

Heads Up

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Although the feedback from most industries was similar and generally indicated support for the boards' efforts to develop a single comprehensive revenue recognition standard, respondents expressed concerns about several aspects of the revised ED.

Sizing Up the Feedback

Comments on the Revised Exposure Draft on Revenue Recognition

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Introduction

On November 14, 2011, the FASB and IASB (the "boards") jointly issued their [revised exposure draft](#) (ED) on revenue recognition.¹ The comment period for the revised ED was 120 days and ended on March 13, 2012. The boards received approximately 350 comment letters on the proposal — significantly fewer than the nearly 1,000 they received on the original ED issued in June 2010. The boards plan to hold various roundtable discussions, perform additional outreach activities in April, discuss the comments received and the project plan in May, begin redeliberations in June, and complete the project by the first quarter of 2013. The effective date of the final standard will be determined during redeliberations.

This *Heads Up* summarizes responses to the proposal's questions for respondents and the general themes of the comment letters. Although the feedback from most industries was similar and generally indicated support for the boards' efforts to develop a single comprehensive revenue recognition standard, respondents expressed concerns about several aspects of the revised ED. The appendixes to this *Heads Up* outline some of these industry-specific concerns.

Summary of Feedback on Questions for Respondents

The boards requested comments on the entire revised ED but specifically sought feedback on six aspects of it: (1) the criteria for evaluating when a good or service transfers over time, (2) the measurement and presentation of a customer's credit risk, (3) constraining revenue to the amount that is reasonably assured, (4) the scope of the onerous performance obligations test, (5) the proposed interim financial statement disclosure requirements, and (6) the application of certain provisions from the revised ED to the transfer of a nonfinancial asset that is not within the proposal's scope (such as the sale of property, plant, and equipment). Feedback on these six aspects is summarized below.

Criteria for Evaluating When a Good or Service Transfers Over Time

Under the revised ED, an entity must evaluate whether a performance obligation transfers over time by considering whether certain criteria are met. Many respondents supported the ED's method of determining when a performance obligation is transferred over time and the resulting recognition of revenue over time. However, certain respondents expressed concerns that entities may not interpret or apply the guidance consistently. They therefore requested that the boards clarify certain aspects of the guidance and provide additional examples.

¹ Proposed FASB Accounting Standards Update, *Revenue From Contracts With Customers*. See Deloitte's November 15, 2011, [Heads Up](#) for a summary of the key provisions of the revised ED.

In particular, concerns were raised about the guidance on determining whether an entity's performance creates an asset with an "alternative use" (i.e., whether an entity is able to "contractually" or "practically" direct an asset to another customer).

In particular, concerns were raised about the guidance on determining whether an entity's performance creates an asset with an "alternative use" (i.e., whether an entity is able to "contractually" or "practically" direct an asset to another customer). Some concerns addressed the potential for structuring contracts to meet or not meet the criteria for satisfying a performance obligation over time purely on the basis of contractual terms with no economic substance. Others thought the guidance would unintentionally result in the recognition of revenue for certain goods (e.g., customer specific or contract manufacturing type inventory) over time (as the inventory is produced) rather than upon delivery (which is generally when revenue is recognized under current GAAP in these situations).

A number of respondents requested that the boards clarify how payment terms affect whether an entity satisfies a performance obligation over time; that is, they should clarify whether the assessment of a good or service that is satisfied over time is ongoing throughout the contract or whether it is only performed once at contract inception and how the guidance should be applied when the entity receives an up-front payment for part of (or the entire) contract amount. Other respondents questioned how the guidance would apply to payment and other terms in certain real estate transactions (see [Appendix D](#) for additional discussion).

Measurement and Presentation of a Customer's Credit Risk

Under the revised ED, an entity would continue to apply the measurement and recognition guidance in ASC 310² to consideration the entity deems uncollectible because of a customer's credit risk. However, the entity would be required to present initial and subsequent adjustments for collectibility in the income statement as a separate line item next to gross revenue (i.e., as contra revenue). Respondents' feedback on this question was mixed. Some supported the revised ED's proposals. Others indicated that presenting uncollectible amounts on the face of the income statement would unnecessarily emphasize them. Respondents that disagreed with the revised ED's proposal suggested that the boards either (1) consider allowing an option to present these amounts on the face of the financial statements or within the related footnotes or (2) maintain the current practice of presenting these amounts as an expense outside of revenues.

Editor's Note: As stated in our comment letter on the revised ED, we agree with the proposals (1) not to reduce revenue for the effects of a customer's credit risk and (2) to present this amount as a separate line item next to gross revenue. These proposals would allow financial statement users to understand clearly the extent of an entity's bad debts and how they relate to its reported revenue. For many entities, the amounts may not be material and therefore would not need to be reflected in the separate line item. However, we agree that separate presentation is important when the amounts are material.

Constraining Revenue to the Amount That Is Reasonably Assured

While some respondents expressed concerns about certain aspects of the revised ED's constraint to limit revenue recognition to the amount an entity is reasonably assured to be entitled, many supported the overall concept. Many respondents requested that the boards clarify the meaning of the term "reasonably assured" and indicate whether it is meant to refer to a qualitative or quantitative threshold (there were mixed views about which it should be). Some also questioned the use of the term "reasonably assured," indicating it may have inconsistent meanings under U.S. GAAP and IFRSs, which could result in inconsistent application.

The revised ED indicates that the cumulative amount of revenue recognized for a satisfied performance obligation is limited to the amount to which the entity is reasonably assured to be entitled.

² For titles of FASB Accounting Standards Codification (ASC) references, see Deloitte's "Titles of Topics and Subtopics in the FASB Accounting Standards Codification."

Concerns were also expressed about the transaction-specific requirements for licenses of intellectual property for which the consideration varies on the basis of subsequent sales to an end-customer (e.g., a sales-based royalty). The proposed guidance states that when an entity licenses intellectual property, the “entity is not reasonably assured to be entitled to the additional amount of consideration until the uncertainty is resolved (that is, when the customer’s subsequent sales occur).” Many respondents questioned why this guidance only applies to licenses of intellectual property and noted that such specific application may result in economically similar transactions being accounted for differently. Some suggested that the boards either expand the scope of this guidance beyond licenses of intellectual property or develop a principle that would apply to sales-based royalty-type (and similar) arrangements.

Scope of the Onerous Performance Obligations Test

Most respondents did not agree with the level at which the revised ED’s onerous test would be required to be performed (i.e., the separate-performance-obligation level rather than the contract level or possibly the overall-customer-relationship level). While some agreed with limiting the scope of the test to (1) goods or services that are satisfied over time and (2) contracts that are satisfied over a period greater than one year, others believed there was no basis for such scope limitation (and suggested that the one-year time constraint be removed and the test apply to all goods or services, not just those satisfied over time). Other respondents believed that all the onerous loss guidance should be removed from the revised ED and instead be addressed separately by the boards.

The revised ED states that entities that satisfy separate performance obligations in a contract over time and over a period greater than one year are required to determine whether those obligations are onerous.

Most respondents did not agree with the level at which the onerous test would be required to be performed (i.e., the separate-performance-obligation level rather than the contract level or possibly the overall-customer-relationship level).

Editor’s Note: In our comment letter on the revised ED, we requested that the boards not proceed with the onerous loss proposal in the revised ED and instead evaluate this concept separately in accordance with the main ideas of IAS 37.³ We reiterated our response to the June 2010 ED that if the boards retain this guidance, the onerous test should be performed at the contract level, not the separate-performance-obligation level.

Proposed Interim Financial Statement Disclosure Requirements

The boards specifically asked for feedback on the proposed interim disclosure requirements (which would amend ASC 270). While many respondents expressed support for the boards’ objective to improve financial statement disclosures, most believed that the proposed interim disclosures would be overly burdensome and costly to prepare. Further, they thought that requiring such disclosures would be inconsistent with the current principles in ASC 270 and would hamper the ability of entities to meet interim reporting deadlines.

Many respondents also commented on the annual disclosure requirements proposed in the revised ED. While some expressed support for the practical expedients added since the June 2010 ED, most suggested that rather than prescribing a list of required items, the boards should adopt a more principles based approach. Certain of these respondents recommended that the FASB consider disclosure requirements in conjunction with its disclosures framework project. Respondents strongly suggested that if the boards proceed with the disclosure requirements proposed in the revised ED, they should add examples to clarify some of them.

³ IAS 37, *Provisions, Contingent Liabilities and Contingent Assets*.

Application of the Revised ED to a Transfer of a Nonfinancial Asset

The boards requested feedback on a proposal to apply certain aspects of the revised ED's guidance (and supersede the current accounting) to the transfer of nonfinancial assets (e.g., to amend ASC 360-20). Specifically, the revised ED proposes that an entity apply the revenue recognition principles for the transfer of control, and the proposed measurement guidance, to the derecognition of (and the determination of gains or losses on) the transfer of nonfinancial assets that are not an output of an entity's ordinary activities. While many constituents generally indicated support for this proposal, some noted that it could be inconsistently applied and that unintended consequences could result. Particularly, such constituents indicated that the scope of the proposed guidance was unclear and could conflict with existing guidance. Certain respondents suggested that the boards consider excluding this proposal from the final revenue standard and handling it in a separate project.

Other Comment Letter Themes

Other common themes reflected in the comment letters are discussed below.

Scope

The revised ED clarifies that contracts with counterparties that are collaborators or partners rather than customers (which is common in the pharmaceutical and biotechnology, oil and gas, and health care industries) are not contracts with customers and thus are outside the scope of the proposal. Some respondents asked the boards to clarify what constitutes a collaborator or partner and what accounting guidance would be applied to these types of arrangements.

Some respondents asked the boards to clarify what constitutes a collaborator or partner and what accounting guidance would be applied to these types of arrangements.

Linked Contracts With Multiple Unrelated Parties

Some respondents raised concerns that the revised ED's guidance on determining when contracts can be combined may not appropriately reflect the economics of certain linked transactions with multiple unrelated parties. Some of these respondents requested that the boards expand the guidance in the "contract combination" and "consideration payable to a customer" sections of the revised ED on allowing these transactions to be accounted for together. For example, a manufacturer may sell its goods through a reseller but enter into a separate contract with the reseller's customer to give the reseller's customer free goods or services. The revised ED requires transactions to be accounted for separately in such cases because the reseller and end-customer do not meet the definition of related parties. (See [Appendix D](#) for a discussion of related observations by respondents in the credit card industry.)

The revised ED provides guidance on determining when an entity would combine contracts with the same customer or related parties and does not specifically permit combining contracts with multiple unrelated parties.

Contract Modifications

Under the proposed guidance, a contract modification would be accounted for separately from the original contract when certain criteria are met. Otherwise, an entity would evaluate the modified contract and allocate the remaining transaction price to the remaining performance obligations (prospectively) and update its measure of progress toward completion for performance obligations that are satisfied over time (which could result in a cumulative catch-up). However, if the modification to the contract is only a change in the transaction price, the modified transaction price would be reallocated to all performance obligations in the contract. Some respondents disagreed with requiring an entity to follow a different model when the modification was primarily a change in the transaction price but also happened to include an additional good or service that may or may not be significant to the modified contract.

Some respondents requested that the boards further clarify how to identify separate performance obligations within a contract that includes repetitive deliveries of the same good or service (e.g., a long-term-power sales contract or a three-year support or consulting services contract).

Identifying Separate Performance Obligations

Under the revised ED, a bundle of distinct goods or services would be combined into a single performance obligation when certain criteria are met or, as a practical expedient, when two or more goods or services have the same pattern of transfer. Some respondents requested that the boards further clarify how to identify separate performance obligations within a contract that includes repetitive deliveries of the same good or service (e.g., a long-term-power sales contract or a three-year support or consulting services contract). For example, it is unclear whether the guidance requires that a three-year license to provide postcontract customer support be treated as a single three-year performance obligation or separated into multiple performance obligations with shorter periods (e.g., annually, quarterly, monthly, daily). These respondents also requested that the boards clarify (1) use of the practical expedient that permits an entity to account for two or more distinct performance obligations as a single performance obligation when those goods or services have the same pattern of transfer and (2) the meaning of the phrase “the same pattern of transfer.” Finally, some respondents, especially those in the aerospace and defense industry, the engineering and construction industry, and the technology industry, asked the boards to clarify the application of the proposed guidance on bundling otherwise separate performance obligations when certain criteria are met (see paragraph 29 of the revised ED). See [Appendix A](#) and [Appendix E](#) for additional discussion.

The revised ED requires an entity to separately account for a good or service in a contract when it meets the criteria to be considered “distinct.”

Editor’s Note: As stated in our comment letter on the revised ED, we agree with the respondents that expressed concerns about the application of the guidance on bundling otherwise separate performance obligations. We recommend that the boards redraft the concept on bundling by starting with an underlying principle and that they provide indicators to help entities determine when it may be appropriate to combine otherwise separate performance obligations into a single unit of account.

Time Value of Money

While some respondents agreed with the revised ED’s concept of adjusting the promised amount of consideration to reflect the time value of money, many commented that the proposed requirements for adjusting the time value of money, especially within longer-term contracts with multiple elements and variable consideration, could be extremely complex and difficult to apply. Respondents suggested that the boards either eliminate the requirements or provide more detailed examples of how to apply this guidance.

Under the revised ED, if a contract has a significant financing component, an entity is required to “adjust the promised amount of consideration to reflect the time value of money.”

Contract Costs

The proposed model requires that costs associated with obtaining a contract be capitalized if certain criteria are met. As a practical expedient, such costs can be expensed as incurred (even if they qualify for capitalization) when the expected amortization period is one year or less. The amortization period may include a future “anticipated contract.” Some respondents supported the guidance as proposed, and others asked the boards to remove the guidance from the standard or at least permit an accounting policy election to either expense or capitalize such costs. Further, respondents suggested that to ensure consistency of application, the boards should clarify when a future “anticipated contract” should be included within the amortization period of capitalized costs.

Transition

Many respondents commented on the potential cost (relative to the benefits) and the impracticability of retrospective application of the proposed guidance. However, others acknowledged the benefits of having comparable periods. The boards were asked to consider prospective transition (with disclosure about the impact of adoption) or a transition similar to that allowed when ASU 2009-13⁴ became effective. Some respondents suggested that if retrospective application is ultimately required, the boards should extend the effective date to allow adequate time to understand and apply the final standard.

The revised ED requires retrospective application of the final standard in accordance with ASC 250, with certain optional practical expedients.

⁴ FASB Accounting Standards Update No. 2009-13, *Multiple-Deliverable Revenue Arrangements — a Consensus of the FASB Emerging Issues Task Force*. For more information, see Deloitte's October 1, 2009, *Heads Up*.

Appendix A — Aerospace and Defense and Engineering and Construction Industries

The boards received about 30 comment letters from entities in the aerospace and defense (A&D) and engineering and construction (E&C) industries. In addition to the topics discussed in the [Summary of Feedback](#) section above, comments addressed the bundling of otherwise separate performance obligations, satisfying separate performance obligations over time, and contract modifications.

Bundling Otherwise Separate Performance Obligations

Under the revised ED, an entity would account for a bundle of goods or services as a single performance obligation if the goods or services are (1) highly interrelated and the entity provides a significant service of integrating them into a combined item or items and (2) significantly modified or customized to fulfill the contract. A number of respondents noted that accounting under current GAAP closely reflects the way contracts in these industries are bid, negotiated, and managed, and they encouraged the boards to maintain such accounting. Some expressed concern about the lack of clarity regarding the ability to bundle goods or services into a single performance obligation. They indicated that when certain criteria are met, the proposed guidance may result in items being separated in a way that does not necessarily reflect the underlying economics of the contract. One respondent offered an example that described a contract to sell 10 tanks to the U.S. government. The respondent suggested that all of the activities to develop and manufacture the 10 tanks should be treated as a single performance obligation (accounting unit) since they are bid, negotiated, and managed as a single arrangement. Certain respondents in the E&C industry, however, noted that the proposed guidance may result in the bundling of goods or services that should otherwise be treated as separate performance obligations. For example, the proposed guidance would result in the bundling of engineering, procurement, and construction contracts into a single performance obligation because a significant service is usually performed to integrate the goods and services. The boards were asked to clarify this guidance to ensure consistent application.

Satisfying Performance Obligations Over Time

Many respondents in the A&D and E&C industries commented on certain aspects of the proposal related to satisfying performance obligations over time. Specifically, the revised ED requires an entity that applies the input method of measuring progress toward completion to “exclude the effects of any inputs that do not depict the transfer of control of goods or services to the customer (for example, the costs of wasted materials, labor, or other resources to fulfill the contract that were not reflected in the price of the contract).” While they generally agreed conceptually with the proposed guidance, many thought it would be difficult to apply. They observed that it is common for a proposal to include an estimate for rework or cost overruns (a portfolio approach is often used to estimate these costs) because they are viewed as normal costs of fulfilling a contract. Therefore, many questioned how costs that are wasteful or inefficient would be determined and noted that that excluding the effects of such costs from the measure of progress toward completion might be misleading to users of financial statements.

When a performance obligation is deemed to be satisfied over time, an entity recognizes revenue by measuring the obligation’s progress toward completion in a manner that best depicts the transfer of goods or services to the customer (using an input or output method).

Further, some respondents expressed concerns about the guidance that would require an entity to recognize revenue equal to cost when a customer obtains control of certain goods before services are performed. They questioned why such guidance was necessary and noted that it would cause inconsistent results that do not reflect the underlying economics of the transactions.

Contract Modifications

When a customer has approved a change in the scope of a contract but has not agreed to a change in price, the modification would be accounted for when entity has an “expectation” that the price will be approved.

There are established practices in the A&D and E&C industries for accounting for both approved and unapproved change orders. It is common for these entities to seek price adjustments for changes in scope or cost for a variety of reasons. Most respondents raised concerns that as proposed, the revised ED might not allow the transaction price to be modified until a change in scope has been specifically approved by the customer even though the customer has had extensive historical experience estimating the amount that should be included in the transaction price. Many asked the boards to permit entities to use more judgment when considering contract modifications.

Appendix B — Automotive Industry

Fewer than 10 comment letters were received from entities in the automotive industry. In addition to commenting on subjects discussed in the [Summary of Feedback](#) section above, respondents expressed concerns about some of the revised ED's guidance on warranties and manufacturer incentives.

Warranties

Respondents noted that the proposed guidance was not sufficiently clear regarding determining whether a specific aspect of a warranty was assurance or a service. For example, roadside assistance may be provided to a customer under a warranty; however, a portion of the assistance may be for assuring that the product works as intended (i.e., protection against defects) or may include a separate service (e.g., assisting the customer with a non-warranty-related item). Respondents were concerned that under the proposed guidance, warranties would be analyzed unnecessarily and would be arbitrarily bifurcated into portions accounted for under (1) the cost accrual model and (2) the deferred revenue model.

The revised ED allows entities to continue to use a cost accrual model to account for warranty obligations that assure that the good or service complies with the agreed-upon specifications. Any warranty service that goes beyond this assurance would be accounted for as a separate performance obligation.

Manufacturer Incentives

The revised ED requires an entity to separately account for a good or service in a contract when it meets the criteria to be considered "distinct." A good or service is "distinct" if the entity regularly sells it separately or the customer can benefit from the good or service on its own or together with resources that are readily available.

Several respondents expressed concerns about applying the guidance on identifying separate performance obligations in the context of certain manufacturer incentives. The automotive industry frequently offers incentives to end-customers on products sold through a third-party dealer. These incentives include rebates, dealer allowances, free services honored by a third party (e.g., free maintenance to be provided by the dealer), and other free products or services. Respondents observed that under the revised ED, certain incentives may have to be treated as separate performance obligations, requiring the entity to allocate and defer a portion of the total consideration received upon sale of a vehicle. These respondents argued that such items do not represent separate goods or services sold by the entity but instead are pricing incentives to encourage the purchase of the vehicle by the customer. Respondents also questioned who the customer would be in these transactions (i.e., the dealer or the end-customer) if the boards determined that such incentives were revenue generating activities.

Appendix C — Energy and Resources Industry

Approximately 15 comment letters were received from entities in the energy and resources industry (including the oil and gas and utilities sectors). In addition to addressing the items outlined in the [Summary of Feedback](#) section above, respondents commented on allocation of the transaction price, contract modifications, and bundled commodity contracts under the revised ED.

Allocating the Transaction Price

Under the revised ED, when a contract contains more than one separate performance obligation, an entity would generally be required to allocate contract consideration to each separate performance obligation on a relative stand-alone selling price basis. Respondents expressed concerns that the revised ED would allocate the transaction price on the basis of the stand-alone selling price of a good or service to be delivered in the future (i.e., on the basis of the available forward curve). Many respondents argued strongly that allocating the transaction price on the basis of the negotiated contract price is most representative of the economics of the transaction (and would result in the most consistent application of the standard). They asked the boards to include in the final standard examples of allocating consideration to the continuous (or repetitive) delivery of the same goods or service (e.g., a long-term power sales contract) over multiple periods to ensure consistency in financial reporting. Further, they highlighted the practical limitations to allocating consideration on the basis of forward (and constantly changing) prices, noting that such limitations are exacerbated by the guidance requiring adjustments for the time value of money.

Contract Modifications

Contract modifications in this industry often involve the extension of an existing contract term, with pricing for the remaining deliveries representing a blend of the market price for the extension period and the contract price of the “premodification” remaining deliveries (often referred to as “blend-and-extend” arrangements). The blended price results in an equivalent contract fair value before and after modification and effectively “smooths” the unit price for the remaining delivery period (not just the added period). Some respondents requested that the boards clarify the meaning of “appropriate adjustment” in the evaluation of whether to account for the contract modification as a separate contract. Specifically, respondents requested the boards to clarify the application of the guidance on these types of modifications and provide additional guidance on the appropriate accounting for modifications that should be treated as a new contract and for those that should not.

A contract modification would be accounted for as a separate contract only if the modification results in (1) a separate performance obligation and (2) additional consideration that reflects the entity’s stand-alone selling price of that separate performance obligation (when appropriate adjustments for the contract’s particular circumstances are taken into account).

Bundled Commodity Contracts

Some respondents requested that the boards provide additional guidance on identifying and accounting for separate items in a contract that contains derivatives (and thus is partially within the scope of ASC 815). These respondents noted there may be diversity in practice related to defining the appropriate unit of account and accounting for a contract with a hybrid instrument (e.g., a physical commodity contract that contains an element that meets the definition of a derivative and another that does not). They suggested that the boards clarify the appropriate accounting as part of either the revenue recognition project or their joint project on accounting for financial instruments.

Appendix D — Financial Services Industry

Over 30 comment letters were received from entities in the financial services industry, including those in the banking, asset management (i.e., private equity, hedge and mutual funds, and other investment companies), credit card, and real estate sectors. In addition to the feedback discussed in the [Summary of Feedback](#) section above, comments included concerns about scope, credit card and loyalty programs, underwriting fees, performance-based fees, and real estate transactions.

Scope

Some respondents expressed concerns that because the revised ED does not list certain financial instrument topics as specific scope exceptions (e.g., letters of credit and financial instruments accounted for under ASC 323, ASC 325, and ASC 948), entities may not realize that the guidance excludes all financial instruments from its scope. These respondents recommended that the boards specifically exclude from the revised ED's scope all contracts that meet the ASC Master Glossary's definition of a financial instrument. Some respondents' concerns were similar to those they expressed regarding the June 2010 ED with respect to identifying the types of separate performance obligations under a contract that are within the scope of the revised ED as opposed to being part of the guidance on financial instruments. These respondents noted uncertainties about the scope of the revised ED, the interplay between the revised ED and certain fees from financial instruments, and combining fees with interest income and interest expense on certain financial instruments transactions.

Credit Cards and Loyalty Programs

Many respondents with credit card operations commented on the revised ED's scope with respect to revenues from credit card transactions and the related obligations (which may be paid in cash or noncash) to the cardholder enrolled in a loyalty program. The concerns focused on the ability to combine contracts that are otherwise economically linked (specifically, the merchant contract and the cardholder contract). Separately accounting for each of these contracts may not reflect a transaction's underlying economics. For example, consideration payable to a cardholder under loyalty programs is directly linked to the consideration received from a merchant (which is a result of the cardholder transaction). It is not clear whether, as a result of the proposed guidance, the consideration payable to the cardholder would be reflected as a reduction of the related revenue received from the merchant (since the two contracts would be accounted for separately).

The proposed ASU provides guidance on determining when an entity would combine contracts entered into at or near the same time with the same customer (or parties related to the customer).

Respondents further observed that the accounting for loyalty programs may differ depending on the form of the reward. Cash rewards would potentially be an adjustment to consideration received from the cardholder (if any), while noncash rewards would potentially represent a separate performance obligation requiring the deferral of revenue (if any). Respondents noted that the accounting for these loyalty programs is not clear when no consideration is received directly from a cardholder (and the entity cannot take into account the consideration received from the merchant).

Performance-Based Fees

The revised ED limits the cumulative amount of revenue that is able to be recognized for a satisfied performance obligation to the amount to which the entity was reasonably assured to be entitled.

A number of asset managers (mostly from entities that manage alternative asset portfolios) on the revised ED had the same concerns they noted in the June 2010 ED about the guidance in EITF Topic D-96¹ (codified in ASC 605-20-S99) being superseded. That guidance provides two acceptable methods for recognizing revenue during interim periods for arrangements that contain performance-based fees that are not finalized until the end of a period specified in a contract. Sometimes these performance-based fees are finalized annually (and may include claw-back provisions for underperformance in future periods), and other times these fees are not finalized until the end of the fund (which could be 10 to 15 years after its inception). Respondents that currently follow Method 2² in EITF Topic D-96 noted that the revised ED's

recognition constraint regarding the amount the entity is reasonably assured to be entitled may result in the deferral of significant amounts of revenue until long after cash has been received by the fund and distributed to employees (as compensation). They indicated that such deferral would not result in meaningful financial reporting and that users may therefore require entities to provide them with new non-GAAP measures. Further, these fees are often paid, in part, in the form of equity in the assets being managed (commonly referred to as "carried interest"). Certain respondents did not believe that the carried interest should be within the scope of the revised ED because it represents an equity method investment. Other respondents suggested that if the carried interest is deemed to be within the scope of the revised ED, the reasonably assured constraint should be modified to permit recognition that is consistent with the model in Method 2.

¹ EITF Topic No. D-96, "Accounting for Management Fees Based on a Formula."

² Under Method 2, an entity recognizes performance-based fee revenue in the amount that would be due under the contract at any point in time as if the contract was terminated at that date.

Underwriting Fees

The revised ED would supersede the current guidance in U.S. GAAP (specifically, ASC 940-605) on the recognition of broker-dealer underwriting revenue and related expenses. Under current practice, underwriting costs may be deferred until the related underwriting revenue is recognized (and net presentation is permitted). Some respondents indicated that the current guidance should be retained because the revised ED would require gross presentation and potentially result in revenues and the related costs being recognized in different periods, which is inconsistent with how users evaluate underwriting revenues.

Real Estate Transactions

Few real estate entities submitted comments. However, comments from real estate developers that currently follow percentage-of-completion accounting during the construction phase indicated that the criteria for a performance obligation to be considered satisfied over time (and thus for revenue to be recognized over time) are difficult to assess. These respondents expressed concern that, depending on the payment terms, recognition of revenue over time could be inappropriately precluded. They cited examples, including payments made by the customer that are for principle and interest for an outstanding note and not for progress payments during the construction period, contractual eligibility criteria for the buyer that must be met in a future period, and the right to a refund for a developer's nonperformance. These respondents requested that the boards provide additional guidance on how the criteria for a performance obligation would be satisfied over time in such situations.

When an entity's performance does not create an asset with an alternative use and the entity has a right to payment for performance to date, control of that good or service transfers to the customer over time (and thus revenue may be recognized over time).

Appendix E — Technology, Media, and Entertainment Industries

The boards received over 40 comment letters from entities in the technology, media, and entertainment industries. In addition to the remarks highlighted in the [Summary of Feedback](#) section above, comments included concerns about bundling otherwise separate performance obligations and licensing and rights to use.

Bundling Otherwise Separate Performance Obligations

Some respondents in the technology industry questioned the revised ED's use of the terms "highly interrelated" and "significant service of integrating" as well as whether those terms were limited to a particular industry (e.g., the construction industry). Specifically, they questioned whether providing a customer with (1) a software license with implementation or integration services or (2) the design, build, and hosting of a software offering would need to be accounted for as a single performance obligation. They noted that the implementation, integration, or design services are frequently sold separately (or offered separately by competitors) and therefore would seem to represent separate performance obligations. However, since under the contract they would be "required" to be performed by the entity, the services would have to be bundled. Respondents also asked the boards to further clarify application of the guidance to contracts that are common in the technology industry.

Under the revised ED, an entity would account for a bundle of goods or services as a single performance obligation if the goods or services are (1) highly interrelated and the entity provides a significant service of integrating them into a combined item or items and (2) significantly modified or customized to fulfill the contract.

In addition, some respondents questioned whether the intent of the boards was to suggest that postcontract support (PCS) services that transfer to the customer on a when-and-if-available basis would be considered a performance obligation that is separate from the related software license (or whether the bundling criteria would require the contract to be accounted for as a single performance obligation). Other respondents questioned whether the boards intended that PCS be further divided into items such as unspecified product upgrades, enhancements, and telephone support and requested clarification about whether such items could be combined as a single performance obligation under the practical expedient for multiple performance obligations that have the same pattern of transfer.

Licensing and Rights to Use

The proposed guidance suggests that control of intellectual property that an entity grants to a customer would generally transfer (and thus revenue would be recognized) at a point in time.

The boards received numerous comments about the revised ED's implementation guidance on licensing and rights to use the intellectual property of an entity. Respondents expressed concerns about applying this guidance to time-based software licenses and certain forms of media and entertainment licenses, patents, trademarks, and copyrights. Specifically, respondents questioned the application of up-front revenue recognition of time-based licenses, especially since the payment terms and underlying economics seem to imply that the entity is earning revenue over time. Similarly, respondents in the media and entertainment industries noted that they must often remain actively involved in their business or maintain specific working arrangements with customers for the right (license) to have value. Noting that immediate recognition could be

misleading to users, these entities encouraged the boards to consider a model of recognizing revenue over time because it would more appropriately reflect the substance of the arrangements. Further, many of these respondents highlighted that adjusting for the time value of money may result in distorted financial results that are meaningless to financial statement users.

Appendix F — Telecommunications Industry

The boards received approximately 15 comment letters from entities in the telecommunications industry. In addition to the topics discussed in the [Summary of Feedback](#) above, respondents commented on the effect of the proposed guidance on allocating the transaction price and the accounting for contract modifications.

Allocation of Transaction Price

Telecommunications entities currently reporting under U.S. GAAP, and most reporting under IFRSs, apply a “contingent revenue cap” to the amount of revenue to be recognized upon the sale of a handset. This limits the amount of revenue to be recognized upon the delivery of a handset and results in the recognition of service revenue over time as billed. The proposed guidance requires an entity to allocate contract consideration to the separate performance obligations (i.e., the handset and subsequent wireless service) on a relative stand-alone selling price basis and does not include such a cap. Many respondents objected to this proposal, arguing that the changes do not appropriately reflect the substance of arrangements and would reduce the usefulness of financial statements. They also noted that the proposal would (1) increase the complexity of revenue recognition, (2) require the use of estimates and subjective judgment, and (3) result in inconsistent accounting for economically similar transactions.

Under the revised ED, when a contract contains more than one separate performance obligation, an entity would generally be required to allocate contract consideration to each separate performance obligation on a relative stand-alone selling price basis.

Several respondents requested that the boards carefully reconsider the industry-specific impact of the proposed model, particularly related to transaction price allocation and the impact of the elimination of the contingent revenue cap. Certain respondents suggested that the boards reinstate this cap, while others suggested adjusting the scope of the use of the residual approach to allow an allocation of consideration in a manner consistent with current practice.

Contract Modifications

The revised ED should be applied to an individual contract with a customer. However, it may be applied to a portfolio of contracts (or performance obligations) with similar characteristics if an entity reasonably expects the result would not differ materially. Several respondents expressed concern about the revised ED’s accounting framework for contract modifications. Most indicated that application of the model on a contract-by-contract basis was overly complex and impractical given the large population of contracts and the frequency with which they are modified. Respondents asked that the boards reconsider this aspect of the proposal and that they consider potential alternatives that use a portfolio approach to contract modifications.

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