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# Defining Issues®

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# FASB Finalizes Technical Corrections to Revenue Standard

The FASB recently issued an Accounting Standards Update (ASU) that provides disclosure relief, and clarifies the scope and application of the new revenue standard and related cost guidance.[1] This ASU represents the last expected standard-setting activity on this topic before the revenue standard becomes effective.

## Key Facts

- An entity that is not required to estimate variable consideration to recognize revenue will generally not be required to estimate the amount of that consideration when disclosing the transaction price allocated to remaining performance obligations. This is sometimes referred to as the backlog disclosure.
- The ASU makes technical corrections and improvements to the new revenue standard and to other Codification topics to address unintended consequences from applying the new guidance.
- The technical corrections address many narrowly focused questions that stakeholders raised about the scope and application of certain revenue and cost guidance. The technical corrections address impairment testing of contract costs, losses on long-term construction and production-type contracts, certain advertising costs, and other issues.

## Key Impacts

- The optional exemptions from the disclosure requirement for remaining performance obligations will provide some quantitative disclosure relief for an entity with sales- or usage-based royalties for licenses of intellectual property and, under certain conditions, for contracts accounted for using the series guidance. An entity still is required to disclose fixed consideration (including contractual minimums).
- An entity that applies one of the new optional exemptions will be required to provide additional qualitative disclosures about the nature of the performance obligations, the remaining contract duration, and characteristics of variable consideration and how that variability will be resolved.

[1] FASB Accounting Standards Update 2016-20, Technical Corrections and Improvements to Topic 606, Revenue from Contracts with Customers, December 21, 2016, available at www.fasb.org.

The new disclosure relief is available only under U.S. GAAP. IFRS 15 was not amended to provide the same relief.

## Disclosure Relief for Remaining Performance Obligations

The new revenue standard requires an entity to disclose the aggregate amount of the transaction price allocated to unsatisfied or partially satisfied performance obligations each reporting period, and when it expects to recognize this amount as revenue.[2]

This disclosure is not required if the performance obligation is part of a contract with an expected duration of one year or less, or if an entity qualifies for the practical expedient to recognize revenue in the amount that it has the right to invoice.[3] The FASB provided this optional exemption because it did not want an entity to be required to estimate the transaction price for disclosure purposes if the estimate was not required for recognition purposes.[4]

The ASU expands the optional exemption from this disclosure to two additional scenarios in which an entity is not required to estimate variable consideration when determining the transaction price for recognition purposes. The disclosure will not be required for variable consideration that:

- Is a sales- or usage-based royalty for a license of intellectual property; or
- Meets the criteria to be allocated entirely to a wholly unsatisfied performance obligation or to a wholly unsatisfied promise to transfer a distinct good or service that is part of a single performance obligation under the series guidance.[5]

The optional exemptions do not apply to fixed consideration, including contractual minimums, that may be part of an arrangement that satisfies one of the variable consideration conditions.

An entity that applies the optional exemptions is required to disclose:

- The optional exemptions that are applied;
- The nature of the performance obligations;
- The remaining contract duration; and
- A description of the variable consideration (e.g., its nature and how it is resolved) excluded from the disclosure because of the optional exemption.

These additional qualitative disclosures are intended to provide sufficient information for financial statement users to understand the remaining performance obligations.

An entity should consider the nature of its arrangements when determining whether to apply an optional exemption. It may be challenging for an entity to provide meaningful disclosures if some arrangements within a similar line of business do not qualify for an exemption, or if there are arrangements with a mix of fixed and variable consideration. In certain cases, an entity may decide not to apply an optional exemption to avoid confusing disclosures.

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[2] ASC paragraph 606-10-50-13, available at www.fasb.org.

[3] ASC paragraphs 606-10-50-14 and 55-18, available at www.fasb.org.

[4] FASB Accounting Standards Update No. 2014-09, Revenue from Contracts with Customers, paragraph BC352, available at www.fasb.org.

[5] ASC paragraph 606-10-32-40, available at www.fasb.org.

## Summary of Technical Corrections

| Scope Clarifications |
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| **Loan Guarantee Fees** |
| Guarantees (other than product or service warranties) are not accounted for under the new revenue standard. Loan guarantee fees are accounted for as either guarantees or derivatives.[6] |
| **Insurance Entities** |
| All contracts accounted for under the insurance guidance, not just those that create an insurance risk, are excluded from the scope of the new revenue standard.[7] This extends the scope exception to investment contracts that are accounted for under Topic 944. |
| **Fixed-odds Wagering Contracts** |
| Fixed-odds wagering contracts (e.g., slot machines or sports betting) in the gaming industry are accounted for under the new revenue standard, not under the derivatives guidance. |

| Clarifications to Accounting and Disclosure Requirements |
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| **Impairment of Contract Costs (Costs to Obtain or Costs to Fulfill)** |
| The ASU clarifies that when an entity performs impairment testing of contract costs and determines the consideration it expects to receive in exchange for the goods or services to which the asset relates, an entity should include consideration that it:[8]<br>• Expects to receive in the future, which may include expected contract renewals and extensions with the same customer; or<br>• Has received from the contract with the customer but has not yet recognized as revenue. |
| The ASU clarifies that the order in which costs are tested for impairment is:<br>(1) Assets outside the scope of Topics 340, 350, and 360 (e.g., inventory costs accounted for under Topic 330 or software costs under the scope of Subtopic 985-20);[9]<br>(2) Assets accounted for under Topic 340; |

[6] ASC Topics 460, Guarantees; and 815, Derivatives and Hedging, both available at www.fasb.org.

[7] ASC Topic 944, Financial Services—Insurance, available at www.fasb.org.

[8] ASC Subtopic 340-40, Other Assets and Deferred Costs – Contracts with Customers, available at www.fasb.org.

[9] ASC Topics 330, Inventory; 340, Other Assets and Deferred Costs; 350 Intangibles—Goodwill and Other; 360 Property, Plant, and Equipment; and Subtopic 985-20, Software – Costs of Software to Be Sold, Leased, or Marketed; all available at www.fasb.org.

| Clarifications to Accounting and Disclosure Requirements |
|---|
| **Impairment of Contract Costs (Costs to Obtain or Costs to Fulfill)** |
| (3) Asset groups for amortizable and depreciable assets accounted for under Topics 350 and 360; and<br>(4) Goodwill reporting units accounted for under Topic 350. |
| **Losses on Long-term Construction- and Production-type Contracts** |
| The ASU provides an accounting policy election to determine anticipated losses on long-term construction- and production-type contracts at either the contract level or the performance obligation level. The election must be applied consistently to similar contracts. |
| The concept of a performance obligation is not equivalent to the concept of an individual segment under current U.S. GAAP.<br>An entity should not assume that losses determined at the segment level today will be the same as losses determined at the performance obligation level under the new standard.<br>An election to determine losses at the performance obligation level will result in an assessment at a level lower than under current practice in some cases. |
| **Direct Response Advertising Costs** |
| The ASU reinstates cost guidance about when to recognize a liability for certain advertising costs (e.g., cooperative advertising) by moving it to Subtopic 720-35.[10] |
| **Cost Capitalization Guidance for Investment Companies** |
| Cost-capitalization guidance for offering costs by advisors is aligned between public and private investment funds.[11] |
| **Disclosure Clarification** |
| The ASU clarifies that a company must disclose revenue recognized in the reporting period from performance obligations satisfied (or partially satisfied) in previous periods (e.g., change in transaction price) for all performance obligations, not just performance obligations with corresponding contract balances. |

[10] ASC Subtopic 720-35, Other Expenses – Advertising Costs; and ASC paragraph 340-20-25-2, both available at www.fasb.org.

[11] ASC Subtopic 946-720, Financial Services—Investment Companies – Other Expenses, available at www.fasb.org.

| Clarifications to Examples |
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| **Contract Modifications** |
| The ASU clarifies Example 7 to better align with the contract modification guidance in the new revenue standard. |
| **Contract Asset versus Receivable** |
| The ASU revises Example 38, Case B, to more clearly link the analysis with the receivable presentation guidance in the new revenue standard. The revisions eliminate the previous guidance that a receivable could not be recorded until it was due. |
| **Refund Liability** |
| The ASU removes a reference to contract liability in Example 40 to avoid a conclusion that a refund liability is always characterized as a contract liability. |
| An entity should determine whether a refund liability should be characterized as a contract liability and whether it represents a monetary or nonmonetary item for foreign currency remeasurement, based on the specific facts and circumstances of the arrangement. |

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