Multiple-Element Arrangements
A Roadmap to Applying the Revenue Recognition Guidance in ASU 2009-13

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Contents

Preface

FASB Accounting Standards Update 2009-13, *Multiple-Deliverable Revenue Arrangements*, significantly changes the accounting for revenue recognition arrangements with multiple deliverables. The ASU enables entities to separately account for individual deliverables for many more revenue arrangements than they could under previous guidance. By removing the criterion that entities must use objective and reliable evidence of fair value in separately accounting for deliverables, the FASB expects the recognition of revenue to more closely align with the economics of certain revenue arrangements. However, the ability to separately account for more deliverables comes with significantly increased disclosure responsibilities.

Multiple-Element Arrangements — A Roadmap to Applying the Revenue Recognition Guidance in ASU 2009-13 (1) summarizes the changes that were made by ASU 2009-13 and (2) provides interpretive guidance (Q&As) on applying the provisions of this ASU. We hope that financial statement preparers will find this Roadmap helpful.

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Overview

Background

As the business landscape has evolved and become more complex, customers have increasingly demanded integrated solutions to address their needs. In response, entities have diversified, offering more products and services to their customers. Such diversification has resulted in revenue arrangements containing multiple deliverables and, in many cases, multiple payment streams. For example, a service provider may receive an up-front payment upon signing a service contract with a customer and then receive additional payments as multiple services are provided to that customer. Other examples can be much more complex and involve both product and service deliverables. To determine the unit(s) of accounting in such multiple-deliverable arrangements,entities have historically looked to Issue 00-21.[1, 2] Ever since Issue 00-21 became effective, numerous questions have been raised about the application of the accounting guidance therein as well as about the resulting financial reporting.

Issue 00-21 provided guidance on separating deliverables into different units of accounting and on allocating an arrangement's consideration to those units. Specifically, this guidance required entities to identify deliverables in an arrangement; assess whether the delivered items in an arrangement had stand-alone value; determine whether there was objective and reliable evidence of fair value for the undelivered items; and, if a general right of return related to the delivered item exists, assess whether delivery or performance of the undelivered item(s) is considered probable and substantially in the control of the vendor. The required analysis under Issue 00-21 not only was often difficult, but also at times resulted in an accounting conclusion that did not faithfully reflect the economics of a given transaction.

In response to these challenges, the EITF[3] added a project to its agenda to address practice concerns related to the accounting for revenue arrangements with multiple deliverables. This project resulted in Issue 08-1, ultimately codified by ASU 2009-13, which supersedes the guidance from Issue 00-21 that was codified in ASC 605-25. At inception, Issue 08-1 had a fairly narrow focus — whether, under certain circumstances, it may be acceptable to use a multiple-attribution model to recognize revenue for a single unit of accounting. Under a multiple-attribution model, multiple methods are used to recognize arrangement consideration for a single unit of accounting; for example, an up-front payment may be recognized on a straight-line basis over the term of the arrangement, while a price paid per unit may be recognized as units are delivered.

While discussing multiple-attribution models, the EITF acknowledged that there are many different views and interpretations regarding identifying deliverables, determining an "attribution model," and describing the substance of different arrangements. In some circumstances, views differed on whether particular revenue recognition models were, in fact, multiple-attribution models. Accordingly, the EITF requested that the FASB staff perform additional research on the transactions and underlying causes that were giving rise to the practice concerns with applying Issue 00-21.

As has often been its practice when addressing challenging EITF Issues, the Task Force formed a working group to explore the topic in more detail. During discussions of the Issue 08-1 Working Group (the "Working Group") and the Task Force, it was determined that when an entity applies Issue 00-21, one of the more common, and perhaps most significant, causes for financial reporting that did not faithfully reflect the economics of a given transaction was the inability to separate deliverables because of a lack of objective and reliable evidence of fair value for one

[1] The titles of the standards, topics, and regulations referenced in this Roadmap are defined in Appendix C.

[2] Certain transactions that were within the scope of what was previously considered higher-level accounting literature (e.g., AICPA Statements of Position 81-1 and 97-2 and FASB Statements No. 13, 45, and 66) were accounted for under the appropriate higher-level literature and specifically excluded from the scope of Issue 00-21. The *FASB Accounting Standards Codification* (ASC or the "Codification") has not changed the scope of this guidance. ASC 605-25 still specifically excludes from its scope transactions that are covered by other Subtopics in the Codification. Further, Issue 08-1 (codified by ASU 2009-13; see below) does not amend this guidance.

[3] The abbreviations referenced in this Roadmap are defined in Appendix D.

or more of the undelivered items. When separate deliverables are combined into a single unit of accounting, the result is often either no immediate revenue recognition or only partial immediate recognition of revenue related to a product or service already delivered to the customer. In some instances, the delivered item may have represented the substantial portion of the value in the arrangement and yet revenue could only be recognized when the relatively insignificant product or service was subsequently delivered.

Hence, Issue 08-1 evolved from addressing the acceptability and applicability of a multiple-attribution revenue recognition model for a single unit of accounting into addressing the specific question of how to "fix" the separation criteria in Issue 00-21.

Editor's Note: During meetings of both the Working Group and the Task Force, it was generally agreed that a multiple-attribution model of revenue recognition would be acceptable, and that the SEC had accepted such a model, in certain circumstances. However, views differed on what would constitute a multiple-attribution model as well as under what circumstances the use of such a model would be acceptable. Because ASU 2009-13 does not address this topic, an entity will need to use judgment when concluding that a multiple-attribution model is appropriate for a single unit of accounting. In addition, the FASB has issued ASU 2010-17 (formerly Issue 08-9), which addresses certain arrangements involving contingent consideration and the application of a multiple-attribution model.

Key Provisions

The EITF decided that ASU 2009-13 (formerly Issue 08-1) should retain much of the guidance originally included in Issue 00-21 and codified in ASC 605-25. ASU 2009-13 applies to all deliverables in contractual arrangements in all industries in which a vendor will perform multiple revenue-generating activities, except when some or all deliverables in a multiple-deliverable arrangement are within the scope of other, more specific sections of the Codification (e.g., ASCs 840, 952, 360-20 (pre-Codification guidance from Statements 13, 45, and 66) and other sections of ASC 605 on revenue recognition (e.g., pre-Codification guidance from SOPs 81-1 and 97-2)). Specifically, ASU 2009-13 addresses the unit of accounting for arrangements involving multiple deliverables. It also addresses how arrangement consideration should be allocated to the separate units of accounting, when applicable. However, guidance on determining when the criteria for revenue recognition are met and on how an entity should recognize revenue for a given unit of accounting is located in other sections of the Codification. The timing and pattern of revenue recognition for a given unit of accounting depend on the nature of the deliverable(s) composing that unit and on whether the applicable criteria for revenue recognition have been met. In determining the appropriate revenue recognition model to use, an entity should consider other accounting literature (e.g., SAB Topic 13).

ASU 2009-13 requires a vendor to evaluate all deliverables in an arrangement to determine whether they represent separate units of accounting. This evaluation must be performed at the inception of an arrangement and as each item in the arrangement is delivered. ASU 2009-13 retains from Issue 00-21 two of the three criteria for when delivered items in a multiple-deliverable arrangement should be considered separate units of accounting and states (codified in ASC 605-25-25-3):

> In an arrangement with multiple deliverables, the delivered item or items shall be considered a separate unit of accounting if both of the following criteria are met:
>
> a. The delivered item or items have value to the customer on a standalone basis. The item or items have value on a standalone basis if they are sold separately by any vendor or the customer could resell the delivered item(s) on a standalone basis. In the context of a customer's ability to resell the delivered item(s), this criterion does not require the existence of an observable market for the deliverable(s).
>
> b. [Superseded by ASU 2009-13.]
>
> c. If the arrangement includes a general right of return relative to the delivered item, delivery or performance of the undelivered item or items is considered probable and substantially in the control of the vendor.

A delivered item that does not meet both of the criteria above would not qualify as a separate unit of accounting and would be combined with other deliverables in an arrangement. The allocation of consideration and recognition of revenue would then be determined for those combined deliverables as a single unit of accounting.

ASU 2009-13 removes the previous separation criterion under Issue 00-21 that objective and reliable evidence of the fair value of any undelivered items **must** exist for the delivered items to be considered a separate unit or separate units of accounting. Under ASU 2009-13, an entity must determine the selling price of deliverables otherwise qualifying for separation ("qualifying deliverables") by using VSOE or TPE of selling price **or** by making its best estimate of the selling price. That is, under Issue 00-21, an entity could only use certain types of evidence when determining the fair values of deliverables. ASU 2009-13 does not contain any such restriction.

Editor's Note: ASU 2009-13 replaced all references to "fair value" in ASC 605-25 (Issue 00-21) with references to "selling price" to clarify that the selling-price measure in Issue 08-1 is not a market-participant measure as required by ASC 820 (formerly Statement 157). The selling price of an item is an entity-specific measure that represents the amount an entity would sell that item for in a stand-alone transaction with a customer. An entity is permitted, but not required, to incorporate market-based inputs, such as TPE, into the determination of selling price (note also, however, that an entity would be required to do so in determining fair value under ASC 820).

While the changes outlined above may seem relatively minor in the context of the model for determining separate units of accounting for multiple-deliverable arrangements, the implications of those changes may be quite significant, as illustrated in the following example:

Example

Entity A, a manufacturer of highly specialized electronic equipment, enters into a $3 million arrangement to deliver this equipment and provide implementation services after the delivery. The effort A must expend to perform the implementation services can vary significantly from customer to customer. Thus, A cannot reliably estimate the amount of time it needs to perform the implementation services for any particular customer. Entity A therefore determines that it does not have objective and reliable evidence of fair value for the implementation services. The electronic equipment has stand-alone value to the customer, and the agreement has no general right of return.

Evaluation Under Issue 00-21

Because A does not have objective and reliable evidence of fair value for the implementation services, the electronic equipment and implementation services are one unit of accounting. Entity A determines that an appropriate method of revenue recognition for its single unit of accounting is to recognize the $3 million fee as implementation services are provided.

Evaluation Under ASU 2009-13

The separation criteria for the electronic equipment are met because the equipment has stand-alone value to the customer and no general right of return exists. Therefore, both the electronic equipment and the implementation services deliverables are accounted for as separate units of accounting and A must determine the selling price for each deliverable and allocate a portion of the fee to each deliverable.

Entity A determines that an appropriate method of revenue recognition is to recognize the portion of the fee allocated to the electronic equipment upon its delivery and the remaining portion of the fee as implementation services are provided.

Selling Price Hierarchy

ASU 2009-13 discusses how an entity should allocate arrangement consideration to separate units of accounting. In doing so, entities are required, at the inception of an arrangement, to establish the "selling price" for all deliverables that qualify for separation. The manner in which "selling price" is established is based on a hierarchy of evidence that entities must consider. Total arrangement consideration is then allocated on the basis of the deliverables' relative selling price.

In considering the hierarchy of evidence under ASU 2009-13, an entity first determines the selling prices by using VSOE of selling price, if it exists; otherwise, TPE of selling price must be used. If neither VSOE nor TPE of selling price exists for a deliverable, an entity must use its best estimate of the selling price for that deliverable to allocate consideration among the deliverables in an arrangement. As stated in ASU 2009-13 (codified in ASC 605-25-30-2), in deciding whether the entity can establish VSOE or TPE of selling price, the "vendor shall not ignore information that is reasonably available without undue cost and effort."

ASU 2009-13 further defines each of the three levels within the hierarchy. ASC 605-25-30-6A defines VSOE as follows:

> Vendor-specific objective evidence of selling price is limited to either of the following:
>
> a. The price charged for a deliverable when it is sold separately [or]
>
> b. For a deliverable not yet being sold separately, the price established by management having the relevant authority (it must be probable that the price, once established, will not change before the separate introduction of the deliverable into the marketplace).

ASC 605-25-30-6B defines TPE as follows:

> Third-party evidence of selling price is the price of the vendor's or any competitor's largely interchangeable products or services in standalone sales to similarly situated customers.

ASC 605-25-30-6C defines estimated selling price as follows:

> The vendor's best estimate of selling price shall be consistent with the objective of determining [VSOE] of selling price for the deliverable; that is, the price at which the vendor would transact if the deliverable were sold by the vendor regularly on a standalone basis. The vendor shall consider market conditions as well as entity-specific factors when estimating the selling price.

Editor's Note: Issue 00-21 allowed for separation of deliverables if there was VSOE or TPE of fair value for the undelivered item(s). Accordingly, the threshold for establishing VSOE and TPE of selling price under ASU 2009-13 is unchanged from the threshold for establishing VSOE or TPE of fair value under Issue 00-21. Consequently, entities that appropriately established VSOE or TPE of fair value for deliverables under Issue 00-21 will be able to establish VSOE or TPE of selling price for those same deliverables under ASU 2009-13 (provided that the relevant facts and circumstances have not changed).

Because of the use of entity-specific assumptions coupled with the various judgments necessary to determine the selling price of a deliverable in accordance with the required selling price hierarchy, entities applying ASU 2009-13 may determine selling prices in very different ways. As a result, the amount of revenue recognized in a particular period, as well as the amount of revenue recognized for similar deliverables, may be different. The following example illustrates how seemingly similar arrangements result in different accounting conclusions on the basis of the entity's business practices and judgments.

Example

Entities A, B, and C manufacture, sell, and install high-pressure water jet cutting systems. In limited situations, customers of A, B, and C have sold the water jet cutting systems to others who have installed the systems themselves.

Entity A's systems can be purchased on a stand-alone basis for $400,000 or bundled with installation for $450,000. In addition, A provides installation services for most other competitors' systems for $100,000.

Entity B's systems and installation services are similar to A's, except that B does not sell either its systems or installation services separately. Entity B sells its systems and installation services for a combined price of $475,000.

Entity C typically bundles its systems with installation and does not separately sell installation services. Entity C's systems contain advanced technology that is still under patent. The advanced technology requires a proprietary installation service offered by C. Some customers with the appropriate level of expertise perform the installation services, although this is infrequent. Entity C sells its bundled systems and installation for a combined price of $450,000. Entity C's best estimate of the selling price of its systems and installation on a stand-alone basis is $450,000 and $150,000, respectively.

Because A has transactions in which it separately sells its systems and installation, A determines that it has VSOE of selling price for both elements — $400,000 for the system and $100,000 for the installation. Therefore, when it sells the two combined for $450,000, A should allocate $360,000 [($400,000 ÷ $500,000) × $450,000] to the system and $90,000 [($100,000 ÷ $500,000) × $450,000] to the installation.

Because B only sells the system and installation services as a bundle, it does not have VSOE of selling price for either deliverable. However, B determines that its systems and installation are largely interchangeable with A's systems and installation. Accordingly, B determines that it has TPE of selling price for both deliverables, $400,000 for the system and $100,000 for the installation, on the basis of A's selling prices when A sells the deliverables separately. Therefore, B should allocate $380,000 [($400,000 ÷ $500,000) × $475,000] to the system and $95,000 [($100,000 ÷ $500,000) × $475,000] to the installation.

Because C typically sells the system and installation services as a bundle, it too does not have VSOE of selling price for either deliverable. In the limited instances in which the system was sold separately, there was significant variation in pricing and customer type. In addition, C believes that because of its patented advanced technology, its systems and installation services are not sufficiently similar to A's or B's systems and installation services. Accordingly, C determines that it must use its best estimate of selling price, $450,000 for the system and $150,000 for the installation, to allocate the arrangement consideration. Therefore, C should allocate $337,500 [($450,000 ÷ $600,000) × $450,000] to the system and $112,500 [($150,000 ÷ $600,000) × $450,000] to the installation.

The previous example illustrates the different outcomes that may result from the different judgments necessary to apply ASU 2009-13. It also illustrates one of the other significant changes to Issue 00-21, the change in arrangement consideration allocation method to require the relative selling price method for all multiple-deliverable arrangements. That method requires that once selling prices are determined at the inception of an arrangement, consideration is allocated to each respective deliverable on the basis of its relative selling price. ASU 2009-13 (codified in ASC 605-25-30-2) refers to this method of allocation as the "relative selling price method."

Relative Selling Price Method

ASU 2009-13 (codified in ASC 605-25-30-2) describes the way in which arrangement consideration should be allocated to the individual deliverables and states that "[a]rrangement consideration shall be allocated at the inception of the arrangement to all deliverables on the basis of their relative selling price (the relative selling price method)."

Because of ASU 2009-13's new requirements that entities use a three-level hierarchy when establishing the selling price and that they use the relative selling price method when allocating arrangement consideration, the "residual method" under Issue 00-21 is no longer appropriate. Therefore, upon adopting the guidance in ASU 2009-13, entities will be required to estimate the selling price for **all** deliverables that qualify for separation in an arrangement, regardless of whether those deliverables have been delivered or remain undelivered. In comparison, under Issue 00-21, an entity using the "residual method" did not need to determine the fair value of the delivered items if it did not have VSOE or TPE for that item. This new requirement represents a significant change from the accounting under Issue 00-21. To allocate arrangement consideration, many entities will now have to devote time and resources to determine the estimated selling price for delivered items when the residual method was used historically.

Example

Entity Y sells a product and related services. Services are purchased for a 12-month term for an annual fee of $100.

Entity Y enters into an arrangement to deliver the product and provide related services for one year for a total arrangement fee of $300. Entity Y has determined that VSOE of fair value/selling price for the services is $100. Entity Y has not historically established VSOE or TPE of fair value/selling price for the product because Y does not sell these items separately and does not consider competitor products to be interchangeable.

Under Issue 00-21, Y applied the residual method to allocate revenue to the deliverables in the arrangement. That is, because Y had established VSOE of fair value for the undelivered item (i.e., the services), Y allocated the remaining consideration to the delivered item. Therefore, under Issue 00-21, Y allocated $100 to the services and the remaining $200 to the product.

Because ASU 2009-13 prohibits the use of the residual method, Y must determine the estimated selling prices for all deliverables in the arrangement — in this case, the product and related services. As previously noted, Y is unable to establish VSOE or TPE of selling prices for the product. Accordingly, Y must use market- and entity-specific factors to make its best estimate of the selling price for that item.

Assume that Y's best estimate of selling prices for the product is $250. In this case, Y would need to allocate arrangement consideration to all deliverables on the basis of their relative selling prices as follows:

- Product — $214 ($250 ÷ $350) × $300.
- Services — $86 ($100 ÷ $350) × $300.

Similarly to Issue 00-21, ASU 2009-13 requires that amounts allocated to delivered units of accounting be limited to the amount of consideration that is not contingent on delivering additional items or on meeting other specified performance conditions. Further, under ASU 2009-13 (codified in ASC 605-25-30-6), the measurement of revenue per period is limited to the amount "that results from assuming that cancellation of the arrangement will not occur." Accordingly, any amounts recorded as either revenue or an asset (in cases in which revenue recognized exceeds cash or other consideration received) are limited to amounts that the vendor is legally entitled to.

Disclosure Requirements

In addition to the accounting changes outlined above, ASU 2009-13 significantly expands the previous disclosure requirements under Issue 00-21. The Task Force expanded the disclosures partly because of the significant judgment that is now required and partly because of the perception by some that disclosures under Issue 00-21 did not provide financial statement users with sufficient decision-useful information regarding multiple-deliverable revenue arrangements. ASU 2009-13 introduces the following disclosure objective, which is supplemented with specific detailed disclosure requirements by similar type of arrangement (codified in ASC 605-25-50-1):

> The objective of the disclosure guidance . . . is to provide both qualitative and quantitative information about a vendor's revenue arrangements and about the significant judgments made about the application of this Subtopic [ASC 605-25, as amended by ASU 2009-13] and changes in those judgments or in the application of this Subtopic that may significantly affect the timing or amount of revenue recognition. Therefore, in addition to the required disclosures, a vendor shall also disclose other qualitative and quantitative information as necessary to comply with this objective.

The enhanced disclosures required by ASU 2009-13 are intended to provide financial statement users with a much more robust discussion regarding the significant deliverables in an entity's multiple-deliverable revenue arrangements. The objective of the disclosures is to present both qualitative and quantitative information regarding the significant judgments used to apply ASU 2009-13, any changes in the entity's pricing or business practices that would affect those judgments, and the resulting impact of any changes in the timing and amount of revenue to recognize in future periods. ASU 2009-13 requires a vendor to disclose all of the following information by similar type of arrangement (codified in ASC 605-25-50-2):

a. The nature of its multiple-deliverable arrangements

b. The significant deliverables within the arrangements

c. The general timing of delivery or performance of service for the deliverables within the arrangements

d. Performance-, cancellation-, termination-, and refund-type provisions

e. A discussion of the significant factors, inputs, assumptions, and methods used to determine selling price (whether vendor-specific objective evidence, third-party evidence, or estimated selling price) for the significant deliverables

f. Whether the significant deliverables in the arrangements qualify as separate units of accounting, and the reasons that they do not qualify as separate units of accounting, if applicable

g. The general timing of revenue recognition for significant units of accounting

h. Separately, the effect of changes in either the selling price or the method or assumptions used to determine selling price for a specific unit of accounting if either one of those changes has a significant effect on the allocation of arrangement consideration.

Because these disclosures significantly expand on the previous disclosures under Issue 00-21, it will be substantially more difficult for entities to comply with them. Financial statement preparers will need to assess their ability to isolate this information from their accounting systems to ensure the feasibility of collecting the necessary data. Of particular challenge will be disclosing the effect of changes required by paragraph (h). As discussed above, determining when and how often to reassess selling price for individual deliverables will require significant judgment, as will disclosing the "significant effect on the allocation of arrangement consideration" from those changes. For example, the term "significant effect" is not defined for changes, so entities will need to develop a policy for determining when changes have a significant effect on similar types of arrangements. In addition, all disclosures required by paragraphs (a)–(h) are aggregated by similar type of arrangement. Determining when arrangements are similar in type and just how those disclosures should be aggregated will also require significant judgment and similarly may place additional demands on an entity's accounting systems as the entity attempts to collect the required information.

Transition and Effective Date

ASU 2009-13 must be applied prospectively to revenue arrangements entered into or materially modified in fiscal years beginning on or after June 15, 2010, unless the vendor elects to adopt its guidance retrospectively in accordance with ASC 250 (formerly Statement 154). If an entity adopts the ASU's guidance retrospectively, it must provide the disclosures required in ASC 250-10-50-1 through 50-3.

Entities that adopt the guidance in ASU 2009-13 prospectively must provide, for each period in the year of adoption, the following additional qualitative disclosures by similar types of arrangements to enable financial statement users to understand the effects of the adoption (codified in ASC 605-25-65-1(c)):

1. A description of any change in the units of accounting
2. A description of the change in how a vendor allocates the arrangement consideration to various units of accounting
3. A description of the changes in the pattern and timing of revenue recognition
4. Whether the adoption of [the guidance in ASU 2009-13] is expected to have a material effect on financial statements in periods after the initial adoption.

ASU 2009-13 requires that if the effects of adoption are material, an entity disclose supplemental quantitative information to meet the transition disclosure objective. The ASU gives an entity flexibility in determining the form and content of, and the periods in which to provide, the quantitative information.

Although ASU 2009-13 does not prescribe any specific disclosures, the following examples of quantitative disclosures are provided (codified in ASC 605-25-65-1(d)):

1. The amount of revenue that would have been recognized in the year of adoption if the related arrangements entered into or materially modified after the effective date were subject to the measurement requirements of Subtopic 605-25 (before the amendments resulting from [ASU 2009-13]).
2. The amount of revenue that would have been recognized in the year before the year of adoption if

the arrangements accounted for under Subtopic 605-25 (before the amendments resulting from [ASU 2009-13] were subject to the measurement requirements of [ASU 2009-13].

3. For arrangements that precede the adoption of [ASU 2009-13], the amount of revenue recognized in the reporting period and the amount of the deferred revenue as of the end of the period from applying the guidance in Subtopic 605-25 (before the amendments resulting from [ASU 2009-13]). For arrangements that were entered into or materially modified after the effective date of [ASU 2009-13], the amount of revenue recognized in the reporting period and the amount of deferred revenue as of the end of the period from applying [ASU 2009-13].

If an entity provides one of the disclosures in the above examples, it must either maintain two sets of accounting records in the year of adoption (one in accordance with ASU 2009-13 and one maintaining the revenue that would have been recognized in accordance with Issue 00-21), or determine how ASU 2009-13 would have affected arrangements entered into or materially modified in the prior year. Even entities that had VSOE or TPE of selling price of undelivered items under Issue 00-21 and that therefore account for the separate deliverables in an arrangement as separate units of accounting (provided that all aspects of paragraph 9 had been satisfied) may have to disclose the impact of applying the relative selling price method rather than Issue 00-21's residual method of revenue allocation. Using the two accounting models to capture that information will once again place a greater burden on management to meet not only the new accounting requirements but also its disclosure requirements.

Entities that elect retrospective application in accordance with ASC 250-10-45-5 through 45-10 will need to provide the disclosures required by ASC 250-10-50-1 through 50-3.

Earlier application is permitted. An entity that elects early application in an interim period other than the beginning of its fiscal year should apply ASU 2009-13 retrospectively from the beginning of the entity's fiscal year. For all prior reporting periods of that fiscal year, the entity should disclose the effect of the changes on revenue, income before taxes, net income, and earnings per share, as well as the effect of the change for the appropriate captions presented.

For instance, if an entity whose fiscal year-end is December 31, 2010, elects to adopt the guidance in ASU 2009-13 for the period ended September 30, 2010, the entity must retrospectively adjust (in its current and future financial statements) its prior periods ended March 31, 2010, and June 30, 2010, and disclose the effects of the change as described above.

Questions and Answers

Background and Scope

ASC 605-25

05-1 This Subtopic addresses some aspects of the accounting by a vendor for arrangements under which it will perform multiple revenue-generating activities. Specifically, this Subtopic addresses how to determine whether an arrangement involving multiple deliverables contains more than one unit of accounting, and how arrangement consideration shall be measured and allocated to the separate units of accounting in the arrangement.

05-2 To meet their customers' needs, vendors often provide multiple products, services, rights to use assets, or any combination thereof. These vendors transfer the deliverables to the customer and performance may occur at different times or over different periods of time, and the customer's payments for these deliverables may be fixed, variable, or a combination of fixed and variable.

Entities

15-1 The guidance in this Subtopic applies to all entities.

Transactions

15-2 Except as described in the following paragraph, the guidance in this Subtopic applies to:

a. All deliverables (that is, products, services, or rights to use assets) within contractually binding arrangements (whether written, oral, or implied, and hereinafter referred to as arrangements) in all industries under which a vendor will perform multiple revenue-generating activities.

15-2A The guidance in this Subtopic does not apply to:

a. Arrangements that include vendor offers to a customer for either of the following addressed in Subtopic 605-50:
   1. Free or discounted products or services that will be delivered (either by the vendor or by another unrelated entity) at a future date if the customer completes a specified cumulative level of revenue transactions with the vendor or remains a customer of the vendor for a specified time period
   2. A rebate or refund of a determinable cash amount if the customer completes a specified cumulative level of revenue transactions with the vendor or remains a customer of the vendor for a specified time period.
b. Arrangements involving the sale of award credits by broad-based loyalty program operators (see Subtopic 605-50)
c. Payments relating to research or development deliverables that are accounted for under the milestone method of revenue recognition (see Subtopic 605-28).

Identifying Deliverables in a Multiple-Element Arrangement — 605-25-15 (Q&A 01)

ASC 605-25-15-2 states, in part, that the guidance in ASC 605-25 applies to "[a]ll deliverables (that is, products, services, or rights to use assets) within contractually binding arrangements (whether written, oral, or implied)." Furthermore, ASC 605-25-25-4 indicates that a "vendor shall evaluate all deliverables in an arrangement to determine whether they represent separate units of accounting."

The term "deliverable," however, is not defined. Accordingly, determining whether an item in a multiple-element arrangement constitutes a deliverable requires judgment. Throughout an arrangement, a vendor may commit to various "significant" performance obligations (e.g., obligations to provide products, services, grant licenses), each of which may be likely to constitute a deliverable. An entity may also have various "less significant" or "ancillary" performance obligations under the arrangement. In addition, the terms of an arrangement could generally provide the parties with certain protective and other rights, such as a right to participate in a joint governance activity. The entity may need to consider such obligations to determine whether, on the basis of the specific facts and circumstances, they represent deliverables.

Question

What should a vendor consider when determining whether an item in a multiple-element arrangement constitutes a deliverable?

Answer

A vendor should consider the following as it analyzes an arrangement — **viewed from the perspective of the customer (i.e., the other party to the arrangement)** — to identify potential deliverables:

- Whether an item in an arrangement requires a distinct action from the vendor.
- Whether the exclusion of the item from, or the inclusion of the item in, the arrangement would cause the arrangement fee to vary by more than an insignificant amount.
- Whether the vendor's failure to deliver an item results in (1) the customer's receiving a full or partial refund, (2) the vendor's incurring a contractual penalty, or (3) both.
- Whether each performance obligation (e.g., an obligation to provide a product, service, or right, either at a point in time or over the term of the arrangement) has been identified — particularly performance obligations that (1) may be considered ancillary to the "primary" product(s), service(s), or right(s) being sold or (2) do not have explicit monetary values assigned to them under the terms of the arrangement.
- The degree to which an item is essential to the functionality of other products, services, or rights being sold.
- Whether the customer considers an item significant or of value separately from other deliverables.

This list is not all-inclusive. When identifying deliverables, entities should evaluate the facts and circumstances of each arrangement. Notably, ASC 605-25 does **not** contain a materiality threshold for identifying deliverables in a multiple-element arrangement. 605-25-15 (Q&A 03) discusses whether inconsequential or perfunctory obligations constitute separate deliverables in an arrangement.

An example of an ancillary service obligation that is generally considered a deliverable (that may or may not have a monetary value assigned to it) is an obligation to participate on a joint steering committee (or committees) throughout the term of the arrangement or without a defined term. Such an obligation is common in collaborative arrangements — particularly in the biotechnology and pharmaceutical industries. However, sometimes a company may assess the substance and timing of the participation and conclude that such joint steering committee participation does not constitute a deliverable (i.e., the participation represents a right to joint governance for the mutual protection of each party's interest rather than a service obligation).

Once all deliverables in a multiple-element arrangement have been identified, a vendor should follow the provisions of ASC 605-25-25-5 to determine whether to consider each deliverable a separate unit of accounting.

Example

Entity B enters into an arrangement with a customer to deliver highly specialized equipment. The arrangement requires that upon installation of the equipment, all testing of the equipment occur at the customer's location.

Entity B has previously sold the same equipment separately to other customers, and other vendors can perform the installation of the equipment.

When determining what elements of the arrangement constitute deliverables, B would assess the equipment, installation, testing, and other contractual terms of the arrangement.

Entity B determines that the equipment and the installation are both deliverables because both are sold separately in the marketplace.

Entity B would consider the factors above, among others, when determining whether the testing represents a deliverable. If, during the testing of the product, B allowed the customer's employees to consult its installation technicians about key troubleshooting techniques associated with the equipment and the customer acquired knowledge during that process, B may conclude that testing is a deliverable that it must evaluate under ASC 605-25. That is, B may conclude that the testing is important, has value to the customer, and therefore would cause the arrangement fee to vary by more than an insignificant amount.

Conversely, if the testing of the equipment was a standardized process that is considered perfunctory and results in no transfer of knowledge to the customer, B may conclude that testing is simply a quality-control function that is inseparable from the equipment itself and that B should not evaluate testing as a separate deliverable under ASC 605-25.

Accounting for Future Product Discounts Offered in Connection With a Current Sale — 605-25-15 (Q&A 02)

An entity sells Products A and B separately; the two products are not considered software within the scope of ASC 985-605. With each purchase of Product A, a customer receives a coupon for a discount on Product B. The value of the coupon is $500, which is equal to the amount the customer paid for Product A. A customer may combine up to three coupons ($1,500) to apply to the purchase of Product B, which sells for $100,000. Product B is sold at a significant gross margin, even after the application of any potential coupons.

Question

Upon the sale of Product A, is the entity required to accrue costs or defer revenue associated with the issuance of a coupon on Product B?

Answer

No. While there is no specific guidance on a future discount offered in connection with the current sale of a nonsoftware product or service arrangement, the guidance in ASC 985-605 is applicable by analogy. This guidance addresses the accounting for discounts offered on future products in connection with a current software product sale. ASC 985-605-15-4(c) excludes the following marketing and promotional activities from the scope of the software revenue guidance:

> Insignificant discounts on future purchases that are offered by a vendor in a software arrangement. For example, a vendor may offer a small discount (a coupon or other form of offer for 5 percent off) on additional licenses of the licensed product or other products that exist at the time of the offer but are not part of the arrangement.

ASC 985-605-15-3(d) states, in part:

> More-than-insignificant discounts have all of the following characteristics:
>
> 1. Incremental to the range of discounts reflected in the pricing of the other elements of the arrangement
> 2. Incremental to the range of discounts typically given in comparable transactions
> 3. Significant.
>
> If the discount or other concessions in an arrangement are more than insignificant, a presumption is created that an additional element or elements (as defined in paragraph 985-605-25-5) are being offered in the arrangement. Judgment is required when assessing whether an incremental discount is significant.

While the entity is not required to apply this guidance to an arrangement outside the scope of ASC 985-605, such guidance can be used by analogy.

The entity should evaluate all facts and circumstances in determining whether a discount is significant. In this example, on the basis of a quantitative analysis, the discount on the purchase of future Product B may be considered insignificant. Accordingly, the future discount in this example would be recognized if and when the future transaction occurs.

If the future discount offered is considered significant, the discount on the future product would be deemed an element in a multiple-element arrangement and would be accounted for accordingly (e.g., in accordance with ASC 605-25).

Inconsequential or Perfunctory Deliverables in a Multiple-Element Arrangement — 605-25-15 (Q&A 03)

Question

Is there a materiality threshold an entity would use in determining whether obligations are separate deliverables that need to be evaluated under the separation guidance in ASC 605-25?

Answer

ASC 605-25 does not contain a materiality threshold for identifying deliverables in a multiple-element arrangement. However, SAB Topic 13 clarifies that revenue for a unit of accounting may be recognized if the remaining actions to be performed are "inconsequential or perfunctory," provided that all other revenue recognition criteria are met. SAB Topic 13 defines inconsequential or perfunctory actions as those that, if not completed by the vendor, "would not result in the customer receiving a refund or rejecting the delivered products . . . to date."

SAB Topic 13 also notes that inconsequential or perfunctory actions are not essential to the functionality of the delivered products and that the vendor should have a history of performing these tasks "in a timely manner and reliably estimating the remaining costs."

On the basis of this SEC guidance, inconsequential or perfunctory obligations would not be considered separate deliverables in an arrangement.

In practice, contracts often do not indicate whether the failure of the vendor to complete a particular performance obligation would result in the customer's being able to receive any refund or reject products delivered to date. Accordingly, it will frequently be difficult for a vendor to determine that it has satisfied this condition. In such situations, entities may wish to consult their legal counsel.

Contingent Deliverables — 605-25-15 (Q&A 04)

Question

Is a contingency in a multiple-element revenue arrangement a deliverable that an entity should evaluate under ASC 605-25?

Answer

A contingency in a revenue arrangement may represent a potential deliverable that may be difficult to analyze under ASC 605-25. The EITF discussed this topic during its deliberations on the guidance (codified by ASU 2009-13), but ultimately decided not to address contingencies in an arrangement with multiple deliverables, observing that accounting conclusions on this topic are highly dependent on individual facts and circumstances.

The "Issue 08-1 Working Group," which advised the EITF on this topic, described a contingent deliverable as a revenue-generating activity that is contingent upon the occurrence of a future event not exclusively within the control of the customer. If the future event occurs, the vendor is required by the terms of the arrangement to deliver specified products or services. In describing contingent deliverables, the Working Group noted that such deliverables can be contingent on (1) the actions of a party unrelated to the revenue arrangement (such as a governmental agency), (2) the vendor's actions, or (3) a combination of both. In some industries and arrangements, contingent deliverables may be prevalent and represent deliverables with considerable value.

The following examples illustrate contingencies that could be considered deliverables under ASC 605-25.

Example 1

Entity B is a biotech company that has developed a new technology for monitoring and testing diabetic individuals. Entity B grants Customer X a five-year license to its technology. The terms of the license agreement do not require B (i.e., B is not obligated) to perform any additional R&D activities. However, B agrees (i.e., B has a contingent obligation) that if improvements to its technology are made during the next two years, it will provide X with a license to the updated technology on a when-and-if-available basis. Any new license granted to X will terminate at the same time as the original five-year license.

On the basis of all the facts and circumstances, B determines that the obligation to provide a license for improvements to its technology on a when-and-if-available basis represents a deliverable that must be evaluated and accounted for under ASC 605-25.

Example 2

Entity C enters into an arrangement in which it agrees (i.e., has an obligation) to provide R&D services to Customer Y on a best-efforts basis for three years. If a commercially viable product is developed as a result of those services, C agrees to manufacture 100 units of the product and deliver them (i.e., has a contingent obligation) to Y. Customer Y agrees to pay C $1 million for the R&D services.

On the basis of all the facts and circumstances, C determines that the obligation to manufacture and deliver 100 units if a commercially viable product is developed represents a deliverable that must be evaluated and accounted for under ASC 605-25.

Example 3

Entity D is an automobile manufacturer that includes airbags in its Model T cars. Entity D enters into an arrangement to sell 10,000 Model T cars to a regional automobile dealership. Pursuant to the arrangement terms, D agrees that if new safety standards are adopted for the airbags within the next three years and the airbags currently included in the Model T cars do not comply with the new safety standards, D will replace the existing airbags in all 10,000 Model T cars (i.e., has a contingent obligation), even if such replacement is not required by the new safety standards.

On the basis of all the facts and circumstances, D determines that the contingent obligation to replace the airbags represents a deliverable that must be evaluated and accounted for under ASC 605-25.

Optional Purchases — 605-25-15 (Q&A 05)

Question

An optional purchase is a term in an arrangement that gives a customer the option to purchase products or services in the future. Is an optional purchase a deliverable that an entity should evaluate under ASC 605-25?

Answer

It depends. If a revenue-generating arrangement contains an option to buy products or services in the future and the substance of the arrangement is that the customer truly can elect whether to purchase any of those products or services, the option should be evaluated as a separate arrangement and not as a deliverable of the original arrangement. An entity should evaluate the substance of an arrangement in determining whether an optional purchase of future products or services represents a deliverable.

An entity should analyze all relevant facts and circumstances in determining the substance of the arrangement. For instance, the entity assesses whether the contractual option to purchase the product or service in the future is truly optional to the customer. If, in substance, the option to buy the future product or service is not truly optional because the customer has no choice but to purchase the future product or service, the optional purchase of future products or services is considered a deliverable of the original arrangement. For example, if an arrangement gave a customer the option to purchase future products or services and those future products and services were necessary for the intended use of the delivered product and not readily obtainable from another party, the optional purchase of future products and services would be considered a deliverable of the original arrangement.

If an arrangement's contractual terms represent options to purchase future products and services in which the quantity ultimately purchased is variable but the customer does not really have the option not to buy the product or service in the future, an entity would conclude that those options represent deliverables of the original arrangement. In addition, if an optional purchase of products or services in the future is considered a deliverable because the future products or services are necessary for the intended use of the delivered product and not readily obtainable from another party, concerns may be raised about whether the delivered item has stand-alone value and whether the arrangement could be separated into multiple units of accounting.

For example, a vendor sells medical equipment to a customer. To function, the medical equipment needs cartridges that are only sold by the vendor. The arrangement gives the customer the option of purchasing these cartridges from the vendor. On the basis of all the facts and circumstances, the vendor determines that the customer's purchase of cartridges in the future is not truly optional because they are required for the intended use of the equipment and are only sold by the vendor. Therefore, the vendor determines that the optional purchase of the cartridges represents a deliverable in the original arrangement that must be evaluated. The vendor should also carefully evaluate whether the medical equipment has stand-alone value given that its functionality depends on the subsequent delivery of the cartridges.

If the optional purchase is not considered a deliverable of the original arrangement, entities should still consider whether a discount on optional purchases is present and whether the discount creates a deliverable. In some arrangements, entities may provide significant and incremental discounts (i.e., discounts above those that are usually provided in comparable transactions and above any discounts related to other elements in the arrangement) on future purchases of products or services. (For guidance on how to account for significant and incremental discounts, see ASC 985-605-55-82 through 55-85 and ASC 985-605-55-185 through 55-200.)

Example

Entity X manufactures network computer systems and provides related consulting services. Entity X enters into an arrangement with Customer Y to provide a network computer system and 125 hours of consulting services. The consulting services are priced at $150 per hour, the rate X typically charges for consulting services. Entity X also agrees to provide a 50 percent discount (such a discount is incremental to the range of discounts typically provided by X in comparable transactions) on future consulting services, up to an additional 100 hours, if requested by Y.

On the basis of all the facts and circumstances, X concludes that the discount on the optional purchase of an additional 100 hours of consulting services should be considered a deliverable in the arrangement and evaluated under ASC 605-25.

Software Used With Multiple Units of an Electronic Device — 605-25-15 (Q&A 06)

Certain products consist of software and related electronic devices (e.g., tracking software and its related electronic devices) in which (1) the software is more than incidental to the electronic devices, (2) the software has no utility without the electronic devices, and (3) the electronic devices have no utility without the software. Such software is often sold with one or more electronic devices, with additional devices available on a stand-alone basis. Because in such cases the electronic devices (hardware) and software function together to deliver the product's essential functionality, both would be outside the scope of ASC 985-605[1] and subject to other applicable revenue guidance (e.g., ASC 605-25 or SAB Topic 13).

In these arrangements the software works with one device but it is usually more cost-effective if multiple devices are used with it. An arrangement may require that a customer purchase, for a fixed fee, the software and only one electronic device but permit the customer to purchase a specified number of additional devices at a specified additional price per unit.

Question

In such an arrangement, if all other criteria for revenue recognition are met, should any portion of the fixed fee be deferred and recognized as the additional devices are delivered?

Answer

No. As long as the additional devices are not being sold at a significant incremental discount, no portion of the fixed fee should be deferred and recognized as the additional devices are delivered (see 605-25-15 (Q&A 02)). Because the software can be used once the customer has one electronic device, the seller should recognize the fixed fee when it delivers the software and the first electronic device to the customer. Revenue for each additional optional device sold should be recognized at the time of delivery. See 605-25-15 (Q&A 07) for additional considerations.

Example

Company L manufactures software to track the location of receivers (via a global positioning satellite system) that are installed in automobiles; L also sells the receivers separately. Under its standard arrangement, L sells a package of the software and one receiver for $500. It sells each additional receiver for $100. Company L should recognize $500 in revenue at the time of the delivery of the first package of the software and receiver and $100 at the time of delivery of each additional receiver, provided that all other revenue recognition requirements have been met.

Extended Payment Terms in Multiple-Element Arrangements — 605-25-15 (Q&A 07)

Vendor T, a public company, sells integrated products. These products are primarily hardware but include an embedded software component that is essential to the hardware's functionality. Further, the software and the hardware function together to deliver the products' essential functionality. As the software is essential to the integrated products' functionality, the integrated products (including the software) are outside the scope of ASC 985-605. Before ASU 2009-14, T had accounted for this arrangement under ASC 985-605.

Vendor T recently began offering payment terms that extend beyond one year to some of its customers. Vendor T believes that the arrangement fees for these sales should be considered fixed or determinable even though it does not yet have a history of collecting the payments as they become due. Vendor T believes that its software will not become obsolete.

[1] See ASC 985-605-15-4.

Question

How should T recognize revenue?

Answer

In this situation, T may need to recognize revenue as payments become due. Although this transaction is not within the scope of ASC 985-605, the guidance in ASC 985-605 may be considered by analogy. Further, the SEC provided guidance in footnote 5 of SAB Topic 13-A.1, which states, in part:

> Paragraphs 26–33 of SOP 97-2 [ASC 985-605-25-30 through 25-40] discuss how to apply the fixed or determinable fee criterion in software transactions. The staff believes that the guidance in paragraphs 26 and 30–33 [ASC 985-605-25-30 and 25-31 and ASC 985-605-25-36 through 25-40] is appropriate for other sales transactions where authoritative guidance does not otherwise exist. The staff notes that paragraphs 27 through 29 [ASC 985-605-25-33 through 25-35] specifically consider software transactions, however, **the staff believes that guidance should be considered in other sales transactions in which the risk of technological obsolescence is high**. [Emphasis added]

Accordingly, the arrangement fee may not be considered fixed or determinable. On the basis of the specific facts listed above and without a history of collecting payments as they become due, T may not be able to support a presumption that it will not offer concessions if the software becomes obsolete before all of the contractual payments are received. As a result, T may need to recognize revenue as payments become due.

ASC 605-25

Interaction With Other Codification Topics

15-3 A multiple-deliverable arrangement may be within the scope of another Codification Topic. Those Topics include all of the following:

a. For leases, see Topic 840.
b. For franchisors, see Topic 952.
c. For property, plant, and equipment, see Topic 360; specifically, Subtopic 360-20.
d. For guarantees, see Topic 460.
e. For revenue recognition, see Topic 605; specifically, Subtopics 605-20 and 605-35.
f. For software, see Topic 985; specifically, Subtopic 985-605.
g. For entertainment—films, see Topic 926; specifically, Subtopic 926-605.

15-3A Those Topics may provide guidance with respect to whether and how to allocate consideration of a multiple-deliverable arrangement. Whether deliverables are within the scope of those other Topics is determined by the scope provisions of those Topics, without regard to the order of delivery of that item in the arrangement. The following describes the three categories into which the other Codification Topics fall and the application of this Subtopic or the other Topics in determining separate units of accounting and allocating arrangement consideration:

a. Other Topics address both separation and allocation. If another Topic provides guidance regarding the determination of separate units of accounting and how to allocate arrangement consideration to those separate units of accounting, the arrangement or the deliverables in the arrangement that is within the scope of that Topic shall be accounted for in accordance with the relevant provisions of that Topic rather than the guidance in this Subtopic.
b. Other Topics address separation, but not allocation. If another Topic provides guidance requiring separation of deliverables within the scope of that Topic from deliverables not within the scope of that Topic, but does not specify how to allocate arrangement consideration to each separate unit of accounting, such allocation shall be based on the relative selling price of the deliverables within the scope of that Topic and the deliverables not within the scope of that Topic. For example, leased assets are required to be accounted for separately under the guidance in Subtopics 840-20 and 840-30. See paragraph 605-25-55-3. (For purposes of the allocation between deliverables within the scope of another Topic and deliverables not within the scope of that other Topic, the selling price shall be determined using the guidance as discussed in paragraphs 605-25-30-6A through 30-6B.) Subsequent identification of separate units of accounting and allocation of arrangement consideration to the deliverables not subject to that other Topic would be governed by the provisions of this Subtopic.

ASC 605-25 (continued)

c. Other Topics address neither separation nor allocation. If another Topic provides no guidance regarding the separation of the deliverables within the scope of that Topic from those deliverables that are not or the allocation of arrangement consideration to deliverables within the scope of that Topic and to those that are not, then the guidance in this Subtopic shall be followed for purposes of such separation and allocation. (For example, Subtopic 605-35 provides separation and allocation guidance [segmentation provisions] for deliverables within its scope. However, that Subtopic does not provide separation and allocation guidance for deliverables within its scope and deliverables not within its scope.) In such circumstances, it is possible that a deliverable subject to the guidance of another Topic does not meet the criteria in paragraph 605-25-25-5 to be considered a separate unit of accounting. In that event, the arrangement consideration allocable to such deliverable shall be combined with the amount allocable to the other applicable undelivered items within the arrangement. The appropriate recognition of revenue then shall be determined for those combined deliverables as a single unit of accounting.

Other Considerations

15-4 The guidance in this Subtopic does not address when the criteria for revenue recognition are met or provide revenue recognition guidance for a given unit of accounting. For example, this Subtopic does not address when revenue attributable to a unit of accounting shall be recognized based on proportional performance. The timing of revenue recognition for a given unit of accounting depends on the nature of the deliverable(s) composing that unit of accounting and on whether the applicable criteria for revenue recognition have been met.

Sales Arrangements With Fixed-Price Trade-In Rights — 605-15-25 (Q&A 05)

Certain vendors offer their customers the right to trade in a purchased product for a fixed-price credit toward the purchase of a new product at some point in the future. The vendor may offer the right to the trade-in after the original sales transaction or concurrently with a sales transaction that includes the product subject to the trade-in.

Company C develops commercial products in the telecommunications industry. Company C sells Product A and gives its customers the right to trade in Product A for a specified credit toward the purchase of Product B during some period in the future. The purpose of the program is to help promote sales of Product B and encourage customers to upgrade to that new technology.

Question

How should C account for the fixed-price trade-in right?

Answer

The fixed-price trade-in right should generally be accounted for as a guarantee subject to the requirements of ASC 460. The scope of ASC 460 includes "[c]ontracts that contingently require a guarantor to make payments . . . to a guaranteed party based on changes in an underlying that is related to an asset, a liability, or an equity security of the guaranteed party." Company C has agreed to make a payment to the customer in the form of a fixed-price trade-in credit, contingent on the customer exercising its right to trade in Product A for Product B sometime in the future.

Since C offers the fixed-price trade-in right in conjunction with the sale of Product A, the transaction is a multiple-element arrangement and is therefore accounted for in accordance with ASC 605-25. However, ASC 605-25-15-3 excludes from its scope guarantees that fall within the scope of ASC 460. Accordingly, the guarantee should be separated from the arrangement, measured at fair value, and recognized as a liability in the financial statements. In addition, ASC 460-10-55-23(b) states, in part, "the overall proceeds . . . would be allocated between the consideration being remitted to the guarantor for issuing the guarantee and the proceeds from the sale." In other words, the total consideration for the purchased product would be reduced by the amount separated for the guarantee.

Recognition

ASC 605-25

General

25-1 In an arrangement with multiple deliverables, the principles in paragraph 605-25-25-2 and application guidance in Section 605-25-30 and paragraphs 605-25-25-4 through 25-6 shall be used to determine both of the following:

a. Units of accounting, that is, whether the arrangement should be divided into separate units of accounting

b. Measurement and allocation of arrangement consideration, that is, how the arrangement consideration should be measured and allocated among the separate units of accounting.

25-2 The principles applicable to this Subtopic are as follows:

a. Revenue arrangements with multiple deliverables shall be divided into separate units of accounting if the deliverables in the arrangement meet the criteria in paragraph 605-25-25-5.

b. Arrangement consideration shall be allocated among the separate units of accounting based on their relative selling prices (or as otherwise provided in paragraph 605-25-30-4). The amount allocated to the delivered unit of accounting is limited as discussed in paragraph 605-25-30-5.

c. Applicable revenue recognition criteria shall be considered separately for separate units of accounting.

Revenue Recognition When the Allocated Arrangement Consideration Exceeds Selling Price — 605-25-25 (Q&A 05)

Question

How should revenue be recognized in an arrangement in which the consideration allocated to a separate unit of accounting exceeds the selling price(s)[2] of the deliverable(s) in the unit of accounting?

Answer

In situations in which the arrangement consideration allocated to separate units of accounting exceeds the selling prices of the individual deliverables, a company should consider whether the excess is related to an up-front or activation fee. If the company or its competitors regularly charge up-front or activation fees, it should be presumed, in the absence of evidence that the "premium pricing" is due to other factors, that the excess of the arrangement is related to these types of fees. As indicated in Question 1 of SAB Topic 13.A.3(f), the company should consider the specific facts and circumstances to determine the appropriate accounting for the in-substance nonrefundable up-front fee.

Example

Company X is a wireless service provider. Company X sells a handset that is bundled with prepaid wireless minutes for $180. The minutes included in the bundled plan are sold separately for $50. The customer may buy the handset separately for $100 but must pay an activation fee of $50 before purchasing any prepaid minutes or entering into any contract plan.

Under the bundled plan, none of the fee collected is contingent, and there is no general right of return relative to any delivered item. Assume that the handset and prepaid minutes meet the criteria for separation under ASC 605-25 and that the arrangement consideration is allocated (on the basis of relative fair values) as follows:

Calculation of Relative Selling Price Percentages	Selling Price	Relative Percentage
Selling price of handset	$ 100	67%
Selling price of packaged minutes	50	33%
Total	$ 150	100%

[2] ASU 2009-13 replaced all references to "fair value" in ASC 605-25 with references to "selling price" to clarify that the selling-price measure in ASC 605-25 is not a market-participant measure as required by ASC 820.

Calculation of Allocation of Arrangement Consideration	Handset	Minutes
Arrangement consideration	$ 180	$ 180
× Allocation percentage	67%	33%
Allocated Revenue	$ 120	$ 60

The arrangement consideration of $120 allocated to the handset exceeds the handset's selling price of $100. In addition, the arrangement consideration of $60 allocated to the packaged minutes exceeds its selling price of $50. This excess of allocated arrangement consideration over the selling price of the deliverables in both units of accounting is presumed to be a nonrefundable up-front or activation fee because there is no evidence to the contrary. In fact, X and other competitors routinely charge subscribers an activation fee. Therefore, the evidence would suggest that the arrangement contains an implicit activation fee. The absence of a specific reference to an activation fee in an arrangement should not change the accounting for an activation fee. Accordingly, $30 ($20 excess from the handset + $10 excess from the packaged minutes) should be deferred and recognized over the expected customer relationship period.

ASC 605-25

Units of Accounting

25-3 In applying the guidance in this Subtopic, separate contracts with the same entity or related parties that are entered into at or near the same time are presumed to have been negotiated as a package and shall, therefore, be evaluated as a single arrangement in considering whether there are one or more units of accounting. That presumption may be overcome if there is sufficient evidence to the contrary.

25-4 A vendor shall evaluate all deliverables in an arrangement to determine whether they represent separate units of accounting. That evaluation shall be performed at the inception of the arrangement and as each item in the arrangement is delivered.

25-5 In an arrangement with multiple deliverables, the delivered item or items shall be considered a separate unit of accounting if both of the following criteria are met:

a. The delivered item or items have value to the customer on a standalone basis. The item or items have value on a standalone basis if they are sold separately by any vendor or the customer could resell the delivered item(s) on a standalone basis. In the context of a customer's ability to resell the delivered item(s), this criterion does not require the existence of an observable market for the deliverable(s).

b. Subparagraph superseded by Accounting Standards Update No. 2009-13

c. If the arrangement includes a general right of return relative to the delivered item, delivery or performance of the undelivered item or items is considered probable and substantially in the control of the vendor.

See the flowchart in paragraph 605-25-55-1 for an illustration of these criteria. The criteria for dividing an arrangement into separate units of accounting shall be applied consistently to arrangements with similar characteristics and in similar circumstances.

25-6 A delivered item or items that do not qualify as a separate unit of accounting within the arrangement shall be combined with the other applicable undelivered item(s) within the arrangement. The allocation of arrangement consideration and the recognition of revenue then shall be determined for those combined deliverables as a single unit of accounting.

Example of an Evaluation of a Multiple-Element Arrangement — 605-25-25 (Q&A 01)

Company X provides satellite television services to residents of multiple-dwelling units, such as apartment buildings. Company X generates revenue from the sale and installation of hardware to the property owner/manager and from the sale of ongoing programming services. The hardware is standard equipment that X purchases from a manufacturer. The programming services are standard services, purchased by X from media outlets.

Company X never sells and installs equipment unless it concurrently signs a long-term programming contract with the property owner/manager that gives X the exclusive right to supply programming services to residents for a specified number of years. Each of these elements (the hardware and the services) can be purchased separately from numerous vendors. Company X has established third-party evidence of the selling price[3] of each element on the basis of the standard nature of these items and their availability from numerous vendors in the marketplace.

Under certain of X's arrangements, ongoing programming services are sold directly to the residents; under others, they are sold to the property owner, who in turn resells them to the residents. Ongoing programming services consist of various monthly subscription packages; X purchases the right to distribute television stations from various

[3] ASU 2009-13 replaced all references to "fair value" in ASC 605-25 with references to "selling price" to clarify that the selling-price measure in ASC 605-25 is not a market-participant measure as required by ASC 820.

programming sources (e.g., CNN, ESPN), and packages different channels for sale to the end consumer. Company X maintains a customer service center to address problems that customers experience with their satellite service. In addition, X employs technicians to perform ongoing maintenance on the hardware equipment and to visit the building when a customer experiences technical difficulties. Company X's customers (either the building owner/manager or the individual resident) pay a monthly cable programming fee, depending on the package selected, as well as a monthly equipment maintenance fee.

Question

When recognizing revenue, is it appropriate for X to bifurcate the sale of hardware from the ongoing programming arrangement into two separate units of accounting?

Answer

Company X's practice of selling hardware and concurrently entering into a long-term service contract is a multiple-element revenue arrangement. ASC 605-25-25-5 states:

> In an arrangement with multiple deliverables, the delivered item or items shall be considered a separate unit of accounting if both of the following criteria are met:
>
> a. The delivered item or items have value to the customer on a standalone basis. The item or items have value on a standalone basis if they are sold separately by any vendor or the customer could resell the delivered item(s) on a standalone basis. In the context of a customer's ability to resell the delivered item(s), this criterion does not require the existence of an observable market for the deliverable(s).
>
> b. [Superseded by ASU 2009-13.]
>
> c. If the arrangement includes a general right of return relative to the delivered item, delivery or performance of the undelivered item or items is considered probable and substantially in the control of the vendor.

Since each element can readily be purchased separately from numerous vendors, the hardware and programming services appear to have value to the customer on a stand-alone basis. Before the amendments to ASC 605-25 by ASU 2009-13, criterion (b) required entities to provide evidence of fair value of the undelivered items in an arrangement to separate the arrangement into multiple units of accounting. ASU 2009-13 removed this criterion.

With respect to criterion (c), X does not appear to have any right of return.

Therefore, the sale of hardware and the ongoing programming services represent separate elements that X should bifurcate (on the basis of their relative selling prices) into two units of accounting when recognizing revenue.

Multiple-Element Arrangements Example — Product and Installation — 605-25-25 (Q&A 02)

Company N develops, manufactures, sells, installs, and services laser precision equipment used in high-technology manufacturing. The title, risks, and rewards of the equipment pass to the customer upon shipment. According to the terms of the contract, the customer must pay 80 percent of the sales price upon shipment and the remaining 20 percent upon installation.

Before shipment, N performs factory inspection tests to evaluate whether the equipment will meet the agreed-upon specifications for the model of equipment. After N determines that the equipment passes the factory tests, it provides the data it has collected to the customer. The customer evaluates the data and may rerun some of the tests. The customer must approve the factory test data before the equipment is shipped.

After successful completion of the factory inspection tests, the equipment is disassembled and shipped from the factory. Once the customer has received the equipment, N performs the installation, which includes reassembling, adjusting, and testing the equipment at various points during installation. The selling price[4] of the installation, based on service hours and hourly billing rates of employees, is about 5 percent of the total sales price. This estimate of selling price is based on what competitors charge for similar installations and what N charges for separate installations of competitors' equipment.

Specialists are required to perform the installation, which is complex and can take from 60 to 100 days. Proper installation and testing are critical to ensuring that the equipment will function properly and will meet customer-

[4] ASU 2009-13 replaced all references to "fair value" in ASC 605-25 with references to "selling price" to clarify that the selling-price measure in ASC 605-25 is not a market-participant measure as required by ASC 820.

specified criteria. While other companies are available to perform installation, N almost always installs the equipment itself.

Question

Should the separate deliverables — the product and the installation — be accounted for separately?

Answer

Yes. This arrangement represents a multiple-element arrangement. The two elements, delivery of equipment and installation of that equipment, meet the criteria in ASC 605-25 to be accounted for separately.

ASC 605-25-25-5 provides guidance on accounting for multiple-element arrangements, stating that the following conditions must be met for the elements to be considered separately for recognition:

> a. The delivered item or items have value to the customer on a standalone basis. The item or items have value on a standalone basis if they are sold separately by any vendor or the customer could resell the delivered item(s) on a standalone basis. In the context of a customer's ability to resell the delivered item(s), this criterion does not require the existence of an observable market for the deliverable(s).
>
> b. [Superseded by ASU 2009-13.]
>
> c. If the arrangement includes a general right of return relative to the delivered item, delivery or performance of the undelivered item or items is considered probable and substantially in the control of the vendor.

In this example, criterion (a) is met because the equipment has stand-alone value to the customer and there are no general refund rights in this agreement (criterion (c)). Criterion (b) is no longer required. Before the amendments to ASC 605-25 by ASU 2009-13, entities needed to provide evidence of fair value for the undelivered items in an arrangement to separate the arrangement into multiple units of accounting. ASU 2009-13 removed this criterion for separation.

Company N should recognize upon shipment the lesser of the amount of revenue allocated to the sale of equipment on the basis of selling price or the amount for which the customer is obligated at the time of shipment. ASC 605-25-30-5 limits the amount allocable to the delivered unit of accounting "to the amount that is not contingent upon the delivery of additional items." In addition, SAB Topic 13 indicates that revenue should not be recognized in advance of a legally enforceable right to collect the fee. In this case, although the revenue allocated to the equipment is 95 percent of the sales price, the customer only has to pay 80 percent of the sales price upon shipment. Thus, N may recognize only 80 percent of the sales price upon shipment.

Revenue Allocation When the Selling Price of the Delivered Item, but Not of the Undelivered Item, Can Be Determined — 605-25-25 (Q&A 03)

Seller X can reliably determine the selling price[5] of an entire multiple-element arrangement and has VSOE or TPE of selling price of the delivered element. However, X does not have VSOE or TPE of selling price of the undelivered element. The undelivered element is a separate earnings process that is not essential to the functionality of the delivered element.

Question

May X separate the elements for revenue recognition?

Answer

In accordance with ASC 605-25-25-5, X should separate elements in this situation if the following criteria for separation are met:

> a. The delivered item or items have value to the customer on a standalone basis. The item or items have value on a standalone basis if they are sold separately by any vendor or the customer could resell the delivered item(s) on a standalone basis. In the context of a customer's ability to resell the delivered item(s), this criterion does not require the existence of an observable market for the deliverable(s).
>
> b. [Superseded by ASU 2009-13.]
>
> c. If the arrangement includes a general right of return relative to the delivered item, delivery or performance of the undelivered item or items is considered probable and substantially in the control of the vendor.

[5] ASU 2009-13 replaced all references to "fair value" in ASC 605-25 with references to "selling price" to clarify that the selling-price measure in ASC 605-25 is not a market-participant measure as required by ASC 820.

If the criteria for separation are met, X should estimate the selling price of the undelivered element (since VSOE and TPE cannot be established; see 605-25-30 (Q&A 01) for further discussion of the selling price hierarchy) and allocate arrangement consideration to the elements on the basis of relative selling price. ASC 605-25 prohibits use of the residual method, in which an entity calculates the amounts allocable to units of accounting in an arrangement by subtracting from the total arrangement consideration the aggregate fair value of the units of accounting in the arrangement for which VSOE or TPE can be established.

Although it may be difficult to estimate selling price in certain situations, entities are nonetheless required to develop estimates and use them to allocate revenue to multiple deliverables that otherwise qualify for separation. For further considerations on estimating selling price, see 605-25-30 (Q&As 06 through 08).

Revenue Recognition When Two or More Elements Cannot Be Separated — 605-25-25 (Q&A 04)

Question

When two elements do not meet the conditions for separation, how should revenue be recognized?

Answer

When two or more elements do not meet the conditions for separation, they are considered a combined unit for revenue recognition purposes. As a combined unit, they may be subject to two or more accounting principles, and entities may need to consider such guidance in determining the appropriate revenue recognition.

Multiple-Element Arrangement Example — Licensing and Supply Arrangement — 605-25-25 (Q&A 06)

Company B develops, licenses, manufactures, and sells pharmaceutical products. Company B enters into a separate licensing and supply agreement with an unrelated third-party company (the "distributor") to sell and market B's product. The provisions of the licensing agreement are as follows:

- The distributor is responsible for obtaining approval from the relevant regulatory agencies to market and sell B's product. Proprietary product information required by the regulatory agencies will be provided to the distributor.
- The distributor may not obtain any ownership rights to the proprietary information and is prohibited from selling, subleasing, assigning, or otherwise transferring its rights to the proprietary product information licensed from B.

The separate supply agreement stipulates the following:

- The product will be marketed and sold under the distributor's name.
- The distributor must purchase all of its supply of the product from B, at a specified price index for a minimum of 10 years commencing on the date regulatory approval is obtained.
- The distributor may not manufacture the product in-house.
- The distributor is not permitted to market, sell, or distribute similar products sourced from an alternative supplier.

The licensing agreement requires the distributor to pay B an up-front licensing fee. A portion of this fee (66 percent) is refundable if the distributor is unable to receive regulatory approval to sell and market B's product. Payments for the product are due as the distributor purchases its supply for resale from B.

Question

Should the separate deliverables — the license and product — be accounted for as separate units of accounting?

Answer

No. The license has no stand-alone value since the distributor has no ability to resell it and is not allowed to use it to manufacture or source the product from anyone but B. Accordingly, the license and product should be accounted for as one combined deliverable for revenue recognition purposes, in accordance with ASC 605-25-25-5 and 25-6, which state the following:

> In an arrangement with multiple deliverables, the delivered item or items shall be considered a separate unit of accounting if all of the following criteria are met:
>
> a. The delivered item or items have value to the customer on a standalone basis. The item or items have value on a standalone basis if they are sold separately by any vendor or the customer could resell the delivered item(s) on a standalone basis. In the context of a customer's ability to resell the delivered item(s), this criterion does not require the existence of an observable market for the deliverable(s).
>
> b. There is objective and reliable evidence of fair value of the undelivered item(s). [Upon adoption of the amendments made to ASC 605-25 by ASU 2009-13, this criterion is no longer applicable.]
>
> c. If the arrangement includes a general right of return relative to the delivered item, delivery or performance of the undelivered item or items is considered probable and substantially in the control of the vendor.
>
> A delivered item or items that do not qualify as a separate unit of accounting within the arrangement **shall be combined** with the other applicable undelivered item(s) within the arrangement. **The allocation of arrangement consideration and the recognition of revenue then shall be determined for those combined deliverables as a single unit of accounting.** [Emphasis added]

Accounting for Revenues Under a Co-Branded Credit Card Agreement — 605-25-25 (Q&A 07)

The following Q&A applies to entities that have not adopted the guidance in ASU 2009-13, which is effective for new or materially modified arrangements entered into in fiscal years beginning on or after June 15, 2010. Early adoption is permitted. For transition guidance, see ASC 605-25-65.

For entities that have adopted ASU 2009-13's amendments, objective and reliable evidence of fair value for undelivered elements is no longer required for treatment of such elements as separate units of accounting. Accordingly, the conclusion that deliverables in the type of arrangement described in this Q&A would generally not meet the criteria in ASC 605-25 for treatment as separate units of accounting may need to be reevaluated. Entities must still evaluate whether the delivered item or items have value to the customer on a stand-alone basis when determining whether the arrangement qualifies for separation. If an entity concludes that the deliverables in these arrangements do not meet the criteria in ASC 605-25-25-5 (as amended by ASU 2009-13) for treatment as separate units of accounting, since the deliverables do not have value to the customer on a stand-alone basis, then the guidance in this Q&A may still be relevant.

Companies (e.g., retailers) may enter into co-branded or private-label credit card arrangements with financial institutions or banks. Under such arrangements, the company usually has various obligations, such as:

- Licensing of the company's brand name (for use on the credit card).
- Marketing of the credit cards.
- Providing products or services (or discounts on products or services) as part of a rewards/loyalty program.
- Maintaining the credit card program.

Under the arrangements, the company generally receives an up-front or incentive fee (such as a signing bonus) and earns a fee for each new cardholder that signs up for a credit card (sometimes referred to as a "bounty fee"). Other potential compensation includes royalties based on credit card spending or reimbursements for certain costs, such as products or services provided under the reward program, marketing expenses, or other related expenses (such as credit card processing fees).

Question

How should companies account for the up-front, incentive, and bounty fees received under these credit card arrangements?

Answer

As noted above, the company generally has multiple obligations under these arrangements; therefore, the arrangements would be within the scope of ASC 605-25. Deliverables in these arrangements generally would not meet the criteria in ASC 605-25-25-5 for treatment as separate units of accounting because the deliverables do not have value to the customer on a stand-alone basis, no objective and reliable evidence of fair value exists for each deliverable, or both.

As a result, these arrangements often require that payments (such as signing bonuses, bounty fees, and other compensation) be initially deferred and recognized over the period the company performs its obligations. (For additional guidance on identifying deliverables in a multiple-element arrangement, see 605-25-15 (Q&A 01).)

Determining the period over which the company performs its obligations under the arrangements requires an analysis of specific terms of the arrangement, with a focus on the beneficiary of the various deliverables (i.e., the bank or the individual credit card holder). The recognition period will vary on the basis on the specific terms of each arrangement, and the appropriate recognition method will depend on the specific facts and circumstances of each arrangement. We have seen several methods used to amortize deferred payments (e.g., straight-line based on total estimated revenues, prospectively after payments are received, cumulative catch-up once payments are received with the remainder recognized prospectively).

There are many factors to consider in determining the appropriate recognition method, including, but not limited to, (1) a company's experience with and ability to reasonably estimate overall expected revenue and (2) the timing in which obligations are fulfilled and delivery occurs. As stated above, under any method, we would usually expect some portion of the payments to be recorded as deferred revenue associated with obligations to be performed through the end of the recognition period. In some situations, more than one method of recognition may be acceptable; in other situations, however, certain methods of recognition may be unacceptable.

Example

Company V, an electronics retailer, enters into an exclusive cobranded credit card agreement (the "Agreement") with a national bank. Under the Agreement, the bank will issue credit cards bearing V's brand name. The term of the Agreement is three years, and V is obligated to do the following:

- License V's brand name for use on the credit cards.
- Endorse, promote, and market the credit card to new customers.
- Maintain and administer a rewards program for the cardholders.

For performing its obligations under the Agreement, V will receive (1) $60 for each new cardholder that V signs up for the credit card (i.e., a bounty fee) and (2) a 3 percent royalty of each cardholder's monthly expenditures on the credit card (intended to reimburse V for the cost of the rewards program).

Company V has evaluated the deliverables in the Agreement under ASC 605-25-25-5 and has determined that none of the deliverables meet the criteria for treatment as a separate unit of accounting because the individual deliverables do not have value to the customer on a stand-alone basis, and no objective and reliable evidence of fair value exists for each deliverable.

Because the deliverables cannot be separated, it would be appropriate for V to use a proportional performance model to recognize the compensation it receives. Under this model, V would recognize the compensation over the period in which V performs its specific obligations under the Agreement.

Up-front recognition of the bounty fee, as V signs up each cardholder, would generally not be appropriate since at this point V has not fully performed its obligation to the bank under the Agreement.

Provided that V is performing ratably over the term, it may be appropriate for V to use a cumulative catch-up model to recognize the bounty fee as revenue. Under this model, V would recognize a portion of the bounty fee as revenue when due (on the basis of V's performance to date) and would amortize the remaining portion ratably over the remaining period. As long as the appropriate service period is deemed to be three years and V is due a $60 bounty fee at the end of year one, one-third of the bounty fee (or $20) would be recognized immediately when due and the remaining two-thirds (or $40) would be recognized evenly over the remaining two years (since V is performing ratably over the three-year term).

The SEC staff discusses this concept in Question 1 of SAB Topic 13.A.3(f), which states, in part:

> Supply or service transactions may involve the charge of a nonrefundable initial fee with subsequent periodic

> payments for future products or services. The initial fees may, in substance, be wholly or partly an advance payment for future products or services . . . . In such circumstances, the staff believes that up-front fees, even if nonrefundable, are earned as the products and/or services are delivered and/or performed over the term of the arrangement or the expected period of performance and generally should be deferred and recognized systematically over the periods that the fees are earned. [Footnotes omitted]

In this example, it is assumed that V's performance obligations generally correlate with the contractual term rather than the life of the cardholders' relationship. However, in certain circumstances, the recognition period could extend beyond the contract term. Footnote 39 of SAB Topic 13 discusses this concept, stating, in part, that the "revenue recognition period should extend beyond the initial contractual period if the relationship with the customer is expected to extend beyond the initial term and the customer continues to benefit from the payment of the up-front fee."

In other circumstances, the contract period may not be clearly defined, may be indefinite, or may allow for extensions and renewals, all of which will require further analysis of the overall arrangement in determining the appropriate recognition period.

Further, these arrangements often may include other compensation, such as royalties based on credit card spending (as in this example) or reimbursements for certain costs such as products or services provided under the reward program, marketing expenses, or other related expenses (such as credit card processing fees). As with the bounty fee, the deliverables associated with the other compensation generally will not meet the criteria for treatment as a separate unit of accounting under ASC 605-25-25-5 because the deliverables do not have value to the customer on a stand-alone basis, no objective and reliable evidence of the deliverable's fair value exists, or both. Therefore, an entity must also consider this other compensation carefully when determining an appropriate revenue recognition method for the overall arrangement in accordance with ASC 605-25 and other revenue guidance.

Stand-Alone Value — 605-25-25 (Q&A 08)

ASC 605-25-25-5(a) states, in part, the following about stand-alone value:

> The item or items have value on a standalone basis if they are sold separately by any vendor or the customer could resell the delivered item(s) on a standalone basis. In the context of a customer's ability to resell the delivered item(s), this criterion does not require the existence of an observable market for the deliverable(s).

Question

How do the amendments to ASC 605-25 in ASU 2009-13 affect an entity's determination of whether a delivered item has stand-alone value?

Answer

Under ASU 2009-13, entities are likely to place greater significance on the criterion for determining stand-alone value for delivered items in an arrangement with multiple deliverables. Although ASC 605-25, before the amendments in ASU 2009-13, also required entities to determine whether a delivered item has stand-alone value, in practice, entities that determined they did not have objective and reliable evidence of fair value for an undelivered item did not necessarily focus on determining whether the delivered item had stand-alone value because in such circumstances the vendor had already concluded that it could not separate the deliverables in the arrangement. The requirement in ASU 2009-13 that an entity determine the selling price for undelivered items when separating deliverables into separate units of accounting will, therefore, in certain circumstances place a greater burden on an entity to first determine whether the delivered item or items have stand-alone value.

In certain situations, determining whether an item has stand-alone value may be relatively straightforward. For example, if the item being considered is sold separately by the entity and there is a readily observable market in which customers regularly sell similar items separately, it would be reasonable to conclude that stand-alone value exists for the item. In other situations, the determination of whether the delivered item has stand-alone value becomes more complex and therefore requires the use of significant judgment. For example, when the item being considered is not sold separately by the entity but is bundled with other products or services from the entity that are necessary for the customer to derive substantive value from that item, the assessment of stand-alone value is much more challenging.

In developing what ultimately became the amendments to ASC 605-25 in ASU 2009-13, the EITF was asked whether it should offer further clarification to help entities determine stand-alone value. The EITF determined that further guidance on assessing stand-alone value was outside the scope of the issue addressed in the ASU. Accordingly, the EITF did not substantively discuss stand-alone value when deliberating the issue and did not provide clarifying guidance.

For an additional example of stand-alone value, see 605-25-25 (Q&A 06).

Initial Measurement

ASC 605-25

30-1 The amount of total arrangement consideration must be fixed or determinable other than with respect to the impact of either of the following:

a. Any refund rights or other concessions (collectively referred to as refund rights) to which the customer may be entitled

b. Performance bonuses to which the vendor may be entitled.

30-2 Arrangement consideration shall be allocated at the inception of the arrangement to all deliverables on the basis of their relative selling price (the relative selling price method), except as specified in paragraphs 605-25-30-4 through 30-5. When applying the relative selling price method, the selling price for each deliverable shall be determined using vendor-specific objective evidence of selling price, if it exists; otherwise, third-party evidence of selling price (as discussed in paragraph 605-25-30-6B). If neither vendor-specific objective evidence nor third-party evidence of selling price exists for a deliverable, the vendor shall use its best estimate of the selling price for that deliverable (as discussed in paragraph 605-25-30-6C) when applying the relative selling price method. In deciding whether the vendor can determine vendor-specific objective evidence or third-party evidence of selling price, the vendor shall not ignore information that is reasonably available without undue cost and effort.

30-3 Paragraph superseded by Accounting Standards Update No. 2009-13.

30-4 To the extent that any separate unit of accounting in the arrangement is required by guidance included in another Topic to be recorded at fair value (and marked to market each reporting period thereafter), the amount allocated to that unit of accounting shall be its fair value. Under those circumstances, the remainder of arrangement consideration shall be allocated to the other units of accounting in accordance with the requirements in paragraph 605-25-30-2.

30-5 The amount allocable to the delivered unit or units of accounting is limited to the amount that is not contingent upon the delivery of additional items or meeting other specified performance conditions (the noncontingent amount). That is, the amount allocable to the delivered unit or units of accounting is the lesser of the amount otherwise allocable in accordance with paragraphs 605-25-30-2 and 605-25-30-4, or the noncontingent amount. Additionally, although Subtopic 605-15 may affect the amount of revenue recognized, the allocated amount is not adjusted for the impact of a general right of return pursuant to that Subtopic. See the Example in paragraphs 605-25-55-13 through 55-18.

30-6 The measurement of revenue per period shall be limited to the measurement that results from assuming that cancellation of the arrangement will not occur. The amount recorded as an asset for the excess of revenue recognized under the arrangement over the amount of cash or other consideration received from the customer since the inception of the arrangement shall not exceed all amounts to which the vendor is legally entitled, including cancellation fees (in the event of customer cancellation). However, whether a vendor intends to enforce its contractual rights in the event of customer cancellation shall be considered in determining the extent to which an asset should be recorded.

Complying With the Selling Price Hierarchy — 605-25-30 (Q&A 01)

The introduction of and required use of a selling price hierarchy, as well as the elimination of the residual method for allocating arrangement consideration, creates a number of implementation issues with ASU 2009-13. Specifically, entities may be required for the first time to develop estimates of selling prices for deliverables that qualify for separation in an arrangement. For example, because of the elimination of the residual method, which was permitted before ASU 2009-13, entities will be required to determine the estimated selling price of both delivered items (even if VSOE or TPE of selling prices for the undelivered deliverables exists) and undelivered items.

Question

How should an entity comply with the selling price hierarchy under ASC 605-25 (as amended by ASU 2009-13)?

Answer

The required use of selling price forces entities to perform an analysis when determining the selling price for deliverables in an arrangement. As part of this analysis, an entity will be required to consider specific facts about its own revenue-generating activities as well as identify inputs from market information for similar arrangements to determine the level of evidence that the entity has within the selling price hierarchy.

An entity cannot simply make its best estimate of the selling price for a deliverable and use that estimate to allocate arrangement consideration to a deliverable without first determining whether either VSOE or TPE of selling price exists for that deliverable. When an entity allocates consideration to a deliverable on the basis of its best estimate of the selling price, it needs to demonstrate the process used to comply with the selling price hierarchy in ASC 605-25. As entities work through the selling price hierarchy, they may need to document their pricing strategies for each deliverable and then, if applicable, analyze the actual pricing practices for those deliverables.

ASC 605-25-30-2 does offer entities some leniency with respect to the effort they would need to expend to obtain information about the selling price of a deliverable and states that "[i]n deciding whether the vendor can determine vendor-specific objective evidence or third-party evidence of selling price, the vendor shall not ignore information that is reasonably available without undue cost and effort." Entities still need to demonstrate that they complied with ASC 605-25's required use of the selling price hierarchy. As a result, entities may need to assess their internal controls and financial reporting processes to evaluate the manner in which they adhere to this hierarchy.

The selling price hierarchy creates an interesting complexity and implementation issue. Before ASU 2009-13, entities may have commonly found themselves trying to support the existence of VSOE or TPE of fair value for deliverables to separately account for those deliverables. After ASU 2009-13, entities may have to support the fact that VSOE or TPE of selling prices for deliverables **does not** exist in instances in which the best estimate of selling price is used to allocate consideration to separate units of accounting. As a result of this requirement, entities may expend additional effort when accounting for revenue arrangements with multiple deliverables.

For guidance on establishing the existence of VSOE and TPE of selling prices, see 605-25-30 (Q&A 02) and 605-25-30 (Q&A 03), respectively.

Updating the Selling Price Analysis — 605-25-30 (Q&A 04)

Because ASC 605-25 requires an entity to apply the selling price hierarchy to each arrangement, an entity must consider its compliance with the selling price hierarchy for each new multiple-element arrangement. For example, an entity may have determined that VSOE and TPE of selling price did not exist for a certain deliverable and may, therefore, have used its best estimate of selling price for that deliverable to allocate arrangement consideration. Conversely, an entity may have previously concluded that VSOE or TPE of selling price did exist for deliverables and used that evidence to allocate arrangement consideration to a multiple-deliverable arrangement.

Question

How often should an entity update its selling price analysis under ASC 605-25?

Answer

Entities should continually analyze their business, as well as the overall market landscape, and update their assessment of whether VSOE or TPE of selling prices exists (or does not exist) whenever facts and circumstances come to light that might change any previous assessments made by the company. The frequency with which entities will perform or update such analyses will vary on the basis of the nature of an entity's business and levels of variability in their pricing policies. Timing and frequency of such analyses will differ on the basis of the nature of the industry/marketplace in which an entity operates.

Specifically, entities that allow their sales personnel a larger degree of flexibility in pricing negotiations with customers, or whose product and service values change rapidly as a result of supply-and-demand issues or changes in technology, should perform analyses of VSOE or TPE of selling price more frequently than entities that do not exhibit more-than-minimal price fluctuation and whose products and services are not affected by technological change. Other factors that may affect the frequency of such analyses are the useful life of an entity's products and services, where in the life cycle their products and services are, and the related impact on pricing strategies.

Entities should at least, in connection with every reporting period, consider any changes in facts and circumstances that could affect any previous conclusions reached about whether VSOE or TPE of selling price exists and document such considerations. Any updated analyses of actual pricing practice will be most relevant if performed in a manner consistent with what was done when the company first determined whether VSOE or TPE of selling price existed.

In addition to updating the selling price determined by using VSOE or TPE, a company should periodically reassess and update its own best estimates of selling prices (i.e., selling prices that represent a vendor's best estimate of the deliverable's selling price). The frequency and extent of such updates will vary on the basis of factors similar to those described above with respect to VSOE and TPE of selling price.

Example

Entity X is a distributor of certain consumer electronic products and primarily sells the products to retailers in bundled arrangements. Entity X specializes in identifying the latest trends in consumer electronics, and many of its products are high-tech novelty items that have a relatively short life cycle, sometimes as short as one or two years. Because of changes in trends and technology, the pricing for X's products is often subject to significant price reductions throughout the product's life cycle. Upon the launch of a new product, X will provide a large degree of pricing latitude to its sales personnel to get its products in the stores. However, when or if a sufficient market develops for its products, X will tighten its pricing practices.

On the basis of the nature of its pricing practices and products, X concludes that it will quarterly perform an updated analysis of its pricing practices to determine the selling price for each product and whether it will be based on VSOE, TPE, or best estimate of selling price.

Impact on Prior and Future Revenue Arrangements When VSOE or TPE of Selling Price Is Established After the Inception of a Revenue Arrangement — 605-25-30 (Q&A 05)

An entity's assessment of whether VSOE or TPE of selling price exists is an ongoing activity (see 605-25-30 (Q&A 04)). ASC 605-25 requires that arrangement consideration be allocated to all deliverables at the **inception** of a revenue arrangement. In certain instances, an entity may not be able to establish VSOE or TPE of selling price at the inception of an arrangement and would be required to use its best estimate of selling price to allocate arrangement consideration among the deliverables in the arrangement.

Question

If an entity subsequently establishes VSOE or TPE of selling price for a deliverable to which arrangement consideration was previously allocated on the basis of the entity's best estimate of selling price, what is the impact on the prior and future revenue arrangements?

Answer

The establishment of VSOE or TPE of selling price after the inception of a revenue arrangement would have no effect on the revenue arrangement — regardless of whether deliverables under those arrangements remained undelivered. There would be an effect, however, on new arrangements entered into after the establishment of VSOE or TPE of selling price. In those new arrangements, the entity would need to allocate arrangement consideration to the element(s) on the basis of the recently established VSOE or TPE of selling price. The entity would also need to consider the effects on its disclosures as a result of the change.

These same principles would apply to situations in which TPE of selling price was being used to allocate consideration to a deliverable and VSOE of selling price for the deliverable was subsequently established.

ASC 605-25

30-6A Vendor-specific objective evidence of selling price is limited to either of the following:

a. The price charged for a deliverable when it is sold separately

b. For a deliverable not yet being sold separately, the price established by management having the relevant authority (it must be probable that the price, once established, will not change before the separate introduction of the deliverable into the marketplace).

Establishing Vendor-Specific Objective Evidence of Selling Price — 605-25-30 (Q&A 02)

ASC 605-25 requires an entity to use VSOE, if it is available, to establish the selling price of a deliverable. ASC 605-25-30-6A limits the evidence that qualifies as VSOE of selling price to (1) "[t]he price charged for a deliverable when it is sold separately" or (2) "[f]or a deliverable not yet being sold separately, the price established by management having the relevant authority (it must be probable that the price, once established, will not change before the separate introduction of the deliverable into the marketplace)."

Question

How does an entity establish VSOE of selling price for a deliverable in a multiple-element arrangement?

Answer

To establish VSOE of selling price for a deliverable, an entity needs to analyze actual pricing practices for that deliverable. Such analyses might include capturing sales of the deliverable for a recent period to determine whether a consistent concentration of sales price exists. For example, if such an analysis indicates that the pricing for 80 percent of recent stand-alone sales of a deliverable falls within a range of plus or minus 15 percent of a midpoint sales price, the vendor may conclude that it has VSOE of selling price for the deliverable.

When analyzing actual pricing practices, entities might also consider whether stratification of the sales by customer type (i.e., on the basis of specific characteristics of customers or sales transactions) is appropriate. A concentration of sales prices for a particular deliverable for a certain class of customer could also indicate that VSOE of selling price has been established and that it therefore must be used by the vendor to determine the selling price of the deliverable.

The guidance in ASC 985-605 on VSOE may also be applied analogously. See ASC 985-605-25-6 and ASC 985-605-25-67 and the related Deloitte guidance (see Appendix B).

Example

Entity X is a manufacturer of heavy equipment that is sold directly to end users. Entity X offers a full year of maintenance service, which is included in the initial purchase price of the equipment. (The maintenance service is outside the scope of the separately priced extended warranty and product maintenance costs guidance of ASC 605-20.) At the end of the initial year of ownership, customers may then purchase additional maintenance services annually at prices that are specifically stated in the initial sales contract. Because customers typically do not possess the necessary skills or resources to efficiently maintain the machinery, most customers renew the maintenance services.

Entity X sells heavy equipment to Customer B for $250,000, which includes a full year of initial maintenance services. After one year, B has the option of purchasing additional annual maintenance services for $15,000 each year for the following five years. While the initial sales price of the equipment varies from list price on the basis of customer profiles (e.g., size, geography), X has established targeted pricing for maintenance services as a percentage of the initial sales price of the equipment. Entity X typically targets maintenance services at 8 percent of the initial sales price, but the ultimate pricing often differs from the targeted rate as a result of negotiations.

On the basis of X’s normal pricing practices and other factors, X concludes that the $15,000 stated renewal rate (6 percent of the initial sales price) in the contract with B is substantive. Accordingly, the stated renewal rate provides VSOE of selling price for the maintenance services.

Using Hourly Rates to Establish Vendor-Specific Objective Evidence of Selling Price — 605-25-30 (Q&A 10)

Question

Is it appropriate for an entity to use hourly rates to establish VSOE of selling price for services?

Answer

If a service element consists of entity personnel that are often contracted out under separate arrangements at hourly per diem rates, those rates may be used to establish VSOE of selling price for the services, but only if the entity can reasonably estimate the amount of time that providing the service will require. In addition, in determining whether VSOE of selling price for a service element exists, entities might also consider whether there are renewal rates for such deliverables. In certain circumstances, the existence of renewal rates in an arrangement could also serve as VSOE of selling price as long as such rates are substantive.

ASC 985-605-25-67 specifically refers to the renewal rate for postcontract customer support services as providing evidence of VSOE of selling price as long as this rate is substantive. By analogy to ASC 985-605, VSOE of selling price for service deliverables included in an arrangement subject to ASC 605-25 could be established by reference to an explicitly stated substantive renewal rate for such services.

Example

Entity C is an application service provider that hosts on-demand software over the Internet. The software allows entities to manage their customer service call center function online. Entity C typically sells various professional services with the application services, but C’s core business is the application services. The initial hosting period is typically two years, and customers may renew the application services for additional two-year periods at the same price specified in the initial sales contract. While the professional services are priced at a standard rate per hour, the pricing for the application services will vary depending on the customer's industry, the different applications included, and negotiated discounts. On the basis of historical experience, C is able to demonstrate that a substantial majority of its customers renew the application services at the stated price.

Entity C sells application services to Customer D for $50,000 for an initial two-year period. The arrangement also includes certain professional services that are billed at a stated rate per hour. Customer D has the option to renew the application services indefinitely for additional two-year periods at the stated rate of $50,000.

On the basis of C's normal pricing practices and other factors, C concludes that the $50,000 stated renewal rate in the contract with D is substantive. Accordingly, the stated renewal rate would provide VSOE of selling price for the application services.

ASC 605-25

30-6B Third-party evidence of selling price is the price of the vendor's or any competitor's largely interchangeable products or services in standalone sales to similarly situated customers.

Establishing Third-Party Evidence of Selling Price — 605-25-30 (Q&A 03)

ASC 605-25 requires an entity to use VSOE, if it is available, to establish the selling price of a deliverable. If VSOE is not available, an entity should use TPE to determine selling price. If neither VSOE nor TPE of selling price exist for a deliverable, then the entity must use its best estimate of the selling price for that deliverable to allocate consideration among the deliverables in an arrangement.

Question

How does an entity establish TPE of selling price for a deliverable in a multiple-element arrangement?

Answer

In determining whether TPE of selling price exists, an entity should, without undue cost and effort, do the following (this list is not all-inclusive):

- Assess the marketplace in which it operates.
- Look to competitors' products and services to determine whether such products and services are largely interchangeable with its own products or services.
- Determine whether competitors' products and services are offered to customers that are similarly situated to their own.
- Consider whether such sales are made on a stand-alone basis.

In determining whether the products or services are interchangeable, an entity needs to consider the degree of customization of the vendor's products and services and, for service elements, the levels of skill, training, and experience that are needed to provide such services. An entity should also consider the types of customers purchasing the products and services from third parties to ensure that those customers are similar to the vendor's own customers. For example, in certain situations, it would not be appropriate for a retailer of a product to use sales of the same product by a wholesaler as TPE of selling price, since the nature of a retailer and wholesaler and their position in the supply chain are significantly different.

If an entity determines that largely interchangeable products or services exist that are sold to similarly situated customers, it must then determine whether "readily determinable" information (i.e., available without undue cost or effort) about competitors' pricing practices exists. For elements to support TPE of selling price, an entity would need to analyze the readily determinable information to determine whether there is an appropriate concentration in pricing. Sources a vendor should consider in accumulating TPE of selling price might include published list prices, quoted marketplace prices, industry reports, and statistics or other sources of publicly available information. However, an entity must also consider the existence of, or common practices related to, discounts on products and services from published list prices. In summary, among other factors, the absence of a sufficient concentration in pricing, a lack of stand-alone sales, or the dissimilarity of customer types would indicate that TPE of selling price does not exist.

Example

Entity X has recently developed and patented a unique substance that can be infused into the rubber compound found within golf balls, thus significantly increasing their durability and extending their playable life. Although no other entities have developed such a highly innovative substance, the market is highly competitive; thus, such technologies often become obsolete over a period of two to three years. Entity X has not previously licensed its recently developed substance.

Entity X has entered into a $500,000 contract with a golf ball manufacturer. The contract provides the manufacturer with a one-year nonexclusive license to use X's patented substance and requires X to deliver ratably, over a three-month period, 10,000 golf balls that contain the patented substance. Under the terms of the contract, the manufacturer has the ability to transfer the license. While X has previously used its patented substance to manufacture golf balls during its development effort, X has not previously sold those golf balls as a commercial product.

On the basis of all the facts and circumstances, X determines that neither VSOE nor TPE of selling price can be established for the deliverables in this arrangement (i.e., the one-year license and the delivery of 10,000 golf balls).

In reaching its conclusion, X notes that its licensed substance is a proprietary product of X that it has never licensed before, and that VSOE of selling price therefore does not exist. Entity X also notes that no other substances similar to X's substance are currently on the market. Thus, X determines that there are no comparable third-party transactions that can be used to establish TPE of selling price.

In reaching its conclusion regarding the golf ball deliverable, X notes that it has never previously sold golf balls and does not intend to do so in the future. Thus, X determines that VSOE of selling price does not exist for the golf balls. Entity X also carefully considers whether the stand-alone sales of other golf balls could provide TPE of selling price. While the golf ball manufactured by X looks identical to other golf balls currently on the market and can be used for the same intended purpose, X believes its golf ball is nonetheless sufficiently different from the other golf balls because of the inclusion of its patented substance, which X believes represents a degree of customization and enhanced performance capability not found in other golf balls. Accordingly, X determines that the sale of other golf balls does not constitute TPE of selling price.

Entity X will have to make its best estimate of the selling price for the license and the golf balls before allocating the arrangement consideration among the deliverables.

ASC 605-25

30-6C The vendor's best estimate of selling price shall be consistent with the objective of determining vendor-specific objective evidence of selling price for the deliverable; that is, the price at which the vendor would transact if the deliverable were sold by the vendor regularly on a standalone basis. The vendor shall consider market conditions as well as entity-specific factors when estimating the selling price.

Determining "Best Estimate of Selling Price" — 605-25-30 (Q&A 06)

ASC 605-25 (as amended by ASU 2009-13) discusses how an entity should allocate arrangement consideration to separate units of accounting. In doing so, entities are required, at the inception of an arrangement, to establish the "selling price" for all deliverables that qualify for separation. The manner in which "selling price" is established is based on a hierarchy of evidence that entities must consider. Total arrangement consideration is then allocated on the basis of the deliverables' relative selling price.

In considering the hierarchy of evidence under in ASC 605-25, an entity first determines the selling prices by using VSOE of selling price, if it exists; otherwise, the entity uses TPE of selling price. If neither VSOE nor TPE of selling price exists for a deliverable, an entity must use its **best estimate** of the selling price for that deliverable to allocate consideration among the deliverables in an arrangement. As stated in ASC 605-25, in deciding whether the entity can establish VSOE or TPE of selling price, the "vendor shall not ignore information that is reasonably available without undue cost and effort."

Question

When VSOE or TPE of selling price cannot be established, how does an entity determine "best estimate of selling price"?

Answer

An entity will need to use significant judgment when evaluating what method(s) to use in developing its best estimate of selling price for deliverables. A company should evaluate each deliverable separately and determine which method will provide the best estimate for that particular deliverable on the basis of the deliverable's specific characteristics. ASC 605-25 includes two examples that depict possible methods entities might use to determine the best estimate of selling prices for particular deliverables.

In ASC 605-25-55-37 through 55-47, Example 6: Human Resources Outsourcing Services describes a scenario in which a vendor provides a variety of human-resource-related services consisting of payroll processing services, executive compensation assessments, development of an employee handbook, and the delivery of three periodic training events. Because none of these services has been sold separately before, the vendor is unable to establish VSOE of selling price for any of the services, nor can the vendor establish TPE of selling price for the deliverables. Therefore, the vendor must estimate the selling price for each of the services provided in the arrangement. As illustrated in this example, the vendor estimates selling prices for the four deliverables by first calculating the internal costs to be incurred during the delivery of each of the services and then applying their typical gross profit margin, resulting in an estimated selling price for each of the deliverables.

Similarly, in ASC 605-25-55-75 through 55-85, Example 11: Agricultural Equipment illustrates a scenario in which entities use the cost of the equipment plus an estimated gross profit margin to determine the best estimate of selling price. Example 11 also illustrates how the determination of the estimated gross margin includes various data points, such as geographical location, competitor information, and technological complexity.

Entities may often apply a method similar to those illustrated in Examples 6 and 11 when estimating the selling price of deliverables subject to ASC 605-25. That is, in many scenarios, it would be appropriate to use a "cost plus gross profit margin" method to determine the best estimate of selling price.

However, there will be situations in which the determination of an entity's best estimate of selling price is more complex. In these situations, an entity will need to consider factors other than cost and gross margins, such as various market- and entity-specific factors. For additional guidance, see 605-25-30 (Q&A 07) and 605-25-30 (Q&A 08).

Assessing Market- and Entity-Specific Factors When Establishing the Best Estimate of Selling Price — 605-25-30 (Q&A 07)

As discussed in 605-25-30 (Q&A 06), when VSOE or TPE of selling price cannot be established, an entity will need to use significant judgment when evaluating what method(s) to use in developing its best estimate of selling price for deliverables. A company should evaluate each deliverable separately and determine which method will provide the best estimate for that particular deliverable on the basis of the deliverable's specific characteristics. In many scenarios, it may be appropriate to use a "cost plus gross profit margin" method to determine the best estimate of selling price. However, there will be situations in which the determination of an entity's best estimate of selling price is more complex.

Question

In situations in which the determination of an entity's best estimate of selling price is complex, what factors should an entity consider in making such an estimate?

Answer

An entity may need to consider items other than cost and gross margins, such as various market- and entity-specific factors. In doing so, the entity should weigh the relevance of all available data points and document the rationale for its conclusion on the best estimate of selling price.

Market-specific factors an entity may consider when developing the best estimate of selling price include, among others:

- Customer demand.
- The existence and effect of competitors.
- General profit margins realized in the marketplace or industry.
- The effect that technological advancements may have on the deliverables, risk of obsolescence, or both.

- Overall condition of the economy and economic trends.
- Customers' internal costs (and fluctuations of costs) of making products or providing services themselves, which might influence their purchasing decisions.

Entity-specific factors a vendor may consider when developing the best estimate of selling price include, among others:

- The entity's internal costs of providing the deliverable(s).
- The entity's profit objectives, including targeted and historical profit margins realized on similar sales to similar customers.
- The entity's pricing practices in providing discounts for bundled sales, volume discounts, and any other discounting practices that may exist.
- The entity's required rates of return.

An entity should weigh the relevance of all available data points before deciding on the best estimate of selling price. The entity should document such considerations along with the specific rationale that led to its conclusion about the best estimate of selling price. Because of the requirement that entities develop their best estimate of selling price and cannot merely conclude that neither VSOE nor TPE of selling price exists, entities will need to prepare an analysis supporting their best estimate of a deliverable's selling price, including a discussion of the various data points that were considered and evaluated as part of that analysis.

In addition, whereas the determination of whether VSOE or TPE of selling price exists could largely be performed within an entity's accounting department, developing the best estimate of selling price may require entities to use resources outside the accounting group. Personnel in other areas of the business (e.g., sales, operations, planning, marketing, and other departments) may need to be involved to ensure that all appropriate entity- and market-specific factors are considered before a conclusion is reached on an entity's best estimate of selling price.

For additional guidance on establishing the best estimate of selling price, see 605-25-30 (Q&A 08).

Difficulties Determining, and Reliability of, "Best Estimate of Selling Price" — 605-25-30 (Q&A 08)

In many cases, it may be a welcome relief for entities to be able to estimate selling prices in the absence of VSOE or TPE of selling price when separating deliverables in an arrangement. However, an entity may find that determining the best estimate of selling price for deliverables can also be complex. Specifically, an entity may find it difficult to develop its best estimate of selling price for a deliverable when it:

- Introduces a new product or service.
- Introduces an existing product or service to a new market or customer type.
- Cannot reasonably estimate selling price on a cost-plus-margin basis because many of the costs incurred are considered R&D (i.e., nontangible assets).
- Sells a product with very high margins, which may result in significant dispersion of selling price.
- Sells a low volume of the products or services.
- Enters into unique arrangements in which the products, services, or other obligations offered do not exist in the vendor's other arrangements.
- Is motivated to enter into sales for reasons that go beyond typical sales practices and objectives (e.g., distressed sales or sales made to enter a new market or entice future sales of a product or service).
- Involves deliverables that are not the subject of specific pricing policies or strategies (e.g., "less significant" or "ancillary" deliverables).
- Experiences anomalies in the supply or demand of products/services in the marketplace.

Question

If an entity is unable to establish VSOE or TPE of selling price, must the entity still determine its best estimate of selling price?

Answer

During deliberations of the guidance codified in ASU 2009-13, the FASB staff and the EITF agreed that a vendor would generally have enough information to make a reliable estimate of selling price. The EITF did acknowledge that it may be difficult to estimate the selling price in certain instances because of the limited information available from either the vendor's own transactions or similar transactions in the marketplace. However, the EITF was willing to accept potential measurement inaccuracies to give entities the ability to separate deliverables into separate units of accounting and, therefore, recognize revenue upon delivery of a product or performance of a service, which would better reflect the economics of most transactions. That is, relevance of the business economics would outweigh the reliability of best estimates.

Therefore, although it may be difficult to estimate selling price in certain situations, entities are nonetheless required to develop estimates and use them to allocate revenue to multiple deliverables that otherwise qualify for separation. While entities are in a unique position to be able to estimate the selling price of their own products and services provided to customers, in certain situations an entity may consider involving third-party specialists to help improve the reliability of the estimate.

For more information on determining the best estimate of selling price, see 605-25-30 (Q&A 06) and 605-25-30 (Q&A 07).

Using a Single-Point Estimate Rather Than a Range to Determine "Best Estimate of Selling Price" — 605-25-30 (Q&A 09)

ASC 605-25 (as amended by ASU 2009-13) specifies that an entity's best estimate of selling price should be consistent with the objective of determining VSOE of selling price for a deliverable (i.e., the price at which the vendor would transact if the deliverable were sold by the vendor regularly on a stand-alone basis). It also indicates that contractually stated prices for individual products or services in an arrangement should not be presumed to represent the best estimate of selling price.

ASC 605-25 does not specify whether an entity's best estimate of selling price should be expressed as a single-point estimate or whether it can be expressed as a range. Similarly, it does not provide explicit guidance on using a range rather than a single-point estimate with respect to VSOE or TPE of selling price. In Examples 6 and 11 in ASC 605-25-55, however, the best estimate of selling price is expressed as a single-point estimate.

Question

Is an entity required to express the best estimate of selling price as a single-point estimate?

Answer

Generally, the use of a single-point best estimate of selling price is preferable because it is more precise and, in similar arrangements, allows for greater consistency.

However, many entities have established VSOE of selling price on the basis of a range of actual sales transactions. In practice, entities often consider many factors when determining the appropriate selling price of a deliverable, such as the type, size, prestige, or strategic significance of a customer; prior relationship or future sales potential with the customer; or size/volume of the sale. Because the deliverable is sold at varying amounts to similarly situated customers, there is no specific amount that represents VSOE of selling price. In establishing VSOE of selling price, an entity may therefore sometimes determine a reasonable range of sufficiently concentrated prices that it believes represents VSOE of selling price. Since the objective of establishing VSOE of selling price is similar to the objective of determining an entity's best estimate of selling price (under ASC 605-25), it may be acceptable for an entity to use a range to establish the best estimate of selling price.

ASC 605-25

30-7 Contractually stated prices for individual products or services in an arrangement with multiple deliverables shall not be presumed to be representative of vendor-specific objective evidence, third-party evidence, or a vendor's best estimate of selling price.

30-8 Paragraph superseded by Accounting Standards Update No. 2009-13.

30-9 Paragraph superseded by Accounting Standards Update No. 2009-13.

Disclosure

ASC 605-25

50-1 The objective of the disclosure guidance in this Section is to provide both qualitative and quantitative information about a vendor's revenue arrangements and about the significant judgments made about the application of this Subtopic and changes in those judgments or in the application of this Subtopic that may significantly affect the timing or amount of revenue recognition. Therefore, in addition to the required disclosures, a vendor shall also disclose other qualitative and quantitative information as necessary to comply with this objective.

50-2 A vendor shall disclose all of the following information by similar type of arrangement:

a. The nature of its multiple-deliverable arrangements

b. The significant deliverables within the arrangements

c. The general timing of delivery or performance of service for the deliverables within the arrangements

d. Performance-, cancellation-, termination-, and refund-type provisions

e. A discussion of the significant factors, inputs, assumptions, and methods used to determine selling price (whether vendor-specific objective evidence, third-party evidence, or estimated selling price) for the significant deliverables

f. Whether the significant deliverables in the arrangements qualify as separate units of accounting, and the reasons that they do not qualify as separate units of accounting, if applicable

g. The general timing of revenue recognition for significant units of accounting

h. Separately, the effect of changes in either the selling price or the method or assumptions used to determine selling price for a specific unit of accounting if either one of those changes has a significant effect on the allocation of arrangement consideration.

Application of Disclosure Requirements to Multiple-Element Arrangements Subject to EITF Issue 00-21 — 605-25-50 (Q&A 01)

ASU 2009-13 significantly expanded the disclosures required under ASC 605-25. The enhanced disclosures are intended to give financial statement users the benefit of a much more robust discussion about the significant deliverables in an entity's multiple-deliverable revenue arrangements. Under ASU 2009-13's amendments, an entity must provide information about the significant deliverables within the arrangement; the general timing of revenue recognition for significant units of accounting; and a discussion about the significant factors, inputs, assumptions, and methods used to determine selling price (whether VSOE, TPE, or estimated selling price) for the significant deliverables, including the effect of significant changes on those methods or assumptions.

Question

Should an entity provide the disclosures required under ASC 605-25-50-2 (as added by ASU 2009-13) for existing multiple-element arrangements entered into before the entity adopted the guidance in ASU 2009-13 (i.e., arrangements subject to Issue 00-21)?

Answer

The disclosure requirements of ASC 605-25 (as amended by ASU 2009-13) would only apply to multiple-element arrangements that are entered into or materially modified after an entity adopts ASU 2009-13 (unless an entity elects to adopt the guidance retroactively). These disclosures are not specifically required for multiple-element arrangements entered into before the adoption of ASU 2009-13's amendments; however, the disclosure requirements of ASC 605-25 before it was amended by ASU 2009-13 would still apply. Such guidance requires a vendor to disclose (1) its "accounting policy for recognition of revenue from multiple-deliverable arrangements (for example, whether deliverables are separable into units of accounting)" and (2) the "description and nature of such arrangements, including performance-, cancellation-, termination-, or refund-type provisions." Further, an entity may consider providing ASU 2009-13's disclosures for such arrangements after adoption to give users consistent information about all of its multiple-element arrangements.

Transition

ASC 605-25

Transition Related to Accounting Standards Update No. 2009-13, *Revenue Recognition (Topic 605): Multiple-Deliverable Revenue Arrangements*

65-1 The following represents the transition and effective date information related to Accounting Standards Update No. 2009-13, *Revenue Recognition (Topic 605): Multiple-Deliverable Revenue Arrangements*:

a. The pending content that links to this paragraph shall be applied on a prospective basis for revenue arrangements entered into or materially modified in fiscal years beginning on or after June 15, 2010, unless the vendor elects to adopt the pending content on a retroactive basis in accordance with paragraph 605-25-65-1(e).

b. Earlier application is permitted.

    1. If a vendor elects earlier application and the period of adoption is not the first reporting period in the vendor's fiscal year, the pending content that links to this paragraph shall be applied through retrospective application from the beginning of the vendor's fiscal year.

    2. Vendors shall disclose the following information at a minimum for all previously reported interim periods in the fiscal year of adoption:

        i. Revenue

        ii. Income before income taxes

        iii. Net income

        iv. Earnings per share

        v. The effect of the change for the appropriate captions presented.

c. In the year of adoption, a vendor shall disclose information that enables users of the financial statements to understand the effect of the change in accounting principle if the pending content that links to this paragraph is adopted on a prospective basis. To satisfy that objective, a vendor shall disclose at a minimum the following qualitative information by similar types of arrangements:

    1. A description of any change in the units of accounting

    2. A description of the change in how a vendor allocates the arrangement consideration to various units of accounting

    3. A description of the changes in the pattern and timing of revenue recognition

    4. Whether the adoption of the pending content that links to this paragraph is expected to have a material effect on financial statements in periods after the initial adoption.

d. If the effect of adopting the pending content that links to this paragraph is material, the qualitative information shall be supplemented with quantitative information in the period of adoption to satisfy the objective of enabling users to understand the effect of the change in accounting principle. Depending on a vendor's facts and circumstances, the following are examples of methods (but not the only potential methods) that may individually or in combination provide quantitative information to satisfy that objective:

    1. The amount of revenue that would have been recognized in the year of adoption if the related arrangements entered into or materially modified after the effective date were subject to the measurement requirements of Subtopic 605-25 (before the amendments resulting from Update 2009-13).

    2. The amount of revenue that would have been recognized in the year before the year of adoption if the arrangements accounted for under Subtopic 605-25 (before the amendments resulting from Update 2009-13) were subject to the measurement requirements of the pending content that links to this paragraph.

    3. For arrangements that precede the adoption of the pending content that links to this paragraph, the amount of revenue recognized in the reporting period and the amount of the deferred revenue as of the end of the period from applying the guidance in Subtopic 605-25 (before the amendments resulting from Update 2009-13). For arrangements that were entered into or materially modified after the effective date of the pending content that links to this paragraph, the amount of revenue recognized in the reporting period and the amount of deferred revenue as of the end of the period from applying the guidance in the pending content that links to this paragraph.

e. A vendor may elect, but is not required, to adopt the pending content that links to this paragraph through retrospective application applying the guidance in paragraphs 250-10-45-5 through 45-10. If a vendor elects retrospective application, the disclosures in paragraphs 250-10-50-1 through 50-3 shall be provided.

Materially Modified Revenue Arrangements — 605-25-65 (Q&A 01)

ASU 2009-13 must be applied prospectively to revenue arrangements entered into or **materially modified** in fiscal years beginning on or after June 15, 2010, unless an entity elects retrospective application in accordance with ASC 250.

During the public-comment exposure period for ASU 2009-13, questions arose regarding the meaning of "materially modified" — specifically, whether it referred only to financial impacts or whether it could also apply to other important terms and conditions that would not necessarily affect the amount of revenue included in an arrangement. The EITF decided that it was not necessary to clarify the meaning of materially modified, believing that it would be difficult to address all situations in which an arrangement may be materially modified or in which a modification would not be considered a material modification.

Question

How does an entity determine whether a revenue arrangement under ASC 605-25 is materially modified?

Answer

In assessing whether an arrangement is materially modified, an entity should evaluate both the quantitative and the qualitative implications of the modification. Entities should not evaluate the modification on the basis of the quantitative or qualitative impact to the financial statements as a whole; rather, the modification should be assessed with respect to the individual arrangement. Entities should evaluate the business purpose for any modification and whether the modification is substantive. While changing the consideration under an arrangement may often be considered a material modification, other changes to an arrangement, such as adding or removing deliverables, exchanging one deliverable for another, or extending the period of performance under an arrangement may also, under certain circumstances, represent a material modification to a revenue arrangement.

For information on how to account for materially modified arrangements, see 605-25-65 (Q&A 02).

Example 1

Entity X, an equipment manufacturer, enters into a multiple-deliverable revenue arrangement to (1) deliver 20 machines and 20 related user manuals to Customer Y, (2) install the 20 machines at Y's site, and (3) provide monthly safety inspection and testing services for two years after the date of installation. Under the original terms of the contract, payment terms are 30 days after installation of the 20 machines, and monthly for the safety inspection and testing services.

After delivery, but before installation, of the machines, X modifies its arrangement to provide five additional user manuals and extends the payment term for the 20 machines to 45 days after installation.

Entity X would need to evaluate the business purpose for the contract modifications as well as the quantitative and qualitative implications of the modifications to the contract. On the basis of its evaluation of all the facts and circumstances, X concludes that its arrangement has not been materially modified. Entity X determines that delivery of five additional user manuals represents an inconsequential obligation and that extending the payment terms on the machines from 30 to 45 days is consistent with industry standards and does not present significant additional risk to X or a concession on the part of X.

Example 2

Assume the same facts as in the example above except for the following:

After delivery, but before installation, of the machines, X modifies its arrangement to extend the monthly safety inspection and testing services from two to three years and agrees to provide the customer access to a "help desk technician" 24 hours a day, 7 days a week, for three months after installation.

Entity X would need to evaluate the business purpose for the contract modifications as well as the quantitative and qualitative implications of the modifications to the contract. On the basis of its evaluation of all the facts and circumstances, X concludes that its arrangement has been materially modified. Entity X determines that providing monthly safety inspection and testing services for an additional year and providing access to a technician for three months represent significant additional deliverables.

Transition for Materially Modified Revenue Arrangements — 605-25-65 (Q&A 02)

ASU 2009-13 must be applied prospectively to revenue arrangements entered into or materially modified in fiscal years beginning on or after June 15, 2010, unless an entity elects retrospective application in accordance with ASC 250. Early adoption is permitted. The ASU does not specify how to account for an arrangement that is deemed to have been materially modified. In addition, because the ASU does not provide guidance on when changes to a contract are considered material modifications, entities must use professional judgment to determine when such modifications would be considered material (see 605-25-65 (Q&A 01)) and would be accounted for under the new accounting guidance.

Question

How does an entity account for an arrangement that is deemed to have been materially modified?

Answer

As noted above, ASU 2009-13 does not specify how to account for a revenue arrangement that was accounted for under ASC 605-25 (before the ASU's amendments) if it is materially modified and now subject to the guidance in the ASU. For example, entities may have deferred revenue associated with an arrangement being accounted for in accordance with ASC 605-25 (before the ASU's amendments). Once the ASU is effective, if the arrangement is materially modified, prospective application of the ASU is required. However, the ASU does not specify how deferred revenue associated with the arrangement should be adjusted (if at all) upon modification of the contract.

Informal discussions with the SEC staff have indicated that it would be appropriate to account for materially modified revenue arrangements by allocating to the deliverables (in periods both before and after the modification) the arrangement consideration on a relative-selling-price basis. Any amount of revenue allocated to previously delivered items in excess of the revenue actually recognized in the periods that preceded the modification is recognized in its entirety in the period the modification occurs. In applying such an approach, an entity's objective would be to "true-up" deferred revenue to reflect the amount that would have been deferred had the guidance in the ASU been effective at the time the contract was executed.

While the SEC has noted that the above approach ("Approach 1") is acceptable, it has also indicated that entities may use an approach in which they would account for the materially modified arrangement as a new arrangement and allocate the total arrangement consideration (defined as deferred revenue recorded on the balance sheet at the time of the modification and any remaining consideration due under the modified terms) to the remaining deliverables on the basis of their relative selling price ("Approach 2"). However, to the extent that total consideration (as defined above) exceeds the sum of the total selling prices for the remaining deliverables, that excess would be recognized in income in the period of the modification, with a corresponding adjustment to deferred revenue. If total consideration (as defined above) is less than the sum of selling prices for the remaining deliverables, a discount would result, which entities would allocate to the remaining deliverables by using the relative-selling-price method. Judgment may be necessary in the application of either of the approaches described herein.

Example

Consider an agreement that is "materially modified." As of the date of the material modification, deferred revenue of $500 is recorded on the company's balance sheet because there was no objective and reliable evidence of the fair value of the undelivered items. Also assume that the remaining deliverables under the arrangement have an aggregate selling price of $400 and that, had ASU 2009-13 been applied at the inception of the arrangement, the amount of deferred revenue recorded on the balance sheet as of the date the contract was modified would have been $50 rather than $500. The remaining consideration to be paid under the contract is $300.

Under Approach 1, a company would "true up" the deferred revenue balance to the amount that would have been recorded had ASU 2009-13 always been applied to the contract. Therefore, a company would record $450 as an adjustment to deferred revenue in the period the contract is modified, leaving a remaining deferred revenue balance of $50.

Under Approach 2, a company would also "true up" the deferred revenue balance, but the adjustment would be based on the selling price of the remaining deliverables only. That is, because the remaining deliverables have an aggregate selling price of $400 and the remaining consideration to be paid is $300, the company would adjust the deferred revenue balance from $500 to $100. The adjusted deferred revenue balance of $100, combined with the remaining consideration of $300 to be paid, would then equal the aggregate selling price ($400) of the remaining deliverables. Approach 2 is analogous to a "residual" type approach.

If an entity's management believes that, because of certain facts or circumstances, using either of the above approaches to account for a materially modified revenue arrangement would be inappropriate or impractical, a discussion with a professional advisor and the SEC staff about the specific situation may be warranted.

Quantitative Transition Disclosures — 605-25-65 (Q&A 03)

ASC 605-25 requires an entity to disclose information that enables users of the financial statements to understand the effect of the change in accounting principle if the entity adopts ASU 2009-13's amendments prospectively. ASC 605-25-65-1 requires entities to disclose certain qualitative information in the period of adoption. If the adoption of ASU 2009-13's guidance has a material effect on the financial statements, entities should also provide **quantitative** information to supplement the qualitative information. ASC 605-25-65-1(d) lists the following three examples for disclosing this quantitative information:

> 1. The amount of revenue that would have been recognized in the year of adoption if the related arrangements entered into or materially modified after the effective date were subject to the measurement requirements of Subtopic 605-25 (before the amendments resulting from [ASU 2009-13]).
> 2. The amount of revenue that would have been recognized in the year before the year of adoption if the arrangements accounted for under Subtopic 605-25 (before the amendments resulting from [ASU 2009-13] were subject to the measurement requirements of [ASU 2009-13].
> 3. For arrangements that precede the adoption of [ASU 2009-13], the amount of revenue recognized in the reporting period and the amount of the deferred revenue as of the end of the period from applying the guidance in Subtopic 605-25 (before the amendments resulting from [ASU 2009-13]). For arrangements that were entered into or materially modified after the effective date of [ASU 2009-13], the amount of revenue recognized in the reporting period and the amount of deferred revenue as of the end of the period from applying [ASU 2009-13].

Question

If the adoption of the guidance in ASU 2009-13 has a material effect on an entity's financial statements, is an entity required to disclose the information described in **more than one** of the above examples?

Answer

No. An entity should provide quantitative information in a format that best enables users of the financial statements to understand the effect of the change in accounting principle upon the entity's prospective adoption of ASU 2009-13's guidance. ASC 605-25-65-1(d) explains that the methods presented above are examples of disclosures that may achieve that objective and are not the only available alternatives. Accordingly, while it may be acceptable for entities to use more than one of the above examples to provide disclosures, it is not required.

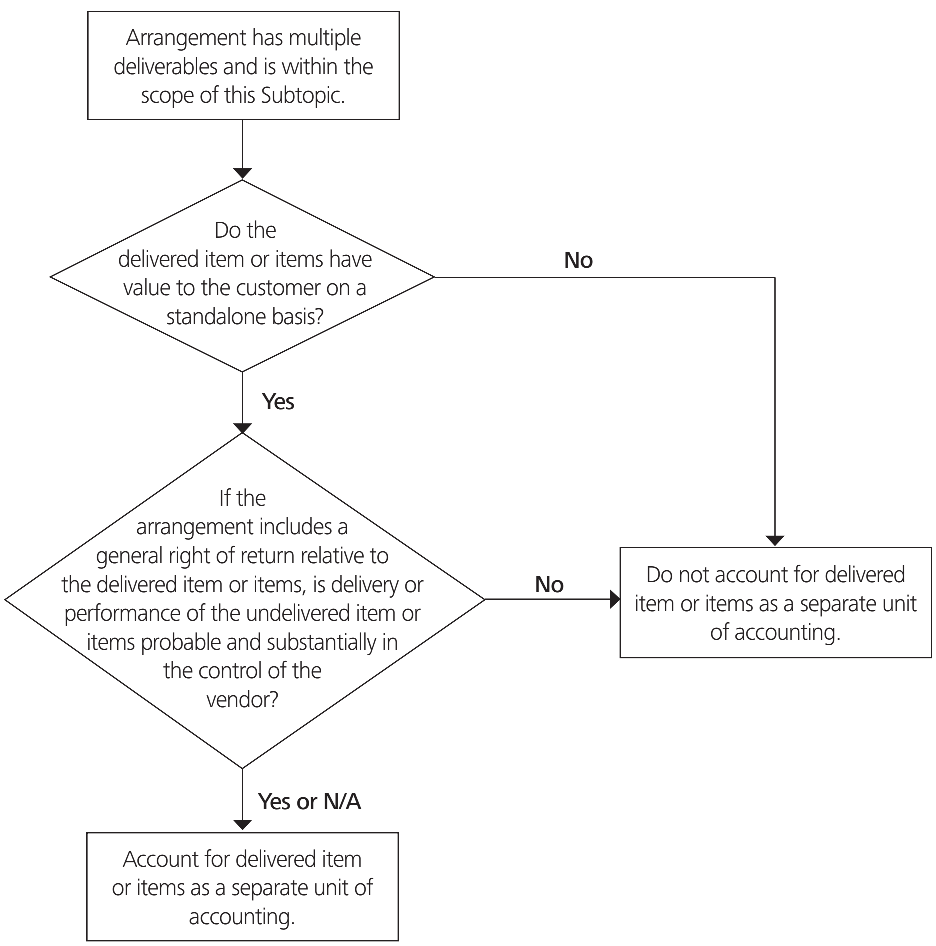
Appendix A — Implementation Guidance and Illustrations

ASC 605-25

Implementation Guidance

Diagram of Overview of Subtopic Provisions

55-1 This diagram represents an overview of the provisions of this Subtopic with respect to determining the separate units of accounting in an arrangement and should, therefore, be reviewed in conjunction with the guidance in the entire Subtopic.



Multiple Deliverables in an Arrangement That Includes Leased Equipment

55-2 The following provides implementation guidance on how to allocate arrangement consideration to each separate unit of accounting when a multiple-deliverable arrangement contains deliverables that are within the scope of other Topics and those Topics only provide guidance on how to separate the deliverables (see paragraph 605-25-15-3A(b)).

ASC 605-25 (continued)

55-3 For example, leased assets are required to be accounted for separately under the guidance in Subtopics 840-20 and 840-30. Consider an arrangement that includes the lease of equipment under an operating lease, the maintenance of the leased equipment throughout the lease term (executory cost), and the sale of additional equipment unrelated to the leased equipment. The arrangement consideration should be allocated between the deliverables subject to the guidance in Subtopic 840-20 and the other deliverables using the relative selling price method. (Although Topic 840 does not provide guidance regarding the accounting for executory costs, it does provide guidance regarding the allocation of arrangement consideration between the lease and the executory cost elements of an arrangement. Therefore, this example refers to the leased equipment and the related maintenance as deliverables subject to the guidance in that Topic.) The guidance in Topic 840 would then be applied to separate the maintenance from the leased equipment and to allocate the related arrangement consideration to those two deliverables. This Subtopic would be applied to further separate any deliverables not subject to the guidance in Topic 840 and to allocate the related arrangement consideration.

Multiple Deliverables in a Production-Type Contract

55-4 The following provides implementation guidance on multiple-element arrangements that contain deliverables that are within the scope of other Codification Topics where the other Topic does not provide guidance on how to separate deliverables or how to allocate arrangement consideration (see paragraph 605-25-15-3A(c)).

55-5 For example, Subtopic 605-35 provides separation and allocation guidance (segmentation provisions) for deliverables within its scope. However, that Subtopic does not provide separation and allocation guidance between construction and production deliverables and other deliverables. Consider an arrangement that includes designing complex electronic equipment, manufacturing complex electronic equipment (both deliverables subject to that Subtopic), and providing the service of running the equipment for a fixed period of time once the equipment is designed, manufactured, and placed in service (a deliverable not subject to that Subtopic). This Subtopic would be applied to identify separate units of accounting and to allocate arrangement consideration to those separate units of accounting.

55-6 If applying the guidance in this Subtopic results in the separation of the design and manufacture of the equipment from the service of running the equipment, the segmentation provisions of Subtopic 605-35 would be used to determine if it is appropriate to further segment the design deliverables from the manufacture deliverables in accordance with its segmentation provisions. If this Subtopic prohibits separation of the deliverables subject to that Subtopic from those that are not, then the amounts otherwise allocable to the design and manufacture deliverables and to the service of running the equipment would be combined. The appropriate recognition of revenue then would be determined for those combined deliverables as a single unit of accounting.

Illustrations

55-7 The following Examples provide guidance only with respect to determining whether a multiple-deliverable revenue arrangement contains more than one unit of accounting and, if so, how to measure and allocate the arrangement consideration to the separate units of accounting. As discussed in paragraph 605-25-15-4, this Subtopic (including the Examples) does not address (for any unit of accounting) when the criteria for revenue recognition are met or provide revenue recognition guidance. The examples illustrate potential application of this Subtopic based on the limited facts presented. The evaluations following each of the example fact patterns are not intended to represent the only manner in which the guidance in this Subtopic could be applied. Additional facts would most likely be required to fully evaluate the deliverables, units of accounting, and presentation issues related to these arrangements.

Example 1: Cellular Telephone Contract

55-8 This Example illustrates the unit of accounting guidance in paragraph 605-25-25-5 and the allocation and contingencies guidance in paragraphs 605-25-30-2 through 30-5.

55-9 CellularCo runs a promotion in which new customers who sign a two-year contract receive a free phone. There is a one-time activation fee of $50 and a monthly fee of $40 for the ongoing service. The same monthly fee is charged by CellularCo regardless of whether a free phone is provided. The phone costs CellularCo $100. Further, assume that CellularCo frequently sells the phone separately for $120. CellularCo is not required to refund any portion of the fees paid for any reason. CellularCo is a sufficiently capitalized, experienced, and profitable business and has no reason to believe that the two-year service requirement will not be met.

55-10 CellularCo is considering whether the phone and the phone service (that is, the airtime) are separable deliverables in the arrangement. The activation fee is simply considered additional arrangement consideration to be allocated. The phone and activation are delivered first, followed by the phone service, which is provided over the two-year period of the arrangement.

55-11 Based on an evaluation of the circumstances, the first condition for separation is met for the phone. That is, the phone has value on a standalone basis because it is sold separately by CellularCo. The second condition is also met because there are no general rights of return in this arrangement. Therefore, the phone and the phone service should be accounted for as separate units of accounting.

55-12 The total arrangement consideration is $1,010. The selling price of the phone service is $960 ($40 × 24 months), the price charged by CellularCo when sold separately. The selling price of the phone is $120, the price of the phone when sold separately by CellularCo. Without considering whether any portion of the amount allocable to the phone is contingent upon CellularCo's providing the phone service, CellularCo would allocate the arrangement consideration on a relative selling price basis as follows: $112.22 [$1,010 x ($120 ÷ [$120 + $960])] to the phone and $897.78 [$1,010 × ($960 ÷ [$120 + $960])] to the phone service. However, because a free phone is provided in the arrangement and the customer has no obligation to CellularCo if phone service is not provided, $62.22 (assuming the customer has paid the nonrefundable activation fee) is contingent upon CellularCo's providing the phone service. Therefore, the amount allocable to the phone is limited to $50 ($112.22 – $62.22), and the amount allocable to the phone service is increased to $960.

ASC 605-25 (continued)

Example 2: Can Manufacturing Equipment

55-13 This Example illustrates the unit of accounting guidance in paragraph 605-25-25-5 and contingencies guidance in paragraph 605-25-30-5.

55-14 Entity C sells high-speed aerosol can manufacturing equipment. Entity C sells a complete manufacturing process, which consists of Equipment X, Y, and Z. Entity C does not sell Equipment X, Y, and Z separately; however, other entities do sell the same equipment separately and there is a market for used equipment. Installation is not considered in this Example.

55-15 Entity C is evaluating whether Equipment X, Y, and Z are separate units of accounting under the following scenario.

55-16 Entity C delivered Equipment X and Z on March 27, but did not deliver Equipment Y until April 6. Without Equipment Y, the customer does not have use of Equipment X and Z. However, there is an active market for new Equipment X, Y, and Z on a separate basis, as the equipment is often bought separately from other vendors as replacements become necessary. The contract provides that if all pieces of equipment are not delivered, the customer may return Equipment X and Z and have no liability to Entity C. The contract requires delivery of all equipment prior to June 1, and Entity C has sufficient production capacity and inventory to deliver all of the equipment prior to that contractual deadline.

55-17 Based on an evaluation of the circumstances, the first condition for separation is met for Equipment X and Z. Equipment X and Z have value on a standalone basis because they are sold separately by other vendors. The second condition is also met because there is no general right of return in the arrangement.

55-18 Therefore, Equipment X, Y, and Z should be accounted for as separate units of accounting. However, even though accounted for as separate units of accounting, the arrangement consideration allocable to both Equipment X and Z is $0 because the full amount otherwise allocable to those separate deliverables is contingent upon the delivery of Equipment Y.

Example 3: Standard Equipment and Installation

55-19 This Example illustrates the unit of accounting guidance in paragraph 605-25-25-5 and allocation guidance in paragraph 605-25-30-2.

55-20 Entity E is an experienced manufacturer of equipment used in the construction industry. Entity E's products range from small to large individual pieces of automated machinery to complex systems containing numerous components. Unit selling prices range from $200,000 to $2.5 million. Unit selling prices are quoted inclusive of installation.

55-21 Each equipment model has standard performance specifications and is not otherwise customized for the specific needs of a buyer. Entity E extensively tests the equipment against those specifications prior to shipment. The installation process does not involve changes to the features or capabilities of the equipment and does not require proprietary information about the equipment in order for the installed equipment to perform to specifications.

55-22 While there are others in the industry with sufficient knowledge about the installation process for the equipment, as a practical matter, most purchasers engage Entity E to perform the installation services. However, some customers choose not to have the equipment installation performed by Entity E for various reasons (for example, their proprietary use of the equipment, their preference that installation be performed by their own employees or other vendors with whom the customers have established relationships, or for their own convenience). If a potential customer wishes to purchase equipment without installation, Entity E will not reduce the quoted selling price for the commensurate value of the installation. If a customer chooses to purchase equipment without installation, there is only one deliverable.

55-23 Assume that a customer enters into an arrangement to purchase equipment with a price of $200,000 (the price at which Entity E regularly sells the equipment without installation) from Entity E and chooses to have Entity E perform the installation for that equipment. The customer is obligated to pay Entity E the arrangement consideration upon delivery of the equipment. The price of the installation service when it is performed by vendors other than Entity E is $8,000 (third-party evidence of selling price). There are no refund rights (general or otherwise) in the arrangement. Entity E is considering whether the equipment and the installation service are separable units of accounting in the arrangement.

55-24 Based on an evaluation of the circumstances, the first condition for separation is met for the equipment. The equipment has standalone value as it is sometimes sold separately. The second condition for separation is also met because there are no general refund rights. Therefore, the equipment and the installation are considered separate units of accounting in the arrangement.

55-25 Regardless of whether the installation is performed, the total arrangement consideration is $200,000. Entity E has either vendor-specific objective evidence or third-party evidence of selling price for all units of accounting in the arrangement. The arrangement consideration of $200,000 should be allocated to the separate units of accounting using the relative selling price method. Thus, allocation of the arrangement consideration would be $192,308 [$200,000 × ($200,000 ÷ [$200,000 + $8,000])] to the equipment and $7,692 [$200,000 × ($8,000 ÷ [$200,000 + $8,000])] to the installation service. Additionally, none of the amount allocable to the equipment is contingent upon performing the installation.

Example 4: Automobiles Sold With Lifetime Maintenance Services

55-26 This Example illustrates the unit of accounting guidance in paragraph 605-25-25-5 and the allocation guidance in paragraph 605-25-30-2.

ASC 605-25 (continued)

55-27 Entity A is an established auto dealer. Entity A's service center provides all scheduled maintenance services (including oil changes) at no additional charge (other than for parts) for any customer who purchases an automobile from Entity A for the period that the customer owns the automobile. The customer also may choose to have the maintenance services performed by others without affecting the vehicle warranty, but most customers utilize Entity A's maintenance services unless they move to a distant location. Neither Entity A nor any other dealer sells the automobile without the lifetime maintenance services. However, Entity A sells maintenance services separately to customers who did not purchase their vehicles from Entity A. The automobiles are sold subject to a limited warranty and there are no refund rights in the arrangement. Customers are obligated to Entity A for all arrangement consideration upon taking delivery of the automobile. Since lifetime maintenance services are not separately priced when a customer purchases an automobile from Entity A, they are not within the scope of Subtopic 605-20.

55-28 Based on an evaluation of the circumstances, the first condition for separation is met for the automobile because, even though the automobile is not sold separately by any vendor, it is considered to have standalone value because the customer could resell the automobile on a standalone basis. The second condition for separation also is met because there are no refund rights (general or otherwise) in the arrangement. Therefore, the automobile and the maintenance services should be considered separate units of accounting in the arrangement.

55-29 Because no entity sells the automobile separately, neither vendor-specific objective evidence nor third-party evidence of selling price exists for the automobile. However, there is vendor-specific objective evidence of selling price of the maintenance services (as evidenced by the amount charged on a standalone basis by Entity A for maintenance services and data available from which to estimate the volume and types of maintenance services provided during a typical customer's ownership of the vehicle). As a result, when applying the relative selling price method, Entity A should use its best estimate of selling price for the automobile and vendor-specific objective evidence of selling price for the maintenance. Additionally, none of the amount allocable to the automobile is contingent upon providing the maintenance services.

Example 5: Sale of Home Appliances With Installation and Maintenance Services

55-30 This Example illustrates the unit of accounting guidance in paragraph 605-25-25-5 and the interplay between the accounting for a separately priced maintenance agreement in Subtopic 605-20 and the allocation guidance in paragraph 605-25-30-2.

55-31 Entity S is an experienced home appliance dealer. Entity S also offers a number of services together with the home appliances that it sells. Assume that Entity S regularly sells Appliance W on a standalone basis. Entity S also sells installation services and maintenance services for Appliance W. However, Entity S does not offer installation or maintenance services to customers that buy Appliance W from other vendors. Pricing for Appliance W is as follows:

a. Appliance W only: $ 800

b. Appliance W with installation service: $ 850

c. Appliance W with maintenance services: $ 975

d. Appliance W with installation and maintenance services: $1,000.

55-32 In each instance in which maintenance services are provided, the maintenance service is separately priced within the arrangement at $175. Additionally, the incremental amount charged by Entity S for installation of $50 approximates the amount charged by independent third parties.

55-33 Appliance W is sold subject to a general right of return. If a customer purchases Appliance W with installation and/or maintenance services, and Entity S does not complete the services satisfactorily, the customer is entitled to a refund only of the portion of the fee that exceeds $800.

55-34 Assume that a customer purchases Appliance W with both installation and maintenance services for $1,000. Based on its experience, Entity S believes that it is probable that installation of the equipment will be performed satisfactorily to the customer. The maintenance services are priced separately and should be accounted for based on the guidance in Subtopic 605-20. Entity S is evaluating whether Appliance W and the installation service represent separate units of accounting.

55-35 Based on an evaluation of the circumstances, the first condition for separation is met for Appliance W because it sometimes is sold separately by Entity S. The second condition for separation is also met because, even though a general right of return exists, performance of the appliance installation is probable and within the control of Entity S. Therefore, Appliance W and installation should be accounted for as separate units of accounting.

55-36 Entity S would allocate $175 of the arrangement consideration to the maintenance services based on the guidance in Subtopic 605-20. Without considering whether any of the amount otherwise allocable to Appliance W is contingent upon the performance of the installation, Entity S would allocate the remainder of the arrangement consideration ($825) to Appliance W and the installation service using the relative selling price method. The vendor-specific objective evidence of selling price of Appliance W is its price when sold separately ($800), and the third-party evidence of selling price of the installation service is the amount charged by independent third parties, which approximates $50. Therefore, the amounts allocable to Appliance W and to the installation services are $776 [$825 × ($800 ÷ [$800 + $50])] and $49 [$825 × ($50 ÷ [$800 + $50])], respectively. Since the customer is entitled to a refund only of the portion of the fee that exceeds $800 if the installation is not performed, no portion of the amount allocable to Appliance W is contingent upon that installation.

ASC 605-25 (continued)

Example 6: Human Resources Outsourcing Services

55-37 This Example illustrates an approach to estimating the selling price of deliverables under paragraph 605-25-30-6C when neither vendor-specific objective evidence nor third-party evidence of selling price exists. The approach in this Example should not be considered the only appropriate approach to estimating the selling price of the deliverables.

55-38 Entity HR provides its customers with human resource solutions (for example, support and guidance in areas such as employee relations, payroll and taxes, health benefits administration, 401(k) administration). Customers may do one of the following:

a. Choose a prepackaged bundle of services.

b. Customize an existing bundle of services.

c. Select the individual services they require.

Because of the many services provided by Entity HR and its customers' varying needs, no two arrangements are exactly alike. Entity HR prices its arrangements on the basis of the unique bundle of services to be provided. As a result, Entity HR does not have vendor-specific objective evidence of selling price for any individual service that it provides. Although each service is sold separately by other vendors, and while Entity HR has some information about its competitors' pricing, it is unable to obtain third-party evidence of selling price for any individual service.

55-39 Assume that on January 1, 20X1, Entity HR begins providing human resource solution services to Customer Y under a three-year arrangement. Under the arrangement, Entity HR agrees to provide Customer Y with payroll processing, three periodic training events, employee handbook development, and an executive compensation assessment. The executive compensation assessment and employee handbook development are expected to be completed by June 30, 20X1, and 20X2, respectively. Entity HR expects to provide one training event annually. Total compensation under the arrangement is $1,275,000. Entity HR receives compensation under the arrangement as follows: an upfront payment of $375,000 and monthly payments of $25,000. There are no general refund rights included in the arrangement.

55-40 Entity HR is evaluating whether all of the following represent separate units of accounting and how to allocate arrangement consideration to the separate units of accounting:

a. Payroll processing

b. Periodic training

c. Employee handbook development

d. Executive compensation assessment.

55-41 Based on an evaluation of the circumstances, Entity HR concludes that there are no units of accounting at inception of the arrangement because no item in the arrangement has been delivered at that date. However, Entity HR will reassess whether a delivered item should be considered a separate unit of accounting each time it performs under the arrangement.

55-42 Entity HR determines that each of the deliverables in the arrangement has standalone value. Because Entity HR does not have either vendor-specific objective evidence or third-party evidence of selling price for the deliverables in the arrangement, Entity HR must use its best estimate of selling price for each deliverable when allocating arrangement consideration under the relative selling price method.

55-43 In estimating the selling price for the deliverables, Entity HR considered all of the following:

a. Its internal costs

b. Its profit objectives

c. The pricing practices it used to establish the bundled price for its services

d. Whether any market constraints exist that may limit its selling price (for example, whether competitors could charge a lower price for the same service or whether the price for the service exceeds the cost savings to its customers). Entity HR believes that as the price for its service begins to exceed the customers' internal cost, the customers will be less likely to purchase the service.

ASC 605-25 (continued)

55-44 When determining the price for its bundled services, Entity HR typically applies a gross profit margin to the cost (primarily labor and other time and expenses) it will incur in providing the contracted services. The profit margin varies with the types of services to be provided and generally includes a discount based on the number of services being purchased. For example, Entity HR typically includes the following gross profit margins, which have been developed over time (by a relevant, authorized level of management) on the basis of available market data and demand for the services:

a. A 26 percent gross profit margin on its payroll processing services

b. A 15 percent gross profit margin on its employee handbook development services and executive compensation assessments

c. A 22 percent gross profit margin on its training services before considering any discount on the total arrangement.

Entity HR believes that these returns are consistent with the gross margins sought by its competitors. In addition, Entity HR has no information that would indicate that a competitor would charge a price that could affect the price Entity HR could charge for its service, either by limiting the price that Entity HR could charge or by allowing Entity HR to increase its price. In addition, Entity HR's analysis also indicates that the price of the individual services calculated using its internal gross profit margins would be in a range in which the service would still be attractive to its customers (that is, the cost of the service would be less than the internal costs for the same service if the customers had to provide the service themselves).

55-45 Using its internal gross profit margins and the total estimated costs it will incur to deliver the remaining units of accounting and after considering market constraints, Entity HR estimates the selling price for the undelivered units of accounting as follows.

Cost to be incurred for payroll processing for 3 years	$976,250
(1 – Payroll processing gross profit margin of 26 percent)	÷ .74
Estimated selling price for payroll processing	1,319,257
Cost to be incurred for executive compensation assessment	45,223
(1 – Executive compensation assessment gross profit margin of 15 percent)	÷ .85
Estimated selling price for executive compensation assessment	53,204
Cost to be incurred for employee handbook	56,113
(1 – Employee handbook gross profit margin of 15 percent)	÷ .85
Estimated selling price for employee handbook	66,015
Cost to be incurred for 3 training events	40,706
(1 – Training event gross profit margin of 22 percent)	÷ .78
Estimated selling price for training events	52,187
Total estimated selling price of all deliverables	$1,490,663

55-46 Therefore, at January 1, 20X1, Entity HR allocates the arrangement consideration ($1,275,000) as follows (before determining whether any individual deliverable should be considered a separate unit of accounting).

Payroll processing	[1,275,000 × (1,319,257 ÷ 1,490,663)]	$1,128,392
Executive compensation	[1,275,000 × (53,204 ÷ 1,490,663)]	45,507
Employee handbook	[1,275,000 × (66,015 ÷ 1,490,663)]	56,464
3 training events	[1,275,000 × (52,187 ÷ 1,490,663)]	44,637
Total consideration		$1,275,000

55-47 At the inception of the arrangement and as each item in the arrangement is delivered, Entity HR must perform an evaluation to determine whether the delivered item represents a separate unit of accounting. If the delivered item does not qualify as a separate unit of accounting, the arrangement consideration allocable to the delivered item shall be combined with the amount allocable to the other applicable undelivered item(s) within the arrangement.

55-48 Paragraph superseded by Accounting Standards Update No. 2009-13.

55-49 Paragraph superseded by Accounting Standards Update No. 2009-13.

55-50 Paragraph superseded by Accounting Standards Update No. 2009-13.

Example 7: Sale of Medical Equipment With Cartridges and Installation

55-51 This Example illustrates the unit of accounting guidance in paragraph 605-25-25-5 and the allocation guidance in paragraph 605-25-30-2.

55-52 Entity M manufactures and sells complex medical equipment to physicians and hospitals for medical scanning purposes. Prior to shipment, each piece of equipment is tested extensively to meet entity and Food and Drug Administration specifications. The equipment is shipped fully assembled, but some installation and setup is required. No other entities sell the same or largely interchangeable equipment.

ASC 605-25 (continued)

55-53 Installation is a standard process, outlined in the owner's manual, consisting principally of uncrating, calibrating, and testing the equipment. A purchaser of the equipment could complete the process using the information in the owner's manual, although it would probably take significantly longer than it would take Entity M's technicians to perform the tasks. Although other vendors do not install Entity M's equipment, other vendors do provide largely interchangeable installation services for $25,000. Historically, Entity M has never sold the equipment without installation. Most installations are performed by Entity M within 7 to 24 days of shipment. Installation is included in the overall sales price of the equipment.

55-54 In addition, the customer must pay for cartridges that record images. Entity M is the only manufacturer of the cartridges and it only sells them on a standalone basis to wholesalers through a wide network of distributors. The distributors' retail price for each cartridge is $250. Each cartridge can handle only a specific number of scans. Once a cartridge is exhausted, a new one must be purchased in order to use the equipment. Entity M always sells its equipment with a starter supply of 20 cartridges.

55-55 The sales price of the arrangement that consists of the equipment, installation, and 20 cartridges is $400,000. The customer is obligated to pay in full upon delivery of the equipment. The customer is entitled to a refund of $25,000 if Entity M does not perform the installation or if the 20 cartridges are not delivered. On March 15, Entity M delivers the equipment and on April 5 delivers the 20 cartridges and performs the installation. Entity M is evaluating whether delivery of the equipment represents a separate unit of accounting.

55-56 Based on an evaluation of the circumstances, the first condition for separation is met for the equipment because, even though Entity M has never sold the equipment without the cartridges, a customer could resell the equipment (in a primary or secondary market). The second condition for separation also is met because there are no general rights of return involved in this arrangement. Therefore, the equipment should be accounted for as a separate unit of accounting.

55-56A Entity M does not have vendor-specific objective evidence of selling price for the equipment because it does not sell the equipment separately (without installation services and cartridges). In addition, third-party evidence of selling price does not exist as no vendor separately sells the same or largely interchangeable equipment. Therefore, Entity M must use its best estimate of selling price when allocating arrangement consideration. For the cartridges, Entity M uses third-party evidence of the price charged when sold separately by its distributors ($5,000 = 20 × $250). In addition, Entity M has third-party evidence of selling price for the installation ($25,000).

55-56B In estimating its selling price for the equipment, Entity M considered its cost to produce the equipment, its profit margin for similar arrangements, customer demand, effect of competitors on Entity M's equipment, and other market constraints. After weighing the relevance of the available data points, Entity M estimates its standalone selling price for the equipment to be $385,000. Total selling price for all deliverables in the arrangement on a standalone basis is $415,000.

55-57 When applying the relative selling price method, Entity M should use its best estimate of selling price for the equipment, third-party evidence of selling price for the cartridges, and third-party evidence of selling price for the installation. Accordingly, without considering whether any portion of the amount allocable to the equipment is contingent upon delivery of the other items, the amount allocable to the equipment, cartridges, and installation is as follows:

a. $371,084 to the equipment ($400,000 × [$385,000 ÷ 415,000])

b. $4,819 to the cartridges ($400,000 × [$5,000 ÷ 415,000])

c. $24,097 to the installation ($400,000 × [$25,000 ÷ 415,000]).

Additionally, no portion of the amount allocable to the equipment is contingent upon the delivery of the cartridges or performance of the installation. That is, if the cartridges are not delivered and the installation is not performed, Entity M would be entitled to $375,000.

Example 8: Sale of Computer System

55-58 This Example illustrates the unit of accounting guidance in paragraph 605-25-25-5, the allocation guidance in paragraph 605-25-30-2, and the limitation in paragraph 605-25-30-5 to noncontingent amounts.

55-59 Entity B sells computer systems. On April 20, a customer purchases a computer system from Entity B for $1,000. The system consists of a central processing unit (CPU), a monitor, and a keyboard. Solely for purposes of simplifying this illustration of the application of the guidance in this Subtopic, it is assumed that the provisions of Subtopic 985-605 do not apply. On April 30, Entity B delivers the CPU to the customer without the monitor or keyboard. Each of the items is regularly sold separately at a price of $700 for the CPU, $300 for the monitor, and $100 for the keyboard. The CPU could function with monitors or keyboards manufactured by others, who have them readily available. The customer is entitled to a refund equal to the separate price of any item composing the system that is not delivered. The arrangement does not include any general rights of return. Entity B is evaluating whether delivery of the CPU represents a separate unit of accounting.

55-60 Based on an evaluation of the circumstances, the first condition for separation is met for the CPU, as it is sold separately by Entity B. The second condition for separation is met because there are no general rights of return. Therefore, the CPU would be accounted for as a separate unit of accounting.

ASC 605-25 (continued)

55-61 Entity B has vendor-specific objective evidence of selling price for all deliverables in the arrangement as each is sold regularly on a standalone basis. Without considering whether any portion of the amount allocable to the CPU is contingent upon delivery of the other items, Entity B would allocate the arrangement consideration using the relative selling price method. Therefore, the portion of the arrangement fee otherwise allocable to the CPU is $636.36 ($1,000 × [$700 ÷ $1,100]), of which $36.36 ($636.36 – [$1,000 – $300 – $100]) is subject to refund if the monitor and keyboard are not delivered. Therefore, the amount allocable to the CPU is limited to $600, which is the amount that is not contingent upon delivery of the monitor and keyboard.

Example 9: Sale of Bolts of Fabric

55-62 This Example illustrates the unit of accounting guidance in paragraph 605-25-25-5 and the limitation in paragraph 605-25-30-6 to all amounts to which the vendor is entitled, including cancellation fees.

55-63 Entity D sells fabric for use in manufacturing clothing. Customers may purchase fabric from Entity D in individual 50-yard bolts or in bulk lots consisting of multiple bolts. One of Entity D's customers (Customer A) is a manufacturer of band uniforms that prefers to purchase the fabric in bulk because it needs the fabric to have a high level of consistency in color and quality. Customer A enters into an arrangement with Entity D to purchase a 12-bolt bulk lot of fabric that is to be delivered by Entity D in 3 4-bolt installments over a period of 3 months.

55-64 At Customer A's request, Entity D provides a customer satisfaction guarantee that it will refund double the price (up to a maximum of the total arrangement fee) for each bolt of fabric that is not delivered or not delivered from the same dye lot as the initial installment. That is, the double-money-back guarantee provides that, in addition to having no obligation for bolts of fabric not delivered or not delivered from the appropriate dye lot, the customer will receive a refund for (or will not be obligated to pay for) an equal number of bolts.

55-65 There are no general rights of return included in the arrangement. The price for an individual 50-yard bolt of fabric is $160, and the price for a 12-bolt bulk lot is $1,824.

55-66 In determining the units of accounting under the arrangement, Entity D considered the following.

55-67 Entity D sold the 12-bolt bulk lot of fabric to Customer A on November 1, 20X2. Entity D will deliver the first of three four-bolt installments of fabric on November 15 and will deliver the remaining installments on December 15, 20X2, and January 15, 20X3. Customer A is obligated to Entity D for the full price of the fabric on November 15, 20X2, subject to the money-back guarantee. Entity D has sufficient production capacity and inventory to deliver all of the fabric in accordance with the installment provisions of the arrangement and, therefore, believes that it will do so. In addition, Entity D has entered into similar arrangements with many other customers in the past and rarely has failed to deliver fabric from the appropriate dye lot under its bulk-sale arrangements.

55-68 Based on an evaluation of the circumstances, the first condition for separation is met for the delivered fabric because Entity D also sells bolts of fabric individually. The second condition for separation is also met because there are no general rights of return in the arrangement. Therefore, the delivered fabric should be accounted for as a separate unit of accounting.

55-69 Without considering whether any portion of the amount allocable to the individual bolts of fabric are contingent upon delivery of the other bolts of fabric, Entity D would allocate the arrangement consideration evenly among the 12 bolts of fabric using the relative selling price method because each bolt has an identical selling price. Therefore, the portion of the arrangement fee otherwise allocable to each bolt of fabric is $152 ($1,824 ÷ 12). However, in allocating the arrangement consideration, no amount is allocable to the initial delivered fabric because the arrangement provides the customer with a double-money-back guarantee for each bolt of fabric not delivered from the same dye lot as the initial installment. However, upon delivery of the second four-bolt installment (assuming that installment is delivered from the same dye lot as the initial installment), the amount allocable to that installment would be the amount related to four bolts of fabric, $608 ($152 × 4 bolts of fabric). That is, if the third installment was not delivered or was not delivered from the same dye lot as the initial installment, Entity D would be entitled only to the price charged for four bolts of fabric.

Example 10: Painting Contract

55-70 This Example illustrates the unit of accounting guidance in paragraph 605-25-25-5 and the limitation in paragraph 605-25-30-5 to noncontingent amounts.

55-71 PainterCo is a contractor that provides painting services for commercial and private residences. PainterCo contracts with a customer to paint the customer's house for $3,000. The price is inclusive of all paint, which is obtained by PainterCo at a cost of $800. The customer is given the right to purchase paint separately if so desired (although the customer did not opt to do so in this Example). The paint would have cost the customer $900 if purchased from a hardware store. The painting service would have cost $2,150 if purchased without the paint.

55-72 All paint necessary to complete the project is delivered to the customer's house prior to the beginning of the work. The customer has a general right of return with respect to any unopened can of paint. Further, the customer may receive a full refund of the sales price for all of the paint (whether or not the cans were opened) if PainterCo does not paint the house. PainterCo has always completed the painting service in accordance with contract terms and, therefore, believes that performance of the painting service in this arrangement is probable. PainterCo does not sell paint without providing the painting service.

ASC 605-25 (continued)

55-73 Based on an evaluation of the circumstances, the first condition for separation is met because the paint is sold separately by other vendors. The second condition for separation is also met because, even though a general right of return exists, performance of the painting service is probable and within the control of PainterCo. Therefore, the paint and the painting service are considered separate units of accounting.

55-74 However, in allocating the arrangement consideration, no amount would be allocated to the paint because, in the event that PainterCo does not perform the painting service, the customer may return all of the paint for a full refund.

Example 11: Agricultural Equipment

55-75 This Example illustrates the unit of accounting guidance in paragraph 605-25-25-5 and an approach to estimating the selling price of deliverables under paragraph 605-25-30-6C when neither vendor-specific objective evidence nor third-party evidence of selling price exists. The approach in this Example should not be considered the only appropriate approach to estimating the selling price of the deliverables.

55-76 Entity A, a public entity, engages in the manufacture and distribution of farm equipment and related service parts, including tractors, harvesters, integrated agricultural management systems technology, and precision agricultural irrigation equipment. Each product has standard performance specifications but can be customized to meet the specific needs of any buyer. Entity A extensively tests the equipment against the standard and customer specifications before shipment.

55-77 On December 29, 20X8, Entity A enters into an arrangement to deliver a tractor and customized irrigation equipment to Customer M for a fee of $270,000. For purposes of this example, the irrigation equipment is accounted for in accordance with Section 605-10-S99. The customer is obligated to pay $100,000 upon delivery of the tractor and the remainder of the arrangement consideration upon delivery of the irrigation equipment. On December 31, 20X8, Entity A delivers the tractor, and on April 5, 20X9, Entity A delivers the irrigation equipment. Neither product requires installation.

55-78 The tractor in this arrangement is often sold separately by Entity A for a price of $100,000, which is considered vendor-specific objective evidence of selling price. The irrigation equipment is also sold separately; however, because of the customized nature of the product, Entity A has neither vendor-specific objective evidence nor third-party evidence of selling price.

55-79 Entity A is considering whether the tractor is a separate unit of accounting and, if so, how to allocate the arrangement consideration at December 31, 20X8.

55-80 Based on an evaluation of the circumstances, the first condition for separation is met for the tractor. The tractor has standalone value as it is sold separately by Entity A. The second condition for separation is also met as there are no general rights of return. Therefore, the tractor should be accounted for as a separate unit of accounting.

55-81 Entity A has vendor-specific objective evidence of selling price for the tractor but has neither vendor-specific objective evidence nor third-party evidence of selling price for the irrigation equipment. Therefore, Entity A must estimate the selling price for the irrigation equipment.

55-82 Entity A considered all of the following in estimating the standalone selling price for the irrigation equipment:

a. Entity A's cost to produce the customized irrigation equipment is $110,000.

b. The division of Entity A that produces the irrigation equipment and other similar products earns an average gross profit margin of approximately 30 percent. The range of profit margins within the irrigation product line varies from 10 to 45 percent. Entity A generally receives a higher profit margin on the more specialized or customized products.

c. When selling noncustomized irrigation equipment, Entity A averages, on a worldwide basis, a selling price of approximately $140,000, which includes a gross profit margin of 25 percent.

d. Customer M is located in Asia where high demand has resulted in Entity A being able to command 10 to 15 percent higher prices for its irrigation product line than it commands in other markets it serves. This pricing is also consistent with Entity A's ongoing marketing strategy in Asia.

e. Direct competitors to Entity A's irrigation product line, Entity D and Entity E, earn average gross profit margins in Asia of 30 percent and 32 percent, respectively, based on a review of their periodic filings.

f. The customized irrigation equipment includes enhanced functionality that Entity A does not believe its competitors can provide. Entity A believes that this enhanced functionality has additional value in the marketplace.

g. Entity A's price list provided to prospective customers lists the price for irrigation equipment before customization at $155,000.

ASC 605-25 (continued)

55-83 After weighing the relevance of the available data points, Entity A estimates its standalone selling price for the irrigation equipment to be $185,000. The determination of that estimated selling price was based on the cost of the irrigation equipment of $110,000 plus an estimated gross profit margin of 40 percent. The 40 percent gross profit margin is management's best estimate based on the margin they would expect to earn on the irrigation equipment if sold separately in Asia. The estimated margin of 40 percent is higher than the 30 percent average margin of the division because the 30 percent average margin includes lower margin products. Entity A also notes that it could command higher margins in Asia than the average margin due to the high demand in that market and the recent history combined with its ongoing pricing strategy. Entity A also considered the margins reported by its competitors and believes its estimated 40 percent margin is reasonable in relation to the competitor margins considering the enhanced functionality it believes the irrigation equipment has over its competitors' products.

55-84 Entity A did not rely on the $170,000 price of the irrigation equipment that was stated in the arrangement because the stated prices were negotiated to provide for more cash consideration earlier in the arrangement rather than to reflect the standalone selling price of the products. In addition, the arrangement prices are net of any discount embedded in the bundled arrangement rather than standalone selling prices of the products. Considering the customized nature of the irrigation equipment, Entity A did not consider the estimated selling price of $185,000 to be inconsistent with the list price of $155,000 for uncustomized irrigation equipment.

55-85 Accordingly, at December 31, 20X8, using the relative selling price method, Entity A would allocate $94,736 ($270,000 × [$100,000 ÷ $285,000]) to the tractor and $175,264 ($270,000 × [$185,000 ÷ $285,000]) to the irrigation equipment. Additionally, none of the amount allocable to the tractor is limited by the amount of payment contingent upon delivery of the irrigation equipment.

Example 12: Biotech License and Research and Development Agreement

55-86 This Example illustrates the accounting for deliverables combined into one unit-of-accounting required by paragraph 605-25-25-6.

55-87 The entity, Biotech, enters into an agreement with a pharmaceutical entity, Pharma. The agreement includes the following, as detailed in paragraphs 605-25-55-88 through 55-93:

a. Biotech licensing certain rights to Pharma

b. Biotech providing research and development services to Pharma.

55-88 License. Biotech licenses certain rights on an exclusive basis to Pharma for a period of 10 years. The license gives Pharma the exclusive right to market, distribute, and manufacture Drug B as developed using Technology A. Biotech retains all ownership rights to Technology A and Drug B. There are no when-and-if-available clauses or other performance obligations associated with the license, except as described in the paragraphs 605-25-55-89 through 55-93.

55-89 Research and development. Biotech agrees to provide research and development services on a best-efforts basis to Pharma. Biotech agrees to devote four full-time equivalent employees to the research and development activities, and Pharma expects to devote several full-time equivalent employees to the research and development activities as well. The objective of the research and development services is to develop Drug B using Technology A. The ultimate objective is to receive U.S. Food and Drug Administration approval on Drug B.

55-90 Compensation under the arrangement is as follows:

a Biotech receives $5 million up-front upon signing the agreement.

b. Biotech receives $250,000 per year for each full-time equivalent employee who performs research and development activities.

55-91 None of these payments, once received, is refundable, even if U.S. Food and Drug Administration approval is never received. In addition, Biotech must perform on a best-efforts basis.

55-92 Pharma must use Biotech to perform the research and development activities necessary to develop Drug B using Technology A because the know-how and expertise related to Technology A is proprietary to Biotech. In other words, Biotech is the only party capable of performing the level and type of research and development services required by Pharma under the agreement. Biotech has determined that the fees charged for the research and development services (that is, the $250,000 per year for each full-time equivalent employee who performs research and development activities) are competitive with the price other third-party vendors charge for similar research and development services (that is, they represent third-party evidence of selling price for those services).

55-93 Based on an evaluation of the circumstances, there are two deliverables in this arrangement that should be considered for separation:

a. A license deliverable

b. A research and development activities deliverable.

The license deliverable does not meet the first criterion for separation because it does not have standalone value to Pharma. Because Drug B has not yet been developed, the license is of no value to Pharma and could not be sold without the accompanying research and development activities using Technology A, which is proprietary to Biotech. Likewise, Pharma could not sell the license on a standalone basis to another party (that is, because without Biotech agreeing to provide the research and development activities for that other party, the other party would not purchase the license). Therefore, the license and research and development activities should be considered a single unit of accounting in the arrangement.

Appendix B — Additional ASC Paragraphs and Deloitte Guidance

The Q&As in this Roadmap refer to the following ASC 985-605 paragraphs and corresponding Deloitte guidance on establishing VSOE of selling price. Although this guidance applies to software revenue arrangements, an entity may apply it analogously to other multiple-element arrangements.

ASC 985-605

25-6 If an arrangement includes multiple elements, the fee shall be allocated to the various elements based on vendor-specific objective evidence of fair value, regardless of any separate prices stated in the contract for each element. Vendor-specific objective evidence of fair value is limited to the following:

a. The price charged when the same element is sold separately

b. For an element not yet being sold separately, the price established by management having the relevant authority; it must be probable that the price, once established, will not change before the separate introduction of the element into the marketplace.

VSOE of Fair Value for Elements Not Sold Separately — 985-605-25 (Q&A 04)

Question

ASC 985-605-25-6 limits the evidence that qualifies as VSOE of fair value. Does an element of an arrangement that has already been introduced into the marketplace have to be sold on a stand-alone basis in order to have VSOE of fair value?

Answer

Yes. The requirement in ASC 985-605 for a separate sale to validate fair value was controversial throughout the development of the guidance. This requirement was more restrictive than that of (1) any existing literature that applies to bundled arrangements that do not include software and (2) SOP 91-1 (superseded by SOP 97-2 and codified in ASC 985-605). Under SOP 91-1, if remaining vendor obligations were deemed insignificant, the arrangement fee could be recognized and the costs of the insignificant obligations could be accrued. Under ASC 985-605, insignificant obligations may be considered elements that must be measured separately at fair value.

For software arrangements, the separate-sale requirement has been particularly onerous because, in many such arrangements, some of the elements are never sold separately. The most common arrangement involves software bundled with first-year PCS. Although PCS may be sold separately in subsequent years, the software is never sold separately. Likewise, the PCS would never be sold separately since it is directly associated with the software product. However, ASC 985-605-25-67 clarifies that PCS “shall be determined by reference to the price the customer will be required to pay when it is sold separately (that is, the renewal rate).” Thus, although PCS is never sold separately at the inception of an arrangement, it is sold separately from the license in PCS renewal periods, satisfying the requirements of ASC 985-605-25-6.

Elements Sold Separately Infrequently — 985-605-25 (Q&A 05)

Question

Would the sale of a software product as a separate element represent VSOE of fair value if the software is sold separately infrequently?

Answer

It depends. The vendor should closely evaluate whether infrequent separate sales of an item constitute sufficient VSOE of the current fair value of the element. The vendor specifically would need to evaluate the timing of the most recent sales in evaluating the relevance of the sale to fair value. For example, if a significant amount of time has elapsed since the last sale, the market may have changed and the sales price in the last sale may not represent the VSOE of fair value of the element.

Other Considerations in Determining VSOE of Fair Value — 985-605-25 (Q&A 06)

Question

Should vendors consider factors other than those described in 985-605-25 (Q&A 04) and 985-605-25 (Q&A 05) when determining VSOE of fair value?

Answer

Yes. Vendors should consider the following additional factors when determining whether there is sufficient VSOE of fair value:

- **For Items Sold Separately** — A vendor could use historical pricing information. If prices vary significantly, however, the vendor may be unable to use separate sales prices. To conclude that separate sales prices provide sufficient evidence of VSOE of fair value, a vendor must demonstrate that these prices are highly concentrated around a specific point and within a narrow range. For example, if 90 percent of a vendor's separate sales of PCS during the past 12 months were priced between 15 percent and 17 percent of the net license fee, it may be appropriate to conclude that such separate sales prices constitute evidence of fair value. On the other hand, if the vendor's separate sales prices reflected the following distribution, it would be inappropriate to conclude that VSOE exists:

Sales Price as a Percentage of Net License Fee	Percentage of Separate Sales
2% to 5%	20%
5% to 10%	30%
10% to 15%	35%
15% to 20%	15%

In evaluating whether separate sales prices are sufficiently concentrated to establish VSOE, a vendor should consider whether the population of separate sales needs to be stratified. Stratification may be required if the vendor has different pricing practices for different types of transactions or products. For example, a vendor may provide larger discounts to large blue-chip customers than it does to its smaller customers. In these situations, the dispersion of separate sales prices of the entire population may be wide, but the dispersion of separate sales prices for transactions with large blue-chip customers may be much less. Stratification should be based on objective criteria associated with a particular transaction. Factors that may affect pricing, and that a vendor should therefore consider in determining whether the population of separate sales should be stratified, include, but are not limited to:

1. Customer type.
2. Distribution channel.
3. Transaction size or volume (i.e., license fee, number of users).
4. Geographic location.
5. Products sold.
6. The size of the discount granted to a customer would not be a sufficient basis for stratifying the population.
7. If separate sales prices are sufficiently concentrated for a vendor to establish VSOE, a reasonable method of establishing fair value is to use the weighted average of the more recent prices charged for actual transactions when there is some variability in the prices charged.

- **For Items Not Yet Sold Separately** — When a vendor's management establishes a price for an element not yet sold separately, it should be probable that the element will actually be sold separately for the established price. The price established for an element that the vendor does not have the ability or intent to sell separately would not constitute VSOE of fair value. Factors that may affect whether it is probable that the price will not change include (1) the time between the announcement and the actual sale of the product and (2) whether the vendor has announced the intended price to its customers.

  Assume that Vendor A sells a software license that includes installation services. Vendor A's management has determined that if the company were to sell the installation services separately, the price charged would be $500. However, A has never sold installation services separately and does not intend to do so in the future. As a result, the $500 would not constitute VSOE of fair value for the installation services.

- **New Products vs. Existing Products** — The provisions of ASC 985-605 apply both to existing products that have not been sold separately in the past and to products currently under development. In each situation, management with the appropriate level of authority should establish the price, and it should be probable that the price will not change before the actual sale of the product as a separate element. Vendors should also consider selling elements separately to establish VSOE of fair value (e.g., establishing hourly rates for services performed by the vendor).

List Price Used as VSOE of Fair Value — 985-605-25 (Q&A 07)

Question

Can the list price of a product be used as VSOE of fair value (or in the absence of VSOE of fair value) of an element in a multiple-element arrangement?

Answer

The list price of a product can be used only if the list price represents VSOE of fair value. Software vendors often offer customers discounts from the list price; the undiscounted list price may not represent VSOE of fair value. See 985-605-25 (Q&A 06) for further discussion about determining VSOE of fair value.

Penalties Used as VSOE of Fair Value — 985-605-25 (Q&A 08)

Question

If a multiple-element arrangement stipulates a penalty for not delivering a certain element, would the amount of the penalty represent VSOE of fair value?

Answer

Parties to an arrangement can set penalties for nonperformance on the basis of factors including, but not limited to, the fair value of the undelivered element. These other factors could indicate that the amount of the penalty is not VSOE of fair value. See 985-605-25 (Q&A 06) for further discussion about determining VSOE of fair value and 985-605-25 (Q&A 07) for discussion of when list price may represent VSOE of fair value.

Multiple Elements Accounted for as a Single Element — 985-605-25 (Q&A 09)

Question

ASC 985-605-25-6 discusses VSOE of fair value in the context of each element in a multiple-element arrangement. If an arrangement includes multiple elements, can a group of elements be considered a single element under ASC 985-605?

Answer

Yes. Although ASC 605-25 excludes software elements included in multiple-element arrangements, its guidance is applicable by analogy. The guidance in ASC 605-25 refers to units of accounting that may consist of more than one deliverable. Two elements that are sold together may be treated as one element for unbundling purposes. For example, an arrangement may include a three-year term license for software and PCS that typically are sold together and services that are sold separately. The software and PCS may be treated as a single element — i.e., the arrangement fee would be allocated on the basis of the VSOE of fair value of the software and PCS as a single element, and services would be treated as a separate element.

Example

A software vendor enters into an arrangement to deliver Software Products A, B, and C to a customer. Product A is sold separately; VSOE of fair value can be established on that basis. Products B and C are always sold together, never separately; therefore, VSOE of fair value does not exist separately for Products B and C. However, since Products B and C are always sold together, VSOE of fair value does exist on a combined basis (i.e., the price charged when the products are sold together). Under these circumstances, Products B and C can be combined and treated as a single element in the arrangement.

VSOE of Fair Value for Nonsoftware Elements — 985-605-25 (Q&A 10)

Question

Do the VSOE rules in ASC 985-605-25-6 apply to nonsoftware elements of an arrangement in which software elements are more than incidental?

Answer

No. ASC 985-605-15-3 states that in an arrangement that contains nonsoftware deliverables, only software and software-related elements are within the scope of ASC 985-605. Accordingly, elements not defined as software or software-related elements (as defined in ASC 985-605-15-3) should be separated from the software elements in accordance with ASC 605-25.

Residual Value as Evidence of VSOE of Fair Value — 985-605-25 (Q&A 11)

Question

Assume that a company enters into a multiple-element arrangement in which VSOE of fair value exists for the undelivered element (Product B) but not for the delivered element (Product A). The company uses the residual value method to allocate the arrangement fee, as detailed in ASC 985-605-25-10(e) (i.e., the portion allocated to Product A is the total arrangement fee less the fair value of Product B). If the company enters into a subsequent multiple-element arrangement in which VSOE of fair value is required for Product A, can the portion of the arrangement fee allocated to Product A under the residual method in the first arrangement be used as VSOE of fair value in the subsequent arrangement?

Answer

No. The amount allocated to a particular element in an arrangement under the residual method does not represent VSOE of fair value. VSOE of fair value should be determined in accordance with ASC 985-605-25-6.

ASC 985-605

25-67 If a multiple-element software arrangement includes explicit or implicit rights to postcontract customer support, the total fees from the arrangement shall be allocated among the elements based on vendor-specific objective evidence of fair value, in conformity with paragraphs 985-605-25-6 through 25-7. The fair value of the postcontract customer support shall be determined by reference to the price the customer will be required to pay when it is sold separately (that is, the renewal rate). The portion of the fee allocated to postcontract customer support shall be recognized as revenue ratably over the term of the postcontract customer support arrangement, because the postcontract customer support services are assumed to be provided ratably.

PCS Renewal Rate — 985-605-25 (Q&A 81)

ASC 985-605-55-62 states that a one-year PCS renewal rate within a time-based license constitutes VSOE of fair value under ASC 985-605 if the PCS renewal rate and term are substantive. ASC 985-605-55-63 indicates that factors to consider in determining whether the PCS renewal term is substantive include the initial (bundled) PCS term, the aggregate PCS renewal term, and the term of the license.

Question

Should any other factors be considered in determining whether a PCS renewal rate is substantive?

Answer

Yes. The estimated useful life of the software should also be considered. For example, a five-year term license includes two years of bundled PCS and three one-year renewal terms. Under this scenario, the bundled PCS term is for a relatively short period compared with the term of the license. In addition, the aggregate PCS renewal term is greater than the initial (bundled) PCS term. Accordingly, it appears that the PCS renewal term is substantive. However, if the useful life of the software is expected to be only two years, the PCS renewal terms would not be substantive since the period of bundled PCS is greater than the useful life of the software.

Example of a PCS Arrangement for an Off-the-Shelf Software Product — 985-605-25 (Q&A 82)

Vendor V licenses software in arrangements that include delivery of an off-the-shelf software product and PCS in the form of telephone support. The telephone support is offered free of charge if the calls are made during business hours. For calls made outside of business hours, the customer must pay for the call at a preset rate. Vendor V maintains an extensive database of the support calls and prices the arrangement to cover (including a margin) the level of support provided. Vendor V's history demonstrates that, on average, customers make less than one call per license. Vendor V has chosen to unbundle the PCS included in the arrangement on the basis of the average price of the support provided on each license (number of calls expected multiplied by price per call on calls made outside of business hours) and, provided that all other requirements for revenue recognition are met, to recognize this revenue over the life of the product.

The method V uses to measure the fair value of the PCS bundled in the arrangement is acceptable. ASC 985-605-25-67 provides guidance on determining the fair value of PCS, stating that "[t]he fair value of the postcontract customer support shall be determined by reference to the price the customer will be required to pay when it is sold separately (that is, the renewal rate)." In this example, the PCS provided during business hours has no renewal rate because the PCS is perpetual. Therefore, fair value is determined by using an acceptable alternative, the rate charged outside of normal business hours multiplied by the estimated number of calls based on vendor-specific historical evidence.

The guidance generally requires the recognition of PCS ratably over the term of the PCS arrangement. Because in V's arrangement the PCS term is unlimited, PCS revenue would be recognized over the estimated life of the off-the-shelf software product (provided that all other requirements for revenue recognition are met).

The SEC staff has indicated that it would not object to the approach described above.

Bargain Renewal Rates on PCS (Part I) — 985-605-25 (Q&A 83)

Vendor X typically sells PCS to end users at a stated rate of 18 percent of the list price of the software license. However, X enters into an agreement in which it sells software for $1,000 (which equals list) and provides the customer with rights to PCS at a stated rate of 2 percent of list in year 1. In year 2, the customer is given the opportunity to renew PCS at 10 percent of list. In year 3, the customer has to pay 18 percent of list. The contract is silent as to PCS renewals beyond year 3. The expected life of the product is five years.

Question

What is the VSOE of fair value of PCS in this arrangement?

Answer

The VSOE of fair value of PCS is $180 (18 percent of the list price of the software). This is both the standard renewal rate and the rate charged in year 3 of this arrangement (the last year for which there is a stated renewal rate).

Bargain Renewal Rates on PCS (Part II) — 985-605-25 (Q&A 84)

Vendor X typically sells PCS to end users at a stated rate of 18 percent of the list price of the software license. However, X enters into an agreement in which it sells software for $1,000 (which equals list) and provides the customer with rights to PCS at a stated rate of 2 percent of list in year 1. In year 2, the customer is given the opportunity to renew PCS at 10 percent of list. In year 3, the customer has to pay 18 percent of list. The contract is silent as to PCS renewals beyond year 3. The expected life of the product is five years.

Question

In applying the residual method, how much of the initial license fee should X allocate to the software license?

Answer

Vendor X should allocate $760 to the software license, calculated as follows:

Initial license fee		$ 1,000
Less:		
Fair value of Year 1 PCS ($180) less PCS fee ($20)	$ (160)	
Fair value of Year 2 PCS ($180) less PCS fee ($100)	(80)	(240)
		$ 760

Because X has offered the customer the right to a significant and incremental discount on PCS for years 1 and 2, X would be required to unbundle the full fair value of PCS for years 1 and 2 (the discount years), taking into consideration the initial PCS and renewal fees that will be paid. Since X will receive $20 in year 1, and $100 in year 2, for PCS (as long as the customer renews the PCS), X should unbundle $240 of the initial $1,000 ($160 + $80). If the customer does not renew PCS for year 2, the respective deferred amount would be recognized, provided that all other revenue recognition criteria are met, as the PCS renewal right lapses.

Bargain Renewal Rates on PCS (Part III) — 985-605-25 (Q&A 85)

Vendor X typically sells PCS to end users at a stated rate of 18 percent of the list price of the software license. However, X enters into an agreement in which it sells software for $1,000 (which equals list) and provides the customer with rights to PCS at a stated rate of 2 percent of list in year 1. In year 2, the customer is given the opportunity to renew PCS at 10 percent of list. In year 3, the customer has to pay 18 percent of list. The contract is silent as to PCS renewals beyond year 3. The expected life of the product is five years.

Question

Assume the same facts, except that the stated renewal rate is 2 percent and does not ramp up over time. In applying the residual method, how much of the initial license fee should X allocate to the software license?

Answer

Vendor X should allocate $200 to the software license, calculated as follows:

Initial license fee	$ 1,000
Less:	
Fair value of PCS for 5 years ($900) less PCS fees ($100)	(800)
	$ 200

The 2 percent renewal rate is significantly below the vendor's normal pricing practice and would indicate that the renewal rate is nonsubstantive (see ASC 985-605-55-62 and 55-63). Therefore, the vendor would look to the standard price for PCS (18 percent of the list price of the software) as VSOE of the fair value of PCS. Because X has offered the customer the right to a significant and incremental discount on PCS for an undetermined number of years, X would be required to unbundle the full fair value of PCS for the life of the product (maximum discount period), taking into consideration the additional PCS fees. Since the product has an expected life of five years and the customer would be expected to renew PCS at the discounted rate during that period, X should unbundle an additional $800 ([$180 – $20] × 5 years). Should the customer fail to renew PCS during the five-year period, the respective deferred amounts would be recognized as the PCS renewal rights lapse, provided that all other revenue recognition criteria are met.

Substantive Renewal Rates on PCS — 985-605-25 (Q&A 86)

Company E sells software to end users with one year of bundled PCS. To date, E has routinely offered PCS renewal rates at 20 percent of the initial license fee. However, E has a new product that it plans to offer only to select customers. Company E has never sold this product before, but management believes the product will require little or no support and decides to offer PCS at a stated renewal rate of 3 percent of the license fee.

Question

Does the 3 percent stated renewal rate establish VSOE of fair value for PCS on the new product?

Answer

Probably not. Although evaluating the substance of a stated renewal rate is a facts-and-circumstances judgment, the 3 percent stated renewal rate does not appear to be substantive. While E has not sold PCS on this product before, it has sold PCS on other products at a stated rate of 20 percent of the license fee. Further, while not considered VSOE, renewal rates for PCS in the software industry typically range between 10 percent and 20 percent of the software license fee. Accordingly, in the absence of actual renewals (i.e., separately sold transactions), or a compelling business case supporting the divergence from past practice and industry norms, it would appear that E does not have VSOE of fair value for the PCS element included in the contemplated arrangement. Examples of evidence that would be helpful in supporting the divergence from past practice and industry norms include:

- Contemporaneous documentation of the pricing decisions reached by management for the new product, including a discussion of (1) the planned frequency for updates, enhancements, and costs of PCS compared with other products, and (2) pricing used by competitors for similar products.
- Use of similar pricing on a number of concurrent transactions (i.e., proposals, letters of intent, or licensing agreements).

Such evidence might also support immediate recognition of the arrangement fee and accrual of PCS costs in accordance with ASC 985-605-25-71 and 25-72.

VSOE of Fair Value for PCS Over a Deployment Period (Part I) — 985-605-25 (Q&A 108)

Vendor Z enters into an arrangement with Customer A to provide A with software and related PCS for three years. The software is deployed in stages over the same three-year period. The PCS fee increases as the software is deployed: the fee in year one is $2,000; year two, $3,000; and year three, $4,000. After the deployment period, the customer may renew PCS at a rate of $5,000 per year.

Question

What rate must Z use to establish VSOE of fair value for PCS (assuming Z uses renewal rates to establish VSOE)?

Answer

Vendor Z should use the predetermined renewal rate of $5,000 to establish VSOE of fair value for PCS. In accordance with the implementation guidance in ASC 985-605-55-53 through 55-55, the fully deployed renewal rate in this example is the only indicator of fair value because it is the only price at which Z will sell PCS separately to the customer.

VSOE of Fair Value for PCS Over a Deployment Period (Part II) — 985-605-25 (Q&A 109)

Vendor Z enters into an arrangement with Customer A to provide A with software and related PCS for three years. The software is deployed in stages over the same three-year period. The PCS fee increases as the software is deployed: the fee in year one is $2,000; year two, $3,000; and year three, $4,000. After the deployment period, the customer may renew PCS at a rate of $5,000 per year.

Question

Assume that PCS during the three-year deployment period is optional. How does optional PCS affect the VSOE of fair value?

Answer

Vendor Z would not be able to establish VSOE of fair value for PCS on the basis of the renewal rates in the arrangement. Because the first three years of PCS are optional, Z is essentially offering PCS separately at four different rates. Although the renewal rate in year four represents the "ultimate renewal rate," this rate is not the only price at which the PCS can be purchased separately.

However, in accordance with the implementation guidance in ASC 985-605-55-70 through 55-73, if Z can provide sufficient objective evidence that the $5,000 renewal rate in year four is comparable to that in similar arrangements in which Z separately sells PCS, the rates in the first three years would be deemed to be discounted. Therefore, Z would establish VSOE of fair value at $5,000 for PCS and would apply the discount proportionately to the delivered elements in the arrangement.

VSOE for a PCS Renewal Rate That Changes on the Basis of an Inflation Index — 985-605-25 (Q&A 110)

Question

Would an annual increase in a PCS renewal rate on the basis of an inflation index, such as the CPI, preclude establishment of VSOE of fair value for the PCS?

Answer

Generally, no. As long as the increase in the PCS renewal rate is meant to approximate inflation (e.g., the renewal rate is based on an inflationary index such as the CPI), it would still be appropriate for a vendor to establish VSOE of fair value. However, a vendor should carefully evaluate the terms of the arrangement to ensure that the increase is based on inflationary factors alone.

Example 1

A vendor enters into an arrangement to license software and provide PCS. The PCS renewal rate is $100,000 and is subject to an automatic annual price increase that is based on the CPI. The annual increase in this case would not preclude the vendor from establishing VSOE of fair value for PCS because it is based solely on inflation. Thus, VSOE in year five is essentially the same as VSOE in year one and the vendor should establish VSOE on the basis of the initial renewal fee.

Example 2

Assume the same facts as in Example 1, except that the PCS renewal rate is subject to an automatic annual increase of 10 percent. Even though the purpose of the annual increase may be to compensate the vendor for potential increases in costs, establishing VSOE on the basis of the initial renewal fee would not be appropriate because the annual increases are not necessarily based on inflationary factors alone.

Determining the Method to Use in Establishing VSOE of Fair Value for PCS — 985-605-25 (Q&A 112)

Historically, Vendor V has used the stated PCS renewal rate in its software arrangements to establish VSOE of fair value.

Question

If V enters an arrangement without a stated or a substantive renewal rate, can V use another method to establish VSOE of fair value for PCS?

Answer

Yes. If V cannot establish VSOE of fair value by using a substantive renewal rate, V can establish VSOE by using separate sales if such sales are priced within a reasonably narrow range (see 985-605-25 (Q&A 06)).

ASC 985-605-25-6 limits VSOE of fair value to "the price charged when the same element is sold separately." Further, ASC 985-605-25-67 states that "[t]he fair value of the postcontract customer support shall be determined by reference to the price the customer will be required to pay when it is sold separately (that is, the renewal rate)."

If V enters into an arrangement with a renewal rate that is either not stated or not substantive, but can demonstrate that separate sales are highly concentrated around a specific point and within a narrow range, V could establish VSOE of fair value on that basis.

Bifurcation of PCS Between Software Deliverables and Nonsoftware Deliverables — 985-605-25 (Q&A 113)

Vendor X sells equipment bundled with software that is essential to the functionality of the equipment (software A) and software that enhances, but is not essential to, the functionality of the equipment (software B). The arrangement includes PCS for both software A and software B. Vendor X has established VSOE of selling price for the PCS on the bundled software products. Upon adopting ASU 2009-14, X concludes that software A would be considered part of the nonsoftware deliverable and software B would be considered a separate software deliverable.

Vendor X continues to offer PCS on the bundle of software products (one of which will now be outside the scope of ASC 985-605 and one of which will remain within the scope of ASC 985-605). In accordance with ASC 985-605-25-10, as amended by ASU 2009-14, the vendor would bifurcate the PCS into two deliverables: (1) PCS for the "nonsoftware deliverables" outside the scope of ASC 985-605 and (2) PCS for the "software deliverables" accounted for under ASC 985-605.

Question

If VSOE of selling price exists for the PCS on the bundled software products, is it acceptable for X to conclude that VSOE of selling price exists for the separate bifurcated portions of PCS even though X does not sell the bifurcated portions of PCS separately?

Answer

Generally, yes. The determination of whether VSOE of selling price exists requires the use of professional judgment and depends on an analysis of the specific facts and circumstances unique to each arrangement. If VSOE of selling price exists for the PCS deliverable as a whole, it would generally be acceptable to conclude that VSOE of selling price exists for the bifurcated portions of PCS. The bifurcation guidance in ASC 985-605-25 was not intended to require vendors to separately sell each bifurcated component of PCS to establish VSOE of selling price.

Appendix C — Glossary of Standards

FASB Accounting Standards Codification Topic 250, *Accounting Changes and Error Corrections*

FASB Accounting Standards Codification Subtopic 250-10, *Accounting Changes and Error Corrections: Overall*

FASB Accounting Standards Codification Subtopic 360-20, *Property, Plant, and Equipment: Real Estate Sales*

FASB Accounting Standards Codification Topic 460, *Guarantees*

FASB Accounting Standards Codification Topic 605, *Revenue Recognition*

FASB Accounting Standards Codification Subtopic 605-15, *Revenue Recognition: Products*

FASB Accounting Standards Codification Subtopic 605-20, *Revenue Recognition: Services*

FASB Accounting Standards Codification Subtopic 605-25, *Revenue Recognition: Multiple-Element Arrangements*

FASB Accounting Standards Codification Subtopic 605-35, R*evenue Recognition: Construction-Type and Production-Type Contracts*

FASB Accounting Standards Codification Topic 820, *Fair Value Measurements and Disclosures*

FASB Accounting Standards Codification Subtopic 835-30, *Interest: Imputation of Interest*

FASB Accounting Standards Codification Topic 840, *Leases*

FASB Accounting Standards Codification Subtopic 840-20, *Leases: Operating Leases*

FASB Accounting Standards Codification Subtopic 840-30, *Leases: Capital Leases*

FASB Accounting Standards Codification Subtopic 926-605, *Entertainment—Films: Revenue Recognition*

FASB Accounting Standards Codification Topic 952, *Franchisors*

FASB Accounting Standards Codification Topic 985, *Software*

FASB Accounting Standards Codification Subtopic 985-605, *Software: Revenue Recognition*

FASB Accounting Standards Update 2010-17, *Milestone Method of Revenue Recognition*

FASB Accounting Standards Update 2009-14, *Certain Revenue Arrangements That Include Software Elements*

FASB Accounting Standards Update 2009-13, *Multiple-Deliverable Revenue Arrangements*

FASB Statement No. 157, *Fair Value Measurements*

FASB Statement No. 154, *Accounting Changes and Error Corrections*

FASB Statement No. 66, *Accounting for Sales of Real Estate*

FASB Statement No. 45, *Accounting for Franchise Fee Revenue*

FASB Statement No. 13, *Accounting for Leases*

EITF Issue No. 08-9, "Milestone Method of Revenue Recognition"

EITF Issue No. 08-1, "Revenue Arrangements With Multiple Deliverables"

EITF Issue No. 00-21, "Revenue Arrangements With Multiple Deliverables"

AICPA Statement of Position 97-2, *Software Revenue Recognition*

AICPA Statement of Position 91-1, *Software Revenue Recognition*

AICPA Statement of Position 81-1, *Accounting for Performance of Construction-Type and Certain Production-Type Contracts*

SEC Staff Accounting Bulletin Topic 13, "Revenue Recognition"

SEC Staff Accounting Bulletin Topic 13.A.1, "Revenue Recognition: Selected Revenue Recognition Issues: Revenue Recognition — General"

SEC Staff Accounting Bulletin Topic 13.A.3, "Revenue Recognition: Selected Revenue Recognition Issues: Delivery and Performance"

SEC Regulation S-X, Rule 3-05, "Financial Statements of Businesses Acquired or to Be Acquired"

Appendix D — Abbreviations

AICPA	American Institute of Certified Public Accountants
ASC	FASB Accounting Standards Codification
ASU	FASB Accounting Standards Update
CPI	consumer price index
EITF	Emerging Issues Task Force
FASB	Financial Accounting Standards Board
GAAP	generally accepted accounting principles
PCS	postcontract customer support
R&D	research and development
SAB	Staff Accounting Bulletin
SEC	Securities and Exchange Commission
SOP	Statement of Position
TPE	third-party evidence
VSOE	vendor-specific objective evidence