entity's efforts to transfer each distinct good or service within the series (see Section 8.3.2.1 5 of our revenue recognition guide)
- An entity is entitled to sales- or usage-based royalties and the only, or predominant, item to which the royalty relates is the license of IP (see Section 7.3.5 of our revenue recognition guide)

- An entity elects to apply the practical expedient that allows revenue to be recognized for the amount the entity has a right to invoice (see Section 9.3.1.1 of our revenue recognition guide)

Outside of these exceptions, an estimate of the variable consideration to which a BPS entity expects to be entitled should be included in the transaction price to the extent it is probable that its inclusion will not result in a significant reversal of cumulative revenue recognized when the uncertainty giving rise to the variability is resolved. This approach to determining the amount of variable consideration that a BPS entity should include in the transaction price suggests the following two steps should be performed:

1. Estimate the amount of variable consideration to which the BPS entity expects to be entitled using either the expected value method or the most likely amount method (the specific method used depends on which will better predict the amount of variable consideration in a particular set of facts and circumstances).
2. Constrain the estimated amount of variable consideration such that it is probable that the inclusion of the estimate in the transaction price will not result in a significant reversal of cumulative revenue recognized for the contract when the uncertainty giving rise to the variability is resolved.

Determining whether the BPS entity's process for estimating "variable consideration already incorporates the principles on which the guidance for constraining estimates of variable consideration is based" will require significant judgment to be exercised and careful consideration of all the facts and circumstances.

The following are factors that may (depending on the likelihood and magnitude) increase the probability of the BPS entity experiencing a significant reversal in cumulative revenue recognized upon resolution of the uncertainty giving rise to the variability in the amount the customer ultimately will be obligated to pay:

- The amount of consideration is highly susceptible to market volatility, the judgments or actions of others, weather conditions or other factors outside the BPS entity's control or influence.
- The period of time until the uncertainty is resolved is long.
- The BPS entity has limited experience with or information about similar contracts.
- The BPS entity's experience with or information about similar contracts has limited predictive value.
- The BPS entity has a history of offering a broad range of price concessions in similar situations.
- The BPS entity has a history of changing payment terms or conditions in similar situations.
- The number of possible amounts the customer ultimately could be required to pay is large, and those amounts fall across a broad range.

The more of these factors that exist in a particular situation, the more likely it is that the BPS entity's estimate of variable consideration should be constrained.

Determining whether the BPS entity's estimate of variable consideration should be constrained will require significant judgment to be exercised and careful consideration of all the facts and circumstances.

The estimate of variable consideration must be reassessed each reporting period until the underlying uncertainty is resolved. Any changes in the estimate of variable consideration are treated the same as any other changes in the transaction price. The method used to initially estimate the variable consideration included in the transaction price also should be used when the estimate is reassessed each reporting period.

5.3.1 Accounting for incentive payments

Contracts with BPS customers often include variable consideration in the form of an incentive payment. For example, the fees paid to a consulting firm may include an amount that is payable only if the

consulting firm finishes providing the promised services by a particular date. An estimate of the amount of variable consideration to which the BPS entity expects to be entitled will be included in the transaction price, subject to a constraint that limits the variable consideration to the amount for which it is probable that a significant reversal in cumulative revenue recognized will not occur. Even with this constraint, earlier recognition of variable consideration is still expected to occur in many cases. To properly account for variable consideration, service providers that include such consideration in their customer contracts should carefully evaluate the nature of the underlying contingency and the likelihood of the contingency's potential outcomes occurring.

5.3.2 Price matching and price protection

Some contracts include clauses in which the price paid by a customer for services will be reduced retroactively if a BPS entity's competitor sells the same services at a lower price within a specified future time period ("price matching") or the entity itself sells the same services to another customer at a lower price within a specified future time period ("price protection"). In both of these situations, the BPS entity would be obligated to refund the excess amount charged to the customer for these services or provide them a credit equal to this amount. These potential refunds and credits must be accounted for as variable consideration because it is uncertain whether the BPS entity will have to provide the refund (and hence adjust the transaction price) on prior purchases given that it is contingent on a future pricing decision made by the entity or a competitor.

6. Step 4: Allocating the transaction price to the performance obligations

6.1 Overall allocation model

Step 4 of the five-step revenue recognition model in ASC 606 requires a BPS entity to allocate the transaction price (determined in Step 3) to each performance obligation in the contract (identified in Step 2).

The overall objective of the guidance on allocating the transaction price is to allocate an amount to each performance obligation (or distinct good or service in a single performance obligation resulting from the series exception [refer to Section 6.3 of [our revenue recognition guide](#)]) that represents the consideration to which the BPS entity expects to be entitled as a result of transferring control of the underlying goods or services to the customer.

If a contract has more than one performance obligation, the transaction price generally should be allocated to each performance obligation based on the standalone selling prices of each performance obligation in relation to the total of those standalone selling prices (i.e., on a relative standalone selling price basis). Exceptions are provided for certain situations involving discounts or variable consideration that can be shown (by meeting certain criteria) to be related to one or more (but less than all) performance obligations. In addition, a contract with one performance obligation also may be affected by the guidance on allocating variable consideration when that one performance obligation is made up of a series of distinct goods or services that are treated as a single performance obligation under the series exception ([Section 4.3](#)).

6.2 Standalone selling prices

The standalone selling price of a performance obligation is the amount the BPS entity charges (or would charge) when the distinct goods or services that make up the performance obligation (i.e., the underlying distinct goods or services) are sold on their own to a customer. Standalone selling prices are determined at contract inception and are not subsequently adjusted for changes in facts and circumstances.

The best evidence of the standalone selling price of the underlying goods or services is the observable price charged by the BPS entity for those goods or services when they are sold separately in similar circumstances to similar customers. Absent evidence of a directly observable standalone selling price, the BPS entity is required to estimate a standalone selling price. In making this estimate, the BPS entity should maximize observable inputs and consider all reasonably available and relevant information, which includes information specific to the entity, the market, the customer and the customer class. In addition, a BPS entity should be consistent in how it applies an estimation method and the situations in which it applies an estimation method.

Whether the contract price or list price for a good or service represents the good's or service's standalone selling price depends on the facts and circumstances. There is no presumption that the contract price or list price for a good or service represents its standalone selling price, nor is there a presumption that the contract price or list price for the good or service does not represent its standalone selling price.

If the contract price or list price for a good or service is different from the observable price charged by the BPS entity for that good or service when it is sold separately in similar circumstances to similar customers, the contract price or list price does not represent the good's or service's standalone selling price because the observable price (to the extent one exists) should be used as the standalone selling price.

When an observable standalone selling price does not exist, the contract price or list price for a good or service is one data point that should be considered by the BPS entity in addition to other data points (such as the standalone selling price for the good or service estimated using the adjusted market assessment approach or the expected cost plus a margin approach). Only after considering all reasonably available and relevant data points will a BPS entity know if the contract price or list price for a good or service represents the good's or service's standalone selling price. Question 8Q.2.3 in our revenue recognition guide discusses other data points that may be considered by a BPS entity when an observable standalone selling price does not exist.

6.3 Allocating variable consideration to a series of distinct goods or services

ASC 606 provides an exception to the requirement to allocate variable consideration on a proportionate basis to each distinct good or service in a single performance obligation resulting from the application of the series exception. The exception applies variable consideration included in the transaction price should be allocated on a proportionate basis to each of the performance obligations in a contract, except when the following two criteria are met:

- The terms of the variable payment are specifically related to the BPS entity's efforts to: (a) satisfy, or achieve a specific outcome from satisfying, a specific performance obligation or (b) transfer, or achieve a specific outcome from transferring, a distinct good or service in a single performance obligation resulting from application of the series exception.
- Allocating the variable payment to the specific performance obligation, or distinct good or service in a single performance obligation resulting from the series exception, depicts the amount of consideration to which the BPS entity expects to be entitled in exchange for transferring that good or service to the customer when considering all of the performance obligations and payment terms in the contract.

When these criteria are met, the variable payment included in the transaction price that meets these criteria, and any change in the estimate of that payment, should be allocated in its entirety to the specific performance obligation or distinct good or service to which the variable payment relates.

The remaining transaction price is allocated as it otherwise would be under ASC 606 (i.e., allocated on a relative standalone selling price basis unless the discount exception applies [which is discussed in Section 8.3.1 of our revenue recognition guide]). For example, for a service provider that charges a fee calculated based on the number of hours of service provided each month, if the variable fee relates specifically to the BPS entity's efforts to transfer the distinct increments of service for a specific month, the

BPS entity should allocate the variable fee to the distinct increments of service provided during that month.

When variable consideration is allocated entirely to a distinct good or service that forms part of a series, a BPS entity is not required to estimate that variable consideration since the amount would become known at the same time the distinct good or service is transferred to the customer and revenue is recognized.



Example 6-1: Allocating the transaction price when there is variable consideration and a single performance obligation consisting of distinct goods or services resulting from the series exception (ASC 606-10-55-157B to 55-157E)

An entity, a hotel manager, enters into a contract with a customer to manage a customer-owned property for 20 years. The entity receives consideration monthly that is equal to 1 percent of the revenue from the customer-owned property.

The entity evaluates the nature of its promise to the customer in this contract and determines that its promise is to provide a hotel management service. The service comprises various activities that may vary each day (for example, cleaning services, reservation services, and property maintenance). However, those tasks are activities to fulfill the hotel management service and are not separate promises in the contract. The entity determines that each increment of the promised service (for example, each day of the management service) is distinct in accordance with paragraph 606-10-25-19. This is because the customer can benefit from each increment of service on its own (that is, it is capable of being distinct) and each increment of service is separately identifiable because no day of service significantly modifies or customizes another and no day of service significantly affects either the entity's ability to fulfill another day of service or the benefit to the customer of another day of service.

The entity also evaluates whether it is providing a series of distinct goods or services in accordance with paragraphs 606-10-25-14 through 25-15. First, the entity determines that the services provided each day are substantially the same. This is because the nature of the entity's promise is the same each day and the entity is providing the same overall management service each day (although the underlying tasks or activities the entity performs to provide that service may vary from day to day). The entity then determines that the services have the same pattern of transfer to the customer because both criteria in paragraph 606-10-25-15 are met. The entity determines that the criterion in paragraph 606-10-25-15(a) is met because each distinct service meets the criteria in paragraph 606-10-25-27 to be a performance obligation satisfied over time. The customer simultaneously receives and consumes the benefits provided by the entity as it performs. The entity determines that the criterion in paragraph 606-10-25-15(b) also is met because the same measure of progress (in this case, a time-based output method) would be used to measure the entity's progress toward satisfying its promise to provide the hotel management service each day.

After determining that the entity is providing a series of distinct daily hotel management services over the 20-year management period, the entity next determines the transaction price. The entity determines that the entire amount of the consideration is variable consideration. The entity considers whether the variable consideration may be allocated to one or more, but not all, of the distinct days of service in the series in accordance with paragraph 606-10-32-39(b). The entity evaluates the criteria in paragraph 606-10-32-40 and determines that the terms of the variable consideration relate specifically to the entity's efforts to transfer each distinct daily service and that allocation of the variable consideration earned based on the activities performed by the entity each day to the distinct day in which those activities are performed is consistent with the overall allocation objective. Therefore, as each distinct daily service is completed, the variable consideration allocated to that period may be recognized, subject to the constraint on variable consideration.



RSM COMMENTARY: This example illustrates one of the reasons why the FASB provided the series exception, which is discussed in Question 6Q.3.3 of [our revenue recognition guide](#). If the FASB had not provided this exception, the daily variable consideration would have to be estimated and then allocated to the single performance obligation as a whole and recognized over the contract term for the single performance obligation. Instead, because the exception applies, the daily variable consideration does not need to be estimated and instead is allocated to each distinct day of hotel management services and recognized on that day as control of the services transfers to the customer.

7. Step 5: Recognizing revenue when (or as) each performance obligation is satisfied

To properly assess when revenue should be recognized, a BPS entity must perform at contract inception an evaluation focused on whether a performance obligation is satisfied at a point in time (in which case revenue is recognized at the point in time control of the underlying goods or services is transferred to the customer) or over time (in which case revenue is recognized over time as control of the underlying goods or services is transferred to the customer). If a performance obligation meets one or more of the following criteria, it is considered satisfied over time:

- *Customer simultaneously receives and consumes benefits as the BPS entity performs.* A performance obligation is satisfied over time if the customer consumes the benefits of the BPS entity's performance at the same time as: (a) the customer receives those benefits and (b) the BPS entity performs and creates those benefits.
- *Customer controls the asset as the BPS entity creates or enhances the asset.* A performance obligation is satisfied over time if the customer controls the asset (which could be tangible or intangible) as it is created or enhanced by the BPS entity's performance.
- *No alternative use and an enforceable right to payment for performance to date.* A performance obligation is satisfied over time if: (a) the asset created by the BPS entity's performance does not have an alternative use to the entity upon its completion and (b) the BPS entity's right to payment for its performance to date is enforceable.

If a performance obligation does not meet any of the three criteria, it is considered satisfied at a point in time. In customer contracts for certain BPS (e.g., transaction processing services), the first or second criteria may be met, depending on the facts and circumstances. However, customer contracts for other BPS likely will not meet the first or second criteria, but may meet the third criterion, depending on the facts and circumstances. Consider, for example, a customer contract for consulting services in which a final report will be provided to the customer. In this example, it is unlikely that the first or second criteria are met because the customer likely consumes the benefits, or controls the output of the services, when it receives the service provider's report, which is after (and not as) the service provider performs. With respect to whether the third criterion is met in this example, the service provider's report likely will not have an alternative future use to the BPS entity because it is customer specific. While that part of the third criterion is met in this example, whether the other part, which requires the BPS entity to have an enforceable right to payment for services provided to date, is met will depend on the terms of the customer contract. As a result, whether customer contracts for BPS that do not meet the first or second criteria meet the third criterion often will depend on whether the service provider has an enforceable right to payment for services provided to date. If not, the performance obligation would be considered satisfied, and revenue recognized, at a point in time instead of over time.

In addition to determining whether a performance obligation is satisfied (and revenue is recognized) at a point in time or over time, detailed guidance is provided with respect to identifying: (a) the point in time control of a good or service transfers to the customer and (b) the manner or pattern in which control of a good or service transfers to a customer over time.

Consider the following example:



Example 7-1: Determining whether the customer simultaneously receives and consumes benefits as the entity provides it with payroll processing services (ASC 606-10-55-159 to 55-160)

An entity enters into a contract to provide monthly payroll processing services to a customer for one year.

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



RSM COMMENTARY: This example includes setup activities that would need to be undertaken by another entity to continue to provide payroll processing services. This is a practical limitation that should not be considered by the entity in determining whether the other entity could step in and fulfill the remaining payroll processing performance obligation without having to substantially reperform the work already performed by the entity.

7.1 Stand-ready obligations

Identifying stand-ready obligations in a contract and determining whether they are performance obligations is discussed in [Section 4.4](#). To the extent a stand-ready obligation exists and it is considered a performance obligation satisfied over time, the BPS entity must identify an appropriate method by which to measure progress toward its complete satisfaction.

The measure of progress for a stand-ready obligation should be based on its nature and what is required of the BPS entity to satisfy the obligation. While a time-based measure of progress may be appropriate for many stand-ready obligations, service providers should not assume a time-based measure of progress would be appropriate for all stand-ready obligations.

The following table includes examples of stand-ready obligations identified in [Example 4-4](#) and an indication as to whether a time-based method of measuring progress would be appropriate.

Example of stand-ready obligation	Would a time-based measure of progress be appropriate?
Promise to transfer unspecified software upgrade rights over the contract term	A time-based measure of progress generally would be appropriate because the stand-ready obligation is essentially a guarantee from which the customer benefits evenly over the period it is in effect.
Promise to provide snow removal services over the contract term	A time-based measure of progress is not appropriate because snow removal services are seasonal, which should be reflected in the measure of progress.
Promise to continuously make the health club available during normal operating hours for the member's use over the membership period	A time-based measure of progress is appropriate because the customer benefits from the health club being available for its use over the membership period, regardless of how much they use it.
Promise to provide printer repair services over the contract term on an as needed basis	If the BPS entity has no basis to expect that it will provide proportionately more printer repair services in certain time segments of the contract term compared to the other time segments in the contract term, a time-based measure of progress may be appropriate.

8. Principal vs. agent (i.e., gross vs. net)

The principal vs. agent guidance is only applied when another party (e.g., subcontractor, third-party service provider) is involved with the BPS entity in providing the specified services to the service provider's customer. When that is the case, the service provider must determine whether it should recognize revenue as a principal (i.e., gross) or an agent (i.e., net). Examples of services for which it is not uncommon for more than one party to be involved in providing the service to the customer include internet advertising, maintenance or cleaning services, and travel and ticket agency services.

While ASC 606 incorporates consideration of the following three indicators for determining whether a BPS entity is acting as a principal or an agent, its overall focus is on whether the BPS entity obtains control of the promised good or service before it is transferred to the customer. The three indicators included in ASC 606, as stated below, are only considered along with all relevant facts and circumstances if the control analysis is inconclusive.

- Is the BPS entity primarily responsible?
- Does the BPS entity have inventory risk?
- Does the BPS entity have pricing discretion?

Consider the following few examples:



Example 8-1: Determining whether the entity is acting as a principal or agent for office maintenance services (ASC 606-10-55-324A to 55-324G)

An entity enters into a contract with a customer to provide office maintenance services. The entity and the customer define and agree on the scope of the services and negotiate the price. The entity is responsible for ensuring that the services are performed in accordance with the terms and conditions in the contract. The entity invoices the customer for the agreed-upon price on a monthly basis with 10-day payment terms.

The entity regularly engages third-party service providers to provide office maintenance services to its customers. When the entity obtains a contract from a customer, the entity enters into a contract with one of those service providers, directing the service provider to perform office maintenance services for the customer. The payment terms in the contracts with the service providers generally are aligned with the payment terms in the entity's contracts with customers. However, the entity is obliged to pay the service provider even if the customer fails to pay.

To determine whether the entity is a principal or an agent, the entity identifies the specified good or service to be provided to the customer and assesses whether it controls that good or service before the good or service is transferred to the customer.

The entity observes that the specified services to be provided to the customer are the office maintenance services for which the customer contracted and that no other goods or services are promised to the customer. While the entity obtains a right to office maintenance services from the service provider after entering into the contract with the customer, that right is not transferred to the customer. That is, the entity retains the ability to direct the use of, and obtain substantially all the remaining benefits from, that right. For example, the entity can decide whether to direct the service provider to provide the office maintenance services for that customer, or for another customer, or at its own facilities. The customer does not have a right to direct the service provider to perform services that the entity has not agreed to provide. Therefore, the right to office maintenance services obtained by the entity from the service provider is not the specified good or service in its contract with the customer.

The entity concludes that it controls the specified services before they are provided to the customer. The entity obtains control of a right to office maintenance services after entering into the contract with the customer but before those services are provided to the customer. The terms of the entity's contract with the service provider give the entity the ability to direct the service provider to provide the specified services on the entity's behalf (see paragraph 606-10-55-37A(b)). In addition, the entity concludes that the following indicators in paragraph 606-10-55-39 provide further evidence that the entity controls the office maintenance services before they are provided to the customer:

- The entity is primarily responsible for fulfilling the promise to provide office maintenance services. Although the entity has hired a service provider to perform the services promised to the customer, it is the entity itself that is responsible for ensuring that the services are performed and are acceptable to the customer (that is, the entity is responsible for fulfilment of the promise in the contract, regardless of whether the entity performs the services itself or engages a third-party service provider to perform the services).
- The entity has discretion in setting the price for the services to the customer.

The entity observes that it does not commit itself to obtain the services from the service provider before obtaining the contract with the customer. Thus, the entity has mitigated its inventory risk with respect to the office maintenance services. Nonetheless, the entity concludes that it controls the office maintenance services before they are provided to the customer on the basis of the evidence in paragraph 606-10-55-324E.

Thus, the entity is a principal in the transaction and recognizes revenue in the amount of consideration to which it is entitled from the customer in exchange for the office maintenance services.



Example 8-2: Determining whether the entity is acting as a principal or agent for airline tickets (ASC 606-10-55-325 to 55-329)

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

The entity determines the prices at which the airline tickets will be sold to its customers. The entity sells the tickets and collects the consideration from customers when the tickets are purchased.

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

To determine whether the entity's performance obligation is to provide the specified goods or services itself (that is, the entity is a principal) or to arrange for those goods or services to be provided by another party (that is, the entity is an agent), the entity identifies the specified good or service to be provided to the customer and assesses whether it controls that good or service before the good or service is transferred to the customer.

The entity concludes that with each ticket that it commits itself to purchase from the airline, it obtains control of a right to fly on a specified flight (in the form of a ticket) that the entity then transfers to one of its customers (see paragraph 606-10-55-37A(a)). Consequently, the entity determines that the specified good or service to be provided to its customer is that right (to a seat on a specific flight) that the entity controls. The entity observes that no other goods or services are promised to the customer.

The entity controls the right to each flight before it transfers that specified right to one of its customers because the entity has the ability to direct the use of that right by deciding whether to use the ticket to fulfill a contract with a customer and, if so, which contract it will fulfill. The entity also has the ability to obtain the remaining benefits from that right by either reselling the ticket and obtaining all of the proceeds from the sale or, alternatively, using the ticket itself.

The indicators in paragraph 606-10-55-39(b) through (c) also provide relevant evidence that the entity controls each specified right (ticket) before it is transferred to the customer. The entity has inventory risk with respect to the ticket because the entity committed itself to obtain the ticket from the airline before obtaining a contract with a customer to purchase the ticket. This is because the entity is obliged to pay the airline for that right regardless of whether it is able to obtain a customer to resell the ticket to or whether it can obtain a favorable price for the ticket. The entity also establishes the price that the customer will pay for the specified ticket.

Thus, the entity concludes that it is a principal in the transactions with customers. The entity recognizes revenue in the gross amount of consideration to which it is entitled in exchange for the tickets transferred to the customers.



RSM COMMENTARY: Example 8-2 illustrates whether the entity is a principal or an agent with respect to an airline ticket (i.e., right to fly). In this example, the entity buys the rights to flights prior to having customers that have committed to buying those rights to flights (i.e., it has inventory risk for the rights to flights). That fact plays a key role in the entity concluding it controls the rights to flights before those rights transfer to the customer, resulting in it recognizing revenue for the rights to flights it sells as a principal. In nutshell, all the facts and circumstances would need to be carefully considered in reaching a final conclusion about whether the entity is acting as a principal or agent.



Example 8-3: Determining whether the entity is a principal or agent for recruiting services (ASC 606-10-55-334A to 55-334F)

An entity sells services to assist its customers in more effectively targeting potential recruits for open job positions. The entity performs several services itself, such as interviewing candidates and performing background checks. As part of the contract with a customer, the customer agrees to obtain a license to access a third party's database of information on potential recruits. The entity arranges for this license with the third party, but the customer contracts directly with the database provider for the license. The entity collects payment on behalf of the third-party database provider as part of its overall invoicing to the customer. The database provider sets the price charged to the customer for the license and is responsible for providing technical support and credits to which the customer may be entitled for service down-time or other technical issues.

To determine whether the entity is a principal or an agent, the entity identifies the specified goods or services to be provided to the customer and assesses whether it controls those goods or services before they are transferred to the customer.

For the purpose of this Example, it is assumed that the entity concludes that its recruitment services and the database access license are each distinct on the basis of its assessment of the guidance in paragraphs 606-10-25-19 through 25-22. Accordingly, there are two specified goods or services to be provided to the customer—access to the third-party's database and recruitment services.

The entity concludes that it does not control the access to the database before it is provided to the customer. The entity does not at any time have the ability to direct the use of the license because the customer contracts for the license directly with the database provider. The entity does not control access to the provider's database—it cannot, for example, grant access to the database to a party other than the customer or prevent the database provider from providing access to the customer.

As part of reaching that conclusion, the entity also considers the indicators in paragraph 606-10-55-39. The entity concludes that these indicators provide further evidence that it does not control access to the database before that access is provided to the customer.

- The entity is not responsible for fulfilling the promise to provide the database access service. The customer contracts for the license directly with the third-party database provider, and the database provider is responsible for the acceptability of the database access (for example, by providing technical support or service credits).
- The entity does not have inventory risk because it does not purchase or commit to purchase the database access before the customer contracts for database access directly with the database provider.
- The entity does not have discretion in setting the price for the database access with the customer because the database provider sets that price.

Thus, the entity concludes that it is an agent in relation to the third-party's database service. In contrast, the entity concludes that it is the principal in relation to the recruitment services because the entity performs those services itself and no other party is involved in providing those services to the customer.



RSM COMMENTARY: This example illustrates that: (a) an entity determines whether it is a principal or an agent at the specified good or service level and not the contract level and (b) an entity may be a principal for one specified good or service in a contract and an agent for another specified good or service in the same contract.

9. Contract costs

9.1 Scope

ASC 340-40 addresses the circumstances under which certain costs that arise in conjunction with performing under contracts within the scope of ASC 606 should be capitalized. The two categories of costs addressed in ASC 340-40 include: (a) costs to fulfill a contract and (b) costs to obtain a contract.

9.2 Costs to fulfill a contract

If there is other guidance in the ASC that applies to the costs incurred to fulfill a contract within the scope of ASC 606, that other guidance should be applied. Examples of other guidance on how to account for costs that may be involved in the fulfillment of a contract are listed in the following table:

ASC	Type of fulfillment cost
330	Inventory
340-10-25-1 to 25-4	Preproduction costs related to long-term supply contracts
350-40	Costs of internal-use software
360	Costs related to property, plant and equipment
720-35-25-1A	Certain advertising expenditures incurred after revenue is recognized (e.g., cooperative advertising)
946-720-25-3	Offering costs of advisors of both public and private funds
985-20	Costs of software to be sold, leased or marketed

Note 1: Prior to applying the guidance noted, it is important to understand the specific scope provisions of the guidance to ensure it is applicable to an entity or the specific cost being evaluated.

If the guidance in the table or other specific guidance is applicable to a fulfillment cost incurred by the entity, it must be applied. ASC 340-40 is only applicable to costs to fulfill a contract when there is no other applicable guidance.

If certain criteria are met, fulfillment costs within the scope of ASC 340-40 must be capitalized. A BPS entity may not choose to expense such costs when the criteria are met.

9.3 Costs to obtain a contract

The incremental costs to obtain a specific contract within the scope of ASC 606 are those costs that would not have been incurred if the contract was not obtained, such as a sales commission. For a cost to be considered an incremental cost of obtaining a contract, the BPS entity must be obligated to make a payment only as a result of entering into the contract. The incremental costs to obtain a contract should

be capitalized if the BPS entity expects to recover those costs (i.e., the net cash flows of the contract and expected renewals will cover the costs). However, a BPS entity may elect a practical expedient that allows it to expense the incremental costs to obtain a contract if the amortization period for those costs would otherwise be one year or less.

Costs to obtain a contract within the scope of ASC 606 that are not incremental are those costs related to obtaining the contract that would have been incurred even if the contract was not obtained (e.g., travel costs incurred to present a proposal to the customer). These costs should only be capitalized if they are explicitly chargeable to the customer regardless of whether the BPS entity enters into a contract with the customer. Otherwise, such costs are expensed as incurred.

9.4 Amortization and impairment of capitalized costs

ASC 340-40 provides guidance on amortizing costs capitalized in accordance with its provisions as well as testing those capitalized costs for impairment. This guidance is summarized and illustrated in Sections 13.3 and 13.4 in [our revenue recognition guide](#).

10. Disclosures

Many qualitative and quantitative disclosure requirements are included in ASC 606-10-50 and ASC 340-40-50. ASC 606-10-50-1 states the following as the overall disclosure objective of ASC 606 (which is also the overall disclosure objective of ASC 340-40): “The objective of the disclosure requirements in this Topic is for an entity to disclose sufficient information to enable users of financial statements to understand the nature, amount, timing, and uncertainty of revenue and cash flows arising from contracts with customers.”

The disclosures required to achieve this objective focus on providing a variety of revenue-related information. Some of the information that must be disclosed is high-level, such as the amount of revenue recognized from customer contracts and the amount of any impairment (or credit) losses recognized on receivables or contract assets related to customer contracts. However, there is also a significant amount of detailed information that must be disclosed annually related to customer contracts, including information about:

- Disaggregated revenue
- Contract assets, contract liabilities and receivables
- Performance obligations
- Transaction price allocated to remaining performance obligations at the end of the reporting period (disclosures required for public entities and elective for nonpublic entities)
- Significant judgments about the timing of satisfying performance obligations
- Significant judgments about the transaction price and the amounts allocated to performance obligations
- Practical expedients (disclosures required for public entities and elective for nonpublic entities)
- Capitalized costs related to obtaining or fulfilling a customer contract (disclosures required for public entities and elective for nonpublic entities)

The nature and extent of the required disclosures in each of the preceding categories depends on whether the BPS entity is a public entity (more required disclosures) or nonpublic entity (fewer required disclosures). In addition, while more disclosures are required for annual periods, some disclosures also are required of public entities for interim periods. However, when a BPS entity applies ASC 606 and 340-40 in its interim financial statements for one or more interim periods before it applies ASC 606 and 340-40

in its annual financial statements, the BPS entity must provide all the required annual disclosures in those interim financial statements.

Detailed discussion and illustrations of the disclosure requirements for both public and nonpublic entities are included in Chapter 15 of [our revenue recognition guide](#).

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