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Technical Line

FASB — new guidance

The new revenue recognition standard — engineering and construction

Revenue recognition practices of all E&C entities may be affected by the new standard.

What you need to know

- The new revenue standard creates a single source of revenue guidance for all companies in all industries. Existing revenue literature in ASC 605-35, *Construction-Type and Production-Type Contracts*, that engineering and construction (E&C) entities use today will be eliminated.
- While many of the principles in the new standard are similar to today's guidance, entities should not assume that the pattern of revenue recognition for their arrangements will be unchanged. E&C entities will need to make many judgments that they may not be used to making.
- Key issues for the industry include identifying performance obligations, accounting for contract modifications, applying the constraint to variable consideration, evaluating significant financing components, measuring progress toward satisfaction of a performance obligation, recognizing contract costs and addressing disclosure requirements.
- The new standard is effective for public entities[1] 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

E&C 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 Boards). The new revenue recognition standard will supersede virtually all revenue recognition guidance in US GAAP and IFRS, including industry-specific guidance that E&C entities use today.

The new standard provides the accounting 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 those contracts are in the scope of other US GAAP requirements, such as the leasing literature). In addition, the standard's consequential amendments provide 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.

While many of the concepts in the new model are consistent with those in today's guidance for recognizing revenue from construction contracts in Accounting Standards Codification (ASC) 605-35, the guidance for accounting for certain elements of E&C contracts will change. In addition, the new standard introduces a number of new disclosure requirements that E&C entities will need to evaluate.

This publication highlights key considerations for construction contractors and other entities that provide design and engineering services for infrastructure and real estate projects and currently apply the guidance in ASC 605-35. It also provides an overview of the new revenue recognition model.

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. We also issued a separate Technical Line, *The new revenue recognition model — real estate* (SCORE No. BB2811), for real estate entities that own and operate real estate assets and provide property management services, as well as homebuilders and residential developers.

E&C entities 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 E&C issues. 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 E&C 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 issue updated guidance.

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1 Summary of the new model

The new guidance in ASC 606, *Revenue from Contracts with Customers,* 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 separate performance obligations in the contract
5. Recognize revenue when (or as) the entity satisfies a performance obligation

An entity will need to exercise judgment when considering the terms of the contract(s) and all of the 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 generally will have to provide 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 capitalized contract costs.

Scope, transition and effective date

The scope of ASC 606 includes all contracts, as defined, 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 are nonmonetary exchanges between entities in the same line of business to facilitate sales to customers other than the parties to the exchange.

Entities may enter into transactions that are partially within the scope of the new revenue recognition guidance and partially within the scope of other guidance. In these situations, the new guidance requires an entity to first apply any separation and/or measurement principles in the other guidance before applying the revenue standard.

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, 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.

How we see it

Before determining a transition approach, an E&C entity must understand the new revenue model and develop a plan for analyzing how the standard will affect the accounting for its revenue contracts. Both of the transition methods have pros and cons that will affect individual companies in different ways depending on the characteristics of their contracts (e.g., consideration type, number of performance obligations, contract length). The Securities and Exchange Commission (SEC) staff expects entities to disclose the transition method they plan to use once they select it.

Analyzing transition approaches also will help entities determine whether they will need to change their systems, processes and controls to account for revenue under the new model. We expect that any such changes, along with activities such as training personnel and educating analysts and external stakeholders, may require significant investments of time and capital.

2 Identify the contract with the customer

To apply the new revenue model, an entity must first identify the contract, or contracts, to provide goods and services to customers. Such contracts may be written, oral or implied by the entity's customary business practice but must be enforceable by law and meet specified criteria. These criteria include approval of the contract by all parties and their commitment to perform their respective obligations, the ability to identify each party's rights regarding goods and services to be transferred and the associated payment terms, and whether the contract has commercial substance.

In addition, before an arrangement with a customer is considered a contract in the scope of the new revenue guidance, an entity must conclude that it is probable that it will collect the transaction price. The transaction price is the amount to which the entity expects to be entitled in exchange for the goods or services that will be transferred to the customer as opposed to the contract price. The term "probable" is defined as "the future event or events are likely to occur," consistent with the definition in ASC 450, *Contingencies*. To assess collectibility, an entity should only evaluate the customer's ability and intent to pay the transaction price when due.

The transaction price may be less than the stated contract price if an entity concludes that it has offered or is willing to accept a price concession or other discount. Such concessions or discounts are forms of variable consideration (see Section 4.1) that an entity would estimate at contract inception and reduce from the contract price to derive the transaction price. The estimated transaction price would then be evaluated for collectibility.

How we see it

Significant judgment will be required to determine whether a contract is within the scope of the new standard if an entity believes it will receive partial payment for performance. The entity will be required to determine whether the amount of consideration that it does not expect to receive is a price concession or an amount that the customer does not have the ability and intention to pay. In making this determination, an entity will have to consider whether its customary business practices, published policies or specific statements provide the customer with a valid expectation that the entity will accept an amount of consideration that is less than the price stated in the contract.

If an entity concludes it has met all of the criteria to have a contract under the revenue standard, the entity will not reassess those criteria unless there is an indication of a significant change in facts and circumstances. An example of this scenario is included in the standard relating to the significant deterioration in a customer's ability to pay the consideration when due. Entities in this situation will need to determine whether it is still probable that they will be able to collect the amount of consideration to which they are entitled, or the contract may no longer be within the scope of the revenue standard. E&C entities will need to apply significant judgment in these circumstances.

The new standard provides guidance for entities to follow when an arrangement does not meet the criteria of a contract under the standard (i.e., an entity concludes that it is not probable that it will collect the transaction price or that the arrangement does not meet any of the other criteria described above). Any consideration received from a customer (e.g., an advance payment) before the contract criteria have been satisfied is initially accounted for as a liability (not revenue).

An entity may recognize the consideration received as revenue only when it determines that the agreement meets the criteria of a contract under the revenue model, or when either (1) the entity has no remaining obligations to transfer goods or services and substantially all of the consideration has been received by the entity and is nonrefundable, or (2) the contract has been terminated and the consideration received is nonrefundable. The Boards indicated[2] they intended this accounting to be similar to the "deposit method" that was previously included in US GAAP and applied when there was no consummation of a sale.

2.1 Combining contracts

For construction-type contracts, ASC 605-35 requires companies to identify one or several profit centers (i.e., the unit of account) to account for contract revenue and related expenses. The guidance presumes that each contract is a profit center for revenue recognition, cost accumulation and income measurement. However, in certain specified circumstances, a contractor can overcome that presumption and either combine a group of contracts into one profit center or segment a single contract into several profit centers.

Under the new standard, an entity will generally apply the model to an individual contract with a customer. However, the new guidance *requires* entities to combine contracts entered into at or near the same time with the same customer if they meet one or more of the following criteria:

- The contracts are negotiated as a package with a single commercial objective.
- The amount of consideration to be paid in one contract depends on the price or performance of the other contract.
- The goods or services promised in the contracts (or some goods or services promised in each of the contracts) are a single performance obligation (see Chapter 3 for a discussion on identifying performance obligations).

The Boards clarified[3] that negotiating multiple contracts at the same time is not sufficient evidence to demonstrate that the contracts represent a single arrangement.

How we see it

Unlike ASC 605-35, which permits entities to combine contracts in certain circumstances, the new standard requires that contracts be combined when certain criteria are met.

While the underlying principle for combining contracts is similar under both standards, the specific criteria for the application of that guidance are different. As a result, entities will need to carefully evaluate the new contract combination guidance to determine whether they can reach the same conclusions they do under ASC 605-35.

Today's guidance in ASC 605-35 lists criteria for entities to apply when determining whether different elements or phases of a contract should be treated as separate segments. The new model requires entities to identify the performance obligations in the contract, using different criteria than those in today's segmentation guidance. Refer to Chapter 3 for further discussion on identifying performance obligations.

2.2 Contract modifications

Parties to E&C arrangements frequently agree to change orders that modify the scope or price (or both) of a contract. Contractors also regularly submit claims to customers when unanticipated additional costs are incurred as a result of delays, errors or changes in scope caused by the customer. The new standard states that "a contract modification exists when

the parties to a contract approve a modification that either creates new, or changes existing, enforceable rights and obligations of the parties to the contract." Approvals of a modification may be written, oral or implied by the entity's customary business practices.

Generally, if a contract modification has not been approved, the new revenue model is not applied to the modification until the approval occurs. However, the standard also states that an entity may have to account for a contract modification prior to the parties reaching final agreement on changes in scope or pricing (or both). Instead of focusing on the finalization of a modified agreement, this guidance focuses on the enforceability of the changes to the rights and obligations in the contract. That is, once the entity determines the revised rights and obligations are enforceable, the entity is required to account for the contract modification. If the parties to a contract have approved a change in the scope of the contract but have not yet determined the corresponding change in price, an entity will have to estimate the change to the transaction price arising from the modification in accordance with the guidance for estimating variable consideration (see Section 4.1).

The standard provides the following example to illustrate this point:

Contract modifications that add distinct goods or services at their standalone selling prices are treated as separate contracts.

Excerpt from Accounting Standards Codification

Revenue from Contracts with Customers — Overall

Implementation Guidance and Illustrations

Example 9 — Unapproved Change in Scope and Price

606-10-55-134

An entity enters into a contract with a customer to construct a building on customer-owned land. The contract states that the customer will provide the entity with access to the land within 30 days of contract inception. However, the entity was not provided access until 120 days after contract inception because of storm damage to the site that occurred after contract inception. The contract specifically identifies any delay (including force majeure) in the entity's access to customer-owned land as an event that entitles the entity to compensation that is equal to actual costs incurred as a direct result of the delay. The entity is able to demonstrate that the specific direct costs were incurred as a result of the delay in accordance with the terms of the contract and prepares a claim. The customer initially disagreed with the entity's claim.

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The entity assesses the legal basis of the claim and determines, on the basis of the underlying contractual terms, that it has enforceable rights. Consequently, it accounts for the claim as a contract modification in accordance with paragraphs 606-10-25-10 through 25-13. The modification does not result in any additional goods and services being provided to the customer. In addition, all of the remaining goods and services after the modification are not distinct and form part of a single performance obligation. Consequently, the entity accounts for the modification in accordance with paragraph 606-10-25-13(b) by updating the transaction price and the measure of progress toward complete satisfaction of the performance obligation. The entity considers the constraint on estimates of variable consideration in paragraphs 606-10-32-11 through 32-13 when estimating the transaction price.

Once an entity has determined that a contract has been modified (e.g., because of a change order or claim), the entity has to determine the appropriate accounting for the modification. Certain modifications are treated as separate, standalone contracts, while others are combined with the original contract and accounted for in that manner.

An entity should account for a contract modification as a *separate contract*, with no effect on the original contract, if (1) the scope of the contract increases because of the addition of promised goods or services that are distinct (see Chapter 3) and (2) the price of the contract increases by an amount of consideration that reflects the entity's standalone selling prices of the additional promised goods or services. In these circumstances, the standalone selling prices of the additional goods or services may include adjustments that reflect the circumstances of the particular contract (e.g., a discount provided to a customer because materials and equipment needed for a change order are already on site). See Illustration 2-1 below for an example.

If a contract modification is not accounted for as a separate contract, an entity would account for the promised goods or services not yet transferred at the date of the contract modification (including those in the original contract) in whichever of the following ways is applicable:

- If the remaining goods and services after the contract modification are distinct from the goods or services transferred on or before the contract modification, the entity would account for the modification as if it were *the termination of the old contract and the creation of a new contract*. For these modifications, the revenue recognized to date on the original contract (i.e., the amount associated with the completed performance obligations) is not adjusted. Instead, the remaining portion of the original contract and the modification are accounted for together on a prospective basis by allocating the remaining consideration to the remaining performance obligations. See Illustration 2-1 below.
- If the remaining goods and services to be provided after the contract modification are not distinct from the goods and services already provided and therefore form part of a single performance obligation that is partially satisfied at the date of modification, the entity would account for the contract modification as if it were *part of the original contract*. For these modifications, the entity will adjust revenue previously recognized, either up or down, to reflect the effect that the contract modification has on the transaction price and the measure of progress (i.e., the revenue adjustment is made on a cumulative catch-up basis). See Example 8 below.
- Finally, a change in a contract also may be treated as a combination of the two: a modification of the existing contract and the creation of a new contract. In this case, an entity would not adjust the accounting for completed performance obligations that are distinct from the modified goods or services. However, the entity would adjust revenue previously recognized, either up or down, to reflect the effect of the contract modification on the estimated transaction price allocated to performance obligations that are not distinct from the modified portion of the contract and the measure of progress.

In some respects, the requirement to determine whether to treat a change in contractual terms as a separate contract or a modification to an existing contract is consistent with today's guidance for contract accounting in ASC 605-35. For example, ASC 605-35 requires that contract additions be treated as separate contracts when certain criteria are met (e.g., when the product or service to be provided differs significantly from those provided under the original contract or the price of the new product or service is negotiated without regard to the original contract).

When assessing how to account for a contract modification, an entity must consider how any revisions to promised goods or services interact with the rest of the contract. That is, although a change order may add a new good or service that would be distinct in a standalone transaction, the new performance obligation may not be distinct in the context of the modified contract. For example, in a building construction project, a customer may request a

change order to add an additional floor. The construction firm may commonly perform construction services to add a new floor to an existing, completed building, which would likely be considered a distinct service in those contracts. However, when that service is added to an existing contract (e.g., a contract to construct the entire building) and the entity has already determined that the entire project is a single performance obligation, the added goods and services normally would be combined with the existing bundle of goods and services.

The following illustrates an entity's potential analysis of the accounting for a contract modification:

Illustration 2-1: Modification of a construction contract

Contractor E agrees to construct a manufacturing facility on a customer's land for $10 million. During construction, the customer determines that a separate storage facility is needed at the location. The parties agree to modify the contract to include the construction of the storage facility, to be completed within three months of completion of the manufacturing facility, for a total price of $11 million.

Scenario A

When the contract is modified, an additional $1 million is added to the consideration Contractor E will receive. Contractor E would normally charge $1.1 million to construct a similar facility. However, much of the equipment and labor force necessary to complete construction of the storage facility is already on site and available for use by Contractor E, thus the additional $1 million reflects the standalone selling price at contract modification, adjusted for the particular circumstances of the contract. Assume that Contractor E determines that the construction of the separate storage facility is a distinct performance obligation.

As a result, the contract modification for the additional storage facility is, in effect, a new and separate contract that does not affect the accounting for the existing contract.

Scenario B

As in Scenario A, the contract is modified when Contractor E agrees to build the storage facility and the customer agrees to pay an additional $1 million. Assume that Contractor E determines that the construction of the separate storage facility is a distinct performance obligation. However, Contractor E determines that it would normally charge $1.5 million to construct a similar facility. While Contractor E can attribute some of the discount to its ability to use equipment and labor that are already on site, the price reduction was primarily driven by other factors, such as Contractor E's desire to maintain the customer relationship and keep its resources deployed. Therefore, the additional $1 million does not reflect the standalone selling price at contract modification.

Assume that Contractor E concludes that it transfers control of each facility over time. As a result, Contractor E accounts for the modification as both a modification of the existing contract and the creation of a new contract. The revised transaction price of $11 million is allocated between the two performance obligations, based on the relative standalone selling prices of each (see Chapter 5). Any revenue previously recognized for the manufacturing facility is adjusted on a cumulative catch-up basis to reflect the allocated transaction price. Revenue from the construction of the storage facility (i.e., a separate performance obligation) is recognized based on the appropriate measure of progress.

In practice, a contractor that is already performing work on a project may have leverage that provides it with the ability to charge a higher price for a change order than it otherwise would if the activities were performed on a standalone basis because, for example, the customer doesn't enter into an open bidding process for each individual change order. In these circumstances, determining whether the consideration from the modification reflects the standalone selling price of the activities will require significant judgment.

The following example from the standard illustrates a contract modification that is accounted for as part of the original contract.

Excerpt from Accounting Standards Codification

Revenue from Contracts with Customers — Overall

Implementation Guidance and Illustrations

Example 8 — Modification Resulting in a Cumulative Catch-Up Adjustment to Revenue

606-10-55-129

An entity, a construction company, enters into a contract to construct a commercial building for a customer on customer-owned land for promised consideration of $1 million and a bonus of $200,000 if the building is completed within 24 months. The entity accounts for the promised bundle of goods and services as a single performance obligation satisfied over time in accordance with paragraph 606-10-25-27(b) because the customer controls the building during construction. At the inception of the contract, the entity expects the following:

Transaction price	$ 1,000,000
Expected costs	$ 700,000
Expected profit (30%)	$ 300,000

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At contract inception, the entity excludes the $200,000 bonus from the transaction price because it cannot conclude that it is probable that a significant reversal in the amount of cumulative revenue recognized will not occur. Completion of the building is highly susceptible to factors outside the entity's influence, including weather and regulatory approvals. In addition, the entity has limited experience with similar types of contracts.

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The entity determines that the input measure, on the basis of costs incurred, provides an appropriate measure of progress toward complete satisfaction of the performance obligation. By the end of the first year, the entity has satisfied 60 percent of its performance obligation on the basis of costs incurred to date ($420,000) relative to total expected costs ($700,000). The entity reassesses the variable consideration and concludes that the amount is still constrained in accordance with paragraphs 606-10-32-11 through 32-13. Consequently, the cumulative revenue and costs recognized for the first year are as follows:

Revenue	$ 600,000
Costs	$ 420,000
Gross profit	$ 180,000

606-10-55-132

In the first quarter of the second year, the parties to the contract agree to modify the contract by changing the floor plan of the building. As a result, the fixed consideration and expected costs increase by $150,000 and $120,000, respectively. Total potential consideration after the modification is $1,350,000 ($1,150,000 fixed consideration + $200,000 completion bonus). In addition, the allowable time for achieving the $200,000 bonus is extended by 6 months to 30 months from the original contract inception date. At the date of the modification, on the basis of its experience and the remaining work to be performed, which is primarily inside the building and not subject to weather conditions, the entity concludes that it is probable that including the bonus in the transaction price will not result in a significant reversal in the amount of cumulative revenue recognized in accordance with paragraph 606-10-32-11 and includes the $200,000 in the transaction price. In assessing the contract modification, the entity evaluates paragraph 606-10-25-19(b) and concludes (on the basis of the factors in paragraph 606-10-25-21) that the remaining goods and services to be provided using the modified contract are not distinct from the goods and services transferred on or before the date of contract modification; that is, the contract remains a single performance obligation.

606-10-55-133

Consequently, the entity accounts for the contract modification as if it were part of the original contract (in accordance with paragraph 606-10-25-13(b)). The entity updates its measure of progress and estimates that it has satisfied 51.2 percent of its performance obligation ($420,000 actual costs incurred ÷ $820,000 total expected costs). The entity recognizes additional revenue of $91,200 [(51.2 percent complete × $1,350,000 modified transaction price) – $600,000 revenue recognized to date] at the date of the modification as a cumulative catch-up adjustment.

How we see it

E&C entities will need to carefully evaluate performance obligations at the date of a modification to determine whether the remaining goods or services to be transferred are distinct and priced commensurate with their standalone selling prices. This assessment is important because the accounting can vary significantly depending on the conclusions reached. See further discussion of identifying performance obligations in Chapter 3.

3 Identify the performance obligations in the contract

After identifying the contract, an entity will evaluate the contract terms and its customary business practices to identify all promised goods and services within the contract and determine which of those promised goods and services (or bundled goods and services) should be accounted for as separate performance obligations (i.e., the unit of account for purposes of applying the standard). The revenue standard identifies several activities common to E&C entities that are considered promised goods and services, including the construction, manufacture or development of an asset on behalf of a customer and the performance of a contractually agreed-upon task for a customer (e.g., design and engineering services).

The criteria in the new revenue standard for identifying performance obligations differ from the contract segmentation guidance in ASC 605-35, which could result in different conclusions about the units of account. For example, today a contractor may consider an entire contract to be a profit center (i.e., a single unit of account), but under the new standard, it may determine that the contract contains two or more performance obligations that would be accounted for separately. These judgments may be more complex when, for example, a construction contract also includes design, engineering or procurement services.

Promised goods and services represent separate performance obligations if (1) the goods or services are distinct (by themselves or as part of a bundle of goods and services) or (2) 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.

3.1 Determination of distinct

Entities that provide engineering or project management services will need to determine if the activities comprise a series of distinct services.

The new standard outlines a two-step process for determining whether a promised good or service (or a bundle of goods and services) is distinct: (1) consideration at the level of the individual good or service (i.e., the goods or services are capable of being distinct) and (2) consideration of whether 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). Both of these criteria must be met to conclude that the good or service is distinct, and when met, the individual units of accounting must be separated.

In many cases, goods or services are capable of being distinct but may not be distinct in the context of the contract. The standard provides factors to help entities determine whether goods or services in a bundle of promised goods and services should be combined as one performance obligation (i.e., are not distinct in the context of the contract). These factors, if present, would indicate that a bundle of goods and services should be combined:

- The entity provides a significant service of integrating the good or service with other goods or services promised in the contract into a bundle that represents the combined output for which the customer has contracted.
- The good or service significantly modifies or customizes another good or service promised in the contract.
- The good or service is highly dependent on, or highly interrelated with, other goods or services promised in the contract.

The Boards concluded that a good or service is not separable from other promises in the contract when an entity provides an integration service to incorporate individual goods and/or services into a combined output. The Boards observed that this may be relevant in many construction contracts if a contractor provides an integration service to manage and coordinate the various construction tasks and to assume the risks associated with the integration of those tasks.

If an entity determines that a promised good or service is not distinct, the entity has to combine that good or service with other promised goods or services until a distinct bundle of goods or services is formed. This distinct bundle is accounted for as a single performance obligation.

How we see it

Properly identifying performance obligations within a contract is a critical component of the revenue model because revenue allocated to each performance obligation is recognized as the obligation is satisfied.

E&C entities, particularly those with long-term construction contracts, should carefully assess whether applying the new requirements results in the identification of performance obligations that are different from the unit(s) of account (i.e., profit center) identified under ASC 605-35. These differences may result in a change in the pattern of revenue recognition and associated profit.

E&C entities likely will find that evaluating whether a good or service is distinct within the context of the contract will be a significant aspect of implementing the new standard. Entities should follow ongoing implementation efforts of the AICPA's task force and the TRG for further insights that may be provided on this topic.

3.2 Series of distinct goods and services that are substantially the same and that have the same pattern of transfer

As mentioned above, goods and services that 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 will be accounted for as a single performance obligation if both of the following criteria are met:

- Each distinct good or service in the series that the entity promises to transfer represents a performance obligation that would be satisfied over time (see Section 6.1) if it were accounted for separately.
- The entity would measure its progress toward satisfaction of the performance obligation using the same measure of progress for each distinct good or service in the series (see Section 6.1.4).

For contracts with variable consideration (e.g., performance bonuses or fees earned based on hours incurred), identifying a series of distinct services as a single performance obligation could have a significant effect because, if certain criteria are met, variable consideration will be allocated to one or more, but not all, distinct services in a performance obligation. See Chapter 5 for further discussion on allocating variable consideration.

The Boards provided examples of services that may represent a series of goods or services that would be accounted for as a single performance obligation such as a cleaning contract, asset management services, transaction processing services and a contract to deliver electricity. It is unclear how this guidance will be applied to a series of goods or to services that are not repetitive.

For example, when an entity enters into a two-year contract to provide engineering services, it will need to determine whether the services it provides are substantially the same over the term of the contract (i.e., while the specific activities that occur each day may vary slightly, the overall service of providing engineering services is substantially the same), have the same pattern of transfer and meet the two criteria above. If all of these criteria are met, the

contract represents one performance obligation. In contrast, if the entity determines that it provides distinct services in the contract (e.g., planning, design, construction support) that are not all substantially the same, it may identify multiple performance obligations. If an entity determines that these activities represent separate performance obligations, and the contract does not specify separate revenues that reflect the standalone selling prices of these services, the fee must be allocated to each performance obligation (see Chapter 5 for further discussion of allocating the transaction price).

How we see it

Because the standard does not explain what is meant by the term "same pattern of transfer," judgment will be required to evaluate whether project management, construction supervision or engineering services provided by E&C entities meet this criterion. E&C entities should follow implementation efforts that may clarify the types of services that have the same pattern of transfer.

3.3 Principal versus agent considerations

Some E&C contracts (e.g., project management, procurement arrangements) contain provisions under which an entity's customer receives goods or services from another entity that is not a direct party to the contract. The standard states that when other parties are involved in providing goods or services to an entity's customer, the entity must determine whether its performance obligation is to provide the good or service itself (i.e., the entity is a principal) or to arrange for another party to provide the good or service (i.e., the entity is an agent). The determination of whether the entity is acting as a principal or an agent will affect the amount of revenue the entity recognizes. That is, when the entity is the principal in the arrangement, 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 the entity is entitled to retain in return for its services as the agent. The entity's fee or commission may be the net amount of consideration that the entity retains after paying the other party the consideration received in exchange for the goods or services to be provided by that party.

A principal's performance obligations in an arrangement differ from an agent's performance obligations. For example, if an E&C entity obtains control of building materials from another party before it transfers (i.e., installs) those materials to the customer, the entity's performance obligation may be to provide the goods or services itself as part of a larger performance obligation (e.g., to construct a building). Hence, the entity may be acting as a principal and should recognize revenue in the gross amount to which it is entitled. In contrast, an entity that obtains control of materials only momentarily before control is transferred to the customer is not necessarily acting as a principal. For example, if an E&C entity is acting as a project manager and facilitates materials procurement or identifies trade contractors for the customer in exchange for a fee or commission and does not control the goods or services for any length of time, the performance obligation is likely to arrange for another party to provide the goods or services to the customer and the entity is likely acting as an agent.

Because it isn't always clear which party is the principal in a contract, the Boards provided the following indicators of when a performance obligation involves an agency relationship:

- Another party is primarily responsible for fulfilling the contract.
- The entity does not have inventory risk before or after the goods have been ordered by a customer, during shipping, or on return.

- The entity does not have discretion in establishing prices for the other party's goods or services, and therefore the benefit that the entity can receive from those goods or services is limited.
- The entity's consideration is in the form of a commission.
- The entity is not exposed to credit risk for the amount receivable from a customer in exchange for the other party's goods or services.

The Boards noted[4] that these indicators are based on indicators that are in today's revenue recognition guidance in US GAAP and IFRS. However, the indicators in ASC 606 have a different purpose than today's revenue recognition guidance in that they are based on the concepts of identifying performance obligations and the transfer of control of goods or services.

How we see it

E&C entities will need to carefully evaluate whether a gross or net presentation is appropriate. Although the new standard includes guidance that is similar to existing guidance, there are some notable differences that may affect an entity's principal-agent judgments and conclusions. For example, the standard requires an entity to consider whether it has control of the goods and services as part of the evaluation. 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 will determine which indicators are most important based on the facts and circumstances.

4 Determine the transaction price

The transaction price is the amount of consideration to which an entity expects to be entitled in exchange for transferring promised goods or services to a customer, excluding amounts collected on behalf of third parties. This amount is meant to reflect the amount that the entity has rights to under the present contract, which may differ from the contractual price (e.g., if the entity intends to offer a price concession).

The consideration promised in a contract may include fixed or variable amounts. When determining the transaction price, entities must estimate, at contract inception, the variable consideration they expected to receive, which is similar to the accounting in ASC 605-35 that E&C entities follow today (e.g., including award fees, incentives and penalties in estimates of total revenue). However, the new standard requires that entities constrain variable consideration to amounts for which it is probable that a significant reversal of revenue will not occur. The transaction price will also include the effects of any noncash consideration (e.g., customer-furnished materials for which control is transferred to the entity) and the effect of a significant financing component (i.e., the time value of money).

4.1 Variable consideration

The transaction price may vary in amount and timing as a result of discounts, credits, price concessions, incentives or bonuses. In addition, consideration may be contingent on the occurrence or nonoccurrence of a future event (e.g., a performance bonus).

An entity is required to estimate each type of variable consideration using either the "expected value" approach (i.e., the sum of probability-weighted amounts) or the "most likely amount" approach (i.e., the single most likely outcome), whichever better predicts the amount of consideration to which it expects to be entitled. That is, the method selected is not meant to be a "free choice." An entity should apply the selected method consistently throughout the contract and for similar types of contracts. The entity must update the estimated transaction price at each reporting date.

The Boards indicated that the most likely amount approach may be the better predictor when the entity expects to be entitled to one of only two possible amounts (e.g., a contract in which an entity is entitled to receive all or none of a specified performance bonus, but not a portion of that bonus). The following illustrates how an E&C entity may estimate variable consideration:

Illustration 4-1: Estimating variable consideration

On 1 January 2017, Contractor M enters into a contract with Company B to construct a new corporate headquarters on land owned by Company B. Contractor M determines that control of the building is passed to Company B as it is constructed, thus the performance obligation is satisfied over time (see Chapter 6).

The contract price is $25 million, but that amount will be reduced or increased depending on when construction of the building is completed. For each day before 30 June 2018 that the building is completed, the promised consideration will increase by $25,000. For each day after 30 June 2018 that the building is incomplete, the promised consideration will be reduced by $25,000.

The parties have also agreed that, when the building is completed, it will be inspected and assigned a green building certification level. If the building achieves the certification level specified in the contract, Contractor M will be entitled to an incentive bonus of $200,000.

Analysis: Contractor M has to determine whether the "expected value" or "most likely amount" approach better predicts the variable consideration it will receive. Contractor M determines that the "expected value" approach is the better predictor of the variable consideration associated with the daily incentive or penalty (i.e., $25 million, plus or minus $25,000 per day) since multiple outcomes are possible. Assume for purposes of this illustration that the constraint, discussed further below, does not limit the amount that can be included in the transaction price.

Based on the current construction schedule and its experience with past projects, Contractor M estimates that it is 50% likely to complete the project 10 days ahead of schedule and receive an incentive of $250,000, 25% likely to complete the project on time and receive no incentive, and 25% likely to complete the project five days past schedule and incur a $125,000 penalty. Using a probability-weighted estimate, Contractor M would include $93,750 [($250,000 x 50%) + ($0 x 25%) - ($125,000 x 25%)] in the transaction price associated with this contingent consideration.

Contractor M determines that the "most likely amount" approach is the better predictor to estimate the variable consideration associated with the green building certification bonus because there are only two possible outcomes ($200,000 or $0). Based on its history of completing building projects that achieve the green building certification level specified in the contract, and the absence of factors that may indicate the criteria will not be met, Contractor M determines that the $200,000 bonus should be included in the transaction price. Therefore, Contractor M estimates the total transaction price, after consideration of the base fee, daily incentive or penalty, and green building certification bonus to be $25,293,750 ($25,000,000 + $93,750 + $200,000) at contract inception.

Contractor M updates its estimate of the transaction price at each subsequent reporting date. For example, at 31 March 2018, after evaluating construction completed to date and the remaining project schedule, Contractor M determines it is now 75% likely to complete the project 10 days ahead of schedule and receive an incentive of $250,000 and 25% likely to complete the project on time and receive no incentive bonus. As a result, Contractor M updates its estimate of variable consideration from the daily incentive or penalty to $187,500 [($250,000 x 75%) + ($0 x 25%)] and adds $93,750 ($187,500 - $93,750) to the transaction price.

4.1.1 Constraining estimates of variable consideration

To include variable consideration in the estimated transaction price, the entity has to first conclude that it is "probable" that a significant revenue reversal will not occur when the uncertainties related to the variability are resolved. For purposes of this analysis, "probable" is defined as "the future event or events are likely to occur," consistent with the existing definition in US GAAP. The Boards provided factors that may indicate that revenue is subject to a significant reversal:

- The amount of consideration is highly susceptible to factors outside the entity's influence (e.g., market volatility, judgment or actions of third parties, weather conditions).
- The uncertainty about the amount of consideration is not expected to be resolved for a long period of time.
- The entity's experience (or other evidence) with similar types of contracts is limited or that experience (or other evidence) has limited predictive value.

- The entity 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.
- The contract has a large number and broad range of possible consideration amounts.

The indicators are not meant to be all-inclusive, and entities may note additional factors that are relevant in their evaluations. In addition, the presence of any one of these indicators does not necessarily mean that it is probable that a change in the estimate of variable consideration will result in a significant revenue reversal.

For example, when determining whether variable consideration is constrained, E&C entities will need to consider a variety of factors, including the extent of their experiences with similar arrangements, uncertainties that may exist in the latter periods of a long-term contract, and market and other factors that may be outside of their control (e.g., weather). E&C entities may find this evaluation to be especially difficult when determining whether variable consideration from contract claims should be included in the transaction price because one or more of the above indicators may be present. E&C entities will need to determine how the existence of such indicators affects their assessment of the constraint, which may be different for each individual claim since the risks associated with each claim could vary. All entities will want to make sure they sufficiently and contemporaneously document the reasons for their conclusions, including conclusions about both corroborating and contrary evidence.

When an entity is unable to conclude that it is probable that a change in the estimate of variable consideration that *would* result in a significant revenue reversal will not occur, the amount of variable consideration is limited. In addition, when a contract includes variable consideration, an entity should update both its estimate of the transaction price and its evaluation of the constraint throughout the term of the contract to depict conditions that exist at each reporting date.

How we see it

While E&C entities that apply ASC 605-35 may already estimate variable consideration (e.g., award and incentive fees) they expect to earn, E&C entities may need to change their processes for making those estimates and possibly their conclusions about the amount and timing of variable consideration to include in the transaction price due to the constraint.

Further, while the Boards noted[5] that entities should evaluate the magnitude of a potential reversal relative to the total consideration (i.e., fixed and variable), they did not include any quantitative guidance for evaluating "significance." This will require entities to use judgment when making this assessment.

4.2 Customer-furnished materials

In many E&C arrangements, the customer may choose to procure and provide to the contractor certain materials that are necessary for the entity to complete a project. In other circumstances, the contractor may purchase and pay for the required materials using the customer's procurement and purchase functions.

The new standard states that a customer's contribution of goods or services (e.g., materials, equipment, labor) that are used in the fulfillment of a contract is a form of noncash consideration if the contractor obtains control of the goods or services. The contractor has to evaluate whether it obtains control of the goods or services using the transfer of control guidance (see Chapter 6) in the new standard and consider whether it is serving in the capacity of a principal or an agent (see Section 3.3).

When an entity receives, or expects to receive, noncash consideration, the fair value of the noncash consideration is included in the transaction price.[6] The entity applies the principles of ASC 820, *Fair Value Measurements*, in measuring the fair value of the noncash consideration. If an entity cannot reasonably estimate the fair value of noncash consideration, it should measure the noncash consideration indirectly by reference to the estimated standalone selling price of the promised goods or services.

4.3 Significant financing component

A significant financing component may exist when the receipt of consideration does not match the timing of the transfer of goods or services to the customer (i.e., the consideration is prepaid or is paid well after the goods or services are provided). Entities will be required to adjust the transaction price for this component if the financing is significant to the contract. Entities will need to evaluate all relevant facts and circumstances when making this evaluation, including the difference between the promised consideration and the cash selling price of the promised goods or services and the combination of the expected length of time between the transfer of the goods and services and receipt of consideration and the prevailing interest rates in the relevant market.

The requirement to consider whether a significant financing component is present in a contract represents a significant change for E&C entities.

To reduce the burden of this requirement, the Boards included a practical expedient in the standard that allows entities to ignore a significant financing component when the period between the customer's payment and the entity's transfer of the goods or services is expected to be one year or less at contract inception. For example, billings in excess of costs (i.e., overbillings) that will be resolved within one year generally would not constitute a significant financing component.

The standard also states that a contract would not contain a significant financing component if the difference between the promised consideration and the cash selling price of the good or the service is due to reasons other than the provision of financing to either the entity or the customer (e.g., retainage). In addition, a significant financing component is not present if (1) the customer pays for the goods or services in advance and the timing of the transfer of those goods or services is at the discretion of the customer or (2) a substantial amount of the consideration promised by the customer is variable, and the amount or timing depends on the occurrence or nonoccurrence of an event that is not substantially within the control of the customer or the entity.

When an entity concludes that a financing component is significant to a contract, it determines the transaction price by discounting the amount of promised consideration. The entity uses the same discount rate that it would use if it were to enter into a separate financing transaction with the customer. The discount rate has to reflect the credit characteristics of the borrower; using a rate explicitly stated in the contract that does not correspond with market terms in a separate financing arrangement would not be acceptable. Subject to certain limitations, the transaction price will need to be accreted when there is a prepayment (e.g., an advanced payment) that is determined to be a significant financing component.

The standard provides the following illustration to assist entities in determining whether a significant financing component is present in a long-term contract:

Excerpt from Accounting Standards Codification

Revenue from Contracts with Customers — Overall

Implementation Guidance and Illustrations

Example 27 — Withheld Payments on a Long-Term Contract

606-10-55-233

An entity enters into a contract for the construction of a building that includes scheduled milestone payments for the performance by the entity throughout the contract term of three years. The performance obligation will be satisfied over time, and the milestone payments are scheduled to coincide with the entity's expected performance. The contract provides that a specified percentage of each milestone payment is to be withheld (that is, retained) by the customer throughout the arrangement and paid to the entity only when the building is complete.

606-10-55-234

The entity concludes that the contract does not include a significant financing component. The milestone payments coincide with the entity's performance, and the contract requires amounts to be retained for reasons other than the provision of finance in accordance with paragraph 606-10-32-17(c). The withholding of a specified percentage of each milestone payment is intended to protect the customer from the contractor failing to adequately complete its obligations under the contract.

How we see it

A significant financing component may exist in a contract even when there is no explicit purpose of financing between the parties (i.e., a significant financing component may be implicit). Entities will need to carefully evaluate certain payment terms common in E&C contracts (e.g., retainage, milestones, progress payments, award/incentive fees) and the timing of billings to determine whether a significant financing component exists. This represents a significant change from current guidance that doesn't require consideration of the presence of a financing component.

Further, the standard does not include any quantitative guidance for evaluating whether a financing component is significant to the contract. This will require entities to use judgment when making this assessment, and they will need to sufficiently document their analyses to support their conclusions.

5 Allocate the transaction price to the performance obligations

Once the performance obligations are identified and the transaction price has been determined, the standard generally (with some exceptions as discussed below) requires an entity to allocate the transaction price to the performance obligations in proportion to their standalone selling prices (i.e., on a relative standalone selling price basis).

To allocate the transaction price on a relative standalone selling price basis, an entity must first determine the standalone selling price (i.e., the price at which an entity would sell a good or service on a standalone basis at contract inception) for each performance obligation. The observable price of a good or service sold separately provides the best evidence of standalone selling price. However, in many situations, standalone selling prices will not be readily observable. In those cases, the entity has to estimate the standalone selling price.

The standard discusses three estimation methods: (1) the adjusted market assessment approach, (2) the expected cost plus a margin approach and (3) the residual approach. However, these are not the only estimation methods permitted. The standard allows an entity to use any reasonable estimation method (or combination of approaches), as long as it is consistent with the notion of a standalone selling price, maximizes the use of observable inputs and is applied consistently in similar circumstances.

Under the relative standalone selling price method, once an entity determines the standalone selling price for the performance obligations in a contract, the entity allocates the transaction price to those performance obligations based on the proportion of the standalone selling price of each performance obligation to the sum of the standalone selling prices of all of the performance obligations in the contract. The following illustrates this allocation:

Illustration 5-1: Allocating revenue to performance obligations

Contractor Z enters into an arrangement to build a retail shopping center and detached parking garage for $60 million. Assume that Contractor Z determines that the building and parking garage each represent performance obligations.

Analysis: To allocate the transaction price to the two performance obligations, Contractor Z must first determine the standalone selling price of the shopping center and parking garage. Contractor Z builds similar structures on a regular basis and determines that the standalone selling prices of the shopping center and parking garage are $54 million and $10 million, respectively. Contractor Z allocates the $60 million transaction price on a relative basis as follows:

Shopping center: $50.63 million [($54 million / $64 million) x $60 million]

Parking garage: $9.37 million [($10 million / $64 million) x $60 million]

Contractor Z recognizes revenue allocated to each performance obligation based on the selected measure of progress for each (see Section 6.1.4).

5.1 Exceptions to the relative standalone selling price method

The standard requires an entity to use the relative standalone selling price method to allocate the transaction price except in two specific circumstances. The first requires an entity to allocate a discount in a contract only to the specific goods or services to which it relates rather than proportionately to all of the separate performance obligations if certain criteria are met.

The second exception requires variable consideration to be allocated entirely to a specific part of a contract, such as one or more (but not all) performance obligations or one or more (but not all) distinct goods or services promised in a series of distinct goods or services that forms part of a single performance obligation, if both of the following criteria are met:

- The terms of a variable payment relate specifically to the entity's efforts to satisfy the performance obligation or transfer the distinct good or service (or to a specific outcome from satisfying the performance obligation or transferring the distinct good or service).
- Allocating the variable amount of consideration entirely to the performance obligation or the distinct good or service is consistent with standard's overall objective of allocating revenue in an amount that depicts the amount of consideration to which the entity expects to be entitled in exchange for transferring the promised goods or services to the customer.

An E&C entity that determines that a contract contains multiple performance obligations may use this exception if it concludes that variable consideration relates only to one performance obligation (or more than one but not all performance obligations). For example, Illustration 2-1 describes a contract in which the contractor determined that the construction of manufacturing and storage facilities represented separate performance obligations. If the contract included an incentive fee for completing construction of the manufacturing facility ahead of schedule, the entity would allocate consideration from that incentive fee only to the performance obligation representing the construction of the manufacturing facility (provided the contractor determined the total consideration allocated to this performance obligation depicts the amount to which it is entitled).

Entities that provide project management or engineering services may allocate variable consideration to the period in which the related services were performed, if certain criteria are met.

In addition, E&C entities that provide project management, construction supervision or engineering services that are a series of distinct services that form part of a single performance obligation may use this exception and allocate variable consideration to distinct services if the above criteria are met. That is, variable consideration that relates specifically to an entity's efforts to transfer the services for a certain period within a contract (e.g., a month or a quarter) that are distinct from the services provided in other periods within the contract, should be allocated to those distinct periods instead of being spread over the entire performance obligation.

The following example illustrates the application of this exception by an engineering services company that determines that the services it is providing represent a single performance obligation:

Illustration 5-2: Engineering services with variable consideration

On 1 January 2018, Engineer X enters into a one-year contract with a municipality to provide engineering consultation services for a sewer project. Engineer X receives a fee of $100 for each hour incurred (i.e., variable consideration based on effort expended).

Analysis: Assume that Engineer X concludes that the management services are a single performance obligation recognized over time because they are determined to be a series of distinct services that are substantially the same and that have the same pattern of transfer to the customer.

Engineer X determines that the transaction price is allocated to the services provided within each period because the hours incurred during the period relate specifically to the entity's efforts to satisfy the performance obligation, and the allocation is consistent with the objective of allocating an amount that depicts the consideration to which the entity expects to be entitled in exchange for transferring the promised services.

For example, if Engineer X provided 800 hours of services during the first quarter of 2018, revenue of $80,000 (800 hours x $100 per hour) would be recognized at 31 March 2018.

How we see it

E&C entities will need to evaluate their contracts to determine whether this allocation exception will apply to contracts that are based on an hourly rate, including those contracts that an entity concludes contain only one performance obligation. Some entities will find that applying the exception, and therefore recognizing fees that relate specifically to the entity's efforts to transfer the service in a distinct period, is relatively straightforward. However, certain contracts may contain multiple forms of consideration that relate to a single performance obligation. For example, a contract could also include a fixed fee that would generally be recognized over the term of the contract using the entity's selected measure of progress (e.g., time elapsed, hours incurred), which may differ from the pattern in which the variable consideration is recognized.

5.2 Changes in transaction price after contract inception

Changes in the total transaction price are allocated to the separate performance obligations on the same basis as the initial allocation, whether they are allocated based on the relative standalone selling price (i.e., using the same proportionate share of the total) or to individual performance obligations as discussed above. Standalone selling prices are not updated after contract inception. However, if the changes in the transaction price are a result of a contract modification, the contract modification guidance discussed in Section 2.2 must be followed.

When contracts include variable consideration, it is possible that changes in the transaction price can arise after a modification, and such changes may or may not be related to performance obligations that existed before the modification. For changes in the transaction price arising after a contract modification, for which the contract modification was not treated as a separate contract, an entity must apply one of the following approaches:

- If the change in transaction price is attributable to an amount of variable consideration promised before the modification and the modification was considered a termination of the existing contract and the creation of a new contract, the entity allocates the change in transaction price to the performance obligations that existed before the modification.
- In all other cases, the change in the transaction price should be allocated to the performance obligations in the modified contract (i.e., the performance obligations that were unsatisfied and partially unsatisfied immediately after the modification).

6 Satisfaction of performance obligations

Under the new standard, an entity recognizes revenue when (or as) 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 the good or service refers to the ability to direct its use and to obtain substantially all of its remaining benefits (i.e., right to cash inflows or reduction of cash outflows generated by the good or service). Control also means the ability to prevent other entities from directing the use of, and receiving the benefit from, a good or service.

The change to a control transfer model in the new standard will require E&C entities to carefully assess when revenue can be recognized. The standard indicates that an entity has to determine at contract inception whether it will transfer control of a promised good or service over time, regardless of the length of the contract or other factors. Depending on the measure of progress the entity applies (see Section 6.1.4), the accounting for a contract that meets the criteria for recognition of revenue over time may be similar to method it currently applies under existing guidance in ASC 605-35 (e.g., percentage-of-completion).

If an entity does not satisfy a performance obligation over time, the performance obligation is satisfied at a point in time. The recognition of revenue for this type of performance obligation is similar to the completed-contract method in ASC 605-35, which an E&C entity may use today if it is unable to make reliable estimates or its financial position and result of operations would not be materially different from those under the percentage-of-completion method.

6.1 Performance obligations satisfied over time

An entity transfers control of a good or service over time (rather than at a point in time) when any of the following criteria are met:

- The customer simultaneously receives and consumes the benefits provided by the entity's performance as the entity performs.
- The entity's performance creates or enhances an asset (e.g., work in process) that the customer controls as the asset is created or enhanced.
- 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 performance completed to date.

If an entity is unable to demonstrate that control transfers over time, the presumption is that control transfers at a point in time (see Section 6.2).

6.1.1 Customer simultaneously receives and consumes benefits as the entity performs

In some instances, the assessment of whether a customer simultaneously receives and consumes the benefits of an entity's performance will be straightforward (e.g., maintenance services for which the simultaneous receipt and consumption by the customer is readily evident). However, in circumstances where simultaneous receipt and consumption is less evident, the standard clarifies that revenue recognition over time is still appropriate if "an entity determines that another entity would not need to substantially reperform the work that the entity completed to date if that other entity were to fulfill the remaining performance obligation to the customer." In making this determination, entities would not consider practical or contractual limitations that limit transfer of the remaining performance obligation.

As discussed in the Basis for Conclusions,[7] the Boards created this criterion to clarify that in "pure" service contracts, entities generally transfer services over time. In addition, they meant for this criterion to apply only to services, not to goods. As a result, the Boards note that an entity does not apply this guidance to determine whether a performance obligation is

satisfied over time if the entity's performance creates an asset the customer does not consume completely as the asset is received. Instead, an entity assesses that performance obligation using the criteria discussed in Sections 6.1.2 and 6.1.3.

E&C entities that provide project management, construction supervision or engineering services will need to carefully evaluate their contracts to determine whether the services performed are simultaneously received and consumed by the customer. It may be apparent that activities such as day-to-day site supervision services meet the criteria for recognition of revenue over time. These judgments also may be affected by an entity's conclusion about the number of performance obligations (i.e., single or multiple) within the contract (see Section 3.1).

6.1.2 Customer controls asset as it is created or enhanced

The second criterion to determine that control of a good or service is transferred over time is that the customer controls the asset as it is being created or enhanced. For purposes of this determination, the definition of "control" is the same as previously discussed (i.e., the ability to direct the use of and obtain substantially all of the remaining benefits from the asset).

The Boards said[8] that in the case of a construction contract in which an entity is building on the customer's land, the customer generally controls any work in progress resulting from the entity's performance. In addition, many construction contracts with the US federal government contain clauses indicating that the government owns any work-in-progress as the contracted item is being built. The Boards said they believe the customer's control over the asset as it is being created or enhanced indicates that the entity's performance transfers goods or services to a customer over time.

6.1.3 Asset with no alternative use and right to payment

The Boards acknowledged[9] that the application of the first two criteria could be challenging in certain circumstances. For example, a contractor may construct an asset but transfer title to the customer only upon completion, or an entity may provide services that result in a tangible deliverable (e.g., drawings, site plans, technical specifications) in the latter part of a contract. As a result, a third criterion was added that, if both of the following requirements are met, will require entities to recognize revenue for a performance obligation over time:

- The entity's performance does not create an asset with alternative use to the entity.
- The entity has an enforceable right to payment for performance completed to date.

Alternative use

An asset created by an entity has no alternative use if the entity is either restricted contractually or practically from readily directing the asset for another use (e.g., selling to a different customer). An entity has to make this assessment at contract inception and does not update its assessment unless the parties to the contract approve a contract modification that substantively changes the performance obligation.

The Boards specified that a contractual restriction on an entity's ability to direct an asset for another use must be substantive (i.e., a buyer could enforce its rights to the promised asset if the entity sought to sell the unit to a different buyer). In contrast, a contractual restriction may not be substantive if the entity could instead sell a different asset to the buyer without breaching the contract or incurring significant costs.

Further, the Boards believe a practical limitation exists if an entity would incur significant economic losses to direct the asset for another use. A significant economic loss may arise when significant costs are incurred to redesign or modify an asset, or when the asset is sold at a significantly reduced price.

A contractor may be able to determine that an asset has no alternative use because its characteristics (e.g., location, design, technical specifications, materials) would generally result in a contractual and/or practical limitation to redirect its use to another buyer. In addition, an E&C entity that provides architectural or design services may conclude that drawings and plans prepared for a specific project have no alternative use.

Enforceable right to payment for performance completed to date

An entity has an enforceable right to payment for performance completed to date if, at any time during the contract term, the entity would be entitled to an amount that at least compensates it for work already performed. This right to payment must be present, even if the buyer can terminate the contract for reasons other than the entity's failure to perform as promised.

To satisfy this criterion, the amount to which an entity is entitled must approximate the selling price of the goods or services transferred to date, including a reasonable profit margin. Compensation for a reasonable profit margin doesn't have to equal the profit margin expected for complete fulfillment of the contract but must at least reflect either of the following:

- A proportion of the expected profit margin in the contract that reasonably reflects the extent of the entity's performance under the contract before termination by the customer (or another party)
- A reasonable return on the entity's cost of capital for similar contracts (or the entity's typical operating margin for similar contracts) if the contract-specific margin is higher than the return the entity usually generates from similar contracts

The laws or legal precedent of a jurisdiction may affect an entity's conclusion of whether a present right to payment is enforceable.

Entities are required to consider any laws, legislation or legal precedent that could supplement or override contractual terms. In addition, the standard clarifies that including a payment schedule in a contract does not, by itself, indicate that the entity has the right to payment for performance completed to date. For example, progress billings collected from a customer may not reflect a reasonable profit margin on work completed to date. The entity has to examine information that may contradict the payment schedule and may represent the entity's actual right to payment for performance completed to date (e.g., an entity's legal right to continue to perform and enforce payment by the buyer if a contract is terminated without cause).

E&C entities that provide design or engineering services may consider the following example from the standard when assessing these criteria:

Excerpt from Accounting Standards Codification

Revenue from Contracts with Customers — Overall

Implementation Guidance and Illustrations

Example 14 — Assessing Alternative Use and Right to Payment

606-10-55-161

An entity enters into a contract with a customer to provide a consulting service that results in the entity providing a professional opinion to the customer. The professional opinion relates to facts and circumstances that are specific to the customer. If the customer were to terminate the consulting contract for reasons other than the entity's failure to perform as promised, the contract requires the customer to compensate the entity for its costs incurred plus a 15 percent margin. The 15 percent margin approximates the profit margin that the entity earns from similar contracts.

606-10-55-162

The entity considers the criterion in paragraph 606-10-25-27(a) and the guidance in paragraphs 606-10-55-5 through 55-6 to determine whether the customer simultaneously receives and consumes the benefits of the entity's performance. If the entity were to be unable to satisfy its obligation and the customer hired another consulting firm to provide the opinion, the other consulting firm would need to substantially reperform the work that the entity had completed to date because the other consulting firm would not have the benefit of any work in progress performed by the entity. The nature of the professional opinion is such that the customer will receive the benefits of the entity's performance only when the customer receives the professional opinion. Consequently, the entity concludes that the criterion in paragraph 606-10-25-27(a) is not met.

606-10-55-163

However, the entity's performance obligation meets the criterion in paragraph 606-10-25-27(c) and is a performance obligation satisfied over time because of both of the following factors:

a. In accordance with paragraphs 606-10-25-28 and 606-10-55-8 through 55-10, the development of the professional opinion does not create an asset with alternative use to the entity because the professional opinion relates to facts and circumstances that are specific to the customer. Therefore, there is a practical limitation on the entity's ability to readily direct the asset to another customer.

b. In accordance with paragraphs 606-10-25-29 and 606-10-55-11 through 55-15, the entity has an enforceable right to payment for its performance completed to date for its costs plus a reasonable margin, which approximates the profit margin in other contracts.

606-10-55-164

Consequently, the entity recognizes revenue over time by measuring the progress toward complete satisfaction of the performance obligation in accordance with paragraphs 606-10-25-31 through 25-37 and 606-10-55-16 through 55-21.

How we see it

For many construction-type contracts, it is likely that E&C entities will determine that control of many goods or services is transferred over time. However, E&C entities should understand all contract terms related to control and legal ownership of work in process, as well as whether the asset has no alternative use and the entity has a right to payment for performance completed to date, when determining whether their construction-type contracts meet the criteria to recognize revenue over time.

6.1.4 Measuring progress

When a performance obligation is satisfied over time, the standard provides two methods for measuring progress under the contract: an input method or an output method. The standard requires an entity to select a single measurement method for the relevant performance obligations that best depicts the entity's performance in transferring goods or services, and it does not allow a change in methods. That is, a performance obligation is accounted for under the method the entity selects (i.e., either the input or output method) until it has been fully satisfied.

Input methods recognize revenue "on the basis of the entity's efforts or inputs to satisfy the performance obligation … relative to the total expected inputs to the satisfaction of that performance obligation." The standard includes resources consumed, labor hours expended, costs incurred and time elapsed as possible input methods. The standard also notes it may be appropriate to recognize evenly expended inputs on a straight-line basis.

Output methods recognize revenue "on the basis of direct measurements of the value to the customer of the goods or services transferred to date relative to the remaining goods or services promised under the contract." Measurements of output may include surveys of performance completed to date, appraisals of results achieved, milestones reached and time elapsed.

When an entity applies an output method, the standard includes 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 service contract in which an entity bills a fixed amount for each hour of service provided). This practical expedient allows an entity to recognize revenue in the amount for which it has the right to invoice.

The standard does not say which method (input or output) is preferable, but it says that entities should use careful judgment in evaluating the advantages and disadvantages of each method and consider both the nature of the promised goods and services and the entity's performance. The Boards also said[10] the selected method should be applied to similar arrangements in similar circumstances.

How we see it

ASC 605-35 provides two alternatives (i.e., Alternative A and Alternative B) for E&C entities to compute income using the percentage-of-completion method. This guidance will be replaced with acceptable measures of progress in the new standard that focus solely on the recognition of revenue (i.e., measures based on gross margin are not considered).

While input methods (e.g., cost incurred, which is similar to Alternative A in ASC 605-35) may continue to be appropriate measures of progress, all E&C entities will need to carefully evaluate the principles of the new standard to determine how the pattern of revenue recognition from construction arrangements will be affected. If an entity does not have a reasonable basis to measure its progress, the Boards decided that too much uncertainty would exist, and therefore revenue should not be recognized until progress can be measured. This guidance will represent a change for entities that today apply the completed contract method when their contracts don't meet the conditions for using the percentage-of-completion method at contract inception (i.e., reasonably dependable estimates cannot be made at contract inception) because the new standard requires revenue recognition over time once reasonable estimates of progress can be made. Under ASC 605-35, entities cannot change from the completed-contract method to the percentage-of-completion method.

However, if an entity cannot reasonably measure its progress, but expects to recover costs incurred toward satisfaction of the performance obligation (i.e., a loss will not be incurred), the new standard requires revenue to be recognized to the extent that costs are incurred until the entity is able to reasonably measure its progress. This guidance is consistent with today's guidance in ASC 605-35 that allows for zero-margin revenue recognition when a final outcome cannot be estimated, but an entity is assured that no loss will be incurred.

Units-of-delivery

E&C entities should consider that the Boards noted a units-of-delivery or units-of-production method may not be appropriate if the contract provides both design and production services because each item produced may not transfer an equal amount of value to the customer. That is, the items produced earlier likely have a higher value than the ones produced later. However, the Boards indicated that units of delivery may be an appropriate method for certain long-term manufacturing contracts of standard items that individually transfer an equal amount of value to the customer.

In addition, the standard states that output methods based on units produced or units delivered would not faithfully depict an entity's performance in satisfying a performance obligation if, at the end of the reporting period, the entity's performance has produced work in process or finished goods controlled by the customer that are not included in the measurement of output.

Uninstalled materials

The new guidance for considering uninstalled materials when calculating the entity's performance to date differs from today's guidance in ASC 605-35. Today, no revenue is recognized when costs are incurred for uninstalled materials that are not unique to the project. In contrast, as noted in the following paragraph, the new standard provides for recognition of revenue equal to the costs incurred (i.e., zero margin) when certain criteria related to uninstalled materials are met:

Excerpt from Accounting Standards Codification

Revenue from Contracts with Customers — Overall

Implementation Guidance and Illustrations

Input Methods

606-10-55-21

A shortcoming of input methods is that there may not be a direct relationship between an entity's inputs and the transfer of control of goods or services to a **customer**. Therefore, an entity should exclude from an input method the effects of any inputs that, in accordance with the objective of measuring progress in paragraph 606-10-25-31, do not depict the entity's performance in transferring control of goods or services to the customer. For instance, when using a cost-based input method, an adjustment to the measure of progress may be required in the following circumstances:

a. When a cost incurred does not contribute to an entity's progress in satisfying the performance obligation. For example, an entity would not recognize revenue on the basis of costs incurred that are attributable to significant inefficiencies in the entity's performance that were not reflected in the price of the contract (for example, the costs of unexpected amounts of wasted materials, labor, or other resources that were incurred to satisfy the performance obligation).

b. When a cost incurred is not proportionate to the entity's progress in satisfying the performance obligation. In those circumstances, the best depiction of the entity's performance may be to adjust the input method to recognize revenue only to the extent of that cost incurred. For example, a faithful depiction of an entity's performance might be to recognize revenue at an amount equal to the cost of a good used to satisfy a performance obligation if the entity expects at contract inception that all of the following conditions would be met:

1. The good is not distinct.
2. The customer is expected to obtain control of the good significantly before receiving services related to the good.
3. The cost of the transferred good is significant relative to the total expected costs to completely satisfy the performance obligation.
4. The entity procures the good from a third party and is not significantly involved in designing and manufacturing the good (but the entity is acting as a principal in accordance with paragraphs 606-10-55-36 through 55-40).

E&C entities using a cost-to-cost input method may find that certain costs incurred do not contribute to the entity's progress in satisfying the performance obligation. In such situations, entities should exclude the costs that may be related to wasted materials or other significant inefficiencies. In contrast, when uninstalled materials meet all of the four criteria above, an entity will recognize revenue in an amount equal to the cost of the goods (i.e., at zero margin) and adjust its measure of progress to exclude the costs from the costs incurred and from the transaction price (i.e., from both the numerator and the denominator of its percentage complete calculation). The standard provides the following illustration for considering uninstalled materials in a cost-to-cost calculation:

Excerpt from Accounting Standards Codification

Revenue from Contracts with Customers — Overall

Implementation Guidance and Illustrations

Example 19 — Uninstalled Materials

606-10-55-187

In November 20X2, an entity contracts with a customer to refurbish a 3-story building and install new elevators for total consideration of $5 million. The promised refurbishment service, including the installation of elevators, is a single performance obligation satisfied over time. Total expected costs are $4 million, including $1.5 million for the elevators. The entity determines that it acts as a principal in accordance with paragraphs 606-10-55-36 through 55-40 because it obtains control of the elevators before they are transferred to the customer.

606-10-55-188

A summary of the transaction price and expected costs is as follows:

Transaction price	$ 5,000,000
Expected costs:	
Elevators	1,500,000
Other costs	2,500,000
Total expected costs	$ 4,000,000

606-10-55-189

The entity uses an input method based on costs incurred to measure its progress toward complete satisfaction of the performance obligation. The entity assesses whether the costs incurred to procure the elevators are proportionate to the entity's progress in satisfying the performance obligation in accordance with paragraph 606-10-55-21. The customer obtains control of the elevators when they are delivered to the site in December 20X2, although the elevators will not be installed until June 20X3. The costs to procure the elevators ($1.5 million) are significant relative to the total expected costs to completely satisfy the performance obligation ($4 million). The entity is not involved in designing or manufacturing the elevators.

606-10-55-190

The entity concludes that including the costs to procure the elevators in the measure of progress would overstate the extent of the entity's performance. Consequently, in accordance with paragraph 606-10-55-21, the entity adjusts its measure of progress to exclude the costs to procure the elevators from the measure of costs incurred and from the transaction price. The entity recognizes revenue for the transfer of the elevators in an amount equal to the costs to procure the elevators (that is, at a zero margin).

606-10-55-191

As of December 31, 20X2, the entity observes that:

a. Other costs incurred (excluding elevators) are $500,000.

b. Performance is 20% complete (that is, $500,000 ÷ $2,500,000).

606-10-55-192

Consequently, at December 31, 20X2, the entity recognizes the following:

Revenue	$ 2,200,000	(a)
Costs of goods sold	2,000,000	(b)
Profit	$ 200,000	

(a) Revenue recognized is calculated as (20% × $3,500,000) + $1,500,000. ($3,500,000 is $5,000,000 transaction price – $1,500,000 costs of elevators.)

(b) Cost of goods sold is $500,000 of costs incurred + $1,500,000 costs of elevators.

6.2 Control transferred at a point in time

For performance obligations for which control is not transferred over time, control is transferred at a point in time. In many situations, the determination of *when* that point in time occurs is relatively straightforward. However, in other circumstances, this determination is more complex.

The Boards provided the following indicators for entities to consider in determining when control of a promised asset has been transferred:

- The entity has a present right to payment for the asset.
- The customer has legal title to the asset.
- The entity has transferred physical possession of the asset.
- The customer has the significant risks and rewards of ownership of the asset.
- The customer has accepted the asset.

None of these indicators individually are meant to be determinative. The Boards also clarified that the indicators are not meant to be a checklist, and not all of them must be present for an entity to determine that the customer has gained control. An entity has to consider all relevant facts and circumstances to determine whether control has transferred.

7 Other measurement and recognition topics

The new revenue standard also includes guidance for contract costs and warranties that may result in changes for certain E&C entities. In contrast, the Boards decided not to amend existing guidance related to loss contracts.

7.1 Contract costs

Along with the guidance in ASC 606, ASC 340-40, *Other Assets and Deferred Costs — Contracts with Customers*, was added to codify the guidance on other assets and deferred costs relating to contracts with customers. This guidance specifies the accounting for costs an entity incurs in obtaining and fulfilling a contract to provide goods and services to customers for both contracts obtained and contracts under negotiation. This guidance replaces the guidance for contract costs in ASC 605-35.

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

The standard cites sales commissions that are directly related to sales achieved as an example of an incremental cost that may require capitalization. In contrast, some bonuses and other compensation that is based on other quantitative or qualitative metrics (e.g., profitability, EPS, performance evaluations) likely do not meet the criteria for capitalization because they are not directly related to obtaining a contract.

ASC 340-40 also includes guidance for recognizing costs incurred in fulfilling a contract (i.e., costs that relate directly to a contract such as materials and labor) that are not in the scope of another ASC topic. Costs to fulfill a contract that are accounted for under ASC 340-40 are divided into two categories: (1) those that give rise to an asset and (2) those that are expensed as incurred. Entities will recognize an asset when costs incurred to fulfill a contract meet all of the following criteria:

- The costs relate directly to a contract or to an anticipated contract that the entity can specifically identify (e.g., costs of designing an asset to be transferred under a specific contract that has not yet been approved).
- The costs generate or enhance resources of the entity that will be used in satisfying performance obligations in the future.
- The costs are expected to be recovered.

When determining whether costs may be eligible for capitalization, an entity must consider its specific facts and circumstances. The standard discusses and provides examples of costs that may be eligible for capitalization (i.e., costs that relate directly to the contract). Those costs include:

- Direct labor (e.g., salaries and wages of employees who provide the promised services directly to the customer)
- Direct materials (e.g., supplies used in providing the promised services to a customer)

- Allocations of costs that relate directly to the contract or to contract activities (e.g., costs of contract management and supervision, insurance, depreciation of tools and equipment used in fulfilling the contract)
- Costs that are explicitly chargeable to the customer under the contract
- Other costs that are incurred only because an entity entered into the contract (e.g., payments to subcontractors)

For costs to meet the "expected to be recovered" criterion, the costs need to be either explicitly reimbursable under the contract or reflected through the pricing on the contract and recoverable through margin.

How we see it

The Boards noted[11] that only costs that meet the definition of an asset (i.e., meet the criteria described above) are eligible for capitalization. Entities are precluded from deferring costs merely to normalize profit margins throughout a contract by allocating revenue and costs evenly over the life of the contract. As discussed in Section 6.1.4, this may limit an E&C entity's ability to recognize revenue using a measure of progress that is similar to Alternative B in ASC 605-35.

7.2 Loss contracts

The guidance for evaluating loss contracts in ASC 605-35 has been retained with certain amendments.

The FASB elected to retain existing guidance in ASC 605-35, with certain amendments, for situations in which an entity expects to incur a loss, either on a single performance obligation (called an onerous performance obligation) or on an entire contract (called an onerous contract).

Therefore, E&C entities will follow the amended expected loss guidance in ASC 605-35 after the new revenue standard takes effect (assuming they continue to meet the revised scope criteria for ASC 605-35, as amended by ASC 606). The amended guidance also requires that entities separately evaluate each identified performance obligation when determining whether a loss should be recognized.

7.3 Contract assets and contract liabilities

Today's guidance in ASC 605-35 requires entities to record assets for unbilled accounts receivable when revenue is recognized but not billed. Once the invoice is submitted to the customer, the unbilled receivable is reclassified as a billed accounts receivable. Similarly, billings in excess of costs are generally recognized as liabilities.

The new model is based on the notion that a contract asset or contract liability is generated when either party to a contract performs. The guidance requires that an entity present these contract assets or contract liabilities in the statement of financial position. Under the new standard, entities are not required to use the terms "contract asset" or "contract liability" but must disclose sufficient information so that users of the financial statements can clearly distinguish between an unconditional right to consideration (a receivable) and a conditional right to receive consideration (a contract asset).

Under the new standard, when an entity satisfies a performance obligation by delivering the promised good or service, the entity has earned a right to consideration from the customer and therefore has a contract asset. Once the entity has an unconditional right to receive the consideration from the customer, the right represents a receivable from the customer that should be classified separately from contract assets. This occurs when there are no further performance obligations required to be satisfied before the entity has the right to collect the

customer's consideration. A right is unconditional if nothing other than the passage of time is required before payment of that consideration is due. Therefore, unlike the guidance in ASC 605-35, the timing of the reclassification of a balance from a contract asset to accounts receivable balance may be different than the invoicing of the receivable. For example, a contractor could record a receivable (rather than a contract asset) for revenue related to construction completed to date prior to submitting a progress billing in accordance with the billing schedule in the contract.

When the customer performs first — for example, by prepaying its promised consideration — the entity has a contract liability. This is consistent with today's guidance for billings in excess of costs in ASC 605-35.

After initial recognition, receivables and contract assets are subject to an impairment assessment in accordance with ASC 310 on receivables. In addition, if upon initial measurement there is a difference between the measurement of the receivable under ASC 310 and the corresponding amount of revenue, that difference will be presented as an expense (e.g., as an impairment loss). Impairment losses resulting from contracts with customers are presented separately from losses on other contracts.

7.4 Warranties

Warranties are commonly included in contracts to sell goods or services, whether explicitly stated or implied based on the entity's customary business practices. The new revenue standard identifies two types of warranties.

Warranties that promise the customer that the delivered product is as specified in the contract are called "assurance-type warranties." The Boards concluded that 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. For example, E&C entities often provide various warranties against construction defects and the failure of certain operating systems for a period of time. Under the standard, the estimated cost of satisfying these warranties is accrued in accordance with the current guidance in ASC 460-10 on guarantees.

Warranties that provide a service to the customer in addition to assurance that the delivered product is as specified in the contract are called "service-type warranties." If the customer has the option to purchase the warranty separately or if the warranty provides a service to the customer beyond fixing defects that existed at the time of sale, the entity is providing a service-type warranty. The Boards determined that this type of warranty represents a distinct service and is a separate performance obligation. Therefore, the entity will allocate a portion of the transaction price to the warranty based on the estimated standalone selling price of the warranty. The entity will recognize revenue allocated to the warranty over the period the warranty service is provided. Service-type warranties are infrequent in the E&C industry.

Next steps

E&C 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.

E&C entities also may want to monitor the discussions of the Boards, the SEC staff, the TRG and the E&C industry working group 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 caused by the new standard with investors and other stakeholders, including their plan for disclosures about the effects of new accounting standards discussed in SEC Staff Accounting Bulletin (SAB) Topic 11.M. 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] The FASB defined public entity for purposes of this standard more broadly than just entities that have publicly traded equity or debt. The standard defines a public entity as one of the following: (1) a public business entity (PBE); (2) a not-for-profit entity that has issued, or is a conduit bond obligor for, securities that are traded, listed, or quoted on an exchange or an over-the-counter market; or (3) an employee benefit plan that files or furnishes financial statements with the SEC.

[2] ASU 2014-09, *Basis for Conclusions*, paragraph 48

[3] ASU 2014-09, *Basis for Conclusions*, paragraph 73

[4] ASU 2014-09, *Basis for Conclusions*, paragraph 382

[5] ASU 2014-09, *Basis for Conclusions*, paragraph 217

[6] This statement applies only to transactions that are in the scope of the new guidance. Nonmonetary exchanges between entities in the same line of business that are arranged to facilitate sales to third parties (i.e., the entities involved in the exchange are not the end consumer) are excluded from the scope of the new guidance.

[7] ASU 2014-09, *Basis for Conclusions*, paragraph 125

[8] ASU 2014-09, *Basis for Conclusions*, paragraph 129

[9] ASU 2014-09, *Basis for Conclusions*, paragraph 132

[10] ASU 2014-09, *Basis for Conclusions*, paragraph 161

[11] ASU 2014-09, *Basis for Conclusions*, paragraph 308

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