

Changes to revenue recognition in the technology industry

Prepared by:

Bill Gaetz, Partner, RSM US LLP
bill.gaetz@rsmus.com, +1 612 629 9005

Greg Hicks, Partner, RSM US LLP
greg.hicks@rsmus.com, +1 205 949 2131

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A. Introduction and background

In May 2014, the Financial Accounting Standards Board (FASB) and International Accounting Standards Board (IASB) issued substantially converged final standards on revenue recognition. These final standards were the culmination of a joint project between the boards that spanned many years. FASB Accounting Standards Update (ASU) 2014-09, *Revenue from Contracts with Customers (Topic 606)*, provides a robust framework for addressing revenue recognition issues and replaces almost all pre-existing revenue recognition guidance in current U.S. generally accepted accounting principles (GAAP) (i.e., legacy GAAP), including industry-specific guidance and SEC Staff Accounting Bulletin Topic 13 (which is also part of legacy GAAP for public entities and generally was followed by private companies).

Implementation of the robust framework provided by ASU 2014-09 should result in improved comparability of revenue recognition practices across entities, industries, jurisdictions and capital markets. For public business entities (PBEs) and certain not-for-profit entities, implementation was required no later than annual reporting periods beginning after December 15, 2017, and the interim periods therein. However, if an entity is a PBE solely because its financial statements or financial information is included in a filing with the SEC pursuant to certain SEC rules and regulations (e.g., an acquired private company when its financial statements must be included in the acquirer's filing with the SEC), it may choose to adopt the new guidance in accordance with either (a) the effective date otherwise applicable to PBEs or (b) the effective date applicable to private companies, which is annual reporting periods beginning after December 15, 2018, and interim periods thereafter.

The FASB has amended the guidance originally included in ASU 2014-09 several times since its issuance. The new guidance primarily is included within the following sections of the FASB's Accounting Standards Codification (ASC):

- Topic 606, "Revenue from Contracts with Customers"
- Subtopic 340-40, "Other Assets and Deferred Costs – Contracts with Customers"

For a detailed discussion of the new guidance (as amended), refer to [A guide to revenue recognition](#). Additional information is available in our [Revenue Recognition Resource Center](#).

To help address issues identified by entities as they implement the new guidance, the FASB and IASB established the Joint Transition Resource Group. In addition, the American Institute of Certified Public Accountants (AICPA) organized several industry-specific task forces, including one focused on software, to identify and provide guidance on revenue recognition implementation issues. The culmination of the AICPA task forces' activities was the issuance in 2019 of a final comprehensive nonauthoritative revenue recognition guide (the Revenue Recognition AAG) that provides helpful discussion and illustrative examples on how to apply the new guidance. Additional information about the AICPA's industry-specific task forces and the Revenue Recognition AAG can be found on its [website](#).

ASC 606 supersedes virtually all of the guidance previously applied by entities in the technology industry (e.g., software companies, providers of software as a service [SaaS]), including the vast majority of ASC 985-605, "Software – Revenue Recognition". Implementing the new guidance when accounting for customer contracts in the technology industry could significantly affect the timing and amount of revenue recognized in an accounting period. This whitepaper highlights aspects of the new guidance that are particularly relevant to technology companies.

B. New five-step revenue recognition model

The new guidance includes the following five-step revenue recognition model:



An overview of each step is provided in this section of the white paper. For a comprehensive discussion of the five-step revenue recognition model and other aspects of the new guidance, refer to [A guide to revenue recognition](#).

B.1. Step 1 - Identify 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 ASC 606, the following five criteria (the contract existence criteria) must be met:

- Commercial substance exists
- 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
- 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) (the collectibility criterion)

When all of the contract existence criteria are met, the remaining steps in the five-step revenue recognition model are applied to the contract.

Spotlight on change

While there are many similarities between the objectives of the legacy GAAP criterion requiring there to be persuasive evidence of an arrangement and the new guidance requiring there to be enforceable rights and obligations and the contract existence criteria to be met, the legacy GAAP criterion only was met once an entity had evidence of an arrangement that was consistent with its customary business practice in similar situations. For example, if an entity’s customary business practice was to evidence arrangements with signed contracts from its customers, a signed contract must be executed before revenue could be recognized under legacy GAAP. However, under the new guidance, the entity in this example is focused on whether there are enforceable rights and obligations and whether the contract existence criteria are met, which do not necessarily require a signed contract. As a result, the lack of a signed contract does not affect the recognition of revenue if there are enforceable rights and obligations and the contract existence criteria have otherwise been met. Because it is very common for entities in the technology industry to evidence arrangements with signed contracts, such entities must carefully evaluate the process they currently have in place to evaluate whether persuasive evidence of an arrangement exists to determine whether any changes to that process are needed to properly apply the new guidance. For example, a technology entity may continue to provide SaaS or post-contract support (PCS) services after an initial contract expires while negotiating the terms of a new agreement. If the entity has a practice of continuing to provide service and the customer continues to pay under the terms of the original contract, the entity will need to change its process to focus on when there are

enforceable rights and obligations and when the contract existence criteria are met, which may be before a new contract is executed.

B.1.1. Evaluating collectibility and price concessions

To meet the collectibility criterion for contract existence, an entity must be able to conclude that collection of substantially all of the amount to which it expects to be entitled in exchange for the goods or services that will be transferred to the customer is probable (i.e., likely to occur). For this purpose, only the customer's ability and intention to pay is considered. However, before an entity can determine whether the collectibility criterion is met, it must determine the amount that should be evaluated for collectibility. To do so, there are two primary considerations:

- *Transaction price.* In general, the transaction price does not consider the customer's credit risk, but does consider: (a) whether the entity intends to offer the customer a price concession and (b) whether the customer has a valid expectation of receiving a price concession based on the entity's customary business practices, published policies or specific statements. It is not uncommon for certain entities in the technology industry to offer price concessions or extended payment terms to customers or to sell goods or services to customers that do not have a proven ability to pay the entire contract price. As a result, the transaction price could be less than the contractually stated price.
- *Mitigating credit risk.* An entity should take into consideration its ability to mitigate credit risk related to the transaction price (and, if so, to what extent). This is consistent with the collectibility criterion focus on the amount to which the entity expects to be entitled for the goods or services that *will be transferred* to the customer, which may not be all of the promised goods or services in the contract. This is especially common for SaaS entities, which typically have the ability to suspend service immediately in the event a customer stops paying.

Software entities should be particularly diligent when determining the transaction price as price concessions are more common in this industry due to the relatively low incremental cost associated with licensing a software product. For example, price concession can take the form of extended payment terms that are subsequently renegotiated to reduce annual payments in later years. Determining whether an amount that is not expected to be collected from a customer results from a price concession or the customer's inability to pay may be difficult. However, appropriately making this determination could significantly affect the timing and amount of revenue recognized in the following ways:

- **Price concession.** The amount that is not expected to be collected due to a price concession is not included in the transaction price (which is the amount ultimately recognized as revenue).
- **Inability to pay.** When one or more of the contract existence criteria is not met (e.g., the entity cannot conclude that collection of substantially all of the amount to which it will be entitled in exchange for the goods or services that will be transferred to the customer is probable), 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 only is recognized when the amounts paid by the customer (or by another party on the customer's behalf) are nonrefundable and at least one of the following applies:
 - The entity has no remaining performance obligations, and it has received all or substantially all of the amounts promised by the customer.
 - The contract has been terminated.
 - The entity has both (a) transferred control of the goods or services to which the nonrefundable consideration relates and (b) stopped transferring additional goods or services to the customer and is under no obligation to transfer any additional goods or services to the customer.

Application of this guidance could result in the initial deferral of revenue for what may be a significant period of time even if nonrefundable cash has been received.

If all of the contract existence criteria have been met (one of which requires the entity to conclude that collection of substantially all of the amount to which it will be entitled in exchange for the goods or services that will be transferred to the customer is probable), the remaining four steps would be applied to the contract for purposes of recognizing revenue. If accounts receivable or a contract asset is recognized as a result of applying the new guidance to the contract, the recognition of any related credit losses is reflected as bad debt expense (and not as a reduction of revenue).

Spotlight on change

While both legacy GAAP and the new guidance include a collectibility threshold that affects the timing of revenue recognition, the new guidance includes more considerations when evaluating collectibility. In addition, while the new guidance could result in the deferral of nonrefundable cash received due to a customer's inability to pay the remaining amount to which the entity expects to be entitled in exchange for the goods or services that will be transferred to the customer, this typically would not have been the case under legacy GAAP. In other words, application of legacy GAAP typically would not result in the deferral of nonrefundable cash received if the criteria for revenue recognition were otherwise met. As a result, there is a greater likelihood of revenue deferral due to collectibility issues in these situations under the new guidance as compared to legacy GAAP.

Entities in the technology industry may need to change the processes they have in place to evaluate collectibility to ensure compliance with the new guidance, particularly as it relates to (a) determining whether amounts not expected to be collected from a customer result from a price concession or the customer's inability to pay and (b) accounting for nonrefundable cash received when the collectibility criterion has not been met. In doing so, an entity will need to understand and document the terms of its contracts, its customary business practices and the knowledge it has of its customers.

B.1.2. Accounting for contract modifications

It is common for contracts in the technology industry to be modified, particularly those contracts that span multiple years. For example, a five-year contract in which the entity agrees to provide its customer with a hosted software solution may be modified by the entity and the customer in the contract's third year to add one more year to the contract term.

Under legacy GAAP, there was very little guidance about how to account for contract modifications, which resulted in diversity in practice. Conversely, the new guidance provides a comprehensive model related to accounting for contract modifications. When a contract modification has been approved, the new model results in accounting for the contract modification as a separate contract when it includes both of the following: (a) additional promised goods or services that are distinct (see section B.2.2) and (b) additional consideration that reflects the standalone selling prices (see section B.4.1) of the additional promised goods or services adjusted for the contract's specific facts and circumstances. When a contract modification does not meet both of these requirements to be accounted for as a separate contract, it is accounted for as follows:

- *The termination of one contract and execution of a new contract (i.e., prospectively)*, when the contract modification includes only promised goods or services that are distinct from the goods or services that were transferred on or before the modification date and any additional consideration does not reflect the standalone selling prices of the additional promised goods or services adjusted for the contract's specific facts and circumstances
- *Part of the original contract (which could result in recognition of a cumulative catch-up adjustment)*, when the modified contract includes only promised goods or services that are not distinct

While the comprehensive model in the new guidance will result in less diversity in practice on how contract modifications are accounted for among entities in the technology industry, it also will result in at least some of those entities changing how they currently account for those modifications.

B.2. Step 2 - Identify the performance obligations in the contract

Identifying the performance obligations in the contract establishes the units of account to which the transaction price should be allocated and for which revenue is recognized. In other words, if a contract has more than one performance obligation, an entity must estimate the standalone selling prices of each performance obligation and allocate the transaction price to each performance obligation using the relative standalone selling price method (Step 4) and determine whether the transaction price allocated to each performance obligation should be recognized over time (and if so, the method of measuring progress toward complete satisfaction of the performance obligation) or at a point in time (and if so, the point-in-time control of the underlying goods or services transfers to the customer) (Step 5).

The first step in identifying the performance obligations in the contract is to identify all of the promises to provide goods or services in the contract. Once that step is complete, criteria are applied to determine whether the promises to provide goods or services should be treated as performance obligations and accounted for separately.

Contracts in the technology industry often include multiple promised goods or services. For example, such contracts may include hardware, installation, software licenses (term or perpetual), PCS, specified updates and (or) hosting services. After an entity identifies each of the promised goods or services in the contract, the next step to account for a contract with multiple promised goods or services is to determine whether the promises to provide goods or service should be treated as performance obligations and accounted for separately. This section discusses each of these steps, along with the additional considerations involved in identifying the performance obligations in SaaS or hosted software arrangements and contracts that include options for additional goods or services.

B.2.1. Identifying promises to transfer goods or services

Technology entities should scrutinize their customer contracts and identify all promises to transfer goods or services to the customer. Consideration also needs to be given to whether there are promises to transfer goods or services that arise out of the entity's customary business practices instead of out of an explicit contract provision. For example, paragraph BC87 of ASU 2014-09 notes that when-and-if-available software upgrades may be an implied promised good or service.

Not all activities performed by an entity in connection with the contract transfer a good or service to the customer. For example, setup activities, such as building an interface between the entity's systems and the customer's systems to allow the customer to access the entity's software product, and testing that interface, do not transfer a good or service to the customer. Instead, those activities are necessary for the entity to fulfill the contract and do not in and of themselves represent a good or service transferred to the customer. As a result, they cannot represent a performance obligation.

Spotlight on change

While legacy GAAP included various multiple-element-arrangement (which was the terminology used in legacy GAAP) models, there was very little discussion in those models with respect to what constitutes an element. Conversely, detailed guidance on identifying the promised goods or services in a contract is provided in the new guidance. Applying this detailed guidance to contracts in the technology industry may result in the identification of more promised goods or services (and potentially more units of account). For example, consider PCS, which typically includes the right to receive technical support and unspecified future software upgrades and enhancements. Under the legacy multiple-element-arrangement model in ASC 985-605, PCS was viewed as a single element. In other words, the technical support and unspecified future software upgrades and enhancements were not

evaluated as individual elements to determine whether they should be accounted for separately. Conversely, examples in the new guidance treat unspecified future software upgrades and technical support as two promised goods or services that meet the criteria to be accounted for as separate performance obligations (i.e., units of account). These examples illustrate the need for entities in the technology industry to consider PCS from a different perspective when identifying the promised goods or services in a contract. In doing so, such entities should not only consider the promised goods or services explicitly stated in the contract, but also should consider what the customer expects to receive or the entity expects to provide based on its customary business practices and communications.

Applying the new guidance for identifying promised goods or services in a contract could result in the identification of more promised goods or services when compared to the elements identified under legacy GAAP. The identification of more promised goods or services under the new guidance, in turn, could result in the identification of more units of account when compared to the units of account identified under legacy GAAP. The identification of more units of account could change the timing and (or) pattern of revenue recognition for a contract.

B.2.2. Separating promises to transfer goods or services into performance obligations

If there is more than one promise to transfer goods or services in a contract, consideration must be given to whether the promises to transfer goods or services should each be considered performance obligations and treated separately for accounting purposes. The determining factor in this analysis is whether each promised good or service is distinct. If a promised good or service meets both of the following criteria, it is considered distinct and accounted for separately as a performance obligation unless the series exception applies:

- *Capable of being distinct.* If a customer can benefit from the promised good or service (or a bundle of goods or services) on its own or by combining it with other resources readily available to the customer, the good or service is capable of being distinct. A promised good or service is capable of being distinct when the entity regularly sells that good or service separately or when the customer can generate an economic benefit either on its own or when combined with other readily available resources. For a resource to be readily available to the customer, it must be sold separately either by the entity or another party or it must be a good or service that the customer already has obtained as a result of either a contract with the entity (including the contract under evaluation) or another transaction or event. For example, technical support and software updates for a software product that remains functional without the updates and technical support would be capable of being distinct because the customer can benefit from each of the goods and services either on their own or together with the other goods and services that are readily available.
- *Distinct within the context of the contract.* If the promised good or service is separately identifiable from other promised goods or services in the contract, it is distinct within the context of the contract. To determine whether a promised good or service is distinct within the context of the contract, the entity must ascertain which of the following best describes its promise within the context of the specific contract:
 - *The promise within the context of the specific contract is to transfer the promised good or service individually.* If this best describes the entity's promise within the context of the specific contract, the promised good or service is distinct within the context of the contract.
 - *The promise within the context of the specific contract is to transfer a combined item or items to which the promised good or service is an input.* If this best describes the entity's promise within the context of the specific contract, the promised good or service is not distinct within the context of the contract.

Indicators are provided to assist in determining whether a promised good or service is distinct within the context of the contract. Answering “yes” to any of the following questions is an indication that the promised good or service is *not* distinct within the contract:

- Is the entity providing a significant service of integrating the promised good or service with one or more of the other promised goods or services in the contract, with the result of that integration being one or more of the combined outputs contracted for by the customer?
- Does the promised good or service significantly modify or customize one or more of the other promised goods or services in the contract, or is the promised good or service significantly modified or customized by one or more of the other promised goods or services in the contract?
- Is the promised good or service highly interdependent or highly interrelated with one or more of the other promised goods or services in the contract, such that each of the promised goods or services is significantly affected by one or more of the other promised goods or services?

If a promised good or service is distinct, it is considered a performance obligation and accounted for separately. However, 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 and (b) the entity otherwise having to use the same method of measuring progress toward completion for each of the goods or services.

Promised goods or services that are not distinct are combined until the group of promised goods or services is considered distinct, at which point that group is considered a performance obligation and accounted for separately. It is possible that all of the promised goods or services in the contract might have to be accounted for as a single performance obligation. This happens when none of the promised goods or services are considered distinct on their own or together with less than all of the other promised goods or services in the customer contract.

Additional discussion is provided in Section C.1 related to determining whether a software license is distinct from any other promised goods or services included in the contract.

Spotlight on change

Under the multiple-element-arrangement model in ASC 985-605, if undelivered services in a contract were essential to the functionality of a delivered software element in the contract, the software element could not be accounted for separately. Under the general multiple-element-arrangement model in other legacy GAAP, an element generally represented its own unit of account if the delivered element had standalone value to the customer.

The basis for determining whether a promised good or service is distinct under the new guidance is different from both: (a) the basis for determining whether undelivered services were essential to the functionality of a delivered software element under ASC 985-605 and (b) the basis for determining whether an element had standalone value to the customer under the general multiple-element-arrangement model in other legacy GAAP. As a result of the different bases used to identify the units of account, an entity in the technology industry may identify different units of account under the new guidance, which could lead to changes in the timing and amount of revenue recognized.

The multiple-element-arrangement model in ASC 985-605 also resulted in a delivered element not being accounted for separately if vendor-specific objective evidence (VSOE) of fair value did not exist for the undelivered elements in the contract. Following are examples of software and software-related elements included in a contract that were accounted for as one unit of account under ASC 985-605 when VSOE of fair value did not exist for the undelivered elements:

- **Perpetual software license sold with other software-related goods or services.** When bundled together as one unit of account because VSOE of fair value does not exist for the other software-related goods or services that will be delivered to the customer after it receives the perpetual software license, revenue was recognized over the longest period of performance.
- **Term software license sold with PCS.** When bundled together as one unit of account because VSOE of fair value does not exist for the PCS (i.e., the undelivered element), revenue was recognized over the term of the license and PCS. This was typically the case in practice because PCS sold with a term license generally is not sold on a standalone basis (i.e., a term license and PCS typically are renewed at the same time), thereby hindering an entity's ability to establish VSOE of fair value for PCS.
- **Perpetual or term software license and specified updates and (or) upgrades.** When bundled together as one unit of account because VSOE of fair value does not exist for the specified updates and (or) upgrades, revenue typically was deferred until the specified update and (or) upgrade is delivered to the customer.

The concept of VSOE has been eliminated under the new guidance, and promised goods or services are only bundled together into one performance obligation (i.e., unit of account) if they are not distinct from each other. For example, a perpetual or term software license is only bundled together with PCS into a single performance obligation if the software and PCS are not distinct from one another. In other words, the identification of separate performance obligations is not determined based upon observable sales of undelivered elements; consequently the lack of standalone sales at consistent pricing for PCS does not result in the software license and PCS being bundled together into one performance obligation under the new guidance.

In addition, as discussed in Section C.3, revenue related to a software license that is its own performance obligation is typically recognized under the new guidance at the point in time control of the software is transferred to the customer. As a result, revenue related to a software license that is its own performance obligation under the new guidance that was deferred under ASC 985-605 due to a lack of VSOE of fair value for the undelivered elements in the contract could be recognized much sooner under the new guidance.

B.2.3. Additional considerations when accounting for SaaS or hosted software

The accounting for a contract that includes software and hosting services depends at least in part on whether the following criteria are met:

- The customer has the contractual right to take possession of the software at any time during the hosting period without significant penalty.
- It is feasible for the customer to either run the software on its own hardware or contract with another party to host the software.

If one or both of these criteria are not met, the hosted software arrangement does not include a license of intellectual property (IP) and is accounted for under the general guidance in ASC 606.

For purposes of determining whether the software and hosting services are distinct from each other and should be treated as one or two performance obligations when both criteria are met, consideration is given to whether the promise to the customer within the context of the specific contract is to (a) transfer the software and hosting services individually (in which case each is a performance obligation accounted for separately) or (b) transfer hosted software to the customer over a period of time to which the software license and hosting services are inputs (in which case the hosted software is one performance obligation). Section C.1 provides additional discussion related to determining whether a software license is distinct from any other promised goods or services included in the contract.

Spotlight on change

The criteria for determining whether software should be considered a unit of account under legacy GAAP are the same criteria for determining whether a contract includes a separate promise of a license under ASC 606. If one or both of these criteria are not met, the hosted software arrangement represents one unit of account and generally is accounted for as a service contract, consistent with treatment of these types of contracts under legacy GAAP.

If both criteria were met, under legacy GAAP the software element in the hosting arrangement was separated from the hosting service and accounted for in accordance with ASC 985-605. Under ASC 606, the software and hosting services each represent promised goods or services that are further evaluated to determine whether they should be treated as one or two performance obligations.

However, as noted in paragraph 9.2.15 of the Revenue Recognition AAG, when the software subject to a hosting arrangement meets the criteria in ASC 985-20-15-5, the software license is considered capable of being distinct from the hosting service and generally also will be distinct within the context of the contract, resulting in the software license being considered a separate performance obligation.

Thus, while there are differences related to identifying the units of account under legacy GAAP and the new guidance when a contract includes SaaS or hosted software, we do not expect those differences to result in different accounting consequences in many cases.

B.2.4. Additional considerations when accounting for options for additional goods or services

As part of a contract, the entity may provide the customer with options for additional goods or services, such as the following: (a) an option to purchase additional goods or services in the future at a discount, or (b) a contract renewal right that can be exercised in the future. An option for additional goods or services is treated as a performance obligation (and some of the transaction price is allocated to it) if it provides a material right to the customer that the customer would not have received without entering into the contract with the entity. An example of an option that provides a material right is a discount that is incremental to the range of discounts typically given by the entity on the same goods or services to the same class of customer in the same geographical area or market.

It is fairly common in the technology industry for a contract to include an option to purchase additional copies of or allow additional users access to software previously sold to a customer. As noted in paragraph 9.2.16 of the Revenue Recognition AAG, when an entity provides customers with the right to purchase additional or incremental rights to software that the customer did not previously control, that should be considered an option. In contrast, when an entity is entitled to additional consideration from a customer based on the level of usage of software that it already controls, the usage-based payments should be considered variable consideration. In many cases, distinguishing between an option and variable consideration will require significant judgment.

It is also very common in the technology industry (particularly in SaaS or maintenance contracts) for a contract to (a) include an option to renew the contract at potentially favorable rates once the initial contract term expires or (b) offer an option to purchase multiple renewal periods at once for a discount. These renewal options must be evaluated to determine whether they represent a material right to the customer that it would not have received without entering into the contract with the entity. If the renewal option represents a material right, it is a performance obligation and a portion of the transaction price is allocated to it. The presence of a significant nonrefundable upfront fee paid on initial signing of a contract but not charged on renewal may also trigger a material right, as discussed in Section D.

Making the determination as to whether an option for additional goods or services represents a material right and thus a performance obligation requires significant judgment. In addition, if such an option should be treated as a performance obligation, estimating its standalone selling price for allocation purposes (see Section B.4) could be quite difficult. However, there is a practical alternative provided in the new

guidance that allows an entity in certain circumstances to allocate a portion of the transaction price to the optional goods or services based on the consideration to which the entity expects to be entitled for the goods or services that are expected to be provided. Entities in the technology industry that include options for additional goods or services in their contracts will need to change the processes they have in place to track and evaluate these options to ensure compliance with the new guidance.

Spotlight on change

ASC 985-605 provided guidance related to accounting for significant and incremental discounts offered on future purchases that results in a proportionate amount of that discount being applied to each element in the contract based on its fair value (provided VSOE of fair value exists). Because other legacy GAAP did not address the accounting for significant and incremental discounts, the guidance in ASC 985-605 often was analogized to in practice for goods or services not within its scope. The new guidance addresses options for additional goods or services more holistically than legacy GAAP.

While the definition of a material right in ASC 606 is similar to a significant and incremental discount in legacy GAAP, legacy GAAP also compared the discount on optional goods and services to the discount provided on the delivered elements in the contract to determine whether it was significant and incremental. Entities in the technology industry that have a business practice of including an option in their contracts to purchase additional goods or services in the future at a discount should carefully evaluate those options to determine whether they should be accounted for as a performance obligation (i.e., unit of account) under the new guidance. For example, under legacy GAAP, a renewal option was only accounted for separately if the renewal pricing represented a significant and incremental discount, which is typically not the case. As a result, the approach to accounting for a renewal option under the new guidance could significantly change how an entity accounts for a contract with one or more renewal options.

B.2.5. Additional considerations when a third-party is involved in delivery of good or service

When another party is involved with the entity in providing the specified goods or services to the customer, the principal vs. agent guidance must be applied. Technology entities often sell products or services through a reseller. A reseller of technology products or services therefore will need to evaluate whether it is the principal or agent. There are two key steps in the principal vs. agent guidance:

- Identifying the specified goods or services being provided to the customer
- Determining whether the entity obtains control of the specified goods or services before transferring control of those goods or services to the customer

Additionally, a technology entity selling through a reseller will need to consider whether the reseller is the principal or agent to determine whether its customer is the end user or the reseller.

B.3. Step 3 - Determine the transaction price

Step 3 of the five-step revenue recognition model in ASC 606 requires an entity to determine the transaction price, which is the amount to which the entity expects to be entitled and often includes variable consideration. In the technology industry, common forms of variable consideration include early payment discounts, rebates, price concessions and sales- or usage-based royalties. Variability in the amount of consideration to which the 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 of receiving based on the entity's customary business practices, published policies or specific statements.

B.3.1. Accounting for variable consideration

Entities must estimate the amount of variable consideration and include it within the transaction price if it is probable that a significant reversal of cumulative revenue recognized will not occur when the underlying uncertainty around the variability in consideration is resolved (typically referred to as the variable consideration constraint). The only exceptions to this are for:

- A sales- or usage-based royalty when the only, or predominant, item to which the royalty relates is the license of IP (see Section C.2).
- Variable consideration allocated entirely to a distinct good or service that forms part of a series subject to certain criteria (see Section B.3.2)

When accounting for other forms of variable consideration, such as performance bonuses payable upon meeting certain criteria or implied price concessions, entities need to assess whether they expect to be entitled to the bonuses or expect to grant price concessions and whether it is probable that a significant reversal of cumulative revenue recognized based on these expectations will not occur when the underlying uncertainties are resolved.

Spotlight on change

Under ASC 985-605 and other legacy GAAP applied by entities in the technology industry, one of the criteria that had to be met before revenue was recognized required there to be a fixed or determinable fee or price. If some or all of the fee or price was not considered fixed or determinable at the onset of the contract, the amount of the arrangement consideration that was not fixed or determinable was deferred. For example, variable consideration in the form of a performance bonus that was payable to the technology company only upon meeting certain conditions in the future was not considered fixed or determinable until those conditions had been met and thus revenue for that performance bonus was not recognized until all uncertainty was settled. Another example relates to implied price concessions, which commonly occur in the technology industry to incentivize customers to renew contracts for PCs or to upgrade software licenses, often led to a full deferral of revenue under ASC 985-605. In many circumstances, the change in how variable consideration is evaluated under the new guidance will result in revenue being recognized sooner. For example, under the new guidance, the potential exists for some or all of a performance bonus that is payable only upon meeting certain conditions in the future to be recognized before those conditions are actually met.

Sales involving a distributor or reseller also may be impacted by the change in guidance. Under legacy GAAP, revenue attributed to these types of customers often was recognized by the developer of the products on a sell-through basis, which resulted in revenue being deferred until the product was sold to the end user (rather than being recognized when delivered to the distributor). This was because arrangements with a distributor may include provisions for extended payment terms or significant product return rights, which draw into question whether the fee is fixed or determinable and whether the risks and rewards of ownership have transferred to the distributor - two key attributes of the general revenue recognition model in legacy GAAP. Under the new guidance, the estimated transaction price is recognized as revenue at the point in time control transfers to the distributor (i.e., the customer), which may be sooner than it would have been recognized if it were accounted for on a sell-through basis under legacy GAAP.

Applying the variable consideration constraint

Once the entity has estimated the amount of variable consideration to which it expects to be entitled, it then needs to apply the constraint focused on whether it is probable that the inclusion of the estimated variable consideration 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. Only estimated

variable consideration for which it is probable that its inclusion in the transaction price will not result in a significant reversal of cumulative revenue recognized should be included in the transaction price. If it is probable that a significant reversal of cumulative revenue recognized will not occur with respect to just a portion of the estimated variable consideration to which the entity expects to be entitled, that portion would be included in the transaction price.

Spotlight on change

Under ASC 985-605 and the general multiple-element arrangement model in other legacy GAAP, any arrangement consideration allocated to a delivered element that is contingent on delivery of the undelivered elements in the arrangement must be deferred until delivery of those undelivered elements occurs. For example, if an entity sold software and installation services and payment for the software was contingent upon delivery of the installation services, no revenue was recognized for the software until the installation services were provided.

Under the new guidance, when some or all of the transaction price is contingent upon the delivery of undelivered promised goods or services, the effects of that contingency are addressed by applying the variable consideration guidance. While the new guidance includes a constraint on the variable consideration included in the transaction price as previously discussed, this constraint is not expected to limit the transaction price to the amount that is not contingent upon delivery of the undelivered promised goods or services in many cases because resolution of the contingency is typically within the entity's control (i.e., the entity typically controls whether it delivers the undelivered promised goods or services). As a result, the change in how amounts contingent upon the delivery of undelivered promised goods or services are treated from an accounting perspective is expected to result in recognizing those contingent amounts as revenue sooner in many cases under the new guidance.

B.3.2. Variable consideration in a series

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 when the following two criteria are met:

- The terms of the variable payment are specifically related to the entity's efforts to 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 distinct good or service in a single performance obligation resulting from the series exception depicts the amount of consideration to which the 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 distinct good or service to which the variable payment relates. For example, for a SaaS company that charges a fee calculated based on the number of transactions processed on the platform each month, if the variable fee relates specifically to the entity's efforts to transfer the distinct increments of service for a specific month, the entity should allocate the variable fee to the distinct increments of service provided during that month.

Paragraph BC285 of ASU 2014-09 clarifies that when variable consideration is allocated entirely to a distinct good or service that forms part of a series, an entity is not required to estimate the total variable consideration because the uncertainty related to the consideration is resolved as each distinct good or service in the series is transferred to the customer.

B.3.3. Significant financing component

It is not uncommon for contracts in the technology industry to include either deferred payment terms or advance payment terms. For example, an entity may not require payment for a three-year software license until sometime during the second year of the license or an entity may require a customer to pay a large upfront fee in a multi-year contract that includes a software license and PCS. In determining the transaction price, entities must consider whether these terms result in a significant financing component. The new guidance addresses both deferred and advance payment terms, which means a significant financing component in a contract could result in the entity recognizing interest income or expense.

Entities also should note that a significant financing component does not exist in any of the following situations:

- The customer makes an advance payment and the timing of transferring the promised goods or services to the customer is at the customer's discretion.
- There is substantial variable consideration, and payment of that consideration is contingent on the resolution of an uncertainty that is not substantially in the entity's or customer's control.
- There are reasons not related to financing that justify the nature and amount of the difference between the cash selling prices of the promised goods or services and the promised consideration.

Determining whether a significant financing component exists in a contract requires exercising significant judgment and careful consideration of all the facts and circumstances and may be particularly relevant for SaaS companies, which typically satisfy their performance obligations over time but charge a significant upfront fee.

If, after careful consideration of the facts and circumstances, an entity determines that a contract has a significant financing component, a practical expedient to ignore that financing component when estimating the transaction price can be applied if the entity expects the difference between the following two events to be one year or less at contract inception: (a) the entity's transfer of the promised goods or services to the customer and (b) customer payment for those goods or services. When assessing whether the practical expedient can be applied, it is important to focus on these two events and not the duration of the contract in its totality.

Spotlight on change

While legacy GAAP addresses deferred payment terms, the existence of advance payment terms in a contract did not result in the recognition of interest expense for that contract under legacy GAAP.

With respect to deferred payment terms, if a significant portion of the fee to be paid by a customer for a software license was not due until more than 12 months after the software was delivered, a presumption existed in ASC 985-605 that the fee was not fixed or determinable. While this presumption could be overcome, doing so was challenging in practice. As a result, revenue recognition typically was deferred in these situations. Under other legacy GAAP typically applied by entities in the technology industry, receivables for which the payment was not due for more than one year generally were discounted. This guidance also applied when the presumption in ASC 985-605 was overcome and revenue was recognized for an arrangement that had deferred payment terms.

Under the new guidance, when a contract includes a significant implicit or explicit benefit of financing to either the entity or the customer (i.e., a significant financing component), that significant financing component is taken into consideration in determining the transaction price, unless the entity qualifies for and elects to apply a practical expedient. While the existence of extended payment terms does not result in the deferral of revenue under the new guidance in the same way it resulted in the deferral of revenue under ASC 985-605 when the presumption discussed earlier was not overcome, an entity should still consider whether the existence of extended payment terms increases the likelihood of the

entity providing the customer with a price concession in the future (i.e., an implied price concession). If so, that implied price concession should be considered in estimating the transaction price under the new guidance.

Given the change in how deferred payment terms should be evaluated, it is likely that revenue subject to deferred payment terms will be recognized sooner in many cases under the new guidance compared to the guidance in ASC 985-605. In addition, the existence of payments deferred for greater than one year would result in the recognition of interest income if those deferred payments represent a significant financing component. Similarly, it is likely that the accounting for some advance payments could change under the new guidance and would result in the recognition of interest expense if those advanced payments represent a significant financing component.

Impact of contract modifications on significant financing components

As previously noted, it is common for contracts in the technology industry to be modified, particularly those contracts that span multiple years, which are more likely to include a significant financing component. Contract modifications that change the timing of payment or the satisfaction of the performance obligations could result in a significant financing component that was not present in the original contract. As noted in paragraph 9.3.23 of the Revenue Recognition AAG, when a contract is modified, an entity should consider whether a significant financing component is present based on the terms and conditions of the newly modified contract. While the guidance in ASC 606 states that after contract inception entities should not adjust the financing component for changes to interest rates or other circumstances, Paragraph 9.3.25 of the Revenue Recognition AAG makes it clear that this is not meant to apply to situations in which a contract is modified, and entities should use discount rate assumptions in place at the time of the modification.

B.4. Step 4 - Allocate the transaction price to the performance obligations

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 and (or) variable consideration that can be shown 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 (see Section B.3.2).

B.4.1. Estimating standalone selling price

The standalone selling price of a performance obligation is the amount the 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 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 entity is required to estimate a standalone selling price. This is especially likely to be common in the software industry where many software vendors only sell software licenses bundled with PCs. While there are any number of approaches to estimating a standalone selling price that are consistent with the overall objective of allocating the transaction price, ASC 606 discusses the following three approaches:

- Adjusted market assessment approach

- Expected cost plus a margin approach
- Residual approach

A residual approach only may be used to estimate a standalone selling price when there is an observable standalone selling price for the other performance obligation(s) in the contract and one of the following criteria is met:

- The price at which the entity has sold the goods or services underlying a performance obligation on a standalone basis at or near the same time represents a broad range of prices within which a representative standalone selling price cannot be identified (i.e., the selling price is highly variable)
- The goods or services underlying a performance obligation have not previously been sold on a standalone basis, and the entity has not yet established a price for those goods or services (i.e., the selling price is uncertain).

Spotlight on change

As discussed in paragraph BC273 of ASU 2014-09, the residual method under ASC 985-605 was an allocation method. In contrast, the residual approach under ASC 606 is an estimation method. Under ASC 985-605, a residual method was used to allocate the arrangement consideration in a multiple-element arrangement when VSOE of fair value only existed for the undelivered elements. Most entities in the technology industry used the residual method under ASC 985-605 to allocate consideration to a software license in a contract with multiple elements due to the lack of VSOE of fair value for the software license.

Under the new guidance, while a residual approach may be used to estimate the standalone selling price of a performance obligation, the transaction price is still allocated to all of the performance obligations in the contract using the relative standalone selling prices of each performance obligation (except in certain situations involving discounts and [or] variable consideration that can be shown to be related to one or more [but less than all] performance obligations). As a result, how amounts are allocated to the units of account in a contract could change under the new guidance.

In making an estimate of standalone selling prices, the 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, an entity should be consistent in how it applies an estimation method and the situations in which it applies an estimation method.

The type of information used to estimate standalone selling price will vary significantly across industries and entities and even within an entity based on the products or services offered. Paragraph 9.4.31 of the Revenue Recognition AAG provides examples of the types of information that a technology entity may consider in developing an estimate. The following list is not all inclusive, but includes data that may be helpful to consider as entities develop estimates of standalone selling price.

- *Historical selling prices.* Even if limited standalone sales exist, historical pricing may still be relevant in determining an estimate for current standalone selling price. For example, standalone sales of renewals of software maintenance may be an appropriate data point to use when estimating the standalone selling price of maintenance in an initial combined contract including both software and maintenance services.
- *Competitor pricing for similar products.* For entities that operate in highly competitive markets with relatively homogenous goods, competitors' pricing may be especially helpful in developing an estimate of standalone selling price.

- *Entity's pricing for similar products.* Entities that have observable standalone selling prices for similar products may be able to use that pricing as a starting point, adjusting for differences in functionality and features.
- *Industry or entity pricing practices.* Entities typically will have certain pricing or profit objectives and methods of developing pricing for products for similar products. For example, when prices are developed based on costs incurred plus a target profit margin, a cost-plus-margin approach may be used to estimate a standalone selling price.
- *Effect of proposed transaction on pricing and the class of the customer.* Entities should consider the size of the deal, the characteristics of the targeted customer, the geography of the customer, or the attractiveness of the market in which the customer resides when developing an estimate of standalone selling price.
- *Published price lists.* While price lists cannot be assumed to be equivalent to standalone selling price, they may be a useful data point to estimate a standalone selling price.
- *Valuation techniques.* In some cases the use of a valuation technique, such as estimating the value of intellectual property using expected future cash flows based on a reasonable royalty rate, may be appropriate.

The data points accumulated by an entity should be considered in conjunction with one another. In other words, an entity should not just select a single data point and determine their best estimate of selling price based on that alone.

It is especially common for software companies to lack observable sales or comparable third-party or industry pricing. As a result, entities may have to focus more on entity-specific factors when estimating standalone selling price. As noted in paragraph 9.4.44 of the Revenue Recognition AAG, some entities may conclude that they have established a value relationship between a software product and the maintenance that is helpful in determining standalone selling price. For example, an entity that sells perpetual licenses bundled with the first year of maintenance and that sells subsequent maintenance renewals on a stand-alone basis may conclude that the established practice of pricing and selling maintenance as a percentage of the net fee for related software licenses indicates the entity has established a value relationship between the software and maintenance that provides insight into the stand-alone selling price for each element on its own.

Entities also may begin with the standalone selling price of a similar item when developing an estimate. For example perpetual and term licenses often are bundled with maintenance. As noted in paragraph 9.4.51 of the Revenue Recognition AAG, a software company that has established a value relationship between a perpetual software license and maintenance services may use that as a starting point to establish the standalone selling price for maintenance associated with a term license without renewal pricing and then adjust for any facts and circumstances that might cause the standalone selling price of the maintenance to differ based on the type of license with which it was associated.

Additionally, because many technology companies do not consistently sell products or services at the same price, it may be appropriate for an entity to use a range as an estimate of the standalone selling price. However, the range should be sufficiently narrow so that any price within the range represents a price that the entity would accept if the product or service were sold regularly on a standalone basis. For example, if an entity has observable data showing that recent standalone sales of installation services were priced at 60 percent to 70 percent of the entity's list price, and over 50% of bundled transactions were priced at 40 percent to 60 percent of the entity's list price, paragraph 9.4.39 of the Revenue Recognition AAG indicates it likely would not be appropriate for the entity to conclude that its standalone selling price is a range of 40 percent to 70 percent of the list price. Instead, the entity would have to consider the relative importance of all available data to determine a reasonably narrow range, likely considering the standalone sales data as more relevant. Continuing with this example, the entity may

determine that while over 50% of its transactions were priced at 60 percent to 70 percent of the list price, it could expand the estimate of standalone selling price to 40 percent to 80 percent of the list price in order to encompass 75 percent of its transactions. However, paragraph 9.4.39 of the Revenue Recognition AAG indicates that it would not be appropriate to expand the range simply to cover a higher percentage of the population. In order to comply with the objective of allocating the transaction price in an amount that depicts consideration to which the entity expects to be entitled in exchange for transferring the promised goods or services to the customer, the range must be reasonably narrow such that any price within the range represents a price that the entity would accept if the product or service were sold on a standalone basis.

Once a range is established, entities also must select a reasonable and systematic approach when allocating the transaction price when the stated contractual price for a distinct good or service is outside of that range. Paragraph 9.4.41 of the Revenue Recognition AAG indicates that the use of a consistent point in the range, such as the midpoint of the range, would be appropriate, as long as the overall allocation objective in ASC 606-10-32-28 is still met.

Spotlight on change

Both legacy GAAP and the new guidance include approaches that must be followed to allocate arrangement consideration (which is the terminology typically used in legacy GAAP) or the transaction price (which is the terminology used in the new guidance) to the elements or performance obligations that should be accounted for separately (i.e., the units of account). While there are some similarities between the allocation approaches in legacy GAAP and the new guidance, there are also some noteworthy differences, particularly related to the allocation approach included in ASC 985-605.

Under ASC 985-605, an entity was required to have VSOE of fair value for the undelivered units of account in a contract to allocate the arrangement consideration. Under the general multiple-element-arrangement model in other legacy GAAP, selling prices were estimated for all units of account using a three-level evidence hierarchy in which: (a) VSOE of selling price was used first to the extent it existed, (b) third-party evidence of selling price was used to the extent it existed when VSOE of selling price did not exist and (c) the best estimate of selling price was used when neither VSOE or third-party evidence of selling price existed.

Under the new guidance, standalone selling prices must be estimated for all performance obligations using what is essentially a two-level evidence hierarchy in which: (a) directly observable standalone selling prices (i.e., observable prices charged by the entity for the same goods or services when they are sold separately in similar circumstances to similar customers) should be used to the extent they exist and (b) the estimated standalone selling price should be used in the absence of directly observable standalone selling prices.

While the best evidence of a standalone selling price under the new guidance is the directly observable standalone selling price, if such evidence does not exist, a standalone selling price must otherwise be estimated. As such, entities in the technology industry that applied the guidance in ASC 985-605 are no longer required to use VSOE of fair value for purposes of allocating arrangement consideration to the units of account. In addition, in the absence of VSOE of fair value for an undelivered element, such entities no longer have to bundle that undelivered element with delivered elements (and delay revenue recognition on the delivered element as a result) under the new guidance.

While the changes are not as significant for entities in the technology industry that previously applied the general multiple-element-arrangement model in other legacy GAAP, such entities must still consider whether they are estimating the standalone selling prices for their units of account in accordance with the new guidance.

B.5. Step 5 - Recognize revenue when (or as) each performance obligation is satisfied

Revenue is recognized when (or as) a performance obligation is satisfied, which is when control of the underlying good or service (i.e., an asset) is transferred to the customer. The amount of revenue recognized upon satisfaction of a performance obligation is the transaction price allocated to it.

To properly assess when revenue should be recognized, an entity must perform at contract inception an evaluation focused on whether a performance obligation is satisfied over time or at a point in time.

Specific guidance, which is discussed in Section C, is provided with respect to making this determination when the performance obligation consists solely of a license of IP (e.g., software). When accounting for a performance obligation that does not include a license of IP or that includes a license of IP combined with other goods or services, at least one of the following criteria must be met to conclude that the performance obligation is satisfied over time:

- *Customer simultaneously receives and consumes benefits as the entity performs.* A performance obligation is satisfied over time if the customer consumes the benefits of the entity's performance at the same time as: (a) the customer receives those benefits and (b) the entity performs and creates those benefits. This criterion often applies to PCS or SaaS arrangements in which the entity receives the benefit of access to the software platform as the entity provides it.
- *Customer controls the asset as the 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 entity's performance. In the technology industry, this could apply to a professional service contract in which an entity is engaged to make modifications within software owned by the customer.
- *No alternative use and an enforceable right to payment.* A performance obligation is satisfied over time if (a) the asset created by the entity's performance does not have an alternative use to the entity upon its completion and (b) the entity's right to payment for its performance to date is enforceable. This criterion often applies to contracts for custom software development in which the entity is entitled to payment, including a reasonable margin, for the work performed throughout the contract term but does not transfer the software to the customer until it is complete.

If a performance obligation does not meet any of these three criteria, it is considered satisfied at a point in time and revenue is recognized at the point in time the customer obtains control over the underlying good or service. In addition to determining whether a performance obligation is satisfied (and revenue is recognized) at a point in time or over time, the new guidance also addresses: (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.

Spotlight on change

Under ASC 985-605, revenue was recognized when four criteria were met, one of which required delivery to have occurred. Specific guidance was provided in ASC 985-605 with respect to when delivery of software that was its own unit of account had occurred. In addition, ASC 985-605 provided guidance about recognizing revenue for a unit of account that included software and other software-related goods or services (e.g., PCS, specified updates and (or) upgrades, services). For example:

- When a term software license sold with PCS was treated as one unit of account because VSOE of fair value did not exist for the PCS, ASC 985-605 required revenue to be recognized over the term of the license and PCS.
- When undelivered services were essential to the functionality of a delivered software element, ASC 985-605 did not allow the software element to be accounted for separately as its own unit of

account. The revenue for the combined unit of account likely would have been recognized as the services were provided.

In addition, when a contract included software that required significant production, modification or customization, ASC 985-605 required an entity to follow contract accounting. It is important to note that while ASC 606 superseded most of the contract accounting guidance in legacy GAAP, guidance will continue to be provided for when a provision for losses should be recognized on a contract including software or a software system to be delivered (either alone or with other products or services) that requires significant production, modification or customization.

Under other legacy GAAP typically applied by entities in the technology industry, there were also four criteria that must be met to recognize revenue, one of which was that delivery had occurred or services had been rendered. While some guidance existed with respect to the application of this criterion, it mostly was focused on when delivery of a product had occurred. In other words, there was very little guidance related to accounting for service contracts in other legacy GAAP. While it is possible that recognizing revenue under legacy GAAP and the new guidance may be similar in certain circumstances (e.g., recognizing revenue for a unit of account consisting solely of a perpetual license [with no PCS] paid for upfront in cash), it is more likely that there will be differences between recognizing revenue under legacy GAAP and the new guidance. An entity only will know the full effects of applying the new guidance to its contracts after carefully evaluating each one under the new guidance.

C. Accounting for licenses and rights to use IP

Licensing involves an entity (i.e., licensor) providing a customer (i.e., licensee) with a right to use its IP, which may come in many different shapes and sizes. Examples of IP that may be the subject of a license include software, trademarks, patents, copyrights, etc. It is important to note that the entity still owns the IP subject to the license (i.e., ownership of the IP does not transfer to the customer).

The discussion in the remainder of this section focuses on how the following aspects of the new guidance should be applied to contracts that include a license of IP: (a) identifying the performance obligations (i.e., units of account), (b) determining the transaction price when a contract includes a sales and usage based royalty and (c) determining when a performance obligation that includes a license of IP is satisfied (i.e., when does control of the IP transfer to the licensee).

Spotlight on change

While ASC 985-605 and other industry-specific legacy GAAP provided guidance on how to recognize revenue for certain licenses of IP, the guidance was not the same and was limited in its applicability. As a result, there was not guidance in legacy GAAP on how to account for certain other licenses of IP. One of the most important aspects of the new guidance is that it explicitly addresses and illustrates how the relevant concepts should be applied to all licenses of IP.

With respect to recognizing revenue from a software license, there are many differences between the guidance in ASC 985-605 and the new guidance. Some of those differences result from the guidance in ASC 985-605 being focused on whether delivery of the software has occurred, while the new guidance is focused on when control of the software transfers to the customer. Other differences result from aspects of ASC 985-605 that require revenue related to a software license to be recognized other than when it is delivered due to other factors. For example, consider the following situations discussed earlier:

- A term software license sold with PCS often was bundled together as one unit of account under ASC 985-605 because VSOE of fair value did not exist for the PCS, and revenue for that unit of account was then recognized over the term of the license and PCS.
- When the customer is not obligated to pay for a software license until more than 12 months after the software is delivered, revenue typically was deferred under ASC 985-605 until the cash was collected because there was a presumption that the fee was not fixed or determinable.

Because of these and other differences between ASC 985-605 and the new guidance, the analysis of when revenue should be recognized for a software license will change significantly. However, whether that change in analysis ultimately affects the timing and (or) amount of revenue recognized for a software license will require careful consideration of the specific facts and circumstances in the context of the new guidance.

C.1. Identifying the performance obligations in a contract that includes a license of IP

When a contract includes a license of IP and other promised goods or services, the entity must consider whether the license of IP is distinct from the other implicit or explicit promised goods or services in the related contract. For example, consider a contract that includes a software license and installation services. The software license and installation services are distinct if each meets the following two criteria:

- **Capable of being distinct.** If a customer can benefit from the software license on its own or by combining it with other resources readily available to the customer (e.g., installation services provided by a third party), the software license is capable of being distinct. If a customer can benefit from the installation services on their own or by combining them with resources readily available to the customer (e.g., the software license provided by the entity in the contract), the installation services are capable of being distinct.
- **Distinct within the context of the contract.** If the software license and installation services are separately identifiable from each other, then each is distinct within the context of the contract. For this purpose, the entity must ascertain which of the following best describes its promise within the context of the specific contract:
 - *The promise in the contract is to transfer the software license and installation services individually.* If this best describes the entity's promise within the context of the specific contract, the software license and installation services are distinct within the context of the contract.
 - *The promise in the contract is to transfer installed software to which the software license and installation services are inputs.* If this best describes the entity's promise within the context of the specific contract, the software license and installation services are not distinct within the context of the contract.

Indicators are provided to assist in determining whether a promised good or service is distinct within the context of the contract. When the promised goods or services involved are a software license and installation services, those indicators are focused on whether the installation services significantly integrate, modify or customize the software and whether the software license is highly interdependent or highly interrelated with the installation services. Entities will need to exercise significant judgment when evaluating this criterion.

When the software license and installation services are not distinct, they are treated as a single performance obligation. Additional information about accounting for a single performance obligation that includes a software license and other promised goods or services is provided in Sections C.2 and C.3.

When a contract includes a software license and updates, entities also will need to evaluate whether the updates are distinct from the license. In most cases, software will remain functional without the software

updates, which leads to a conclusion that the customer can benefit from both the software and the updates either on their own or with other available resources. However, in some cases the updates may not remain functional without the updates, which could lead an entity to conclude that the software is highly interdependent or interrelated with the updates. When assessing whether when-and-if-available updates are distinct from a software license, entities should consider the degree to which the software remains functional without the updates, as well as the frequency and method with which updates are made. For example, a five-year license for software that monitors compliance with frequently changing laws or regulations may lose its functionality without frequent updates. If such updates are made immediately upon the change of a law, pushed out to all software users, and occur multiple times a month, that could indicate that the software and updates are not distinct.

ASC 606 provides an example in which the contract includes a three-year license to anti-virus software and when-and-if-available software updates during the three-year license term. While the software license and when-and-if-available updates are considered capable of being distinct, they are not considered distinct within the context of the contract. More specifically, the software license and when-and-if-available updates are not distinct within the context of the contract because the updates: (a) significantly modify the software's functionality so as to protect against new viruses and (b) are integral to maintaining the software's utility over the three-year term. As a result, the entity concludes the software license and when-and-if-available updates are inputs to providing anti-virus protection. In other words, there is one performance obligation (i.e., unit of account), which includes both the software license and the when-and-if-available updates.

C.2. Determining the transaction price when a contract includes a sales- and (or) usage-based royalty

The overall variable consideration guidance in ASC 606 should not be applied to a sales- and (or) usage-based royalty when the only, or predominant, item(s) to which the royalty relates is the license of IP, such as software. Royalties received related to a license of IP should not be included in the transaction price until the later of (a) the resolution of the related uncertainty (i.e., sales and [or] usage occur) or (b) the satisfaction of the related performance obligation in whole or in part.

It should be noted that the point in time at which the entity receives sales data from its customers has no bearing on when the entity includes royalties related to those sales in the transaction price. If the entity does not yet have the sales data from its customer upon the later of those two events happening, it should estimate the royalties to which it expects to be entitled for purposes of including them in the transaction price at that point in time. This answer is consistent with the views expressed by SEC Deputy Chief Accountant Wesley Bricker in his [Remarks before the 35th Annual SEC and Financial Reporting Institute Conference](#) on June 9, 2016.

If there is a subsequent change in the entity's estimate of the royalties to which it expects to be entitled as a result of receiving the sales data from the customer, the entity should account for that change as it would account for any other change in the transaction price.

C.3. Determining when a performance obligation that includes a license of IP is satisfied

When the license of IP is distinct (i.e., its own performance obligation), the entity must determine whether the transaction price allocated to the license should be recognized over time or at a point in time. Specifically with respect to a software license, because software has significant standalone functionality, it typically is considered a right to use the IP and the allocated transaction price is recognized at the point in time that control of the right to use the software transfers to the customer.

A software license would not be considered a right to use IP (i.e., it would be considered a right to access IP) for which the allocated transaction price is recognized over time) only when the following two criteria are met:

- Substantive changes to the functionality of the IP are expected to result during the license period from activities of the entity that do not transfer a promised good or service to the customer.
- The customer must use (either contractually or practically) the substantively changed IP.

If both of these criteria are met, what would otherwise be considered a right to use the IP would be considered a right to access the IP. The FASB indicated in paragraph BC59 of ASU 2016-10 that it would expect both of these criteria to be met “only infrequently.”

When the license of IP is not distinct, it is combined with other promised goods or services in the contract until a performance obligation exists. The entity then applies the overall approach to recognizing revenue, which requires consideration of whether the performance obligation is satisfied at a point in time or over time (see Section B.5) and, if it is the latter, the method that should be used to measure progress toward the complete satisfaction of the performance obligation.

Prior to recognizing revenue related to a license of IP (whether over time or at a point in time), both of the following must take place: (a) a copy of the IP has been provided or otherwise made available to the licensee and (b) the period over which the licensee is able to use and benefit from its rights to the IP has started (i.e., the license period has begun). The need to meet these criteria before revenue is recognized results in revenue related to a license renewal being recognized no earlier than the beginning of the renewal period.

Spotlight on change

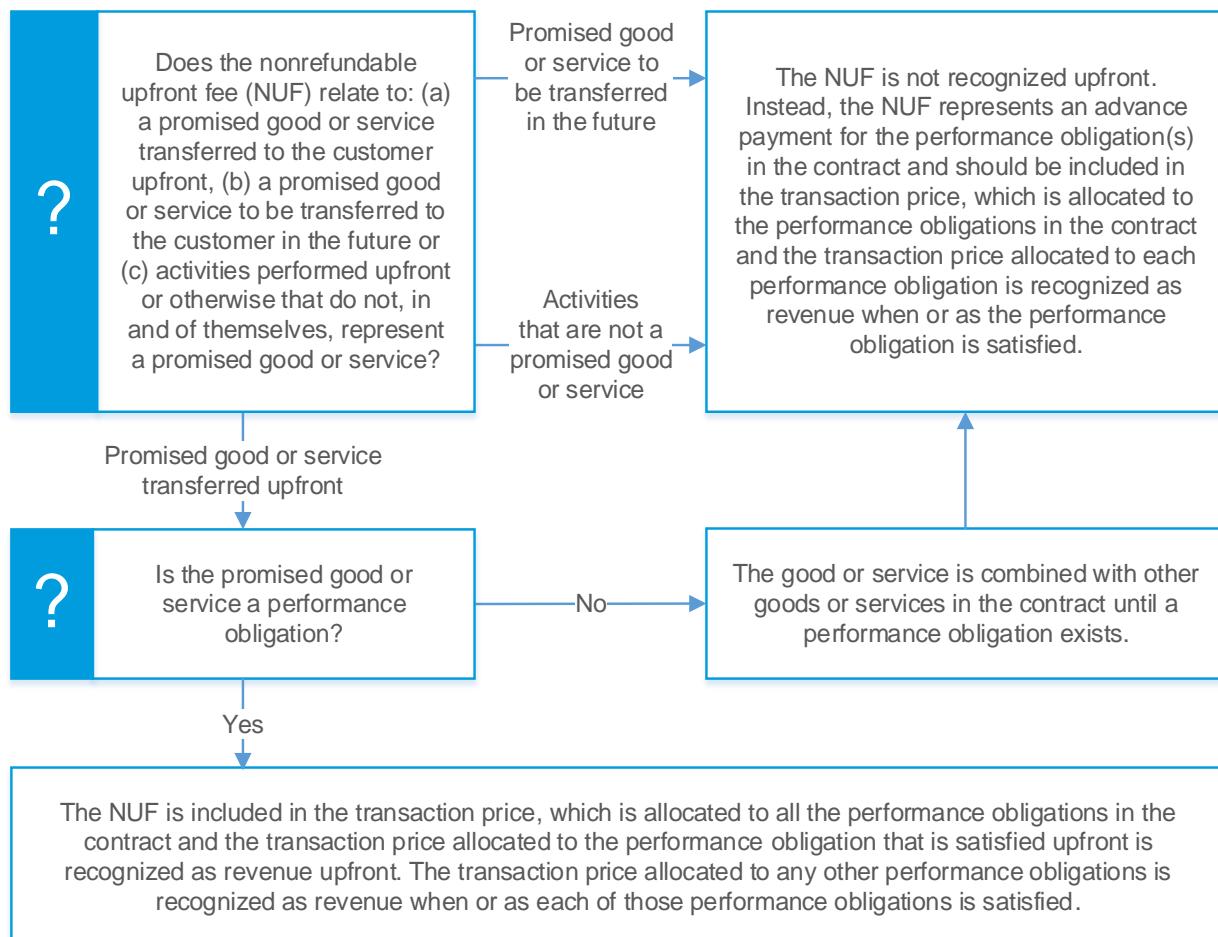
Under legacy GAAP, ASC 985-605 allowed entities to recognize revenue from the extension of an active term-based license when the renewal agreement was executed, assuming all other revenue recognition criteria and VSOE of fair value for the undelivered element existed. This no longer will be the case under ASC 606. The new guidance requires entities to wait until the license period has begun, which could result in a delay in revenue recognition for renewals.

D. Accounting for certain nonrefundable upfront fees

Contracts entered into by entities in the technology industry may require the customer to pay a nonrefundable upfront fee. For example, a SaaS customer may be required to pay a setup fee at the beginning of a three-year contract, in addition to monthly payments to access the hosted software.

As discussed in Section E, costs incurred by the entity to perform activities that do not represent a performance obligation (e.g., setup activities related to providing hosted software) may need to be capitalized and amortized. However, if applying the guidance in ASC 606 results in recognizing revenue for a nonrefundable upfront fee over time, the period over which that fee is recognized may not be the same as the period over which any costs capitalized under ASC 340-40 are amortized.

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 necessary for that accounting result, as well as the other potential accounting results for nonrefundable upfront fees, are illustrated in the flowchart that follows.



As explained in the flowchart, 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, 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: Determining whether a nonrefundable upfront fee relates to promised goods and services or setup activities

Company A enters into a SaaS contract with Customer B to provide access to its software platform over a five-year period. Before providing the services, Company A must setup Customer B on its systems, which involves: (a) building an interface between its systems and Customer B's systems and testing that interface, (b) migrating and testing Customer B's data and (c) building and testing a portal that Customer B will use to easily access information about the transactions processed and resolve any errors identified in the process. Company A is entitled to a nonrefundable upfront fee of \$1 million as compensation for the costs it will incur performing the setup activities, and annual transaction processing fees of \$3 million.

Building and testing the interface and portal and migrating and testing data are activities Company A performs to enable it to provide access to the software platform to Customer B. These setup activities do not provide any benefit to Customer B absent Company A providing access to the platform. As a result, the setup activities do not provide Customer B with a promised good or service, which also means they cannot be a performance obligation. This conclusion is unaffected by the presence of a \$1 million nonrefundable upfront fee meant to compensate Company A for the performance of the setup activities. In other words, setup activities do not represent a promised good or service even if a customer pays a nonrefundable upfront fee to compensate the entity for performing those activities.

Example: Accounting for a nonrefundable upfront activation fee and a contract renewal right

The following example is from paragraph 27 of TRG 32:

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. Since 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.

Assume the \$50 one-time activation fee is nonrefundable.

RSM commentary: This example was discussed by the FASB staff and TRG. The basis for these discussions was TRG 32, and a summary of the discussions is provided in TRG 34. The FASB staff and TRG concluded that the period of time over which the nonrefundable activation fee should be recognized depends on whether it provides the customer with a material right (see Section 6.6.2):

- *Payment of the nonrefundable activation fee provides the customer with a material right related to contract renewal.* The activation fee should be recognized over the period the customer is expected to benefit from paying the activation fee. The period over which the customer is expected to benefit from paying the activation fee may not necessarily be the two-year average customer life. The entity should take various qualitative and quantitative factors into consideration in identifying the period of time the customer is expected to benefit from paying the activation fee, which are similar to the factors considered in determining whether the nonrefundable activation fee provides the customer with a material right (see discussion of some of those factors later in this commentary).
- *Payment of the nonrefundable activation fee does not provide the customer with a material right related to contract renewal.* The activation fee should be included in the transaction price for the contract and recognized as revenue as the services the entity is obligated to provide under the contract are transferred to the customer. As a result, the transaction price of \$150 (\$100 monthly fee for the one-month contract term and \$50 activation fee) should be recognized over the one-month contract term.

To determine whether the nonrefundable activation fee provides the customer with a material right, an entity should consider the guidance on determining whether an option to purchase additional goods or services represents a material right, which is discussed in detail in Section 6.6.2. Based on that guidance, the FASB staff provided a number of factors in paragraph 28 of TRG 32 that the entity should consider, including the following:

- Does the renewal price of \$100 per month the customer would pay provide it with a material right compared to the \$150 (\$50 activation fee and \$100 monthly fee) a new customer would pay for the same service?
- Could the customer obtain equivalent service from another service provider, and if so, how does what the customer would pay the other service provider compare to what it would pay the entity? For example, does the other service provider charge an activation fee that is nonrefundable, and if so, in what amount?
- How does the average customer life compare to the one-month contract period? For example, is the average customer life significantly longer than the contract period because customers are incentivized to continue to purchase services from the entity so that they do not have to pay another activation fee?

When the entity concludes that paying the nonrefundable activation fee provides the customer with a material right, considering these factors also may assist in identifying the period over which the customer expects to benefit from paying that fee.

Determining whether the payment of an upfront nonrefundable fee represents a material right will require significant judgment to be exercised and careful consideration of all the facts and circumstances.

Spotlight on change

Under SEC Staff Accounting Bulletin (SAB) Topic 13 in legacy GAAP, nonrefundable upfront fees that do not relate to goods or services transferred to a customer upfront (e.g., initiation or setup fees) generally were recognized as revenue on a straight-line basis over the longer of the contract term or expected customer life.

Under the new guidance, 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 there is a contract renewal option that is a performance obligation because it provides the customer with a material right that it would not have received if it had not entered into the contract with the entity, the period over which the nonrefundable upfront fee is recognized will include the renewal periods. Otherwise, the nonrefundable upfront fee generally is recognized as revenue over the contract term. As a result, there could be situations where a nonrefundable upfront fee is recognized as revenue over the expected life of the customer under legacy GAAP, but is recognized as revenue over the contract term under the new guidance. In these situations, the nonrefundable upfront fee would be recognized earlier under the new guidance than under SAB Topic 13.

E. Contract costs

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.

E.1. 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 this other accounting guidance include: (a) ASC 330, "Inventory," (b) ASC 350-40, "Intangibles—Goodwill and Other – Internal-Use Software," (c) ASC 360, "Property, Plant, and Equipment," and (d) the guidance for preproduction costs related to long-term supply contracts in ASC 340-10, "Other Assets and Deferred Costs – Overall." ASC 340-40 is

applied to costs to fulfill a contract when there is no other applicable guidance in the ASC. For example, certain setup costs that do not fall within the scope of other guidance in the ASC would be accounted for in accordance with ASC 340-40.

If there is no specific guidance in the ASC that applies to costs incurred to fulfill a contract, the new guidance should be applied, which requires capitalization of those costs if all of the following criteria are met:

- The costs incurred by the entity are directly related to a specific contract or anticipated contract (e.g., direct labor related to setup activities).
- The costs generate or enhance resources that the entity will use in satisfying its future performance obligations under the contract (e.g., the activities giving rise to the costs are not a performance obligation in and of themselves).
- The entity expects to recover the costs (e.g., based on net cash flows from the contract and expected contract renewals).

If these criteria are met, the fulfillment costs must be capitalized. In other words, the option does not exist to expense fulfillment costs for which these criteria are met.

E.2. Costs to obtain a contract

It is not uncommon for certain entities in the technology industry, such as those that provide SaaS or hosting services, to pay an employee a commission for signing a customer to a long-term 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 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 entity expects to recover those costs (e.g., based on net cash flows from the contract and expected renewals). However, if the amortization period would otherwise be one year or less, an entity may elect a practical expedient under which the incremental costs of obtaining a contract are expensed. Care should be taken when evaluating the period over which costs to obtain a contract should be amortized as it may not be equivalent to the original contract term. When a commission only is paid upon the entity initially obtaining the contract (i.e., no commission is paid upon contract renewals), the capitalized commission cost relates to both the initial contract and any expected contract renewals. Similarly, when the commission paid on renewals is not commensurate with the commission paid on the original contract, entities should consider expected renewals when determining the amortization period.

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 only should be capitalized if they are explicitly chargeable to the customer regardless of whether the entity enters into a contract with the customer. Otherwise, such costs are expensed as incurred.

Spotlight on change

Capitalization of customer acquisition (costs to obtain a contract) and setup costs (costs to fulfill a contract) for which there was no specific guidance in legacy GAAP generally depended on whether those costs met the definition of an asset and whether the entity made an accounting policy election to capitalize such costs. Under the new guidance, an entity may be required to capitalize incremental customer acquisition costs and setup costs under certain circumstances.

The degree to which an entity is affected by the new guidance will depend on the accounting policies it elected under legacy GAAP to account for customer acquisition and setup costs. For example, if an entity's accounting policy under legacy GAAP was to expense setup costs as incurred, its accounting for those costs under the new guidance will change significantly if the criteria for capitalization under

the new guidance are met. In addition, if an entity elected an accounting policy under legacy GAAP to capitalize setup costs to the extent they met the definition of an asset and amortize those costs over the contract term, it may be required by the new guidance to amortize those costs (to the extent they meet the criteria for capitalization) over a period longer than the contract term.

E.3. Amortization of capitalized costs

The amortization method and period used to amortize capitalized costs related to obtaining or fulfilling a contract (including an anticipated contract, such as a contract renewal) should be systematic and consistent with how and when the related goods or services are transferred to the customer. Determining whether it is appropriate to include contract renewals (i.e., specified anticipated contract[s]) in the amortization period for capitalized costs depends on whether the costs relate to goods or services expected to be transferred under: (a) only the initial contract or (b) both the initial contract and one or more expected contract renewal(s). When the capitalized costs relate to goods or services expected to be transferred under both the initial contract and one or more expected contract renewal(s), the expected contract renewals are reflected in the amortization period.

If capitalized contract costs relate to more than one distinct good or service, Revenue Recognition Transition Resource Group Memo No. 23 indicates that entities may choose to either (a) allocate the contract asset among those distinct goods and services or (b) amortize the capitalized costs using a single measure of progress.

F. Disclosure requirements

The new guidance includes many new qualitative and quantitative disclosure requirements. The objective of the disclosure requirements is to help financial statement users understand the nature, amount, timing and uncertainty of revenue and related cash flows. In general, entities are required to disclose a variety of information about the contracts they have with customers and significant judgments used in the application of the new guidance.

While the most disclosures are required of public entities, many disclosures also are required of nonpublic entities. In addition, more disclosures are required of public entities on an annual basis than an interim basis, with many of the disclosures required on an interim basis being quantitative in nature.

An entity should review its systems, processes, procedures and controls to determine whether it is capable of providing the information necessary to satisfy the new disclosure requirements discussed in the remainder of this section, and if not, what changes it must make to enable it to provide the necessary information.

F.1. Disaggregated revenue

Public companies are required to disclose a quantitative disaggregation of revenue based on how economic factors affect the nature, amount, timing and uncertainty of revenue recognition and cash flows.

Nonpublic companies that do not elect to provide the quantitative disclosures required for public entities should disaggregate revenue based on when control of the goods or services transfers to the customer (e.g., over time or at a point in time). In addition, such nonpublic entities should provide qualitative discussion about how economic factors (such as those that might otherwise serve as the basis for quantitative disaggregation) affect the nature, amount, timing and uncertainty of revenue recognition and cash flows.

When determining the appropriate disaggregation levels and categories to use in financial statement disclosures, public entities (and other entities that elect to provide the disclosures required of public companies) should consider how they present revenue for other purposes, such as to investors and members of management or governance committees. In considering the needs of financial statement

users, an entity will want to carefully evaluate all sources of revenue and the varying judgments used to recognize different types of revenue. Common categories of disaggregated revenue include: (a) type of good or service (e.g., by major product line), (b) geographic region, (c) contract and customer type (e.g., fixed-price and time-and-materials contracts), (d) contract duration, (e) timing of transfer of goods or services (e.g., at a point in time or over time) or (f) market type (revenue from international or U.S. governments), among others.

F.2. Contract balances

All entities should disclose, or present separately on the face of the balance sheet, the opening and closing balances of accounts receivable, contract assets and contract liabilities.

Public entities also are required to disclose the following, which are optional for nonpublic entities:

- *The amount of revenue recognized in the current reporting period that was included in the contract liability balance at the end of the previous reporting period.* For example, if an entity had a contract liability balance at the end of the previous reporting period due to it receiving upfront nonrefundable payments for which it had not yet fully performed, it should disclose the amount of that liability that was recognized as revenue in the current reporting period.
- *An explanation (which may be qualitative) of the timing of the entity's satisfaction of its performance obligations compared to the timing of when it typically receives payment for providing the underlying goods or services and how the contract asset and contract liability balances are affected by this timing.*
- *A qualitative and quantitative explanation of what caused significant changes in the contract assets or contract liabilities during the reporting period.* For example, if an entity acquires another entity during the reporting period, it should explain the acquisition's effects on contract assets and contract liabilities.

An entity's revision of estimates (e.g., variable consideration, percentage of completion), if any, should be evaluated for its impact on contract balances. If material, an entity should explain the effects on contract assets and contract liabilities of revising an estimate. This will provide relevant information about the timing of revenue recognition that was not a result of current-period performance.

F.3. Performance obligations

An entity is required to disclose the following about its performance obligations:

- When its performance obligations are typically satisfied
- Significant payment terms
- Nature of the promised goods or services provided to customers
- Obligations it has in its customer contracts related to rights of return or refund or other similar customer rights
- Warranties and related obligations
- Revenue recognized in the current reporting period related to performance obligations satisfied (or partially satisfied) in the prior reporting period

F.4. Transaction price allocated to remaining performance obligations

Remaining performance obligations are those performance obligations identified in a customer contract entered into before the end of a reporting period for which control of some or all of the underlying goods or services has not been transferred to the customer at the end of the reporting period. A remaining

performance obligation may be a partially satisfied performance obligation or a completely unsatisfied performance obligation.

With certain exceptions, the following information about remaining performance obligations at the end of a reporting period should be disclosed by public entities and may be disclosed by nonpublic entities:

- *The total amount of the transaction price allocated to those performance obligations.*
- *An explanation of when the entity expects to recognize the transaction price allocated to these performance obligations as revenue.* This disclosure requirement can be satisfied either quantitatively (using appropriate time bands for when the allocated transaction price is expected to be recognized as revenue) or qualitatively.

As described further in ASC 606-10-50-14 to 50-14B, there are two optional exemptions related to these remaining performance obligation disclosure requirements. An entity should disclose which of the optional exemptions it has elected to apply, as well as the following information about the related remaining performance obligations: (a) their nature, (b) their remaining duration and (c) a description of any variable consideration excluded from the disclosures as a result of electing one or both of the optional exemptions.

F.5. Significant judgments

An entity should disclose judgments (and changes to those judgments) it makes in applying the new guidance that significantly affect when and how much revenue is recognized related to its customer contracts. The disclosures should include those judgments (and changes in judgments) involved in determining the transaction price, allocating the transaction price to performance obligations and determining when performance obligations are satisfied.

The following information should be disclosed by all entities:

- *For performance obligations satisfied over time, the specific input or output method used to recognize revenue.*
- *In applying the variable consideration constraint, the judgments involved in identifying the methods, inputs and assumptions used.*

The following additional information should be disclosed by public entities and may be disclosed by nonpublic entities:

- *For performance obligations satisfied over time, an explanation of why the specific input or output method used to recognize revenue over time provides a faithful depiction of how the entity transfers control of goods or services to its customers.*
- *For performance obligations satisfied at a point time, the significant judgments made in determining when control of the goods or services transfers to the entity's customers.*
- *The judgments involved in identifying the methods, inputs and assumptions used to determine and allocate the transaction price and measure any obligations related to the customer contract (e.g., returns, refunds), including (but not limited to) the following:*
 - If there is variable consideration, the entity should explain how it estimates the variable consideration (e.g., the most likely amount method or the expected value method).
 - If there is a significant financing component, such as certain long-term payment plans, the entity should disclose how it was reflected in the transaction price. Public entities electing the practical expedient that results in not reflecting a significant financing component in the transaction price should disclose that fact.
 - If there is noncash consideration, the entity should disclose how it was measured.

- *For contracts that include more than one performance obligation, the judgments involved in identifying the methods, inputs and assumptions used to: (a) estimate the standalone selling price of each performance obligation and (b) allocate any discount or variable consideration included in the contract.*
- *For rights of return or refund (e.g., right of refund related to some or all of an advance payment), the judgments involved in identifying the methods, inputs and assumptions used to estimate the related obligation.*

F.6. Contract costs

The following information related to costs incurred to obtain or fulfill a customer contract should be disclosed by public entities and may be disclosed by nonpublic entities:

- A description of the judgments made in identifying the costs that should be capitalized
- A description of the method used in each reporting period to amortize the capitalized costs and the amount of related amortization recognized for the reporting period
- The ending balances of capitalized costs by main category of asset (e.g., incremental costs to obtain a contract, setup costs)
- Any impairment loss recognized in the reporting period related to the capitalized costs
- If an entity elects the practical expedient allowing it to expense the incremental costs to obtain a contract if the amortization period for those costs would otherwise be one year or less, that fact.

G. Conclusion

This white paper discusses those differences between the new guidance and legacy GAAP that are likely to have the most significant effects on how entities in the technology industry recognize revenue. For comprehensive discussion about the new guidance, including its scope, core principle and key steps, implementation guidance, presentation and disclosure requirements, and effective date and transition provisions, refer to [our revenue recognition guide](#).

All entities in the technology industry whose financial statements are prepared in accordance with U.S. GAAP will be affected by the new guidance because their accounting policies for revenue recognition will need to change to reflect the five-step revenue recognition model. In addition, every entity in the technology industry will be significantly affected by the disclosure requirements in the new guidance because they substantially increase the volume of revenue-related information disclosed in the financial statements, particularly for public entities. The new guidance will require entities in the technology industry to evaluate whether any changes are needed to their current revenue and financial reporting processes, systems and procedures. This undoubtedly will require substantive involvement by more than just those involved in the accounting function. To discuss the impacts of the new guidance on your company and its financial statements, please contact your RSM representative, Bill Gaetz (+1 612 629 9005) or Greg Hicks (+1 205 949 2131).

+1 800 274 3978

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