

# **Wiley Revenue Recognition**

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Understanding and Implementing  
the New Standard

**Joanne M. Flood**

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## WHAT IS REVENUE?

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### U.S. GAAP

Revenue: Influx or other enhancement of assets of an entity or settlements of liabilities (or a combination of both) from delivering or producing goods, rendering services, or other activities that constitute the entity's ongoing major or central operations. (ASC 606-10-20)

### IFRS

Revenue: Income arising in the course of an entity's ordinary activities. (IFRS 15, Appendix A)

Income: Increases in economic benefits during the accounting period in the form of inflows or enhancements of assets or decreases in liabilities that result in an increase in equity other than those relating to contributions from equity participants. (IASB Framework)

### Revenue versus Gains

**U.S. GAAP.** The U.S. Financial Accounting Standards Board (FASB) distinguishes revenue from gains. Gains are defined in Statement of Financial Accounting Concept 6 (CON6), *Elements of Financial Statements*, as

*Increases in equity (net assets) from peripheral or incidental transactions of an entity and from all other transactions and other events and circumstances affecting the entity except those that result from revenues or investments by owners.*

Revenue is commonly distinguished from gains in U.S. GAAP for the three reasons listed below.

#### Exhibit ES.1 Distinguishing between revenue and gains in U.S. GAAP

Revenue	Gains
Results from an entity's central operations.	Result from incidental or peripheral activities of the entity.
Is usually earned.	Result from nonreciprocal transactions (such as winning a lawsuit or receiving a gift) or other economic events for which there is no earnings process.
Is reported gross.	Are reported net.

### IFRS

The IASB's definition of income includes revenue and gains. Gains are defined as increases in economic benefits and other items of revenue. They may or may not occur in the ordinary course of business.

## THE NEW REVENUE STANDARD<sup>1</sup>

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*The revenue recognition standard represents a major milestone in our efforts to improve and converge one of the most important areas of financial reporting. It will eliminate a major source of inconsistency in GAAP, which currently consists of numerous disparate, industry-specific pieces of revenue recognition guidance.*

—Russell Golden, Chairman of the FASB

*The successful conclusion of this project is a major achievement for both boards. Together, we have improved the revenue requirements of both IFRS and U.S. GAAP, while managing to achieve a fully converged standard. Our attention now turns to ensuring a successful transition to these new requirements.*

—Hans Hoogervorst, Chairman of the IASB  
FASB/IASB Press Release May 28, 2014

In May 2014, the FASB and the IASB jointly issued *Revenue from Contracts with Customers* as, respectively,

- Accounting Standards Update (ASU) 2014-09 and
- IFRS 15.

## DEVELOPMENT OF REVENUE GUIDANCE

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Revenue numbers are a critical metric for investors. Revenue recognition has often been a source of restatements and comments from regulators, such as the U.S. Securities and Exchange Commission (SEC). Over the years, regulators have increased their enforcement activities in this area.

### U.S. GAAP

Revenue recognition guidance in the U.S. was initially found in

- CON 5, which specifies that an entity should recognize revenue when realized or realizable and earned, and
- CON 6, which defines revenue as inflows or other enhancements of assets and/or settlements of liabilities from delivering goods or services as a result of the entity's ongoing major or central operations.

In 1999, the SEC provided additional guidance to public companies in Staff Accounting Bulletin (SAB) No. 101 (amended in 2003 by SAB No. 104 and codified in Topic 13).

U.S. GAAP related to revenue developed piecemeal, with specific, often industry-related requirements, but also has broad concepts. In some cases, the guidance resulted in different accounting for economically similar transactions. In addition to the guidance in ASC Topic 605, *Revenue Recognition*, U.S. guidance can be found in numerous pieces of industry-specific guidance, such as that for the software industry, construction contracts, real-estate

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<sup>1</sup> The Financial Accounting Standards Board (FASB) and the International Accounting Standards Board (IASB) (the Boards) issued two separate standards. For ease of reference, this publication refers to them as “the revenue standard” or “the Standard.”

sales, and multiple-element arrangements. Industry guidance often addressed narrow issues and was not built on a common framework. This led to economically similar transactions being accounted for differently. Even though in the U.S. there were 200 separate pieces of guidance, there were still transactions for which there was no guidance, in particular for service transactions.

## IFRS

IFRS does not have as many rules, but the standards can be confusing and difficult to apply, and were sometimes based on different principles. The guidance was limited for some significant topics, like contracts with multiple-element arrangements. This lack of guidance made it difficult to account for some complex transactions. When IFRS guidance was absent, preparers at times turned to industry-specific U.S. literature.

## THE REVENUE RECOGNITION PROJECT

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Driven by the need to achieve simplification and consistency, the FASB and the IASB (the Boards) began a joint project in 2002.

The Boards issued an exposure draft (ED) in June 2010 that elicited over 1,000 comment letters. The Boards issued a revised ED in November 2011 and conducted numerous meetings and outreach activities before issuing the final Standard. The basically converged, new Standard is principles based, eliminating the existing transaction- and industry-specific guidance. This move away from prescriptive guidance and bright lines increases the need for professional judgment, which in turn increases the need for expanded disclosures. To compensate for the lack of rules, the revenue standard provides extensive application guidance.

### The New Standards

In the U.S., ASU 2014-09

- superseded 200 separate items of FASB Accounting Standards Codification® (ASC) guidance, most of it industry specific
- created Topic 606, *Revenue from Contracts with Customers* and Subtopic 340-40, *Other Assets and Deferred Costs—Contracts with Customers*.
- created Topic 610, *Other Income*

ASU 2014-09 is over 700 pages long and was released in the following sections:

- Amendments to the FASB Accounting Standards Codification
  - Section A—Summary and Amendments That Create Revenue from Contracts with Customers (Topic 606) and Other Assets and Deferred Costs—Contracts with Customers (Subtopic 340-40)
  - Section B—Conforming Amendments to Other Topics and Subtopics in the Codification and Status Tables
- Background Information and Basis for Conclusions
  - Appendix: Comparison of Topic 606 and IFRS 15
- Amendments to XBRL Taxonomy.



IFRS 15 replaces the previous standards IAS 11, *Construction Contracts* and IAS 18, *Revenue* and several interpretations:

- IFRIC 13, *Customer Loyalty Programmes*
- IFRIC 15, *Agreements for the Construction of Real Estate*
- IFRIC 18, *Transfers of Assets from Customers*
- SIC-31, *Revenue—Barter Transactions Involving Advertising Services*.

IFRS 15 is over 300 pages long and was released in these sections:

- IFRS 15 with Appendices
- Defined Terms
- Application Guidance
- Effective Date and Transition
- Amendments to Other Sections
- Basis for Conclusion with Appendices
- Comparison of IFRS 15 and Topic 606
- Amendments to the Basis for Conclusions in Other Sections
- Illustrative Examples
- Appendix
- Amendments to the Guidance in Other Standards.

### Project Goals

The FASB and the IASB believe that the final documents meet two major goals—simplification of revenue recognition guidance and consistency globally and across entities, jurisdictions, markets, and industries. According to *FASB in Focus*,<sup>2</sup> the Boards believe that the Standard meets their goals to

- remove inconsistencies and weaknesses in existing revenue 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 organization must refer.

The revenue standard provides a robust framework that is expected to simplify the preparation of financial statements by reducing the sources of guidance and replacing them with a single source that users can understand. The Standard adds new guidance for contract modifications and offers consistent application for service contracts. The Standard also provides guidance for related topics, such as warranties, licenses, and when to capitalize the cost of obtaining a contract and some costs of fulfilling a contract.

**Customer Loyalty Programs.** In addition, the changes may affect customer loyalty programs. Companies will have to make new estimates. It is expected that entities will be reviewing their loyalty programs to evaluate their effects, if any, on revenue, and some companies may choose to amend their contracts with customers.

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<sup>2</sup> *FASB in Focus*, May 28, 2014, FASB, Stamford, CT.

**Exhibit ES.2 Key differences between ASU 2014-09 and IFRS 15**

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**EFFECTIVE DATES**

While the FASB and IASB standards are generally aligned, the implementation dates are different. (See the section in this chapter on effective dates.) Also, the IASB allows early implementation and has no relief for nonpublic entities. IFRS for small and medium-sized public entities is available for those entities. The FASB allows early implementation but only for annual reporting periods beginning after December 15, 2016. (ASC 606-10-65-1; IFRS 15.C)

**COLLECTIBILITY THRESHOLDS**

In order for an entity to apply the revenue standard to a contract, collectibility must be probable. The collectibility threshold for recognizing revenue, introduced late in the process, is an area of FASB/IASB difference. R. Harold Schroeder, the lone dissenter on the FASB, pointed out that “probable” does not mean the same under U.S. GAAP and IFRS because the definitions of probable are different under each. According to Schroeder’s dissenting opinion, the IASB’s threshold is lower because it defines probable as “more likely than not,” which is greater than 50%, whereas the FASB Topic 450 defines probable as “likely to occur,” which some have historically interpreted as a 75–80% threshold. The Boards acknowledged this difference, but decided to be consistent with their own definitions. The IASB’s Mackintosh and the FASB’s Golden both believe that the difference will have a small impact on results. [ASC 606-10-25-1(e); IFRS 15.9(e)]

The FASB, but not the IASB, amended its guidance to clarify that when assessing collectibility, an entity should evaluate the consideration for the goods or services it expects to receive rather than the consideration promised for all the goods or services.

In addition, the FASB subsequently decided to clarify that when assessing collectibility, an entity should consider its ability to mitigate its exposure to credit risk. The IASB concluded that its guidance and discussion in the Basis for Conclusions is sufficient. (Also, see the appendix to this summary for information on proposals to amend the Standard as originally issued.)

**INTERIM REQUIREMENTS**

Disclosures are another source of FASB/IASB differences. The Boards generally kept their existing interim requirements. However, the IASB amended its guidance to require interim disclosure of disaggregated information. The FASB amended Topic 270 similarly for public entities, but also added requirements to disclose on an interim basis revenue recognized in the current period that was included in the contract balances at the beginning of the period, revenue recognized in the current period for performance obligations satisfied in previous periods, and remaining performance obligations. The FASB generally prescribes interim disclosures, whereas the IASB leans toward only annual disclosures. (ASC 270-10-50-1A; IAS 34.16A)

**PROMISED GOODS OR SERVICES IMMATERIAL IN THE CONTEXT OF THE CONTRACT**

The FASB, but not the IASB, clarified that an entity is not required to assess whether promises that are immaterial in the context of the contract are performance obligations.

## **PRESENTATION OF SALES TAXES**

The FASB, but not the IASB, provides an accounting policy election that allows an entity to exclude sales and similar taxes from the measurement of transaction price.

## **SHIPPING AND HANDLING ACTIVITIES**

The FASB, but not the IASB, includes a practical expedient that allows entities to account for as fulfillment activities shipping and handling activities that occur after the customer has obtained control of a good.

## **NONCASH CONSIDERATION**

The FASB, but not the IASB, requires noncash consideration to be measured at fair value at contract inception. The FASB also specifies that the constraint on variable consideration applies only to the variability in the fair value of the noncash consideration that arises from reasons other than the form of the consideration.

## **LICENSING**

Both the FASB and the IASB made changes subsequent to the issuance of ASU 2014-09 and IFRS 15 on guidance regarding licenses. Those changes are incorporated into Chapter 6 and relate to

- determining the nature of the entity's promise in granting a license of intellectual property
- contractual restriction in a license and the identification of performance obligations
- renewals of licenses of intellectual property
- when to consider the nature of an entity's promise in granting a license.

## **COMPLETED CONTRACTS**

The FASB amended its definition of a completed contract, but the IASB did not. (See Chapter 9.) The IASB contains a practical expedient to allow an entity applying the full retrospective method of adoption not to restate contracts that are completed contracts at the beginning of the earliest period presented.

## **PRACTICAL EXPEDIENT FOR CONTRACT MODIFICATION—DATE OF APPLICATION**

For entities applying the modified retrospective method, the FASB requires entities to apply the practical expedient at the date of initial application. The IASB allows entities to apply the expedient either at the beginning of the earliest period presented or at the date of initial application.

## **DISCLOSURE RELIEF FOR NONPUBLIC ENTITIES**

The FASB provides specific relief related to disclosure, transition, and effective dates for nonpublic entities, while the IASB does not. IFRS 15 applies to all entities, except for small and medium-sized entities. (ASC 606-10-50-7, 50-11, 50-16, 50-21, 340-40-50-4; IFRS 15.5)

## IMPAIRMENT LOSS REVERSAL

U.S. guidance does not permit impairment loss reversal for an asset that is capitalized under the guidance on costs to obtain or fulfill a contract. IASB guidance requires an entity to reverse an impairment loss, consistent with the guidance of IFRS 36, *Impairment of Assets*. (ASC 340-40-35-6; IFRS 15.104)

In addition to these major differences, the FASB and the IASB have some differences in the articulation of the principles of the Standard. Those differences and the differences above are included in the relevant chapters in this volume.

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Source: Clarifications to IFRS 15, Appendix A; ASU 2014-12, Appendix.

## SCOPE

The scope of the Standard is wide. It affects all public companies, nonpublic companies, and nonprofit organizations. The Standard applies to contracts with customers and defines a customer as:

*a party that has contracted with a company to obtain a good or service that is an output of the company's ordinary activities in exchange for consideration.*

(ASC 606-10-20)

**Practice Pointer:** Care should be taken to determine whether a contract is with a customer or if it is a collaborative effort. To make the recognition and measurement consistent with revenue transactions, the Standard applies to transfers of nonfinancial assets, such as property and equipment, that give rise to revenue. Revenue can be generated by contracts that are not with customers. Examples are alternative revenue programs of utilities and not-for-profit contributions. The Standard is applicable to those transactions.

## Scope Exceptions

The following are outside the scope of the Standard:

- Lease contracts in the scope of ASC 840, *Leases* and IAS 17, *Leases*.
- Insurance contracts issued by insurance entities within the scope of ASC Topic 944, *Financial Services—Insurance* or IFRS 4, *Insurance Contracts*. Note: Insurance contracts issued by entities that do not apply insurance industry-specific guidance under U.S. GAAP are in the scope of the revenue standard. Under IFRS, insurance contracts are scoped out no matter who issues them. Warranty contracts considered insurance contracts under IFRS I are also scoped out.
- Financial instruments and other contractual rights or obligations in the scope of
  - ASC 310, *Receivables*
  - ASC 320, *Investments—Debt and Equity Securities*
  - ASC 323, *Investments—Equity Method and Joint Ventures*
  - ASC 325, *Investments—Other*

- ASC 405, *Liabilities*
  - ASC 470, *Debt*
  - ASC 815, *Derivatives and Hedging*
  - ASC 825, *Financial Instruments*
  - ASC 860, *Transfers and Servicing*
  - IFRS 9, *Financial Instruments*
  - IFRS 10, *Consolidated Financial Statements*
  - IFRS 11, *Joint Arrangements*
  - IAS 27, *Separate Financial Statements*
  - IAS 28, *Investments in Associates and Joint Ventures*.
- Guarantees other than product or service warranties, in the scope of ASC 460, *Guarantees*.
  - Nonmonetary exchanges between entities in the same line of business to facilitate sales to customers or potential customers.
- (ASC 606-10-15-2)

Revenue from transactions or events that do not arise from contracts with customers is not in the scope of the Standard, such as

- dividends
- non-exchange transactions, like donations or contributions
- IFRS only:
  - changes in the fair value of biological assets, investment properties, and the inventory of broker-traders
- U.S. GAAP only:
  - changes in regulatory assets and liabilities arising from alternative revenue programs for rate-regulated activities in the scope of ASC 930, *Regulated Operations*.

The guidance included in new subtopic ASC 340-40 applies only if the costs incurred are related to a contract under ASC 606. (ASC 606-10-5)

The guidance in new topic ASC 610 specifies the standards for income that is not in the scope of ASC 606, including gains and losses from the derecognition of nonfinancial assets and from gains and losses on involuntary conversions.

### **Example ES.1: Nonmonetary Exchanges to Facilitate Sales to Customers or Potential Customers**

ABC Road Salt sells road salt to municipalities. ABC determines the optimum amount of salt on hand to meet a typical winter's demand in New York State. ABC enters into a contract with Penn Road Salt to provide road salt to the other if needed. ABC and Penn are in different regions and rarely experience the same winter storms. The parties provide each other no other consideration.

This transaction is outside the scope of the Standard because it involves nonmonetary exchanges between parties in the same line of business to facilitate sales to customers or potential customers.

### **Contracts Partially in Scope**

If a contract is partially within the scope of the Standard and partially within the scope of other guidance, the entity should apply the other guidance first. That is, if the other standard specifies

how to separate or initially measure parts of the contract, then the entity should apply those requirements first. The remaining portion is accounted for under the requirements of the new Standard. If the other standard does not have applicable separate and/or initial measurement guidance, the entity should apply the revenue standard to separate and/or initially measure the contract. (ASC 606-10-15-4)

### **Example ES.2: Contract Partially Out of Scope**

Power Rentals leases power equipment to builders and provides maintenance for the leased equipment. To record the transaction, Power Rentals must first separate the contract price related to leasing the equipment and account for that under the leasing guidance. The remaining maintenance portion would be accounted for under the revenue standard.

### **Sale of Transfer of Nonfinancial Assets**

Transactions that are not part of the entity's ordinary activities, such as the sale of property, plant, and equipment, nonetheless fall under certain aspects of the Standard. An entity involved in such activities applies the guidance related to transfer of control (Chapter 5) and measurement of the transaction price (Chapter 3) to evaluate the timing and amount of the gain or loss. U.S. GAAP reporters should also apply the guidance in the Standard to determine whether the parties are committed to perform under the contract and, therefore, whether a contract exists (Chapter 1).

## **EFFECTIVE DATES**

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In deciding on effective dates, the Boards wanted to strike the right balance between improving reporting standards as soon as possible and giving entities enough time to implement the broad and potentially significant changes. Ultimately, the Boards decided on a longer than usual implementation period because of the number of entities and line items affected. Despite that added time, soon after the release of the Standard, the Boards heard from many entities that they needed more time to implement the new guidance.

### **Changes to Effective Dates**

**U.S. GAAP.** In response to constituent concerns, the FASB issued ASU 2015-14, *Revenue from Contracts with Customers (Topic 606): Deferral of Effective Dates*. The ASU allows for all entities a one-year deferral from the original effective dates and for early adoption using the original adoption dates.

The ASU is effective as follows:

- For public entities, the guidance in the Standard is effective for annual reporting periods beginning after December 15, 2017, including interim reporting periods within that period; that is, beginning in the first interim period within the year of adoption. Early application is permitted but not earlier than the original effective date of December 15, 2016.
- For nonpublic entities, the new guidance is required for annual reporting periods beginning after December 15, 2018, and interim periods within annual periods beginning after December 15, 2019. A nonpublic entity may elect early application, but no earlier than the original effective date for public entities.

**IFRS.** IFRS 15 was originally effective for annual periods beginning on or after January 1, 2017. Partly because in the near future some companies will transition from national to international standards, the IASB allows for early adoption for current IFRS preparers, provided that fact is disclosed and for first time preparers. In September 2015, the IASB issued an amendment to IFRS 15 deferring the effective date for one year until 2018. Entities still have the option of applying early.

### Other Changes to the Standard

In addition to the ASU deferring the effective date, the FASB responded to feedback by issuing several other EDs to amend ASU 2014-09:

- Accounting Standards Update 2016-08, *Revenue from Contracts with Customers (Topic 606): Principal versus Agent Considerations (Reporting Revenue Gross versus Net)*
- Accounting Standards Update 2016-10, *Revenue from Contracts with Customers (Topic 606): Identifying Performance Obligations and Licensing*
- Accounting Standards Update 2016-12, *Revenue from Contracts with Customers (Topic 606): Narrow-Scope Improvements and Practical Expedients*
- Proposed Accounting Standards Update, *Technical Corrections and Improvements to Update 2014-09, Revenue from Contracts with Customers*. As this volume goes to press, the FASB expects to issue a final document in the fourth quarter of 2016.
- Proposed Accounting Standards Update, *Technical Corrections and Improvements to Update 2014-09, Revenue from Contracts with Customers-Additional Corrections*

As a purchaser of this book, you have exclusive access to a companion website, with the latest technical developments and other useful information. The website will contain updated information about exposure drafts and other technical guidance from the standards' setters. See the back of the book for information on how to access the site.

The IASB decided to issue its changes in one comprehensive document: *Clarifications to IFRS 15*. For more on the FASB's and IASB's changes, see the appendix to this summary.

## IMPLEMENTATION OPTIONS

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Entities have the option to implement the guidance through

- full retrospective application, or
- modified retrospective application.

### Full Retrospective Approach

Under this method, all prior periods presented must be restated in equity in accordance with ASC 250, *Accounting Changes and Error Corrections*. That is, entities must report the cumulative effect for the earliest year reported.

### Modified Retrospective Approach

Using the modified retrospective approach, the entity recognizes the cumulative effect of initially adopting the standard as an adjustment to the opening balance of retained earnings in the annual period when the standard is adopted. If the entity issues comparative statements, then it reports revenue for prior years under the guidance in effect before adoption.

## OBJECTIVE OF THE STANDARD

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The objective of the Standard is

*... to establish the principles that an entity shall apply to report useful information to users of financial statements about the nature, amount, timing, and uncertainty of revenue and cash flows arising from a contract with a customer.*

(ASC 606-10-10-1)

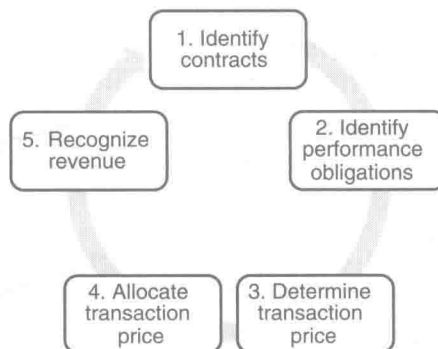
The Standard provides principles to help entities meet this objective when measuring and reporting on revenue.

## CORE PRINCIPLE AND THE FIVE STEPS OF THE REVENUE RECOGNITION MODEL

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The Standard takes an asset and liability approach and articulates a core principle on which the new guidance is based.

**Exhibit ES.3 The five steps**



### Core Principle:

*... recognize revenue to depict the transfer of promised goods 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. (FASB ASC 606-10-05-3 et al., IFRS 15.IN7)*

This core principle reflects the asset and liability approach that underlies the Standard. This approach recognizes revenue based on changes in assets and liabilities. The Boards believe that this is consistent with the conceptual framework approach to recognition and brings more consistency to the measurement compared with the “earned and realized” criteria in previous standards. To achieve the core principle, entities should follow the five steps above, explained through the following simple example.



**Example ES.3: Application of the Core Principle Through the Five Steps**

Assume that on May 1, 20X1, ACME enters into a contract to sell 50 desktop computers to XYZ Company for CU 50,000 with delivery promised on July 15, 20X1. On July 31, 20X1, ACME completes a performance obligation by delivering all the computers and makes the following entries:

	Debit		Credit
Accounts Receivable	CU 50,000	Revenue	50,000
Cost of Goods Sold	CU 30,000	Inventory	30,000

On August 15, 20X1, the customer makes the payment and ACME makes the following entry:

	Debit		Credit
Cash	CU 50,000	Accounts Receivable	50,000

Under the Standard, entities account for assets and liabilities arising from customer contracts. Entities must carefully analyze their contracts for

- terms,
- measurements, and
- promises.

In reviewing a transaction, each of the five steps in Exhibit ES.4 may not be needed, and they may not always be applied sequentially. Be aware that the Standard is not organized by these five steps, but the Boards believe that the steps offer a methodology for entities to use when deciding on the appropriate accounting for a transaction. As mentioned, the model is based on an assets and liabilities or control approach as opposed to the risks and rewards approach under previous standards. However, risks and rewards are a factor when determining control for point-in-time revenue recognition.

Each of the steps encompasses new concepts, and entities will have to carefully analyze their contracts with customers as they transition to the new guidance.

**DISCLOSURES REQUIRED BY THE STANDARD**

*Because there is a greater need to estimate, there is a greater need to disclose.*

*—Russell Golden, FASB Chairman, May 2014*

Revenue is arguably the most significant financial reporting metric, and the Standard requires all entities to make new disclosure requirements designed to provide better information to financial statement users about contracts with customers. The Standard requires entities to disclose both quantitative and qualitative information that enables users of financial statements to understand the nature, amount, timing, and uncertainty of revenue and cash flows arising from contracts with customers. The additional disclosures are partially driven by the increased judgment related to estimates required in the new guidance. The requirements are comprehensive