



## Technology Highlights

# Challenges Associated With Applying the New Revenue Standard: Establishing the Stand-Alone Selling Price as a Range

by Sandie Kim, Jeff Jenkins, and Mohana Dissanayake, Deloitte & Touche LLP

For public entities, the new revenue standard (ASC 606<sup>1</sup>) became effective for annual reporting periods beginning after December 15, 2017. The standard is effective for all other entities for annual reporting periods beginning after December 15, 2018. Early adoption is permitted for annual reporting periods beginning after December 15, 2016.

While ASC 606 will affect organizations differently depending on their facts and circumstances, we have identified certain aspects of its application that are especially challenging for technology companies. The questions and answers (Q&As) below on establishing the stand-alone selling price (SSP) as a range are the second installment in a series intended to help technology entities better understand the new guidance, particularly private organizations that are currently adopting the standard's requirements. (See Deloitte's July 24, 2018, [Technology Alert](#) for Q&As on termination rights.)

### Executive Summary

Step 4 of the five-step process for recognizing revenue under ASC 606 requires entities to determine the SSP for each performance obligation in a contract (to the extent that there is more than one obligation) so that revenue may be allocated and recognized in accordance with the allocation objective in ASC 606-10-32-28. When pricing is steady and stand-alone sales of a good or service are common, the determination of the SSP is likely to be straightforward and involve little to no estimation. This exercise becomes more complex, however, when pricing of a good or service varies from one transaction to another or when the stand-alone sales of a particular good or service are rare or nonexistent.

<sup>1</sup> FASB Accounting Standards Codification (ASC) Topic No. 606, *Revenue From Contracts With Customers*.

Despite the level of complexity involved, ASC 606 requires entities to determine the SSP for each performance obligation in a contract by considering all reasonably available information and maximizing the use of observable inputs.

ASC 606 provides guidance on suitable methods for estimating the SSP. However, as noted in paragraph BC268 of [ASU 2014-09](#),<sup>2</sup> the FASB “decided not to preclude or prescribe any particular method for estimating [the SSP] so long as the estimate is a faithful representation of the price at which the entity would sell the distinct good or service if it were sold separately to the customer.”

Entities in the technology industry frequently use a range (as opposed to a single-point estimate) when establishing the SSP. If a range is used, an entity must assess the appropriateness of the range and how to allocate the transaction price. If the stated selling prices for goods and services sold are outside the range, the entity must apply a consistent accounting policy when allocating the transaction price.

## Guidance and Q&As

The FASB defines “standalone selling price” in ASC 606-10-20 and the ASC master glossary as the “price at which an entity would sell a promised good or service separately to a customer.” In the Codification’s definition, the FASB refers to the term in the singular rather than the plural. In ASC 606, this word choice is further emphasized in illustrative examples in which the SSP is always expressed as a single-point observation or estimate of value (e.g., in Example 33 (ASC 606-10-55-256 through 55-258), the directly observable SSP of Product A is \$50, the estimated SSP of Product B under an adjusted market assessment approach is \$25, and the estimated SSP of Product C under an expected cost plus a margin approach is \$75).

Given the Codification’s definition of “standalone selling price,” some have questioned whether an entity would be precluded from using anything other than a single-point observation or estimate as the SSP (i.e., whether the guidance in ASC 606 precludes an entity from using a range of observations or estimates to establish the SSP).<sup>3</sup>



### Q&A 1-1 — Establishing the SSP as a Range

#### Question

Is it acceptable to establish the SSP of a promised good or service as a range of amounts rather than as a single-point observation or estimate?

#### Answer

Yes. We believe that the SSP for a performance obligation does not need to be a single amount and can be a range of amounts if the range is sufficiently narrow (see Q&A 1-2 below) and the allocation of the transaction price that results from the identified SSP is consistent with the general allocation objective in ASC 606-10-32-28. That guidance states:

The objective when allocating the transaction price is for an entity to allocate the transaction price to each performance obligation (or distinct good or service) in an amount that depicts the amount of consideration to which the entity expects to be entitled in exchange for transferring the promised goods or services to the customer.



### Q&A 1-2 — Determining the Appropriate Range

When a range is used to estimate the SSP, questions have arisen about how to determine whether the range is truly indicative of the SSP.

The software industry has developed a practice of estimating the SSP as a range by demonstrating that a certain number of observable transactions are sufficiently clustered around a midpoint. For example, on the basis of an analysis of historical data (i.e., observable pricing), an entity may use a bell-shaped curve approach and determine that 75 percent of the sales of a particular good are priced within 15 percent of \$5<sup>4</sup> (the midpoint)

<sup>2</sup> FASB Accounting Standards Update (ASU) No. 2014-09, *Revenue From Contracts With Customers (Topic 606)*.

<sup>3</sup> For additional discussion about establishing the SSP as a range, see the AICPA’s *Audit and Accounting Guide Revenue Recognition*.

<sup>4</sup> Some entities may instead establish the SSP by using historical data on discounts off the list price. For example, if an entity consistently priced a particular good or service at 40 percent off the list price, the entity may establish the midpoint as 60 percent of the list price (100 percent less the 40 percent discount), assuming that a sufficient number of transactions were discounted within a reasonable range of that midpoint. This publication does not address (1) the use of a discount off the list price to establish the SSP range or (2) the determination of whether the use of historical discounting data is sufficient and appropriate for establishing the SSP.

in either direction. Therefore, the SSP range is \$4.25 to \$5.75. Both the distribution (i.e., width) of the range and the percentage of transactions clustered around the midpoint within that distribution (i.e., concentration) are important factors to consider in the determination of whether a range is truly indicative of the SSP for a particular good or service.<sup>5</sup>

### **Question**

When a range is used to estimate the SSP, is there a maximum width or minimum concentration that is considered to be indicative of the SSP?

### **Answer**

No. ASC 606 does not prescribe or preclude any method for estimating the SSP. Likewise, ASC 606 does not establish any bright lines regarding which values or ranges are indicative of the SSP, including the width and concentration of a given range. Instead, ASC 606 states that the SSP of each distinct good or service should be a value “that depicts the amount of consideration to which the entity expects to be entitled in exchange for transferring the promised goods or services.”

Since the SSP determined by using a range must meet the allocation objective in ASC 606-10-32-28, we believe that a particular range may not be appropriate if the concentration is too low, the width is too great, or both. For example, an SSP range in which 60 percent of transactions fall within plus or minus 40 percent of a midpoint would most likely be too wide to meet the allocation objective. Likewise, an SSP range in which 10 percent of transactions fall within plus or minus 15 percent of a midpoint would most likely be insufficient to meet the allocation objective. Entities must balance the narrowness of distribution with the adequacy of the concentration. That is, for an entity to establish the SSP by using a range, both the concentration of transactions around the midpoint and the width thereof must be reasonable. For example, we believe that if an entity has maximized the use of observable inputs and has considered all reasonably available information, the entity would most likely meet the allocation objective in ASC 606-10-32-28 when using an SSP range that (1) encompasses the majority of the relevant transactions (i.e., greater than 50 percent) and (2) has a width extending no greater than 20 percent from the midpoint in either direction. We also believe that if there are not enough transactions within a reasonably narrow range, further disaggregation of the data (e.g., by contract value and geography in addition to product type) may be appropriate for determining reasonable SSP ranges.<sup>6</sup>

If the resulting range does not meet the allocation objective after an entity has disaggregated the population of transactions, maximized the use of observable inputs, and considered all reasonably available information, the entity may need to apply other methods to establish the SSP.



## **Q&A 1-3 — Allocation Considerations**

### **Question**

How should an entity allocate the transaction price to multiple performance obligations when the SSP is established as a range?

### **Answer**

An entity that establishes the SSP as a range for a particular good or service will need to implement and consistently apply a policy related to when a contractually stated price does not represent the SSP (i.e., it is not within the established SSP range) and reallocation is required. If a contractually stated price falls within the established SSP range, it is considered “at SSP,” and reallocation is therefore not necessary. By contrast, if a contractually stated price is outside the SSP range, reallocation is required. Accordingly, an entity will need to

<sup>5</sup> Some entities may instead apply a method similar to a bell-shaped curve approach to determine a single-point estimate of the SSP of a performance obligation (e.g., by using the midpoint within the distribution as the SSP). This publication addresses only circumstances in which the SSP is determined as a range.

<sup>6</sup> The level of disaggregation may depend, in part, on an entity's pricing policies and practices.

make a policy election regarding the point in the range that it will use for allocating the transaction price to each performance obligation on the basis of the SSP. The following points are possible alternatives (not all-inclusive):

- The midpoint in the range.
- The outer point in the range, which would be:
  - The high point in the range when the contractually stated price is greater than the high point in the range.
  - The low point in the range when the contractually stated price is less than the low point in the range.
- The low point in the range.
- The high point in the range.

Once an entity elects a policy, the entity must ensure that the policy is consistently applied and that the resulting allocation meets the allocation objective in ASC 606-10-32-28.

## Contacts

### **Sandie Kim**

Audit & Assurance Partner  
National Office Accounting and Reporting Services  
[sandkim@deloitte.com](mailto:sandkim@deloitte.com)

### **Jeff Jenkins**

Audit and Assurance Senior Manager  
National Office Accounting and Reporting Services  
[jejenkins@deloitte.com](mailto:jejenkins@deloitte.com)

### **Mohana Dissanayake**

Audit & Assurance Partner  
U.S. Technology, Media & Telecommunications Industry Leader  
[mdissanayake@deloitte.com](mailto:mdissanayake@deloitte.com)

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