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Technical Line

FASB — final guidance

The new revenue recognition standard — technology

In this issue:

What you need to know

- The new standard is more principles-based than current revenue guidance and will require technology entities to exercise more judgment. They also may recognize revenue sooner than they do today.
- Determining whether to present gross or net revenue for the sale of goods or services when there are more than two parties in an arrangement will continue to be challenging and will require significant judgment.
- The new standard could change practice for technology entities that sell their products through distributors or resellers, potentially accelerating the recognition of revenue.
- Entities will be required to capitalize incremental costs of obtaining a contract (e.g., sales commissions) that meet certain criteria. This will change practice for entities that currently expense such costs.
- The new standard is effective for public entities for fiscal years beginning after 15 December 2016 and for interim periods therein. It is effective for nonpublic entities for fiscal years beginning after 15 December 2017 and interim periods within fiscal years beginning after 15 December 2018.

Overview

Technology entities may need to change certain revenue recognition practices as a result of the new revenue recognition standard jointly issued by the Financial Accounting Standards Board (FASB) and the International Accounting Standards Board (IASB) (collectively, the

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Boards). The new revenue recognition standard will supersede virtually all revenue recognition guidance in US GAAP and IFRS.

The new standard provides accounting guidance for all revenue arising from contracts with customers and affects all entities that enter into contracts to provide goods or services to their customers (unless the contracts are in the scope of other US GAAP requirements, such as the leasing literature). The guidance also provides a model for the measurement and recognition of gains and losses on the sale of certain nonfinancial assets, such as property and equipment, including real estate.

The new standard could change practice for technology entities that sell their products through distributors or resellers. Today, many entities don't recognize revenue until the product is sold to the end customer because they do not meet all of the revenue recognition criteria in Securities and Exchange Commission (SEC) Staff Accounting Bulletin (SAB) Topic 13.[1] Under the new standard, based on the facts and circumstances of an arrangement, technology entities could reach different conclusions than they do today and recognize revenue earlier because they will be required to estimate variable consideration and include these amounts in the transaction price, subject to a constraint. Applying the constraint on variable consideration introduces a different threshold for measurement and recognition than SAB Topic 13.

The SEC staff hasn't said whether it will change or rescind SAB Topic 13 which applies to all public entities and is widely followed by other entities. Among other things, it requires that revenue be fixed or determinable to be recognized.

The requirement to capitalize the incremental costs of obtaining a contract (e.g., sale commissions) and recognize them as assets if the entity expects to recover them also will be a significant change for entities that have historically expensed such costs. Practice is divided today. Some technology companies already capitalize these costs by analogizing to guidance that is narrow in scope.

This publication discusses how technology entities that today do not apply the software guidance in Accounting Standards Codification (ASC) 985-605[2] will be affected by the new standard. It provides an overview of the revenue recognition model and highlights key considerations for the technology industry. This publication supplements our Technical Line, *A closer look at the new revenue recognition standard* (SCORE No. BB2771), and should be read in conjunction with it. For a discussion of the key considerations for technology companies that currently apply software guidance, refer to our Technical Line, *The new revenue recognition standard — software* (SCORE No. BB2805).

Technology companies also may want to monitor the discussions of both the Boards' Joint Transition Resource Group for Revenue Recognition (TRG) and a task force formed by the American Institute of Certified Public Accountants (AICPA) to focus on software issues and possibly broader issues related to technology entities. The Boards created the TRG to help them determine whether more implementation guidance or education is needed. The TRG won't make formal recommendations to the Boards or issue guidance. The AICPA's software industry task force is one of 16 industry task forces the AICPA has formed to help develop a new Accounting Guide on Revenue Recognition and to aid industry stakeholders in implementing the standard. Any views discussed by the TRG or guidance produced by the AICPA is non-authoritative.

The views we express in this publication are preliminary. We may identify additional issues as we analyze the standard and entities begin to interpret it, and our views may evolve during that process. As our understanding of the standard evolves, we will update our guidance.

Scope, transition and effective date

The scope of the new revenue recognition guidance includes all contracts with customers to provide goods or services in the ordinary course of business, except for contracts that are specifically excluded (e.g., leases, insurance contracts, financial instruments, guarantees). Also excluded from the scope of the guidance are nonmonetary exchanges between entities in the same line of business to facilitate sales to customers other than the parties to the exchange.

The standard is effective for public entities[3] for fiscal years beginning after 15 December 2016 and for interim periods therein. It is effective for nonpublic entities in fiscal years beginning after 15 December 2017 and interim periods within fiscal years beginning after 15 December 2018, and they may elect to adopt the guidance as early as the public entity effective date. Under US GAAP, early adoption is prohibited for public entities.

All entities will be required to apply the standard retrospectively, either using a "full retrospective" or a "modified retrospective" approach. The Boards provided certain practical expedients to make it easier for entities to use a full retrospective approach.

Under the modified retrospective approach, financial statements will be prepared for the year of adoption using the new standard, but prior periods won't be adjusted. Instead, an entity will recognize a cumulative catch-up adjustment to the opening balance of retained earnings (or other appropriate component of equity or net assets) at the date of initial application for contracts that still require performance by the entity (i.e., contracts that are not completed). Entities will need to provide certain disclosures in the year of adoption, such as the amount by which each financial statement line item is affected as a result of applying the new standard.

Summary of the new model

The new guidance outlines the principles an entity must apply to measure and recognize revenue and the related cash flows. The core principle is that an entity will recognize revenue at an amount that reflects the consideration to which the entity expects to be entitled in exchange for transferring goods or services to a customer.

The principles in the new standard will be applied using the following five steps:

1. Identify the contract(s) with a customer
2. Identify the performance obligations in the contract
3. Determine the transaction price
4. Allocate the transaction price to the performance obligations in the contract
5. Recognize revenue when (or as) the entity satisfies a performance obligation

Technology entities will need to exercise judgment when considering the terms of the contract(s) and all of its facts and circumstances, including implied contract terms. An entity also will have to apply the requirements of the new standard consistently to contracts with similar characteristics and in similar circumstances.

On both an interim and annual basis, an entity will have to make more disclosures than it does today and include qualitative and quantitative information about its contracts with customers, significant judgments made (and changes in those judgments) and contract assets from costs to obtain or fulfill a contract. On an interim basis, US GAAP will require more disclosure than will be required under IFRS.

Identify the contract with a customer

Contracts may be written, oral or implied by an entity's customary business practices but must be enforceable by law, which the Boards acknowledged may differ by jurisdiction. Further, the Boards identified certain criteria that must be present in order for an arrangement to meet the definition of a contract within the scope of the new standard. These criteria include approval of the contract by all parties, identification of each party's rights regarding goods and services to be transferred and the associated payment terms, and determination that the contract has commercial substance. In addition, an entity must conclude that it is probable that it will collect the consideration to which it will be entitled in exchange for the goods or services that will be transferred to the customer. These criteria are assessed at the inception of the arrangement and, if met, are not reassessed unless there is a significant change in facts and circumstances.

How we see it

Regardless of whether a contract is written, oral or implied, entities will need to exercise judgment to determine whether the contract creates enforceable rights and obligations. For example, a customer may sign and return a contract that the entity has not yet signed. Careful consideration of the facts and circumstances will be required to determine when enforceable rights and obligations exist. This evaluation will be affected by laws or legal precedents involving enforceability in the customer's jurisdiction and will require significant judgment.

Technology entities will need robust documentation to demonstrate that a contract is enforceable by law. Technology entities also may need to develop or update processes to reflect the change in the accounting guidance.

Contracts may be written, oral or implied by an entity's customary business practices but must be enforceable by law.

When considering collectibility, an entity will consider the customer's ability and intent to pay the consideration when due. This criterion creates a collectibility threshold similar to the current collectibility requirement in SAB Topic 13, with one significant difference. The Boards acknowledged that an entity may enter into an arrangement not expecting to collect the full contract amount (e.g., the contract contains an implied price concession) and, therefore, the entity needs to assess collectibility of the amount to which it expects to be entitled rather than the stated contractual amount. This difference could result in the earlier recognition of revenue for arrangements in which a portion of the contract price is considered to be at risk, but not the entire amount. Refer to the section below on determining the transaction price.

Illustration 1: Collectibility is probable

Tech Co. decides to enter a new region that is currently experiencing economic difficulty. Tech Co. expects the economy to recover over the next two to three years and determines that building a relationship in the current environment could result in potential growth in future years. Tech Co. enters into an arrangement with a customer in the new region for networking products for promised consideration of $1 million. At contract inception, Tech Co. expects that it may not be able to collect the full amount from the customer.

Assuming the contract meets the other criteria to be within the scope of the new revenue standard, Tech Co. assesses whether collectibility is probable. In making this assessment, Tech Co. considers whether the customer has the ability and intent to pay the estimated transaction price, which may be an amount less than the contract price (e.g., the entity may offer a price concession to the customer). For purposes of this example, assume Tech Co. determined at contract inception that it may be forced to grant the customer a price concession, and it was willing to do so up to $200,000, if necessary. As a result, Tech Co. determined that the amount to which it is entitled is $800,000 and performs the collectibility assessment based on that amount rather than the $1 million contract price.

Refer to our discussion of implied price concessions in the variable consideration section below.

How we see it

Technology entities may struggle with applying the collectibility criterion. Under today's guidance, when technology entities have significant concerns about whether they will collect the stated contractual amount (i.e., they are unable to conclude collectibility is reasonably assured), they defer the recognition of revenue until cash is collected. Under the new revenue standard, technology entities will need to carefully evaluate and make a judgment about the customer's ability and intent to pay the amount to which they expect to be entitled, which won't necessarily be the contractual price. As a result, entities may reach different conclusions than they do today and may recognize revenue earlier.

Contract modifications

A contract is modified when there is a change in the scope or price (or both). Changes to existing contracts, such as modifications to the quantity or placement of online advertisements that would change the contract price, are examples of contract modifications that may occur in technology arrangements.

An entity must determine whether the modification should be accounted for as a separate contract or as part of the existing contract. Two criteria must be met for a modification to be treated as a separate contract: (1) the additional goods and services are distinct from the goods and services in the original arrangement and (2) the amount of consideration expected for the added goods and services reflects the standalone selling price of those goods or services. In this respect, only modifications that *add* distinct goods and services to the arrangement can be treated as separate contracts. In determining the standalone selling price, entities have some flexibility, depending on the facts and circumstances. For example, an entity may conclude that, with additional purchases, a customer qualifies for a volume-based discount.

Illustration 2: Contract modification represents a separate contract

Tech Co. enters into an arrangement to provide subscription-based services to a customer over a 12-month period for $1 million. After six months, Tech Co. and the customer agree to modify the contract by adding 12 months of subscription-based services. The price for the additional service is $800,000. Tech Co. determines that the additional 12 months of subscription-based services are distinct, and the pricing for the additional term of subscription-based services reflects the standalone selling price of the services at the time of the contract modification, adjusted for the discount frequently awarded to returning customers. The contract modification is considered a separate contract for the additional months of services and would not affect the accounting for the existing contract.

A contract modification that does not meet the criteria to be accounted for as a separate contract is considered a change to the original contract and is treated as either the termination of the original contract and the creation of a new contract, or as a continuation of the original contract, depending on whether the remaining goods or services to be provided after the contract modification are distinct. A modification is accounted for on a prospective basis (i.e., as a termination of the original contract and creation of a new contract), if the goods and services subject to the modification are distinct from the other goods and services provided within the original contract but the consideration does not reflect the standalone selling price of those goods or services. An entity should account for a modification as a continuation of the original contract if the goods or services added or removed are not distinct from the goods and services already provided. Such modifications are accounted for on a cumulative catch-up basis.

Illustration 3: Contract modification for additional products at a price that does not reflect the standalone selling price

A semiconductor entity promises to provide 1,000 microprocessors to the customer for $100,000 ($100 per unit). The goods are transferred to the customer over a six-month period. The entity transfers control of each product upon delivery. After the entity has transferred 300 microprocessors, the contract is modified to require the delivery of an additional 500 microprocessors to the customer (i.e., total of 1,500 microprocessors).

The price for the additional 500 microprocessors is $25,000 ($50 per unit). The price for the additional microprocessors does not reflect the standalone selling price at the time the contract is modified and, therefore, does not meet the criteria to be accounted for as a separate contract. Since the remaining products are determined to be distinct from those already transferred (refer to the section on identifying the performance obligations in the contract for further discussion on the determination of when goods and services are distinct), the semiconductor entity accounts for the modification as a termination of the original contract and the creation of a new contract.

The amount of revenue recognized for the remaining products under the new contract is a blended price of $79.17 {[(700 microprocessors not yet transferred x $100) + (500 microprocessors to be transferred under the contract modification x $50)] ÷ 1,200 remaining microprocessors}.

Goods or services promised in a contract can be either explicitly stated or implied by an entity's customary business practice.

Identify the performance obligations in the contract

Technology entities commonly enter into transactions involving the delivery of multiple goods and services, such as professional services in conjunction with hardware and networking or hosting services. Goods or services promised in a contract with a customer can be either explicitly stated in the contract or implied by an entity's customary business practice (e.g., free access to a vendor's online mobile controller application with the purchase of its audio hardware). The new standard requires entities to consider whether the customer has a valid expectation that the entity will provide a good or service when it is not explicitly stated. If the customer has a valid expectation, the customer would view those promises as part of the goods or services provided under the contract.

Promised goods and services represent separate performance obligations if the goods or services are distinct (by themselves or as part of a bundle of goods and services) or if the goods and services are part of a series of distinct goods and services that are substantially the same and have the same pattern of transfer to the customer. A good or service (or bundle of goods or services) is distinct if (1) the customer can benefit from the good or service on its own or together with other readily available resources (i.e., the good or service is capable of being distinct) and (2) the good or service is separately identifiable from other promises in the contract (i.e., the good or service is distinct within the context of the contract). A promised good or service that an entity determines is not distinct should be combined with other goods or services until a distinct performance obligation is formed.

How we see it

Entities that apply today's multiple-element arrangement guidance in ASC 605-25[4] will find that determining whether a good or service is capable of being distinct under the new revenue standard is similar to identifying separate units of accounting. However, the requirement to determine whether the good or service is distinct within the context of the contract is a new requirement. Entities will need to consider whether the good or service is separable from other promises in the contract, which may be challenging and will require judgment.

Illustration 4: Bundling inseparable goods and services

Entity Z is a software development firm that provides hosting services to a variety of consumer products companies. Entity Z offers a hosted inventory management software product that requires the customer to purchase hardware from Entity Z. In addition, customers may purchase professional services from Entity Z to migrate historical data and create interfaces with existing back-office accounting systems. Entity Z always delivers the hardware first, followed by professional services and finally the ongoing hosting services.

Scenario A — All goods and services sold separately

Entity Z determines that all of the individual goods and services in the contract are distinct because the entity regularly sells each component of the contract separately. Entity Z also determines that the goods and services are separable from other promises in the contract because it is not providing a significant service of integrating the goods and services and the level of customization is not significant. Further, because the customer could purchase or not purchase each good and service without significantly affecting the other goods and services purchased, the goods and services are not highly dependent on or highly interrelated with each other. Accordingly, the hardware, professional services and hosting services are each accounted for as separate performance obligations.

Scenario B — Hardware not sold separately

Entity Z determines that the professional services are distinct because it frequently sells those services on a standalone basis (e.g., Entity Z also performs professional services related to hardware and software it doesn't sell). Further, the entity determines that the hosting services are distinct because it also sells those services on a standalone basis. For example, customers that have completed their initial contractual term and elect each month to continue purchasing the hosting services are purchasing those services on a standalone basis. The hardware, however, is always sold in a package with the professional and hosting services, and the customer cannot use the hardware on its own or with resources that are readily available to it. Therefore, Entity Z determines the hardware is not distinct.

Entity Z must determine which promised goods and services in the contract to bundle with the hardware. Entity Z likely would conclude that because the hardware is integral to the delivery of the hosted software, the hardware and hosting services should be accounted for as one performance obligation, and the professional services, which are distinct, would be a separate performance obligation.

Maintenance services

Entities may provide maintenance services such as telephone support, bug fixes, and unspecified upgrades or enhancements on software-enabled products. Under current guidance, these maintenance services are often treated as a single unit of accounting by analogy to the definition of post-contract support (PCS) in the software guidance in ASC 985-605. PCS is not a unique service contemplated or defined in the new standard. As a result, entities must evaluate whether the individual services comprising what is considered PCS today will be separate performance obligations. For example, a technology entity may conclude that the promise to provide unspecified future upgrades and enhancements is a promised good or service in the arrangement and, therefore, is a revenue element. This entity also may determine that bug fixes and telephone support are provided to ensure that the software is functioning as promised and, therefore, those services are part of the assurance warranty coverage for the software and are not a revenue element (such warranties will be accounted for under ASC 460[5]).

However, other entities may conclude that the promise to provide telephone support and bug fixes contains elements of both an assurance warranty (non-revenue element) and service-type warranty (revenue element), as discussed further in the warranties section below.

Further, when the contract includes the promise to provide unspecified future upgrades and enhancements, the entity must determine the nature of that promise. For example, an entity may conclude that it has established a clear pattern of only providing one significant upgrade or enhancement per year, and therefore, the obligation to provide "future upgrades and enhancements" actually is an obligation to provide this single upgrade or enhancement. Alternatively, if the entity has a history of providing multiple upgrades each year with no clear pattern of timing as to when those upgrades are provided, the entity may conclude that obligation represents more of a "stand-ready" obligation.

Customer options for additional goods or services

Under some contracts, entities provide the customer with the right to future purchases of additional products or services for an amount below fair value. Under the new standard, such options are separate performance obligations only if they provide a material right to the customer that it would not receive without entering into that contract (e.g., a discount that exceeds the range of discounts typically given for those goods or services to that class of customer in that geographical area or market). If an option is determined to be a separate performance obligation, some portion of the transaction price would be allocated to the option, and the allocated amount would be deferred until the option is exercised (or until such right expires), based on the estimated standalone selling price of the option and the results of a relative selling price allocation.

Technology arrangements often include options to purchase additional goods or services that may be priced at a discount, such as sales incentives, contract renewal options (e.g., waiver of certain fees, reduced future rates) or other discounts on future goods or services. Under today's guidance, even if the option is substantive (i.e., the customer makes a separate buying decision and has the ability to exercise or not exercise its right), the option is not considered an element in the arrangement if the specified additional deliverables have not been priced at a significant and incremental discount.

Nonrefundable up-front fees

In many transactions, customers pay an up-front fee at contract inception, which may relate to the initiation, activation or set-up of a good to be used or a service to be rendered in the future. Today, when no goods or services are transferred when the fees are paid, the up-front fees are generally recognized over the longer of the contractual term or the estimated customer relationship pursuant to SAB Topic 13.

Under the new standard, entities must continue to evaluate whether nonrefundable up-front fees relate to the transfer of a good or service. In addition, the existence of such fees may indicate that there are other implied elements in the contract, such as the option to renew a service at a discounted rate because the up-front fee would not be charged for the renewal period. In such situations, the identified promised goods and services also should include those implied items.

Ultimately, under the new standard, the nonrefundable fee is allocated to the identified performance obligations in the contract (which may include some implied performance obligations) and amounts are recognized as revenue as the performance obligations are satisfied. That is, there is no requirement to treat the nonrefundable up-front fees differently from any other consideration received by the entity as part of the arrangement, as there is in current guidance.[6] By requiring allocation of the up-front fees to the future goods or services or renewal options, rather than recognizing those amounts over the longer of the contractual term or the estimated customer relationship, the standard may cause a change in practice.

Principal versus agent considerations

If an arrangement involves three or more parties, an entity will have to determine whether it is acting as a principal or an agent in order to determine the amount of revenue to which it is entitled. For example, technology entities may offer a platform to sell virtual or digital goods on behalf of a third party or contract with an advertising agency to deliver advertising content to a website or mobile application. When the entity is the principal in the contract, the revenue recognized is the gross amount to which the entity expects to be entitled. When the entity is the agent, the revenue recognized is the net amount to which the entity is entitled to retain in return for its services as the agent.

A principal's performance obligations in a contract differ from an agent's performance obligations. The standard notes that a principal controls the goods or services before they are transferred to the customer, and consequently, the principal's performance obligation is to transfer the goods and services to the customer. However, an entity that obtains legal title of a product only momentarily before legal title is transferred to the customer is not necessarily acting as a principal. In contrast, an agent does not control the goods or services before they are transferred to a customer. The agent is simply facilitating the sale of goods or services to the customer in exchange for a fee or commission. Therefore, the agent's performance obligation is to arrange for another party to provide the goods or services to the customer.

Determining whether to present gross or net revenue when there are more than two parties in an arrangement will continue to be challenging, particularly for the sale of intangible items such as virtual goods.

Entities may find it difficult to determine which party controls an intangible good or service prior to its transfer to the customer, and it is not always clear which party is the customer. For example, for an online game developer, the customer may be the intermediary that provides the social networking platform or it may be the end consumer. Depending on an entity's conclusion, the amount and timing of revenue recognition could differ significantly.

As noted in the standard, for the entity to conclude it is acting as the principal in the arrangement, the entity must determine that it controls the goods or services promised to the customer before those goods and services are transferred to the customer. Because this determination is not always clear, the standard provides indicators to assist the entity in making this determination. While the indicators in the new standard are similar to those in today's guidance, they reflect concepts included in the new standard such as identifying performance obligations and the transfer of control of goods or services. Appropriately identifying the entity's performance obligation in a contract is fundamental to the determination of whether the entity is acting as an agent or a principal.

Judgment will be required to apply the indicators to intangible goods or services because they were written in the context of tangible goods. The accounting for a contract involving principal–agent considerations also can be complicated if an entity does not know the gross amount billed to the end consumer. That might be the case when an intermediary contracts directly with the end customer, and the intermediary pays the entity its portion of the arrangement consideration but does not provide full details of its transaction with the end customer.

How we see it

As they do today, technology entities will need to carefully evaluate whether a gross or net presentation is appropriate. Although the new standard appears to be similar to existing guidance, there are some notable differences that may affect an entity's principal-agent judgments and conclusions. For example, the standard includes the notion of considering whether an entity has *control* of the goods and services as part of the evaluation, which adds an overarching principle for entities to evaluate in addition to the indicators. In addition, the new standard removes the requirement in today's guidance to weight certain indicators in the principal-agent determination more heavily than others. As a result, entities can assess the importance of the indicators based on the facts and circumstances. The Boards also eliminated the illustrative examples in US GAAP that entities currently use to make the principal-agent determination. As a result, entities in similar circumstances may reach different conclusions.

The TRG discussed the implementation issue involving intangible (or virtual) goods or services when there are more than two parties in an arrangement. The TRG also discussed whether any of the indicators should be weighted more heavily than others. It is not yet clear whether the Boards will provide additional guidance.

Determine the transaction price

The transaction price is the amount of consideration to which an entity expects to be "entitled" and includes an estimate of any variable consideration, the effect of a significant financing component (i.e., the time value of money), the fair value of any noncash consideration and the effect of any consideration payable to a customer. The entitled amount is meant to reflect the amount to which the entity has rights under the present contract. It may differ from the contractual price. For example, there may be variable consideration (if the entity expects to receive or accept an amount less than the stated contract amounts) or if payment is received before or after the entity provides goods or services.

Variable consideration

Entities enter into contracts in which a portion of the transaction price could vary because of the contract terms or the entity's intention to act under the contract. For example, such terms could represent rights to return networking equipment, discounts or rebates offered on mobile devices or computer hardware and price concessions provided to customers in emerging markets.

The new standard requires the entity to estimate at contract inception any variable consideration in the contract and include such amounts in the transaction price, subject to a constraint. Variable consideration will be estimated using either an "expected value" or "most likely amount" method, whichever better predicts the consideration to which the entity will be entitled. That is, the method selected is not meant to be a "free choice." Rather, an entity needs to consider which method it expects to better predict the amount of consideration to which it will be entitled and apply that method consistently for similar types of contracts.

The estimate of variable consideration is constrained to the amount for which the entity has concluded it is "probable" that a significant reversal in cumulative revenue recognized will not occur when the uncertainty associated with the variable consideration is resolved. This determination includes considering both the likelihood and magnitude of a revenue reversal. The estimate of variable consideration, including the amounts subject to constraint, is updated at each reporting period.

Under today's guidance, if a vendor cannot conclude at the outset of the arrangement that the fee is fixed or determinable, revenue is generally recognized either as payments from the customer become due or as rights of return or refund lapse, if all other basic revenue recognition criteria are met. As previously discussed, under the new standard, the transaction price is based on the amount to which the entity expects to be "entitled." While variable consideration is subject to the constraint (as discussed above), entities will be required to estimate variable consideration and include amounts in the allocable transaction price, which could cause them to recognize revenue earlier than today. As a result, more judgment will be required to measure revenue.

Implied price concessions

In certain situations, entities may enter into a contract anticipating that they will be unable to fully collect the stated contractual price. When the entity is aware of that risk and still chooses to transact with the customer, there may be an implied price concession in the contract. Under the standard, implied price concessions are components of variable consideration and an entity must estimate these amounts at contract inception. For example, consider a technology entity that has a history of providing a price concession in a specific region that is 40% of the contract price. When determining the transaction price for a contract entered into in that region, the entity might determine that 60% of the contract price is the transaction price, and there is an implied price concession for the remaining 40% based on the entity's history.

This could result in a significant change in practice for entities that currently recognize revenue from customers with these types of fact patterns on a cash basis. Although an entity may determine that the likelihood of an adjustment to the stated contract price is high (e.g., because price concessions are granted), an entity must include its estimate of variable consideration in the transaction price, subject to the constraint, rather than default to deferring all revenue until the contingency has been resolved.

How we see it

Technology entities may find it challenging to distinguish between implied price concessions (i.e., reductions of revenue) and customer credit risk (i.e., bad debt) for collectibility issues that were known at contract inception. Technology entities will need to carefully evaluate all facts and circumstances that were available at contract inception, as well as any subsequent events that may affect the customer's ability to pay. Significant judgment will be required when making this determination and documentation of the judgment should be retained. Technology entities should develop clear policies and procedures for these evaluations to ensure consistent application across all transactions.

Right of return

A right of return, either explicitly stated in a contract or implied by an entity's customary business practice, is not a separate performance obligation. However, a right of return in a contract creates variability in the transaction price and, therefore, is a form of variable consideration. Under the new standard, an entity will estimate returns and include that estimate as a reduction to the transaction price (subject to the constraint). The entity will recognize the amount of expected returns as a refund liability, representing its obligation to return the customer's consideration. The entity also will recognize a return asset (and adjust cost of sales) for its right to recover the goods returned by the customer measured at the former carrying amount of the inventory, less any expected costs to recover those goods. Under today's guidance, the carrying value associated with any product expected to be returned typically remains in inventory, but the new guidance requires the asset to be recorded separately from inventory to provide greater transparency.

At each reporting date, an entity will remeasure the refund liability and update the measurement of the asset recorded, if any, for any revisions to its expected level of returns, as well as any potential decreases in the value of the products expected to be returned. That is, a returned item should be recognized at the lower of the original cost less the cost to recover the asset or the fair value of the asset at the time of recovery.

Illustration 5: Determine the transaction price — right of return
Entity Y sells networking equipment, such as routers, switches and hubs, and enters into a contract with a customer to sell 1,000 wireless routers for \$20,000 (i.e., \$20 per wireless router). The contract allows the customer to return unused and unopened products within 30 days. Because the contract provides the customer with a right of return, the consideration is variable. Entity Y has significant experience in estimating returns and uses the expected value method to estimate the consideration to which it expects to be entitled. Entity Y estimates that 2% of the wireless routers will be returned based on historical return data and current expectations. Based on that estimate, Entity Y concludes that the transaction price is \$19,600 [(1,000 wireless routers sold to the customer − (1,000 x 2%) = 980 wireless routers not expected to be returned) x \$20]. Upon transfer of control to the customer, Entity Y would recognize revenue of \$19,600, a refund liability of \$400, and a return asset and corresponding reduction to cost of sales, at the inventory carrying amount (less any expected costs to recover the goods) of the 20 wireless routers expected to be returned.

Extended payment terms

The treatment of extended payment terms under the new standard may represent a significant change from current practice.

Under the new standard, when a contract provides the customer with extended payment terms, an entity will need to consider whether those extended payment terms create variability in the transaction price (i.e., are a form of variable consideration) and whether a significant financing component exists. We address significant financing components in a separate section below.

An entity will need to carefully evaluate contracts that include extended payment terms to determine whether the entity has an intention, or a valid expectation, that it will provide a price concession over the financing term. For example, an entity may have a business practice of providing price concessions in contracts that include extended payment terms in order to negotiate a contract renewal with its customers. Such price concessions are a form of variable consideration, which are required to be estimated at contract inception and deducted from the transaction price.

The treatment of extended payment terms under the new standard may represent a significant change from current practice. SAB Topic 13 notes entities should consider the guidance on extended payment terms in ASC 985-605 even if the arrangement is not subject to the scope of that standard. ASC 985-605 has restrictive criteria for the recognition of revenue that is not certain, including a presumption that extended payment terms lead to a transaction price that is not fixed or determinable because of an increased risk of the entity granting future price concessions to its customer. As a result, under today's guidance, an entity may be restricted from recognizing revenue for arrangements that include extended payment terms unless it can determine that including such terms does not prevent the transaction from meeting the general revenue recognition criteria in SAB Topic 13.

Although the new guidance differs in approach from today's guidance, it has a relatively high threshold (in the form of the constraint on variable consideration) that must be met prior to including amounts in the transaction price that can be recognized as revenue. However, entities that expect to be entitled to the consideration due under a contract may be able to recognize revenue earlier than they do today, despite the extended payment terms, if they determine that the transaction price is not constrained.

Illustration 6: Extended payment terms

Tech Co. enters into an arrangement with a customer for hardware products on 30 December 20X3 for $1.5 million. Payment terms are as follows:

- $250,000 due 31 January 20X4
- $250,000 due 30 April 20X4
- $250,000 due 31 July 20X4
- $250,000 due 31 October 20X4
- $250,000 due 31 January 20X5
- $250,000 due 30 April 20X5

Tech Co.'s standard payment terms for such arrangements are net 45 days, and the entity has not provided this type of extended payment terms to customers in the past.

Analysis

Under current practice, Tech Co. would be required to defer revenue because it has no history of offering and collecting on these types of extended terms. In this example, if all of the other basic revenue recognition criteria have been met, the vendor would recognize revenue as the payments become due.

Under the new standard, if Tech Co. expected that it would be entitled to the entire transaction amount (i.e., it did not anticipate providing concessions or rebates to the customer), the fixed arrangement fee of $1.5 million would be recognized when control of the hardware products is transferred.

In contrast, if at contract inception, Tech Co. anticipates that it may provide some amount of concession or discount to the customer because of the extended payment terms, the transaction would include variable consideration, and the entity will need to estimate the transaction price. Tech Co. will consider factors such as the customer's current financial status in estimating the variable consideration. Based on the results of its expected value calculation, Tech Co. estimates a transaction price of $1.3 million and also concludes that it is probable that a significant revenue reversal of that amount will not occur. Therefore, the constraint does not reduce the amount of variable consideration included in the estimated transaction price. The entity will need to update its estimate of the transaction price throughout the term of the arrangement to depict conditions that exist at each reporting date.

This illustration does not consider whether a significant financing component exists. We discuss that concept below.

Significant financing component

Entities often enter into arrangements under which the timing of the payment from the customer does not match the timing of the entity's transfer of goods or services (i.e., the customer pays in advance or in arrears). For example, payments for maintenance services are frequently made up front while those services are provided over the contractual term. As previously discussed, contracts also may include extended payment terms.

An entity is required to adjust the transaction price for the time value of money if there is a significant financing component, using the same discount rate that it would use if it were to enter into a separate financing transaction with the customer. The assessment of significance is done at the individual contract level, but the standard does not include guidance as to how this assessment would be made. As a practical expedient, an entity is not required to assess whether the contract contains a significant financing component unless the period between the customer's payment and the entity's transfer of goods or services is greater than one year.

How we see it

Technology entities will need to exercise judgment when assessing the significance of the financing component because the standard does not establish quantitative thresholds for significance. The treatment of the time value of money may have a significant effect on long-term contracts, such as multi-year maintenance arrangements with up-front payments. Even entities that don't believe a financing component is significant will need to make a formal assessment. Technology entities may be able to alleviate the burden of performing the significance assessment by using a practical expedient the Boards provided.

Consideration paid or payable to a customer

Entities may agree to compensate a retailer up to a specified amount for shortfalls in the sales price or reimburse a customer for marketing activities related to certain products. Consideration payable to a customer is treated as a reduction of the transaction price and, therefore, of revenue unless the payment to the customer is in exchange for a distinct good or service. The payment for distinct goods and services received should be limited to the fair value of the goods or services, with any amount in excess of the fair value recognized as a reduction of the transaction price.

Entities will need to carefully assess whether the consideration paid to the customer is actually a payment for a distinct good or service or whether it is a reduction of the transaction price for the goods and services the entity is transferring to the customer.

Allocate the transaction price to the performance obligations

The new standard requires an entity to allocate the transaction price to each separate performance obligation, generally in proportion to their standalone selling prices (i.e., on a relative standalone selling price basis), with limited exceptions. An entity will need to allocate variable consideration to one or more, but not all, performance obligations in some situations. The standard also contemplates the allocation of any discount in a contract to one or more, but not all, performance obligations, if specified criteria are met.

The standalone selling price is the price at which an entity would sell a good or service on a standalone basis at contract inception. When determining standalone selling prices, an entity must use observable information, if it is available. If standalone selling prices are not directly observable, an entity will need to make estimates based on reasonably available information. The standard discusses three possible estimation methods technology entities can use: (1) an adjusted market assessment approach, (2) an expected cost plus a margin approach and (3) a residual approach. The use of one or a combination of the methods may be appropriate in estimating the standalone value of a good or service. Further, these are not the only estimation methods permitted.

The new standard's requirement to estimate the standalone selling price should not be a new concept for entities that currently apply the multiple-element arrangements guidance in ASC 605-25. The new guidance is generally consistent with the estimation concepts in ASC 605-25, except that it does not require an entity to follow the hierarchy that today requires entities to consider vendor-specific objective evidence, then third-party evidence and then best estimate of selling price.

Some entities may find it difficult to determine a standalone selling price, particularly for goods or services for which the historical selling price is highly variable or for goods or services that have not yet been or are never sold separately. The new standard says an entity may be able to estimate the standalone selling price of a performance obligation using a residual approach if (1) the entity sells the same good or service to different customers for a broad range of amounts (i.e., the selling price is highly variable) or (2) the entity has not yet established a price for that good or service (i.e., the selling price is uncertain).

Under the new standard, entities also will have to change how they estimate the standalone selling price of options for additional goods or services that provide the customer with a material right. Instead of estimating the standalone selling price of an option, entities may apply a practical alternative provided in the standard when the optional goods or services are both: (1) similar to the original goods and services in the contract and (2) provided in accordance with the terms of the original contract (which may be common for contract renewals). Under this alternative, instead of valuing the option itself, the entity can assume the option is going to be exercised and include the optional additional goods and services (and related consideration) with the identified performance obligations in the estimated transaction price. The requirement to allocate arrangement consideration to an option on a relative standalone selling price basis is consistent with the current guidance in ASC 605-25. However, ASC 605-25 requires the entity to estimate the selling price of the option (unless other objective evidence of the selling price exists) and does not provide the alternative method of assuming the option is exercised.

The new standard may change how entities estimate the standalone selling price of options for additional goods or services that provide the customer with a material right.

Satisfaction of performance obligations

Under the new standard, an entity recognizes revenue only when it satisfies a performance obligation by transferring a promised good or service to a customer. A good or service is considered to be transferred when the customer obtains control. Control of an asset refers to the ability of the customer to direct the use of and obtain substantially all of the cash inflows, or the reduction of cash outflows, generated by the goods or services. Control also means the ability to prevent other entities from directing the use of, and receiving the benefit from, a good or service.

The standard indicates that an entity must determine at contract inception whether it will transfer control of a promised good or service over time. If an entity does not satisfy a performance obligation over time, the performance obligation is satisfied at a point in time.

A performance obligation is satisfied over time if it meets one of the following criteria:

- The customer simultaneously receives and consumes the benefits provided by the entity's performance as the entity performs by providing hosting service, for example.
- The entity's performance creates or enhances an asset that the customer controls as the asset is created or enhanced. An example would be installing network equipment on the customer's premises, if the customer controls the equipment during the installation period.
- The entity's performance does not create an asset with an alternative use to the entity, and the entity has an enforceable right to payment for the performance completed to date. An example would be significantly customizing an asset to the customer's specifications so that it is less likely that the entity would be able to use the asset for another purpose (e.g., sell to a different customer) without incurring significant costs to re-purpose the asset, and the entity also has a right to payment for performance completed to date.

If an entity determines that a performance obligation is satisfied over time, it recognizes revenue over the period the performance obligation is satisfied, using an output or input method that best depicts the pattern of the transfer of control over time. Output methods are used to recognize revenue on the basis of units produced or delivered, contract milestones, time elapsed or surveys of services transferred to date relative to the total services to be transferred. The Boards provided a practical expedient for an entity that has a right to payment from a customer in an amount that corresponds directly with the value of the entity's performance completed to date (e.g., a professional services contract in which a technology entity bills a fixed amount for each hour of service provided) to recognize revenue in the amount for which it has a right to invoice. However, this expedient only applies when the performance obligation is satisfied over time and an output method is used to measure progress.

Input methods are used to recognize revenue on the basis of the entity's efforts or inputs to the satisfaction of a performance obligation relative to the total expected inputs to the satisfaction of that performance obligation. Input methods can include labor hours used, costs incurred, time elapsed or machine hours used. The standard does not indicate a preference for either type of method; however, it does clarify that the selected method should be applied consistently to similar performance obligations and in similar circumstances.

Although the standard requires an entity to update its estimates related to the measure of progress selected, it does not allow a change in method. For example, it would not be appropriate for a technology entity to start recognizing revenue for a performance obligation based on labor hours used and then switch to contract milestones.

For performance obligations that are not transferred over time, control is transferred as of a point in time. For example, when a customer purchases computer hardware, control generally transfers to the customer when the computer hardware is provided. The standard provides indicators to help entities determine when control transfers, including right to payment, legal title, physical possession, risks and rewards of ownership, and customer acceptance.

Consignment arrangements

Entities may deliver inventory on a consignment basis to other parties (e.g., distributor, dealer). By shipping on a consignment basis, consignors are able to better market products by moving them closer to the end customer; however, they do so without selling the goods to the intermediary (consignee).

Entities entering into consignment arrangements must determine the nature of the performance obligation (i.e., whether the obligation is to transfer the inventory to the consignee or to transfer the inventory to the end customer). Under the new standard, this determination should be based on whether control of the inventory has passed to the consignee upon delivery. Typically, a consignor will not relinquish control of consignment inventory until the inventory is sold to the end customer or, in some cases, when a specified period expires. Consignees commonly do not have any obligation to pay for the inventory other than to pay the consignor the agreed-upon portion of the sales price once the consignee sells the product to a third party. As a result, revenue generally would not be recognized for consignment arrangements when the goods are delivered to the consignee because control has not transferred (i.e., the performance obligation to deliver goods to the customer has not yet been satisfied). This result is generally consistent with conclusions under today's guidance.

Bill-and-hold arrangements

In certain technology transactions, the entity fulfills its obligations and bills the customer for the work performed but does not ship the goods until a later date. These transactions, often called "bill-and-hold" transactions, usually are designed this way at the request of the customer for a variety of reasons, including the customer's lack of storage capacity or its inability to use the goods until a later date.

The criteria for determining whether a bill-and-hold transaction qualifies for revenue recognition under the new standard are similar to, but somewhat less specific than, today's criteria in SAB Topic 13 and other SEC guidance.[7] For example, SAB Topic 13 requires that the customer request that the entity retain the completed product and that the arrangement include a fixed delivery schedule, but the new standard does not. We expect that bill-and-hold transactions that qualify for revenue recognition under today's guidance normally will qualify for revenue recognition under the standard.

Other measurement and recognition topics

Reseller and distributor arrangements

The new standard also could change practice for entities that sell their products through distributors or resellers (collectively referred to in this section as resellers). It is common in the technology industry for entities to provide resellers with greater rights than end customers to maintain a mutually beneficial relationship and maximize future sales opportunities through the reseller. For example, an entity may provide a reseller with price protection and extended return rights.

The new standard could change practice for entities that sell their products through distributors or resellers.

Under the new standard, entities will need to first evaluate when control of the product transfers to the customer. To do this, entities may need to first assess whether their contracts with resellers are consignment arrangements, under which control likely would not transfer until delivery to the end customer as discussed previously. The new standard provides three indicators that an arrangement is a consignment arrangement:

- The product is controlled by the entity until a specified event occurs, such as the sale of the product to a customer of the dealer, or until a specified period expires.
- The entity is able to require the return of the product or transfer the product to a third party (such as another dealer).
- The dealer does not have an unconditional obligation to pay for the product (although it may be required to pay a deposit).

An entity should not recognize revenue upon delivery of a product to a reseller if the delivered product is held on consignment because control of the product has not transferred. The entity would wait until the reseller sells the product to an end customer to recognize revenue, which would be considered the point in time that the entity has transferred control of the product. The result would be similar to today's practice of deferring revenue recognition until the reseller sells the product to an end customer.

If an entity concludes its contract with a reseller is not a consignment arrangement, the reseller likely will be considered a customer of the entity. The entity would be required to recognize revenue upon the transfer of control of the promised goods in an amount that reflects the amount to which the entity expects to be entitled. Today, many entities wait until the product is sold to the end customer to recognize revenue because they do not meet all of the criteria in SAB Topic 13 to recognize revenue when they deliver the product to the reseller. For example, if an entity cannot reasonably estimate the future price changes resulting from the price protection, the fee would not be considered fixed or determinable, and deferral of revenue would be required until the reseller sells the product to an end customer.

In determining the amount to which they expect to be entitled, entities will be required to consider whether they will provide resellers with explicit or implicit concessions (e.g., price protection, expanded return rights, stock rotation rights) that will make the transaction price variable. In these instances, an entity will need to estimate the transaction price and, considering the constraint, include only the amount for which the entity determines it is probable that a significant reversal will not occur. An entity will need to carefully consider whether it can include the variable consideration resulting from the concessions it offers to its reseller customer(s) in its transaction price. The standard indicates that an entity that has a practice of either offering a broad range of price concessions or changing the payment terms and conditions of similar contracts in similar circumstances as a factor that could increase the likelihood (or magnitude) of a revenue reversal. Entities will need to assess the facts and circumstances of their contracts to determine whether current practice will change under the new standard.

Contract costs

In addition to the new revenue guidance in ASC 606,[8] ASC 340-40[9] was added to codify guidance on the accounting for certain costs to obtain and fulfill a contract (or, in some instances, an anticipated contract) with a customer.

Costs of obtaining a contract

Under ASC 340-40, the incremental costs of obtaining a contract (i.e., costs that would not have been incurred if the contract had not been obtained) will be recognized as an asset if the entity expects to recover them. Recovery can be direct (i.e., through reimbursement under the contract) or indirect (i.e., through the margin inherent in the contract). As a practical expedient, the standard permits immediate expense recognition of the contract acquisition costs when the asset that would have resulted from capitalizing such costs would have been amortized in one year or less.

Today, there is diversity in practice for capitalizing costs incurred to obtain a contract because there is limited guidance. Therefore, entities make a policy election to expense such costs as incurred or account for them based on an analogy to the provisions of the guidance on accounting for separately priced warranty contracts in ASC 605-20[10] or non-refundable fees and other costs in ASC 310-20.[11] Entities that apply ASC 605-20 defer costs that are directly related to the acquisition of a contract if such costs would not have been incurred but for the acquisition of that contract (incremental direct acquisition costs). Entities that apply ASC 310-20 defer certain direct costs incurred in addition to certain incremental costs. Under the new standard, an entity will capitalize all incremental costs that are expected to be recovered, which could differ from the amounts capitalized today.

Entities will need to exercise judgment when determining whether costs incurred in obtaining a contract are incremental (i.e., costs that an entity incurs to obtain a contract with a customer that it would not have incurred if the contract had not been obtained). The standard cites sales commissions as an example of an incremental cost that may require capitalization under the standard. In contrast, bonuses and other compensation that are based on other quantitative or qualitative metrics (e.g., profitability, earnings per share, performance evaluations) likely do not meet the criteria for capitalization because they are not directly related to obtaining a contract. Entities also may pay commissions upon the renewal of a contract or bonuses based on the achievement of an individual's sales goal or total bookings. Other bonus programs may have escalation provisions under which the bonus amount increases as an individual meets performance targets. The standard provides little guidance about the types of costs that may be considered incremental to obtaining a contract, so this determination may be difficult for entities, particularly when such costs relate to multiple contracts or are incurred over a period of time.

Costs of fulfilling a contract

Entities may incur certain costs to fulfill a contract, such as set-up costs in hosting arrangements. An entity will first apply other authoritative guidance to account for such costs (e.g., guidance on development costs of software to be sold, leased or marketed (ASC 985-20), internal-use software (ASC 350-40), inventory (ASC 330) and property, plant and equipment (ASC 360)). If such costs are not within the scope of another ASC topic, an entity will apply the new guidance in ASC 340-40. Under this guidance, entities will capitalize the costs to fulfill a contract if the costs relate directly to the contract, generate or enhance the resources used to satisfy performance obligations and are expected to be recovered.

The standard discusses and provides examples of costs that meet the first criterion for capitalization (i.e., costs that relate directly to the contract), including direct labor, direct materials, allocation of costs directly related to the contract, costs explicitly chargeable to the customer and other costs that are incurred only because the entity entered into the contract.

In order for costs to meet the "expected to be recovered" criterion, costs should be either explicitly reimbursable under the contract or reflected in the pricing on the contract and recoverable through margin. The standard does not specify whether contract costs should be recoverable over the stated contractual period or the period of expected performance (i.e., the customer life). However, because the standard states that the amortization period can exceed the contract period, it is likely that entities will use that longer period in determining whether contract costs should be recoverable (i.e., use the customer life for this determination as well).

The new revenue standard will have a minimal effect on the cost guidance in development costs of software to be sold, leased or marketed (ASC 985-20), internal-use software (ASC 350-40), inventory (ASC 330) and property, plant and equipment (ASC 360). Entities should continue accounting for costs within the scope of such guidance as they do today.

How we see it

The requirements to capitalize incremental costs of obtaining a contract and direct costs of fulfilling a contract represent a significant change for technology entities that currently expense such costs as incurred.

Although the standard requires incremental costs of obtaining a contract to be capitalized (unless the practical expedient is applied), it is unclear whether certain costs will be considered incremental such as bonuses paid for total bookings or meeting individual sales targets (e.g., costs associated with obtaining a group of contracts).

Amortization and impairment

Any capitalized contract costs are amortized on a systematic basis that is consistent with the transfer of the goods or services to which the asset relates. The standard permits entities to take into account the expected renewal period in their assessment of the appropriate amortization period.

Any asset recorded by the entity is subject to an ongoing impairment assessment. An impairment exists if the carrying amount of any asset(s) exceeds the unconstrained amount of consideration the entity expects to receive in exchange for providing those goods and services, less the remaining costs that relate directly to providing those good and services.

Illustration 7: Amortization period
Tech Co. enters into a three-year contract with a customer for IT services. To fulfill the contract, Tech Co. incurred set-up costs of $60,000, which it capitalized and will amortize over the term of the contract. At the beginning of the third year, the customer renews the contract for an additional two years. Because Tech Co. will benefit from the set-up costs during the additional two-year period, it would change the remaining amortization period from one to three years and adjust the amortization expense recognized in accordance with the guidance in ASC 250[12] on changes in estimates. However, if Tech Co. had anticipated the contract renewal at contract inception, Tech Co. would have amortized the set-up costs over the anticipated term of the contract, including the expected renewal (i.e., five years).

Warranties

A customer may have the option to separately purchase a warranty on a product (e.g., computer hardware, networking equipment) for a period of time at the point of sale or the warranty may be explicitly stated in the contract. The standard identifies two types of warranties:

- Warranties that provide a service to the customer in addition to assurance that the delivered product is as specified in the contract (service-type warranties)
- Warranties that promise the customer that the delivered product is as specified in the contract (assurance-type warranties)

If the customer has the option to purchase the warranty separately or if the warranty is not separately priced or negotiated but provides a service to the customer beyond fixing defects that existed at the time of sale, the entity is providing a service-type warranty. This type of warranty represents a distinct service and is a separate performance obligation. Therefore, the entity allocates a portion of the transaction price to the warranty based on the estimated standalone selling price of the warranty. Revenue related to the warranty is recognized over the period the warranty service is provided.

Assurance-type warranties do not provide an additional good or service to the customer (i.e., they are not separate performance obligations). By providing this type of warranty, the selling entity has effectively provided a quality guarantee (e.g., to replace or repair a defective product). Such warranties are accounted for under the current guidance on guarantees in ASC 460.

If an entity provides both assurance-type and service-type warranties within an arrangement, an entity is required to accrue for the expected costs associated with the assurance-type warranty and account for the service-type warranty as a performance obligation. If the entity cannot reasonably account for them separately, the warranties are accounted for as a single performance obligation (i.e., revenue would be allocated to the combined warranty and recognized over the period the warranty services are provided). For these latter scenarios, the accounting under the new standard may be consistent with current practice.

Next steps

- Entities should perform a preliminary assessment on how they will be affected as soon as possible so they can determine how to prepare to implement the new standard. While the effect on entities will vary, some may face significant changes in revenue recognition. All entities will need to evaluate the requirements of the new standard and make sure they have processes and systems in place to collect the necessary information to implement the standard, even if their accounting results won't change significantly or at all.
- Entities also may want to monitor the discussions of the Boards, the SEC staff, the TRG and the software industry task force formed by the AICPA to discuss interpretations and application of the new standard to common transactions.
- Public entities also should consider how they will communicate the changes with investors and other stakeholders, including their plan for disclosures about the effects of new accounting standards discussed in SAB Topic 11.M.[13] The SEC staff has indicated it expects an entity's disclosures to evolve in each reporting period as more information about the effects of the new standard becomes available, and the entity should disclose its transition method once it selects it.

Endnotes:

1 SAB Topic 13, *Revenue Recognition*.
2 ASC 985-605, *Software — Revenue Recognition*.
3 ASU 2013-12, *Definition of a Public Business Entity*.
4 ASC 605-25, *Revenue Recognition – Multiple-Element Arrangements*.
5 ASC 460, *Guarantees*.
6 SAB Topic 13, *Revenue Recognition*.
7 Securities Exchange Act Release 23507, Accounting and Auditing Enforcement Release No. 108, and SEC Release Nos. 33-8642, 34-52885 and IC-27178.
8 ASC 606, *Revenue from Contracts with Customers*.
9 ASC 340-40, *Other Assets and Deferred Costs — Contracts with Customers*.
10 ASC 605-20, *Revenue Recognition — Services*.
11 ASC 310-20, *Nonrefundable Fees and Other Costs*.
12 ASC 250, *Accounting Changes and Error Corrections*.
13 SAB Topic 11.M, *Disclosure Of The Impact That Recently Issued Accounting Standards Will Have On The Financial Statements Of The Registrant When Adopted In A Future Period*.