Chapter 1

General Accounting Considerations

Notice to readers: This chapter provides an overview of FASB *Accounting Standards Codification* (ASC) 606, *Revenue from Contracts with Customers.* Readers are encouraged to refer to FASB ASC 606 for the full text, implementation guidance, and illustrations.

Due to the effective date of FASB ASC 606, any references to this topic are identified as pending content within FASB ASC, although not designated as such in this guide. Refer to the guide's preface for more information on pending content.

Lastly, fasb.org has information on activities from the FASB/IASB Joint Transition Resource Group for Revenue Recognition, including summaries of issues discussed.

Introduction

1.01 In May 2014, FASB and IASB issued a joint accounting standard on revenue recognition to address a number of concerns surrounding the inconsistencies and complexities in accounting for revenue transactions. FASB issued the update in the form of FASB Accounting Standards Update (ASU) No. 2014-09, *Revenue from Contracts with Customers (Topic 606)*, and the IASB issued International Financial Reporting Standards (IFRS) 15, *Revenue from Contracts with Customers*. FASB ASU No. 2014-09 amended the FASB ASC by creating Topic 606, *Revenue from Contracts with Customers*, and amending Subtopic 340-40, *Other Assets and Deferred Costs—Contracts with Customers*. The guidance in this update supersedes revenue recognition requirements in FASB ASC 605, *Revenue Recognition*, along with most of the revenue recognition guidance under the 900 series of industry-specific topics. IFRS 15 will replace International Accounting Standard (IAS) 11, *Construction Contracts,* and IAS 18, *Revenue*.

1.02 As part of the boards' efforts to converge U.S. generally accepted accounting principles (U.S. GAAP) and IFRS, FASB ASC 606 eliminates the transaction- and industry-specific revenue recognition guidance under current U.S. GAAP and replaces it with a principles-based approach for revenue recognition.

1.03 FASB ASC 606-10-15-2 explains that FASB ASC 606 should be applied by entities to all contracts with customers except for a specific list of exceptions. These exceptions include contracts that are within the scope of other standards (for example, insurance contracts or lease contracts), financial instruments, guarantees (other than product or service warranties), and nonmonetary exchanges between entities in the same line of business to facilitate sales to customers or potential customers.

Authoritative Status and Effective Date

1.04 The guidance in FASB ASC 606 was originally effective for annual reporting periods of public entities[1] beginning on or after December 15, 2016, including interim periods within that reporting period. Early application was not permitted for public entities. For all other entities, the guidance in the new standard was originally effective for annual reporting periods beginning after December 15, 2017, and interim periods within annual periods beginning after December 15, 2018.

1.05 To allow entities additional time to implement systems, gather data, and resolve implementation questions, FASB issued ASU No. 2015-14, *Revenue From Contracts with Customers: Deferral of the Effective Date*, in August 2015, to defer the effective date of FASB ASU No. 2014-09 for one year.

1.06 As a result of this deferral, public business entities, certain not-for-profit entities, and certain employee benefit plans should apply the guidance in FASB ASU No. 2014-09 to annual reporting periods beginning after December 15, 2017, including interim reporting periods within that reporting period. Earlier application would be permitted only as of annual reporting periods beginning after December 15, 2016, including interim reporting periods within that reporting period.

1.07 All other entities should apply the guidance in FASB ASU No. 2014-09 to annual reporting periods beginning after December 15, 2018, and interim reporting periods within annual reporting periods beginning after December 15, 2019. Application would be permitted earlier only as of an annual reporting period beginning after December 15, 2016, including interim reporting periods within that reporting period, or an annual reporting period beginning after December 15, 2016, and interim reporting periods within annual reporting periods beginning one year after the annual reporting period in which an entity first applies the guidance in FASB ASU No. 2014-09.

1.08 The IASB issued an amendment to IFRS 15 deferring the effective date by one year to 2018. The publication of the amendment, *Effective Date of IFRS 15*, follows from the IASB's decision in July 2015 to defer the effective date from January 1, 2017, to January 1, 2018, having considered the feedback to its consultation. Companies applying IFRS continue to have the option to apply the standard early.

Transitioning to the New Standard

1.09 FASB ASC 606-10-65-1 allows entities two options when transitioning to the guidance under FASB ASC 606. FASB ASC 606-10-65-1(d)1 explains that the first option is full retrospective application of the new standard, which requires reflecting the cumulative effect of the change in all contracts on the opening retained earnings of the earliest period presented and adjusting the financial statements for each prior period presented to reflect the effect of applying the new accounting standard. Retrospective application would be applied

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[1] A *public entity* is an entity that is any one of the following:

1. A public business entity
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
3. An employee benefit plan that files or furnishes financial statements to the SEC.

to interim periods, as well as annual periods presented. As stated in FASB ASC 606-10-65-1(f), an entity following the full retrospective approach may elect any of the following practical expedients, applied consistently to all contracts:

- For completed contracts, an entity does not need to restate contracts that begin and are completed within the same annual reporting period.
- For completed contracts that have variable consideration, an entity may use the transaction price at the date the contract was completed rather than estimating variable consideration amounts in the comparative reporting periods.
- For all reporting periods presented before the date of initial application, an entity does not need to disclose the amount of the transaction price allocated to remaining performance obligations and an explanation of when the entity expects to recognize that amount as revenue.
- For contracts that were modified before the beginning of the earliest reporting period, an entity does not need to retrospectively restate the contract for those contract modifications in accordance with paragraphs 12–13 of FASB ASC 606-10-25. Instead, an entity should reflect the aggregate effect of all modifications that occur before the beginning of the earliest period presented when
  - — identifying the satisfied and unsatisfied performance obligations,
  - — determining the transaction price, and
  - — allocating the transaction price to the satisfied and unsatisfied performance obligations.

1.10 As an alternative, under FASB ASC 606-10-65-1(d)2, entities may apply the amendments to the new standard retrospectively with the cumulative effect of initially applying the amendments recognized at the date of initial application. Under this transition method, an entity should elect to apply this guidance retrospectively either to all contracts at the date of initial application or only to contracts that are not completed contracts at the date of initial application. An entity should disclose whether it has applied this guidance to all contracts at the date of initial application or only to contracts that are not completed at the date of initial application.

1.11 When using the cumulative effect method described in paragraph 1.10, the entity should provide additional disclosures of the following, in reporting periods that include the date of initial application:

- The amount by which each financial statement line item is affected in the current reporting period by the application of the new standard as compared to the guidance that was in effect before the change
- An explanation of the reasons for significant changes

1.12 Both application methods include recording the direct effects of the change in accounting principle. Indirect effects that would have been recognized if the newly adopted accounting principles had been followed in prior periods would not be included in the retrospective application. FASB ASC 250-10-45-8 defines direct effects of a change in accounting principle as "those recognized changes in assets or liabilities necessary to effect a change in accounting principle." An example of a direct effect described in this section of FASB ASC 250 is an adjustment to an inventory balance to effect a change in inventory valuation method. Indirect effects are defined within FASB ASC 250-10-20 as "any changes to current or future cash flows of an entity that result from making a change in accounting principle that is applied retrospectively." An example of an indirect change is a change in royalty payments based on a reported amount such as revenue or net income.

Post-Standard Activity

1.13 To assist with implementation of the new standard, FASB and the IASB announced the formation of the Joint Transition Resource Group (TRG) for Revenue Recognition in June 2014. The objective of this group is to keep the boards informed of potential implementation issues that may arise as entities implement the new guidance. Members of the TRG include financial statement preparers, auditors, and financial statement users representing various industries, geographies, and public and private companies. Any stakeholder may submit a potential implementation issue for discussion at TRG meetings, to be evaluated and prioritized for further discussion by each board.

1.14 As of the date of this publication, the TRG had held two meetings in 2014, four in 2015, and two in 2016. A submission tracker is available on the TRG website at fasb.org that includes a listing of all revenue recognition implementation issues submitted and the current status of these issues.

1.15 In addition to advising the boards to defer the effective date, the TRG informed the boards that technical corrections were needed to further articulate the guidance in the standard.[2] As a result, FASB has issued the following accounting updates subsequent to FASB ASU No. 2014-09:

a. FASB ASU No. 2016-08, *Revenue from Contracts with Customers (Topic 606): Principal versus Agent Considerations (Reporting Revenue Gross versus Net)*

b. FASB ASU No. 2016-10, *Revenue from Contracts with Customers (Topic 606): Identifying Performance Obligations and Licensing*

c. FASB ASU No. 2016-11, *Revenue Recognition (Topic 605) and Derivatives and Hedging (Topic 815): Rescission of SEC Guidance Because of Accounting Standards Updates 2014-09 and 2014-16 Pursuant to Staff Announcements at the March 3, 2016 EITF Meeting*

d. FASB ASU No. 2016-12, *Revenue from Contracts with Customers (Topic 606): Narrow-Scope Improvements and Practical Expedients*

Overview of FASB ASU No. 2014-09, *Revenue from Contracts with Customers*

1.16 As stated in FASB ASC 606-10-05-3, the core principle of FASB ASC 606 is that an entity should recognize revenue to depict the transfer of goods

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[2] FASB has also exposed several proposed accounting standards updates for technical corrections related to revenue recognition. FASB is expected to finalize the technical corrections during the fourth quarter of 2016.

or services to customers in an amount that reflects the consideration to which the entity expects to be entitled in exchange for those goods or services.

1.17 To recognize revenue under the new framework, FASB ASC 606-10-05-4 states that an entity should follow these five steps:

a. Step 1—Identify the contract(s) with a customer.

b. Step 2—Identify the performance obligations in the contract.

c. Step 3—Determine the transaction price.

d. Step 4—Allocate the transaction price to the performance obligations in the contract.

e. Step 5—Recognize revenue when (or as) the entity satisfies a performance obligation.

Step 1: Identify the Contract with a Customer

1.18 FASB ASC 606-10-25-2 defines a contract as "an agreement between two or more parties that creates enforceable rights and obligations." FASB ASC 606-10-25-1 states an entity should account for a contract with a customer that is within the scope of FASB ASC 606 when all of the following criteria are met:

a. It has the approval and commitment of the parties.

b. Rights of the parties are identified.

c. Payment terms are identified.

d. The contract has commercial substance.

e. Collectibility of substantially all of the consideration is probable.

1.19 Paragraphs 1–8 of FASB ASC 606-10-25 provide guidance on identifying the contract with a customer. Paragraphs 3A–3C of FASB ASC 606-10-55 provide guidance for assessing the collectibility of consideration as required in FASB ASC 606-10-25-1e.

1.20 FASB ASC 606-10-25-9 provides guidance on when multiple contracts should be combined under FASB ASC 606. Paragraphs 10–13 of FASB ASC 606-10-25 provide guidance on accounting for contract modifications.

Step 2: Identify the Performance Obligations in the Contract

1.21 An entity should assess the goods or services promised in a contract with a customer at contract inception. Each promise to transfer one of the following to the customer is considered a performance obligation, in accordance with FASB ASC 606-10-25-14:

a. A good or service (or bundle of goods or services) that is distinct

b. A series of distinct goods or services that are substantially the same and that have the same pattern of transfer to the customer

1.22 Paragraphs 15–18B of FASB ASC 606-10-25 provide guidance on how to determine a series of distinct goods or services and explicit and implicit promises to customers, and how to account for immaterial promised goods or services, and shipping and handling activities.

1.23 FASB ASC 606-10-19 explains that a good or service that is promised to a customer is distinct if both of the following criteria are met:

a. **Capable of being distinct**. The customer can benefit from a good or service either on its own or together with other resources that are readily available to the customer.

b. **Distinct within the context of the contract**. The entity's promise to transfer the good or service to the customer is separately identifiable from other promises in the contract.

1.24 Paragraphs 20–22 of FASB ASC 606-10-25 provide guidance on determining if a promised good or service is distinct, and combining promised goods or services until an entity identifies a bundle of goods or services that is distinct.

Step 3: Determine the Transaction Price

1.25 FASB ASC 606-10-32-2 explains that 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.

1.26 FASB ASC 606-10-32-3 explains that when determining the transaction price, an entity should consider the effects of all of the following:

a. Variable consideration (paragraphs 5–10 of FASB ASC 606-10-32 and 606-10-32-14)

b. Constraining estimates of variable consideration (paragraphs 11–13 of FASB ASC 606-10-32)

c. The existence of a significant financing component (paragraphs 15–20 of FASB ASC 606-10-32)

d. Noncash considerations (paragraphs 21–24 of FASB ASC 606-10-32)

e. Consideration payable to the customer (paragraphs 25–27 of FASB ASC 606-10-32).

Step 4: Allocate the Transaction Price to the Performance Obligations in the Contract

1.27 FASB ASC 606-10-32-28 explains that the objective when allocating the transaction price is for an entity to allocate the transaction price to each separate performance obligation (or distinct good or service) 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.

1.28 FASB ASC 606-10-32-29 explains that an entity should generally allocate the transaction price to each performance obligation identified in the contract on a relative standalone selling price basis.

1.29 Paragraphs 31–35 of FASB ASC 606-10-32 provide guidance on allocation of the transaction price based on stand-alone selling prices. Paragraphs 36–38 of FASB ASC 606-10-32 provide guidance on allocation of a discount. Paragraphs 39–41 of FASB ASC 606-10-32 provide guidance on allocation of variable consideration. Paragraphs 42–45 of FASB ASC 606-10-32 provide guidance on changes in the transaction price.

Step 5: Recognize Revenue When (or as) the Entity Satisfies a Performance Obligation

1.30 The requirements of FASB ASC 606-10-25-23 state that an entity should recognize revenue when (or as) the entity satisfies a performance obligation by transferring a promised good or service to a customer. An asset is transferred when (or as) the customer obtains control of that asset.

1.31 As stated in FASB ASC 606-10-25-25, control of an asset refers to the ability to direct the use of, and obtain substantially all of the remaining benefits from, the asset. Control includes the ability to prevent other entities from directing the use of, and obtaining the benefits from, an asset.

1.32 For each performance obligation identified in accordance with paragraphs 14–22 of FASB ASC 606-10-25, paragraph 24 states that an entity should determine at contract inception whether it satisfies the performance obligation over time (in accordance with paragraphs 27–29 of FASB ASC 606-10-25) or at a point in time (in accordance with FASB ASC 606-10-25-30). If an entity does not satisfy a performance obligation over time, the performance obligation is satisfied at a point in time.

1.33 Paragraphs 27–29 of FASB ASC 606-10-25 provide guidance for determining if an entity transfers control of a good or service over time. Paragraphs 31–37 of FASB ASC 606-10-25 provide guidance for measuring progress toward complete satisfaction of a performance obligation, methods for measuring progress and reasonable measures of progress. FASB ASC 606-10-25-30 provides indicators of the transfer of control for performance obligations satisfied at a point in time.

Costs to Obtain or Fulfill a Contract With a Customer

Incremental Costs of Obtaining a Contract

1.34 As stated in FASB ASC 340-40-25-1, "an entity should recognize as an asset the incremental costs of obtaining a contract with a customer if the entity expects to recover those costs." FASB ASC 340-40-25-2 explains that the incremental costs of obtaining a contract are those costs that an entity incurs to obtain a contract with a customer that it would not have incurred if the contract had not been obtained (for example, a sales commission). FASB ASC 340-40-25-3 further explains that costs to obtain a contract that would have been incurred regardless of whether the contract was obtained should be recognized as an expense when incurred, unless those costs are explicitly chargeable to the customer regardless of whether the contract is obtained.

1.35 FASB ASC 340-40-25-4 allows for a practical expedient, stating that an entity may recognize the incremental costs of obtaining a contract as an expense when incurred if the amortization period of the asset that the entity otherwise would have recognized is one year or less.

Costs of Fulfilling a Contract

1.36 FASB ASC 340-40-25-5 requires an entity to recognize an asset from the costs incurred to fulfill a contract only if those costs meet all of the following criteria:

a. The costs relate directly to a contract or to an anticipated contract that the entity can specifically identify (for example, costs relating to services to be provided under renewal of an existing contract or costs of designing an asset to be transferred under a specific contract that has not yet been approved).

b. The costs generate or enhance resources of the entity that will be used in satisfying (or in continuing to satisfy) performance obligations in the future.

c. The costs are expected to be recovered.

1.37 FASB ASC 340-40-25-6 explains that for costs incurred in fulfilling a contract with a customer that are within the scope of another topic (for example, FASB ASC 330, *Inventory*; or FASB ASC 360, *Property, Plant, and Equipment*), an entity should account for those costs in accordance with guidance in those topics or subtopics.

1.38 Paragraphs 7–8 of FASB ASC 340-40-25 provide guidance on identifying whether costs relate directly to a contract or should be expensed when incurred. Paragraphs 1–6 of FASB ASC 340-40-35 provide guidance on amortization and impairment of assets recognized in accordance with paragraph 1 or 5 of ASC 340-40-25.

Disclosures

1.39 There are significant disclosure requirements in FASB ASC 606. FASB ASC 606-10-50-1 explains that the objective of the disclosure requirements is to enable users of financial statements to understand the nature, amount, timing, and uncertainty of revenue and cash flows arising from contracts with customers, and to achieve that objective an entity should disclose qualitative and quantitative information about the following:

a. Contracts with customers—including revenue recognized, disaggregation of revenue, and information about contract balances and performance obligations (including the transaction price allocated to the remaining performance obligations)

b. Significant judgments and changes in judgments affecting the amount of revenue and assets recognized—determining the timing of satisfaction of performance obligations (over time or at a point in time), and determining the transaction price and amounts allocated to performance obligations.

1.40 Paragraphs 1–23 of FASB ASC 606-10-50 and paragraphs 1–6 of FASB ASC 340-40-50 provide guidance on required disclosures and practical expedients. Paragraphs 89–91 of FASB ASC 606-10-55 provide considerations for disclosure of disaggregated revenue.

Other Topics

Presentation of Contract With a Customer

1.41 Paragraphs 1–5 of FASB ASC 606-10-45 provide guidance for determining presentation of the contract with a customer in the statement of financial position as a contract asset, a receivable or a contract liability.

Sale With a Right of Return

1.42 Paragraphs 22–29 of FASB ASC 606-10-55 provide guidance for accounting for sales with a right of return.

Warranties

1.43 Paragraphs 30–35 of FASB ASC 606-10-55 provide guidance on accounting for warranties.

Principal versus Agent

1.44 Paragraphs 36–40 of FASB ASC 606-10-55 provide considerations for determining whether an entity is a principal or an agent in a contract with customers.

Customer Options for Additional Goods or Service—Material Rights

1.45 Paragraphs 41–45 of FASB ASC 606-10-55 provide guidance for accounting for customer options to acquire additional goods or services and material rights to the customer.

Customer's Unexercised Rights

1.46 Paragraphs 46–49 of FASB ASC 606-10-55 provide guidance for accounting for customer's unexercised rights.

Nonrefundable Upfront Fees

1.47 Paragraphs 50–53 of FASB ASC 606-10-55 provide guidance for accounting for nonrefundable upfront fees.

Licensing

1.48 Paragraphs 54–60 and 62–65B of FASB ASC 606-10-55 provide guidance for accounting for licenses of intellectual property.

Repurchase Agreements

1.49 Paragraphs 66–78 of FASB ASC 606-10-55 provide guidance for accounting for repurchase agreements.

Consignment Arrangements

1.50 Paragraphs 79–80 of FASB ASC 606-10-55 provide guidance for determining whether an arrangement is a consignment arrangement and the related accounting.

Bill-and-Hold Arrangements

1.51 Paragraphs 81–84 of FASB ASC 606-10-55 provide guidance for accounting for bill-and-hold arrangements.

Customer Acceptance

1.52 Paragraphs 85–88 of FASB ASC 606-10-55 provide guidance for evaluating customer acceptance of an asset.

