FASB and IASB Issue Revised Exposure Draft on Revenue Recognition

November 18, 2011

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The Financial Accounting Standards Board (FASB) and International Accounting Standards Board (IASB) (collectively the "Boards") are jointly working on a project to develop a revenue recognition standard and issued a revised Exposure Draft (ED), *Revenue from Contracts with Customers,* on November 14, 2011. The goals of the project are to clarify the principles for recognizing revenue and develop a common revenue standard that would:

- Remove inconsistencies and weaknesses in existing revenue recognition requirements;
- Provide a more robust framework for addressing revenue issues;
- Improve comparability of revenue recognition practices across entities, industries, jurisdictions, and capital markets;
- Provide more useful information to users of financial statements through improved disclosure requirements; and
- Simplify the preparation of financial statements by reducing the number of requirements to which an entity must refer.

In June 2010, the Boards issued an initial ED for this project. During most of 2011, the Boards evaluated the feedback received as a result of the comment letter process (nearly 1,000 comment letters were received), and redeliberated the conclusions they had reached in the project based on this feedback. Given the extent of feedback, the Boards issued the revised ED, which if finalized as proposed would create a common revenue standard for both U.S. generally accepted accounting principles (GAAP) and International Financial Reporting Standards (IFRS) with certain minor differences. The revised ED was issued by the FASB as a proposed Accounting Standards Update, *Revenue Recognition (Topic 605): Revenue from Contracts with Customers*. While the core principle of the revised ED is unchanged from that in the initial ED, many other elements of the proposal have changed as a result of these redeliberations. This revised ED is available for comment until March 13, 2012. A final standard is currently expected to be issued in late 2012 with an effective date no earlier than January 1, 2015 for public entities and January 1, 2016 for nonpublic entities.

This whitepaper provides a summary of the major provisions included in the revised ED. For those interested in the differences between the revised ED as compared to the initial ED, refer to Appendix B of the revised ED.

Scope

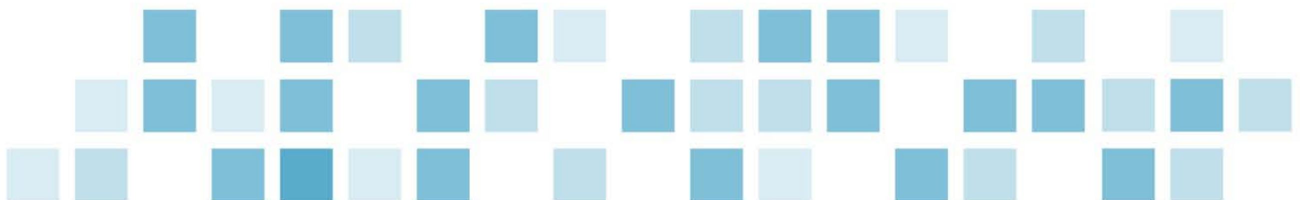
Most contract-based revenue transactions to provide goods or services to a customer that are an output of an entity's ordinary activities are in the scope of the revised ED. Exceptions would include contracts relating to financial instruments, guarantees other than product warranties, insurance, and leases as well as certain nonmonetary exchanges. There are no scope exceptions in the revised ED for certain industries that currently have their own customer contract-based revenue recognition guidance. Examples of industries that would be subject to the guidance in the revised ED and would no longer have their own separate industry-specific revenue recognition guidance include the construction, real estate, and software industries.

A contract may be partially within the scope of the revised ED and partially within the scope of other guidance not affected by the revised ED. An entity would be required to separate and measure portions of a contract within the scope of other guidance in accordance with that guidance. If the other guidance does not state how to separate and measure portions of a contract within its scope, the contract would be separated and measured in accordance with the guidance in the revised ED. In any case, the amount allocated to the portion of a contract within the scope of other guidance would be recognized based on that other guidance. This would be largely consistent with current U.S. GAAP on multiple-element arrangements.

Contracts for the sale of nonfinancial assets that are not an output of an entity's ordinary activities (and hence not classified as revenue), such as the sale of equipment used in an entity's manufacturing process or real estate, would nonetheless follow the recognition and measurement principles of the revised ED.

Key provisions

The core principle of the revised ED is that the amount of revenue recognized by an entity should depict the transfer of promised goods or services to customers and reflect the amount of consideration the entity expects to be entitled to in exchange for those goods or services. The approach required to comply with this principle would be as follows:



Identify the contract with a customer

A contract (which can be written, oral or implied) would be defined as an agreement between two or more parties that creates enforceable rights and obligations. A contract would have to possess certain characteristics to account for it using the guidance in the revised ED. If all parties to a contract can unilaterally terminate a wholly unperformed contract with no penalty, a contract would not be considered to exist.

The guidance proposed in the revised ED generally would be applied on an individual contract basis; however, in certain cases, contracts would be combined. Two or more contracts that are entered into at or near the same time with the same customer (or related parties) would be combined if one or more of the following criteria are met:

- The contracts are negotiated as a package with a single commercial objective;
- The amount of consideration in one contract depends on the price or performance of the other contract; or
- All goods and services in the contracts (or some goods or services from each contract) are considered to be a single performance obligation.

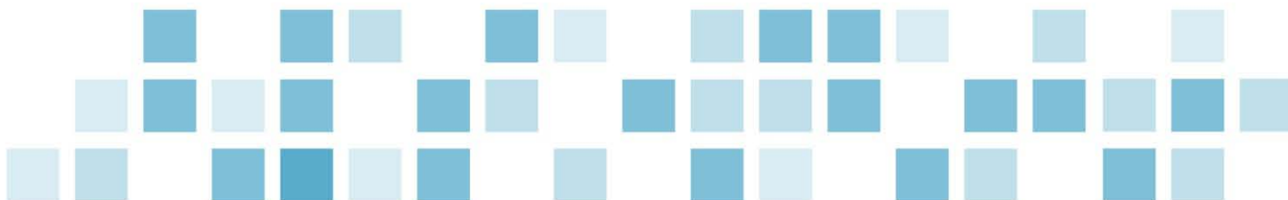
A modification to an existing contract that results in the addition of separate performance obligations with consideration that is consistent with the standalone selling price of those performance obligations (adjusted for the circumstances of the particular contract) would be accounted for as a separate contract. Otherwise, the accounting for the contract modification would be based on whether the remaining performance obligations, including those resulting from the contract modification, are distinct (*i.e.*, a separate performance obligation) from those previously transferred:

- *Distinct* – Account for the modification on a prospective basis as the termination of the original contract and the creation of a new contract with the remaining consideration not yet recognized as revenue allocated to the remaining separate performance obligations.
- *Not distinct and are part of a single partially satisfied performance obligation* – Account for the modification on a cumulative catch-up basis as though the modified contract was in place since inception.

The revised ED also provides guidance for situations in which the modified contract includes remaining performance obligations that are distinct and not distinct from those previously transferred.

Identify the separate performance obligations in the contract

A performance obligation would be defined as a promise in a contract to transfer a good or service to a customer. Activities that do not transfer a good or service to a customer as the activities are performed (*e.g.*, certain setup activities) would not be considered a performance obligation. Performance obligations could include goods or services not explicitly stated in a contract that are nonetheless expected by the customer as they ordinarily are provided by the entity as part of its customary business practice. For example, an entity's customary business practice may be to provide six months of telephone support for a product after purchase. In this scenario, the entity would have to consider whether that implicit telephone support is a performance obligation, regardless of whether it is specifically stated in a contract.



An entity would identify all performance obligations in a contract and then determine whether they should be accounted for separately from one another because they are distinct. A performance obligation would be considered distinct if the underlying goods or services meet either of the following criteria:

- The entity regularly sells the good or service separately; or
- The customer can benefit from the good or service either on its own or together with other resources that are readily available to the customer.

Notwithstanding the preceding criteria, a bundle of goods or services would not be considered distinct and would be accounted for as one performance obligation if both of the following criteria are met:

- The goods and (or) services in the bundle are highly interrelated and transferring them to the customer requires the entity to provide a significant service of integrating the goods and (or) services into the combined item(s) for which the customer has contracted; and
- The bundle of goods and (or) services is significantly modified or customized to fulfill the contract.

If goods or services are not considered distinct from other goods or services, they would be combined with other goods and services until there is a distinct bundle. If a distinct bundle cannot be identified, all goods and services would be combined into a single performance obligation.

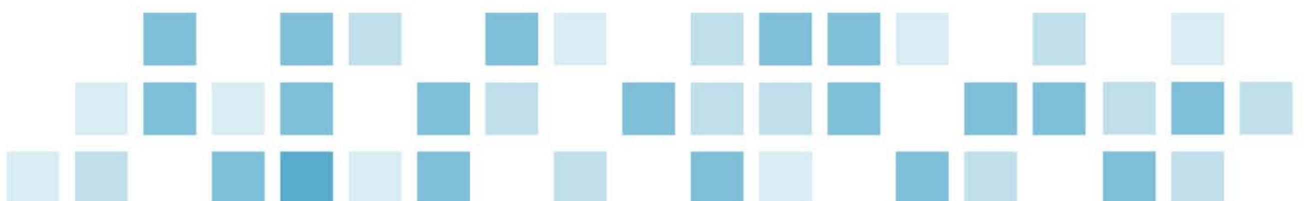
As a practical expedient, those goods or services in a contract that are transferred to a customer in the same pattern could be accounted for as one performance obligation even if they are considered distinct.

Determine the transaction price

A transaction price in a contract would be the amount of consideration an entity expects to be entitled to as a result of transferring promised goods or services to the customer, excluding amounts collected on behalf of third parties (*e.g.*, sales taxes) and the risk of not collecting the consideration. When determining the transaction price, an entity would begin with the fixed cash consideration. This amount would be adjusted for any estimated variable consideration (*e.g.*, performance bonuses, rebates, penalties) to which the entity would be entitled. The resulting amount would be further adjusted to take into consideration the time value of money, noncash consideration, and consideration payable to the customer.

Variable consideration

The amount of variable consideration to include in the transaction price would be based on either the probability-weighted expected value or the most-likely amount, whichever best predicts the consideration to which the entity would be entitled. The amount of variable consideration included in the transaction price would be updated if circumstances (*e.g.*, the estimate of the variable consideration to which the entity will be entitled) change during the term of the contract. The two alternative methods of estimating variable consideration could result in significant differences in the amount to include in the transaction price. Furthermore, the inclusion of estimated variable consideration as part of the transaction price would be a significant change



compared to current U.S. GAAP and may result in earlier recognition of revenue in cases in which an entity is reasonably assured of being entitled to the variable consideration.

Time value of money

The effect of the time value of money would only impact the transaction price if there is a significant financing component in the contract. In determining whether there is a significant financing component, the following factors would be considered (among others):

- The expected length of time between payment and the transfer of promised goods or services;
- Whether the consideration would be substantially different if it were paid in cash at the time of transfer of promised goods or services; and
- The interest rate in the contract and prevailing market interest rates.

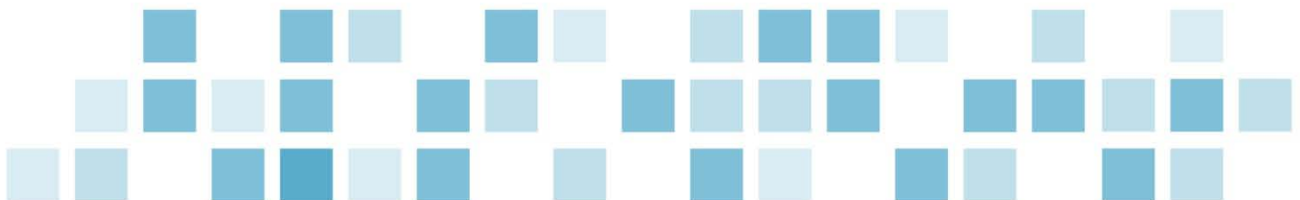
As a practical expedient, the effect of the time value of money would not impact the transaction price if the period between payment of substantially all of the consideration and the transfer of promised goods or services is one year or less. This proposed guidance may result in an increase or reduction in the transaction price. For example, if payment is made by a customer over a year after the transfer of promised goods such that the financing component is significant, the transaction price would be reduced. The amount by which the transaction price (and ultimately revenue, once the performance obligation is satisfied) is reduced would be recognized as interest income through the payment date based on the interest method. In contrast, if payment is made by a customer over a year prior to the transfer of promised goods such that the financing component is significant, the transaction price would be increased. The amount by which the transaction price (and ultimately revenue, once the performance obligation is satisfied) is increased would be recognized as interest expense through the date the goods are transferred based on the interest method.

Collectibility

The risk of not collecting consideration from the customer would not be considered in the determination of the transaction price. Rather, any allowance for uncollectible amounts (*i.e.*, bad debt) would be reflected in the income statement adjacent to revenue as a separately stated line item (*e.g.*, contra-revenue) as revenue is recognized. Furthermore, any changes to the allowance subsequent to the related revenue being recognized also would be included in this line item. This would represent a significant change in accounting treatment from current U.S. GAAP in a number of ways. For one, current U.S. GAAP requires that collectibility be reasonably assured prior to recognizing revenue, which would no longer be the case under the revised ED. Also, current U.S. GAAP requires an allowance for uncollectible amounts to be reflected as a bad debt expense in the income statement within operating expenses, rather than adjacent to revenue. This will have a direct impact on the gross margins reported by entities in their income statements.

Allocate the transaction price to the separate performance obligations

If a contract has multiple performance obligations, the transaction price would generally be allocated to each separate performance obligation based on their standalone selling prices in relation to one another (*i.e.*, on a relative standalone



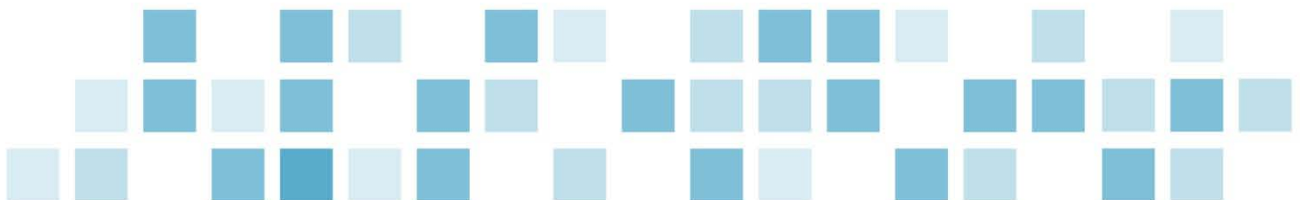
selling price basis). The standalone selling price of a separate performance obligation would be determined at contract inception and any changes in standalone selling prices after inception would not be considered for purposes of allocating the transaction price. The best evidence of the standalone selling price of a separate performance obligation would be the observable price of the goods or services underlying the performance obligation when those goods or services are sold by the entity separately in similar circumstances and to similar customers.

If there is no separate observable selling price, an entity would be required to estimate the standalone selling price. The estimate may be based on the underlying good's or service's cost plus a margin, the prices at which similar goods or services are sold separately by competitors adjusted for the entity's own cost structure and margin expectations, or another suitable method that utilizes observable inputs to the extent possible. If the standalone selling price of the goods or services underlying a separate performance obligation is highly variable or uncertain, an entity could also use a residual technique to estimate the standalone selling price. A residual technique would be one in which the standalone selling price of a separate performance obligation is determined based on the total transaction price less the observable standalone selling prices of all other separate performance obligations in the contract. This proposed guidance differs from current U.S. GAAP on software arrangements in FASB *Accounting Standards Codification®* (ASC) Topic 985, *Software*, which requires vendor-specific objective evidence (VSOE) of fair value for allocation purposes. In addition, the use of a residual technique to estimate the standalone selling price of an undelivered performance obligation would provide a result similar to a "reverse residual" allocation method, which is not currently allowed under U.S. GAAP.

One exception to the relative standalone selling price basis of allocation would exist in certain situations in which an entity gives discounts to a customer (*i.e.*, when the sum of the relative standalone selling prices of the performance obligations exceeds the transaction price). If an entity regularly sells each good or service separately on a standalone basis and those selling prices provide evidence of the separate performance obligations to which the discount should be allocated, the discount would be allocated entirely to those performance obligations (rather than to all performance obligations).

The other exception to the relative standalone selling price basis of allocation would be for certain situations in which the transaction price includes contingent amounts or there are other changes in the transaction price that are not the result of a contract modification that includes additional performance obligations. If both of the following criteria are met, the contingent amount (and any subsequent changes to either the contingent amount or other amounts that are not the result of a contract modification that includes additional performance obligations) would be allocated entirely to one or more separate performance obligations (rather than to all performance obligations):

- The payment terms for the separate performance obligation relate specifically to the entity's efforts to satisfy the performance obligation (or a specific outcome from satisfying the performance obligation); and
- Allocating the amount entirely to the performance obligation would result in the overall transaction price being allocated to all separate performance obligations in the contract in amounts consistent with that which an entity would expect to be entitled for satisfaction of each performance obligation.



Otherwise, any contingent amount (and any subsequent changes to either the contingent amount or other amounts that are not the result of a contract modification that includes additional performance obligations) would be allocated to all separate performance obligations on a relative standalone selling price basis. If a change in the transaction price affects the amount allocated to a satisfied performance obligation, it would be recognized as revenue or a reduction of revenue during the period in which the change occurs.

Recognize revenue when (or as) each performance obligation is satisfied

Revenue would be recognized as the separate performance obligations are satisfied, based on transfer of control of the underlying goods or services to a customer. Control of a good or service would be considered transferred to a customer when the customer has the ability to direct the use of and receive substantially all of the remaining benefits from the good or service. The amount allocated to each separate performance obligation (with the exception of certain variable consideration as discussed in the "Revenue limitation for variable consideration" section of this whitepaper) would be recognized as revenue once the obligation is satisfied.

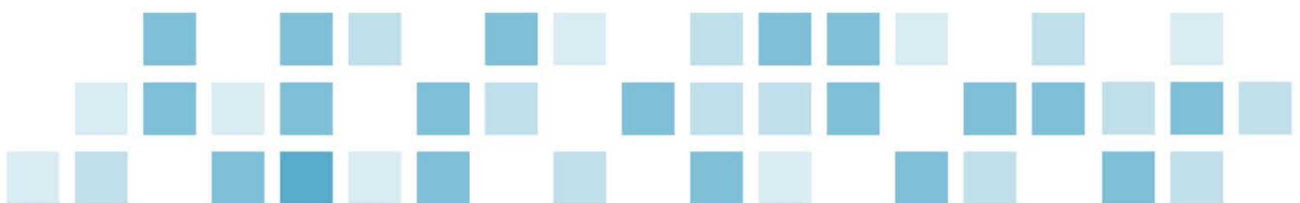
At inception of a contract, an entity would determine whether a performance obligation is satisfied over time or at a single point in time. If either of the following two criteria is met, a performance obligation would be satisfied over time:

- The entity's performance creates or enhances an asset that the customer controls as the asset is created or enhanced; or
- The entity's performance does not create an asset with alternative use to the entity and any one of the following criteria is met:
  - The customer receives and consumes the benefits of the entity's performance at the same time as the entity performs;
  - Another entity would not need to substantially reperform the work completed to date if that other entity were to fulfill the remaining obligation to the customer; or
  - The entity expects to fulfill the contract as promised and has a right to payment for performance completed to date even if the customer could cancel the contract for reasons other than the entity's failure to perform.

A performance obligation would be considered satisfied at a point in time if neither of these criteria is met.

Satisfaction over time

If a performance obligation is satisfied over time, then a method of measuring progress toward completion of the performance obligation that faithfully depicts the entity's performance (and hence the timing of revenue recognition) would be determined. The methods selected to measure progress toward completion might include those based on outputs (*e.g.*, units produced or delivered) or inputs (*e.g.*, costs incurred or labor hours expended). In general, an entity would have to be able to reasonably measure its progress toward complete satisfaction of a performance obligation to recognize revenue over time. However, revenue would still be recognized over time in an amount equal to the costs incurred to satisfy a performance obligation (if those costs are expected to be recovered) when an entity is unable to reasonably measure its progress.



If setup activities do not transfer a service to the customer as the activities are performed and therefore are not considered a performance obligation, the costs associated with those activities would be disregarded for purposes of applying an input method. These costs could be recognized as an asset when incurred if they meet the criteria discussed in the "Contract costs" section of this whitepaper. In addition, when an input method is used and a performance obligation includes goods that are procured and transferred to a customer significantly prior to the service portion of the performance obligation being performed (*e.g.*, control of materials are transferred to a customer significantly prior to being installed), measurement of progress toward completion would result in recognition of revenue for those goods equal to the costs incurred (*i.e.*, no margin would be recognized) if both of the following conditions exist at inception of the contract:

- The cost of the transferred goods is significant; and
- The entity procures the goods from another entity and is not significantly involved in designing and manufacturing the goods.

This differs from current U.S. GAAP in ASC Subtopic 605-35, *Revenue Recognition - Construction-Type and Production-Type Contracts*, as the cost of uninstalled materials not specifically produced or fabricated for a project would be excluded from costs incurred in the measurement of progress toward completion.

Satisfaction at a point in time

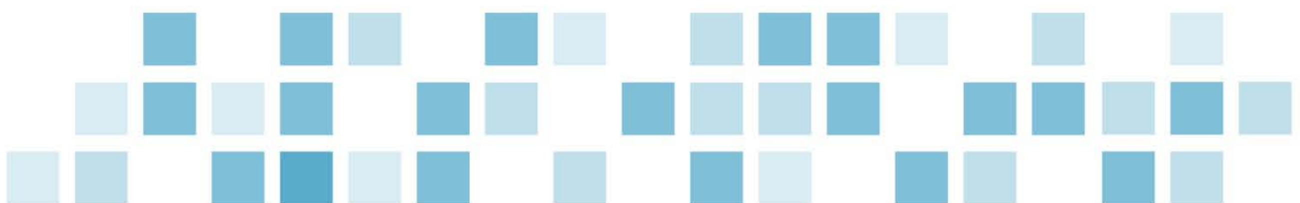
When a performance obligation is considered satisfied at a point in time, revenue would be recognized for each performance obligation as a customer obtains control of the goods or services. While not conclusive on a standalone basis or necessarily relevant for every good or service, indicators of control being transferred would include the following:

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

Revenue limitation for variable consideration

The amount of revenue recognized for variable consideration would be limited to the cumulative amount to which the entity is reasonably assured of being entitled in exchange for a satisfied performance obligation. An entity would not be reasonably assured of being entitled to any amounts that are based on a customer's future sales (*e.g.*, sales-based royalties) until those sales occur. An entity would only be reasonably assured of being entitled to variable consideration if both of the following criteria are met:

- The entity has experience with similar types of performance obligations (or has other evidence such as access to the experience of other entities); and
- The entity's experience (or other evidence) is predictive of the amount of consideration to which the entity will be entitled in exchange for satisfying those performance obligations.



Indicators that an entity would not be reasonably assured of being entitled to variable consideration because its experience (or other evidence) is not predictive of the amount of consideration to which the entity will be entitled would include the following:

- The amount of consideration is highly susceptible to factors outside the entity's influence, such as market volatility, third-party judgments, weather conditions, or a high risk of obsolescence of the promised good or service;
- 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 performance obligations is limited; and
- The contract has a large number and broad range of possible consideration amounts.

Other significant accounting guidance

Several other significant items included in the revised ED are described in this section. Other topics included in the revised ED that are not specifically addressed in this whitepaper include principal vs. agent considerations, repurchase agreements, consignment arrangements, bill-and-hold arrangements, and customer acceptance.

Onerous performance obligations

An onerous performance obligation would be a separate performance obligation that an entity satisfies over a time period of greater than one year (*e.g.*, long-term service contracts) for which the lowest cost to settle that performance obligation exceeds the allocated transaction price. The lowest cost to settle a performance obligation would be the lower of: (a) the costs that relate directly to satisfying the performance obligation or (b) the amount an entity would have to pay to exit the performance obligation, if permitted. Direct costs to satisfy a performance obligation would include:

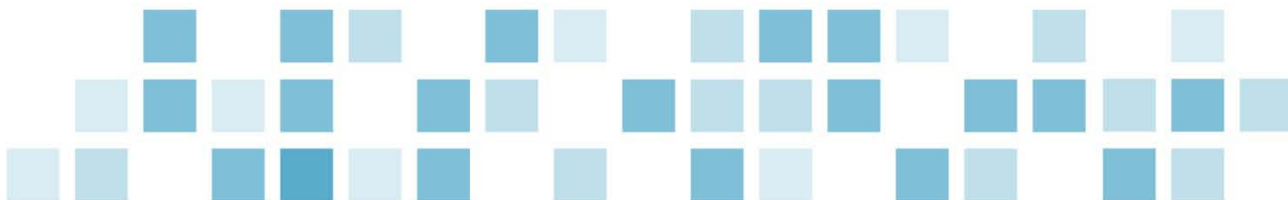
- Direct labor and materials;
- Allocated costs directly related to the contract;
- Costs explicitly chargeable to the customer; and
- Other costs incurred only because the entity entered into the contract.

An onerous performance obligation liability would be recognized separately from other assets and liabilities resulting from the contract for the excess of the lowest cost to settle the performance obligation over the allocated transaction price. The measurement of this liability would be adjusted at the end of each subsequent reporting period. For U.S. GAAP only, performance obligations within those contracts entered into by a not-for-profit entity for a social or charitable benefit would not be subject to this guidance.

Contract costs

Certain costs relating to contracts with customers would be required to be expensed as incurred, while others would be recognized as an asset when initially incurred. The following costs to fulfill a contract would be expensed as incurred:

- General and administrative costs, unless explicitly chargeable to the customer;



- Costs of wasted materials, labor, or other resources that were not reflected in the contract price;
- Costs related to satisfied or partially satisfied performance obligations; and
- Costs related to remaining performance obligations that are indistinguishable from costs related to satisfied performance obligations.

Unless the practical expedient discussed later in this section applies, other costs to fulfill a contract would be recognized as an asset if those costs:

- Relate directly to a contract or a specific anticipated contract;
- Generate or enhance a resource that will be used to satisfy performance obligations in the future; and
- Are expected to be recovered.

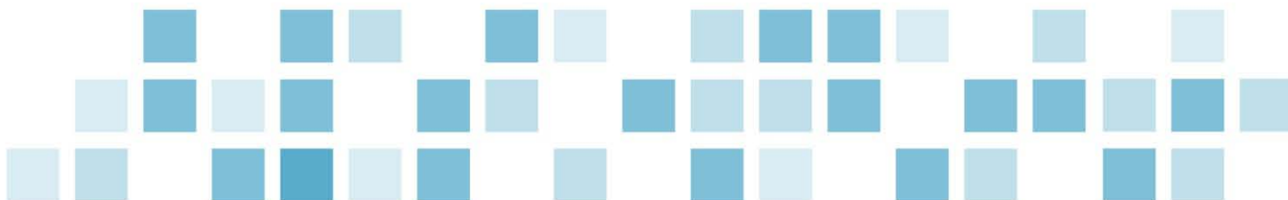
The cost guidance included in the revised ED would not be applicable to those costs incurred in fulfilling a contract with a customer that are within the scope of other guidance (*e.g.*, ASC Topic 330, *Inventory*, Topic 360, *Property, Plant and Equipment*, or Subtopic 985-20, *Software – Costs of Software to be Sold, Leased, or Marketed*).

The incremental costs of obtaining a contract (*e.g.*, sales commissions) that are expected to be recovered would meet the threshold for recognizing an asset. However, as a practical expedient, an entity would be allowed to expense these costs as incurred if the amortization period for the asset that would otherwise be recognized is one year or less. This may be a significant change compared to current U.S. GAAP for those entities that currently expense these costs immediately even if an amortization period would be greater than one year.

The costs that are recognized as an asset when initially incurred would be amortized consistent with how the related goods or services are transferred to the customer, which may extend beyond the term of the initial contract (*e.g.*, for renewals). Furthermore, an impairment loss would be recognized if the asset's carrying amount is greater than (a) the remaining amount of consideration to which an entity expects to be entitled in exchange for the goods or services related to the assets less (b) the remaining direct costs of providing those goods or services. For U.S. GAAP only, future reversals of any impairment loss recognized would be prohibited.

Return rights

Entities often transfer control of a product to a customer and grant the customer a right to return the product under certain conditions for a refund, credit or a different product. The requirement for an entity to stand ready to accept those goods for return would not be considered a separate performance obligation. However, the transaction price allocated to those goods would only be recognized as revenue to the extent of the amount to which the entity is reasonably assured of being entitled. In other words, an entity would have to determine the amount of transferred goods expected to be returned for an exchange (unless the exchange is for another product of the same type, quality, condition, and price, which is not considered a return) or refund (*i.e.*, the amount to which the entity is not reasonably assured of being entitled) and recognize this amount as a refund liability rather than revenue. This refund liability would be adjusted each reporting period (with a corresponding adjustment to revenue) for changes in exchange and refund expectations. Furthermore, an entity would recognize a related asset for its right to recover these



products on settlement of the refund liability (rather than cost of sales) based on the asset's former carrying amount less expected costs of recovery. This asset would also be adjusted each reporting period to correspond with changes in the measurement of the refund liability. This accounting treatment appears to be substantially consistent with current U.S. GAAP.

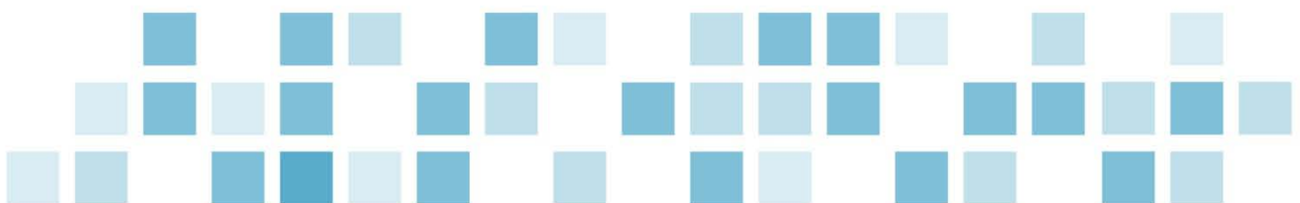
Warranties

Along with the sale of a product, an entity often warrants that the product conforms to certain agreed-upon specifications and in some cases provides a service as part of the warranty. If a customer has the option to purchase a warranty separately, it would be considered a warranty service and accounted for as a separate performance obligation to which a portion of the transaction price would be allocated and recognized as revenue as the warranty is satisfied. In situations in which the customer does not have the option to purchase a warranty separately and the warranty does not provide a service to the customer in addition to the assurance that the product conforms to certain agreed-upon specifications, expected warranty costs would be accrued when revenue is recognized consistent with current U.S. GAAP (rather than a portion of the transaction price being allocated to the warranty). In evaluating whether a warranty provides an additional service, an entity should consider, among other things, whether the warranty is required by law, the length of the coverage period, and the nature of the tasks the entity promises to perform.

Optional goods or services

An entity may grant customers the option of acquiring additional goods or services in the future as part of a contract (*e.g.*, sales incentives, contract renewal options, loyalty programs). These options would be considered separate performance obligations if they provide the customer a material right it would not otherwise receive without entering into the contract. For example, if a customer is granted an option to purchase additional products at a 50% discount off of list price and the products are normally sold at list price, the option would be considered a separate performance obligation. The entity would be required to allocate a portion of the transaction price to this performance obligation (along with the other performance obligations in the contract) on a relative standalone selling price basis. If not directly observable, the estimate of the standalone selling price of the option would be based on the discount the customer would obtain on exercise of the option as adjusted for the likelihood of its exercise and any discount the customer could receive without exercising the option. Alternatively, in certain scenarios, such as contract renewals, another approach could be applied depending on the facts and circumstances.

If the option only provides the customer with a right it would have received without having entered into the contract, the option would not be considered a performance obligation and therefore would have no accounting consequences at contract inception. For example, if the preceding example were modified such that the products are normally sold at a 50% discount off of list price, the option would not be considered a separate performance obligation.



Nonrefundable upfront fees

An entity may receive nonrefundable upfront fees as part of the terms of a customer contract (*e.g.*, initiation fees, activation fees, service contract setup fees). In such situations, an entity would determine whether those fees relate to goods or services that represent a performance obligation. If the fees relate to goods or services that represent a performance obligation, an entity would account for that performance obligation as discussed in the "Identify the separate performance obligations in the contract" section of this whitepaper. Otherwise, the fees would be considered a prepayment for performance obligations to be satisfied in the future and would be recognized as revenue as those future performance obligations are satisfied (or over the period in which those performance obligations are expected to be satisfied if a renewal option provides the customer with a material right it would not otherwise receive without entering into the contract). This would be largely consistent with current U.S. GAAP.

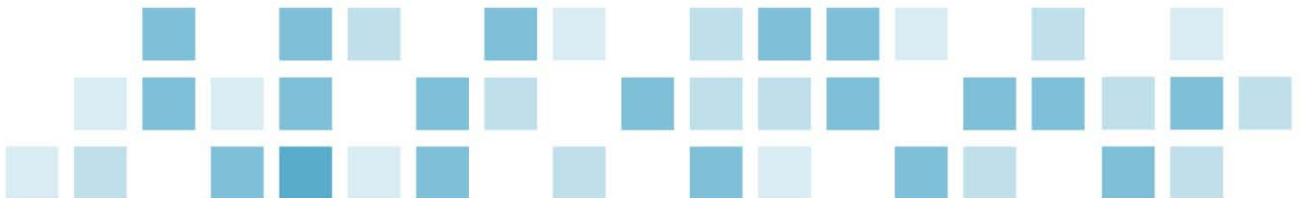
Breakage

An entity may receive nonrefundable prepayments from customers for future goods or services, which would be recognized as a contract liability on receipt. In certain cases, the customer may not fully exercise its rights resulting from those prepayments. The portion of those prepayments for which the customer doesn't exercise its rights is often called breakage. This frequently occurs in relation to gift cards whereby a customer does not fully use the prepaid amount included on the gift card. If an entity is reasonably assured that a breakage amount is included in the initial contract liability, this amount would be recognized as revenue at the same time as the "future" goods or services are transferred to the customer. For example, assume an entity sells a $50 gift card to a customer and expects, based on historical experience, that only $45 of the gift card will be utilized. In this case, there would be $5 of breakage, and this breakage would be recognized as revenue as the revenue related to the goods or services transferred to the customer ($45) is recognized. If an entity is not reasonably assured that a breakage amount is included in the initial contract liability, any potential breakage would not be recognized as revenue until the likelihood of the customer exercising its remaining rights becomes remote.

Licensing and rights to use

Entities in many industries, such as software, franchising and motion pictures, enter into arrangements to allow customers the right to use their intellectual property through a license rather than selling their intellectual property. These types of promised rights would be considered performance obligations that are satisfied, and for which revenue would be recognized, at the point in time the customer obtains control of the right to use the intellectual property. This would be consistent with the revenue recognition model for other goods and services.

If additional performance obligations are sold along with a license to use intellectual property, an entity would need to determine whether the license is distinct and therefore a separate performance obligation. This determination could have a significant impact on the timing of revenue recognition given that a separate performance obligation that is a license would be satisfied at a point in time (and recognized as revenue at that point) while a performance obligation that includes a license combined with services would generally be satisfied over time (and recognized as revenue over that time period).



Presentation

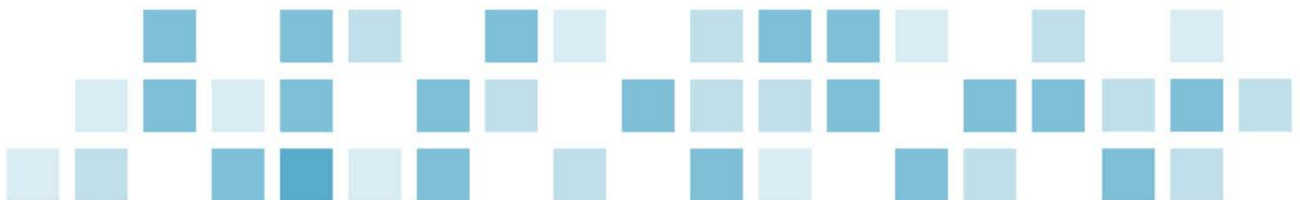
An asset or liability would be recognized in the statement of financial position dependent upon the relationship between the entity's performance (*i.e.*, right to consideration in exchange for goods or services transferred to the customer) and the customer's performance (*i.e.*, consideration paid to the entity). If a customer's performance is greater than that of the entity, a liability would be recognized. If an entity's performance is greater than that of the customer, an asset would be recognized. These assets and liabilities could be labeled "contract assets" and "contract liabilities" or another suitable description. Furthermore, an unconditional right to receive consideration would be recognized as a receivable separately from the preceding asset or liability.

Disclosures

An entity would be required to disclose certain quantitative and qualitative information to help financial statement users understand the nature, amount, timing, and uncertainty of revenue and related cash flows. The following are some of the disclosures that would help meet that objective:

- A disaggregation of revenue into the primary categories that depict how the nature, amount, timing, and uncertainty of revenue and related cash flows are affected by economic factors;
- A reconciliation of the opening and closing balances of contract assets and liabilities, liabilities for onerous performance obligations, and assets arising from costs to obtain or fulfill a contract;
- A description of performance obligations including the nature of the performance obligations and when they are typically satisfied;
- The amount of transaction price allocated to remaining performance obligations and when that amount is expected to be recognized as revenue for certain contracts;
- Information about onerous performance obligations, including their nature and amount and the reasons why they are onerous;
- A description of significant judgments made in the revenue recognition process; and
- Information about methods, inputs, and assumptions used to determine the transaction price; estimate standalone selling prices of promised goods or services; measure obligations for returns, refunds, and other similar obligations; and measure the amount of the liability recognized for onerous performance obligations.

Certain of the preceding disclosures would also be required in interim financial statements. Furthermore, for U.S. GAAP, some disclosures such as the reconciliation of the opening and closing balances of contract assets and liabilities and the amount of the transaction price allocated to remaining performance obligations would not be required for nonpublic entities.



Transition method

The proposed method of transition in the revised ED is retrospective, which would require entities to recast their financial statements for all periods presented. Allowable practical expedients to the full retrospective transition method would include:

- Contracts completed prior to initial application that begin and end in the same prior annual reporting period would not need to be restated;
- For contracts with variable consideration that are completed prior to initial application, the transaction price on the date of contract completion could be used;
- The onerous test would not need to be performed prior to initial application, unless an onerous contract liability was recognized previously based on existing revenue recognition guidance; and
- For periods prior to initial application, the amount of transaction price allocated to remaining performance obligations and when that amount is expected to be recognized as revenue would not need to be disclosed.

If any of these practical expedients were utilized, they would have to be disclosed along with a qualitative assessment of the estimated effect of their use on the financial statements.

Effective date

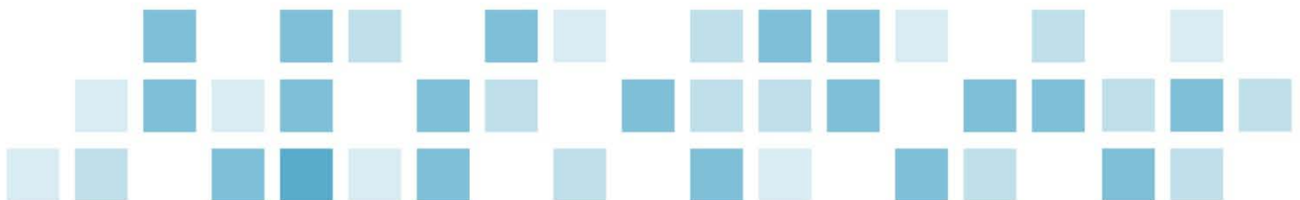
The revised ED does not specify the effective date of any final guidance that will result from this project. However, the revised ED does indicate that the effective date would be no earlier than for annual periods beginning in 2015. For U.S. GAAP only, the effective date for nonpublic entities would be no earlier than for annual periods beginning in 2016 and early adoption would not be allowed for any entities.

Comments

The revised ED is available for comment until March 13, 2012. The Boards are inviting comments on all matters in the revised ED and are requesting specific feedback on:

- The criteria for determining whether an entity satisfies a performance obligation and recognizes revenue over time;
- The measurement and presentation requirements related to a customer's credit risk;
- The reasonably assured revenue recognition constraint;
- The requirement that the onerous performance obligation test is only applicable to contracts spanning a period of greater than one year;
- The interim financial statement disclosure requirements; and
- The application of the recognition and measurement principles of the revised ED to the transfer of a nonfinancial asset that is not an output of an entity's ordinary activities.

Comments can be made using the FASB's electronic feedback form or sent in the form of a written letter via email to director@fasb.org.



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