Revenue Recognition under ASC 606

November 2016
# Revenue Recognition under ASC 606

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Introduction

To our clients and friends

In May 2014, the Financial Accounting Standards Board (FASB) released Accounting Standards Update No. 2014-09, *Revenue from Contracts with Customers* (Topic 606). The new standard, scheduled to go into effect in 2018, will impact in some ways or others most, if not all, companies that follow US accounting principles. Its complexity arises not just from the volume (close to 150 pages of authoritative content related to revenue, and an additional 500 pages of changes to other topics and background material), but also from transition to a principle-based approach that requires matching specific circumstances of revenue transactions to concepts, criteria, and assessment factors dispersed throughout the standard and often requiring considerable judgment to apply.

Over the past several years, Connor Group has been in the forefront of the evolving revenue landscape, assisting many companies with the adoption of the existing multiple-element revenue guidance released in 2009, helping tackle other complex revenue recognition issues, and participating in the ASU 2014-09 drafting process through comment letters and roundtables. In doing so, we helped companies develop methods and approaches to revenue recognition that are widely used today across multiple industries. We are now helping clients implement ASU 2014-09, both technical and operational aspects, applying our customary technical thought leadership, practical approach, and excellence in execution.

We have prepared this publication for the benefit of industry executives, revenue professionals and others, with a view to present ASU 2014-09 content by potential topic of interest, in a concise, easy to review manner, handy to use as a reference tool. For practical benefit, the attached material includes, in addition to the information directly from the new standard, our judgments and interpretations of how its provisions could be applied in typical revenue circumstances, a list of key impacts of the standard adoption by industry, and a summary of our implementation roadmap. These are based on our understanding of the concepts underlying the standard, background material information, and early publications from the accounting industry. There are many areas in the new standard which are subject to interpretation and judgment, which may differ among professionals. As the ASC 606 landscape continues to evolve, we will update this publication on a periodic basis.

This publication has been updated to reflect the effect of ASC 606 amendments released through October 2016.

Your Connor Group Team
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Fast Facts

- ASC 606, Revenue from Contracts with Customers
- Released May 2014, amendments in 2015-2016
- Largely the same standard for US GAAP and IFRS
- Effective Jan 1, 2018 for public companies, Jan 1, 2019 for private companies (2017 early adoption permitted)

Adoption alternatives:

i. Re-cast all prior periods presented as if applied to those periods

ii. Apply from current period only to all contracts, with pre-adoption cumulative effect on retained earnings
Why Investors Care

- Likely to impact reported revenue and expenses
- Makes revenue more volatile, less predictable
- Requires extensive business-focused revenue disclosures
- Expensive to adopt
  - Operational and system changes
  - Requires new technical judgments
- Permanently “lost” or “recycled” revenue upon adoption
- Opportunities to align with business strategy
Why New Standard

- Converge (mostly) US GAAP with IFRS
- Single principle-based standard for all
- Eliminate hundreds of today’s revenue pronouncements
  - Inconsistencies and hard to navigate – from many years of accounting evolution and many ‘cooks’
  - Special industry treatments
- Principles instead of prescriptions
Framework Overview

Step 1
• Identify contract with customer

Step 2
• Identify performance obligations

Step 3
• Determine expected transaction price (consideration)

Step 4
• Allocate to performance obligations

Step 5
• Recognize revenue upon transfer of control over goods/services
## Language Changes

<table>
<thead>
<tr>
<th>Old</th>
<th>New</th>
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<tr>
<td>Element, deliverable</td>
<td>Performance obligation</td>
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<tr>
<td>Delivery</td>
<td>Transfer (of control), satisfaction (of obligation)</td>
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<td>Price, consideration</td>
<td>Transaction price</td>
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<td>Variable consideration</td>
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<td>Percentage of completion</td>
<td>Measuring progress</td>
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<td>Contract asset</td>
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<td>Contract liability</td>
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Key Impact Areas – Multiple Industries

- Okay to retain certain delivery risks when taking revenue (assess transfer of control)
- Estimate and accrue for concessions, returns, refunds, rebates, other uncertainties when recognizing revenue
- If collectibility uncertain, record revenue on full payment, or to the extent of cash received if delivery ended/stopped
- Recognize financing component if significant
- Capitalize commissions and other direct incremental costs
- “Lost” or “recycled” revenue upon adoption
- Consider portfolio approach where expedient
- Apply to sales of fixed assets and intangibles
Key Impact Areas – Software (1)

- Can relax pricing of support and services (VSOE not required)
- Recognize most license revenue up front even where support/services do not have VSOE
- Most term licenses recognized upfront
- Roadmaps/specific upgrades do not prevent revenue recognition
- Pricing of add-on license seats will matter
- Can offer flexible software upgrade options

See also separate slides for cloud and professional services.
Key Impact Areas – Software (2)

- Multi-element allocation can be more complex (relative prices, judgmental allocations for variable fees)
- Okay to estimate revenue for extended payment terms
- May need to bifurcate updates from support and go non-straight-line
- Support renewal option may require revenue allocation/deferral if at below normal pricing

See also separate slides for cloud and professional services.
Key Impact Areas – Technology (1)

- Sell-through revenue with distributors gone in many instances
- Multi-element allocation different (relative prices, revenue not limited to non-forfeitable)
- Option for additional goods requires revenue allocation/deferral if at below normal pricing
Key Impact Areas – Technology (2)

- Service components of warranty (standard or non-standard) – i.e. beyond product assurance – require revenue allocation/deferral (unless immaterial)

- For extended warranty/maintenance, continue to record loss upfront, but follow standard allocation process

- Trade-in provisions could be treated as right of return, leases or financing arrangements

- Sale of assets under operating leases (or to be leased by purchaser) recognized despite continuing involvement

- Estimate earned royalties (no lag method)
Key Impact Areas – Professional Services (1)

- Combine with software/hardware if these elements deliver combined output to the customer
- Over-time recognition may require enforceable right to progress payments, or customer access to WIP
- Revenue on completion if cannot estimate progress
- Could take revenue before acceptance (if probable and can estimate progress)
Key Impact Areas – Professional Services (2)

- No margin normalization (percentage of completion)
- No milestone method
- Continue to record loss upfront for construction type and software customization services
Key Impact Areas – Cloud and Internet Services

- Free or discounted implementation may require revenue accrual (revenue not limited to non-forfeitable)
- Implementation may be combined with cloud service even if it could be provided by 3rd party
- Nature of promise to customer will determine if fees can be recorded straight line or as-earned
- Contract renewal option requires revenue allocation/deferral if at below normal pricing (e.g. no setup)
- Gross/net based on control of 3rd party goods/services before transfer to customer (vs. primary obligor)

See also separate slides for software and professional services.
Key Impact Areas – Life Sciences

- Asset development part of collaboration may not be customer activity or revenue
- License with ongoing R&D may have to be amortized if control over development is retained
- Cannot default to straight-line if license is to be amortized
- No milestone method (estimate outcome and use pattern of delivery)
- Estimate earned royalties (no lag method)
- Sell-through model with distributors gone in many instances
Key Impact Areas – Real Estate and Solar

- No changes for sales-type or operating lease transactions
- If entire amount not deemed probable to collect, no revenue until full payment or until full delivery (to the extent of cash received)
- No initial/continuing investment criteria, but customer must have control of the asset sold
- Estimate impact of continuing involvement and recognize revenue
- Sale of assets under operating leases (or to be leased by purchaser) recognized despite continuing involvement
Key Impact Areas – Consumer Goods

- Coupons, reward programs/points may require revenue allocation/deferral as options
- Estimate breakage revenue and recognize proportionately
- Extended warranty requires different revenue allocation (relative prices)
- Re-evaluate virtual goods revenue model
Key Impact Areas – Quantitative Disclosures

- Revenue $ by timing*, nature, geography, channel; tie to segment revenues
- Contract assets and liabilities* (contingent and deferred revenue)
- Changes in contract assets and liabilities
- Current revenue related to past period obligations
- Amount $ and timing of future revenue (contracts > 1 year)
- Deferred costs, amortization and impairment
- Impairment $ for receivables and contract assets*
- Gross up receivables and contract liabilities*

* Required for private companies; all other only required for public companies
Key Impact Areas – Non-Revenue

- Income taxes
- Compensation: performance awards, profit sharing metrics
- Purchases: apply concept of control transfer?
- Royalties payable: royalties based on GAAP revenue
- Business combinations: due diligence, pricing, earn-outs
- Borrowings: financial covenants
- Non-cash consideration paid: measurement date
- SEC significance tests for acquisitions and dispositions (in particular, with retrospective adoption)
- Auditor materiality (with retrospective adoption)
Recent Developments

- Additional deferrals unlikely
- Standard clarifications (most were approved by FASB in 2016)
  - Licenses (functional v. symbolic model)
  - When item is distinct within context of contract (e.g. razor and razor blade, integration)
  - Immaterial obligations
  - Contracts modified before ASC 606 adoption
  - Shipping and handling fees and sales taxes
  - Value of noncash consideration
  - Collectibility
  - Principal v. agent
  - Timing of receivable recognition (draft exposed for comments – not yet approved)
- Transition Resource Group
  - Consensuses around various technical matters – mandatory for public companies!
- AICPA Revenue Recognition Task Forces (Software, Telecom, etc. – total 16 task forces)
  - a number of issues exposure drafts
Post 606 Revenue World
Adoption and Transition

- **Adoption dates alternatives** (EGC public entities: private company dates OK unless elected not to use them)

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<td>EGC Private</td>
<td>Private</td>
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<td>Public Private</td>
<td>Public Private</td>
<td>EGC Private</td>
<td>Private</td>
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- **Transition methods**

  - **Full retrospective** (with prior period recasting)
    - Recast all periods presented in financials
      - Okay to exclude intra-year contracts and…
      - …use hindsight for estimates (complete contracts)
    - Disclosures for all periods presented
  - **Retrospective without prior period recasting**
    - No change to prior periods
      - Okay to apply either to all contracts, or only to contracts with remaining ASC 605 revenue
    - Dual reporting for year of adoption

- Okay to combine pre-transition contract modifications with original contract terms
- Recognize cumulative effect on retained earnings at date of initial application

**Guidance** 606-10-65-1; 2016 Guides: EY 1.2, 1.3; KPMG 13; PwC 13.2, 13.3; DT 15.1, 15.2
Choice of Transition Method

Benefits of Full Retrospective

- Comparable financial information from adoption date
- Less distraction to investors
- Clean start to IPO
- Reflect pre-adoption business changes properly
- Easier transition if significant adoption date impact

Benefits of Retrospective without recasting

- 1 year of dual reporting instead of 2
- More time to adapt business to mitigate impact
- More time for implementation
- Additional resources available
- Avoid extra work if revenue is a less important metric
- Full retrospective adoption may require additional (3rd prior) year converted to ASC 606 when filing registration statements

Guidance

606-10-65-1; 2016 Guides: EY 1.3; KPMG 13; PwC 13.3; DT 15.2; KPMG Revenue Transition Options guide
Contract-Level Revenue Recognition Model

Step 1
Identify contract

Step 2
Identify distinct performance obligations

Step 3
Determine expected transaction price

Step 4
Allocate to performance obligations using SSP

Step 5
Recognize revenue upon transfer of control

Guidance 606-10-5-4
Portfolio Approach

(A) Available to aggregate items with similar characteristics, and provided there is
Reasonable expectation that effects would not differ materially (quantitative comparison not required)

- Practical application examples:
  - Identifying deliverables and allocating consideration across multiple contracts
  - Estimating variable consideration across multiple contracts/customers
  - Credit assessment across multiple customers

Guidance 606-10-10-4; 2016 Guides: EY 3.3.1; KPMG 4.4; PwC 1.3.3; DT 3.1.2.2
Performance Obligations

- Identify at contract **inception** as performance obligations:
  - **Distinct** goods / services (or bundles)
  - Distinct, satisfied over time, with same pattern of transfer, and substantially the same items ("series") – **must** aggregate into a single performance obligation
    - Daily, monthly… (does not need to be consecutive) – or units of quantity
  - Include **implied** obligations (e.g. business practice) if create a customer **expectation**
    - Even if legally unenforceable

**EXAMPLES:**

<table>
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<th>Goods (sale, resale)</th>
<th>Services</th>
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<td>Producing/developing on behalf of other</td>
<td>Licenses (e.g. IP, software)</td>
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<td>Options to purchase goods/services (if there is a <strong>material right</strong>)</td>
<td>Stand-ready service (e.g. if and when available, if and when requested/unspecified, access to good/service)</td>
</tr>
<tr>
<td>Rights to future goods/services for resale</td>
<td>▪ Master supply agreement is not a stand-ready</td>
</tr>
<tr>
<td>Making arrangements for others (e.g. as agent)</td>
<td>Resale of rights to goods/services (e.g. tickets)</td>
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**Guidance**: 606-10-25-14 through 16 and 18; 2016 Guides: EY 4.1, 4.2; KPMG 5.2; PwC 3.3; DT 5.2.1, 5.2.2, 5.2.2.1, 5.3.1, 5.3.3
Distinct Goods or Services
[replaces Standalone Value; Essential Undelivered Elements]

**Capable** of being distinct

- Can be used, consumed, sold, held for economic benefits
  - On its own, or
  - With resources already obtained from entity or from other transactions, or
  - With resources sold separately (by any entity)

**Distinct in context of contract**

- *aka* “separately identifiable”
- Combined output requested by customer is nature of promise. Indicators include:
  - Significant integration
  - Significantly modify or customize another item
  - **Each** item is significantly affected by other item(s)
  - Separable execution risks

---

**EXAMPLES**

Likely not distinct:
- Materials, tasks, etc. used in construction
- Equipment with complex installation
- Software license with significant integration or modification
- Software integral to hardware or requiring a service or updates
- Product development with prototypes

---

**Guidance**

606-10-25-19 through 22, 55-56; 2016 Guides: EY 4.2.1; KPMG 5.2.1, 5.2.3; PwC 3.4; DT 5.3.2
Miscellaneous Obligations [replaces Inconsequential and Perfunctory; Incidental Obligations]

- **Immaterial** performance obligations do not need to be identified
  - Assessment in the context of a contract (or at entity level) (does not apply to options!)
  - Potential examples: installation, training, warranty service, when and if available IP updates, phone support…
  - Accrue costs related to immaterial obligations if revenue already recognized
- Free handsets, free car maintenance, etc. are performance obligations (unless immaterial)
- **Do not** qualify as **performance obligations**:
  - Warranty if limited to assurance of compliance with specifications
  - Optional goods/services if the option does not convey a **material right** (marketing offers)
  - Credit card fees and related reward programs (if represent interest yield – ASC 310)
- Consider if performance obligations:
  - Contingent deliverables subject to R&D or other uncertainties – stand-ready obligations?
  - Pre-production or pre-sale activities (does control transfer?)

Guidance

- 606-10-25-16A, 16B, 55-32, 42 and 43; TRG 1/2015, 7/2015 and 11/2015; 2016 Guides: EY 4.1.1; KPMG 5.2.4; PwC 3.2.1, 3.6.2; DT 5.2.3, 5.2.4.1
Internal Activities and Protective Provisions

- Do not represent performance obligations:
  - Internal activities to fulfill customer contract that do not transfer goods/services
  - Certain protective provisions

**EXAMPLES...**
- Administrative tasks to set up a contract
- Promises embedded in licenses
- Other internal activities
- Product liability provisions
- IP indemnification provisions
- Maintaining own IP rights

**...more EXAMPLES**
- Promises to defend IP (patents, trademarks, copyrights)
- Maintaining software code in escrow
- Protective software “sunset” clauses
- Other rights protecting customer, vendor or goods/services

See also Shipping & Handling slide!

Guidance
606-10-25-17; 55-35 and 64A; Ex 57; TRG 1/2015; 2016 Guides: EY 4.1; KPMG 5.2.2; PwC 3.6.1, 3.6.3; DT 5.2.4
Customer Contracts [replaces Evidence of Arrangement]

- **Customer** is a party that contracts to obtain output of *ordinary* activities for **consideration**
- Agreement between two or more parties that creates **enforceable** rights and obligations
  - Enforceability is a matter of law
  - Consider entity contract practices and processes to determine whether/when enforceable
  - Written, oral or implied by customary business practices
  - No contract if each party can unilaterally terminate and wholly unperformed
- Parties must **approve** (in writing, orally, or per other customary business practices) and be **substantially** committed to perform
- Contract must allow to identify:
  - Each party’s **rights regarding goods/services**
  - Payment terms
- Collection of amounts for goods/etc. that **will** be delivered must be assessed as **probable**

**Guidance**
606-10-25-1.a through d, 25-2 through 4; TRG 3/15; 2016 Guides: EY 3.1; KPMG 5.1.1; PwC 2.6; DT 4.2, 4.7
Contract Unit of Account / Combination
[replaces Linking]

- ASC 606 guidance is applied to the performance obligations over duration of the contract

- **Duration of contract**: period in which parties have present enforceable rights and obligations
  - Right to cancel in exchange for substantive termination penalty is evidence of enforceable rights

**Consider**
- Legal term
- Enforceable obligations period
- Cancellation rights (=>option?)

**Include**
- Renewal terms…
- Optional items…
  - …if **material rights** are conveyed

**Exclude**
- Marketing offers
- Mutual termination rights at no substantive cost

- **Combine** separate contracts with the same customer if:
  - Entered into at or near the same time, and one or more of these applies:
    - Contracts negotiated as a package with a single commercial objective
    - Consideration in one contract depends on price/performance of the other contract
    - Some or all goods/services are a single performance obligation

Guidance
606-10-25-9, 55-42, 43 and 45; TRG 10/14 and 11/2015;
2016 Guides: EY 3.2, 3.3; KPMG 5.1.2, 5.1.4; PwC 2.7, 2.8; DT 4.6
Contract Modifications

- Change in scope and/or price approved by the parties
  - OK to estimate price change even if not yet approved

- Apply appropriate modification model based on criteria, facts and circumstances

<table>
<thead>
<tr>
<th>Original – Transferred</th>
<th>Goods or Services</th>
<th>Modification</th>
<th>Price Modification</th>
<th>Contract Original – Transferred</th>
<th>Modification</th>
</tr>
</thead>
<tbody>
<tr>
<td>No change</td>
<td>No change</td>
<td>Additional</td>
<td>Adjusted SSP</td>
<td>No change</td>
<td>New</td>
</tr>
<tr>
<td>No change</td>
<td><strong>Distinct</strong> from transferred</td>
<td>N/A</td>
<td>Terminated</td>
<td>New</td>
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</tr>
<tr>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Not <strong>distinct</strong> from transferred</td>
<td>N/A</td>
<td></td>
<td></td>
<td><strong>Combined</strong></td>
<td></td>
</tr>
<tr>
<td></td>
<td></td>
<td></td>
<td></td>
<td>• Recalculate progress</td>
<td></td>
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<tr>
<td></td>
<td></td>
<td></td>
<td></td>
<td>• Cumulative revenue catchup</td>
<td></td>
</tr>
<tr>
<td></td>
<td></td>
<td></td>
<td></td>
<td><strong>“consistent with the objectives” manner (hybrid)</strong></td>
<td></td>
</tr>
<tr>
<td>Some <strong>distinct</strong> and some not</td>
<td>N/A</td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
</tbody>
</table>

- Modifications should also meet one of contract combination criteria (except time proximity)

Guidance: 606-10-25-9 through 13; 2016 Guides: EY 3.4; KPMG 7.1, 7.2; PwC 2.9; DT 9
Collection is Probable
[replaces Collectibility is Probable/Reasonably Assured]

- **Objective** is to determine whether contract is valid, genuine transaction
- Assessment limited to amounts for goods/etc. that will be delivered – not the entire contract!
  - Consider expected potential concessions and other variable consideration
  - Concession v. lack of full collectibility
  - Consider prepayments and ability to suspend goods/etc. delivery on non-payment
  - If collection is probable, re-assess if significant change in facts/circumstances
  - If collection is not probable, contract criteria are not met… re-assess quarterly
- Only consider customer’s ability and intention to pay
  - No explicit assessment scope required (credit score/check, financials, history, etc.)
- **Portfolio approach** for similar contracts if effects would not differ materially
- Insuring or factoring AR does not make collection probable

Guidance: 606-10-25-1.e, 25-3, 25-5, 25-6, 55-3A through 3C; TRG 1/2015; 2016 Guides: EY 3.1.5; KPMG 5.1.1; PwC 2.6.1.5; DT 4.2.5
Contract Criteria Are Not Met
[replaces Cash Receipt Based Revenue]

- Contract criteria required to meet to enable recognition of any revenue:

| Rights and obligations are enforceable | Approved and parties committed to perform |
| Parties' rights regarding goods and services can be identified | Payment terms can be identified |
| Contract has commercial substance | Probable collection of amounts for goods/etc. that will be supplied |

- If not met, only recognize revenue:
  - On cash basis - only if entity transferred goods/etc. it got paid for, has stopped transferring additional goods, and has no remaining obligations to transfer
  - On contract completion: either of the following
    - No remaining performance obligations, and substantially all consideration received
    - Contract terminated
  - On reassessment (quarterly if not met)

- Record consideration received as deposit or contract liability if cannot be recognized

Guidance 606-10-25-7 and 8; 2016 Guides: EY 3.5; KPMG 5.1.3; PwC 2.6.2; DT 4.5
Obligation Satisfied Over Time or At a Point In Time [replaces Delivery Model]

**Simultaneous receipt and consumption of benefits**
- 3rd party no need to re-perform work completed to date
  - Disregard contractual or practical transfer restrictions
  - No benefits from assets that would not be transferred
  - Cannot apply if customer does not consume (e.g. for professional services, as there is work in process)

**Asset controlled by customer throughout period**
- **Asset type**: tangible or intangible
- **Controlled**: apply control guidance for Point in Time

**Asset with no alternative use at inception + enforceable right to payment for work to date**
- **Alternative use**: practical and contractual restrictions
- **Right to payment**: upon termination by customer
  - @ selling price, or cost + contract or typical margin %
  - enforceable based on contract, laws

**Cloud services**
- Transaction processing
- Technical support

**Installation**
- Implementation

**Construction**
- Custom-built products
- Prof services

**Distinct IP licenses**: separate guidance

**Recognize revenue over time**

**Recognize at a point in time**

**Guidance**: 606-10-25-27 through 29; 55-5 through 15; TRG 7/2015; 2016 Guides: EY 7.1 through 7.1.3; KPMG 5.5.2; PwC 6.3; DT 8.4
Obligation Satisfied At a Point In Time
[replaces Delivery Considerations]

- Revenue is recognized upon transfer of control
- **Control**: present ability to direct the use and obtain substantially all benefits from the asset
- Indicators of **transfer** (not all inclusive; some may not be met; no explicit weighting):
  - Right to payment
  - Title
  - Physical possession
  - Acceptance (waiving requires “objective” determination)
  - Risks and rewards of ownership
- Retention of risk may not preclude revenue recognition
  - Complex delivery terms (e.g. “synthetic” FOB destination)
  - Alternate site delivery

**Guidance**
606-10-25-23, 25 and 30, 55-37A.c; PwC ID Technology; DT Life Sciences Spotlight;
2016 Guides: EY 7.2; KPMG 5.5.4; PwC 6.5; DT 8.6
Customer Acceptance Rights

- Acceptance is one of the indicators of transfer of control
- Revenue can be recognized prior to acceptance if an entity can **objectively** determine that control has been transferred (= acceptance is formality)
  - Agreed-upon objective specifications
  - Experience with contracts for similar goods or services
- No revenue prior to acceptance if an entity **cannot objectively** determine that control has been transferred
  - Subjective acceptance clauses
  - Trial or evaluation purposes
- Acceptance vs. right of return
  - **Right of return**: after control transferred

**Guidance**
606-10-55-85 through 88; 2016 Guides: EY 7.2.1; KPMG 5.5.8; PwC 6.5.5; DT 8.6.5
## Consignment Arrangements

**INDICATORS (not all inclusive):**

- Seller controls product until resale, another event or set date
- Seller can return or transfer product
- No unconditional obligation to pay

➢ Do not recognize revenue as control has not transferred

### ASC 606 considerations: Assess...

<table>
<thead>
<tr>
<th>SAB 104 potential consignment situations</th>
<th>...transfer of control</th>
<th>...variable consideration</th>
<th>...additional performance obligations</th>
</tr>
</thead>
<tbody>
<tr>
<td>Title did not transfer</td>
<td>✓</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Right of return + Payment contingent on resale or not required</td>
<td>✓</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Right of return + Reseller does not have funds to pay without resale</td>
<td>✓</td>
<td>✓</td>
<td></td>
</tr>
<tr>
<td>Right of return + Significant obligations to bring about resale</td>
<td>✓</td>
<td>✓</td>
<td>✓</td>
</tr>
<tr>
<td>Seller controls resale price, credit risk, specifications, advertising</td>
<td>✓</td>
<td></td>
<td></td>
</tr>
</tbody>
</table>

**Guidance**

606-10-55-79 and 80; 2016 Guides: EY 4.5; KPMG 5.5.6; PwC 8.6; DT 8.6.6
Bill and Hold Arrangements

- **Bill and hold arrangement**: Company bills the customer for the product but retains possession until transferred to the customer in the future. Revenue recognition requirements:
  - Customer must obtain control of the product
  - Arrangement must have substantive reason (e.g. customer request)
  - Product must be identified separately as belonging to customer
  - Ready for physical transfer to customer
  - Company cannot have ability to use or re-direct the product

- **SAB 104 requirements not explicitly required under ASC 606**:
  - Fixed delivery schedule; buyer must request; no remaining performance obligations; risks have transferred
  - Consider payment terms; past experience; insurable seller’s custodial risks; other seller risks

- **Storage performance obligation**

**Guidance**: 606-10-55-81 through 84; Ex 63; 2016 Guides: EY 7.5; KPMG 5.5.7; PwC 8.5; DT 8.6.7
**Custom-Built Products**  
[replaces “Built to Specification”]

| 606-10-25-27c | • Semiconductor chips  
|               | • Custom medical products  
|               | • Other (ultimate finished product) |
| 605-35        | • Complex equipment (aero, electronic) built to specification  
|               | • Ships and other vehicles |

**Guidance**  
606-10-25-27 through 29; 55-8 through 15; Ex 10B, 15, 46; 2016 Guides: PwC, Examples 6-5, 6-6, 6-7; DT FAQ 8-10 example

**IF ultimate** asset has no alternative use to entity  
(=may not be redirected to another customer due to…  
...contract terms ...cost (rework, transportation) ...can be sold only for scrap ...other reasons

**...and IF enforceable** right to pay for performance to date  
if contract were terminated (despite entity performing  
At least cost + contract or typical margin  
Assess based on contract terms or laws  
Must exist at any time

**THEN recognize over time** as asset is created  
(before delivery) (otherwise, upon transfer of control)  
Output based methods  
e.g. units of production  
Input based methods  
e.g. cost to cost; okay to include pre-contract inventory cost
Obligation Satisfied Over Time – Measuring Progress [replaces POC, Proportional]

- **Must** choose one method/one measure to depict *performance in transferring* goods or services
- Defer revenue if cannot **reasonably** measure progress (lack of *reliable* information)
  - **Exception**: must recognize revenue equal to costs incurred if expected that total costs will be recovered
  - Revenue deferral does not mean cost deferral
- When measuring progress, exclude:
  - Goods or services for which control is not transferred
  - Abnormal losses and inefficiencies
- Adjust for other costs not proportionate to progress
- Cumulative catch-up for changes in estimates, including at inception of contract
- If obligation is a *series*, could recognize as earned

### Input methods
- Hours used
- Resources
- Costs
- **Time elapsed** (e.g. stand-ready)

### Output methods
- Milestones
- Units
- **Value as billed** (T&M, royalty)
- **Time elapsed**

---

Third party materials

1. Not distinct
2. Transfer of control significantly before providing services
3. Cost is significant
4. No significant involvement in design or manufacturing

**Revenue = cost** upon delivery
**Not considered** when measuring progress

**Guidance**

606-10-25-31 through 37; 55-16 through 21; Ex 18 and 19; TRG 1/2015, 3/2015 and 7/2015;
2016 Guides: EY 7.1.4; KPMG 5.5.3; PwC 6.4; DT 8.5
## Professional Services

### Revenue over time (=✓✓) or at completion?

**Must** have reliable information to measure progress

<table>
<thead>
<tr>
<th>No alter use + right to payment for perf to date</th>
<th>Customer controls asset over service period</th>
</tr>
</thead>
<tbody>
<tr>
<td>Customer consumes benefit over time, 3rd party could take over</td>
<td></td>
</tr>
</tbody>
</table>

<table>
<thead>
<tr>
<th>Time and materials</th>
<th>??</th>
<th>?</th>
<th>✓</th>
<th>✓</th>
</tr>
</thead>
<tbody>
<tr>
<td>Time and materials with a cap</td>
<td>??</td>
<td>?</td>
<td>?</td>
<td>?</td>
</tr>
<tr>
<td>Fixed price</td>
<td>??</td>
<td>?</td>
<td>?</td>
<td>?</td>
</tr>
<tr>
<td>Milestones/customer acceptance</td>
<td>??</td>
<td>?</td>
<td>?</td>
<td>??</td>
</tr>
<tr>
<td>Software implementation</td>
<td>??</td>
<td>?</td>
<td>✓</td>
<td>?</td>
</tr>
<tr>
<td>Software development</td>
<td>??</td>
<td>??</td>
<td>✓</td>
<td>??</td>
</tr>
<tr>
<td>Life science research</td>
<td>??</td>
<td>?</td>
<td>✓</td>
<td>?</td>
</tr>
</tbody>
</table>

### Variable Fees (e.g. Time & Materials)

- Assess scope: series of distinct services, single service (estimated volume), or multiple optional services
- Recognize fees as earned if:
  - Fees relate to T&M efforts only and resulting amounts depict what’s earned for each obligation
  - If this would approximate value transferred (consider impact of cap!), or
  - If T&M is a series with each service earning a commensurate amount

### Fixed Price / Milestone

- Input measure: hours vs. cost
- **No milestone method**
- Could recognize revenue ahead of milestone achievement
  - If no revenue reversal is probable

### Guidance

606-10-25-31 through 37; 32-39 through 41; 55-16 through 21;
2016 Guides: EY 7.1.4.1; KPMG 5.5.3.1; PwC 6.4.1.1; DT 8.5.6.1
## Cloud and Transaction Services

### Contractual Terms
- **Implementation**: Setup, cloud configuration
- **Cloud service**: Access to HW, SW, data hosting
- **Series**: Transaction processing, add on services
- **Extras**: Transaction processing, add on services
- **Option**: Renewal

### Distinct Obligation?
- **Obligations combined?**
  - Significant customization/integration?
  - Can others perform implementation?
  - Does customer buy combined output?
  - Are there separable execution risks?

### Over Time/Point in Time
- **Distinct** implementation over time if:
  - can estimate progress, and
  - customer controls/can benefit from WIP, or must pay WIP w/no alt use
- **Cloud service and extras over time**:
  - Consume benefits
- **Material right renewal option over time**:
  - Consume benefits

### Revenue Recognition based on Allocated Amounts
- For distinct implementation, based on measure of progress:
  - Hours, costs, milestones, etc.
  - T&M fees could often be recognized as incurred
  - Non-distinct setup – reallocated
- If cloud/extras are a series:
  - Record usage fees as earned – only if this would reflect service value
  - All other – estimate measure of progress (time, volume…)
- **Material right renewal option**: Defer, recognize over renewal term

### Guidance
- ASC 606 Ex 13, 53; TRG 11/2015;
- 2016 Guides: EY FAQ 4-7, 9.3.3-III. 9-4; KPMG 8.2; PwC Examples 5-8, 10-3; DT 8.5.2, Q&A 5-7, Q&A 8-18

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Nonrefundable Upfront Fees

- Identify if associated with a distinct performance obligation
  - Administrative setup activities likely not distinct
  - Cloud service configuration activities could be distinct
- Include in total transaction price
  - Even if no distinct obligation, do not default to straight-line
    - Cannot use SAB 104: “A systematic method would be on a straight-line basis unless…”
    - Recognized revenue should reflect transfer of goods/services
- Consider if contract renewal option (without a new upfront fee) conveys a material right
  - If so, revenue will spread into optional renewal periods
    - Based on (i) value of option or (ii) assuming option exercise
  - No requirement to amortize setup fee over customer relationship period
    - Similar effect may result from recognition of option value over time

Guidance: 606-10-55-50 through 53, Ex 53: 2016 Guides: EY 5.8; KPMG 10.6; PwC 8.4; DT 5.7, 8.9.3
Installation / Implementation Services

Nature of Work
- 3rd party systems
- Hardware
- Software

Distinct from Product?
- Consider in context of contract

Over Time/ Point in Time
- Simple installation
- Installation, implementation, configuration
- Significant integration, customization

Pattern of Delivery and Revenue Recognition
- Hours or cost based
- Nature of obligation (labor, labor + equipment, 3rd party materials impact)
- Consider ability to estimate progress
- Consider impact of acceptance (no revenue reversal probable)?

Guidance
- 606-10-25-19 through 22, 27 and 33 through 35; 55-20 through 21; Ex 10A, 11A, 11C, 11D, 19;
- 2016 Guides: PwC Examples 3-3, 3-4, 3-5, 9-2
## Customer Support Services

### Distinct Obligations

<table>
<thead>
<tr>
<th>Obligation</th>
<th>Standard warranty</th>
<th>Technical support</th>
<th>Compatibility with 3rd party products</th>
<th>Repairs, supplies, parts</th>
<th>Unspecified updates upgrades</th>
<th>Specified upgrades</th>
</tr>
</thead>
<tbody>
<tr>
<td>Over Time/Point in Time</td>
<td>N/A (cost accrual)</td>
<td>over time (consume benefits)</td>
<td>over time or point in time (stand ready v. set pattern)</td>
<td>at point in time</td>
<td></td>
<td></td>
</tr>
</tbody>
</table>

### Pattern of Delivery and Revenue Recognition Model

- **Over Time**
  - time (stand ready)
  - costs or hours
  - instances
- **Point in Time**
  - time (stand ready)
  - costs and/or hours
  - instances
  - **upon supply/release**

Most companies do not currently expect to bifurcate technical support from unspecified updates due to same pattern of transfer.

### Guidance

606-10-25-18; Ex 11, 51, 54; ASU 2014-09 BC116, BC160; EY TL Software

- Defer revenue if cost of technical support is uncertain
  - e.g. product novelty
- Consider portfolio approach
Warranty Obligations

- Optional
- Separately priced
- Separately negotiated
- Service beyond compliance with specifications
- Cannot reasonably separate service from compliance
- Compliance with agreed specifications
- Warranty required by law
- Return faulty items for refund
- Product liability claims

Service performance obligation:
- Measure progress
- Recognize loss upfront if separately priced extended warranty or product maintenance

Assurance only warranty:
- Warranty (cost accrual) accounting

Right of return

Contingency

Length of coverage

Guidance: 606-10-55-30 through 35; TRG 3/2015; 2016 Guides: EY 9.1; KPMG 10.2; PwC 8.3; DT 5.5, 6.5.3
Bundled (Combined) Performance Obligation

Pattern of recognition:

- Based on predominant deliverable
  - Customer ascribes significantly more value

- Based on a single measure of progress
  - Must best depict performance in transferring goods/services
  - Exclude internal activities

- Equal to costs incurred
  - If costs are expected to be recovered

- Upon completion
  - If cannot measure progress and may not recover costs

- Cannot default to methods existing today:
  - Based on final deliverable
  - Starting when all services have commenced
  - Combined services approach
  - Straight-line

Recognize over time (vs. at a point in time):

- Consider predominant deliverable
  - Customer ascribes significantly more value

- Consider nature of bundled IP licenses
  - Symbolic IP/functional IP access over term

- Customer simultaneously receives and consumes benefits

- Customer controls the combined asset throughout transfer period

- Customer is obligated to pay and asset has no alternative use

Guidance:
606-10-25-27 through 29, 31 through 37, 55-57, 55-65A; TRG 7/2015;
2016 Guides: EY FAQs 7-4, 7-5 and 8.2.4; KPMG Example 43; PwC 6.4.4; DT 8.5.2
Intellectual Property (IP) Licenses

Does IP have significant standalone functionality?
- Can process transaction
- Can perform function
- Can be played, etc.

IP is functional
Value is derived from IP functionality
- Software, technology, movies, music, biotech

Substantive changes to IP by licensor are expected...
...that do not transfer a good/service to customer...
...and customer required/compelled to use updated IP

Right to access IP throughout term (or IP life, if shorter)
Recognize over time measure progress

Yes No

Single license: all current scope restrictions (time, geography, use)
Multiple licenses: scope restrictions change over time

Right to use IP as licensed
Recognize at a point @ enabled/renewed

If IP not distinct, consider nature of overall obligation (including nature of IP rights) and apply general over time/point in time guidance

Guidance 606-10-55-54 through 64; Ex 54-61B; 2016 Guides: EY 8; KPMG 8; PwC 9; DT 8.9.1, 11
<table>
<thead>
<tr>
<th>Software elements and terms</th>
<th>ASC 606 considerations</th>
</tr>
</thead>
<tbody>
<tr>
<td>Perpetual licenses</td>
<td>▪ Distinct from professional service (PS)? See PS below.</td>
</tr>
<tr>
<td></td>
<td>▪ Residual allocation could be possible</td>
</tr>
<tr>
<td></td>
<td>▪ If all other elements (PCS, PS) have observable SSP</td>
</tr>
<tr>
<td></td>
<td>▪ Substantive renewal-rate based VSOE may not be observable SSP</td>
</tr>
<tr>
<td></td>
<td>▪ If not available, use relative SSP based allocation</td>
</tr>
<tr>
<td></td>
<td>▪ Recognize upon delivery and start of term</td>
</tr>
<tr>
<td></td>
<td>▪ Electronic or key delivery acceptable</td>
</tr>
<tr>
<td>Time-based licenses</td>
<td>▪ Distinct?</td>
</tr>
<tr>
<td></td>
<td>▪ Usually distinct from PCS</td>
</tr>
<tr>
<td></td>
<td>▪ May not be distinct from frequent information updates (e.g. anti-virus)</td>
</tr>
<tr>
<td></td>
<td>▪ Likely not distinct from other essential services</td>
</tr>
<tr>
<td></td>
<td>▪ Residual allocation is unlikely</td>
</tr>
<tr>
<td></td>
<td>▪ Recognize upon delivery and start of term if distinct</td>
</tr>
<tr>
<td></td>
<td>▪ For renewal term, recognize when renewal term starts</td>
</tr>
<tr>
<td>Firmware (embedded software) licenses</td>
<td>▪ Not distinct from related hardware or cloud service</td>
</tr>
<tr>
<td>Cloud service licenses</td>
<td></td>
</tr>
<tr>
<td>Additional seat options</td>
<td>▪ Assess if discounted to create material rights. If so, allocate and defer some revenue</td>
</tr>
</tbody>
</table>

**Guidance**

ASC 606 Ex. 10C, 11A, 11B, 54, 59B; TRG Memo 45; AICPA FRC Issue 14-1; 2016 Guides: EY 4.2, 8.5; KPMG 8.2; PwC 9.3; DT 8.9.1, 11.2, 11.5.4, Q&A s 11-2, 11-3,11-4, 11-5, 11-6
# Software (2)

## Software elements and terms

<table>
<thead>
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<th>Professional services</th>
<th>ASC 606 considerations</th>
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<tbody>
<tr>
<td>Distinct from software license if not an input to a single output</td>
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<tr>
<td>Core software likely not distinct</td>
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<tr>
<td>Significant customizations and modifications likely not distinct</td>
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<tr>
<td>Turnkey integration projects likely not distinct</td>
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<tr>
<td>Recognize over time if</td>
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<tr>
<td>Can estimate progress, and</td>
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<tr>
<td>Customer controls WIP, or must pay for WIP which has no alternative use</td>
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<tr>
<td>Recognition pattern (measure progress):</td>
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<tr>
<td>Hours, costs, milestones…</td>
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<tr>
<td>Can use T&amp;M if reflects value to customer, or if services are a series</td>
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<tr>
<td>Exclude costs not proportionate to progress (e.g. inefficient hours)</td>
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<tr>
<td>Zero margin method required if cannot estimate progress, but there is no loss</td>
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</tbody>
</table>

| Specific upgrades, roadmaps, products | |
|---------------------------------------| |
| Likely distinct from software license (unless essential) | |
| Could be deemed immaterial to the contract (if value or cost to develop is low) | |

| Unspecified software products | |
|------------------------------| |
| Could be a standby-ready obligation | |

| Future discounts | |
|-------------------| |
| Assess if they represent material rights | |
| If so, determine SSP based on likelihood of exercise and value | |

---

**Guidance**

- ASU 2014-09 BC 109, 110; TRG Memo 45; AICPA FRC Issue 14-4(b);
- 2016 Guides: EY FAQs 4-2, 4-3; KPMG 8.2; PwC 6.4.2.3; DT Q&A 5-10

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## Software (3)

<table>
<thead>
<tr>
<th>Software elements and terms</th>
<th>ASC 606 considerations</th>
</tr>
</thead>
</table>
| **Post-contract customer support (PCS)** | - Evaluate if unspecified upgrades and phone support are distinct
  - Usually can be combined based on same pattern of recognition
  - Unless there is a recognizable pattern of upgrade delivery
  - Both upgrades and phone support could be immaterial to contract
    - If value or cost to provide is low
  - Recognition pattern (measure progress):
    - Usually straight-line, but could deviate for some companies |
| **Product liability, IP indemnification** | - Not performance obligations as they are protecting customer rights in software |
| **Sunset and code escrow clauses** | - Not performance obligations as they are protecting customer rights in software |
| **Price concessions** | - Estimate at inception or when they become expected
  - Adjust transaction price and allocation among performance obligations |
| **Extended payment terms** | - Assess impact on transfer of control, collectibility, concession estimates, and whether financing is present |
| **License usage-based fees and royalties** | - Exclude from transaction price
  - Account for in the month **earned** (allocate to license and other obligations, if any) |

**Guidance**
- TRG Memo 45; AICPA FRC Issues 14-2, 14-4(a);
- 2016 Guides: EY 5.2.1.1, 8.5; KPMG 5.3.1.2, 8.2; PwC 5.5.3; DT Q&As 5-9, 5-10, 5-11, 7-1; 8-17, 11-11
## Software (4)

<table>
<thead>
<tr>
<th>Software elements and terms</th>
<th>ASC 606 considerations</th>
</tr>
</thead>
</table>
| Standalone selling prices (SSP) for performance obligations | - Observable pricing must be used if available  
  - Bell curve VSOE, other observable pricing  
  - Substantive renewal rate VSOE not observable unless actual renewals occur  
  - If no observable pricing and no VSOE, SSP could be based on target pricing, cost to develop/deliver service, internal metrics, and other factors  
  - Residual SSP possible for licenses if all other elements have observable SSP |
| Allocation | - Allocate variable consideration to underlying elements if this would meet allocation objective  
  - Otherwise, if residual SSP is not used, apply relative SSP method |
| Complex licenses | - For licenses with complex terms (e.g. lapsed license period), determine if this is a single license or multiple licenses  
  - Multiple licenses will impact revenue recognition as each will get recognized separately when delivered/activated |
| Lapsed PCS reinstatement | - Fees for lapsed support could imply renewal-rate PCS price is below SSP level offered to customers without current PCS contract  
  - This could lead to PCS pricing being deemed to include a material right |
| Service level guarantees | - Variable consideration if penalties may apply and would result in payouts to customer; otherwise, account using warranty guidance |

### Guidance

ASC 606 Ex. 61B; ASU 2014-09 BC 273; TRG Memo 45; AICPA FRC Issue 14-6; 2016 Guides: EY 6.1.2.2; KPMG 8.2; DT 7.2.2, Q&A 7-1
## Life Science Collaboration Arrangements (1)

### Contractual Terms

<table>
<thead>
<tr>
<th>Term</th>
<th>Description</th>
</tr>
</thead>
<tbody>
<tr>
<td>Joint work</td>
<td>Sharing risks/benefits, mutual licenses...</td>
</tr>
<tr>
<td>IP License</td>
<td>Develop, make, sell, regulatory..</td>
</tr>
<tr>
<td>R&amp;D Service</td>
<td>Pre-clinical, clinical trials, ...</td>
</tr>
<tr>
<td>JSC</td>
<td>Joint steering committee</td>
</tr>
<tr>
<td>Manufacturing</td>
<td>Manufacturing services</td>
</tr>
</tbody>
</table>

### Nature of Contract

<table>
<thead>
<tr>
<th>Other</th>
<th>Contract with customer (revenue)</th>
</tr>
</thead>
<tbody>
<tr>
<td>Develop an asset jointly</td>
<td>Obtain output of entity’s ordinary activities...</td>
</tr>
<tr>
<td>...in exchange for consideration</td>
<td></td>
</tr>
</tbody>
</table>

### Distinct Obligation?

- Capable and in context of contract
- Could be revenue by analogy (ASC 808), or another item
- Obligations distinct?
  - What is IP stage of development
  - Does vendor control R&D/Mfctg.
  - Can customer use/sell/monetize IP without R&D, Mfctg., etc.

### Over Time/Point in Time

- Technology transfer
  - on activation
- Use pattern of performance (hours, costs, units)
  - When control transfers
- at point in time if distinct
  - over time if: can estimate progress, and customer controls/can access IP, or must pay for WIP w/no alt use
- point in time

### Revenue Recognition

Refer to milestones and royalties considerations on the next slide

### Guidance

- 606-10-15-3, Ex 56A, 56B; ASU 2014-09 BC54 through BC56, 808-10;
- 2016 Guides: EY 2.3; KPMG 8.2, 8.6 Observations; PwC Examples 2-2, 8-4, 9-1, 9-6, 9-8; DT 3.2.4
# Life Science Collaboration Arrangements (2)

## Milestones

<table>
<thead>
<tr>
<th>Type of milestone</th>
<th>Transaction Price</th>
<th>Allocate to…</th>
<th>Recognize…</th>
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</thead>
<tbody>
<tr>
<td>Sales-based, relates solely/predominantly to IP license</td>
<td>Exclude</td>
<td>IP license and other obligations (if any)</td>
<td>When achieved (IP license portion)</td>
</tr>
<tr>
<td>From <strong>licensee</strong> performance (unrelated to R&amp;D services)</td>
<td>Include ($0 unless/until probable)</td>
<td>Entirely to IP license</td>
<td>Upfront, true up as time goes</td>
</tr>
<tr>
<td>From <strong>licensor</strong> R&amp;D service and reflects only its value</td>
<td></td>
<td>Entirely to R&amp;D service</td>
<td>As service is performed, true up as time goes</td>
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<tr>
<td>Other</td>
<td></td>
<td>All obligations</td>
<td>As/when control transfers</td>
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</tbody>
</table>

## Royalties on IP license

**Flowchart**

- **Inputs**
  - Includes R&D service and/or manufacturing margin? (Yes/No)
  - IP license drives most of royalty value? (Yes/No)
  - IP is not predominant royalty driver (Yes/No)

- **Outputs**
  - Exclude from Transaction Price, recognize when earned
  - Include in Transaction Price, estimate and allocate to all obligations
  - Exclude from Transaction Price, recognize when earned
  - Include in Transaction Price, estimate and allocate to all obligations

**Guidance**

- 606-10-25-30 through 37; 32-5 through 9, 11 through 13, 29, 39 through 41; 55-65 through 65B; Ex 56A, 56B; 2016 Guides: EY 2.3; KPMG 8.2, 8.6 Observations; PwC Examples 2-2, 8-4, 9-1, 9-6, 9-8; DT 3.2.4
Milestones and Other Performance Fees

If included in **Transaction Price**,
- “Most likely amount” method if pass/fail milestones
- Value is $0 unless achievement probable
- Apply to each milestone individually
  - Sales/use based milestones related to IP licenses are treated like royalties!

**Allocation considerations**
- Allocate to some obligations only, if
  - Paid for efforts related to such obligations, and…
  - Consistent with the allocation objective

**Control transfer/Measure progress**
- License: point in time v. over time
- Prof services: T&M, milestone, resources, costs, other…
- Cumulative catchup for changes

**Example – Functional IP license with prof services**

<table>
<thead>
<tr>
<th>Licensee performance</th>
<th>Licensor professional service performance</th>
</tr>
</thead>
<tbody>
<tr>
<td>Unrelated to prof services value</td>
<td>Exceeds value of prof services</td>
</tr>
<tr>
<td>Reflects value of prof services</td>
<td></td>
</tr>
</tbody>
</table>

**Allocate milestone to**
- IP license only
- IP license + prof srvcs
- Prof srvcs only

**Guidance**
606-10-25-30 through 37, 32-8, 11 through 13, 29, 39 through 41;
2016 Guides: EY 4.2.2, FAQ 8-4; KPMG 8.6 Observations; DT Q&A 11-10
# NRE/Joint Technology Arrangements

<table>
<thead>
<tr>
<th>Contractual Terms</th>
<th>Joint work Sharing risks/benefits, mutual licenses…</th>
<th>IP License Develop, make, resell product with IP</th>
<th>R&amp;D Service Enhance licensed IP</th>
<th>Manufacturing Supply of product with IP for resale</th>
</tr>
</thead>
<tbody>
<tr>
<td>Nature of Contract</td>
<td><strong>Other</strong></td>
<td><strong>Financing</strong></td>
<td><strong>Contract with customer (revenue)</strong></td>
<td><strong>Is obligation?</strong></td>
</tr>
<tr>
<td>▪ Develop an asset jointly</td>
<td>▪ Repay regardless of R&amp;D success</td>
<td>▪ Obtain output of entity’s ordinary activities…</td>
<td>▪ …in exchange for consideration</td>
<td></td>
</tr>
<tr>
<td>Distinct Obligation?</td>
<td>▪ Could be revenue by analogy (ASC 808), or another item</td>
<td>▪ Not a revenue contract</td>
<td>▪ If R&amp;D service present, likely a single obligation with license</td>
<td>▪ R&amp;D uncertainty</td>
</tr>
<tr>
<td>Capable and in context of contract</td>
<td>▪ Could be revenue by analogy (ASC 808), or another item</td>
<td>▪ Not a revenue contract</td>
<td>▪ If R&amp;D service present, likely a single obligation with license</td>
<td>▪ Alternative sources?</td>
</tr>
<tr>
<td></td>
<td>▪ R&amp;D unique and controlled by vendor</td>
<td>▪ If unique product with enforceable obligation to pay</td>
<td></td>
<td>▪ Priced at SSP?</td>
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<td>▪ Could be option</td>
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<tr>
<td>Revenue Recognition Model</td>
<td>Upfront amount</td>
<td>Pattern of performance (usu. full cost) &amp; or on completion</td>
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<tr>
<td>subject to SSP allocations</td>
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<td>&amp; If can estimate progress and have enforceable right to payments</td>
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</tbody>
</table>
Optional Goods or Services (1)

- **Option** characteristics:
  - No present obligation for vendor, until/unless executed
    - Otherwise, variable consideration
  - No penalty if not executed for customer
    - Even if highly likely to be executed
  - Substantive (may or may not be executed)

- **Material right**: customer would not receive without entering into contract
  - Assess qualitatively and quantitatively
  - Accumulate across transactions
  - E.g. discount > typical discount level for product/customer/market
  - Discount at **same** level as contracted items could be a material right
  - Option at **SSP** is **not** a material right  ➔ **marketing offer**

---

**Guidance**

606-10-55-41 through 45, Ex 49-52; TRG 10/2014, 3/2015 and 11/2015;
2016 Guides: EY 4.6, 6.1.5, 7.8; KPMG 10.4; PwC 3.5, 7.2, 7.2.1, 7.2.2, 7.3; DT 5.6, 6.2.5.4, Q&A 8-31
Optional Goods or Services (2)

- **Does the option convey a material right?**
  - **NO**
    - No accounting consequences
      - Separate arrangement when executed
  - **YES**
    - **Option** is a performance obligation
      - Follow pattern of performance/expiration
    - **Value option**
      - Expected purchase $ × Incr discount × Likelihood %
    - **Value optional deliverables**
      - *(similar items per original contract terms)*
      - Expected purchase $ × Likelihood %

Upon exercise of option with material right, determine if…
- Contract modification
- Change in transaction price (and performance obligations)

**Guidance**
606-10-55-41 through 45, Ex 49-52; TRG 10/2014, 3/2015 and 11/2015:
2016 Guides: EY 4.6, 6.1.5, 7.8; KPMG 10.4; PwC 3.5, 7.2, 7.2.1, 7.2.2, 7.3; DT 5.6, 6.2.5.4, Q&A 8-31

- Financing component may exist/should be assessed
Sales of Fixed Assets (PP&E) and Intangibles

**TOPIC 610**

Applies to sales of:
- Intangibles
- Fixed assets (PP&E)
  - Including fixed asset real estate
- Legal entities that are in substance those assets

Does not apply to sales of:
- Inventory real estate
- Businesses
  - Use deconsolidation accounting (ASC 810)

**Apply Topic 606 Considerations**

Are there additional performance obligations?
- Apply ASC 606 and allocate

**Contract criteria**
- Rights, obligations, payment terms…
- Commitment to perform
- Collectibility (entire amount)

If contract criteria **not met** (or control not transferred), continue to
- Depreciate/amortize (if not held for sale)
- Assess for impairment

**Transaction price**
- Fixed, variable, non-cash
- No gain reversal probable?
- Estimate and add royalties (if relevant)

**Transfer of control**
- Title, right to payment, possession, risks…

**Financing component**
- Carve out or add as applicable

**Recognize gain/loss**
- Transaction price less carrying value

**Guidance**
- 350-10-40-1 through 4; 360-10-40-3A through 3C and 45-5; 610-20; 2016 Guides: EY 11; KPMG 9; PwC 2.3; DT 17
### Transaction Price

[replaces Fixed or Determinable Consideration]

| + Fixed cash amounts |
| + Estimated cash variable consideration (but not sales/usage-based license royalty) |
| + Non-cash consideration |
| - Estimated consideration payable to customer |
| - Contingent amounts, unless no revenue reversal is probable (constraint) |
| +/- Financing component |
| - Amounts collected on behalf of 3rd parties (e.g. sales taxes) |
| = Transaction Price (to be allocated to performance obligations) |

- **Expected** amount from customer or 3rd parties based on **existing** contract
  - Assume goods/services will be transferred as promised
  - Ignore possible renewals, modifications or cancellations, optional goods/services, etc.

- **Update** at each reporting date

---

**Guidance**

606-10-32-2, 3, 4 and 14, 55-65 and 65A; 2016 Guides: EY 5, KPMG 5.3; PwC 4.2; DT 6.1.1
Estimating Variable Consideration

- **Must** develop an estimate using:
  - Expected value approach (sum of probability-weighted amounts in a range of possible), or
  - Most likely amount approach

- Choose based on which is expected to **best predict** ultimate transaction price
  - Can use both methods for different uncertainties in the same contract

- Recognize **refund liability** and update at each reporting date

<table>
<thead>
<tr>
<th>Price related</th>
<th>Volume/scope related</th>
</tr>
</thead>
<tbody>
<tr>
<td>Volume discounts</td>
<td>Rebates, chargebacks</td>
</tr>
<tr>
<td>Credits, discounts</td>
<td>Certain penalties, liquidating damages</td>
</tr>
<tr>
<td>Refunds</td>
<td>Performance incentives, milestones</td>
</tr>
<tr>
<td>Coupons</td>
<td>Contingent fees, restocking fees</td>
</tr>
<tr>
<td>Price protection/MFN</td>
<td>Expected price concessions</td>
</tr>
</tbody>
</table>

**Guidance**: 606-10-32-5 through 10, TRG 7/2015; 2016 Guides: EY 5.2; KPMG 5.3.1.1; PwC 4.3.1; DT 6.2.2
**Variable Consideration Constraint**  
[replaces Contingent Revenue; Fees Subject to Forfeiture…]

- **Constraint**: reduce *Transaction Price* by contingent amounts to such extent as to make it *probable* significant revenue reversal will not occur (for *cumulative* revenue recognized) when uncertainty is resolved
  - Probable = likely to occur (~e.g. 70-80% chance)
  - Significant = magnitude vs. total consideration (fixed & variable)
  - **Update** at each reporting date

**Consider**
- Market volatility
- 3<sup>rd</sup> party actions
- Obsolescence risk
- Length of uncertainty
- Historical experience
- Concession history
- Number and range of outcomes
- At contract level!

**Guidance**  
606-10-32-11, 12 and 14; TRG 1/2015; 2016 Guides: EY 5.2.3; KPMG 5.3.1.2; PwC 4.3.2; DT 6.3.3
Sales or Usage Based Royalties

- **Exclude** from variable consideration/Transaction Price
- Applies **only** if royalty is both:
  - Sales or usage based
  - Solely or **predominantly** related to intellectual property license
- Recognize revenue at *later* of when
  - a) The sale or usage occurs
  - b) Performance obligation is satisfied (in whole/part)
- **Estimates** may be required if sales/usage data reported with a lag
- **Allocation** to other obligations required if license is predominant (i.e. not sole)
- Estimates of expected future royalties may be necessary
  - To determine whether royalty relates solely/predominantly to IP license
  - To test contract cost asset for impairment or to determine loss contracts
- All **other** royalties must be estimated and included in Transaction Price
  - E.g. from sales of IP, or if inclusive of margin from product sales

**Predominant** = >90%? >50%?

- If relate to license recognized over time, “as-earned” can approximate value to customer => output measure of progress

**Guidance** 606-10-55-65 through 65B; 2016 Guides: EY 8.5; KPMG 8.6; PwC 9.8; DT 6.2.5.1, 10.5.6, 11.6
## Non Cash Consideration

### Examples
- Customer goods, services, PP&E, intangibles…
- Customer’s shares, options, warrants…
- Customer materials, labor to facilitate contract fulfilment – only if entity obtains control of such items

### Not in scope
- Exchanges in the same line of business for purposes of facilitating customer sales (ASC 845)
- Exchanges without commercial substance (no revenue to be recognized)

### How to determine value
- **Fair value** of noncash consideration (or promise thereof)
  - Must use if can reasonably estimate
- **SSP** of promised goods/services
  - No guidance if/when required to update
- No other methods are allowed:
  - Book value of promised goods/services
  - $0
  - Real estate exchanges, advertising barter, barter credits – no special exceptions

### When to measure fair value of noncash consideration
- At inception: include estimate in **transaction price**
  - Provided no revenue reversal is probable
  - Based on current stock value and terms
- Subsequently:
  - Changes from form of consideration (e.g. stock value) => gains/losses/other accounting
  - Changes unrelated to form of consideration update **transaction price**

**Guidance**
- 606-10-15-2.e, 32-21 through 24; Ex 31; ASU 2014-09 B.102, 214 and 218;
- 2016 Guides: EY 5.6; KPMG 5.3.3; PwC 4.5; DT 6.4
Rights of Return

- Establish a **refund liability**
  - Not a separate performance obligation
  - Results in **variable consideration**
  - Not part of the **transaction price**
  - **Remeasure** at each reporting date

- Recognize revenue to the extent no reversal is probable
  - Even if unable to reliably estimate

- Product exchanges (same type, quality, **condition** or price) have no accounting consequences

---

**Right of Return**

- Cash refund
- Credit against amounts owed
- Exchange for another product
  - ...against return of asset

---

**Portfolio approach**

---

**Right of Return**

- **Cash/Receivable**
  - Revenue
  - Refund Liability
- **Asset**
  - Carrying amount, less expected costs to recover, diminution in value, restocking costs
- **Cost of goods sold**
- **Inventory**

---

**Acceptance**

- Control is transferred, for example
  - Title is transferred
  - Right to unconditional payment
- Control is **not** transferred, for example
  - Title is retained
  - Payment is conditional on acceptance

---

**Guidance**

606-10-55-22 through 29; Ex 22 and 40; TRG 7/2015; 2016 Guides: EY 4.7, 5.4.1: KPMG 10.1; PwC 8.2; DT 6.2.5.3
Rights of Refunds for Services

- **Recognize revenue using** variable consideration **framework**
  - Full deferral until expiration of right to refund (SAB 104/ASC 405-20) **not** an acceptable approach

- **Estimate transaction price**
  i. Using expected value or most likely amount
  ii. Limit amount so as no significant reversal be probable

- **Record liabilities** for amounts received/receivable
  - **Contract liability** (deferred revenue) up to transaction price amount
    - Recognize in revenue as services are provided, using an appropriate method
  - **Refund liability** for amounts over transaction price

- **Update** (remeasure) at each reporting date

- **Expense “sunk” origination and fulfillment costs** related to contracts expected to be refunded if not recoverable

**Guidance**

- 606-10-32-5 through 13, 55-22 through 26 (by analogy); 340-40-25-1 and 5; 2016 Guides: EY 4.7, 5.4.1: KPMG 10.1; PwC 8.2; DT 6.2.5.3
Extended Payment Terms

- New revenue guidance does not retain the notion of the Extended Payment Terms

Payment terms are longer than usual → Is control transferred prior to due date?

- No → Defer revenue until control transfers
- Yes → Is collectibility of expected amounts probable?

- No → Defer revenue until all collected, or delivery stopped, or terminated
- Yes → Are concessions expected?

- No → Consider financing component and exclude
- Yes → Estimate concessions to reduce revenue
- Update

- Recognize revenue if no reversal probable

- Significant estimates and judgments
  - Is the customer committed to purchase?
  - Is the customer committed to pay?
  - Nature, magnitude and likelihood of potential concessions

Guidance: 2016 Guides: EY 5.2.1.1; KPMG 5.3.1.2; PwC 9.7.3
Customer Concessions and Satisfaction

- **Concessions:**
  - Unfavorable changes to the contract
  - No or little additional consideration
- **May not** preclude revenue recognition

### Price Concessions
- **Are price concessions expected?**
  - Yes
  - No
  - **Defer revenue**
  - **Recognize revenue if no reversal probable**

### Scope Concessions
- **Estimate concessions to reduce revenue**
  - Yes
  - **Implicit performance obligations**
  - No
  - **Contract modification – additional obligations**
- **Are scope concessions expected at contract inception?**
  - Yes
  - Contingency accounting
  - Accrue cost
  - No
  - **Do they become likely before contract completion?**
    - Yes
    - No

### Guidance
- 606-10-32-6 through 12, 25-10; Ex 2, 3, 12, 23;
- 2016 Guides: EY 5.2.1.1; KPMG 5.1.1.1, 5.3.1; PwC 2.6.5.1, 4.3.3.1; DT 4.2.5.1

### Examples
- Refund or return
- Credit for future purchases
- Extending payment terms
- Additional free goods/services
- Concession after contract completion
- Contingency accounting
- Accrue cost

**Unfavorable changes to the contract**
- No or little additional consideration

**May not** preclude revenue recognition

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<tr>
<th>Are price concessions expected?</th>
<th>Yes</th>
<th>No</th>
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<tr>
<td>Is control transferred/collectibility probable?</td>
<td>Yes</td>
<td>No</td>
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<tr>
<td>Defer revenue</td>
<td>Recognize revenue if no reversal probable</td>
<td></td>
</tr>
<tr>
<td><strong>Estimate concessions to reduce revenue</strong></td>
<td>Yes</td>
<td>No</td>
</tr>
<tr>
<td>Implicit performance obligations</td>
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<tr>
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<td>Contingency accounting</td>
<td>Accrue cost</td>
<td></td>
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<tr>
<td><strong>Do they become likely before contract completion?</strong></td>
<td>Yes</td>
<td>No</td>
</tr>
</tbody>
</table>
Consideration to Customer

- Applies to customers and distribution chain but…

A **distinct** good/service is purchased from customer?

- YES
  - Can reasonably estimate **fair value**?
    - YES
      - Consideration owed in excess of fair value?
        - YES
          - Treatment as regular purchase
        - NO
          - Reduce **transaction price** (and therefore, revenue)
    - NO
      - Deferred or accrued customer incentives

- NO
  - Aggregate negative revenue

---

**EXAMINES**

- Slotting fees
- Coop advertising
- Buy downs/price protection
- Coupons/rebates
- Upfront payments

**EXAMPLES**

**In scope**
- Cash
- Equity

**Not in scope: perf obligations**
- Product discounts
- Free products

---

Guidance: 606-10-32-25 through 27; TRG 3/2015; 2016 Guides: EY 5.7; KPMG 5.3.4; PwC 4.6; DT 6.5
Volume Discounts

Is volume discount prospective or retrospective?

- **PROSP**
  - Is volume either guaranteed, or optional but option is not substantive?
    - NO
      - Does the option pricing (volume discount) convey a material right?
        - NO
          - Value either option or optional items (if allowed)
        - YES
          - Estimate purchases (units)
            - **Update at each reporting date**
          - Determine average price per unit (APPU)
          - Recognize Revenue
            - **Units sold x APPU price**
          - Record Refund Liability
            - **Cash/AR in excess of APPU**
          - No accounting implications
          - Recognize revenue as earned
          - **OPTIONAL ITEMS**
            - Determine value of option
              - **Volume x Incr disc x % likelihood**
            - Recognize over time
              - **As optional deliveries occur**
            - Recognize on expiration
              - **If option not used**

Is volume either guaranteed, or optional but option is not substantive?

- **NO**
  - Yes
    - Value either option or optional items (if allowed)

Determine average price per unit (APPU)

- Estimate purchases (units)
  - **Update at each reporting date**
- Determine value of option
  - **Volume x Incr disc x % likelihood**
- Recognize Revenue
  - **Units sold x APPU price**
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Determine value of option

- Estimate purchases (units)
  - **Volume x Incr disc x % likelihood**
- Recognize Revenue
  - **Units sold x APPU price**
- Record Refund Liability
  - **Cash/AR in excess of APPU**
- No accounting implications

Guidance

- 606-10-32-5 through 12; 55-41 through 45; Ex 24;
- 2016 Guides: EY FAQs 4-14, 4-15; KPMG 5.3; PwC 4.3.3.3, 7.2.3; DT Q&A 6-12
### Coupons, Rebates, Chargebacks

<table>
<thead>
<tr>
<th>Examples</th>
<th>Application</th>
<th>Amount</th>
<th>Record when/as…</th>
</tr>
</thead>
<tbody>
<tr>
<td>Reseller, consumer or eligible consumers can rebate an amount off price of item (item not yet sold by entity)</td>
<td>Variable consideration</td>
<td>Estimate expected value or most likely amount</td>
<td>Revenue is recognized</td>
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<td>• incl. purchases by eligible consumers if relevant</td>
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</tr>
<tr>
<td>Reseller or consumer can rebate an amount off price of item (item already sold by entity to reseller)</td>
<td>Transaction price change</td>
<td>Limit resulting revenue amount so as no significant reversal be probable</td>
<td>Rebate program is announced</td>
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<td>• Update at each reporting date</td>
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<tr>
<td>Coupon (issued with current purchase) entitles to discount on a future purchase</td>
<td>Optional items</td>
<td>If there is material right,</td>
<td>Defer value on current purchase</td>
</tr>
<tr>
<td></td>
<td>• Determine if material right exists</td>
<td>• Allocate value to option, or optional purchases</td>
<td>Recognize upon use or expiration</td>
</tr>
<tr>
<td></td>
<td></td>
<td>• No accounting if no material right</td>
<td></td>
</tr>
<tr>
<td>Coupon issued with purchase for 3rd party goods or services</td>
<td>Contra-revenue for amounts due to 3rd parties if entity is not principal for 3rd party deliverables</td>
<td>Revenue is recognized</td>
<td></td>
</tr>
<tr>
<td>Reseller issues to consumer a manufacturer coupon and is reimbursed by manufacturer</td>
<td>Revenue for reseller if reimbursed at face value per the terms of the same program for all resellers</td>
<td>Add to reseller revenue when it is recognized</td>
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<tr>
<td></td>
<td>• Otherwise, cost reduction</td>
<td></td>
<td></td>
</tr>
</tbody>
</table>

**Guidance**

606-10-32-5 through 12, 25 through 27, and 55-41 through 45;
2016 Guides: EY 5.7.2, 5.7.3; KPMG 5.3.4, 10.4.1; PwC 4.3.3.4, 4.3.3.8, 4.6; DT 5.6.7
Customer Loyalty and Points Obligations

- Determine if loyalty points provide **material right**
- If so, points are a separate **performance obligation**
  - Cannot be called **immaterial** obligation
  - Determine **SSP** and allocate **transaction price** based on SSP

**Cost accrual for points not allowed!**

**Examples**
- Airline miles
- Hospitality points
- Retail rewards, stamps
- Virtual credits

### Recognize revenue when points...

<table>
<thead>
<tr>
<th>If redeemable by 3rd party principal:</th>
<th>If redeemable by entity:</th>
<th>Customer decides entity or 3rd party:</th>
</tr>
</thead>
<tbody>
<tr>
<td>Are issued</td>
<td>Are redeemed</td>
<td>Are redeemed</td>
</tr>
<tr>
<td>Expire</td>
<td></td>
<td>Are transferred to 3rd party</td>
</tr>
<tr>
<td></td>
<td></td>
<td>Expire</td>
</tr>
</tbody>
</table>

Consider unexercised rights guidance!

### Determining Standalone Selling Price (SSP)

- Price in standalone sales of points
- SSP of goods or services points can purchase
- Customer redeemable value
  - Incorporate likelihood of redemption (breakage)

### Principal vs Agent Consideration

When points must or may be redeemed with 3rd party, determine if entity has control over points (i.e. is principal)

**Principal**

- Revenue is gross
- 3rd party fee is cost

**Agent**

- Revenue is net of fees paid to 3rd party

**Guidance**

606-10-55-41 through 49, 25-16B; Ex 52; 2016 Guides: KPMG 10.4.2; PwC 7.2.5 through 7.2.7; DT 5.6.2.1
Unexercised Rights [replaces Unredeemed / Breakage]

- Recognize contract liability upon receipt of prepayment

Is remittance to government entity required (e.g. escheat laws)?

YES

Recognize liability (not revenue) for customer’s unexercised rights

NO

Does entity expect (is it probable?) to be entitled to a breakage amount?

NO

Recognize in revenue when likelihood of customer exercise becomes remote

YES

Recognize in revenue based on pattern of all goods/services in contract

Consistent with/based on accounting for optional goods/services

Guidance 606-10-55-46 through 49; EY 7.9; KPMG 10.5; PwC 7.4; DT 8.8

EXAMPLES

- Gift cards
- Loyalty points
- Virtual credits
- Prepayments
- Take or pay

No longer permitted:
- Indefinite deferral method
- Deferral until expiration

Example
- $105 in gift cards sold
- $5 expected breakage
- $40 gift cards redeemed
- $2 breakage recognition
## Reseller Arrangements (1)

<table>
<thead>
<tr>
<th>Reseller scenarios with impact under ASC 605/SAB 104</th>
<th>ASC 606 considerations</th>
</tr>
</thead>
</table>
| Right of return (excluding exchanges), stock rotation | **Estimate variable consideration**  
Constrain to make no significant revenue reversal probable  
- Constraint could reduce revenue to $0 (=sell-through model) |
| Chargebacks, discounts, end customer coupons or rebates, other credits | **No accounting consequences** |
| Price protection, most favored customer pricing, guarantee of resale value through payment up to guaranteed price | |  
| Price concessions | |  
| Product exchanges (same type, quality, condition or price) (treated as returns under ASC 605) | **Repurchase agreement**  
right of return or financing |
| Guarantee of resale value through guarantee to re-acquire items sold | |  

- Refer to additional considerations on two next pages

### FACTORS
- Limited or non-predictive return history, new products
- Channel stuffing
- Significant competition
- Dependence on other products
- Reseller bargaining position
- History of concessions
- Informal communications
- Other factors

### Guidance
ASC 606 Ex 12A, 12B, 12C, 23A, 23B, 23C; EY HT Technology; PwC ID Pharma & Technology; 2016 Guides: EY 7.3.3; KPMG 5.3, 5.3.4, 5.5.4; PwC Examples 8-1, 8-2; DT Q&A 12-5
### Reseller Arrangements (2)

#### Reseller scenarios with impact under ASC 605/SAB 104

<table>
<thead>
<tr>
<th>Scenario</th>
<th>ASC 606 considerations</th>
</tr>
</thead>
<tbody>
<tr>
<td>Right of return + Payment contingent on resale or not required</td>
<td><strong>Consignment</strong> (no unconditional obligation to pay)</td>
</tr>
<tr>
<td>Right of return + Reseller does not have funds to pay without resale</td>
<td>• No control transfer</td>
</tr>
<tr>
<td></td>
<td>• No revenue on shipment</td>
</tr>
<tr>
<td>Seller controls resale price, credit risk, specifications, advertising</td>
<td>• = sell-through model</td>
</tr>
<tr>
<td>Right of return + Significant obligations to bring about resale</td>
<td>• May be a consignment (lack of control transfer/obligation to pay), OR</td>
</tr>
<tr>
<td></td>
<td>• Additional obligations (and variable consideration)</td>
</tr>
<tr>
<td>Linking of individual orders under the same master agreement</td>
<td>• Usually, can treat as separate arrangements</td>
</tr>
<tr>
<td>New, thinly capitalized resellers – collectibility assessment</td>
<td>• Collectibility may not be probable. If so,</td>
</tr>
<tr>
<td></td>
<td>• Contract criteria are not met</td>
</tr>
<tr>
<td></td>
<td>• No revenue until reassessed, order paid in full, or delivery stopped/ended</td>
</tr>
</tbody>
</table>

- Refer to additional considerations on next page

**Guidance**

ASC 606 Ex 12A, 12B, 12C, 23A, 23B, 23C; EY HT Technology; PwC ID Pharma & Technology;
2016 Guides: KPMG 5.3, 5.3.4, 5.5.4; PwC Examples 8-1, 8-2; DT Q&A 12-5
## Reseller Arrangements (3)

### Reseller scenarios with impact under ASC 605/SAB 104

<table>
<thead>
<tr>
<th>Extended payment terms</th>
<th><strong>ASC 606 considerations</strong></th>
</tr>
</thead>
<tbody>
<tr>
<td>• Assess if collectibility is probable</td>
<td></td>
</tr>
<tr>
<td>• Contract criteria may not be met</td>
<td></td>
</tr>
<tr>
<td>• OR Potential for price concessions</td>
<td></td>
</tr>
<tr>
<td>• Variable consideration including constraint</td>
<td></td>
</tr>
<tr>
<td>• OR Control may not have transferred</td>
<td></td>
</tr>
<tr>
<td>• No revenue recognized</td>
<td></td>
</tr>
</tbody>
</table>

<table>
<thead>
<tr>
<th>Reseller financing, reseller lacks economic substance</th>
<th><strong>ASC 606 considerations</strong></th>
</tr>
</thead>
<tbody>
<tr>
<td>• Evaluate if one of the preceding scenarios applies</td>
<td></td>
</tr>
<tr>
<td>• Evaluate if reseller is a variable interest entity (VIE)</td>
<td></td>
</tr>
<tr>
<td>• Consolidation of reseller could be required</td>
<td></td>
</tr>
</tbody>
</table>

<table>
<thead>
<tr>
<th>Reseller fees and end-customer payments</th>
<th><strong>ASC 606 considerations</strong></th>
</tr>
</thead>
<tbody>
<tr>
<td>• Evaluate if a distinct good/service is purchased, and its fair value (if estimatable)</td>
<td></td>
</tr>
<tr>
<td>• If so, recognize asset/expense to extent of fair value</td>
<td></td>
</tr>
<tr>
<td>• Reduce transaction price by remaining amounts</td>
<td></td>
</tr>
</tbody>
</table>

### Guidance

ASC 606 Ex 12A, 12B, 12C, 23A, 23B, 23C; EY HT Technology; PwC ID Pharma & Technology; 2016 Guides: KPMG 5.3, 5.3.4, 5.5.4; PwC Examples 8-1, 8-2; DT Q&A 12-5
**Standalone Selling Prices** [replaces VSOE, ESP]

- **Standalone Selling Price (SSP):** selling price for an item if sold by itself
  - Replaces VSOE, TPE and BESP
  - Determined at outset of contract
  - Must allow to meet *allocation objective* (depict expected consideration for the item)
  - Consider all information, maximize observable inputs

**SSP Metrics**
- $ amount
- Cost plus margin
- % of list price
- % of another item price

**SSP range is OK**

### Observable historical pricing
- same item sold by itself, similar circumstances, customers
  - **must** use if available

### Same contract pricing

### Valuation (appraisal)

### Other historical pricing/metrics

### Company target pricing

### Adjusted market price

**Guidance** 606-10-32-31 through 35; 2016 Guides: EY 6.1; KPMG 5.4.1; PwC 5.2, 5.3; DT 7.1, 7.2
Transaction Price Allocation

Allocation objective: allocation that depicts expected consideration for each item

Variable consideration allocation

- Allocate entirely to some of the obligations or items in a series, if…
  - …paid for efforts related to such obligations/items, and…
  - …consistent with the allocation objective
- Consider expected variable consideration (i.e., ignore revenue constraint)

Discount allocation

- Allocate entirely to some of the obligations, if…
  - …such obligations regularly sold separately as bundle at discount…
  - …which is the same as in contract…
  - …and all obligations are also sold separately…
  - …allowing observable evidence that points to where the discount belongs.

Residual method

- residual amount should be reasonable (in SSP range) to use the method
- validate compliance with allocation objective

Relative SSP method

- apply to all remaining obligations
- validate compliance with allocation objective

Guidance

606-10-32-28 through 30 and 36 through 41; TRG 3/2015 and 7/2015;
2016 Guides: EY 6.2, 6.3, 6.4; KPMG 5.4.2; PwC 5.5, 5.5.1.1; DT 7.3, 7.4
Changes in Transaction Price

- Changes in variable consideration
  - Follow the approach used for such variable consideration at inception
    - Allocate entirely to some of the obligations/items in a series, or follow relative SSP

- Changes from contract modification
  - Follow contract modification accounting model
    - New contract (modification only), new contract (combined with remaining items), combined contract, hybrid

- Changes in variable consideration after a contract modification
  - If change is from contract terms pre-modification and modification results in a new contract,
    - Allocate the change to obligations existing before modification
    - Update allocation at modification for new contract (if relevant)
  - Otherwise, allocate to obligations in modified contract

- Other changes in transaction price
  - Follow the same % for allocation as at inception
  - Do not take into account subsequent changes in SSP

Guidance: 606-10-32-42 through 45; 2016 Guides: EY 6.5; KPMG 5.4.3; PwC 5.5.2; DT 7.5, 7.6, 9.4
Balance Sheet Presentation

Guidance: 606-10-45-1 through 5; TRG 10/2014; 2016 Guides: EY 10.1, 10.2; KPMG 11; PwC 12.2; DT 13
Bad Debt Allowance

**Price concessions, variable consideration**
- at outset or subsequently
  - Reduce revenue

**Amounts included in transaction price customer does not have intent or is (or becomes) unable to pay**
- at outset of arrangement
  - Do not recognize any revenue
    - Until re-assessed, paid in full or delivery stopped/ended
- for future deliveries
  - Do not reverse past revenue, estimate bad debt allowance
    - Do not recognize new revenue
- for past deliveries
  - Do not reverse revenue
  - Estimate bad debt allowance (contract assets, receivables)

**Any amounts not collectable – segregate between**
- price concessions (reduction in transaction price)
- lack of customer intent or ability to pay (precludes new revenue recognition and bad debt expense for past amounts)
- Do not recognize same customer same period revenue and bad debt expense (except for portfolios)

**Presentation**
- **Bad debt allowance**: reduction in carrying value of receivables
  - Must be probable and reasonably estimable
- **Bad debt expense**: operating expense (impairment loss on receivables and contract assets) disclose separately

**Guidance**
- 606-10-45-3 and 4, 50-4, Ex 2, 3, 4; ASU 2014-09 BC265; 310-10-35-7 through 10, 41 and 47; TRG 1/2015
**Principal vs Agent** [replaces Gross/Net]

Principal controls **specified goods/services before** they are transferred to customer
- Principal recognizes revenue gross

- 3rd party goods/other assets
- Right to direct 3rd party services
- Sign. integration of 3rd party goods/etc.

To establish if control exists, apply concept of control
- Ability to direct the use and obtain benefits from the asset...

Use additional indicators of control if needed:
- Primary fulfilment responsibility
- Quality responsibility
- Inventory risk before or after transfer to customer
- Pricing discretion

Control received from 3rd party

To assess separately for each **specified goods or services**
- Distinct good/service being acquired by the **customer**
- Assessment: what is nature of entity obligation?
  - Principal: transfers control or right to 3rd party goods/services
  - Agent: arranges for 3rd party to transfer control
- If 3rd party is also deemed customer (e.g. for platform access), entity is agent for 3rd party goods/services

**Goods/services transferred to customer**

Some time period **required**

**Guidance**

606-10-55-36 through 40, 25-25; 2016 Guides: EY 4.4; KPMG 10.3; PwC 10.1, 10.2; DT 10

Existing gross/net criteria **not** carried into ASC 606:
- Changes to products/services
- Discretion in supplier selection
- Involved in product specs
- Credit risk
- Paid on commission basis
Shipping and Handling Costs and Fees

- Shipping complete before transfer of goods to customer, or
- Entity **elected** to treat shipping as fulfilment activity

**Is the entity Principal in shipping/handling trx?**

- **NO**
  - Control of shipping service before consumed by customer
  - Primarily responsible for fulfillment of shipping/handling
  - Inventory risks (for goods shipped OR volume of shipping services)
  - Discretion in establishing shipping/handling prices

- **YES**
  - Recognize shipping costs as fulfilment costs
    - Accrue costs if revenue already recognized
    - Shipping not a distinct performance obligation
    - If there are shipping fees, add to **transaction price**/allocate

**Recognize shipping costs as cost of shipping service sales**

- Shipping not a performance obligation
- Arranging to ship for customer could be a performance obligation (could be immaterial)
- Recognize shipping fees **net** of shipping costs

**Guidance**

606-10-25-18A and 18B; 2016 Guides: EY 4.1.2; KPMG 5.2.4; PwC 10.3; DT 5.2.4.2, 10.5.4
# Taxes Billed to Customer (Sales…)

**Policy choice:**
Okay to exclude certain taxes from revenue & transaction price

Limited to taxes imposed…
- on specific transaction (vs. total sales or other bases)...
- …concurrent with transaction…
- …and that are collected from customer

## Type of Tax

<table>
<thead>
<tr>
<th>Type of Tax</th>
<th>Possible examples (subject to legal assessment)</th>
<th>Entity is...</th>
<th>Presentation</th>
</tr>
</thead>
</table>
| Taxes levied on customer  
  - Collected by entity from customer on behalf of third parties (e.g. government) |  
  - Sales (use) taxes (US)  
  - VAT (Europe)  
  - GST (Canada) | Agent |  
  - Tax not shown in income/expense (not part of transaction price) |
| Taxes levied on entity  
  - May or may not be re-billed explicitly to customer |  
  - Taxes based on production or sales  
  - USF telecom tax (US) | Principal | For eligible taxes with election made:  
  - Tax not shown in income/expense (not part of transaction price)  
  Otherwise:  
  - Tax is operating expense  
  - Tax reimbursement is included in transaction price / allocated |

**Guidance**  
606-10-32-2A; 2016 Guides: EY 5.1; KPMG 10.3; PwC 10.5; DT 6.6, 10.5.2
Expense Reimbursement by Customer

Is expense (e.g. travel) “integrated” with other inputs into output ordered by customer?

Who arranges for expense vendor selection, pricing, contract and payment to vendor?

Is the entity **Principal** in expense transactions?

Unlikely, unless expenses arranged directly by customer or are for customer personnel
- Expenses are not performance obligation
- Arranging to manage expenses for customer could be performance obligation (could be immaterial)
- Recognize reimbursed amounts net of costs incurred, when incurred

Are expenses a **distinct** performance obligation?

Unlikely to be distinct
- Allocate reimbursed amounts to expenses only (if reasonable)
- Recognize gross as revenue…
  - when expenses are incurred
- Recognize expense costs in **cost of sales** (fulfilment costs), when incurred

Expenses are fulfilment cost
- Allocate reimbursed amounts to underlying service only (if reasonable)
- Recognize reimbursement gross as revenue and costs as expense, as incurred if correlates with value delivered

Guidance  606-10-25-19 through 22, 55-36 through 40, 55-18; 2016 Guides: EY FAQ 4-8; KPMG 5.2.3; PwC 10.4
Financing Component

- **Financing component**: timing of payments provides *either* party with a *significant* benefit of financing (assess only at contract level)
- Factors indicating potential financing component
  - **Significant** lag from due date to transfer of goods or services
  - Difference between promised amounts and cash price
- Estimating discount rate (do **not** update after inception!):
  - Borrowing rate for *financed* party (consider if there is collateral)
  - Rate implicit in transaction

**Key challenges**
- Effective interest method
- How adjust transaction price
- Current v. long-term
- L/T receivable impairment
- May depend on payments direct tie vs. allocating
- Allocate to perf obligations

<table>
<thead>
<tr>
<th>Term license (monthly fees)</th>
<th>Prepaid 3-year PCS</th>
</tr>
</thead>
<tbody>
<tr>
<td><strong>Revenue &lt; contractual $</strong></td>
<td><strong>Revenue &gt; contractual $</strong></td>
</tr>
<tr>
<td>Customer credited</td>
<td>Seller credited</td>
</tr>
<tr>
<td>Dr. AR</td>
<td>Dr. AR</td>
</tr>
<tr>
<td>Cr. Revenue</td>
<td>Dr. Interest expense</td>
</tr>
<tr>
<td>Cr. Interest income</td>
<td>Cr. Revenue</td>
</tr>
</tbody>
</table>

**There May Not Be a Financing Component If…**

- **Advance** payment by customer and transfer of goods or services at customer’s discretion
- **Variable** consideration based on events not controlled by either customer or seller (e.g., sales or usage based royalty)
- **Financing** is not the primary reason for the difference between promised consideration and cash price (e.g. risk mitigation...)
- Expected **period** between transfer and due date < 1 year

**Insignificant financing components are optional to carve out**

**Guidance**
- 606-10-32-15 through 20; EY TL 5.3; TRG 3/2015; 2016 Guides: EY 5.5; KPMG 5.3.2; PwC 4.4, 7.2.4; DT 6.3
Repurchase Agreements

Contract contains...

...obligation to repurchase (Forward) or Right to repurchase (Call option) &

Is option substantive?

...obligation to repurchase at customer option (Put).

Consider if repurchase price $ is...

Repurchase price $ < $ selling price

Repurchase price $ < $ selling price, and $ > $ expected market value, and no significant incentive to return product

Repurchase price $ > $ selling price, and either > $ expected market value & or incentive to return &

Does customer have significant incentive to return product?

Sale with Right of Return

Financing Arrangement

Is option substantive?

Financing Arrangement

Applies to contract manufacturing

Lease

Yes

Keep asset on books
- Record financing liability for $ amount received
- $ amount payable to customer less $ amount received – allocate
  - Interest expense
  - Processing/holding costs
- If option not exercised, derecognize liability and recognize revenue

No

Yes

Yes &

No

No

& Control is not deemed surrendered to the customer

Guidance

606-10-55-66 through 78; 2016 Guides: EY 7.3; KPMG 5.5.5; PwC 8.7; DT 8.7
Origination Costs

Initial term of contract
- Amortize over expected benefit period
- Consistent with transfer of goods/services to which asset relates
- Test for impairment
  - Asset plus future direct costs less remaining revenue (with renewals)
  - Exclude impact of constraint
  - After contract’s other assets test
- Okay to expense if amortization one year or less

Renewal period
- ...over periods incl. expected renewals
- Cannot reverse impairment

Inception of contract
- Capitalize
  - incremental (e.g. sales commissions) and recoverable
- Expense
  - Non-incremental (e.g. fixed salaries)
  - Not recoverable
    - E.g. sunk costs where refund expected
- Exception: Capitalize costs explicitly chargeable to a customer even if not obtained

Key challenges
- Allocate to obligations
- Fringe benefits
- Cumulative amounts
- Contingent amounts
- Renewals and modifications

Guidance
340-40-25-1 through 4, 35-1 through 6; TRG 7/2014, and 1/2015;
2016 Guides: EY 9.3.1, 9.3.3, 9.3.4; KPMG 6.1, 6.3, 6.4; PwC 11.1, 11.2, 11.4; DT 8.9.4, 12.2, 12.4
Fulfilment Costs

- Directly relate to contract or anticipated contract
- Generate/enhance resources to be used to satisfy future performance obligations
- Expected to be recovered

YES

Capitalize
- Amortization
- Impairment

Includes pending amendments!

EXCLUDE
Inventories
Fixed assets
Software development

Directly relate to contract or anticipated contract
Generate/Enhance resources to be used to satisfy future performance obligations
Expected to be recovered

Capitalize Expense

<table>
<thead>
<tr>
<th>Capitalize</th>
<th>Expense</th>
</tr>
</thead>
<tbody>
<tr>
<td>Direct wages/labor</td>
<td>General &amp; administrative</td>
</tr>
<tr>
<td>Direct materials/supplies</td>
<td>Wasted resources (labor, materials)</td>
</tr>
<tr>
<td>Other direct contract costs</td>
<td>Relates to past performance (even if =&gt; loss on an overall profitable contract)</td>
</tr>
<tr>
<td>Costs billable to customer</td>
<td></td>
</tr>
<tr>
<td>Allocated indirect costs</td>
<td>Uncertain if relate to past or future performance</td>
</tr>
<tr>
<td>Costs incurred pre-contract okay</td>
<td></td>
</tr>
</tbody>
</table>

Guidance
340-40-25-5 through 8, 35-1 through 6; TRG 3/2015 and 11/2015; Proposed ASU (2016-240);
2016 Guides: EY 9.3.2, 9.3.3, 9.3.4; KPMG 6.2, 6.3, 6.4; PwC 11.1, 11.2, 11.4; DT 12.2, 12.4

same as origination costs
Onerous Contracts or Performance Obligations [also known as Loss Contracts]

Recognize loss when probable/evident

- Software (if requiring significant production, modification, customization)
- Construction- and Production-Type (based on customer specifications)
- Extended Warranty and Product Maintenance
- Inventories

Recognize loss when it becomes probable/evident; however:
- Apply loss guidance to entire contract
- Calculate loss at contract or performance obligation level…
- …using transaction price plus amounts that are likely but not probable (i.e. ignore constraint)…
- …adjust loss to factor in credit risk

ASC 606 No change

Recognize loss:
- Include contract origination costs (and write off if a loss)
- Group contracts

Recognize loss:
- Write down to net realizable value or market
- At item, category or total level

& Additional guidance for health care entities

All other contracts: do NOT recognize loss until costs have been incurred, even when probable
- Consistent with prevailing practice today

Guidance
606-10-60-7 through 10; 605-20*; 605-35*; 985-605 (as amended by ASU 2014-09); 330-10; Proposed ASU (2016-240); 2016 Guides: EY 9.2; KPMG 10.7; PwC 11.5; DT 12.5
2. Summary of Accounting Policies

Revenue Recognition

- Performance obligations*
  - Nature of goods and services
  - How satisfied (e.g. upon shipment, over service term…)
  - Significant payment terms (e.g. variable consideration, impact of constraint, financing component…)
  - Obligations for returns, refunds, etc.
  - Types of warranties and related obligations

- Revenue methods, judgments, inputs
  - Timing of control transfer; compare to timing of payment
  - Input and output methods* and why appropriate
  - Transaction price (incl. constraint*)
  - Estimating Standalone Selling Prices
  - Allocating transaction price
  - Measurement of return, refund and similar obligations

- Capitalization and amortization of contract costs

7. Revenue Information

- Disaggregated revenue $ based on economic factors: (select based on facts and circumstances)
  - Type of good or service
  - Geography
  - Timing of transfer of goods or services*
  - Sales channels
  - Contract duration
  - Market or type of customer
  - Type of contract

- Relationship between disaggregated revenue and segment disclosures

- How revenue and cash flows are affected by economic factors*

- Additional information as noted on next page

Guidance

606-10-50-5 through 7, 12 and 17 through 23; 55-89 through 91; 340-40-50-2, 4 through 6; 2016 Guides: EY 10.3, 10.6; KPMG 12.1, 12.2, 12.3; PwC 12.3; DT 14; KPMG Illustrative Disclosures guide

Enable understanding of nature, amount, timing, and uncertainty of revenue and cash flows
Disclosures – Quantitative

* Disclosures required for private companies; all others for SEC registrants only

Beginning of period

- Receivables*
- Contract Assets*
- Contract Liabilities*

...from obligations satisfied in prior periods

Capitalized costs

Revenue from contracts with customers*

Significant balances changes

such as...
- Business combinations
- Cumulative catchup adjustments
- Impairment of assets
- Changes in recognition timeframe

Includes pending amendments!

Period revenue

End of period

- Receivables*
- Contract Assets*
- Contract Liabilities*

Perf obligations &

- Allocated transaction price and timing of recognition by period

Includes pending amendments!

Capitalized costs

Amortization

Impairment

Guidance

606-10-50-3, 4, 8 through 11, 13 through 16; 340-40-50-3 and 4; Proposed ASU (2016-240); 2016 Guides: EY 10.4, 10.5; KPMG 12.1; PwC 12.3; DT 14; KPMG Illustrative Disclosures guide

Disclosure of amounts is optional for contracts < 1yr and certain types of revenue
IFRS 15 Differences (1)

- IFRS 15 is the IFRS equivalent of ASC 606
  - Mostly aligned as the Boards developed the original standards together
  - Differences emerged during 2016 as changes/clarifications were not aligned

<table>
<thead>
<tr>
<th>Area, slides</th>
<th>Differences</th>
</tr>
</thead>
</table>
| Effective date (25) | - Companies must adopt IFRS 15 for years beginning on or after January 1, 2018  
- IFRS allows early adoption effective at beginning of any year. |
| Immaterial obligations (31) | - ASC 606 specifically allows to exclude certain obligations as immaterial. No specific guidance exists under IFRS 15, though no difference may result in application. |
| Collectibility threshold (33, 36) | - Collectibility of consideration must be probable. Under IFRS, this means >50%  
  - Under US GAAP, probable means “likely”, usually 70-80%. |
| Collectibility assessment objective (36) | - ASC 606 defines objective of collectibility assessment is to determine if there is a genuine transaction in place. No similar guidance under IFRS 15, though no difference may result in application. |
| Contracts not meeting contract criteria (37) | - ASC 606 allows to recognize revenue for cash received if entity has transferred goods/etc. entity was paid for, has stopped transferring additional goods, and has no remaining obligations to transfer (“cash basis”).  
  - No such option under IFRS 15 – wait until substantially all consideration received and no remaining performance obligations, or until contract is terminated. |

Guidance: IFRS 15; 2016 Guides: EY App H; DT App A
### IFRS 15 Differences (2)

<table>
<thead>
<tr>
<th>Area, slides</th>
<th>Differences</th>
</tr>
</thead>
</table>
| Intellectual property (IP) licenses – substance of license rights (52,53) | - IFRS 15 requires to assess if licenses provide a right to use IP (as licensed) or right to access IP (as it exists over time). ASC 606 requires first to assess if the IP is functional on its own, or if the license is symbolic (has no functionality). Symbolic IP licenses are always recognized over time.  
  - Some symbolic licenses may be recognized upon grant date under IFRS if the entity is not involved in any activities to maintain IP value during the license term. |
| IP license renewals (52) | - Under ASC 606, revenue from IP license renewals must be recognized no sooner than the renewal date. No similar requirement under IFRS 15.  
  - Renewal licenses under IFRS 15 could be recognized prior to renewal date. |
| Noncash consideration (68) | - ASC 606 requires to measure value of noncash consideration at contract inception. There is no specific guidance under IFRS 15, and differences may result. |
| Transaction price for principals (64, 86) | - If price paid by end customer to intermediary is not known, under ASC 606 it is likely not part of transaction price. Under IFRS 15, estimates may be required if entity is principal for the end customer. |
| Shipping and handling (87) | - ASC 606 allows to elect to treat shipping and handling as a fulfilment cost. No similar option under IFRS 15.  
  - IFRS companies may have to treat shipping and handling as a separate performance obligation, which could impact timing of recognition, margin, and sometimes presentation of shipping costs. |
## IFRS 15 Differences (3)

<table>
<thead>
<tr>
<th>Area, slides</th>
<th>Differences</th>
</tr>
</thead>
<tbody>
<tr>
<td>Taxes billed to customers (88)</td>
<td>- ASC 606 allows to elect to exclude certain taxes billed to customers from transaction price. No similar option under IFRS 15.</td>
</tr>
<tr>
<td></td>
<td>- IFRS companies must assess for each tax if the company is principal or agent, which could impact total revenue and margin.</td>
</tr>
<tr>
<td>Origination and fulfillment costs (92, 93)</td>
<td>- ASC 606 does not allow to reverse impairment losses on capitalized origination and fulfillment costs. IFRS 15 requires to reverse such losses if circumstances change.</td>
</tr>
<tr>
<td>Disclosures in interim periods (95, 96)</td>
<td>- ASC 606 requires interim disclosures of contract balances and remaining performance obligations. No similar requirement exists under IFRS.</td>
</tr>
<tr>
<td>Disclosures for private companies (95, 96)</td>
<td>- Under ASC 606, many disclosures are only required for public companies. Under IFRS 15, all disclosures are required for both public and private companies.</td>
</tr>
<tr>
<td></td>
<td>- Under ASC 606, private companies do not have to disclose most of their revenue recognition methods, judgments and inputs, disaggregated revenue information, changes in contract assets and liabilities, remaining performance obligations, etc.</td>
</tr>
</tbody>
</table>
## IFRS 15 Differences (4)

<table>
<thead>
<tr>
<th>Area, slides</th>
<th>Differences</th>
</tr>
</thead>
<tbody>
<tr>
<td>Transition – contracts completed prior to adoption (25)</td>
<td>- IFRS 15 allows to exclude from its scope contracts where deliveries were completed prior to adoption. Alternatively, it allows to use for such contracts the transaction price amount as of the delivery completion date. Conversely, ASC 606 allows to exclude from its scope contracts where revenue was recognized in full prior to adoption, and only if it is adopted using retrospective without recasting method.</td>
</tr>
<tr>
<td>Transition – modifications prior to adoption (25)</td>
<td>- ASC 606 allows to combine all modifications that occurred prior to the earliest application date as if they occurred at the same time. Under IFRS 15, if it is adopted using retrospective without recasting method, it alternatively also allows to combine only those modifications that occurred prior to the earliest date presented in the financial statements.</td>
</tr>
</tbody>
</table>
ASC 606 Implementation Strategy

I. HIGH-LEVEL ASSESSMENT
   A. Scoping...
   B. Impact memo...

II. OPERATIONAL & PLANNING
   A. Operational...
   B. Detailed Plan...

III. IMPLEMENTATION
   A. Detailed technical...
   B. Processes and systems...
   C. Revenue conversion...
How To Start Implementation

- Executive sponsorship and concerted effort are critical
  - Board/Audit Committee/CEO/CFO buy-in
  - Designated internal project champion with enough time to spare
  - Budget for initial exercise only – ASC 606 adoption is not cheap!
- Companies often start with one of these four approaches

<table>
<thead>
<tr>
<th>High-level assessment</th>
<th>Adoption memo draft</th>
</tr>
</thead>
<tbody>
<tr>
<td>▪ Excel + PPT summary</td>
<td>▪ Technical accounting memo</td>
</tr>
<tr>
<td>▪ 5 steps of revenue + costs</td>
<td>▪ 5 steps of revenue + costs</td>
</tr>
<tr>
<td>▪ Compare to current practice</td>
<td>▪ Presentation and disclosures</td>
</tr>
<tr>
<td>▪ Initial high-level judgments</td>
<td>▪ Initial high-level judgments</td>
</tr>
<tr>
<td>▪ Roadmap for next steps</td>
<td>▪ Suitable for auditor review</td>
</tr>
<tr>
<td>▪ Roadmap for next steps</td>
<td>▪ Roadmap for next steps</td>
</tr>
</tbody>
</table>

<table>
<thead>
<tr>
<th>Use cases</th>
<th>Comprehensive</th>
</tr>
</thead>
<tbody>
<tr>
<td>▪ Using Excel template</td>
<td>▪ E.g. strategy outlined in the following slides</td>
</tr>
<tr>
<td>▪ Specific transactions</td>
<td>▪ Start with team setup, project priorities, logistics and scoping</td>
</tr>
<tr>
<td>▪ 5 steps revenue analysis</td>
<td>▪ Some accounting judgments</td>
</tr>
<tr>
<td>▪ Some accounting judgments</td>
<td>▪ Revenue/cost waterfall</td>
</tr>
<tr>
<td>▪ Revenue/cost waterfall</td>
<td>▪ Selecting right cases critical!</td>
</tr>
</tbody>
</table>

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I.A Scoping

- Executive sponsors, PMO, team, initial budget
- Revenues and costs streams
- Quote to cash, Cost, Close, etc. processes
- ERP and other IT systems
- Business imperatives

Key risks
Expected impact
ASC 606
Opportunities
I.B. High-Level Impact Memo

1. Distinct deliverables
2. Standalone selling prices
3. Pattern of delivery and recognition
4. Transaction price estimates
5. Commissions and other costs

Memo
Business
Auditors
II.A. Operational Assessment

- Operational & accounting processes and controls (SOX)
- Systems – financial & operational
- Operational & accounting policies
- Financial reporting, forecasting & metrics
- Business objectives and strategy
II.B Detailed Plan and Approval

Detailed plan, timeline, resources, budget

Adoption dates and transition methods

Transition vs. post-transition operations

Management, auditor, Audit Committee presentations

Transition to Implementation phase
III.A Detailed Technical

- Use cases
- SSP calculations
- Disclosure data
- Cost of revenue calculations
- Technical memos and policy
III.B Processes and Systems

- Implement and configure IT systems and tools
- Update forms, templates, data, reports, checklists
- Policies, process and control changes
- Communication, training, transition
- Process transactions, journal entries, disclosures, audit
III.C Data Conversion

- Transactions in scope
- Contract analysis checklist
- Journal entries
- Ongoing reporting
- Prepare disclosures
**Implementation Approaches**

**Deferred Approach**
- Private or simpler public
- Few products/services
- Few multiple element transactions
- Few locations
- No significant automation
- No significant changes expected with adoption
- No plans for IPO
- Retrospective without recasting adoption method

**Practical Approach**
- Large private or public
- Moderate volume of transactions
- Few products lines and transaction types
- Centralized operations, few process owners
- Low to moderate automation
- Light operational changes may be required
- Flexibility in transition method

**Immediate Action Approach**
- Public, esp. large accelerated
- Diverse products/services
- Planned product changes
- Software industry or many long-term contracts
- Multiple sites, not centralized
- IPO is planned
- Pervasive automation
- Mitigating business changes required
- Full retrospective adoption

**Best for companies that are/have...**

**Deferred Approach**
- Private or simpler public
- Few products/services
- Few multiple element transactions
- Few locations
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**Leverage Implementation Roadmap!**

**Do NOW:**
- Assess impact high-level
- Recruit PMO, advisors, communicate with business
- Develop plan, budget, timing
- Present to Board/Audit Cmtee

**Full implementation:**
- 6-9 months (okay in 2017)
- Leverage others’ examples

**Do NOW:**
- Create PMO, find advisors, create project plan, budget
- Engage business/operations
- Get under way ASAP in 2016

**Full implementation:**
- 9-15 months
- Full retrospective a challenge if not yet started

**Do NOW:**
- Implementation should be well under way – no time to lose

**Full implementation: NOW**
- 12-30 months
- High gear, blaze trails
- Full retrospective a challenge if not yet started
# Key Implementation Documentation

<table>
<thead>
<tr>
<th>Implementation execution</th>
<th>Project plan and timeline</th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td>Communication protocols</td>
</tr>
<tr>
<td></td>
<td>Budget</td>
</tr>
<tr>
<td></td>
<td>Team and governance status reports</td>
</tr>
</tbody>
</table>

<table>
<thead>
<tr>
<th>Deliverables</th>
<th>Technical accounting adoption memo (overall, attachments on specific issues or transactions)</th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td>Revenue recognition and cost accounting policies (update)</td>
</tr>
<tr>
<td></td>
<td>SOX flow charts, risk/control matrices (update)</td>
</tr>
<tr>
<td></td>
<td>Accounting and SOX transaction processing forms and templates (update)</td>
</tr>
<tr>
<td></td>
<td>Chart of accounts (update/add new accounts)</td>
</tr>
<tr>
<td></td>
<td>Standalone selling price (SSP) analyses</td>
</tr>
<tr>
<td></td>
<td>Transaction price allocation and recognition model spreadsheets</td>
</tr>
<tr>
<td></td>
<td>Disclosure reports (for new required disclosures)</td>
</tr>
<tr>
<td></td>
<td>Product SKUs and pricing (new, updated)</td>
</tr>
<tr>
<td></td>
<td>IT re-configurations</td>
</tr>
</tbody>
</table>
Implementation efforts under way at many public companies, but often in very early phases – many other public companies have not yet started

Executive/Board buy-in, sponsorship and budget allowances are often lacking

Industry still learning full extent of challenges and costs

Guidance is still evolving through TRG, AICPA Task Forces and Big 4 – and sometimes there is reluctance to make interpretations

No expectation of additional deferral by the FASB

Automation options still in development – few are comprehensive

ASC 606 experts are busy
About Connor Group
Thought Leaders Since 2006

- Premier professional services advisory firm
  - Technical Accounting, IPOs, M&A and Financial Operations
- Assistance with over 100 IPO’s; over 75 acquisitions
- 500+ clients on 5 continents
- Big 4 alumni and industry executives
- Independent and without auditor restrictions
Connor Group Services

- Revenue recognition: SAB 104, SOP 97-2, EITF 08-1, ASC 606
- IPOs/Capital markets: S-1, IPO readiness, PMO, 10Q/K, cross border trx
- Audit readiness: Close books, PBCs, tech. papers, audit mgmt
- Equity and debt: Debt, pref stock, warrants, SFAS 123R, EPS
- Mergers/acquisitions: Due diligence, pro-formas, purchase accounting, integration
- Financial Operations: Key process design (e.g., Close, Revenue, Global Entities, etc.), internal controls, ERP support
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