

Financial Reporting Insights



REVENUE RECOGNITION FOR INDUSTRIAL ENTITIES

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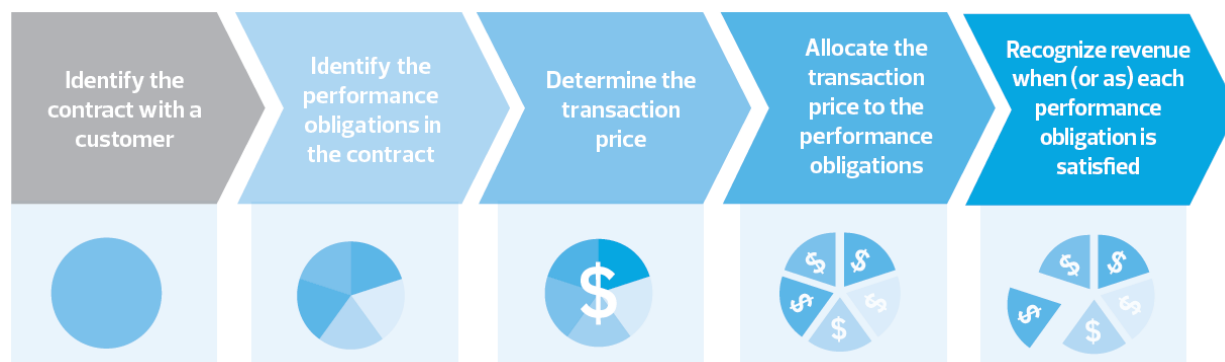
1. Introduction

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

While virtually all aspects of ASC 606 and ASC 340-40 are relevant to industrial entities, this white paper highlights aspects of the guidance that are particularly pertinent for these entities. For additional information about all of the revenue recognition guidance, including those aspects discussed in this white paper, as well as numerous examples illustrating how to apply the guidance, refer to [our revenue recognition guide](#).

2. Core principle and key steps

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



3. Step 1: Identifying the contract with a customer

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

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

Most industrial entities enter into written contracts in which the criteria for contract existence are clearly evidenced within the contract terms. The one criterion which is most likely to require additional judgement

is whether collection of substantially all of the amount to which the entity will be entitled in exchange for the goods or services that will be transferred to the customer is probable. Making this determination is partly forward looking and requires consideration of all the relevant facts and circumstances, which include contractual terms as well as the entity's customary business practices and knowledge of the customer.

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

4. Step 2: Identifying performance obligations in the contract

After contract identification (Step 1), an industrial entity needs to identify the performance obligations in the contract (Step 2). Identifying performance obligations in a contract establishes the units of account to which the transaction price should be allocated and for which revenue is recognized.

4.1 Identifying promises to transfer goods or services

The first step in identifying the performance obligations in the contract is to identify all promises to provide goods or services. In many cases, identifying the promised goods or services in an industrial entity's contracts is relatively straightforward, with examples of such promised goods or services being manufacturing equipment, installation of manufacturing equipment, agricultural machinery and components for construction vehicles. However, in other cases, identifying the promised goods or services in an industrial entity's contracts may not be as straightforward:

- Some activities performed by an industrial entity in fulfilling a contract (e.g., setup activities) do not transfer goods or services to the customer, and thus are not accounted for as a performance obligation. While performing these activities is necessary to provide the promised goods or services in the contract, the activities themselves do not give rise to a promised good or service. Determining whether nonrecurring engineering and preproduction activities represent promised goods or services or setup activities is discussed in [Section 4.4](#).
- While promised goods and services are most often explicitly stated in the contract, consideration also needs to be given to whether an industrial entity's customary business practices, published policies or specific statements give rise to a promise to transfer a good or service to the customer. For example, if an industrial entity's customary business practice creates a valid expectation on the customer's part to receive training on how to use a piece of complex manufacturing equipment, an implicit promise to transfer services exists that should be accounted for like an explicit promise to transfer services.

4.1.1. Shipping and handling activities

Industrial entities are commonly faced with accounting for shipping and handling activities arising from delivering promised goods to their customers. The accounting for shipping and handling activities depends on whether the activities are performed before or after a customer obtains control of the promised goods. Passage of legal title is one of several indicators an industrial entity should consider in determining when control of promised goods has transferred to the customer. If, after considering all control indicators (discussed in [Section 7.1](#)), the industrial entity concludes that control transfers to the customer based on transfer of title, the following guidance applies:

- *When promised goods are shipped free-on-board (FOB) destination*, title to those goods passes to the customer when the goods reach their destination (e.g., the customer's warehouse). In these situations, the shipping and handling activities occur *before* the customer obtains control of those

goods. As a result, the shipping and handling activities should be considered fulfillment activities and not a promised service that should be further evaluated under ASC 606.

- *When promised goods are shipped FOB shipping point*, title to those goods passes to the customer when the shipping company picks up the goods from the shipping point (e.g., the industrial entity's facilities). In these situations, the shipping and handling activities occur *after* the customer obtains control of those goods. As a result, the shipping and handling activities should be considered a promised service and further evaluated under ASC 606. However, the industrial entity may elect an accounting policy under which shipping and handling activities are accounted for as fulfillment activities and not promised services requiring further evaluation under ASC 606. If the industrial entity elects this accounting policy, the costs related to the shipping and handling activities should be accrued when the industrial entity recognizes revenue for the related promised goods. If elected, the accounting policy must be applied consistently to similar transactions. In addition, an industrial entity that elects the accounting policy must provide the accounting policy disclosures required by ASC 235, "Notes to Financial Statements."

Additional practices and terms may need to be taken into consideration in determining the effects of shipping terms on the identification of promised goods or services and when control of the promised goods transfers to the customer. For example, consider situations in which an industrial entity ships promised goods using FOB shipping point terms, but either insures the promised goods during shipment or has a practice of replacing promised goods that are lost or stolen while in transit (which may be referred to as synthetic FOB destination). In all situations, the industrial entity should determine when control of promised goods transfers to a customer by performing a thorough analysis of its facts and circumstances in the context of all five indicators of control transfer, two of which are passage of title and transfer of risk of loss. An industrial entity shipping promised goods using FOB shipping point terms, but either insuring the promised goods during shipment or having a practice of replacing promised goods that are lost or stolen while in transit, results in title to the promised goods transferring to the customer (which would be when the shipping company picks up the goods at the shipping point) before the risk of loss associated with the promised goods transfers to the customer (which would be when the customer receives the goods). As a result, determining when control transfers in these situations hinges on the analysis of the three additional indicators of control transfer discussed in [Section 7.1](#). If, based on the analysis of all five indicators of control transfer, the industrial entity concludes that control of the promised goods transfers to the customer at the shipping point, then the insurance or service of replacing promised goods lost or stolen in transit should be treated as a promised service the industrial entity is providing to the customer. Conversely, if the industrial entity concludes that control of the promised goods transfers to the customer upon receipt of the goods by the customer, then the costs associated with the insurance or replacing the promised goods lost or stolen in transit should be treated as a fulfillment cost related to those promised goods.

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

An industrial entity may choose not to identify for further evaluation under ASC 606 those promised goods or services that are immaterial in the context of the contract. However, if the industrial entity chooses not to identify such promised goods or services for further evaluation, the costs related to the goods or services that are immaterial in the context of the contract should be accrued if revenue related to the performance obligation in which those goods or services are included is recognized before those goods or services are transferred to the customer. In addition, the industrial entity should document the evaluation performed in arriving at a conclusion that the promised good or service is immaterial in the context of the contract. This evaluation should consider whether the promises are either quantitatively or qualitatively material to the customer. Because the guidance indicates that to not be identified for further evaluation under ASC 606 the promised good or service must be immaterial in the context of the contract, the industrial entity is not required to aggregate the promised goods or services that are immaterial in the context of the related contracts for purposes of evaluating whether those promised goods or services are material as a whole to the financial statements.

4.2 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 accounted for separately. The determining factor in this analysis is whether each promised good or service is distinct. A promised good or service is considered distinct if it meets both of the following criteria: (a) it is capable of being distinct and (b) it is distinct within the context of the contract. A promised good or service that is considered distinct is accounted for separately as a performance obligation unless the series exception applies. For additional information about the series exception, refer to Section 6.3 of [our revenue recognition guide](#).

4.2.1. Capable of being distinct

If a customer can benefit from the promised good or service 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 industrial entity regularly sells that good or service separately or when the customer could generate an economic benefit from using, consuming, selling or otherwise holding the good or service for 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 industrial 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 industrial entity (including the contract under evaluation) or another transaction or event.

4.2.2. Distinct within the context of the contract

To determine whether a promised good or service is distinct within the context of the contract, the industrial 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 promised good or service individually.* If this best describes the industrial 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 in the contract is to transfer a combined item or items to which the promised good or service is an input.* If this best describes the industrial 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 context of the contract:

- Is the industrial 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? Another way to think of this question is can the industrial entity satisfy each of the promises in the contract independent of its efforts to satisfy the other promises?

[Sections 4.2.3 to 4.2.5](#) discuss identifying the performance obligations in contracts that include installation services, warranties and contract manufacturing services.

4.2.3. Installation services

When an industrial entity sells equipment or machinery to a customer, it is not uncommon for it to also sell the customer services to install the equipment or machinery in the customer's own environment. The following example: (a) illustrates a situation in which equipment and installation services are distinct from each other and (b) discusses how the facts and circumstances would need to change to arrive at a conclusion that the equipment and installation are not distinct from each other.



Example 4-1: Identifying the performance obligations in a contract including equipment and installation services (ASC 606-10-55-150A to 606-10-55-150D)

An entity contracts with a customer to sell a piece of equipment and installation services. The equipment is operational without any customization or modification. The installation required is not complex and is capable of being performed by several alternative service providers.

The entity identifies two promised goods and services in the contract: (a) equipment and (b) installation. The entity assesses the criteria in paragraph 606-10-25-19 to determine whether each promised good or service is distinct. The entity determines that the equipment and the installation each meet the criterion in paragraph 606-10-25-19(a). The customer can benefit from the equipment on its own, by using it or reselling it for an amount greater than scrap value, or together with other readily available resources (for example, installation services available from alternative providers). The customer also can benefit from the installation services together with other resources that the customer will already have obtained from the entity (that is, the equipment).

The entity further determines that its promises to transfer the equipment and to provide the installation services are each separately identifiable (in accordance with paragraph 606-10-25-19(b)). The entity considers the principle and the factors in paragraph 606-10-25-21 in determining that the equipment and the installation services are not inputs to a combined item in this contract. In this Case, each of the factors in paragraph 606-10-25-21 contributes to, but is not individually determinative of, the conclusion that the equipment and the installation services are separately identifiable as follows:

- a. The entity is not providing a significant integration service. That is, the entity has promised to deliver the equipment and then install it; the entity would be able to fulfill its promise to transfer the equipment separately from its promise to subsequently install it. The entity has not promised to combine the equipment and the installation services in a way that would transform them into a combined output.
- b. The entity's installation services will not significantly customize or significantly modify the equipment.
- c. Although the customer can benefit from the installation services only after it has obtained control of the equipment, the installation services do not significantly affect the equipment because the entity would be able to fulfill its promise to transfer the equipment independently of its promise to provide the installation services. Because the equipment and the installation services do not each significantly affect the other, they are not highly interdependent or highly interrelated.

On the basis of this assessment, the entity identifies two performance obligations (the equipment and installation services) in the contract.

The entity applies paragraphs 606-10-25-23 through 25-30 to determine whether each performance obligation is satisfied at a point in time or over time.



RSM COMMENTARY: If the facts were such that the entity is the only party that could perform the installation and the entity never sells the equipment without the installation services, the entity would have to carefully consider how the customer could benefit from the equipment on its own or by combining it with other resources readily available to it for purposes of determining whether the equipment is capable of being distinct. If the customer could sell the

equipment on a secondary market for more than scrap value, it is likely that the customer could benefit from the equipment on its own, which means it is likely that the equipment is capable of being distinct. Conversely, if the equipment had no alternative use to the customer (even for resale on a secondary market), the customer could not benefit from the equipment on its own, which means the equipment is not capable of being distinct.

Determining whether equipment and installation are distinct from each other often will require significant judgment to be exercised and careful consideration of an industrial entity's own relevant facts and circumstances.

4.2.4. Warranties

Industrial entities often provide a warranty to the customer when the customer purchases promised goods or services, such as equipment, machinery and installation services, etc. In addition, some industrial entities will sell the customer an extended warranty that includes maintenance services. The key accounting question for a warranty is whether it represents or includes a performance obligation (i.e., a distinct service). If a warranty represents or includes a performance obligation, part of the transaction price is allocated to the warranty and recognized as revenue as control of the warranty services is transferred to the customer. If a warranty does not represent or include a performance obligation, no part of the transaction price is allocated to it. Instead, the warranty is accounted for in accordance with the product warranty guidance included in ASC 460, "Guarantees," which requires accrual of expected warranty costs.

If a customer has the option to purchase a warranty, the warranty represents a performance obligation and is accounted for separately. If such an option does not exist, the industrial entity must determine whether it is providing: (a) only a warranty that the product complies with agreed-upon specifications (i.e., an assurance-type warranty) or (b) a service (e.g., maintenance) in addition to the assurance-type warranty (i.e., a service-type warranty). Some factors an industrial entity should consider in determining whether it is providing a service-type warranty in addition to an assurance-type warranty include the following:

- A warranty required by law is indicative of an assurance-type warranty.
- The longer the warranty is in effect, the more likely it is that the warranty includes a service-type warranty.
- If the industrial entity has to perform certain steps to provide assurance that agreed-upon specifications are met, those steps are likely not performance obligations.

In many cases, determining whether an industrial entity is providing a service-type warranty in addition to an assurance-type warranty will be clear. For example, if the warranty only results in the industrial entity replacing a product during the warranty period as required by law because the product does not comply with agreed-upon specifications (i.e., the product is defective), the warranty is an assurance-type warranty that is accounted for in accordance with ASC 460. However, determining whether an industrial entity is providing a service-type warranty in addition to an assurance-type warranty in other cases may not be as clear and, as a result, will require the exercise of significant judgment and careful consideration of all the facts and circumstances.

When applying ASC 606 to a service-type warranty accounted for as a performance obligation, consideration should be given to whether the warranty represents a stand-ready obligation, which is discussed in detail in Section 6.1.3 of [our revenue recognition guide](#).

If the warranty goes beyond the promise that the product complies with agreed-upon specifications, the industrial entity must determine whether it can reasonably account for the assurance-type warranty

separate from the service-type warranty. If the industrial entity can reasonably account for the two warranties separate from each other, the assurance-type warranty is accounted for under ASC 460 and the service-type warranty is accounted for as a performance obligation under ASC 606. If the industrial entity cannot reasonably account for the two warranties separate from each other, both warranties are accounted for together as a single performance obligation under ASC 606. An industrial entity should put forth reasonable effort to determine whether it can reasonably account for the two warranties separate from each other. Only after putting forth that effort and drawing the conclusion that it cannot reasonably account for the two warranties separate from each other should the industrial entity account for the warranties as a single performance obligation under ASC 606.

4.2.5. Contract manufacturing

In the most basic sense, contract manufacturing is an industrial entity outsourcing the manufacture of a product or a product component to another entity. For example, an industrial entity and its customer may enter into a contract under which the industrial entity manufactures 20 complex pieces of equipment in accordance with the customer's specifications. As illustrated in the following example, the industrial entity's accounting for this contract under ASC 606 could result in the identification of one performance obligation, depending on the specific facts and circumstances.



Example 4-2: Identifying the performance obligations in a contract to manufacture multiple units of a specialized complex device (ASC 606-10-55-140A to 606-10-55-140C)

An entity enters into a contract with a customer that will result in the delivery of multiple units of a highly complex, specialized device. The terms of the contract require the entity to establish a manufacturing process in order to produce the contracted units. The specifications are unique to the customer based on a custom design that is owned by the customer and that were developed under the terms of a separate contract that is not part of the current negotiated exchange. The entity is responsible for the overall management of the contract, which requires the performance and integration of various activities including procurement of materials; identifying and managing subcontractors; and performing manufacturing, assembly, and testing.

The entity assesses the promises in the contract and determines that each of the promised devices is capable of being distinct in accordance with paragraph 606-10-25-19(a) because the customer can benefit from each device on its own. This is because each unit can function independently of the other units.

The entity observes that the nature of its promise is to establish and provide a service of producing the full complement of devices for which the customer has contracted in accordance with the customer's specifications. The entity considers that it is responsible for overall management of the contract and for providing a significant service of integrating various goods and services (the inputs) into its overall service and the resulting devices (the combined output) and, therefore, the devices and the various promised goods and services inherent in producing those devices are not separately identifiable in accordance with paragraphs 606-10-25-19(b) and 606-10-25-21. In this case, the manufacturing process provided by the entity is specific to its contract with the customer. In addition, the nature of the entity's performance and, in particular, the significant integration service of the various activities mean that a change in one of the entity's activities to produce the devices has a significant effect on the other activities required to produce the highly complex specialized devices such that the entity's activities are highly interdependent and highly interrelated. Because the criterion in paragraph 606-10-25-19(b) is not met, the goods and services that will be provided by the entity are not separately identifiable, and, therefore, are not distinct. The entity accounts for all of the goods and services promised in the contract as a single performance obligation.



RSM COMMENTARY: Industrial entities that provide contract manufacturing services should carefully consider their own facts and circumstances in the context of ASC 606 to ensure they have obtained an appropriate understanding of the nature of the promised goods or services included in the contract and identified the appropriate performance obligations. If that were not done in this example, the entity might have inappropriately concluded that each highly complex and specialized device was a performance obligation. Arrangements for contract manufacturing services are often unique and complex. As a result, identifying the performance obligations when such services are being provided to the customer will require significant judgment to be exercised and careful consideration of the industrial entity's own relevant facts and circumstances.

Whether the entity in this example should recognize revenue for its single performance obligation over time or at a point in time is discussed in [Section 7.2.1](#).

4.2.5.1. Loss provisions on production-type contracts

When ASC 606 was issued, the guidance for the recognition of loss provisions on contracts with customers within ASC 605 was one of the only sections of prior revenue guidance to be retained. ASC 605-35-15-2(a) indicates that the scope of the guidance in ASC 605-35 related to recognizing loss provisions on a contract applies to the following types of contracts entered into by contractors:

The performance of contracts for which specifications are provided by the customer for the construction of facilities or the production of goods or the provision of related services. However, it applies to separate contracts to provide services essential to the construction or production of tangible property, such as design, engineering, procurement, and construction management (see paragraph 605-35-15-3 for examples). Contracts covered by this Subtopic are binding agreements between buyers and sellers in which the seller agrees, for compensation, to perform a service to the buyer's specifications. Specifications imposed on the buyer by a third party (for example, a government or regulatory agency or a financial institution) or by conditions in the marketplace are deemed to be buyer's specifications.

ASC 605-35-15-3 specifically notes that the guidance for recognizing loss provisions on production-type contracts applies to, amongst other things, contracts to design, develop, manufacture or modify complex aerospace or electronic equipment to a buyer's specification or to provide services related to the performance of such contracts.

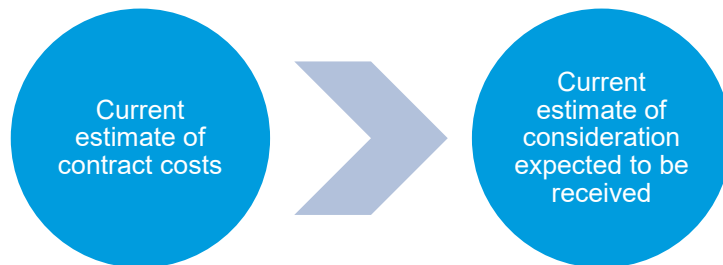
Recognition and measurement

A contractor in the industrial industry may elect to recognize and measure loss provisions on contracts within the scope of ASC 605-35 at one of the following two levels:

1. *Contract level (or combined contract level)*. The contract (or combined contracts) is the unit of account for which a loss provision is recognized and measured (when necessary). Combined contracts should only be the unit of account if the contracts were combined as a result of applying the contract combination guidance in ASC 606 (see Section 5.4 of [our revenue recognition guide](#)). If loss provisions are recognized and measured at this level, more than one performance obligation may be affected.
2. *Performance obligation level*. The performance obligation is the unit of account for which a loss provision is recognized and measured (when necessary).

The same accounting policy must be applied to similar contracts.

If a contractor anticipates a loss on a particular unit of account, the entire anticipated loss should be recognized and measured by the contractor in the period the loss becomes evident. A loss provision is recognized and measured when:



The entire loss is recognized in the period it becomes evident.

Current estimate of contract costs

The current estimate of contract costs should include all of the fulfillment costs allocable to a contract (see [Section 8.2](#)). For its cost-plus contracts, a contractor also should consider whether any nonreimbursable costs should be included in the current estimate of contract costs. For all its contracts, the contractor should consider whether there are any costs associated with change orders accounted for as contract modifications (see [Section 5.5 of our revenue recognition guide](#)) that should be included in the current estimate of contract costs. In addition, for purposes of determining its total cost overrun on a contract, the contractor should use its normal cost accounting methods.

Current estimate of consideration expected to be received

The current estimate of consideration expected to be received is determined in accordance with ASC 606 and depends on whether the unit of account for recognizing and measuring a loss provision is the:

- **Contract (or combined contracts).** The current estimate of consideration expected to be received is the transaction price for the contract (or combined contracts) (see Chapter 7 of [our revenue recognition guide](#)) reduced by the amount the contractor does not expect to collect from the customer due to its credit risk (see [Section 5.2.1 of our revenue recognition guide](#) for discussion of how credit risk is addressed in ASC 606) and increased by the effects of removing the variable consideration constraint (if any) (see [Section 5.2](#)).
- **Performance obligation.** The contractor allocates the current estimate of consideration expected to be received for the contract (or combined contracts) to the performance obligations using the guidance in ASC 606 on allocating the transaction price to the performance obligations (see [Section 6](#)), which results in the current estimate of consideration expected to be received for each performance obligation.

Presentation of loss provision

The loss provision for a unit of account should be presented as an additional contract cost on the income statement and should not be: (a) presented as a reduction of revenue or (b) classified as a separate line item on the income statement unless the amount of the loss is material or the nature of the loss is unusual or infrequent. In those limited situations in which the loss is classified as a separate line item on the income statement, it should still be included in the determination of gross profit.

To the extent a significant liability is recognized related to a loss provision, it should be separately presented on the balance sheet. However, if there are costs accumulated on the balance sheet related to the unit of account, a contractor may choose to recognize the loss provision for that unit of account as a reduction of the accumulated costs instead of recognizing it as a liability. When a separate liability is presented on the balance sheet for a loss provision, it should be classified as a current liability.

4.3 Customer options for additional goods or services

As part of a contract, an industrial entity may provide its customer with options for additional goods or services, such as an option to purchase additional goods or services in the future at a discount or a contract renewal right that can be exercised in the future.

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

4.3.1. Determining whether a contract includes a customer option for additional goods or services or variable consideration

In many cases, determining whether a contract includes a customer option for additional goods or services will be relatively straightforward. However, in other cases, such as those in which the contract has variable attributes, it may not initially be clear whether those variable attributes give rise to an option for additional goods or services or variable consideration.

Understanding the industrial entity's and the customer's rights and obligations is critical to determining whether the variable attributes in a contract should be accounted for as an option or variable consideration. The following table captures the rights and obligations of the industrial entity and the customer that point to the variable attributes in a contract being either an option or variable consideration for accounting purposes:

Points to variable attributes in a contract being...	
An option	Variable consideration
The industrial entity is not obligated to transfer additional promised goods or services unless and until the customer exercises its right to purchase those additional goods or services.	The industrial entity is obligated to provide the promised goods or services without the customer exercising an incremental right. The action taken by the customer is resolving the uncertainty of how much it will pay.
The customer becomes obligated to transfer additional consideration to the industrial entity only after it both exercises its right to purchase additional promised goods or services and takes control of those goods or services.	The customer becomes obligated to transfer additional consideration to the industrial entity <i>after</i> (or <i>as</i>) it obtains control of the promised goods or services transferred by the industrial entity.
Actions taken by the customer obligate the industrial entity to provide additional promised goods or services.	Actions taken by the customer serve to resolve the uncertainty related to the amount of consideration it is obligated to pay.

While in some situations there will be minimal differences between accounting for the variable attributes in a contract as an option instead of variable consideration (or vice versa), it remains important in those situations to reach the appropriate conclusion, given the disclosure requirements in ASC 606. For example, if the contract includes an option that is accounted for as a performance obligation, the industrial entity would be required to include the option in its disclosure requirements about its performance obligations. Conversely, if the contract includes variable consideration, the industrial entity's disclosures about the transaction price allocated to the remaining performance obligations would be affected (unless the industrial entity is eligible for and elects an available practical expedient).



Example 4-3: Determining whether the variability in the quantity of widgets a customer might purchase is an option or variable consideration (Question 23 of FASB's [Revenue Recognition Implementation Q&As](#))

Optional Purchases (Example 2)

Entity B enters into a contract to provide 100 widgets to Customer Y at CU10 per widget. Each widget is a distinct good transferred at a point in time. The contract also provides Customer Y the right to purchase additional widgets at the standalone selling price of CU10 per widget. Therefore, the quantity that may be purchased by Customer Y is variable.

Although the quantity that may be purchased is variable, the transaction price for the existing contract is fixed at CU1,000. That is, the transaction price includes only the consideration for the 100 widgets specified in the contract and any exercise of an option is accounted for as an independent contract (because there is no material right given the pricing of the option to acquire additional widgets in this contract). The contract provides a right that allows the customer to choose the number of additional widgets which are distinct goods. In addition, while Entity B may have an obligation to stand ready to deliver additional widgets, Entity B is not legally obligated to provide the widgets until Customer Y exercises the option.

Supply Agreement (Example 7)

Supplier enters into a 5-year exclusive master supply agreement with a customer which obligates the supplier to produce and sell parts for a particular product the customer manufactures to the customer as requested. The customer is not obligated to purchase any parts, however, it is highly likely it will purchase parts because the part is required to manufacture the product and it is not practical to get parts from multiple suppliers. Each part is a distinct good that transfers to the customer at a point in time.



RSM COMMENTARY: In both examples, the variability in the quantity of widgets or parts the customer may buy should be accounted for as options because the entity is not obligated to transfer (and the customer is not obligated to pay for) the widgets or parts until the customer exercises its option (and the entity transfers control of the widgets or parts to the customer).

In the widget example, the option does not provide a material right to the customer that it would not have obtained without entering into the contract because the widgets that can be purchased by the customer under the option are priced at their standalone selling price. As a result, the option represents a marketing offer that is not accounted for until the option is exercised.

In the parts example, more information would be needed to determine the accounting for the option, including the price at which the customer can buy the parts on an as-needed basis and the standalone selling price of the option.

4.3.1.1. Contract renewal and contract termination rights

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

As discussed in Section 5.3.2 of [our revenue recognition guide](#), the contract term for purposes of ASC 606 should include the period subject to an enforceable termination right if exercising that right results in

a substantive termination penalty or other substantive required payment. When a termination penalty or other required payment upon termination of the contract is not substantive (or is nonexistent), the period subject to the enforceable termination right is not included in the contract term for purposes of ASC 606. Instead, the industrial entity should evaluate the contract as one with a contract renewal right. In essence, requiring no or a nonsubstantive termination penalty or other required payment upon exercising a termination right turns that termination right into a renewal right for accounting purposes.

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

4.3.2. Determining whether customer options for additional goods or services are performance obligations

The question that arises when an industrial entity includes an option for additional goods or services in a contract is whether that option is a performance obligation that should be accounted for separately. The answer to this question hinges on whether the option provides a material right to the customer that it would not have received without entering into the contract with the industrial entity. In general, if an option included in a contract gives the customer the right to a discount that is incremental to the range of discounts typically given by the industrial entity on the same goods or services to the same class of customer in the same geographical area or market, the option provides a material right to the customer that it would not have received without entering into the contract. Conversely, if an option included in a contract gives the customer the right to purchase products or services at their standalone selling prices in the future, the option does not provide a material right to the customer that it would not have received without entering into the contract. This type of option is essentially a marketing offer that is not accounted for until the customer exercises the option.

When evaluating whether an option provides a material right, the industrial entity should take into consideration all transactions, which include current, past and future transactions with the customer that are relevant to the evaluation.

A question that arises when evaluating whether an option provides a material right is whether the industrial entity should consider only quantitative factors or both quantitative and qualitative factors. The FASB staff and Transition Resource Group (TRG) discussed this question. A summary of their discussion was provided in Question 13 of FASB's [Revenue Recognition Implementation Q&As](#). The FASB staff and TRG concluded that both quantitative and qualitative information should be considered by an entity when evaluating whether an option provides a material right.

See Section 6.6.2 of [our revenue recognition guide](#) for examples of how this guidance is applied.

4.3.3. Accounting for an option that is a performance obligation

When an option is a performance obligation, an industrial entity must determine the standalone selling price for the option for purposes of allocating a portion of the transaction price to the option (see [Section 4.3.3.1](#)). In addition, the transaction price does not include any additional consideration that would result from the customer exercising the option because the option is a material right that the customer is implicitly obligated to pay for as part of the contract in which it is included. The transaction price allocated to the option is recognized as revenue when or as the option is exercised (see [Section 4.3.3.2](#)), or if it is not exercised, when the option expires unused. This accounting model essentially reflects the customer partially paying in advance for goods and services it will purchase when it exercises the option.

4.3.3.1. Estimating the standalone selling price of an option that is a performance obligation

While unlikely to be the case, if there is a directly observable standalone selling price for the option, it should be used for allocation purposes. For the more likely scenario in which a directly observable standalone selling price for the option is not available, the industrial entity must estimate the standalone selling price (which is discussed in detail in Section 8.2 of [our revenue recognition guide](#)). In doing so, the industrial entity should ensure that the estimate reflects both of the following:

- *If the customer could get a discount without exercising the option, that discount should be taken into consideration in the standalone selling price of the option.* For example, consider a situation in which a customer has an option to purchase product from the industrial entity in the future at a 30% discount. If the customer could get a 10% discount on future purchases of the product without the option because, for example, the industrial entity is offering a 10% discount on future purchases of any product to all customers, that should be taken into consideration in estimating the standalone selling price of the option. In this situation, the discount that should be evaluated to determine whether it provides the customer with a material right is the incremental 20% discount on future purchases that the industrial entity is offering to only this customer. This is important to keep in mind because the effects of the customer only getting an incremental discount of 20% (compared to 30%) decreases the value of the option, all other things being equal.
- *How likely it is that the customer will exercise the option.* For example, consider a situation in which a customer has an option to purchase up to \$1,000 of product from the industrial entity in the future at a 30% discount. If the customer is only expected to use the discount to purchase \$800 of product, the standalone selling price of the option should reflect the expected purchase of \$800 and not the maximum possible purchase of \$1,000.

Given the difficulties that may arise in estimating the standalone selling price of an option for additional goods or services, an industrial entity may instead allocate a portion of the transaction price to the optional goods or services based on the goods or services expected to be provided in connection with the option and the related expected consideration. However, this practical alternative may only be elected if the optional goods or services are:

- Similar to the original goods or services in the contract
- Provided in accordance with the terms of the original contract

While the type of option for additional goods or services that most likely would qualify for this practical alternative is a contract renewal option, other types of options also may qualify.



Example 4-4: Determining whether a discount voucher is a performance obligation, estimating its standalone selling price and accounting for its redemption (ASC 606-10-55-336 to 55-339)

An entity enters into a contract for the sale of Product A for \$100. As part of the contract, the entity gives the customer a 40 percent discount voucher for any future purchases up to \$100 in the next 30 days. The entity intends to offer a 10 percent discount on all sales during the next 30 days as part of a seasonal promotion. The 10 percent discount cannot be used in addition to the 40 percent discount voucher.

Because all customers will receive a 10 percent discount on purchases during the next 30 days, the only discount that provides the customer with a material right is the discount that is incremental to that 10 percent (that is, the additional 30 percent discount). The entity accounts for the promise to provide the incremental discount as a performance obligation in the contract for the sale of Product A.

To estimate the standalone selling price of the discount voucher in accordance with paragraph 606-10-55-44, the entity estimates an 80 percent likelihood that a customer will redeem the voucher and that a customer will, on average, purchase \$50 of additional products. Consequently, the entity's estimated standalone selling price of the discount voucher is \$12 (\$50 average purchase price of additional

products × 30 percent incremental discount × 80 percent likelihood of exercising the option). The standalone selling prices of Product A and the discount voucher and the resulting allocation of the \$100 transaction price are as follows:

Performance Obligation	Standalone Selling Price
Product A	\$100
Discount voucher	12
Total	\$112

Performance Obligation	Allocated Transaction Price	
Product A	\$89	$(\$100 \div \$112 \times \$100)$
Discount voucher	11	$(\$12 \div \$112 \times \$100)$
Total	\$100	

The entity allocates \$89 to Product A and recognizes revenue for Product A when control transfers. The entity allocates \$11 to the discount voucher and recognizes revenue for the voucher when the customer redeems it for goods or services or when it expires.



RSM COMMENTARY: While not explicitly stated, the entity concludes that it should account for the promise to provide the incremental discount of 30% as a performance obligation because it represents a material right the customer would not have received if it had not entered into the contract with the entity to purchase Product A for \$100.

Assuming the inventory cost of the \$100 product purchased by the customer is \$40, the entity records the following journal entry when it transfers control of Product A to the customer:

	Debit	Credit
Cash	\$100	
Cost of goods sold	40	
Revenue		\$89
Discount voucher liability		11
Inventory		40

The following journal entry summarizes how the entity would recognize revenue if the customer used the voucher to purchase products totaling \$30, \$50 or \$70 over the 30-day period, respectively:

	\$30		\$50		\$70	
Account	Debit	Credit	Debit	Credit	Debit	Credit
Cash (Note 1)	\$18		\$30		\$42	
Discount voucher liability	11		11		11	
Revenue (Note 2)		\$29		\$41		\$53

Note 1: The cash reflected for each purchase was calculated by reducing the purchase price (\$30, \$50 or \$70) by the 40% discount. For example, if the discount voucher were used to purchase an item with a price of \$30, the cash received on that purchase would be \$18 ($\$30 \times [1 - 40\%]$).

Note 2: The revenue reflected for each purchase is the amount the customer pays for the current purchase plus the discount voucher liability recorded when the customer made the purchase that entitled it to the discount voucher.

The entity should take its experience with the redemption of this discount voucher into consideration when estimating the standalone selling prices of similar discount vouchers in the future.

4.3.3.2. Accounting for the customer's exercise of an option that provides a material right

The FASB staff and TRG discussed how an entity should account for the customer's exercise of an option that provides a material right. For this purpose, the FASB staff and TRG concluded that two models are supportable under ASC 606. One of the models is based on continuing to account for the performance obligations previously identified in the contract as they otherwise would have been accounted for absent exercise of the option, and separately accounting for the performance obligations created by the customer's exercise of the option. The other model is based on the change in scope or price resulting from exercise of the option being evaluated as a contract modification. The industrial entity must elect an accounting policy related to which model it will use to account for the customer's exercise of an option that provides a material right, disclose that accounting policy and consistently apply it in similar facts and circumstances. It is worth noting that the TRG and FASB staff considered and rejected a view that the customer's exercise of an option that provides a material right should (or may) be accounted for as variable consideration. They did not believe this view was supportable under ASC 606.

Additional information about (and an example illustrating) each of the supportable models is provided in Section 6.6.3.2 of [our revenue recognition guide](#).

4.4 Nonrecurring engineering and preproduction (NE&P) activities

It is not uncommon for an industrial entity to undertake NE&P activities for a customer, often in connection with fulfilling a long-term supply contract or in anticipation of entering into such a contract. For example, an industrial entity may enter into a contract with its customer to produce a component that its customer will use in the production of a vehicle. In connection with that contract, the industrial entity may be involved in the design and development of the component. In addition, the industrial entity may need to design and develop molds, dies and other tools to facilitate its production of the component. The industrial entity may or may not be explicitly paid or reimbursed for these NE&P activities.

4.4.1. Determining whether reimbursement for NE&P activities generate revenue

Diversity in practice exists with respect to whether cost reimbursements from the customer for NE&P activities should be accounted for as revenue. In some cases, industrial entities have concluded that the NE&P activities do not generate revenue and should be accounted for as cost reimbursements under other applicable accounting guidance, such as ASC 340-10, 340-40 or 730. In other cases, industrial entities have concluded that the NE&P activities generate revenue, and any related reimbursements should be accounted for as such. Industrial entities may need to give a careful consideration in assessing the accounting guidance that applies to costs related to NE&P activities.

[Sections 4.4.2](#) and [4.4.3](#) address the following two topics, respectively: (a) the accounting under ASC 606 for NE&P activities that generate revenue and (b) the accounting for NE&P activities that do not generate revenue. The accounting for costs incurred in performing NE&P activities is discussed in [Section 8.2.1](#).

4.4.2. Accounting under ASC 606 for NE&P activities that generate revenue

The FASB, its staff and the TRG discussed the application of ASC 606 to NE&P activities. The FASB staff included a flowchart in Question 65 of FASB's [Revenue Recognition Implementation Q&As](#) that captures the major decision points and accounting implications of applying ASC 606 to such activities, including:

- To the extent an industrial entity concludes that NE&P activities generate revenue that should be accounted for under ASC 606, any payments or cost reimbursements from the customer for such activities should be considered part of the transaction price for the contract
- The industrial entity must determine whether the NE&P activities: (a) transfer a promised good or service to the customer or (b) are setup activities that do not transfer a promised good or service to the customer

Determining whether NE&P activities should be considered promised goods or services or setup activities was discussed by the FASB staff and TRG. A summary of their discussion is included in Question 16 of FASB's [Revenue Recognition Implementation Q&As](#).

If the industrial entity determines that the NE&P activities transfer one or more promised goods or services to the customer, the industrial entity must determine whether the promised goods or services are distinct:

- If so, each distinct promised good or service is accounted for as a performance obligation and the transaction price allocated to the performance obligation is recognized as revenue when or as it is satisfied (i.e., when or as control of the promised good or service transfers to the customer)
- If not, each promised good or service is bundled with other promised goods or services until there is a bundle of promised goods or services that is distinct, in which case that bundle of promised goods or services is accounted for as a performance obligation, and the transaction price allocated to the performance obligation is recognized as revenue when or as it is satisfied (i.e., when or as control of the bundle of promised goods or services transfers to the customer)

Determining whether a promised good or service is distinct is discussed in detail in [Section 4.2](#). In addition, determining whether the transaction price allocated to a performance obligation should be recognized when (at a point in time) or as (over time) it is satisfied is discussed in [Section 7](#).

If the industrial entity determines that the NE&P activities are setup activities that do not transfer a promised good or service to the customer, it does not recognize revenue when or as it performs those activities. For example, if the industrial entity determines that the NE&P activities are performed to set up the entity to produce vehicle components for the customer under a long-term supply arrangement, revenue is not recognized as the entity performs the NE&P activities, but instead when or as it satisfies its performance obligations related to producing and delivering the vehicle components. Determining when revenue should be recognized for a performance obligation is discussed in [Section 7](#), along with specific considerations relevant to contract manufacturing arrangements in [Section 7.2.1](#).

4.4.3. Accounting for NE&P activities that do not generate revenue

To the extent an industrial entity concludes that NE&P activities do not generate revenue that should be accounted for under ASC 606, it should account for such activities in accordance with other applicable GAAP. Consideration should be given to whether the guidance in ASC 610-20 related to transfers of nonfinancial assets applies. While much of the recognition and measurement guidance in ASC 606 may ultimately be applied to certain transfers of nonfinancial assets under ASC 610-20, the proceeds related (or allocated) to such transfers are not reflected as revenue in the income statement.

5. Step 3: Determining the transaction price

5.1 General requirements for determining the transaction price

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

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

If an industrial entity does not elect the accounting policy, it must determine whether it is a principal or an agent with respect to each sale or similar tax assessed on its revenue-generating transactions. If it is a principal, the sales or similar tax is included in the transaction price. If it is an agent, the sales or similar tax is not included in the transaction price. Making the determination as to whether the entity is a principal or an agent with respect to each sale or similar tax in every tax jurisdiction in which its revenue-generating transactions are subject to such taxes could be a very onerous exercise. It is for this reason that the FASB provided the option to elect an alternative accounting policy.

5.2 Accounting for variable consideration

Variable consideration can take many forms. For industrial entities, some common examples include early payment discounts, volume discounts, rebates, price concessions and rights of return. The variability in the amount of consideration to which the industrial 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 that the industrial entity intends to offer the customer or that the customer has a valid expectation of receiving based on the industrial entity’s customary business practices, published policies or specific statements.

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

- An entity provides a series of distinct good or services for which the variable payments relate specifically to the entity’s efforts to transfer each distinct good or service within the series (see Section 8.3.2.1 5 of [our revenue recognition guide](#))
- An entity is entitled to sales- or usage-based royalties and the only, or predominant, item to which the royalty relates is the license of IP (see Section 7.3.5 of [our revenue recognition guide](#))
- An entity elects to apply the practical expedient that allows revenue to be recognized for the amount the entity has a right to invoice (see Section 9.3.1.1 of [our revenue recognition guide](#))

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

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

While these appear to be two discrete steps, as discussed in Question 7Q.3.3.1 of [our revenue recognition guide](#), an industrial entity's use of the expected value method to estimate the variable consideration to which it expects to be entitled may reduce, depending on the facts and circumstances, the probability of a revenue reversal such that the industrial entity does not have to separately constrain its estimate of variable consideration.

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

When a contract has variable attributes, it may not initially be clear whether those variable attributes give rise to an option for additional goods or services or variable consideration. Additional discussion and examples are provided in Section 6.6 of [our revenue recognition guide](#).

Application of the variable consideration guidance in ASC 606 to volume and early payment discounts and rebates and rights of return is discussed further in [Sections 5.2.1](#) and [5.3](#), respectively. Section 7.3 of [our revenue recognition guide](#) provides additional information and examples related to accounting for variable consideration.

5.2.1 Volume and early payment discounts and rebates

Discounts and other contract terms that are fixed at contract inception do not give rise to variable consideration. For example, if the contract terms indicate that the customer is receiving a 5% discount off list price for the equipment purchased, that discount is fixed. In contrast, if the contract terms indicate any of the following, the consideration is variable:

- The customer will receive a 5% discount off list price *if* the customer pays the amount owed within 30 days (early payment discount)
- The customer will receive a 10% discount off list price *if* the customer buys more than 10 units of equipment (retrospective volume discount)
- The customer will receive a rebate of \$10,000 *if* the customer purchases four machines (volume rebate)

The consideration is variable in these situations because it is uncertain whether the industrial entity will have to provide the discount or rebate, given that it is contingent on an action by the customer.

The following example illustrates application of the variable consideration guidance to a common retrospective volume discount scenario, and also considers how the accounting effects would differ if there was an early payment discount or rebate instead of a volume discount.



Example 5-1: Applying the variable consideration constraint to a retrospective volume discount (ASC 606-10-55-216 to 55-220)

An entity enters into a contract with a customer on January 1, 20X8, to sell Product A for \$100 per unit. If the customer purchases more than 1,000 units of Product A in a calendar year, the contract specifies that the price per unit is retrospectively reduced to \$90 per unit. Consequently, the consideration in the contract is variable.

For the first quarter ended March 31, 20X8, the entity sells 75 units of Product A to the customer. The entity estimates that the customer's purchases will not exceed the 1,000-unit threshold required for the volume discount in the calendar year.

The entity considers the guidance in paragraphs 606-10-32-11 through 32-13 on constraining estimates of variable consideration, including the factors in paragraph 606-10-32-12. The entity determines that it has significant experience with this product and with the purchasing pattern of the entity. Thus, the entity concludes that it is probable that a significant reversal in the cumulative amount of revenue recognized (that is, \$100 per unit) will not occur when the uncertainty is resolved (that is, when the total amount of purchases is known). Consequently, the entity recognizes revenue of \$7,500 (75 units × \$100 per unit) for the quarter ended March 31, 20X8.

In May 20X8, the entity's customer acquires another company and in the second quarter ended June 30, 20X8, the entity sells an additional 500 units of Product A to the customer. In light of the new fact, the entity estimates that the customer's purchases will exceed the 1,000-unit threshold for the calendar year and, therefore, it will be required to retrospectively reduce the price per unit to \$90.

Consequently, the entity recognizes revenue of \$44,250 for the quarter ended June 30, 20X8. That amount is calculated from \$45,000 for the sale of 500 units (500 units × \$90 per unit) less the change in transaction price of \$750 (75 units × \$10 price reduction) for the reduction of revenue relating to units sold for the quarter ended March 31, 20X8 (see paragraphs 606-10-32-42 through 32-43).



RSM COMMENTARY: The fixed price of Product A is \$90 per unit, and there is variable consideration of \$10 per unit. The uncertainty related to the variable consideration is whether the customer will buy more than 1,000 units of Product A. The entity determined that the transaction price per unit for the customer's purchases in the first quarter ended March 31, 20X8 was \$100 per unit (i.e., the variable consideration of \$10 per unit was not constrained based on the entity's analysis of the facts and circumstances at that point in time). In the second quarter ended June 30, 20X8, the entity reassesses the variable consideration and concludes it should be constrained because of a change in the facts and circumstances (i.e., the customer's acquisition of another company and the increase in the relative quantity of Product A purchased by the customer in that quarter). Accounting for the change in the transaction price results in the entity making an adjustment to reduce revenue by \$750 (75 units sold in the first quarter × \$10 per unit) in the second quarter for the units of Product A transferred to the customer in the first quarter for which revenue was recognized at \$100 per unit. Also in the second quarter, the entity recognizes revenue of \$45,000 (500 units sold in the second quarter × \$90 per unit).

Consider a change to the fact pattern in this example that would result in a reduction to the unit price for Product A from \$100 to \$90 if the customer paid for all shipments of Product A under the contract within 25 days of receipt. In this revised fact pattern, the entity would need to assess the likelihood of the customer making all payments for Product A over the contract term within the 25-day discount period (instead of assessing whether the customer would buy more than 1,000 units of Product A over the contract term). If the entity concluded in the first quarter that the customer would not make all payments for Product A within the 25-day discount period,

but reassessed its conclusion in the second quarter and concluded that the customer would make all payments for Product A within the 25-day discount period, the accounting for the early payment discount would produce the same accounting results as the volume discount in the preceding example. If the early payment discount applied to each shipment of Product A (instead of all shipments of Product A), the accounting results may differ depending on the entity's assessment of the likelihood of the customer paying for some shipments of Product A within the 25-day discount period and others outside the 25-day discount period.

Consider a different change to the fact pattern in this example that would result in the entity receiving a \$10,000 rebate if the customer purchases more than 1,000 units. While the entity's accounting in the first quarter would remain the same in this revised fact pattern, its accounting in the second quarter would depend, at least in part, on how many units it expects the customer to purchase. For example, if the entity believes it is probable that the customer will purchase 1,200 units over the contract term, then the per unit price of \$91.68 $[(1,200 \text{ units} \times \$100 \text{ per unit}) - \$10,000 \text{ rebate}] \div 1,200 \text{ units}$) would be used to calculate the adjustment to the revenue recognized in the first quarter and to calculate the revenue that would be recognized in the second quarter provided the variable consideration of \$1.68 included in that per unit price would not otherwise need to be constrained.

Accounting for variable consideration often will require significant judgment to be exercised and careful consideration of an industrial entity's own relevant facts and circumstances. It is critically important for an industrial entity to exercise consistent judgment in similar facts and circumstances.

5.3 Rights of return or refund

A customer's right to return a product and receive a refund of fees for services is not considered a performance obligation. Instead, it is treated as variable consideration. As a result, when the industrial entity recognizes revenue, it does so for the amount of the transaction price to which it expects to be entitled, limited to the amount for which it is probable that a significant reversal of cumulative revenue recognized will not occur (i.e., the transaction price reflects expected returns and refunds). In assessing the probability of a significant reversal in the cumulative revenue recognized, an industrial entity should take many factors into consideration, including its history with the same or similar return rights, relevant industry information and economic trends.

An industrial entity recognizes a refund liability for the amount received or receivable to which it ultimately does not expect to be entitled as a result of the return or refund right (i.e., the amount it is expected to refund). In addition, an industrial entity also separately recognizes an asset representing the right to returned inventory and an adjustment to cost of sales for estimated returns. The asset for the right to returned inventory is measured by using the former carrying amount of the product reduced for the costs expected to be incurred to recover the product, which include any decrease in value of the returned product. The refund liability and asset for the right to returned inventory should be separately recognized (i.e., they should not be netted against each other). In addition, the refund liability to the customer typically is not considered a contract liability and should not be included with the contract liability for presentation purposes.

At the end of each reporting period, an industrial entity should review its estimated returns and refunds compared to actual and determine whether any adjustments are needed to the refund liability, revenue, asset for the right to returned inventory and cost of goods sold related to products sold subject to a right of return or refund.

This guidance does not apply to: (a) product exchanges, provided the products are of the same type, quality, condition and price (which have no accounting effect) or (b) product exchanges due to defects (which are accounted for as warranties, [see [Section 4.2.4](#)]).

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

6.1 Overall allocation model

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

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

If a contract has more than one performance obligation (e.g., equipment and installation that are distinct from each other), the transaction price generally should be allocated to each performance obligation based on the standalone selling prices of each performance obligation in relation to the total of those standalone selling prices (i.e., on a relative standalone selling price basis). Exceptions are provided for certain situations involving discounts or variable consideration that can be shown (by meeting certain criteria) to be related to one or more (but less than all) performance obligations. Those exceptions are discussed in [Section 6.3](#) of this whitepaper and Section 8.3.1 of [our revenue recognition guide](#).

6.2 Standalone selling prices

The standalone selling price of a performance obligation is the amount the industrial 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 industrial 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 industrial entity is required to estimate a standalone selling price. In making this estimate, the industrial entity should maximize observable inputs and consider all reasonably available and relevant information, which includes information specific to the industrial entity, the market, the customer and the customer class. In addition, an industrial entity should be consistent in how it applies an estimation method and the situations in which it applies an estimation method.

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

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

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

6.3 Allocating variable consideration

Variable consideration included in the transaction price should be allocated on a proportionate basis to each of the performance obligations in a contract, except when the following two criteria are met:

- The terms of the variable payment are specifically related to the industrial entity's efforts to: (a) satisfy, or achieve a specific outcome from satisfying, a specific performance obligation or (b) transfer, or achieve a specific outcome from transferring, a distinct good or service in a single performance obligation resulting from application of the series exception
- Allocating the variable payment to the specific performance obligation, or distinct good or service in a single performance obligation resulting from the series exception, depicts the amount of consideration to which the industrial 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 their entirety to the specific performance obligation or distinct good or service to which the variable payment relates.

The remaining transaction price is allocated as it otherwise would be under ASC 606 (i.e., allocated on a relative standalone selling price basis unless the discount exception applies [which is discussed in Section 8.3.1 of [our revenue recognition guide](#)]). For example, consider a situation in which an industrial entity is providing its customer with engineering and design services and contract manufacturing services, and based on the facts and circumstances, each set of services represents its own performance obligation. The industrial entity will receive a bonus if it completes the contract manufacturing services by a certain date. If the facts and circumstances indicate that the bonus relates to only the contract manufacturing services because the criteria discussed earlier are met, then the bonus is allocated to only the performance obligation for those services. Conversely, if the facts and circumstances indicate that the bonus relates to both the design and engineering services and the contract manufacturing services because the criteria discussed earlier are not met, then the bonus is allocated to both performance obligations for each set of services. Example 8-5 in [our revenue recognition guide](#) provides a detailed numerical example illustrating how to allocate the transaction price when the contract includes variable consideration.

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

To properly assess when revenue should be recognized, an industrial entity must perform at contract inception an evaluation focused on whether a performance obligation is satisfied over time or at a point in time. Central to this evaluation is understanding what constitutes *control having transferred to the customer*.

7.1 Transfer of control

Control of an asset has transferred to a customer when the customer has the ability to direct the use of the asset and receive substantially all of the related remaining benefits, which includes the customer being able to stop others from directing the use of the asset and receiving substantially all of the related remaining benefits. For this purpose, benefits are considered in terms of the potential cash flows the customer can obtain or save (directly or indirectly) as a result of having control of the asset.

ASC 606 provides several indicators that should be considered in assessing whether control of an asset has transferred to the customer. When present, the following indicators may signal that the customer has the ability to direct the use of the asset (and restrict others' use of the asset) and receive substantially all of the asset's remaining benefits:

- The customer is presently obligated to pay the industrial entity for the transferred asset
- The customer has legal title to the transferred asset
- The customer has physical possession of the transferred asset
- The customer has the significant risks and rewards of owning the asset
- The customer has accepted the asset

It is important to note the following about the presence or absence of an indicator:

- *The presence of an indicator is not determinative evidence that control has transferred to the customer.* For example, the customer may have legal title and physical possession of equipment transferred subject to a call option, but the industrial entity concludes the customer does not have the ability to direct the use of the equipment and receive substantially all of the equipment's remaining benefits because of that call option (see Section 9.7.1 of [our revenue recognition guide](#)). As a result, control has not transferred to the customer even though at least two of the indicators are present.
- *The absence of an indicator is not determinative evidence that control has not transferred to the customer.* For example, an industrial entity might enter into a bill-and-hold transaction that results in it holding the machinery bought by the customer for a period of time before the customer takes physical possession. If the industrial entity is able to demonstrate that the other indicators of control transfer are present and that the incremental bill-and-hold criteria in ASC 606 have been met (see [Section 7.4](#)), the industrial entity would conclude that control of the machinery has transferred to the customer while the industrial entity holds the machinery for the customer (i.e., control of the machine transfers to the customer prior to the customer obtaining physical possession of the machinery).

Determining whether control of an asset has transferred to a customer often will require significant judgment to be exercised and careful consideration of all the facts and circumstances.

7.2 Determining whether a performance obligation is satisfied over time or at a point in time

As indicated earlier, an industrial entity must perform an evaluation at contract inception focused on whether a performance obligation is satisfied over time or at a point in time. If a performance obligation meets one or more of the following criteria, it is considered satisfied over time:

- *Customer simultaneously receives and consumes benefits as industrial entity performs.* A performance obligation is satisfied over time if the customer consumes the benefits of the industrial entity's performance at the same time as: (a) the customer receives those benefits and (b) the industrial entity performs and creates those benefits.
- *Customer controls the asset as the industrial 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 industrial entity's performance.

- *No alternative use and an enforceable right to payment for performance to date.* A performance obligation is satisfied over time if: (a) the asset created by the industrial entity's performance does not have an alternative use to the industrial entity upon its completion and (b) the industrial entity's right to payment for its performance to date is enforceable.

The same criteria are evaluated regardless of whether the performance obligation includes one or more promised goods or services. In addition, these criteria include no predispositions that will result in a performance obligation that includes a promised good being satisfied at a point in time or a performance obligation that includes a promised service being satisfied over time. Each performance obligation should be evaluated against these criteria to determine whether revenue should be recognized over time or at a point in time.

If the performance obligation is considered satisfied over time because one of the criteria discussed earlier is met, the related revenue is recognized over time if the industrial entity is able to reasonably measure its progress toward complete satisfaction of the performance obligation using reliable information. The objective of this method should be to measure the progress made in transferring control of the underlying goods or services to the customer. Output methods or input methods can be used to measure progress toward complete satisfaction of performance obligations. Output methods rely on the value of the underlying goods or services included in the performance obligation. Input methods rely on the efforts put forth by the industrial entity to satisfy the performance obligation.

Regardless of whether an output or input method is used, the measurement of progress toward complete satisfaction of a performance obligation should only reflect the underlying goods or services for which control has transferred to the customer and should not reflect: (a) any underlying goods or services for which control has not transferred to the customer or (b) any activities that are not themselves promised goods or services (e.g., setup activities). Identifying an appropriate measurement of progress toward complete satisfaction of a performance obligation could be complex when the entity is recognizing revenue over time because the asset has no alternative use and the right to payment is enforceable. In these situations, the entity should consider whether there being no alternative use or an enforceable right to payment for performance completed to date effectively results in control of the entity's performance to date transferring to the customer.

Entities that utilize a standard costing method for inventory should evaluate the potential impact of period-end inventory cost absorption adjustments on revenue recognition. If standard costs are not current or there have been substantial fluctuations in costs, significant discrepancies may arise between standard and actual costs, which may potentially cause the recognized revenue to not accurately reflect the economic progress of the contract.

If a performance obligation does not meet any of the three criteria discussed earlier, it is considered satisfied at a point in time, and the control transfer criteria discussed earlier are used to determine the point in time that control transfers to the customer.

7.2.1. Contract manufacturing considerations

As discussed in [Section 4.2.5](#), industrial entities that provide contract manufacturing services should carefully consider their own facts and circumstances in the context of ASC 606 to determine whether their contracts for contract manufacturing services include one or more performance obligations. Example 4-2 in [Section 4.2.5](#) illustrates a situation in which an entity identifies the performance obligations in a contract to manufacture multiple units of a highly complex and specialized device. For the reasons described in that example, the entity concludes that there is only a single performance obligation in the contract. In other words, the entity did not conclude that each highly complex and specialized device that it will manufacture under the contract is a performance obligation.

As a result of having identified a single performance obligation, the entity in Example 4-2 must determine whether the revenue for that single performance obligation should be recognized over time or at a point in

time. In evaluating the criteria that are used to make that determination, the entity would consider the following:

- *Customer simultaneously receives and consumes the benefits as industrial entity performs.* Given the nature of the promised goods and services included in the single performance obligation in Example 4-2, this criterion would not be met.
- *Customer controls the asset as the industrial entity creates or enhances the asset.* Given the nature of the promised goods and services included in the single performance obligation in Example 4-2, it is unlikely that this criterion would be met. For example, it is unlikely that the customer obtains control of the manufacturing process, specialized devices and other promised goods or services as the related asset is created. However, the entity should consider whether there are any contract terms or other facts and circumstances that affect when the customer obtains control of the asset created by the entity's performance.
- *No alternative use and an enforceable right to payment for performance to date.* There are not enough facts and circumstances provided in Example 4-2 to determine whether this criterion is met.

Of the three criteria, the last criterion has the most potential to be met in Example 4-2, and perhaps in most contract manufacturing scenarios in which there is a single performance obligation. ASC 606 provides a significant amount of supplemental guidance on what it takes to meet the last criterion, which is discussed and illustrated in Section 9.2.3 of [our revenue recognition guide](#).

If none of the three criteria are met in Example 4-2, the entity recognizes revenue for the single performance obligation at a point in time. While additional facts and circumstances would be needed to reach a final conclusion, that point in time would likely be when the contract is complete, which would likely be when control of the last device to be manufactured by the entity transfers to the customer. Conversely, if one or more of the three criteria are met in Example 4-2, the entity recognizes revenue for the single performance obligation over time using a method to measure its progress toward complete satisfaction of that performance obligation that is consistent with how control of the promised goods or services in the performance obligation transfers to the customer. If the entity in Example 4-2 were to decide to use a units-produced or units-delivered method, it should ensure the method takes into consideration any work in process at the beginning of the reporting period for which control transferred to the customer in the previous reporting period and any work in process at the end of the reporting period for which control transferred to the customer in the current reporting period. Section 9.3 of [our revenue recognition guide](#) discusses and illustrates how to recognize revenue over time under ASC 606.

7.3 Sales involving distributors and consignment sales

When an industrial entity ships products to a third party (e.g., a dealer or distributor) and that third party sells the products to consumers, the industrial entity needs to consider whether the third-party seller obtains control over the products received from the industrial entity prior to selling them to the consumer. In some cases, inventory shipped to third-party sellers is held on consignment, which means the third-party seller has not obtained control of the products received. Indicators that the third-party seller is holding the inventory on consignment include: (a) the industrial entity retains control over the inventory until it is sold through to the consumer or until another specific point in time, (b) the third-party seller is not obligated to pay for the products until they are sold through to the consumer or (c) the industrial entity can redirect the products to itself (i.e., require the third-party seller to return the products to the industrial entity) or other parties (e.g., a different third-party seller). A performance obligation has not been satisfied (and no revenue is recognized) if a product shipped to a third-party seller is held on consignment because the third-party seller has not obtained control of the products.

When products sold and shipped to a third-party seller are not held on consignment, and each product is a performance obligation satisfied at a point in time, revenue should be recognized when control of each product transfers to the third-party seller. Deferring revenue recognition until each product is sold by the third-party seller to the end consumer (which is commonly referred to as recognizing revenue on a sell-

through basis) is not appropriate under ASC 606 if control of the product has transferred to the third-party seller.

7.4 Bill-and-hold arrangements

A bill-and-hold arrangement refers to a contract in which the customer purchases products and is billed for the products, but the industrial entity retains physical possession of the products for a period of time. The key question in a bill-and-hold arrangement is whether control of the goods has transferred to the customer, despite the fact the goods are not in the customer's physical possession. Given the difficulty in answering this question, ASC 606 requires an industrial entity to evaluate whether control has transferred to the customer using: (a) the general concept of control and indicators of control transfer (other than physical possession) (see [Section 7.1](#)) and (b) the following criteria specifically related to bill-and-hold arrangements, all of which must be met:

- *There is a substantive reason for the bill-and-hold arrangement.* An example of a substantive reason is the customer requesting to purchase the product on a bill-and-hold basis.
- *The products are separately identified as belonging to the customer.* This would be the case if the industrial entity has segregated the products and labeled them as belonging to the customer.
- *The products are ready to be physically transferred to the customer.* This would be the case if the products are complete and ready for shipment. Further, to meet this criterion there should be no other costs to be incurred to satisfy the performance obligation other than standard shipping costs that would be incurred in other than bill-and-hold arrangements
- *The industrial entity is unable to use the products or redirect them to other customers.* To meet this criterion, the industrial entity should not be able to use the specific products set aside for the customer in the bill-and-hold arrangement to fulfill orders from other customers. Further, if the industrial entity has ever used or redirected product in the past that was set aside for a customer in connection with a bill-and-hold arrangement, its ability to meet this criterion and recognize revenue prior to shipment of the product in future bill-and-hold arrangements is tainted.

Revenue is recognized in a bill-and-hold arrangement prior to the customer taking physical possession of the product only if: (a) the industrial entity's evaluation of the general concept of control transfer and the general indicators of control transfer results in a conclusion that control of the product has transferred to the customer and (b) the specific bill-and-hold criteria have been met.

If an industrial entity concludes control of the products subject to a bill-and-hold arrangement has transferred to the customer prior to shipment, consideration should be given to whether the industrial entity's obligation to hold the products for a period of time after it transferred control to the customer represents a performance obligation that should be accounted for separately.

8. Contract costs

8.1 Scope

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

8.2 Costs to fulfill a contract

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

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

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

If the guidance in the table or other specific guidance is applicable to a fulfillment cost incurred by the entity, it must be applied. ASC 340-40 is only applicable to costs to fulfill a contract when there is no other applicable guidance. For example, if there are setup costs that do not fall within the scope of the preproduction cost guidance in ASC 340-10 or other guidance in the ASC, then such costs would be accounted for in accordance with ASC 340-40.

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

8.2.1. NE&P costs related to long-term supply contracts

It is not uncommon for an industrial entity to undertake NE&P activities for a customer, often in connection with fulfilling a long-term supply contract or in anticipation of entering into such a contract. Whether revenue should be recognized related to those activities (and, if so, how that revenue should be recognized) is discussed in detail in [Section 4.3](#). With respect to accounting for the costs of NE&P activities, ASC 340-10 provides guidance on how to account for preproduction costs related to long-term supply arrangements, which include: (a) the costs to design and develop the products that will be sold under a long-term supply arrangement and (b) the costs to design and develop molds, dies and other tools that will be used in manufacturing the products that will be sold under the long-term supply arrangement.

Industrial entities with preproduction should refer to Question 66 of FASB's [Revenue Recognition Implementation Q&As](#), which provides a summary of how the preproduction costs guidance in ASC 340-10 interacts with ASC 340-40. In addition, it is worth noting that if the industrial entity concludes that NE&P activities do not generate revenue that should be accounted for under ASC 606, the related costs cannot be within the scope of ASC 340-40.

8.3 Costs to obtain a contract

The incremental costs to obtain a specific contract within the scope of ASC 606 are those costs that would not have been incurred if the contract was not obtained, such as a sales commission. For a cost to be considered an incremental cost of obtaining a contract, the industrial 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 industrial entity expects to recover those costs (i.e., the net cash flows of the contract and expected renewals will cover the costs). However, an industrial entity may elect a practical expedient that allows it to expense the incremental costs to obtain a contract if the amortization period for those costs would otherwise be one year or less.

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

8.4 Amortization and impairment of capitalized costs

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

9. Disclosures

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

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

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

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

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

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